The State of Kenya’s Private Sector
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A thriving private sector is central to achieving the objectives of Kenya’s Vision 2030. In fact the success of Vision 2030 is largely premised on the role of the private sector in achieving the countries growth objectives and, thereby, creating greater wealth and employment opportunities.

Six priority sectors were targeted in Vision 2030 to raise the national GDP growth up to 10% by 2012. These sectors are: Tourism; Agriculture, Livestock and Fishing; Wholesale, Retail and International Trade; Manufacturing; Business Process Outsourcing; and Financial Services. In addition, the Government prepared a Private Sector Development Strategy (PSDS) 2006-2010 and Private Sector Development Strategy Implementation Plan (PIP) 2007-2012 to support the development of the private sector. The PSDS and PIP were focused, primarily, on addressing the poor business environment, and improving the competitiveness and productivity of the private sector (especially micro, small and medium enterprises).

The purpose of this report is to measure the private sector’s actual contribution to the Kenyan economy and, as a result, the progress and success of the aforementioned policies. This is done by providing an in-depth profile of the private sector and how it has evolved over the last five or so years, as well as a detailed assessment of the current business environment for private sector growth in Kenya. Given the new constitution and a new system of devolved government, a section is also dedicated to understanding what this might mean for private sector activities.

Ultimately, we hope the insights and recommendations in this report are instructive in guiding Kenyan policy makers as they formulate a new approach to developing the private sector going forward and, thereby, enhancing its role as the primary driver of the economy. In addition, the report also draws insights and recommendations for development partners active in this space, as well as the private sector itself and the options they have to enhance their contribution to the economy.

The African Development Bank has recently adopted a Ten Year Strategy (2013-2022), which is designed to place the Bank at the center of Africa’s transformation. One key priority of this strategy is private sector development. Through this report and the Bank’s continued support to Kenya, we hope to play our role in building an even stronger, more dynamic and inclusive private sector.

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1. **Executive Summary**

**Introduction**

The purpose of the study is to profile the state of the private sector in Kenya and the context in which it operates. An associated objective is to distil observations, insights and recommendations for policy makers, development partners and private sector firms, to develop the private sector further and faster.

The report highlights the strengths of the private sector, of which there are many, challenges, some of which are persistent, and opportunities which have the potential to transform the growth and development of Kenya if supported with good policy and governance.

The recommendations will inform the approaches adopted by the Government of Kenya, private sector and development partners in further growing and developing the Kenyan private sector.

The research and analysis was undertaken by independent development consultants Genesis Analytics (South Africa and India), in association with Integral Advisory (Kenya).

**Main findings**

**Overall:** The overall finding of the report is that the private sector in Kenya is generally vibrant and in good health. Kenya is a promising place to do business with growing markets and good opportunities. Importantly, there is a widespread intellectual appreciation amongst Kenyans, including government officials, that the private sector is important and should be developed as the main driver of growth and employment. Also positively, the business climate in general has improved over the last decade; frustratingly it is the same recurrent challenges that prevent the private sector from reaching its full potential: political uncertainty, corruption, infrastructural deficits, and an untapped informal sector.

**Importance and size:** The private sector is well developed and large by sub-Saharan and regional standards and plays the leading role in the Kenyan economy. The health of the economy, and benefits to citizens, are directly correlated to the health of the private sector.

**Structure and formalisation:** Noticeably, the private sector is split into two disconnected parts: a formal, large business sector which is relatively healthy and productive, and a massive, informal small business sector that is poorly understood yet which supports almost nine out of ten Kenyan workers (excluding agriculture). Links between the two are very weak. The informal sector is poorly documented, and is not supported by coherent government action.

**Diversification:** The private sector is well diversified between primary, secondary and tertiary activities, with a significant tertiary sector for a developing country. Goods exports are dominated by a handful of globally competitive agricultural products, notably tea, cut flowers, leguminous vegetables and palm oil.

**Sectors:** Agriculture, manufacturing, trade, tourism, transport and communication, and financial services account for over 80% of the private sector’s contribution to total GDP. Agriculture remains the most important sector in terms of contribution to private sector GDP and employment, though is declining in importance relative to other sectors. Manufacturing remains relatively stagnant. Growth in the private sector is increasingly driven by trade, transport, ICT and financial services.

**Growth:** The private sector is growing, even impressively at times, though on balance does not reach its full growth potential consistently.

**Stability:** Private sector performance is volatile. The private sector is structurally exposed to shocks – tourism to demand shocks, agriculture to supply shocks, and the whole economy to import inflation, especially from fuel imports.
Political disruption and uncertainty is the most obvious brake on consistent private sector (and economic) growth.

Local versus foreign ownership: The Kenyan private sector is relatively closed and concentrated and is dominated by domestic concerns. Remarkably, Kenya has consistently attracted less FDI than neighbouring countries for more than a decade, in both relative and absolute terms, which is an anomaly for a pre-eminent regional market. The reasons for this are unclear – interviewees suggest they may be a combination of political uncertainty, macroeconomic volatility, high costs of doing business, company and land ownership restrictions, perceptions of corruption, a closed and protective political economy with strong local vested interests and anti-competitive behaviour by dominant incumbent firms. Early indications are that this FDI underperformance may be changing, possibly related to the discovery of oil.

The business climate

Kenya’s business climate has been documented comprehensively, and the failings in the business climate are well known. There is widespread consensus in both secondary literature and from views in Kenya that the business climate has improved in the last decade and continues to improve. However, Kenya’s performance on a number of global indices indicates that the business environment is still regarded as poor in comparative terms.

The most commonly cited challenges in the business climate are the cost and reliability of energy; a poor logistics system, including physical infrastructure and processes, a perception of corruption and political interference and patronage, resulting in anti-competitive behaviour; the burden of inefficiencies within the tax system; political uncertainty; and barriers to formalisation that give rise to a large, fragmented and delinked informal sector.

Impact of the constitution and devolved government on business

The report specifically considers the likely impact of the Constitution and the system of devolved government on business. It finds that the impact of the Constitution is likely to be positive for the private sector if constitutional institutions are properly empowered. The Constitution should promote a more transparent and stable economic environment in which the private sector can confidently invest.

The impact on business of devolved government is still unclear but likely to be mildly negative, at least initially. The ability to maximise county-level opportunities and foster a business friendly environment will greatly depend on the vision and capability of county leadership, which is still untested.

Opportunities

The opportunities available to the private sector are documented in the report. They include an increasingly attractive domestic market with improving appeal for foreign investors;
a rapidly urbanising population; technological innovations emerging from the ICT industry; government’s intention to increase public-private partnerships (PPPs), particularly in large infrastructural projects; increased regional trade in goods and services as a result of the EAC common market; government actions emerging from the MSE Act; and possibilities in Kenya’s “budding sectors”, namely oil & gas and real estate. The discovery of oil in the Lake Turkana region can play a transformative role in the economy, accelerating the growth trajectory of the private sector and providing a boost to the fiscus. If handled poorly it may also bring the attendant problems of “Dutch disease” and escalate the extent and magnitude of corrupt activity, and civil unrest.

Recommendations

A number of recommendations emerge for developing the private sector further and faster. Recommendations are set out in the report for government, development partners and the private sector itself, and are grouped around six topics:

- Improving the business and investment climate;
- Understanding and supporting MSEs and the informal sector;
- Mitigating possible negative consequences of devolved government, and upholding the Constitution;
- Encouraging further public/private co-operation;
- Supporting sector growth and competitiveness; and
- Improving the collection of economic data relating to the private sector.

The report finds that the responsibility for developing the private sector is not that of government alone. It is true that much of the vision for a more inclusive, growing and wealth-creating private sector depends on government’s ability to implement stated policies and plans in a timely fashion. Development partners have a large support role to play here. However, they also depend on a more responsible, growth-oriented agenda being set by the private sector itself, especially by improving linkages between established firms and MSEs, supporting the Constitution, exposing and preventing corruption, taking part in public-private partnerships (PPPs), taking advantage of increased regional trade in goods and services; and the possibilities in managing the establishment of the oil industry responsibly and with a long-term view of Kenya’s development.
The purpose of the study is to profile the state of the private sector in Kenya; an associated objective is to distil observations, insights and recommendations in order to develop the private sector faster and further. The audience for this report will be policy makers, development partners, and the private sector itself and the recommendations provided will inform the approaches adopted by these stakeholders in further growing and developing the Kenyan private sector.

The research and analysis was undertaken by independent development consultants Genesis Analytics (South Africa and India), in association with Integral Advisory (Kenya).

### 2.1. Study Framework

The study framework is set out in the diagram below, starting at the bottom and working up.

The *problem statement* is identified as follows: What is the state of Kenya’s private sector? To develop the private sector quicker, who needs to do what?

The *data gathering process* consisted of three stages. The first stage focused on a review of all available data relating to Kenya’s private sector, including data kindly made available by the Kenya National Bureau of Statistics (KNBS) and from the World Bank, UNCTAD, business associations, and other secondary material.

1. **Review of all available secondary data:** KNBS, Vision 2030, World Bank Doing Business, Investment Climate Assessments, business association reports, government policy papers, sector studies, donor studies and other secondary material.

2. **Approximately 50 face-to-face consultations with senior government officials, development partners, business associations and business leaders (See Appendix A for interview list)**

3. **5 workshops with members of business associations including in ICT, Tourism, Agriculture, MSMEs and “Jua Kali”**

The *data gathering process* consisted of:

- **Overview of the Kenyan private sector**
- **Detailed profiles of six sectors**
- **General business environment analysis**
- **Constitutional and devolved government analysis**

**Output**

- **Observations and recommendations for**
  - Government
  - Development partners
  - Private sector
- **Face-to-face consultations to test recommendations**
- **Validation workshop (28 November 2012)**
- **FINAL REPORT**
- **TARGETED BRIEF**

**Problem statement**

*What is the state of Kenya’s private sector? To develop the private sector quicker, who needs to do what?*

Source: Genesis Analytics, 2012
government policy papers, and sector studies, as well as all literature from 2007 to 2012 describing the business environment. Next, fifty face-to-face interviews were held with all interested parties, including government officials, development partners, business associations and business leaders (see Appendix A for full list of interviewees). Lastly, five workshops were held with members of business associations - KENFAP, KFC, KATO, KAHC, KNCCI, the informal sector and Jua Kali, and others, as an additional means of testing the state of the private sector.

The interim findings were then presented for validation to a group of stakeholders representing government, development partners and the private sector. Observations, insights and recommendations for each audience are provided in a separate targeted brief, accompanying this paper.

The next section provides an overview of the Kenyan private sector and the context in which it operates. This is followed by a description of the Kenyan business environment and the implications of the new Constitution and system of devolved government for business in the country. The report then provides detailed descriptions of the six sectors that have contributed the most to Kenyan GDP, employment or rate of growth, and/or have been identified by the Government as “budding” or priority sectors in Vision 2030. The report then highlights strengths, of which there are many, challenges, which tend to persist, and opportunities for the private sector, which could contribute to the future growth and development of Kenya.
3. Overview of Kenya’s Private Sector

3.1. Introduction

The overall finding of the report is that the private sector in Kenya is vibrant and in good health. Kenya is a promising place to do business, with growing markets and good opportunities.

There are, however, still a number of persistent challenges that prevent the private sector from reaching its full potential, and with it creating higher levels of growth and employment.

This report explores seven general characteristics of the private sector:

1. **Importance and size**: The private sector is well developed and large by sub-Saharan and regional standards and plays the leading part in the Kenyan economy. The health of the economy and benefits to citizens are directly correlated to the health of the private sector.

2. **Growth**: The private sector has been growing and continues to grow, impressively at times, though on balance remains below full potential. A number of infrastructure, regulatory, security and political challenges persist in restraining private sector growth.

3. **Structure**: The private sector is noticeably split into two parts: a formal, large business sector which is relatively healthy and productive, and a massive, informal small business sector that is poorly understood and supported, yet which employs almost nine out of ten workers. Links between the formal and informal sectors are very weak – and initiatives that bridge the gap should be a priority.

4. **Diversification**: The formal private sector is well diversified across primary, secondary and tertiary activities, and the tertiary sector is impressive for a developing country. Exports, however, are dominated by a handful of globally competitive agricultural products, with limited value addition.

5. **Sectors**: Agriculture, manufacturing, trade, tourism, transport and communication, and financial services account for over 80% of the private sector’s contribution to total GDP. Agriculture remains the most important sector in terms of contribution to private sector GDP and employment, though the importance of agriculture in terms of its contribution to GDP is declining relative to other sectors, while that of manufacturing remains relatively stagnant. Growth in the private sector is increasingly driven by trade, transport, ICT and financial services.

6. **Local versus foreign ownership**: The private sector is relatively closed and concentrated – dominated by domestic companies and attracting less FDI than much smaller neighbouring countries, in both absolute and relative terms. Early indications are that this FDI underperformance may be changing, possibly related to the discovery of oil.

7. **Stability**: The performance of the private sector is volatile primarily because business must operate in a politically charged environment. Political disruption and uncertainty is the most obvious brake on consistent private sector (and economic) growth. Also, the private sector is structurally exposed to shocks – tourism to demand shocks, agriculture to supply shocks and the whole economy to import inflation, especially from fuel imports, make stable and consistent growth harder to achieve.

3.1.1. Importance and Size

The majority of Kenya’s recorded GDP and formal employment is attributable to private sector activities (Figure 2). By African and regional standards, the Kenyan private sector is large. In fact, Kenya’s private sector output exceeds the total GDP of each of its neighbouring economies (Figure 3). This suggests that the Kenyan private sector is an important creator of value and employment.

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1 Note: agriculture is not included in the measure for informal sector employment, as KNBS observes the ILO definition of the informal sector, which excludes primary activities. KNBS calculations suggest that most people working in the informal sector (approximately 60%) are traders in the wholesale and retail trade sector.

2 KNBS only captures data for ‘hotels and restaurants’, which is used as a proxy for tourism. In 2007, Vision 2030 estimated that tourism accounts for 10% of Kenya’s GDP, whereas in 2009, KIPPRA estimated a 5% GDP contribution.
3.1.2. Growth

In 2011 Kenya’s GDP was US$33.6 billion (KSh 1.3 trillion)\(^3\), making Kenya one of sub-Saharan Africa’s larger economies and the largest in East Africa. The private sector’s output is growing steadily (the absolute value of private sector output increased by 68% from 1996 to 2011)\(^4\) and is driving growth in the economy. In contrast, public sector output remained relatively constant for the past decade and a half (Figure 4).

The contribution of the private sector to formal employment has also risen, creating the majority of new formal jobs in Kenya (Figure 5). The annual growth rate of formal employment is approximately 3%, which matches the average annual labour force growth rate (1990-2005).

The impact of private sector activities on these two key elements of economic growth suggests that the health of the economy as a whole is highly dependent on the health of the private sector.

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\(^3\) World Bank, World Data Bank, 2012.

3. There is little consensus amongst policymakers and business membership organisations as to the exact definition of ‘informal’, and as such, little certainty regarding the sector’s structure. However, KNBS defines the informal sector as follows: all small-scale activities that are semi-organised, not registered with the registrar of companies and generally use low level and simple technologies. It is a subset of unincorporated enterprises owned by households comprising (a) informal own-account enterprises and (b) enterprises of informal employers.

4 KNBS informal sector employment calculations are based on the results of prior surveys, such as the 1998/9 labour force survey, 2009 census, 2005/6 household budget survey. Informal sector employment excludes agriculture.

3.1.3. Structure

The private sector is worryingly dualistic in nature, comprised of a productive formal sector of big businesses, underpinned by a massive, poorly understood informal sector. According to KNBS calculations, almost 9 out of 10 working Kenyans are employed in the informal sector, of which most are traders in the wholesale and retail trade sector (Figure 6). Generally, the links between the formal and informal sectors are weak. There is little comprehensive understanding of the structure, composition and activity of the informal sector. Indicative of this, is the lack of an official definition of “the informal sector”, as well as inconsistent definitions by informal sector advocates. Definitional uncertainty amongst stakeholders results in descriptors such as ‘the informal sector’ and ‘Micro and Small Enterprises (MSEs)’ often being (incorrectly) used interchangeably.

Figure 6: GDP over time (2001 constant prices)

Source: Genesis Analytics, 2012 (adapted from KNBS Economic Survey 2012)

Note: agriculture is not included in the measure for informal sector employment, as KNBS observes the ILO definition of the informal sector, which excludes primary activities.
Primary research submits that MSEs are (reportedly) dominated by artisans (Jua Kali), hawkers/street vendors, small transport service providers and small farmers.

A working definition by MSE advocates of what constitutes a ‘formal’ MSEs is as follows: enterprises are considered ‘formal’ MSEs if they:

- are registered,
- have acquired the necessary license/s to operate,
- are registered for and submit tax returns,
- comply with other core business legislation e.g. labour laws.

The Micro and Small Enterprises Act7 of 2011 provides further clarity, defining an ‘enterprise’ as any undertaking or business concern whether formal or informal which is engaged in production of goods or the provision of services, and differentiating between micro and small enterprises as follows:

1) A “micro enterprise” refers to any firm, trade, service, industry or a business activity:

   (a) whose annual turnover does not exceed KSh 500,000;
   (b) which employs less than ten people; and
   (c) whose total assets and financial investment shall be as determined by the Cabinet Secretary from time to time, and includes:

   (i) the manufacturing sector, where the investment in plant and machinery does not exceed KSh 10 million;
   (ii) the service sector and farming enterprises where the registered capital of the enterprise is between KSh 5 million and KSh 25 million.

2) A “small enterprise” refers to any firm, trade, service, industry or a business activity

   (a) whose annual turnover ranges between KSh 500,000 and KSh 5 million; and
   (b) which employs between ten and fifty people; and
   (c) whose total assets and financial investment shall be as determined by the Cabinet Secretary8 from time to time, and includes:

   (i) the manufacturing sector, where the investment in plant and machinery as well as the registered capital of the enterprise is between KSh 10 million and KSh 50 million; and
   (ii) service and farming enterprises, where the equipment investment as well as registered capital of the enterprise is between KSh 5 million and KSh 25 million.

The contribution of the informal sector to the economy is unclear. In 2009, KIPPRA estimated that MSEs contribute as much as 25% to GDP, and a report by Tax Justice Network Africa and Action Aid suggests that formalisation of the informal sector could increase the Kenyan tax base by more than KSh79 billion (US$0.9 billion). An indicative (not to scale) representation of the structure of Kenya’s economy is shown in Figure 7.

The dualistic structure of the Kenyan economy is apparent, but poorly quantified

![Figure 7: The dualistic structure of the Kenyan economy is apparent, but poorly quantified](source: Genesis Analytics, 2012)

The high level of informality in the Kenyan economy implies that many entrepreneurs feel that, on balance, the benefits of informality (perhaps lower or no taxation, inspection and licensing burdens) outweigh the costs (perhaps lower access to formal finance). Another possible barrier to formalisation is the shortage of business and financial management skills. These barriers and the weak linkages between the formal and informal sectors need to be better understood in order to design and implement effective economic policy.

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7 Only the Bill was available at time of publication. It is assumed this definition appeared in the Act.
8 “Cabinet Secretary” means the Cabinet Secretary of the Ministry for the time being responsible for matters relating to micro and small enterprises.
3.1.4. Diversification

Relative to other African countries, Kenya’s economy is considered to be diversified, and the transportation, telecommunication and financial hub of East Africa. Kenya’s formal private sector is well split across activities, with tertiary activities dominating and increasing in importance, driven primarily by trade and transport activities. The primary sector is an important for base employment but is gradually shrinking in importance. While the proportion of contributions (in terms of GDP and employment) by formal primary activities is declining, the contribution of secondary activities remains relatively stagnant (Figure 8).

Almost half of Kenya’s exports are sold to African countries (Figure 9) and Kenya benefits greatly from trading with regional neighbours. The EAC members now trade more with each other than with any other region of the world9.

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9 World Bank, Walking on a tightrope: rebalancing Kenya’s economy with a special focus on regional integration, 2012
Kenya’s exports are dominated by low processed agricultural produce. Figure 10 shows that tea and cut flowers are the largest goods exports, with the remainder of Kenya’s top 10 exports comprised of coffee, petroleum oils, cigars and cigarettes, iron products, selected carbonates, cements, palm oil, and leguminous vegetables. Kenya holds a relatively high world ranking in the export of certain products, including tea (2nd largest exporter), cut flowers (4th largest exporter), leguminous vegetables (2nd largest exporter), palm oil (14th largest exporter), and selected carbonates (8th largest exporter). In each of these five export product areas the country’s global market share is increasing – suggesting particular strengths in these areas. On the other hand, Kenya appears to be losing some ground in the export of coffee and cigarettes, showing decreasing market share in industries that growing globally. Transportation services account for almost half (43%) of the value of Kenya’s exported services, with travel services and government services each responsible for approximately 20% of service export output.

**Figure 10:**
Kenya’s exports are dominated by low processed agricultural produce

Source: Genesis Analytics, 2012 (adapted from International Trade Centre data, 2007-2011)

Note: Red bubble represents trade deficit for that product which suggests that imports of this product exceed exports thereof, which may be a function of a wide range of factors, including local production and consumption patterns. Substantial data discrepancies exist between KNBS and International Trade Centre Data - this may be partly due to different classification and/or grouping of export products.
3.1.5. Sectors

Agriculture is the largest single contributor to GDP and formal employment, but is not growing significantly. Financial services, trade, and transport and communication are the fastest growing sectors. Transport and communication and financial services act both as enablers and drivers of economic growth. As such, the relatively rapid growth in these sectors is a positive sign for Kenya. A summary of the relative importance of the key sectors analysed in this report is provided by Figure 11, and a detailed assessment of each can be found in section 6 (‘sector profiles’).\(^{10}\)

Agriculture is consistently the most important contributor to GDP, but the importance of service-related industries such as transport and communication (ICT) and financial services is growing. The importance of agriculture in terms of its contribution to GDP is declining relative to other sectors, while that of manufacturing remains relatively stagnant (Figure 12). Agriculture, manufacturing, trade, tourism\(^ {11}\), transport and communication, and financial services account for over 80% of the private sector’s contribution to total GDP.

\(^{10}\)Sectors which are identified for further analysis (see ‘sector profiles’ section) are those which are ranked top for either % contribution to GDP, employment or rate of growth, and/or have been identified by the Government as ‘budding’ or priority sectors in Vision 2030. Together these six sectors make up more than 80% of the private sector’s contribution to total GDP.

\(^{11}\)KNBS only captures data for “hotels and restaurants”, which is used as a proxy for tourism.
Trade, transport and ICT have been the most consistent contributors to the growth of the Kenyan economy in recent years, while shocks to agriculture (political violence, drought and costs of inputs) and tourism (political violence and terrorism) have significantly negatively affected GDP growth (Figure 13).

Source: Genesis Analytics, 2012 (adapted from KNBS Economic Survey 2012 and Statistical Abstract 2011 data)
Formal private sector employment is dominated by agriculture and manufacturing, followed closely by wholesale and retail trade (including hotels and restaurants). In 2007, the Vision 2030 document suggested that tourism could in fact account for as much as 9% of total employment.

The remainder of private sector employment (not attributed to the key sectors) is attributed to mining and quarrying (0.55%), electricity and water (0.15%), building and construction (6.2%), and community, social and personal services (23.6%) (Figure 14).

3.1.6. Local Versus Foreign Ownership

Most recent FDI has been directed toward horticulture and floriculture, garment manufacture (especially in EPZs) and tourism. Nairobi and Mombasa host over 78% of FDI stock, with the main form of FDI being that of greenfield investment. However, research interviews suggest that the private sector is relatively closed. Almost all companies (99.5%) operating in Kenya are locally owned. Between 2005 and 2010 the number of registered, locally owned tripled, whereas that of foreign-owned companies grew by only 33% (Figure 15).
The relatively low numbers of foreign-owned companies in Kenya may be explained by certain investment requirements and limitations, which potentially act as disincentives for foreign investment in the country. These include a minimum foreign investment threshold of US$100,000 and the fact that foreign ownership for companies listed on the Nairobi Stock Exchange is limited to 60%.

Generally, FDI in Kenya is surprisingly low. In spite of its regional economic pre-eminence, Kenya’s FDI inflows have consistently trended below those of Uganda, Tanzania and Rwanda over the last 15 years. Even in the face of a slight upsurge in 2007 (primarily due to the privatisation of Telkom Kenya and the investment by Helios in Equity Bank), relative to other EAC countries, Kenya’s FDI has been low (Figure 16).
Greater levels of natural resource extraction in Uganda and Tanzania may go some way to explaining this FDI anomaly, but other factors, besides perceptions around political uncertainty and corruption, may include:

- Relatively low returns on investment due to high costs of doing business (for retailers, this is coupled with the impact of high inflation on the already low disposable income of Kenyan consumers);
- Stiff competition from Kenyan firms who can better navigate local terrain;
- Anti-competitive behaviour by dominant firms; and
- Well-connected cartels creating barriers to entry, for example, manipulating the price of sugar\(^{12}\) and maize\(^{13}\) by influencing the approval of import licenses of competitors.

However, the historically low levels of FDI may be changing. A recent\(^{14}\) study ranks Kenya third in Africa after South Africa and Morocco in terms of top destinations for foreign direct investments. The study states that the number of projects coming to Kenya rose 77% from 2010. The other East African countries did not feature in the ranking. It is believed that inflows were boosted by increased fundraising by oil and mineral prospecting companies seeking a share of Kenya’s rising mineral resource profile. Other projects involved infrastructure, real estate, manufacturing and tourism.

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\(^{12}\) The state-led Kenyan sugar industry is inefficient - over half of the total national output comes from one company; Kenyans pay about twice as much for sugar as Europeans.

\(^{13}\) In July 2011, the price of maize in Kenya was 70% above the already high world market prices.

\(^{14}\) FDI Intelligence, Financial Times, 2012
The openness and attractiveness of the Kenyan market appears to be improving, but not at the same rate for all sectors. The most recently available FDI\textsuperscript{15} statistics reveal the bulk of FDI occurring in the information and communications, manufacturing and financial services sectors:

- In 2008 the agricultural sector\textsuperscript{16} represented 2.6% of FDI inflows, 1.5% of FDI outflows, and 5.5% of FDI stocks.
- The information and communication sector was responsible for 19.7%, 0% and 24.6% of the same indicators, respectively.
- The wholesale and retail trade sector accounted for 5.7% of FDI inflows, 6% of FDI outflows and 9.7% of FDI stocks in 2008.
- In 2008, 41.2% of FDI inflows were directed towards manufacturing, while the sector accounted for 71% of FDI outflows and 28.4% of FDI stocks. Most foreign investment in manufacturing since 2001 has been in the Export Processing Zones (EPZs), with the majority in AGOA-related textiles and consumer goods (such as food and beverages).
- Financial and insurance activities in 2008 encompassed 18.2% of FDI inflows, 1.2% of FDI outflows, and 20.1% of FDI stocks.
- In 2008, the hotels and restaurants subsector accounted for 2.9% of FDI inflows, 1.3% of FDI outflows, and 2.3% of FDI stocks.

3.1.7. Stability

The performance of Kenya’s private sector is volatile. Explanations include a dependence on sectors vulnerable to exogenous shocks, a dependence on imports and political instability. Growth rates in agriculture and, ostensibly, tourism significantly affect overall growth. These industries are inherently vulnerable to shocks – agriculture to supply side factors and tourism to factors on the demand side (Figure 17).

![Figure 17: Growth rates of private sector activities (% by industry)](image)

Source: Genesis Analytics, 2012 (adapted from KNBS Economic Survey 2012)

\textsuperscript{15} KNBS, Foreign Investment Survey, 2010

\textsuperscript{16} Including fishing
Kenya is a net importer of goods, driven particularly by the importation of petroleum (Figure 18). This increases the likelihood of volatile economic performance, especially given the fluctuating price of oil. However, this may improve with the domestic supply of oil (see ‘budding sectors’ section in ‘sector profiles’ section of this report).

The perception of instability in an economy can have negative impacts on investment levels as high levels of instability are often taken as a proxy for risk. Limiting dependence on vulnerable industries and expensive imports will be an important strategic step towards improving stability in the future.

Figure 18: Kenya is a net importer, driven particularly by petroleum

![Chart showing imports and exports as % of GDP]

Source: Adapted from KNBS Economic Survey 2012 and Statistical Abstract 2011
4. The Business Environment

Kenya’s GDP growth has seen a marked improvement in recent years. The economy achieved 5.5% GDP growth in 2010 and 4.4%\(^\text{17}\) in 2011\(^\text{18}\), and is estimated to grow at 5% in 2012\(^\text{19}\). Meeting the Kenya 2030 Vision GDP growth target of 10% per annum will require a significant increase in private investment and savings, which will require a business environment that enables the growth and development of the private sector.

Kenya’s performance on a number of global indices indicates that the Kenyan business environment is still generally regarded as poor. While Kenya has improved on most of the World Bank’s Ease of Doing Business sub-indices since 2007 (such as time and cost of processes), this has been at a slower rate than global competitors. The Ease of Doing Business Index\(^\text{20}\) 2013 ranks Kenya at 121 out of 185 countries, down from 109 out of 183 in 2012.

The World Economic Forum Global Competitiveness Index, which aggregates the country’s scores on a number of business climate indicators\(^\text{21}\), ranked Kenya at 102 out of 142 countries in 2011-2012, compared to 106 out of 139 in 2010/11 and 98 out of 133 in 2009/10.

\(^{17}\) Growth rate for 2011 is provisional
\(^{18}\) KNBS, Economic Survey, 2012
\(^{19}\) International Monetary Fund, World Economic Outlook Database, April 2012
\(^{20}\) This is an aggregate measure that provides an overall indication of a country’s regulatory environment for business.
\(^{21}\) This index is an aggregation of a number of indicators relating to institutions, infrastructure, the macroeconomic environment, health and primary education, higher education and training, goods and labour market efficiency, financial market development, technological readiness, market size, business sophistication and innovation.
In-depth secondary research of a number of reports, such as the World Bank’s most recent Investment Climate Assessment, Enterprise Surveys and Doing Business in Kenya reports, as well as reports by Kenyan business associations such as the Kenya Association of Manufacturers (KAM) and the Kenya Private Sector Alliance (KEPSA), identified a broad range of factors that contributed to a poor business and investment climate in the country. The most repeatedly-quoted factors identified in all reports are shown in the figure below.

However, there is a general perception that the private sector in Kenya is vibrant and is moving in the right direction in terms of its economic contribution. The pace of this positive movement and the implementation of these policies and programmes could, however, be improved, particularly if the Vision 2030 targets are to be met.

4.1. What Constitutes a “Good” Business Environment?

The private sector is widely considered to be the engine for growth, investment and innovation. Creating an enabling business environment supports companies in overcoming their growth and operational challenges in order to increase their competitiveness on the global stage.
in a sustainable way. Unleashing dynamic private sector growth ultimately leads to employment and income generation, and the achievement of other developmental objectives.

The fundamental pillars of an enabling business environment, as shown in the framework in Figure 21 below, include a stable political and economic environment, good and reliable physical infrastructure, human capital, accountable and transparent institutions and governance, an efficient and flexible labour market and access to inputs. Building on these, elements that further enhance the business environment include effective government regulation and policy, strong private sector representation and voice, as well as business development and linkages.

This report assesses the Kenyan business environment according to this framework, making use of primary and secondary research.

![Figure 21: An environment in which the private sector can thrive](source: Genesis Analytics, 2012 ©)
4.2. Economic and Political Environment

4.2.1. Macroeconomic Volatility

A large number of firms cite macroeconomic volatility, including high inflation rates, a weak local currency and high interest rates, as a challenge to doing business in Kenya. High interest rates in particular have resulted in a contraction of lending to the private sector.

Inflation decreased in 2010 from a height of 15.1% in 2008, but rose again in 2011 to an estimated 14%. This is driven by the instability of the global economy, resulting in higher oil prices and a weaker Kenyan currency, which depreciated to an all-time low in 2011. In an effort to curb inflationary pressures and to stabilise the exchange rate, the Central Bank raised interest rates from 6.25% in May 2011 to 7% in September 2011, followed by a further increase to 11% in October 2011 and eventually to 18% in December 2011, which it maintained in 2012 until recently lowering it to 13% and then 11% in September and November 2012 respectively.

This macroeconomic volatility is believed to be a result of the poor implementation of fiscal and monetary policies, and an over-dependence on government debt. That said, the national government has introduced fiscal reforms – the Public Financial Management Reform programme was launched in 2006 – to reduce government spending. The primary deficit declined in 2011 due to lower domestically-financed investment, reduced spending and strong tax revenues. The total debt-to-GDP ratio declined to 48.5% in April 2012 from 54.2% in June 2011. Domestic debt to GDP and external debt to GDP ratios declined from 27.8% and 26.4% in June 2011 to 27.2% and 21.3%, respectively, in April 2012. Domestic debt constitutes 56.1% of total debt. The Government’s ability to maintain debt at sustainable levels is however not only an indication of good management but also an unwillingness of creditors to provide financing.

The Kenyan shilling has been relatively stable against the dollar since 2000, but began experiencing a decline in 2008. By mid-October 2011, the shilling had depreciated sharply against major currencies, reaching a historic low.

![Graph showing high cost of capital and variable inflation and exchange rates are challenging for business](image)

Sources: Central Bank of Kenya, October 2012; IMF World Economic Outlook database, UNCTADstat

22 KNBS. Economic Survey, 2012
23 The PFMR programme aims to improve accountability and transparency in public finance systems, including budget formulation, public procurement, external audit, revenue collection, budget execution, internal audit, parliamentary oversight, payroll and pensions, debt and guarantee, external resources, accounting and reporting and the macro-fiscal framework.
of KSh 107 against the US dollar. The combined effects of rising inflation and a weakening shilling presented a toxic risk to Kenya’s economy and as a result, the Parliament formed a Select Committee to investigate the rapid decline of the shilling. It is believed that a number of poor policy responses contributed to the persistence of the problem, including the Central Bank of Kenya (CBK) maintaining a “watch and see attitude” during this period, and inappropriate interventions by a Task Force established by the Prime Minister to help stabilise the shilling, the Monetary Policy Committee, and the Treasury. The pressure for the CBK to intervene persisted throughout the year, but it was only in October 2011 that the Central Bank Rate (CBR) was increased significantly, which has contributed to high lending rates and, therefore, the cost of capital in Kenya.

4.2.2. A Disruptive Political Cycle

At the end of 2007, when post-election violence broke out in Kenya, GDP growth plummeted from 7% to 1.6% per annum. The agricultural and tourism sectors are particularly vulnerable to violence and uncertainty, whether through the destruction of farms, relocation of farmers and restricted distribution capability, or the advice given to tourists that they not visit parts of the country. Data from the World Bank also shows that over the past three decades, Kenya has had its lowest growth periods during or immediately following election years, with GDP growth slumping one percentage point on average below the long-term trend.

To address some of these challenges, a new constitution was promulgated in 2010, leading to the formation of a new electoral body and multiple reforms in the judiciary, which are some of the pivotal institutional changes that the government is implementing to restore faith in the political system and to provide an enabling economic platform for business.

Political stability will bode well for private sector investment and economic growth – especially if the implementation of the new Constitution is smooth and successful in ironing out corruption within the political and economic system. Kenya’s next presidential elections in March 2013 will be an important test of the stability of the political environment.

4.2.3. Safety and Security

Crime and security is another commonly cited challenge facing businesses in Kenya, particularly due to the high costs imposed on firms through theft and preventative security systems.

Domestic security has worsened with the number of crimes reported having increased in 2011 by 7%. The public transport sector alone is reported to lose KSh 7.9 billion a year through illegal taxation and extortions. In a study conducted by the United Nations Development Programme (UNDP), it was found that 53.3% of the urban population is subjected to petty taxation. In peri-urban areas this was measured at 49.9% and in rural areas 27.3% of people pay taxes to outlawed groups.

Domestic social unrest potentially threatens investment. Demonstrations or any violent confrontations with the authorities are of concern to investors in the region. A group named Mombasa Republican Council has started calling for the cessation of Kenya’s coastal strip, where the private sector has invested heavily in the hospitality sector and trade operations. This sort of unrest can be partly explained by Kenya’s high levels of social fractionalisation (ethnic, religious

27 Accessed at [http://www.standardmedia.co.ke/?id=2000042763&cid=658&current-Page=3&articleID=2000042763]
28 Illegal taxation and extortions
and linguistic), which has been shown to indicate a higher potential for conflict and the derailment of growth\(^{29}\).

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Sustained growth countries, average</th>
<th>Fast-growing SSA countries, average</th>
<th>Kenya</th>
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<td>0.3</td>
<td>0.72</td>
<td>0.83</td>
</tr>
<tr>
<td>Religion</td>
<td>0.3</td>
<td>0.53</td>
<td>0.7</td>
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<tr>
<td>Linguistic</td>
<td>0.29</td>
<td>0.76</td>
<td>0.89</td>
</tr>
</tbody>
</table>


From a regional perspective, activities in the Horn of Africa have implications for Kenya’s private sector. The independence of South Sudan has presented business opportunities for Kenyan enterprises. However the delicate political environment between the North and the South has threatened to spill over into violence, which would put Kenya’s economic interests in Sudan and those of Kenyan investors and traders at risk. The resurgence of piracy in the horn of Africa is another major challenge in terms of shipping costs and competitiveness that need to be addressed in a strategic and sustained manner.

Conflict on the Somali border has raised security concerns. Kenya is at war with the al Qaeda-linked al-Shabaab terror group in Somalia. Significant gains have been made in dislodging the group from its strongholds, but that has come at a cost in Kenya where the terror group has been hitting back through blasts that have killed local citizens. In June 2012 the media reported that a US-based intelligence firm, IntelCenter, had warned of an impending attack by Somalia’s al-Shabaab, mainly targeting skyscrapers in Nairobi. The American private spy agency said Kenya is likely to face a growing terror threat until the end of the year\(^{31}\). Besides destroying property, attacks by terror groups scare away tourists and have attracted strong travel advisories by the US Government warning its citizens of insecurity in Kenya. Recently the US instructed its staff to leave the tourist city of Mombasa and warned its citizens against visiting the city.

4.3. Institutions and Governance

Kenya ranks in the lowest quartile globally for ‘control of corruption’\(^{32}\) and ‘rule of law’\(^{33}\), as measured by the World Bank\(^{34}\). Corruption commonly takes the form of the payments of bribes and informal payments “to get things done”, including those related to public contracts, tax inspectors, licensing and utility hook-ups, and payments to police officers for trucks in transit. There is also a perception that corruption has resulted in anti-competitive behaviour in government procurement and investment (the negative effects of which are more acute for MSEs) and that Kenya is politically risky and marked by patronage and political connections in the business arena.
The high-levels of corruption and political patronage in Kenya are believed to be a result of the extensive economic liberalisation that occurred in the country in the 1990s without an effective regulatory framework and institutions in place, as well as weak law enforcement and poor levels of transparency. The result of this has been feelings of mistrust and uncertainty that impede private investment in Kenya and impact negatively on the business environment.

There are a number of positive initiatives underway that aim to address these challenges, but the pace of these reforms could be improved. These include a reform of the judiciary as laid out in the country’s new Constitution, and the increased use of technology such as electronic transactions to reduce petty corruption in government. The Kenya Private Sector Alliance (KEPSA) is also attempting to initiate a private sector anti-corruption charter, which will rely on voluntary audits to curtail private sector participation in corrupt activities.

Protection of intellectual property rights in Kenya has also been largely inadequate. However, the new Constitution expands the description of private property to include intellectual property. This is an important reform for business as it will help in protecting them against counterfeit production, which costs businesses significant revenues.

4.3.1. Property Rights

In theory, the Kenyan legal system protects and facilitates acquisition and disposal of all property rights. In practice, however, obtaining title to land is an often cumbersome and corrupt process. Violations of land rights, including the rights of the generations of Kenyans displaced through historic and recent evictions are also believed to be one of the key unresolved issues in Kenya. According to the Property Rights Index, Kenya performs relatively poorly. This index is a subcomponent of the Index of Economic Freedom, which measures the degree to which a country’s laws protect private property rights, and the degree to which its government enforces those laws.

Figure 25: Property Rights Index – Kenya is average among its EAC peers

![Property Rights Index (2012)](chart)

Source: The Heritage Foundation, 2012

4.3.2. Public Service Efficiency

In Kenya, the delivery of public services has not been entirely successful or effective. This is manifested by the poor road network, periodic water unavailability, inadequate
health facilities and health personnel as well as falling education standards. Some of these are, however, improving.

Kenya’s new Constitution, promulgated in 2010, provides a solid benchmark for quality public service delivery. Various legislations have so far been enacted to operationalise the Constitution focusing on issues such as gender and equality, citizenship, ethics and anti-corruption. The new executive is also reduced in size, with independent institutions established to limit the executive’s control over the public service. A system of devolved government will also allow county governments to better understand the needs of their constituencies, which enables a more effective provision of services as resources can be better directed. The introduction of performance-based management in the public service has also contributed to an improvement in delivery in a number of government sectors.

4.3.3. Corporate Governance

The Kenyan Capital Markets Authority (CMA) is a regulatory body charged with the prime responsibility of supervising, licensing and monitoring the activities of market intermediaries, including the securities exchange, the central depository and settlement system and all the other persons licensed under the Kenyan Capital Markets Act. CMA is the sole regulator of private sector business enterprises listed on the Nairobi Securities Exchange (NSE) and therefore plays a crucial role in contributing to good governance among the private sector.

The CMA has successfully led corporate governance interventions on a number of occasions to protect investors’ interests. For example, some members of the CMC Motors Board were publicly accused of fraudulent behaviour and mismanagement. This led to an intervention by the CMA and the blacklisting of the accused from holding senior positions within NSE-listed companies. The CMA also intervened in the over-subscribed Safaricom IPO that had resulted in some stock brokers misappropriating investors’ money. However, the CMA is believed to be generally constrained by political interference in key appointments and its limited capacity to monitor all the relevant players on a regular basis, and has thus failed to act swiftly to stem malpractices in some instances.

4.4. Infrastructure

4.4.1. Energy

One of the critical challenges to economic growth and investment across Kenya is costly and unreliable energy. This is a result of a number of factors, the first being that Kenya’s main source of energy is hydropower. Electricity supply is therefore restricted by rain shortages, and power shortages occur as a result. The industry is also believed to have been plagued by a lack of coordination between planning and implementation, as well as inefficiency in the public generation and distribution enterprises that are responsible for the majority of the electricity consumed in Kenya. In the late 1990s the Kenyan Government commissioned two independent power providers and deployed additional emergency thermal electricity generation to address generation shortfalls due to drought. These interventions were, however, costly and led to a rise in the price of electricity, which has remained high ever since.

High electricity prices and power shortages add significant costs to businesses operating in Kenya and lower the country’s investment appeal. Some studies suggest that if Kenya’s poor electricity system were improved to the quality of China’s, the resulting cost savings and productivity increases for Kenyan firms would be financially equivalent to the near-total elimination of their labour costs35. Power shortages have a direct impact on Kenyan businesses, lowering production by 1.5% annually and costing

35 Eifert, B. & Ramachandran, V., Competitiveness and private sector development in Africa, World Bank, 2004
firms up to 7% of sales revenue. The majority of firms in Kenya experience losses because of power interruptions, and as a consequence, a large number of firms have generators, which are costly to obtain and to operate.

These high costs and unreliability are also possible contributors to the relatively low levels of diversification in industry in Kenya, and the focus of the economy on industries that are less energy intensive than others.

The Government of Kenya recognises the role of energy as an infrastructure enabler to facilitate commercial activity and subsequent economic growth. Kenya’s Vision 2030 commits to exploring and exploiting new energy sources, along with continued institutional reforms in the energy sector (including a strong regulatory framework) encouraging private generators of power, and separating generation from distribution. As part of the country’s latest Least Cost Power Development Plan, which extends from 2010 to 2030, a number of solar, wind and geothermal sites have been identified and the National Electricity Project was established to determine the viability of nuclear power in Kenya.

4.4.2. Logistics and Transport

Despite Kenya being a regional trade and transport hub, one of the most commonly cited challenges faced by businesses in Kenya is the country’s logistics system, which is characterised by poor physical infrastructure and inefficient processes involved in the trade and transportation of goods. The main causes for concern are poor road, rail and port infrastructure which lead to high transit times and costs, restricted distribution networks, and theft and breakage/spoilage during transport.

A number of investments in power production are currently underway in Kenya, including the establishment of a number of independent power producers, such as:

- The Lake Turkana Wind Power project, which is expected to provide 300 MW of clean power to the national grid
- Thika Power Limited is developing an 87 MW diesel power plant in Thika
- Triumph Power Generating Company was contracted to generate 81 MW of electricity through the installation of a thermal plant at Athi River within the designated Export Processing Zone (EPZ) area

High logistics costs are a result of both physical and non-physical barriers to the trade and transportation of goods. Physical barriers include poorly maintained roads, poor rail infrastructure, police road blocks, traffic jams, blockages at weighbridge stations, congestion at The Port of Mombasa, and poor border infrastructure. Non-physical barriers include inefficient trade transactions, customs clearance processes and license requirements. These barriers are considered to be a result of poor planning and prioritisation and historically insufficient or misplaced investment by government.
The World Bank’s Ease of Doing Business ‘trading across borders’ index – which measures the time and cost associated with importing or exporting a shipment of goods – ranks Kenya at 141 out of 183, where exporting a standard container of goods requires 8 documents, takes 26 days and costs US$2,055 and importing requires 7 documents, takes 24 days and costs US$2,190.

According to the World Bank’s Logistics Performance Index, which scores a country’s logistics system based on a number of dimensions such as efficiency of processes and quality of infrastructure, Kenya performs relatively poorly. Kenya is ranked 122nd out of 155 countries, compared to Tanzania and Rwanda which are ranked 88th and 139th respectively.37 These logistics challenges are also significant because of the strategic importance of the Northern Transport Corridor, which is anchored by the port of Mombasa in Kenya, and is a principal and crucial transport route for national, regional and international trade of the five East African Community (EAC) countries. The corridor is multi-modal, combining road, rail, waterways, and pipeline, and extends from the port of Mombasa to markets in Kenya, Uganda, Rwanda and Burundi as well as southern Sudan, parts of eastern Democratic Republic of Congo (DRC), and parts of northern Tanzania. Freight costs on the corridor per kilometre are more than 50% higher than the USA and Europe and transport costs can be as high as 75% of the value of exports for the landlocked countries. Modernisation of transport infrastructure barriers along this corridor is critical for trade expansion and economic growth, which will in turn be crucial to the success of regional integration as well as to the creation of wealth and the alleviation of poverty in the individual countries.

4.4.3. Water

Kenya is a water-deficient country with about 4,100 small dams and water pans giving a total water storage capacity of only 183.6 million m³ for all uses. This is equivalent to 5.3m³ per capita per year which is among the lowest surface water storage rates in the world.39 Average per capita storage capacity in Africa is about 200m³ per year, which is significantly less than that of countries in other regions.40 Kenya’s water storage capacity amounts to only three months of use. As a result, if the country does not receive rains for three months it experiences famine, drought, low irrigation levels and power rationing – which adversely affects all economic sectors and negatively impacts on manufacturing and cost of production (because emergency thermal power plants are used to generate the energy shortfall). Under Vision 2030, the water subsector plans to increase water storage to 25 billion m³.

37 World Bank, Logistics Performance Index, 2012
38 Kenya Institute of Trade Development, Final Draft Report to Develop a Logistics Performance Survey Index for the Kenya Shippers Council, 2012
40 Africa Infrastructure, Water Resources: A Common Interest
Water security is particularly important for the agricultural sector, on which the economy is highly dependent, because of the limited use of irrigation-based farming in Kenya. Most irrigation schemes are government-driven, but mainly cover large-scale crops and have experienced a number of setbacks, such as the washing away of schemes during heavy flooding in early 201041.

4.4.4. ICT Infrastructure

There has been a rapid increase in internet usage in Kenya in recent years, which is largely attributable to the landing of the Seacom, TEAMS and EASSy submarine fibre optic cables in Kenya in 2009 and the resulting increased bandwidth capacity and connectivity speeds, and the lowering of connectivity costs. The TEAMS project was based on a public-private partnership (PPP) model, where 80% of the KSh14 billion investment was provided by the private sector, while SEACOM was a wholly privately funded venture.

4.4.5. Investment in Infrastructure

While Kenya still faces significant challenges in terms of infrastructure and logistics, the country has made a number of positive advances in addressing these systems in recent years. These include, among others:

- Over the last decade the Kenyan Government has stepped up investments in infrastructure from about 3 to 4 % of GDP42.
- From 2008 to 2011 the Kenyan Government spent US$2.4 billion on the construction and maintenance of roads. In 2010/2011 719 km of roads were constructed and 1002 km of roads were rehabilitated43;
- A US$62 million dredging project was recently completed at the Port of Mombasa, which included the widening of the Likoni Channel and turning basin, and the deepening of the harbor;
- A KSh27 billion new highway along the Nairobi-Thika road has recently been completed, which has spurred a number of developments along the highway, including a KSh2.4 billion PepsiCo bottling plant, the largest retail mall in East Africa, and a number of residential property developments;
- A one stop border post goods clearance programme is in early stage implementation. A pilot has been successfully implemented for rail goods clearance at the Malaba border (Kenya-Uganda border), and this will be replicated at other borders;
- There are plans to invest in an aviation centre/airport terminal and airstrips in Lokichogio, Lodwar and Isiolo;
- A pipeline to the Northern Transport Corridor will form part of the infrastructure required for the oil discovered in Turkana;
- Plans are underway to construct a passenger/commuter railway line from Jomo Kenyatta International Airport to Nairobi city centre;
- Plans are underway to upgrade the airstrip in Kisumu and install a cold storage facility at the airport;
- The state-owned Kenya Airways Authority has signed a commercial contract with a Chinese construction company to build a new terminal at Nairobi's Jomo Kenyatta International Airport; and
- Another Chinese construction company has also signed a contract with Kenya to build a new standard gauge railway line between Mombasa and Nairobi.

Investment in infrastructure, outside of telecommunications infrastructure, is largely driven by the public sector. Today, the third largest allocation of public funds goes to physical infrastructure, after non-discretionary and education sector expenditure. However, a lack of financial capacity for the large scale infrastructural projects that are still required in Kenya (some of which could cost up to US$18 billion) and international benchmarking has resulted in an intention by government to fund those projects set out in the Vision 2030 Medium Term Plan (MTP) predominantly through PPPs44, which presents a significant opportunity for private sector investors in Kenya.

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41 Kenya Red Cross, Kenya: Floods Cause Death, Destruction and Displacement, ReliefWeb, 2010
44 Interview with Ministry of State for Planning, National Development and Vision 2030, September 2012
This indicates that while the perception around infrastructural improvements in Kenya is largely positive, considerably more can still be done in terms of construction, planning and prioritisation, and this will be the responsibility of both the public and private sectors in the future.

4.5. Human Capital

Compared to the rest of Africa, Kenya possesses a skilled and educated workforce, and labour productivity is high in comparison to both Tanzania and Uganda. The country also boasts a high literacy rate relative to other countries in the region and has a high level of qualified upper level staff and skilled labour.

There is, however, believed to be a skills mismatch in Kenya between those leaving the education sector and those that are readily absorbed by the private sector. This is particularly prevalent in new and fast-paced industries such as ICT, where the quantity and quality of Kenyan skills development is not keeping pace with global developments in technology and products. This results in increased investment by companies in terms of time and financial cost to train new recruits or to ‘import’ the necessary skills, and is believed to be a result of a lack of effective engagement between the education sector and industry.

A National Industrial Training Authority has been established and is attempting to address the skills mismatch issue by providing specialised training, but the facilities and technology it has at its disposal are severely constrained. There are also a number of initiatives involving the private sector that aim to address this problem. An example of this is the “SAP Skills for Africa” Programme, which is a partnership between SAP and the Kenya ICT Board that will see 100 talented, underprivileged students from across the country undergo training to become certified SAP software engineers, which will be followed by mentorship and job placement for the students.

In light of the lack of available data related to labour issues in the Kenyan economy, the Manpower Survey was launched as a means of establishing the severity of the Kenyan skills mismatch. The Ministry of Labour aims to use the results of this survey as the basis of its integrated development strategy, the objective of which is to address major labour-related constraints so as to increase the ease of doing business in Kenya. The strategy includes the design of incentives to encourage private sector-led initiatives for skills development to compensate for the capacity constraints faced by the Ministry. However, there have been major delays in the publication of the Manpower Survey, which have been attributed to capacity constraints within government.

4.6. Labour Market

While Kenya’s labour laws are considered to be relatively flexible when compared to other countries in the region, the rigidity and high cost of labour regulation in the country is often cited as a business environment challenge which acts as a deterrent against formalisation in the case of MSEs. The minimum wage in Kenya is increased annually, often not in line with market demand, and some companies complain about a culture of ceremonial wage increases that are not linked to productivity or performance, as well as a difficulty in firing employees due to Industrial Court precedent, all of which contribute to high labour costs.

Labour regulations were reviewed and reformed between 2001 and 2005 and New Labour Laws were passed in 2007, but the implementation of these reforms has been slow and it is felt that they could better facilitate employment through expeditious review and increased dialogue between government and the private sector.

Emphasis has also been placed on the need to increase the productivity of labour in Kenya, especially in the context of competition from international markets.

47 Kenya ICT Action Network, SAP and Kenya ICT Board partner on skills development, 2012
entails addressing operational process and workforce inefficiencies and is the responsibility of the Productivity Centre of Kenya. The Productivity Centre is currently overstretched - serving over 10,000 enterprises in the formal sector - and is in need of increased capacity, which it has been struggling to obtain from either the public or private sectors.

4.7. Access to Inputs

4.7.1. Access to Finance and Financial Services

The Kenyan financial system is more developed than that of most African countries. Reforms to the financial sector, initiated by the Central Bank in collaboration with industry players, have enhanced efficiency and stability of the sector. These reforms cushioned the private sector (especially financial institutions) from the global financial crisis, have contributed to an improved business environment and exerted positive economic influences, directly impacting private sector competitiveness. Still, the financial sector remains vulnerable to government influence, which weakens the attractiveness of Kenya as an investment destination.

Access to and cost of financial services is, however, widely regarded as a significant constraint to the growth of businesses in Kenya and is significantly more difficult for informal micro- and small enterprises.

Although formalisation would facilitate access to financial services for informal firms, the financial burden of registration and taxation and the minimum capital requirements to register a business often act as deterrents against firms choosing to become formalised. The unbanked in Kenya do, however, present a multi-billion Shilling market, and so certain financial institutions are implementing a number of initiatives aimed at tapping into that market, such as the provision of tailor-made products specifically to suit the needs of MSEs. The fact that 10 years ago there were 2.5 million Kenyans in the formal banking system, and that this number has increased to approximately 12 million in 2011, is evidence of the fact that these initiatives are working.

On top of informality, difficulty with access to financial services is usually a result of a combination of a number of factors, including:

- High cost of credit
- Firms being unable to meet collateral requirements;

Box 3: Financial sector reforms to balance the goals of financial efficiency and stability with financial inclusion

The structural transformation of the financial sector is intended to encourage innovations and the development of strong institutions, to deepen the financial sector and to ensure financial inclusion. The reforms initiated by the Central Bank since 2007 include:

- The rollout of mobile phone financial services. Through the use of innovative technological platforms, such as mobile phones, more Kenyans have access to financial services.
- Licensing Deposit Taking Microfinance Institutions (DTMs). DTMs focus on the lower end of the market, which is concentrated in the rural and peri-urban areas. This aims to increase lending and saving activity by including more people in the formal banking sector.
- Introduction of agent banking mechanism in May 2010. Banks are now able to engage third parties to provide certain banking services. This is intended to extend banking services to the large proportion of under-banked and unbanked Kenyan people.
- Licensing credit reference bureaus to collect, collate, analyse and disseminate credit information among credit providers. By sharing credit information it is possible for banks to rely on credit history (information capital) as an alternative form of collateral to tangible assets. This will enable more individuals to secure credit facilities from banks.

It is believed that this will result in a stable, efficient and accessible financial sector.

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*49 Heritage Foundation, Index of Economic Freedom, 2012
*50 Interview with Isaac Awuondo, Group MD of Commercial Bank of Africa, September 2012*
• The complexity of loan application processes;
• Poor financial literacy and a ‘fear’ of the formal financial services industry amongst the unbanked;
• The risk-averse nature of the Kenyan financial services sector and;
• The lack of a clear regulatory authority to keep interest rates in check.

Some formal companies, especially those that operate in industries with long return periods such as tourism and education, as well as manufacturing firms that require long term credit for industrial development, also cite access to finance as a constraint to growth. This is potentially because banks in Kenya are able to provide low interest rates on customers’ savings, and can make a steady return from high interest rates on government paper, and so there is little incentive for banks to make more risky investments.

Improving access to finance in Kenya, specifically for MSEs, will be critical for the growth and development of the country’s private sector. This will require the implementation of a number of initiatives such as an increase in targeted financial literacy programmes, fiscal and monetary policies that address the risk-averse nature within financial services, and the further leveraging of technology to reduce costs and increase accessibility within the sector.

A positive recent development in improving access to financial services in Kenya is the establishment and licensing of two credit reference bureaus by the Central Bank of Kenya through which information on performing and non-performing loans is shared. This has improved credit information in the banking sector, which is believed to significantly reduce information search costs and credit risk, and could lead to lower commercial lending rates.

4.7.2. Access to Market Information

Lack of access to information is often cited as a challenge to the operations and growth of businesses in Kenya, particularly those in the informal sector and rural parts of the country. This includes market and finance information, as well as information on new techniques being used in the relevant industry. This has been attributed to limited accessibility in rural areas, the lack of in-place structures that allow for the trickle-down of information, and sometimes a lack of proactivity on the part of the enterprise in question. This can result in the exploitation of small-scale producers by brokers and also in limitations on the quality and quantity of enterprises’ production. However, the opposite is also true. In some cases agricultural brokers/intermediaries play an active role in providing important market signals, to the benefit of small-holder farmers.

Technology will be an important tool in improving access to information. There have already been a number of technological solutions that have been implemented, particularly in the agricultural sector. These include the National Farmers Information Service (NAFIS), which is an internet- and phone-based service that can provide extension information to up to 4.5 million farmers\(^{51}\), and M-Farm, which disseminates targeted agricultural information via SMS to small-scale and marginal farmers in Kenya. While services like M-Farm are still considered to be expensive, the existence of these tools is evidence that industry is moving in the right direction in terms of overcoming specific business challenge constraints.

4.7.3. Access to Land

Constraints to business in terms of access to land occur in a number of different forms, such as:

• High site lease costs for industrial and farm land in some instances;
• The lack of title deeds;
• Land that belongs to the older generation who are sceptical of leasing it to the younger generation; and
• Land administration and registration systems are fraught with stringent bureaucratic procedures and inefficiencies.

However, the most significant land constraint in Kenya currently is the failure to set up the new National Lands Commission, which should have been in place at the end of August 2012, and which has resulted in a hold-up in the renewing of land leases. This means that property owners are finding it difficult to access finance for investment, production levels in agriculture could potentially drop as farmers and livestock breeders are unsure about lease renewals, and there may be an opportunity for corrupt practices such as the illegal allocation of public land, or the rejection or allowance of land leases with back-dated records.

Only 16% of Kenya’s land is arable with adequate rainfall, where only 5% of arable land is under crop agriculture. Ironically, productive areas also carry the highest population density where land is being subdivided into sizes that are increasingly uneconomical for agribusiness. These factors negatively affect private sector agribusiness and agro-processing activities. Given the scarcity of water and arable land, agricultural productivity, value addition and agro-processing are critical. The Agricultural Sector Development Strategy (ASDS) aims to ensure that all agricultural enterprises are highly productive, commercial in nature and competitive at all levels.\(^\text{52}\)

### 4.8. Policy

#### 4.8.1. Private Sector Development

Throughout the 1990s, Kenya’s economic performance was weak, real per capita income contracted by an average of 0.5% annually, and social indicators worsened. In order to reverse the sustained economic downturn, the government prepared the Economic Recovery Strategy for Wealth and Employment Creation (ERS) in 2003, which laid out plans for economic and structural reforms needed for higher economic growth. Subsequently, the Private Sector Development Strategy (PSDS) was prepared specifically to address the concerns of the private sector and to enhance business growth and competitiveness in line with the ERS. The 5 goals and related outcomes of the PSDS are shown in the table below.\(^\text{53}\):

<table>
<thead>
<tr>
<th>Goal</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goal 1: Improving Kenya’s business environment</td>
<td>Rising confidence, long-term planning and investment by the private sector and a globally recognised country-investment rating</td>
</tr>
<tr>
<td>Goal 2: Accelerating institutional transformation</td>
<td>More efficient public institutions with a proven track record of service delivery</td>
</tr>
<tr>
<td>Goal 3: Economic growth through trade expansion</td>
<td>At least 20% annual growth in export trade</td>
</tr>
<tr>
<td>Goal 4: Improving productivity and competitiveness</td>
<td>Increased private sector productivity as measured by input capital output capital ratio and total factor productivity</td>
</tr>
<tr>
<td>Goal 5: Supporting entrepreneurship and MSE development</td>
<td>A growing dynamic and integrated indigenous enterprise sector</td>
</tr>
</tbody>
</table>

The PSDS Implementation Plan (PIP) was then developed to set out a prioritised, sequenced and costed set of activities for implementing the PSDS over the five years from 2007 to 2012. A number of reforms and initiatives have already been implemented to achieve the goals set out in the PSDS, such as the establishment of the Business Regulatory Reform Unit (BRRU) (Goal 1) and programmes such as the Assistance to Micro and Small


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This is a section from an academic or policy document discussing the challenges and policies related to land use and investment in Kenya. The text highlights the importance of setting up the National Lands Commission and the impact of land constraints on agricultural productivity and private sector development. The document references the Economic Recovery Strategy and the Private Sector Development Strategy as key frameworks for addressing these issues. The table outlines the goals and outcomes of the PSDS, showcasing the government’s efforts to improve the business environment, accelerate institutional transformation, drive economic growth through trade expansion, enhance productivity and competitiveness, and support entrepreneurship and MSE development.
Enterprises Programme (ASMEP) (Goal 5), as well as increased engagement between the public and private sectors.

A review of the PSDS and PIP that was conducted on behalf of the Kenyan Government and development partners in 2009\textsuperscript{54} found that there is general agreement from both the public and private sectors that it provides a platform for understanding and supporting private sector development. It also provides a mandate for linking growth with other government reform agendas. However, while poor monitoring has made progress in implementation difficult to assess, progress is believed to be patchy at best and was particularly adversely affected by the post-election violence. Concerns with the PSDS and PIP predominantly pertain to its complex management structures, lack of activity prioritisation, lack of capacity building, and poor funding support (particularly for monitoring and evaluation), while its content is still regarded to be highly relevant to the country.

The government’s long-term development objectives, expressed in Vision 2030, are to create “a globally competitive and prosperous nation with a high quality of life by 2030,” and call for sustained economic growth of 10% per annum over the period. The private sector was a key stakeholder in the formulation of the Vision 2030 document and medium term plan, and it is believed that the private sector will be a critical partner in the achievement of the Vision’s ambitious targets. Throughout this document reference is made to an improving policy environment for private sector development, including an increase in public-private engagement and partnerships and improved business linkages and development.

The 2009 review of the PSDS and PIP recommended that the strategy and plan be revised to reflect changes that have taken place in the business environment since the inception of the PSDS and to more strongly reflect the aspirations and priorities of the Kenyan government as articulated in Vision 2030. In 2010 the PSDS Management Board tasked the Ministry of Trade with the responsibility of leading the review and subsequent extension of the PSDS to 2012.

4.8.2. Trade and Industrialisation

Kenya benefits significantly from trading with regional neighbours with the majority of its exports going to the East African Community (EAC). However, the Customs Union and Common Market Protocols under the EAC treaty have yet to be fully implemented in Kenya and across the region, with non-tariff barriers to trade posing the biggest implementation challenge. A study by the World Bank in 2012 found that Kenya imposes more non-tariff barriers on trade with regional partners than it does for the rest of the world. This limits opportunities for Kenyan businesses and the country’s ability to increase its growth and development.

Kenya has also experienced difficulty in benefiting from the increased opportunities made available through trade liberalisation in developed countries for the export of manufactured goods. The EU is Kenya’s second largest export partner and the majority of these exports are agricultural with minimal value addition. The majority of Kenya’s exports to the USA are manufactured goods (mostly apparel) under the African Growth and Opportunity Act (AGOA), however this industry is largely dependent on imported raw materials and fabrics and there are reports that out of a total of 6 500 products from Kenya that can be exported to the US, only 20 products are actually exported.

Kenya is currently implementing an industrialisation strategy that was outlined in a sessional paper that was

\textsuperscript{54} Hansell J., On behalf of Kenyan Government and development partners, Mini Review of the Private Sector Development Strategy, 2009
adopted by Parliament in 1996. The strategy aims to transform Kenya into an industrialised state by 2020, particularly through the support of export industries. Vision 2030 also recognises industrial promotion as critical to the achievement of the country’s development objectives.

In 1990 an Export Processing Zones (EPZ) programme was inaugurated in Kenya as part of the Export Development Program (EDP) being undertaken by the government to transform the economy from import substitution to a path of export-led growth. These zones employ close to 40,000 workers and contribute to 10.7% of national exports. Over 70% of EPZ output is exported to the USA under AGOA. However, these zones are currently believed to be in a state of decline in terms of attracting investment as a result of rising costs of doing business. Some manufacturers also believe that EPZ rules are not properly enforced and there is therefore unfair competition with non-EPZ manufacturers. The number of investors in EPZs in Kenya has declined from over 100 a decade ago to about 80. As part of the government’s strategy to address this problem, there are plans to move towards Special Economic Zones (SEZs). The idea behind SEZs is one of knowledge-based parks that produce innovative ideas to create jobs and spur economic growth. The establishment of SEZs in Mombasa, Kisumu and Lama is one of the flagship projects under the economic pillar of Vision 2030.

4.8.3. Land Use Policy

The Kenyan Government’s land policy is rooted in a foundation cast during its colonial history. This includes a continued reliance on a colonial law that prevented certain communities from holding land outright, and allowed others, such as local authorities, to effectively own traditional land on “trust” for these communities. In the last decade there have been several attempts at comprehensive land reform that would allow for final and fair determination of land ownership and create a system to restore land to those unlawfully evicted or to compensate them, none of which were completed. While the adoption by the government of a new land policy in August 2009 marked a significant step forward, it wasn’t felt to be translated into effective protection on the ground for Kenya’s most marginalised.

Vision 2030 and the new Constitution recognise that land reform is a fundamental need in Kenya and that the issue must be addressed comprehensively and with the seriousness it deserves. As such, the Constitution requires the State to manage land in a sustainable manner, to the long-term benefit of the economy. The State is now responsible for regulating the use of land in line with the fundamental values and principles outlined in the Constitution. This should result in increased investment in land and associated sectors of the economy, and encourage resolution in complex land disputes. Importantly, the detailed constitutional provisions on land seek to end corruption in the system of land distribution and the use of land as a political tool. Furthermore, people are protected from arbitrary deprivation of property.

4.8.4. Public Private Partnerships

Like many other developing countries, the Kenyan Government faces a lack of financial and technical capacity for the large scale infrastructural projects that are still required to achieve the country’s Vision 2030 targets. This, as well as lessons from other countries which have succeeded in improving infrastructure services through public private partnerships (PPPs), has resulted in a considerable movement in Kenya towards the use of PPPs to fund these large-scale infrastructural projects.

55 Muchira, J., Kenya moves to revive export processing zones, Engineering News, Sept 2011
In 2009 the Kenyan Government appointed a steering committee whose functions, among others, were to establish PPP standards, guidelines and procedures, serve as a resource centre for best PPP practices in Kenya, and provide final approval/disapproval for PPP projects. This has led to the formulation and promulgation of the PPP Act. The principal objective of the Act is to provide an institutional and regulatory framework for the implementation of PPPs in Kenya.

While the intentions regarding PPPs in Kenya are largely positive, their uptake has been relatively slow. Reasons for this include the need for adequate government capacity for the structuring and negotiating of deals, the lack of widespread public and political acceptance of the benefits of PPPs, and a clear understanding of their complexity, long-term nature and cost implications.

4.8.5. Investment Policy

Among the countries in Sub-Saharan Africa covered by the IFC’s Investing Across Borders indicators, Kenya restricts foreign ownership in more sectors than most other economies. Foreign capital participation in telecommunications, for example, is limited to a maximum of 70%. However, the law provides foreign investors with a grace period of 3 years to build up the required domestic capital contribution of 30%. In the transportation sector, there are ownership restrictions in railway freight, port and airport operation, in which foreign investment is allowed only up to 50%. Furthermore, the Merchant Shipping Act of 2009 requires 50% local ownership in shipping operations. On the other hand, unlike in most other countries covered by the Investing Across Borders indicators, domestic as well as international passenger air transportation is fully open to foreign capital participation. The tourism sector, one of the country’s most important industries, is also fully open to foreign companies, as are the manufacturing and primary sectors.

The Government of Kenya provides a wide range of tax incentives to businesses to attract greater levels of Foreign Direct Investment (FDI) into the country. The primary beneficiaries of Kenya’s tax exemptions and incentives are therefore large domestic firms and foreign multinational companies. However, recent government estimates are that Kenya is losing over KSh 100 billion a year from its tax incentives and exemptions. Furthermore, despite these generous tax incentives, Kenya has attracted relatively low levels of FDI in recent years.
4.8.6. Regional Integration

East Africa is characterised by greater regional integration and reliance on intra-regional and intra-African trade than other regional economic blocs, and now trades more within itself than any other region. Kenya benefits significantly from trading with regional neighbours and is a net exporter to all other EAC countries.

Kenya is a strong regionalisation advocate and has ratified treaties and protocols under the African Union (AU), the East African Community (EAC), the Common Market for Eastern and Southern Africa (COMESA), and the Inter-governamental Authority on Drought and Development (IGAD). In line with the provisions of the EAC treaty, the Customs Union and Common Market Protocols came into force in 2010, which are believed to be significant step towards the achievement of the next milestones in the integration process - Monetary Union and the EAC Political Federation. However, the Customs Union and Common Market Protocols have yet to be fully implemented.

Kenya is the natural entry point to the EAC common market of 130 million people and combined GDP of $80 billion. Greater economic activity within the EAC provides further opportunity for Kenya to increase its exports through intra-regional trade, especially the export of services.

Due to a number of existing advantages (see Figure 28), Kenya is expected benefit from increased FDI and cross-border investment, growing exports and lower priced goods. This may not hold true if Kenya is outstripped by its neighbours in the pace of business environment reform and infrastructure development. In addition, the scale and sophistication advantage of Kenyan firms may be hindered by the variable business environments of EAC members, persistent weaknesses in the national logistics system and trade administration inefficiencies. In particular, non-tariff barriers to trade remain a major challenge. These are manifested in the form of many police road blocks, weigh bridges, inspection requirements and cumbersome documentation procedures at custom points. A study by the World Bank in 2012 found that Kenya imposes more non-tariff barriers on trade with regional partners than it does for the rest of the world.58

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58 World Bank, Walking on a tightrope: rebalancing Kenya’s economy with a special focus on regional integration,
4.8.7. State-Owned Enterprises

In general, competitive equality is the standard applied to private enterprises that are in competition with public enterprises in Kenya. However, certain parastatals have enjoyed preferential access to markets and easier access to government credit at favourable interest rates.

The Kenyan Government has, however, embarked on a privatisation strategy in a move away from competing with private enterprises. Kenya has fully or partially privatised a number of large strategic firms including KenGen, Kenya Railways, Mumias Sugar, Kenya Reinsurance, Telkorn Kenya and Safaricom. These transactions netted over US$ 1 billion towards additional development and infrastructure projects.

4.8.8. Silos Within Government

There is a feeling among business people that the Kenyan Government is too large and has a tendency to act in silos. This results in the duplication of mandates and processes within government, as well as increased bureaucracy and red tape for businesses, all of which can increase the time and cost of doing business in Kenya. There is uncertainty about the effect that the new system of devolved government will have on this
problem, but it is highly likely that there will be a transition period before it can be effectively addressed (See Section 5.3 below).

4.8.9. Local Authority By-Laws

Another challenge cited by businesses in Kenya, especially among MSEs, is the lack of standardisation of local authority by-laws, particularly because these by-laws appear in many cases to be punitive rather than enabling. The Business Regulation Bill and Statutory Instruments Bill which are currently awaiting promulgation will help to address this challenge by reducing the incidence of unwarranted or inefficient local by-laws.

4.9. Legal and Regulatory Framework

4.9.1. Tax Rates and Administration

One of the most commonly cited constraints to doing business in Kenya is the number and magnitude of tax payments. The tax rate has been the most reported bottleneck since 2003. Manufacturers, for instance, pay as much as 56% of their earnings as taxes, charges and levies. While official corporate and personal income tax rates are comparable to other countries in the region, there are a number of additional taxes that increase the real tax rate paid by companies, such as cess fees, which are levied by local authorities on the movement of agricultural produce.

A number of companies have also complained about delays in VAT refunds that limit their ability to grow and expand. The Kenyan flower industry, for example, is currently owed KSh 2 billion in VAT refunds. The Ministry of Finance attributes this to large numbers of companies making VAT claims on zero-rated goods. Kenya has a cumbersome tax regime, and is ranked 166 out of 183 on the ‘ease of paying taxes’, in the Ease of Doing Business Index 2012. In terms of tax administration, it is variables such as time spent preparing forms and filing and paying taxes and visits by tax administration officials which increase the cost of doing business in Kenya. This decreases Kenya’s competitiveness and investment appeal.

The tax and administrative burden in Kenya is believed to act as a barrier to the formalisation of many MSEs. This is due to one or more of the following reasons:

- The lack of understanding of the concept of ‘civic duty’ or the legal obligation to pay tax;
- The belief that tax contributions will be squandered by politicians and government officials; and/or
- Tax rates are considered too high.

A simplified turnover tax has been introduced for smaller companies to address the rates and complexity that hinder formalisation, but the uptake has not been as high as expected. This highlights the need for effective information dissemination processes regarding opportunities and incentives for both MSEs and businesses in more rural areas.

Kenya’s tax regime is currently under review and is set to change under the reformed governance system. This includes a VAT Bill that is aimed at reversing and simplifying a large portion of the zero-rated system.

4.9.2. Business Licensing and Registration

Businesses often cite time and cost to register a business and renew licenses as a major constraint to start-up and operation in Kenya. The country is ranked 126 out of 185 on the ease of ‘starting a business’ on the Ease of Doing Business Index, up from 132 out of 183 in 2012.
Licencing processes in Kenya are currently under review and are being streamlined. An example of this is the implementation of an e-registry which is an online portal that provides detailed information on the relevant local and foreign business licenses and permits required to set up shop in Kenya, including requirements, costs, application forms and contact details for the relevant regulatory agency.

4.9.3. Dispute Resolution

Dispute resolution through the courts in Kenya can add a significant cost to doing business in the country due to the slow domestic court processes, which is often passed on to consumers. Arbitrations are not common in Kenya, but there have also been problems cited with the length of arbitration proceedings and the enforcement of arbitration awards in the country. In 2010, on average, arbitration took one year and 7 months and the enforcement of an arbitration award took 35 weeks to enforce if rendered in Kenya and 43 weeks for a foreign award. Mediation is starting to be used as a dispute resolution technique, and on average, mediation cases are settled within 30 days. Reforms in the judiciary have also begun to support effective arbitration in business-related disputes and encourage private sector development. This further indicates that the legal and regulatory framework in Kenya is improving slowly and will continue to improve, which will contribute to the improvement in Kenya’s investment appeal.

4.9.4. Contract Enforcement

According to the World Bank’s Ease of Doing Business Index, The average time to enforce a contract in Kenya is 429 days and the average cost comes to 40.7% of the claim value in the 13 cities measured in Kenya. This is 2 months faster and 10% cheaper than the average EAC city. It is also faster but twice as expensive relative to claim value as the OECD high-income economies. In line with new constitutional provisions, new Civil Procedure Rules were passed into law in Kenya, but these have not yet had a direct impact on the average time, cost and number of procedures to enforce a contract in the country.

4.9.5. Competition

It is widely recognised that competition law in Kenya has long required urgent review and reform, so as to ensure its utility and effectiveness in encouraging competition and controlling monopolies in the country. The enactment of the new Kenyan Competition Act 2011 has significantly strengthened the regulatory environment for competition through updated competition laws and provisions dealing with consumer rights, and the creation of a new independent watchdog, the Competition Authority of Kenya (CAK). To date, the CAK has concluded 54 merger cases and 2 exemption cases, none of which have been appealed.

Besides its merger activities, the CAK focuses on sectors that have the greatest impact on the poor members of society; and are major inputs into the economy (i.e. have a strong effect on the investment climate). Furthermore, the CAK tries to see how their efforts can complement and enable government policy (e.g. Vision 2030). The CAK’s current short-term focus areas are:

- Trucking: high road freight transport fees have brought into question the possibility of price fixing by members of the truckers association.
- Banking: high, almost uniform lending rates; large interest rate spreads; high switching costs; and consumer unfriendly behaviour (e.g. hidden fees and opaque terms) have brought into question the banking industry. A study will be conducted to understand the root causes of these symptoms.
- Petroleum: the high price of petroleum for end consumers has brought into question the role of SOEs in pushing up the price. SOEs play a pivotal role in the value chain, from port management to the functioning of oil jetties to the oil pipeline. Their role will be explored.
especially the extent to which SOE inefficiencies contribute to higher prices.

Other areas the CAK has may be exploring include bid rigging in public procurement, cement, beer, pyrethrum, maize, fertilizer, pay TV, energy and domestic air passenger transport.

However, the impact of the CAK is yet to be felt in certain sectors, with ongoing instances of abuse of dominant market position taking place, examples of which are listed below.

4.9.6. Legal and Regulatory Reform

The legal and regulatory framework, and the high costs and delays associated with certain processes, is often cited as a challenge to business operations and growth in Kenya. Globally, Kenya is ranked in the second lowest quartile for ‘regulatory quality’ according to the most recent Worldwide Governance Indicators. However, ongoing legal and policy reforms have improved perceptions of regulatory quality from 37.5% in 2000 to 48% in 2010, higher than all other political and governance parameters.

Kenya has responded to the challenge of regulatory capacity and performance through a broad range of programmes and activities involving public sector and civil service reforms, decentralisation and local government reform, anti-corruption campaigns, competition and competitiveness programmes, and legal reform.

Kenya has also embarked on significant judicial reform, which has included the appointment of a new chief justice, the assertion of judicial independence, the establishment of an Integrity and Anti-Corruption Committee, and the resignation and suspension of judges accused of corruption.

Box 6: Competition is improving, but not at the same rate for all sectors

Cement: The main cement company in Kenya has held a virtual monopolistic position in the Kenyan industry as a shareholder in two of the largest cement firms. Competition in this industry is, however, believed to be improving due in part to the CAK.

Beer: The Kenyan beer market is dominated (90% market share in 2011) by one company and it is alleged that abuse of its dominant market position has resulted in the exit of an international competitor.

Mobile telephony: The mobile telephone market has been fairly highly concentrated until recently, exhibiting relatively high prices. The entrance in the market of two new operators has helped to increase competition, and prices have already dropped by about 50%.

Sugar and maize: Well-connected businessmen are believed to create barriers to entry in certain industries. An example of this is the manipulation of the price of sugar and maize by influencing the approval of import licenses. Kenyans pay about twice as much for sugar as Europeans, and in July 2011, the price of maize in Kenya was 70% above the already high world market prices.

Box 7: Reforming existing and influencing future business regulation

One of the most significant initiatives aimed at regulatory reform was the establishment of the Business Regulatory Reform Unit (BRRU) within the Private Sector Development division of the Economic Affairs Department in the Ministry of Finance. The purpose of the BRRU is to create an enabling business environment through a number of regulatory reforms, such as the establishment of the licensing e-registry mentioned above and reducing the licenses required to start a business in Kenya. The Unit is also awaiting the promulgation of the Business Regulation Bill and Statutory Instruments Bill, which will give the BRRU a legal backbone and framework as well as overriding authority to facilitate regulatory reforms. Regulators will not be able to come up with new legislation without consulting the BRRU and all existing by-laws, fees and charges will be forwarded to the BRRU to be reviewed and analysed, and then either eliminated, reduced or simplified before being implemented. The Bill will therefore be particularly important in the context of devolved government.

4.9.6. Legal and Regulatory Reform

Regulatory reform in Kenya appears to be moving in a positive direction but considerably more can be done. It will be essential that the pace of this process is not hindered by political interruptions in the coming years, such as the 2013 presidential election and process of devolution.
4.10. Public-Private Engagement

Engagement between the public and private sectors in Kenya has improved significantly over recent years. This has improved through the formation of KEPSA, which is tasked with providing a unified voice for the private sector to engage and influence policy formulation and implementation, as well as the implementation of a number of engagement forums, such as the Presidential Private Sector Working Forum (PPSWF), Sector Working Groups and the Prime Minister Round Table (PMRT).

There is, however, still believed to be a disconnect between the public and private sectors in terms of both communication and the implementation of government programmes aimed at private sector development. This may be due to the fact that organisations such as KEPSA, which is the principal representation for the private sector in the above-mentioned forums, is predominantly representative of big business in Kenya. There is limited representation of MSEs, which account for over 80% of employment in the country.

4.10.1. Fragmentation Within the Private Sector

Arguably, the growth of the private sector in Kenya has partly been the result of the emergence and efforts of business associations which have become strong advocacy channels for the airing of grievances of the private sector, building the capacities of their members, and promoting ethical practices among the business community that they represent. Many associations have established channels of dialogue with the government in regard to promoting a sustainable business environment in the country.

However, in general, business associations in Kenya have been criticised for the following:

- A lack of strategic thinking and/or any long-term strategic plan.
- Weak revenues through members’ fees.
- A focus on lobbyist activities related to policy and regulation, with limited additional member benefits and/or sector-specific capacity building.
- Resourcing challenges (human capital), ranging from leadership to secretariat staffing.

Box 8: Business Associations in Kenya

Whilst Kenya hosts over 80 business membership organisations (a relatively high number for an economy of its size), only a handful of associations have demonstrably played a substantive and leading role for their members. Examples of vibrant and effective business associations in Kenya that have had a notable impact in driving the private sector agenda include:

Kenya Private Sector Alliance (KEPSA) is an apex body, providing a single voice of the private sector, with a membership comprised of about 60 Business Membership Organizations (BMOs) and 180 corporate organizations. The strategic focus for KEPSA is advocacy on behalf of the private sector in matters relating to creating a favourable business environment in Kenya. KEPSA has been instrumental in influencing the design of key legislation, such as the Tourism Act and MSE Act, and motivating for the relaxation and removal of certain business permits at the local government level.

Kenya Association of Manufacturers (KAM) was established in 1959 as a private sector body, providing a common voice for businesses in the manufacturing sector. KAM provides a link for co-operation, dialogue and understanding with the government by representing the views and concerns of its members in discussions with the relevant authorities. KAM played a crucial role in the lobbying of the government of Tanzania, hosting the country’s president in discussions resulting in the lowering of cross-border charges for goods from Kenya, and engages in capacity building efforts for its members involved in export/import businesses.

Matatu Welfare Association: This association has eased tensions between matatu (privately owned minibuses) operators, managed to consolidate its resources and bought an insurance company to provide necessary services to its members. In addition, the association has worked to increase discipline among their members, by instituting and enforcing strict rules and regulations. In October 2012, the Matatu Welfare Association was also able to bring on board private sector players (those with a national reach) into a joint campaign with the government to curb the increasing number of accidents in Kenya.

Kenya Transport Association operates along similar lines to the Matatu Welfare Association, but is dedicated specifically to truck drivers and owners. The association is setting up a truck drivers’ training school in East Africa with the help of USAID, and has been instrumental in building truck drivers’ capacities in road safety. KTA has been a key player in improving the transport sector for long haul transporters in Kenya.
However, a contributing factor to the continuing disconnect between the public and private sectors in Kenya is the fragmentation that exists within the private sector. Business associations in Kenya are prolific and wide-ranging, and yet representation of the private sector in its engagement with government is not diverse enough. This indicates that there is a need for better organisation within the Kenyan private sector in order to ensure that it is well-represented and its needs and growth and investment objectives are met.

4.11. Business Linkages

4.11.1. The Informal Sector

The informal sector employs over 80% of the working population in Kenya and yet linkages between the formal and informal sectors are limited. While linkages between these two sectors are seen as a source of private sector development, employment generation and poverty reduction, very little success has so far been achieved in developing them in Kenya.

This may be due to the prevailing perception that MSEs are unreliable, which is a potential symptom of the lack of business and management skills among business owners. This is because of limited accessibility and affordability of training and skills development for MSEs and the insufficient priority given to these issues by government. In order to address this, the Ministry of Labour is currently designing a framework for private-public collaborations in the area of skills development for the informal sector. The Kenya Institute of Business Training (KIBT), located within Ministry of Trade, has also been established and offers business training at a lower cost, but take up has been slow. This highlights another commonly-cited characteristic of the Kenyan business environment – while the government has set up a number of bodies and programmes aimed at private sector development, take-up by the private sector is often low. Addressing the barriers that cause this, such as poor information dissemination, or a mismatch between supply and demand, will be critical to ensuring the success of future initiatives.

The informal sector in Kenya is also highly fragmented (there are approximately 1 600 business associations within the sector), resulting in high levels of disorganisation and a lack of coherency within the sector, which is a further constraint to their formalisation and collective growth.

This fragmentation and disorganisation within the sector also contributes to the lack of reliable data relating to the sector. Consequently, there is not an accurate baseline available for assessing the situation or measuring progress. It also contributes to the poor representation of MSEs in policy and regulatory reforms. While there are plans to develop a unified advocacy platform for MSE associations, this has been delayed for over two years.

The Government has passed a number of policy papers, laws and funds to facilitate small enterprise development, improve working conditions, and ease access to credit, basic utilities, and property rights. However, to date, inadequate scale, commitment and coordination of government MSE support, as well as the poor representation of MSEs in policy and regulatory reforms, has resulted in the policies having minimal impact – in terms of both failing to address the specific needs of the informal sector and lacking ownership by the sector.

There is optimism around the MSE Act that has been recently passed, which will ensure that resources allocated to the sector are employed with maximum impact. The objective of the Act is to provide a legal and institutional framework for the promotion, development and regulation of micro and small enterprises by:

(a) providing an enabling business environment;
(b) facilitating access to business development services by micro and small enterprises;
(c) facilitating formalisation and upgrading of informal micro and small enterprises;
(d) promoting an entrepreneurial culture; and
(e) promoting representative associations.

The Act does not, however, distinguish between formal and informal enterprises, other than to note the objective of encouraging the formalisation of informal operations. The Act gives direction to key issues for the MSE sector, such as the legal and regulatory environment, markets and marketing, business linkages, the tax regime, skills and technology and financial services. The Act will create the following:

- MSE Authority: for the development, promotion and regulation of MSEs;
- MSE Tribunal: for conflict resolution e.g. municipalities extorting traders;
- MSE Registrar: to register all small businesses and their associations; and
- MSE Fund: to address the issue of access to affordable credit.

While this is a step in the right direction the pace and efficiency at which it is implemented will be the key determinants of its success.

4.12. Business Development

4.12.1. Innovation

The growth in intellectual property rights infringement, such as piracy and counterfeiting, in Kenya is widely considered to undermine the economy and poses a risk to the health and safety of consumers. Historically poor protection of intellectual property rights also discourages entrepreneurial activity. The Legatum Prosperity Index lists R&D expenditure as 0.3% of GDP in Kenya, compared to a global average of 0.9%67. However, attempts to protect intellectual property rights through the new Constitution will incentivise investment in new technology and production methods.

4.12.2. Investment Promotion

Kenya Investment Authority (KenInvest) is a statutory body established in 2004 through an Act of Parliament with the main objective of promoting investments in Kenya. In the World Bank’s 2009 Global Investment Promotion Benchmarking report, which ranks each country’s investment promotion institution (IPI) on a scale of very weak to best practice based on the website and inquiry handlings, KenInvest is classified as average, as are the Ugandan and Tanzanian IPIs. The two highest ranked country IPIs in sub-Saharan Africa were those from Mauritius and Botswana.

4.12.3. Quality of Firms’ Operations and Strategies

The extent to which firms innovate and invest in new technologies and methods is highly dependent on the vision of individual business leaders. Despite the country’s advances in innovation-intensive sectors such as ICT, there is a sense that a portion of the business population suffers from cultural inertia or a welfare mindset. This manifests itself in a reluctance to embrace new technologies and innovation, or an expectation that government is responsible for resolving the business challenges they face.

There is believed to be a culture of unprofessionalism and casualness in business in Kenya, which is limiting the

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67 Legatum Institute, Legatum Prosperity Index, 2012
private sector’s ability to grow and develop. This is related to both historical practice and to education. Kenya is still transitioning from a traditional to a modern economy – it has a large informal sector, the majority of people have grown up in a rural setting where they have only been exposed to basic rural enterprise and the language of professionalism has not yet become embedded in the education sector.

Ownership structures in the Kenyan private sector are also, in some cases, based on family lineage, and do not favour mergers and acquisitions despite the significant benefits in economies of scale and ability to deepen services that this would offer.

4.13. Conclusion

There is a general perception that the private sector in Kenya is vibrant and is moving in the right direction in terms of its economic contribution. Some of the specific strengths of the Kenyan business environment include:

- A well-educated and entrepreneurial workforce;
- An innovative and fast-developing ICT sector; and
- Government commitment to private sector development, including improved dialogue between the public and private sectors.

However, there are a number of factors that do, on the whole, still pose challenges to the day-to-day operations and growth of businesses in the country. In many cases, however, these are improving, and if overcome will open up a diverse set of opportunities for the Kenyan private sector. Predominant challenges include:

- The cost and reliability of energy;
- A poor logistics system, including physical infrastructure and processes, despite Kenya being a regional trade and transport hub;
- The perception of corruption and political interference and patronage, resulting in anti-competitive behaviour;
- Fragmentation, duplication and a slow pace of reform within government, resulting in unnecessary bureaucracy and red tape;
- The burden of inefficiencies within the tax system;
- A mismatch of skills leaving the education sector and those required by the private sector, particularly in new and fast-paced industries;
- Macroeconomic volatility;
- The lack of comprehensive and consistent economic data; and
- Factors that give rise to a large, fragmented and delinked informal sector.

There is a widely held view that the pace of implementation of the policies and programmes that aim to address these challenges could be improved considerably, particularly if the Vision 2030 targets are to be met. Achieving these targets, as well as further growing and diversifying the Kenyan private sector in a sustainable way, also requires the effective leveraging by the private sector of existing opportunities within the country and region, such as:

- The move towards an increase in public-private partnerships (PPPs), particularly in large infrastructural projects;
- Increased regional trade as a result of the common market;
- Possibilities in Kenya’s “budding sectors”, namely oil & gas and real estate; and
- Outcomes of the country’s new Constitution.
5. The Constitution, Devolved Government and Business

5.1. Introduction

Socio-economic inequality, often with a geographic dimension, abuse of executive and judicial power, and an unhealthy political milieu has been characteristic of Kenya. In response, the new Constitution was developed to promote equitable distribution of wealth and resources, enhance democratic voice and assure public accountability and good governance. Constitutional reforms, including the new government system, have the potential to benefit the business environment and bolster private sector development. However, if they are not successfully implemented there is a risk that bureaucratic inefficiencies, malpractice and political patronage will transcend the new structures. This analysis seeks to explore from a business perspective the possible outcomes of the implementation of the new Constitution.

5.2. New Constitution

Kenya’s new Constitution was promulgated in August of 2010. Resting on the principles of accountability, transparency, and fairness, the Constitution provides the parameters in which Kenya’s people and economy will be governed. An extensive consultation process was conducted to ensure that the design of the Constitution reflects the values of the Kenyan People. The Constitution is underpinned by the objective to address widespread socio-economic inequality through the equitable distribution of resources across Kenya. To this need, several major reforms have been made, with the intention of creating an environment in which economic growth is fostered and democratic power is preserved by enhancing accountability and public participation in government. The new Constitution is therefore generally business-friendly. Most notably, the Constitution introduced a new two-tiered devolved government system. At a national level, government is comprised of the Executive body, the Legislature and the Judiciary. At a sub-national level, county governments comprise of a County Assembly and County Executive.

5.2.1. Constitutional Reforms Pertinent to Business

Business and entrepreneurial activity thrives on a predictable regulatory system where the rule of law is upheld and effectively enforced. The most pertinent reforms in the new Constitution that are likely to positively affect business operation in Kenya are detailed below.

Article 47 : on Fair Administration

(1) Every person has the right to administrative action that is expeditious, efficient, lawful, reasonable and procedurally fair.
(2) If a right or fundamental freedom of a person has been or is likely to be adversely affected by administrative action, the person has the right to be given written reasons for the action.
(3) Parliament shall enact legislation to give effect to the rights in clause (1) and that legislation shall—
(a) provide for the review of administrative action by a court or, if appropriate, an independent and impartial tribunal; and
(b) promote efficient administration.

Prior to the promulgation of the new Constitution, businesses applying for operating licenses, or other business facilitation services (including permits, approvals, clearances, taxation assessments and arbitration), were commonly subjected to arbitrary administrative discretionary action by Public servants. Article 47 protects the right of every citizen to fair administrative action. Furthermore, in the case that this right is infringed upon, persons have the right to demand that reason be given for any adverse administrative action. This is to eliminate excessive and arbitrary administrative burdens, to promote fairness in the exercise of administrative action and to improve the Public officers’ decision time68.

Article 40 : on Intellectual Property Rights

(1) Subject to Article 65, every person has the right, either individually or in association with others, to acquire and own property—
(a) of any description; and
(b) in any part of Kenya.
(5) The State shall support, promote and protect the intellectual property rights of the people of Kenya69.

69 Constitution of Kenya, 2010
The new Constitution expands the description of private property to include intellectual property. This is an important reform for business as it protects them against counterfeit production, which costs businesses significant revenues. Protection of company trademarks and brands can bolster the value of a company and its products.

Consumers’ rights to reasonable quality goods and services are protected in the new Constitution. Business must therefore ensure that all products sold to the public are of an acceptable and satisfactory standard. This may present a challenge to some businesses. Ultimately, if reasonable standards of quality are upheld, both the consumers and businesses are protected against harm or unnecessary cost implications that result from the trade of inferior products.

The new Constitution governs a presidential system, a departure from the previous system that vested enormous power in the position of the President. Appropriate checks and balances within the Constitution are designed to ensure the sharing and devolution of power and to protect democratic functions. This is achieved by instilling authority and power in Parliament and the Judiciary, and county governments. Consequently, good governance, credibility, and accountability are enhanced. Moreover, the new executive is reduced in size, with independent institutions established to limit the executive’s control over the public service (e.g. establishment of offices, appointments and remuneration), which should avail more resources for government investment in economy-building initiatives.

Article 60 of the new Constitution requires the State to manage land in a sustainable manner, to the long term benefit of the economy. The State is now responsible for regulating the use of land in line with the fundamental values and principles outlined in the Constitution. This should result in increased investment in land and associated sectors of the economy, and encourage resolution in complex land disputes. Importantly, the detailed constitutional provisions on land seek to end corruption in the system of land distribution and the use of land as a political tool. Furthermore, people are protected from arbitrary deprivation of property.

Article 40: on Consumer Rights

1. Consumers have the right—
   (a) to goods and services of reasonable quality;
   (b) to the information necessary for them to gain full benefit from goods and services;
   (c) to the protection of their health, safety, and economic interests; and
   (d) to compensation for loss or injury arising from defects in goods or services.

2. Parliament shall enact legislation to provide for consumer protection and fair, honest and decent advertising.

3. This Article applies to goods and services offered by public entities or private persons.

Article 60: on Land and Environment

1. Land in Kenya shall be held, used and managed in a manner that is equitable, efficient, productive and sustainable, and in accordance with the following principles—
   (a) equitable access to land;
   (b) security of land rights;
   (c) sustainable and productive management of land resources;
   (d) transparent and cost effective administration of land;
   (e) sound conservation and protection of ecologically sensitive areas;
   (f) elimination of gender discrimination in law, customs and practices related to land and property in land; and
   (g) encouragement of communities to settle land disputes through recognised local community initiatives consistent with this Constitution.
of Public Prosecutions, whose appointment must be approved by Parliament, and ‘who shall not be under the direction or control of any person or authority’.

The new Constitution protects judicial independence and introduces a new vetting process for judges. All judges and magistrates (including those currently sitting) are to be vetted for their suitability by a tribunal.

The Constitution promotes the use of alternative forms of dispute resolution including reconciliation, mediation, arbitration and traditional dispute resolution mechanisms. It is explicitly stated that justice must be exercised in a timely manner. Judicial authority is decentralized. The Constitution establishes a new supreme court. The supreme-court and court of appeals are assigned presidents and each high court is headed by a principal judge as its head. The number of court of appeal judges is also increased.

A Commercial and Admiralty division was created within the high court. Two new high courts in Machakos and Garissa were established as a result. A specialised commercial court was also established within the high court in Mombasa. Each of Kenya’s counties will ultimately have its own high court with a specialised commercial court in each to facilitate the administration of business and improve the ease of doing business in Kenya.

5.2.2. Summary Implications For the Private Sector

The constitutional reforms were informed by consultation with the private sector, among others, and ongoing collaboration between the public and private sector is encouraged in the Constitution.

The Constitution seeks to ensure that government institutions are equipped with adequate skill, and improves accountability in the public sector. Civil servants are expected to adhere to the national values (e.g. human dignity, equity, social justice, inclusiveness, equality, human rights, non-discrimination and protection of the marginalised) and principles of governance (e.g. good governance, integrity, transparency and accountability). Integrity and efficiency in administrative and decision-making processes will aid private sector operations. At the highest level, these improvements should promote a fair and stable economic environment in which the private sector can confidently invest.

The new framework for management of land and legal protection against corruption, for instance, are expected to minimise exploitation by the State and to enable business to flourish. However, the practical outcomes are unclear on details of provisions on land management and ownership. For example, although certain public land is identified as falling under county control, counties have no legislative power over the land, nor may they determine its use. Furthermore, the requirement that a body corporate only be classed as a citizen if its entire shareholding is held by Kenyans may have unintended consequences in relation to land ownership. Given that land ownership is to be restricted to Kenyan citizens, this citizenship definition for bodies corporate may negatively influence investment flows and the transparency of shareholdings.

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75 Murray, C., Kenya’s 2010 Constitution, 2012
76 Ibid.
77 IFC, Doing Business in Kenya, 2012
78 Murithi, T., Kenya’s Constitutional Renewal: A Post-Referendum Analysis, 2010
Issue 1: The Constitution (2010) seeks to assure integrity and efficiency in government administrative and decision-making processes. The rights of individuals and bodies corporate are enshrined. Furthermore, the Constitution limits and separates the powers of the key pillars of government.

<table>
<thead>
<tr>
<th>Constitutional reform</th>
<th>Key elements</th>
<th>What this might mean for business</th>
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| The executive         | Places limitations on executive power (e.g., President and Attorney-General) and shares power between the pillars of government; reduces the size of the Cabinet and vests prosecutorial authority in an independent Director of Public Prosecutions. | • Mitigates against political interference in business.  
• Enhances efficiency and accountability in the use of public resources.  
• Strengthens rule of law. |
| The judiciary         | The independence of the judiciary is protected and all persons are to be afforded equality before the law and timely execution of justice. | • Improved rule of law – more certain business environment.  
• Greater speed in judgments and dispute resolution, facilitated by an increased number of courts, specialised commercial courts and alternative forms of dispute resolution. |
| Fair administration   | Every person has the right to administrative action that is expeditious, efficient, lawful, reasonable and procedurally fair. | • Reduction of red tape – elimination of excessive and arbitrary administrative burdens.  
• Promotes fairness in the exercise of administrative action.  
• Improvement in public officials’ decision time. |
| Land and environment  | Land is to be held, used and managed in a manner that is equitable, efficient, productive and sustainable. | • Protects landowners from arbitrary deprivation of property.  
• Reduced corruption in land administration.  
• The requirement that a body corporate only be classed as a citizen if its entire shareholding is held by Kenyans may have unintended consequences - given that land ownership is to be restricted to Kenyan citizens, this citizenship definition for bodies corporate may negatively influence investment flows and the transparency of shareholdings. |
| Consumer rights       | Consumers have the right to: goods and services of reasonable quality; the information necessary to derive full benefit; protection of their health, safety, and economic interests; and compensation for loss or injury arising from defects in goods or services. | • May present a challenge to some businesses, but if reasonable standards of quality are upheld, both consumers and businesses are protected against harm or unnecessary cost implications that result from the trade of inferior products or services.  
• May reduce the trade in substandard imports. |
| Intellectual property rights | The State commits to support, promote and protect the intellectual property rights of the people of Kenya. | • Upholds copyright, trademarks, patents and industrial design rights.  
• Incentivises investment in new technology, products and methods. |

The Constitution should promote a more transparent and stable economic environment in which the private sector can more confidently invest.
Protection of intellectual property rights will incentivise investment in new technology and production methods. Whereas the enactment of consumers’ rights provisions may present a challenge for some businesses, these provisions are on balance expected to benefit both consumers and businesses. An example of one possible benefit to business may be the reduction in the flow of substandard imports into Kenya.

Most notably, the revised court system and planned reforms in the Judiciary will restore faith in judicial independence and support effective arbitration in business related disputes. Fair play and expeditious dispute resolution is pertinent to enabling private sector growth and advancing economic activity.

The improvement of operational measures and regulatory reform across Kenya is a gradual process. As decentralisation is implemented and the capacity of institutions outside of Nairobi is built, cost and time savings to businesses and entrepreneurs should become a reality. This will encourage business and entrepreneurial activity across the country. If the provisions of the new Constitution are successfully implemented, business in Kenya could be relieved of bureaucratic and political obstructions and greatly enhanced.

5.3. Devolved Government

The new Kenyan Constitution creates a two-tiered system of government, involving two major transitions: 1) the transition from central to national government; and 2) the transition to 47 county level governments. It should be noted from the outset that this transition period will be characterised by uncertainty, resulting in a possible slow-down of private sector investment as investors take a “wait and see” approach.

The institutional arrangements for counties will match those at the national level. Each county will have an elected county assembly and a directly elected Governor. The Governor will govern with a non-elected executive committee, where the committee appointments are approved by the county assembly. Neither the Governor nor the executive committee members may be members of the county assembly, ensuring a separation of powers between the legislature and executive branches. Furthermore, one Senator is directly elected by county voters to represent the county in the national assembly.

Despite the aforementioned objectives, the Kenyan model of devolution is designed to be an interdependent and cooperative model, giving relatively little autonomy to the counties.

5.4. County Competencies

Functions of government are distributed between the national government and county governments according to the fourth schedule of the Constitution. In general, the national government retains control over policy and standards setting, and has legislative authority over all matters, with the exception of limited county power to impose taxes. A full list of county powers and functions can be found at Appendix 1. The major functions of the counties, and implications of devolved power for each, are outlined below.

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80 Murray, C., Kenya’s 2010 Constitution, 2012

AFRICAN DEVELOPMENT BANK GROUP
5.4.1. Regulation

Each county assembly may make legislations in line with the functions of a county. Counties have the power to develop laws and policies, however, county legislation should be consistent with national policy economic objectives. This could result in a possible ‘Balkanisation’ of the business environment through variable rules and procedures, adding complexity and cost to doing business. If a conflict arises between county legislation and national legislation, the Constitution states that national law is binding if it is applicable to the entire country, i.e. the national law sets a standard by which the entire country must abide. In other instances, the county law will override the national law. It is hard to predict the possibility of a county assembly passing legislation that is both private sector unfriendly and does not conflict with national legislation. Consequently, the risk is probably low. At the least, the ability of counties to legislate reinforces the importance of enacting the current Business Regulation Bill and Statutory Instruments Bill in order to create a consistent and enabling business environment at county level. Furthermore, the mainstreaming of regulatory impact assessments into the process of legislation at the county and national levels will promote an economically sensitive approach to law-making.

5.4.2. Administration

The county level transition involves the restructuring of 8 provinces, 280+ districts and 175 local authorities into a single formal level of devolved government. The reduction in the number of subnational government structures, where there has been duplication of responsibilities, should positively affect the ratio of administration costs to service/infrastructure delivery costs. However, uncontrolled spending on personnel is a common feature of decentralisation. The existing wage bill of local authorities on average represents 50 per cent of total expenditure for local authorities (excluding City Council of Nairobi). It is unclear how the staffing of the new county structures will take place. County manpower should be informed by the re-evaluated needs of the county, which should result in employment gains in some counties and losses in others. Creating additional positions on the basis of political patronage would reinforce current inefficiencies. Furthermore, by matching sub-county structures to political boundaries (constituencies and wards) it could increase the allegiance between sub-county administrators and local politicians (e.g. if the CDF is maintained), and boundaries may not make sense from the point of view of managerial efficiency.

In terms of personnel quality, the settlement pattern of high education individuals is likely to persist for the foreseeable future. High levels of education is positively correlated with high income, which in turn is positively correlated with areas with better infrastructure. Counties with an existing infrastructure base will likely continue to play host to such individuals. For less developed counties this will negatively affect the quality of the labour pool for both the public and private sector. Conversely, better educated and higher qualified individuals are more likely to capitalise on key opportunities presented in some of Kenya’s less developed counties e.g. in Turkana and Lamu (oil and gas), Machakos (Konza City), Isiolo (LAPSSET hub/inter-connection).

In an effort to counteract this human resource challenge, civil servant capacity building programmes are planned. The Ministry of State for Public Service; Transition Authority; Kenya School of Government; and other relevant line ministries will develop and implement a capacity building programme to develop adequate social capital at the county level. It is unclear whether adequate incentives have been built-in the devolution process to attract high quality manpower and whether a re-deployment process from leading to lagging regions will occur.

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81 KNBS, Economic Survey, 2012
82 AusAID & World Bank, Devolution without disruption - pathways to a successful new Kenya, 2012
83 World Bank, A bumpy ride to prosperity: infrastructure for shared growth, 2011
84 Poverty headcount ratio at national poverty line (% population)
85 Credit Suisse, 2012
5.4.3. Planning

Projects and policies developed at a county level must be aligned with national economic objectives. Counties are thus responsible for furthering county specific objectives, whilst ensuring integration of national directives. Devolution theory says that subnational governments are better able to identify the needs of constituencies and can therefore direct resources accordingly. Appropriate projects and initiatives, informed by a closer understanding of county requirements, can thus be developed to effectively meet the needs of citizens. This has been taking place in existing subnational structures, but not to the extent envisioned, where the key challenge has been availability and adequacy of resources.

The heterogeneous nature within and between counties may pose a challenge for the planning and allocation of resources for national and county elected representatives. This heterogeneity can be broadly characterised as ‘rural versus urban’ and ‘more developed versus less developed’ areas. Poverty in the rural areas is about 1.5 times that in the urban centres (50% vs 34%)84. About 25% of Kenyans are categorised as urban, but the country’s expected urbanisation rate is higher than the average for sub-Saharan Africa85. It is possible that the weight of elected representatives will have a rural development bias, especially given that most of Kenya’s cities will be managed through delegated authority by county governments with no guarantee of funding – 21 urban centres each with more than 80,000 residents will be re-centralised into county administration86. As a consequence, planning and project identification may sometimes fail to strike an effective balance between investment in infrastructure that encourages crowding-in of private sector investment in high potential areas, and making investments in poor, sparsely populated areas (e.g. Wajir). In short, this has the potential to result in uneconomic decisions that fail to stimulate and support sustainable private sector growth. On the other hand, some counties may succeed in innovatively exploiting its resources and opportunities, creating a niche or competitive advantage. A great deal will depend on the vision and capacity of the county leadership.

An associated dilemma is the coordination of planning between counties in the instances where certain infrastructure and natural resources transcend boundaries. Provision is made for counties to cooperate and create joint authorities and committees. However, given the different development priorities of the various counties, the prioritisation of plans and the execution thereof may be difficult to coordinate. This may have a negative impact on the timely execution of major cross-county infrastructure or natural resource management initiatives.

5.4.4. Delivery of infrastructure and services

As is the case with planning, a devolved government system allows county governments to better understand the needs of their constituencies, which enables a more effective provision of infrastructure and services as resources can be better directed. Closer relationships between government and the citizenry improves accountability of government, as the public is more likely to observe and respond to misappropriation of funds at a county level than at a national level.

Kenya’s national government has pursued increasingly ambitious infrastructural development goals. County

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84 AusAID & World Bank, Devolution without disruption - pathways to a successful new Kenya, 2012

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Figure 30: Kenya is rapidly urbanising, but remains predominantly rural

governments will be central to the continued infrastructure development of the nation. Counties have been mandated to plan, develop and manage infrastructure within their constituencies.

Counties with an infrastructure deficit, relative to more developed counties, will have to “play catch-up”. Such counties will most likely first focus on delivering basic services to their relatively more deprived residents. Those counties with an infrastructure head start should be in a better position to invest in more expensive, private sector enabling infrastructure.

Roads infrastructure remains particularly important for national economic growth – for facilitating access to services and markets (especially, agriculture and tourism), and opening up opportunities for households to diversify their economic activities. In addition, the judicious extension and maintenance of the roads network will cement Kenya’s position as the trade and transport hub in the region. Careful designation of roads (e.g. new roads or road re-allocations between national and county governments) and establishing and upholding standards will be important to avoid maintenance neglect of key arterials.

Counties are expected to collaborate where the production, provision and transmission of services transcend county boundaries (e.g. roads, water and power). A national policy to guide this process is necessary. Where a county is endowed with bulk water supply or power generation capability, inter-county cooperation is critical to ensure equitable access to such resources and an economically viable approach to the reticulation thereof. Poor county cooperation in the provision of services will likely result in a loss in economies of scale, where the increased per unit cost will in turn be passed on to the end consumer (e.g. user charges to businesses and individuals). Besides possible shortcomings in organisational ability, other reasons for poor county cooperation may be a consequence of divisive inter-ethnic political and clanism, as well as disruptive cultural behaviour e.g. cattle rustling. There is a need to implement civic education on county resources, as some ethnicities or clans are known to refuse to share resources and sometimes fight over them.

The provision of infrastructure and services at the county level should provide more opportunity for private sector suppliers and service providers. In the past, procurement was primarily conducted at a national level. Under the devolved government, procurement is extended to the county level. This may result in the localisation of business at the county level, benefitting small and medium enterprises, as well as county residents through increased competition in the delivery of services – assuming that effective competition by competent local providers takes place equally across all counties. If however, county officials award contracts unfairly, the monopoly previously held by MNCs at a national level may simply be recreated at the county level.

Lastly, the provision of infrastructure is intimately tied up with the financial capability of counties. County governments can engage in public-private partnerships to help meet their infrastructural commitments. In this case, assuming the successful enactment of the PPP Bill, the private sector will benefit from increased county-level demand. More conventionally, counties will likely rely on own resources to fund infrastructure investment, from nationally shared revenue and internally generated revenue.

5.4.5. Revenue Sharing and Raising

County governments will be funded through three main avenues. Each is described below, with associated implications for private sector development.

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87 World Bank, A bumpy ride to prosperity: infrastructure for shared growth, 2011
89 Dyer & Blair and PKF, Business Leaders Forum on the Proposed Constitution, 2010
5.4.5.1. National Revenue Sharing

Revenues raised by the national government is to be divided between the national government and county governments annually according to the Division of Revenue Bill. Article 203(2) of the new Constitution states that not less than 15 per cent of national revenues will be shared equitably among the counties. The equitable distribution of revenue will be calculated according to the recommendations of the County Allocation of Revenue Act (CRA). The county revenue allocation formula for the first government term has been agreed, as follows:

- Population size: 45%
- Basic equal share: 25%
- Poverty incidence: 20%
- Land area: 8%
- Fiscal responsibility: 2%

This formula strikes a good balance in trying to address the fixed cost of government administration, the variable cost of delivering services, promoting a more equitable society and incentivising fiscal responsibility. The weighting for fiscal responsibility was deliberately set low, as there are no historical fiscal performance evaluation measures. However, increasing the weighting of this element over time will be critical to incentivising good fiscal management and exploitation of revenue potential.

The City Council of Nairobi (CCN) is a case in point. Its expected share of national revenue amounts to KSh 10 billion per annum. Given that CCN’s annual expenditure is currently slightly less than KSh 10 billion and its locally raised revenue amounts to almost KSh 6 billion, CCN’s incentive to improve on its 40 per cent collection ratio may be diminished. This may negatively affect its longer term sustainability, unless fiscal responsibility is given a greater weighting in the sharing formula.

Counties with a pre-existing development disadvantage can benefit from an Equalisation Fund – totalling 0.5 per cent of annual national government revenues. This will help fast-track the infrastructure “catch-up”. Equalisation Fund monies can be used to provide basic services including water, roads, health facilities and electricity to marginalised communities over the next 20 years. However, there are concerns that these funds will be too small to address deep spatial inequalities.

5.4.5.2. Own Revenue Sources

Counties will be able to augment their financial resources through internal source revenues: taxes, user charges and license fees. Counties have the power to levy entertainment taxes, property rates and any other taxes permitted by national parliament. The law is intended to limit the possibility of double taxing at a national and county level. Examples of user charges include electricity and water tariffs, whereas licensing fees relate to trading, liquor and food. In addition, county governments will be allowed to borrow, subject to a guarantee issued by the national government and with the approval of county assemblies.

Counties do not have equal ability to raise internal revenue. Counties with an existing strong revenue base stand to benefit much more than those without (if the situation in the aforementioned CCN example is reproduced in other counties). Such counties will be in a much stronger financial position, where existing locally raised revenue will serve to augment their existing budgets, instead of meeting a funding shortfall (assuming the county was not underfunded to big with). If these revenue-flush counties make good use of the additional funds, private sector concerns in those counties should surely benefit.

No limitations are imposed on counties with regards to setting taxes, user charges and license fees. It is expected

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91 Commission on Revenue Allocation, Presentation to Parliament, 8 August 2012
92 Ibid.
93 Sellers & Peng, Structures of Metropolitan Governance and Finance: A Case Study of Nairobi, Kenya, 2012
95 AusAID & World Bank, Devolution without disruption - pathways to a successful new Kenya, 2012
that economically sensible behaviour will prevail. This is based on the understanding that there is a natural incentive for counties to not make taxes, user charges and license fees too high, as this will discourage investment or result in disinvestment. If this does not prove to be true, heavily invested businesses (e.g. hotels) or location-specific businesses (e.g. farms and mines) are most at risk.

It is possible that the possible proliferation and inflation of user charges and license fees may result from counties trying to counteract their poor revenue collection performance. This reinforces the need to promote fiscal responsibility and for counties to regularly revisit and rationalise such charges and fees. It also underlines the importance of enacting the current national Bill on Business Regulation in order to create a consistent and enabling business environment at county level. Popular dislike for the range of existing CESS fees appears to currently prevail, and counties need to better understand how their actions serve to enable or disable profitable business and other priorities, such as the national logistics system (e.g. county roads user charges).

The matter of natural resource taxes (e.g. mining royalties) is currently being reviewed by parliament. There is a Bill before parliament that proposes that counties endowed with such resources receive back from national government a portion of the revenue raised. If a county in this position were to disproportionately benefit from its natural resource endowment it could exacerbate county inequalities, but may alternatively serve to mitigate possible negative externalities posed by natural resource exploitation.

In addition to levying taxes, counties can in the long run raise revenues by taking bank debt and issuing municipal bonds. Such mechanisms can greatly leverage the ability of counties to meet their infrastructure needs and serve to more equitably share the cost of such infrastructure across generations. Again, counties with good existing revenue bases will be in a position to borrow more readily, as will those county administrations that evolve from existing, well-functioning local authority administrations due to a boundary match/overlap. The current pattern of borrowing may support this hypothesis, given that Municipal Councils borrowed Ks799 million in 2011/12, versus the Ks78 million borrowed by Town and County Councils.

Not only will business residents in more creditworthy counties stand to benefit, so will the financial services industry. The 47 county structures represent a big opportunity for the financial services sector, in terms of deposit taking, lending and financial instrument structuring.

5.4.5.3. Other Grant Mechanisms

Other conditional or unconditional grant mechanisms may be available to counties, where the existing Constituency Development Fund (CDF) and Local Authority Transfer Fund (LATF) may be modified to fulfil this function. Such mechanisms are yet to be determined.

5.4.6. Summary Implications For the Private Sector

Businesses and private sector development in general will be affected by the shift to devolved government. There will be a period of uncertainty during the transition phase, followed by a practical experience of the outcomes of devolution.
The ability of county governments to effectively deliver appropriate infrastructure and services that supports human development and private sector growth depends on administrative capability, fiscal capacity, evidence-based planning and inter-county cooperation. The former is expected to be addressed through civil servant capacity building initiatives during the transition period, although the outcome may be hindered by the natural tendency of qualified human capital locating in better resourced geographies.

County fiscal capacity is greatly bolstered by the national revenue sharing mechanism. The formula strikes a good balance in trying to address the fixed cost of government administration, the variable cost of delivering services, promoting a more equitable society and incentivising fiscal responsibility. Likewise, county ability to raise internal revenue - hopefully kept in check through measures such as the proposed Business Regulatory Reform Act - will positively affect fiscal capacity. On the other hand, county fiscal capacity is constrained by the following:

- Counties will likely compete for investment. This means that economically viable counties are likely to be regarded as attractive destinations, with investors disregarding other small economies;
- Richer counties will earn more local revenues than poorer counties. This may fuel a cycle of "rich getting richer, and poor remaining poor";
- A county’s ability to collect local revenue effectively will affect the amount of revenues accrued by that county; and
- Borrowing is determined by a county’s credit rating. If a county is unable to manage its finances well, this may impede economic growth within the county.

These constraints reinforce the need to increase the weighting of fiscal responsibility of the equal share formula over time, in order to incentivise good fiscal management and exploitation of revenue potential – to the benefit of county tax payers.

On a political level, elected county representatives will have to balance the need to boost viable economic activity – to facilitate growth – with the need to assist impoverished areas lacking in economic activity. This trade-off will be difficult to manage, especially given the anticipated weight of rural representatives at the county and national levels. Failure to effectively manage this dilemma may impede economic growth. Furthermore, planning and delivery coordination between counties in the instances where certain infrastructure and natural resources transcend boundaries will be critical to facilitate shared growth.

Lastly, the provision of infrastructure and services at the county level should provide more opportunity for private sector suppliers and service providers, than was afforded through Central Government procurement. In addition, the 47 county structures represent a big opportunity for the financial services sector, in terms of deposit taking, lending and financial instrument structuring.
Devolution power to county governments is expected to bring government closer to the people. An interdependent and cooperative model of devolution is proposed, giving relatively little autonomy to the counties. There may be a period of uncertainty during the transition phase, resulting in a possible slowing of private sector investment as investors take a “wait and see” approach to the effects of devolution.

<table>
<thead>
<tr>
<th>Competency</th>
<th>Description</th>
<th>What this might mean for business</th>
</tr>
</thead>
</table>
| Legislation | Each county assembly may make legislations in line with the functions of a county, insofar as it does not conflict with national policies and legislation. | • Possible ‘Balkanisation’ of business environment through variable rules and procedures, adding complexity and cost to doing business.  
• Difficult to predict the likelihood of a county assembly passing legislation that is both private sector unfriendly and does not conflict with national legislation – risk probably low.  
Agriculture and tourism may benefit greatly. |
| Planning | Through the mechanism of planning, counties are responsible for furthering county-specific objectives, whilst ensuring integration of national directives. | • Due to the anticipated weight of elected representation, this may result in a rural allocation bias that fails to stimulate and support sustainable private sector growth i.e. low recognition of the benefits to agglomeration.  
• The different development priorities of neighbouring counties may constrain the coordination of crucial economic development initiatives that transcend county boundaries. |
| Delivery of infrastructure and services | Counties have been mandated to deliver infrastructure and basic services within their constituencies. Counties are expected to collaborate where the production, provision and transmission of services transcend county boundaries (e.g. roads, water and power). | • Those counties with an infrastructure head-start should be in a better position to invest in more expensive, private sector enabling infrastructure – reinforcing a virtuous cycle of development.  
• Poor county cooperation in the provision of services will likely result in a loss in economies of scale, where the increased per unit cost will in turn be passed on to the end consumer (e.g. user charges to businesses and individuals).  
• Provision of infrastructure and services at the county level could provide more opportunity for private sector suppliers and service providers than was afforded through central government procurement.  
• Possibility of magnification of corruption to 47 new locales for rent-seeking. |
| Revenue raising | Counties will be able to augment their financial resources through entertainment taxes, property rates and any other taxes permitted by national parliament; user charges; and license fees. In addition, county governments will be allowed to borrow. | • Counties do not have equal ability to raise internal revenue. Counties with an existing strong revenue base stand to benefit more than those without (due to the national revenue sharing formula, which excludes fiscal capacity).  
• Possible inflation of taxes, user charges and license fees, unless guided by economically sensitive principles. Heavily invested businesses (e.g. hotels) or location-specific businesses (e.g. farms and mines) are most at risk.  
• Represents a big opportunity for the financial services sector, in terms of deposit taking, lending and financial instrument structuring. |

The impact of devolution on business is still unclear but likely to be mildly negative, at least initially – the ability to maximise county-level opportunities and foster a business friendly environment will greatly depend on the vision and capability of county leadership, which is still untested.
5.5. Conclusion

While the macroeconomic environment is determined at a national level, economic stability should be upheld at a county level. Devolved power and service delivery promotes representation, participation, equitable distribution of resources and financial security for the counties. Decentralising functions to the lowest feasible level of decision making and implementation is expected to enhance the efficiency of business processes by optimising the flow of information and reducing transaction costs. On the other hand, if county competencies result in increased bureaucratic procedures, businesses may be negatively impacted.

County level government is generally expected to result in increased accountability and increased local participation in government. There is a risk that the two-tiered government system simply deepens the culture of corruption by increasing the number of people to potentially bribe, and the number of processes at which point bribes can be paid. Constitutional reforms of the judicial system and the establishment of checks and balances are intended to prevent this risk from materialising.

The allocation of national revenue across the counties enables National Government to equitably distribute wealth across the country, in order to level the playing fields. Ultimately, this should reduce inequality levels by uplifting the economically excluded. In the long run, increased wealth results in increased demand. Business will benefit from the creation of new markets and expansion of existing markets.

Overall, the business environment is expected to benefit from the new Constitution. However, the impact of devolution on business is still unclear. It should be noted though that this implementation of change is a gradual process which requires ongoing commitment.
The following section presents a description of the evolution over the past half-decade of the main economic sectors in Kenya. These sectors are those which are ranked top for either % contribution to GDP, employment or rate of growth, and/or have been identified by the Government as ‘budding’ or priority sectors in Vision 2030. Together these six sectors make up more than 80% of the private sector’s contribution to total GDP:

- agriculture, including forestry and fishing,
- transportation and communications, including activities related to business process outsourcing (BPO),
- wholesale and retail trade,
- manufacturing,
- financial services, and
- tourism (using data for hotels and restaurants as a proxy).

Each sector is described in terms of economic contribution, sector composition and character, and dynamics affecting the sector. Some attention is also paid to two ‘budding’ subsectors – oil and gas, and construction and real estate.

Information has been obtained through a combination of extensive desktop research and the collection of primary data via interviews and workshops with relevant stakeholders. Unless otherwise specified, the various quantitative measures related to the specific sectors refer strictly to the private sector (i.e. public sector figures have been excluded).

### 6.1. Agriculture, Forestry and Fishing

The growth of the Kenyan economy is intimately tied to that of the agriculture sector. Just less than one third of private sector GDP (an average of 30% every year) over the past half-decade is attributable to the agricultural sector, making this sector the largest single contributor to GDP. The agricultural sector provides over 75% of the economy’s industrial raw materials and more than 50% (KSh 289 billion) of Kenya’s total export earnings. Goods export earnings are driven primarily by tea (KSh 102 billion).

The sector’s average growth rate (0.3%) between 2007 and 2011 was significantly dampened by poor performance in three of the years during that period. This was due to post-election violence and erratic weather conditions. Persistent challenges facing the industry relate to availability of arable land, unpredictable climatic conditions, fragmentation and informality within the sector, and rising input costs.

Over the past five years, agriculture has consistently been the country’s largest employer, with an average of just over 3,000 registered formal establishments, responsible for roughly 3% of total recorded employment and one-fifth (20%) of private sector formal employment. However, formal employment numbers in the agriculture sector have been on the wane, since 2007.
The development of other sectors (particularly ICT and financial services) has had positive impacts on the agricultural sector, with technological developments related to insurance, access to finance, and technological progress filtering through to even the informal sector players within the industry.

State involvement in the agriculture sector continues to be relatively high, and there is a continuing focus of policy and strategy on further development and diversification of agricultural activities through mechanisms such as the provision of subsidies, irrigation and extension services schemes.

6.1.1. Economic Contribution

Agriculture is a critical component of the Kenyan economy, with nearly one quarter (24.5%) of Kenya’s total GDP in 2011 and 7.6% of total GDP growth for the same year attributable to the sector. The agricultural sector was responsible for 31.7% of private sector GDP in 2011. In the aggregate, growth of the sector has experienced only a slight increase over the past five years. The estimated value of agricultural output in 2011 is KSh 928 billion, while the estimated value of exported agricultural products is around KSh 289 billion.

Crops and horticulture are consistently the largest contributing subsectors to total agricultural GDP, accounting for more than two-thirds of this amount. The contribution of animal farming has been steadily increasing over the past few years, while the contributions of fishing and forestry have remained small and relatively consistent (Figure 33).

In 2008 the sector contracted by 4.3% as a result of the disruptions to production and distribution caused by post-election violence in Kenya that year. Growth of the sector recovered slightly in 2009 and then peaked (in the context of the past 5 years) at 6.4% in 2010. This recovery has been attributed to a bumper harvest resulting from favourable climatic conditions that year. The sector then recorded a decrease in growth to 1.6% in 2011, reflected in a decrease in contribution to total GDP of 2.3% over the same one-year period (Figure 34). The slower growth in 2011 has been largely attributed to erratic weather conditions and rising farm input costs. This indicates the agricultural sector’s vulnerability to exogenous shocks.

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The agricultural sector is the country’s largest employer, formally employing a total of 345,900 people in 2011. Of these, a relatively high proportion is employed in the public sector (52,900), while 293,000 are employed in the private sector. This accounts for 20% of total private sector employment. A formally employed private sector worker in the agricultural industry earns an average annual wage that is well below the average for private sector workers in general (Figure 35). This may be a function of the relatively low- or un-skilled nature of the average agricultural employee.

The livelihoods of almost 75% of the population (primarily those in rural areas) are almost solely dependent on agriculture-related activities. According to the Ministry of Agriculture, the sector accounts for more than 70% of informal employment in rural areas.102

Figure 34: Agricultural sector growth rate and role as a source of overall GDP growth

![Figure 34](image_url)

Source: Genesis Analytics, 2012 (adapted from KNBS data 2012)

Figure 35: Estimated average annual real wage earnings per employee (agriculture)

![Figure 35](image_url)

Source: Genesis Analytics, 2012 (adapted from KNBS data 2012)

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6.1.2. Composition and Character

The agricultural industry is largely fragmented, with most producers operating as subsistence farmers and small holdings on plots averaging 0.2 to 3 hectares in size. Small-scale production accounts for 75% of the total agricultural output and 70% of marketed agricultural produce. Small-scale farmers produce over 70% of maize, 65% of coffee, 50% of tea, 80% of milk, 85% of fish, and 70% of beef and related products. Large listed companies account for only a fraction of the total market, particularly in terms of revenue and export values of key products103.

In 2010, there were 3,257 registered establishments104 operating within the sector. The largest number of these establishments (1,207) have 4 or fewer employees, while 835 establishments were found to employ 50 or more people, and the remaining establishments employed somewhere between 5 and 49 people. Coffee plantations have the highest number of establishments (284) with 50 or more employees, whereas mixed farming and ‘other agricultural activities’ are dominated by 0-4 employee establishments (904, combined). Numbers of establishments and, most likely, employees in logging and fishing is negligible (Table 3).

Table 3:
Size distribution of establishments (agriculture, forestry and fishing) (2010)

<table>
<thead>
<tr>
<th>Activity</th>
<th>0-4</th>
<th>5-9</th>
<th>10-19</th>
<th>20-49</th>
<th>&gt;49</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coffee plantations</td>
<td>58</td>
<td>27</td>
<td>71</td>
<td>66</td>
<td>284</td>
<td>506</td>
</tr>
<tr>
<td>Tea plantations</td>
<td>15</td>
<td>6</td>
<td>10</td>
<td>6</td>
<td>77</td>
<td>113</td>
</tr>
<tr>
<td>Sugar plantations</td>
<td>24</td>
<td>-</td>
<td>7</td>
<td>10</td>
<td>60</td>
<td>101</td>
</tr>
<tr>
<td>Sisal plantations</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>17</td>
<td>17</td>
</tr>
<tr>
<td>Mixed farming</td>
<td>242</td>
<td>74</td>
<td>57</td>
<td>76</td>
<td>96</td>
<td>545</td>
</tr>
<tr>
<td>Ranches</td>
<td>109</td>
<td>55</td>
<td>68</td>
<td>52</td>
<td>62</td>
<td>345</td>
</tr>
<tr>
<td>Other agricultural activities</td>
<td>662</td>
<td>57</td>
<td>146</td>
<td>71</td>
<td>77</td>
<td>1,012</td>
</tr>
<tr>
<td>Processing co-operatives of small farms</td>
<td>47</td>
<td>35</td>
<td>32</td>
<td>53</td>
<td>52</td>
<td>218</td>
</tr>
<tr>
<td>Agricultural service</td>
<td>52</td>
<td>20</td>
<td>30</td>
<td>24</td>
<td>107</td>
<td>233</td>
</tr>
<tr>
<td>Hunting, trapping and game propagation</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>88</td>
<td>-</td>
<td>88</td>
</tr>
<tr>
<td>Forestry</td>
<td>-</td>
<td>1</td>
<td>-</td>
<td>57</td>
<td>-</td>
<td>58</td>
</tr>
<tr>
<td>Logging</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Ocean and coastal fishing</td>
<td>-</td>
<td>4</td>
<td>7</td>
<td>-</td>
<td>-</td>
<td>11</td>
</tr>
<tr>
<td>Inland water fishing</td>
<td>-</td>
<td>4</td>
<td>2</td>
<td>-</td>
<td>-</td>
<td>7</td>
</tr>
<tr>
<td>Total</td>
<td>1,207</td>
<td>283</td>
<td>430</td>
<td>835</td>
<td>835</td>
<td>3,257</td>
</tr>
</tbody>
</table>


104 Establishments should not be confused with companies. A single company may have multiple establishments. KNBS does not keep records on numbers of companies by sector or activity (subsector).
Using the recorded values of marketed produce as a proxy for determining the relative size of Kenya’s various agricultural activities, the top three activities include: 1) tea, 2) cut flowers, and 3) cattle and calves. Tea dominates, with cut flowers having half the marketed production value of tea. Table 4 below shows the remaining products in rank order, showing the per cent change in value since 2007.\(^{105}\)

Kenya’s major agricultural exports include tea (KSh 102 billion), horticulture (KSh 83 billion) and coffee (KSh 20 billion), which make up 21%, 17% and 4% of Kenya’s total goods exports respectively (collectively, 42%).\(^{106}\)

Box 9: Kenya’s cut flower industry

Kenya’s success in the cut flower industry is mainly due to influence of foreign investors through technology, management processes and market knowledge. The transfer of skills was partly informal and partly structured, for example through some donor assistance. Ownership in the industry is currently around 50% foreign and 50% local. A challenge currently facing the cut flower industry is that it is classified as a primary industry by the Ministry of Trade and a secondary industry by Ministry of Industrialisation, which means it can’t access EPZ benefits, but is required to pay a manufacturing levy. The Kenyan Flower Council believes that accessing EPZ benefits will result in an expansion of the industry and an increase in indirect taxes to the fiscus.

Kenya is globally competitive in a few of its agricultural exports. Of Kenya’s top eight agricultural exports, five are increasing their global export market share. Significantly, three of these five goods exports (plants, cut flowers and leguminous vegetables) are operating in an environment of reduced global demand for those products. Coffee, tobacco (unmanufactured) and vegetables (fresh or chilled) are, however, losing global export market share (Figure 36).

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Table 4: Recorded marketed production values at current prices, 2011

<table>
<thead>
<tr>
<th>Marketed produce in rank order</th>
<th>2011 value (KSh millions)</th>
<th>% change since 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tea</td>
<td>100 146</td>
<td>56%</td>
</tr>
<tr>
<td>Cut flowers</td>
<td>44 506</td>
<td>3%</td>
</tr>
<tr>
<td>Cattle and calves</td>
<td>30 254</td>
<td>43%</td>
</tr>
<tr>
<td>Vegetables</td>
<td>19 991</td>
<td>-12%</td>
</tr>
<tr>
<td>Sugar-cane</td>
<td>18 616</td>
<td>37%</td>
</tr>
<tr>
<td>Coffee</td>
<td>17 826</td>
<td>49%</td>
</tr>
<tr>
<td>Dairy produce</td>
<td>14 548</td>
<td>42%</td>
</tr>
<tr>
<td>Others (livestock and products)</td>
<td>11 855</td>
<td>60%</td>
</tr>
<tr>
<td>Maize</td>
<td>10 146</td>
<td>21%</td>
</tr>
<tr>
<td>Others (cereals)</td>
<td>7 091</td>
<td>50%</td>
</tr>
<tr>
<td>Chicken and eggs</td>
<td>5 533</td>
<td>53%</td>
</tr>
<tr>
<td>Fruits</td>
<td>3 627</td>
<td>50%</td>
</tr>
<tr>
<td>Wheat</td>
<td>3 045</td>
<td>-1%</td>
</tr>
<tr>
<td>Others (temporary industrial crops)</td>
<td>2 776</td>
<td>71%</td>
</tr>
<tr>
<td>Sisal</td>
<td>2 513</td>
<td>41%</td>
</tr>
<tr>
<td>Pyrethrum</td>
<td>133</td>
<td>26%</td>
</tr>
</tbody>
</table>

Source: Genesis Analytics, 2012 (adapted from KNBS Economic Survey, 2012)

\(^{105}\) Per cent change may indicate an increase or decrease in production volumes and/or a change in marketed prices.

\(^{106}\) KNBS data, 2012
Figure 36: Top agricultural exports by export value

Source: Genesis Analytics, 2012 (adapted from International Trade Centre data, 2007-2011)

Note: Red bubble represents trade deficit for that product which suggests that imports of this product exceed exports thereof, which may be a function of a wide range of factors, including local production and consumption patterns.
Kenya’s major tradable agricultural commodities include maize, coffee, tea and sugar-cane. Forecasts of the prices of these commodities are shown in Figure 39. In general, these commodity prices are expected to decrease in real terms, which may have negative impacts on the agricultural sector in the absence of increased value addition or diversification.

Box 10: Major importers of Kenya’s agricultural products

The figures below highlight the importance of the European market for Kenya’s agricultural exports, particularly in the case of cut flowers (with imports frequently entering the EU market via Rotterdam).

Figure 37: Top importers of Kenya’s tea, coffee, mate and spices (2011)

![Chart showing importers of Kenya’s tea, coffee, mate and spices]

Source: International Trade Centre, 2012

Figure 38: Top importers of Kenya’s live trees, plants, bulbs, roots, and cut flowers (2011)

![Chart showing importers of Kenya’s live trees, plants, bulbs, roots, and cut flowers]

Source: International Trade Centre, 2012
6.1.3. Dynamics affecting the sector

In light of its significant influence on the Kenyan economy, it is not surprising that the agricultural sector continues to be given high priority by the Kenyan Government in its development strategy. Agriculture is viewed as an important tool for promoting national development, and a number of qualitative and quantitative targets for growth of the sector have been identified in the Vision 2030 strategic development document published in 2007.

These targets include the reformation and the transformation of institutions and organisations present within the sector; such as cooperatives, regulatory bodies and research institutions, into “complementary and high-performing entities that facilitate growth in the sector”; increasing productivity levels throughout the sector; improving land use policy and developing underdeveloped areas so as to catalyse the growth and development of agricultural operations; and increasing market access through increased investment in local value-addition processes.

In accordance with these targets, total resource allocation by government to the sector through the Economic Stimulus Programme increased by 55.6% between 2008 and 2011 (to KSh 46 billion, almost double the Ministry of Agriculture budget for 2010/11). There have been recent attempts by the Kenyan Government to stimulate the local production of fertiliser, but imported fertiliser is currently subsidised, which contradicts these efforts. In addition, the design of mechanisms to improve the effectiveness of irrigation schemes is underway, and a number of publicly funded economic stimulus programmes to encourage diversification in production (incentivising

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**Figure 39:**
Agricultural commodity price forecast in real 2005 US

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107 Kenya Open Data, 2012
108 Ministry of Finance, Agriculture and rural development sector report, 2012
entry into previously unexplored fields, such as the practise of aquaculture) have recently been implemented. Also currently in effect are a number of private sector and donor driven initiatives aimed at skills development\textsuperscript{109} and improved access to finance (specifically in the form of crop insurance) within the sector.

The Agricultural Sector Coordinating Unit, an entity with which the Kenyan Government is directly involved, is responsible for co-ordinating interaction between various stakeholders. The majority of exported Kenyan agricultural products are exported in unprocessed forms, with processed foods existing as major imports. Collaboration and linkages between smaller farmers (often via available associations) is common in cases where products are exported and in situations where producers are geographically near to one another (as is the case for the tea sector). Localised linkages between the agricultural and tourism sectors are common in the form of the supply of produce to hotels and restaurants (particularly in coastal areas).

The Kenyan Government is currently implementing the Agricultural Sector Development Strategy (ASDS), the overall aim of which is to establish the agricultural sector as a key driver of the projected rate of annual economic growth under the economic pillar of the Vision 2030. The ASDS encourages the private sector to invest in agricultural production at all levels of the supply chain and to enter into public-private partnerships across various sub-sectors wherever possible. This is achieved through, for example, improved access to finance and technology for input supply, farm production, storage and assembly, processing, distribution, and wholesaling and retailing activities. The strategy includes a number of targets that are hoped to be achieved by 2015, including a clear objective to divest from public institutions any production, processing and/or marketing functions which would be best provided by the private sector\textsuperscript{110}.

The ASDS articulates that the provision of key agricultural goods and services (for example, physical infrastructure, utilities, and key research and extension functions) is the responsibility of the Kenyan Government. In providing these goods and services, the state will support the activities of the private sector, including the functions of input supply, farm production, storage and assembly, processing and distribution.

The development and use of new and pioneering technologies is becoming increasingly important in Kenyan agricultural operations, with innovations such as M-Farm (a tool which allows farmers to access information regarding real time prices of agricultural produce using their mobile phones) and Kalimo Salama (also known as “safe agriculture” – an insurance product designed to assist farmers in insuring outputs against unfavourable climatic conditions) becoming increasingly popular (Box 11).

The sector does however face a number of challenges. For instance, only 16% of Kenya’s land is arable with adequate rainfall, and only 5% of that arable land is under crop agriculture. Anecdotal evidence suggests further pressure is being exerted on arable land through real estate development and other land use changes. Demand for residential and commercial properties is placing increasing pressure on the agricultural sector. For example, urbanisation of arable land is expected to directly (and negatively) affect more than 30% of coffee and tea estates in Kiambu, Thika, Murang’a, Nyeri and Ruiri\textsuperscript{111}. Kenya is also susceptible to drought and has one of the lowest water storage rates in the world. Periods of low rainfall therefore have a considerably negative effect on the agricultural sector, particularly due to the lack of irrigation-based farming in the country. Most irrigation schemes are government-driven, cover large-scale crops and have experienced a number of setbacks, such as the washing away of schemes during heavy flooding in early 2010\textsuperscript{112}.

\textsuperscript{109} Based on interviews and workshops with relevant industry stakeholders
\textsuperscript{110} Government of Kenya, Agricultural Sector Development Strategy, 2010
\textsuperscript{111} Waitathu, Urbanisation a threat to agricultural production in Kenya, 2011
\textsuperscript{112} Kenya Red Cross, Kenya: Floods Cause Death, Destruction and Displacement, 2010
The agricultural sector proved particularly vulnerable to the unrest following the 2007-08 election. This included the widespread burning of farms, relocation of farmers and poor distribution of goods, and as a result, the sector contracted at a rate of 4.3% in 2008.

The sector has also been experiencing rising costs in recent years in terms of farm inputs, including electricity, labour\textsuperscript{113}, fuel, fertilizer, agro-chemicals and seeds, which can result in high costs being passed on to consumers, reduced competitiveness and farms closing down or moving into other sub-sectors. The Government is trying to address a number of these issues, such as through the subsidisation of fertilizer and seeds, but the effects of this are not yet being felt by a significant portion of the sector. There have also been a number of innovative initiatives implemented at the individual farm level, such as the use of cost-saving alternative energies, but a farm’s ability to do so is often dependent on economies of scale, and as such has not permeated the sector as a whole.

The sector is also a victim of low agricultural output and productivity resulting from rudimentary and labour intensive technologies being employed along the value chain. Post-harvest losses, usually due to the lack, and poor quality of, cold storage and warehousing facilities, which can be prohibitively expensive at the individual farm level, also results in significant waste and increased costs experienced by the sector.

As Kenya is undergoing a transition from a traditional to a modern economy, and agricultural cash flows and returns can be low relative to other sectors, some sub-sectors within agriculture are regarded as “poor-man’s work”\textsuperscript{114} and are perceived as unattractive to young people of working age. The average age of farmers in some of these sub-sectors is therefore as high as 60-70\textsuperscript{115}, which further contributes to the relatively low productivity levels in the agricultural sector.

The fragmented nature of the sector, as is shown in Table 2 above, also prevents farmers from achieving economies of scale, which would help in areas such as input costs, cold storage and warehousing.

<table>
<thead>
<tr>
<th>Summary of sector dynamics (strengths, challenges, opportunities)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Strengths</strong></td>
</tr>
<tr>
<td>• Pockets of excellence in certain product areas (e.g. tea, cut flowers, leguminous vegetables), resulting in competitive production and export (predominantly to European markets).</td>
</tr>
<tr>
<td>• Labour absorbing (largest formal and rural employer).</td>
</tr>
<tr>
<td>• Extensive government support (financial and technical).</td>
</tr>
<tr>
<td><strong>Challenges</strong></td>
</tr>
<tr>
<td>• Shortage of arable land for crop agriculture, exacerbated by historical land ownership policies and changing land use patterns (e.g. due to urbanisation), limiting growth potential.</td>
</tr>
<tr>
<td>• Reliance on rain fed agriculture and poor water storage rates, increasing exposure to climatic conditions.</td>
</tr>
<tr>
<td>• Fragmentation and informality in the bulk of agricultural activity, reducing competitiveness.</td>
</tr>
<tr>
<td>• Vulnerability to social/political unrest, increasing risk to production.</td>
</tr>
<tr>
<td>• Dependence on imported inputs (e.g. fertilizer, seeds and agro-chemicals), increasing exposure to price inflation and fluctuation.</td>
</tr>
<tr>
<td>• Low productivity due to small plot sizes and outdated technologies and processes.</td>
</tr>
<tr>
<td>• Inadequate diversification of exports (heavily reliant on tea and cut flowers) and limited value addition to agricultural produce presents a risk and hampers greater growth and wealth creation.</td>
</tr>
<tr>
<td>• Competition issues in certain industries e.g. maize and sugar.</td>
</tr>
<tr>
<td>• Unclear practical outcomes on details of constitutional provisions on land management and ownership, especially regarding devolved government authority and foreign land ownership.</td>
</tr>
<tr>
<td><strong>Opportunities</strong></td>
</tr>
<tr>
<td>• Increased collaboration between the informal sector and the formal sector (large producers, manufacturers, retailers and exporters).</td>
</tr>
<tr>
<td>• Access to new technologies (e.g. M-Farm) increases the ease of doing business in this sector.</td>
</tr>
</tbody>
</table>

\textsuperscript{113}As a result of labour shortages experienced in the sector

\textsuperscript{114}Interviews with relevant stakeholders in the agricultural sector revealed that maize and potato farming in particular are regarded as undesirable agricultural sub-sectors in which to work

\textsuperscript{115}KENFAP. Agriculture workshop, Nairobi, September 2012
6.2. Transport and Communication (Including BPO)

Almost 16% of Kenya’s private sector GDP in 2011 was attributable to the transport and communication sector\(^{116}\). This sector has been the third fastest growing sector of Kenya’s main sectors (after financial services and trade), averaging 5% since 2007. The sector employs approximately 138,000 people, which is equivalent to 1% of total recorded employment\(^{117}\) and 9.5% of formal employment\(^{118}\).

Transport is responsible for around 85% of output value generated by the transport and communication sector, where road transport comprises 66% of the transport sector’s output value. Within communication, mobile technology is experiencing especially rapid development, one sign of which is an almost 300% increase in mobile subscriptions between 2003 and 2010. A communication subsector, Business Process Outsourcing (BPO), has been identified by the Government as having the potential to generate over KSh 40 billion per annum and provide 20,000 jobs by 2015. In light of the relative infancy of this industry, the lack of any official baseline against which to measure development is a major challenge to policymakers wishing to prioritise the development of the sector.

While there have been major strides made in terms of investment in communication infrastructure, such as the laying of fibre optic cables, which has contributed to a reduction in costs and the speed of connectivity, this investment has been occurring at a pace that has not yet induced the rate of growth that the sector could (and should) be experiencing. As a result, the communication sector has come together to form a representative association, the purpose of which is to consult with government in order to better direct policy and promote growth in this subsector.

6.2.1. Economic Contribution

Transport and communication activities contributed 11.8% to Kenya’s total GDP in 2011, and make up almost 16% of private sector GDP. The sector grew by 4% in 2011 and experienced an average annual growth rate of roughly 5% since 2007. It was the most important source of GDP growth in the Kenyan economy from 2007 to 2011\(^{119}\).

Transport and communication accounted for 9% of total formal private sector employment in the country in 2011. The average annual real wage earnings of employees within this sector are almost twice those of the average private sector employee. These high real wages may be a function of the relatively high level and specialised nature of skills demanded by (particularly) the communication sector.

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\(^{116}\) Transport and communication are grouped as one sector in this report since they are grouped in this way by KNBS in its data collection and categorisation. Wherever possible, this report will disaggregate available data so as to provide industry-specific analysis of these two sectors.

\(^{117}\) Including informal and formal sector employment

\(^{118}\) Excluding public sector employment

\(^{119}\) KNBS, Economic Survey Highlights, 2012
6.2.2. Composition and Character

Within transport and communication, the subsector that has consistently been responsible for the greatest output over the past five years is that of road transport (KSh 388 billion in 2011). Output growth of the communication sector has been steady, recording KSh 108 billion in 2011 (Figure 41). The relative importance of these subsectors is matched by the export data. In 2010, the export of transportation services, communication services, and computer and information services generated KSh 133 billion, KSh 30 billion, and KSh 9 billion respectively.

The communication sector (including communication services and ICT) is responsible for approximately 15% of the total output value of the transport and communication sector (Figure 41). The sector has experienced notable growth over the past half-decade, recording annual growth rates of 30.3%, 7.8%, 10%, 4.5% and 4.3% between 2007 and 2011. The mobile phone subscriber base has also steadily increased over time, growing from just over 9 million connections in 2007 to 25.3 million in 2011. Mobile phone subscriptions have increased by approximately 300% since 2003. The mobile phone market was concentrated until recently, exhibiting relatively high prices. There are allegations that this was enabled through ownership by politically connected individuals in the main service provider via an opaque minority shareholding entity (Mobitelela Ventures). Consumer friendly regulation and the entrance into the market of two new operators has helped to increase competition, and prices have already dropped by about 50%.

![Figure 41: Value of output of various transport and communication subsectors](image-url)

Source: Genesis Analytics, 2012 (adapted from KNBS data 2012)

Communication

The communication sector (including communication services and ICT) is responsible for approximately 15% of the total output value of the transport and communication sector (Figure 41). The sector has experienced notable growth over the past half-decade, recording annual growth rates of 30.3%, 7.8%, 10%, 4.5% and 4.3% between 2007 and 2011. The mobile phone subscriber base has also steadily increased over time, growing from just over 9 million connections in 2007 to 25.3 million in 2011. Mobile phone subscriptions have increased by approximately 300% since 2003. The mobile phone market was concentrated until recently, exhibiting relatively high prices. There are allegations that this was enabled through ownership by politically connected individuals in the main service provider via an opaque minority shareholding entity (Mobitelela Ventures). Consumer friendly regulation and the entrance into the market of two new operators has helped to increase competition, and prices have already dropped by about 50%.

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Source: Genesis Analytics, 2012 (adapted from KNBS data 2012)

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![Figure 41: Value of output of various transport and communication subsectors](image-url)

Source: Genesis Analytics, 2012 (adapted from KNBS data 2012)
Internet subscriptions in Kenya have also grown significantly in number in recent years. In the first quarter of 2012 there were over 650,000 broadband subscriptions, and 6.49 million internet subscriptions. Most internet subscriptions were to mobile data access technologies such as GPRS and EDGE. While much room for further growth exists, the current levels of connectivity are relatively impressive when compared to the same indicators in a country such as South Africa (Table 5).

The arrival of submarine fibre optic cables SEACOM, TEAMs, and EASSy are, in part, responsible for a rapid increase in internet usage in recent years, while the roll out of 3G networks by operators will boost the uptake of broadband services in the country.

The growth of competition in Kenya’s internet access market is contributing significantly to making services more affordable and channelling investment to network infrastructure expansion and coverage. Kenya has a number of fixed line broadband and internet service providers, including France Télécom-backed Telkom Kenya, Kenya Data Networks (KDN) (in which South Africa’s Allied Technologies (Altech) has a controlling stake) Wananchi, Jamii Telecom, Access Kenya and Kenya Power and Lighting Company (KPLC). In the mobile sector, mobile market leader Safaricom dominates with a 3G network. Telkom Kenya remains the largest provider of fixed telephony services in Kenya. However, at the same time as the recent exponential growth in mobile and internet subscriptions (Figure 42), there has been a significant decline in the use of fixed telephone lines.

### Box 11: Mobile technology innovations in Kenya

**M-Pesa** is a mobile-phone based money transfer and microfinancing service offered by Safaricom, the largest mobile network operator in Kenya. M-Pesa is currently the most developed mobile payment system in the developing world and allows users with a national ID card or passport to deposit, withdraw, and transfer money easily with a mobile device. This has gone a long way to improving financial inclusion in Kenya (see Box 144, section 3.5 for more details).

**M-Farm** is a transparency tool for Kenyan farmers that provides access via SMS to real time price information of various agricultural products in different markets and locations. This in turn helps farmers to bargain with buyers and better respond to market demand. The platform also aggregates farmers’ needs and connects them with each other and farm input suppliers.

**Kalimo Salama** is the largest agricultural insurance programme in Africa (insuring over 70,000 farmers), and helps farmers cope with climate change and the negative impacts of weather shocks. The programme uses a low-cost, mobile phone payment and data system, and automated, solar powered weather stations, which is the key to its affordability and scalability.

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### Table 5: Mobile technology in Kenya: a comparison

<table>
<thead>
<tr>
<th></th>
<th>Kenya</th>
<th>South Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>National population</td>
<td>41 million</td>
<td>51 million</td>
</tr>
<tr>
<td>Mobile phone subscriptions</td>
<td>25.3 million</td>
<td>29 million</td>
</tr>
<tr>
<td>Internet subscriptions</td>
<td>6.49 million</td>
<td>12.6 million</td>
</tr>
<tr>
<td>Broadband subscriptions</td>
<td>650,000</td>
<td>8.2 million</td>
</tr>
</tbody>
</table>


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### BPO

Business Process Outsourcing (BPO) has been identified in the Vision 2030 as a key industry for future job creation.
The BPO industry in Kenya is still in its infancy, accounting for less than 0.01% of the country’s GDP\textsuperscript{123}, but is believed to have potential for growth and is estimated to generate revenues of KSh 43 billion annually and provide 20,000 jobs by 2015\textsuperscript{124}.

There is minimal secondary data on the BPO industry. Primary research suggests that there are approximately ten major BPO operators currently active in Kenya. These larger entities share the market with a host of smaller operators (somewhere between 30 and 40 in total). Of these, more or less 60% are locally owned players, with the foreign-owned contingent currently dominated by Indian-owned firms. Major players include (among others) companies such as Horizon Contact Centers, Technobrain BPO, Dhanush Infotech, Spanco RAPS, Simba Tech, Kencall, Adept Technologies, DaproiM, G47, and Virtual City. The biggest market for BPO is the Kenyan Government (60%). About 20% of BPO revenue generated comes from large telecommunication companies that outsource certain functions, 10% from the financial sector, and 5% from the manufacturing sector\textsuperscript{125}. At present, BPO operators are almost exclusively based in Nairobi. Local jobs created by this industry have increased from approximately 3,000 in 2009 to 15,600 in 2012\textsuperscript{126}.

Kenya recognises that it does not have the scale to become a global BPO player like India or the Philippines, and should instead focus on becoming a niche player. Kenya’s BPO strategy is to initially concentrate on sales and customer care, and to start by targeting African opportunities and Africa-friendly clients in large developed countries, such as the US and UK.

Given the size of the BPO sector, the lack of comprehensive baseline data against which to measure its progress, and the general entrepreneurial drive, growth and advancements in the ICT sector as a whole, the Government should potentially consider elevating priority support from BPO specifically to the ICT sector more generally.

**Transport**

The Transport sector grew by 4% in 2011. The profile of registered establishments\textsuperscript{127} appears to broadly correlate with sector output value, with road freight and passenger transport activities dominating in terms of the number of registered establishments in operation (Table 6).

<table>
<thead>
<tr>
<th>Activity</th>
<th>Number of establishments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Railway transport</td>
<td>8</td>
</tr>
<tr>
<td>Urban, sub-urban and inter-urban highway passenger transport</td>
<td>170</td>
</tr>
<tr>
<td>Other passenger land transport</td>
<td>187</td>
</tr>
<tr>
<td>Freight transport by road</td>
<td>278</td>
</tr>
<tr>
<td>Pipeline transport</td>
<td>19</td>
</tr>
<tr>
<td>Supporting services to land transport</td>
<td>35</td>
</tr>
<tr>
<td>Ocean and coastal water transport</td>
<td>15</td>
</tr>
<tr>
<td>Inland water transport</td>
<td>13</td>
</tr>
<tr>
<td>Supporting services to water transport</td>
<td>45</td>
</tr>
<tr>
<td>Air transport carriers including aircraft rental</td>
<td>193</td>
</tr>
<tr>
<td>Supporting services to air transport</td>
<td>66</td>
</tr>
<tr>
<td>Services incidental to transport</td>
<td>378</td>
</tr>
<tr>
<td>Storage and warehousing</td>
<td>72</td>
</tr>
</tbody>
</table>


\textsuperscript{123}Kenya Ministry of State for Planning, National Development and Vision 2030, 2nd Annual progress report on the implementation of the First Medium Term Plan of Kenya Vision 2030, 2011
\textsuperscript{124}Kenya BPO Strategy, 2009
\textsuperscript{125}Kenya ICT Board interview, 2012
\textsuperscript{126}Ibid.
\textsuperscript{127}Establishments should not be confused with companies. A single company may have multiple establishments. KNBS does not keep records on numbers of companies by sector or activity (subsector).
\textsuperscript{128}Those activities related to communications have been excluded.
Road

There are 160,886 km of public roads in Kenya, 14% of which are paved. From 2008 to 2011 the Kenyan Government spent US$ 2.4 billion on the construction and maintenance of roads\(^\text{129}\). In 2010/2011 719 km of roads were constructed and 1,002 km of roads were rehabilitated. Earnings from road traffic were recorded at KSh 388 billion (KSh 190 billion from passenger traffic and KSh 198 billion from freight traffic). In 2011, almost 206,000 new vehicle registrations were processed, representing a 140% increase in the number of new registrations since 2007\(^\text{130}\).

Rail

The railway sub-sector is responsible for less than 1% of the output value generated by transport and communication. Rail recorded an increase in earnings in both passenger and freight of 20.2% and 14.5% respectively in 2011. This was attributed by KNBS to the restructuring of the operations of the Rift Valley Railways, the only rail line linking Kenya and Uganda, which enabled the injection of additional capital and managerial skills\(^\text{131}\). The Nairobi Commuter Rail Programme, which was envisaged to have been implemented by 2012 as part of the Vision 2030 Medium Term Plan, has not yet been implemented.

Air

Kenya Airways dominates the air transportation market in Kenya and East Africa. There are a number of other smaller operators in the region, including Jetlink, Route 540, and Precision Air, but most of the competition that Kenya Airways faces is provided by larger African airlines, such as South African Airways, Egypt Air and Ethiopian Airways. Government currently holds a minority share in Kenya Airways. Kenya Airways Cargo is continuing to develop its route portfolio since its launch in 2004, and now plans to operate a specialised freighter, as opposed to transporting cargo in the holds of the passenger planes operated by its holding company, Kenya Airways. In 2010 there were 17 paved airports and 174 unpaved airports in Kenya. Significant progress has been made in the development and modernisation of airports and airstrips under the First Medium Term Plan for the Vision 2030, including a construction of a new terminal at Nairobi’s JKIA airport and the extension of the runway at Kisumu International Airport.

Maritime

At the beginning of 2012 a project was launched to develop a port at Lamu in northern Kenya, which will be five times larger than Kenya’s only other port, Mombasa. An oil pipeline, railway and motorway are also planned to be built linking Lamu to South Sudan and Ethiopia, allowing Kenya to earn more revenue from its landlocked neighbours\(^\text{132}\). Plans for the further development of Mombasa Port are also being refined by relevant stakeholders. In 2011, Mombasa Port recorded 1,684 ship dockings and container traffic measuring 770,804 Twenty-foot Equivalent Units (TEUs). In that same year, the main imports and exports moving through the port were bulk liquids and dry general goods, respectively.

\(^\text{130}\) KNBS, Economic Survey, 2012
\(^\text{131}\) KNBS, Economic Survey Highlights, 2012
\(^\text{132}\) BBC News, Lamu port project launched for South Sudan and Ethiopia, March 2012
6.2.3. Dynamics Affecting the Sector

Communication technology is a significant enabler of commercial activity in any economy. The 2012 Energy, Infrastructure and ICT Sector Report notes that although the Government has been providing financial and other support to the sector, the trend over recent years has been to underspend on its development expenditure commitments. This chronic underspending has been attributed to procurement challenges (particularly in the case of donor funded projects), inadequate availability of funds on the part of relevant stakeholders, and delayed or inadequate disbursement of funds by government departments and development partners.

In Kenya, the crucial role and magnitude of impact of improved communication technology is especially evident in the financial services sector. Kenya has more cell phone subscriptions than adult citizens and more than 80% of those with a cell phone also use mobile money. The number of mobile money transfer subscribers increased from 10.6 million in 2010 to 17.4 million in 2011. The world has approximately 60 million mobile money users and almost one in every three of those is a Kenyan. Currently the most developed mobile payment system in the developing world, M-Pesa allows users to deposit, withdraw, and transfer money easily with a mobile device.

Possibly the most influential recent development affecting the communication industry in Kenya has been the arrival of fibre optic internet connections in the country (which, as noted previously, has enabled the rapid expansion of communication technology products and services and has had immense knock-on impacts on the economy as a whole). Also influencing the industry is the current development (by the Kenya ICT Board) of the ‘Centre of Excellence’ – an institution aimed at growing and maximising the potential of the local labour market in terms of industry-specific capabilities. The activation of the BPO standardisation and certification body, the International Institute for Outsource Management (IIOM), and the BPO Certification Institute (BCI) (an industry-specific dedicated skills development and training body) have also had tangible impacts on the development of the industry. Other recent developments impacting the industry include the Data Protection Bill (with the objective of increasing consumer protection) as well as a revised tax regime (to incentivise development of industries likely to generate economic growth and development), which are currently the subject of discussion at the level of parliament, though at this stage no final decisions have been communicated; as well as the development of digital villages, which highlight and promote the development and use of communication technologies.

The Communication Commission of Kenya (CCK) (the regulatory body for the Kenyan ICT sector) was established in 1999 to license and regulate telecommunications, radio communication and postal services in the country. Recent regulatory developments are noted in Table 7.

<table>
<thead>
<tr>
<th>Date of implementation</th>
<th>Description of regulatory development</th>
</tr>
</thead>
<tbody>
<tr>
<td>October 2009</td>
<td>CCK proposed a set of rules to govern pricing and competition in the Kenyan telecoms market. In September 2010, the CCK relaxed some of these controversial telecoms regulations, following complaints by the dominant market player, Safaricom.</td>
</tr>
<tr>
<td>August 2010</td>
<td>CCK issued a new determination on interconnection tariffs for fixed and mobile telecoms services in the country. The rates will progressively decline by 35%, 20% and 15% annually in 2011, 2012 and 2013 respectively to stand at KSh 0.87 per minute by 2014.</td>
</tr>
<tr>
<td>January 2011</td>
<td>CCK announced that it intends to review the fees charged for two types of telecoms licences in the country.</td>
</tr>
<tr>
<td>February 2011</td>
<td>Central Bank of Kenya (CBK) directed telecoms operators offering money transfer services to reduce charges levied on subscribers as a pre-condition for allowing transfers of a higher amount in a single transaction.</td>
</tr>
<tr>
<td>April 2011</td>
<td>Mobile number portability (MNP) was rolled out by Kenya’s four mobile operators in line with regulatory requirements.</td>
</tr>
<tr>
<td>June 2011</td>
<td>Kenya’s President Mwai Kibaki suspended the latest round of cuts to interconnection rates in a directive issued during May 2011.</td>
</tr>
<tr>
<td>April 2012</td>
<td>CBK began monitoring mobile money transfer transactions in the country to ensure that the platforms are secure</td>
</tr>
</tbody>
</table>
While the ICT sector in Kenya has experienced strong growth in recent years, accompanied by increased affordability and access and reduced connectivity speeds, there is still considerably more that can be achieved in terms of rural access and utilisation. The sector is still a relatively new one in Kenya and so some resistance to the uptake of certain technologies is to be expected. There are, however, a number of initiatives underway that aim to address this challenge, which are symptomatic of the Kenyan Government and private sector’s commitment to the growth of this sector. Some examples of these include the Kenya Education Network (KENET), which is a national research and education network that promotes the use of ICT in teaching, learning and research in higher education institutions in Kenya, an ICT innovation fund administered by the ICT Board, and the provision of laptops to schools by the private sector. Other challenges faced by the sector include cyber security, dumping of counterfeit products, and e-waste.

The Kenyan transport sector, particularly air passenger transport, is highly dependent on the tourism sector, and therefore on the levels of political stability and security and the ease of obtaining visas in the country. The sector has also experienced a number of infrastructural challenges such as the slow implementation of the rapid mass transport project and the slow development of the rail transport system, both of which have faced a number of operational and financial constraints. The transport sector is also considerably negatively affected by Kenya’s inefficient logistics system, which includes an inadequate road network, and slow goods clearance at Mombasa port and border posts.

### Summary of sector dynamics (strengths, challenges, opportunities)

<table>
<thead>
<tr>
<th>Transport</th>
<th>Communications</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Strengths</strong></td>
<td><strong>Challenges</strong></td>
</tr>
<tr>
<td>• Regional dominance in transport services, with well-regarded brands (e.g. Kenya Airways placed 4th in Africa at 2012 World Airline Awards).</td>
<td>• Lagging transport infrastructure development and inefficient national logistics increases the cost and time associated with freight and passenger transport.</td>
</tr>
<tr>
<td>• Superior transport infrastructure, relative to the region, with ongoing government investment in road, rail, air and ports.</td>
<td>• Air passenger transport, and to a lesser extent road passenger transport, relies on a healthy tourism industry, which in turn relies on a conducive national image and environment (e.g. safety and security).</td>
</tr>
<tr>
<td></td>
<td>• Local ownership requirements in shipping industry, creating a disincentive for foreign investment.</td>
</tr>
<tr>
<td><strong>Challenges</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Opportunities</strong></td>
<td></td>
</tr>
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<td></td>
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</tr>
</tbody>
</table>
6.3. Wholesale and Retail Trade

The contribution of the wholesale and retail trade industry to private sector GDP has been steadily increasing over the past half-decade, measuring 14.4% in 2011. The growth in contribution to GDP has been matched by consistently positive and relatively high rates of growth in the industry, peaking at 8% in 2010 and remaining relatively steady at 7.3% in 2011. Wholesale and retail trade has contributed no less than 14% to total GDP growth each year over the last five years.

This particular industry is largely informal, made up of only a handful (less than five) of formal retailers, thousands of informal traders, and millions of individual street-side salesmen. While the sector formally employs about 12% of workers, it accounts for 60% of informal sector employment, providing employment for 5.6 million informal sector workers.

The high degree of informality within this sector increases the potential tax and labour regulation infringements. Moreover, unregulated trading activity is likely to generate social and environmental costs, such as environmental degradation, non-enforcement of health standards and infringement of copyright laws (e.g. in the music and film industries).

Government has recently announced its intention to increase efforts to escalate formalisation of the informal sector (made up mainly of small-scale traders) through the development of policies, regulations, and institutions aimed at supporting the growth of MSEs and the linkages between the formal and informal sectors. However, the view from MSEs is that there is inadequate coherence, coordination, commitment and scale in government’s support. This is sometimes exacerbated by rent-seeking behaviour by government officials, who seek to exploit the “grey area” in which MSEs operate. Effective and fair representation of small-scale and informal traders at a policy level remains a challenge due to the fragmented nature of the industry.

6.3.1. Economic Contribution

The contribution of the wholesale and retail trade sector to GDP in Kenya has been increasing steadily over recent years. The sector was responsible for 10.8% of total GDP and 14.4% of private sector GDP in 2011. Private sector wholesale and retail trade activities have experienced an average annual growth rate of roughly 6% over the past four years, with this growth peaking at 8% in 2010. Wholesale and retail trade (including public and private sector activity) was responsible for 17.4% of GDP growth in 2011. In 2008, nearly one third of GDP growth was attributable to wholesale and retail trade. The 2008 spike was most likely a function of the low agricultural output during that year – which had contracted as a result a range of exogenous factors leading up to and during that year, including drought and political violence.

Private sector wholesale and retail trade (including hotels and restaurants) employs approximately 232,300 people, accounting for around 14% of formal private sector employment. Calculations suggest that wholesale and retail trade includes the sale of motor vehicles, parts and accessories, automotive fuel, agricultural raw materials, live animals, food, beverages and tobacco, household goods etc.

This is a calculated estimate, since KNBS employment figures for wholesale and retail trade are based on measures including hotels and restaurants.


This is the measure used by KNBS.
retail trade alone (excluding hotels and restaurants), accounts for the formal employment of approximately 171,600 people (11.9% of formal private sector employment). The estimated average annual real wage earnings for employees in this sector is consistently just above the average annual real wage earnings of private sector employees in general. While employment in this sector has been steadily increasing over the past few years, the formal private sector of wholesale and retail trade in Kenya makes up only a minor proportion of the wholesale and retail trade sector as a whole.

6.3.2. Composition and Character

A common characteristic across the distribution sub-sectors (such as wholesale and retail trade) of all East African countries is the large proportion of the sector which is made up of informal activity. An estimated 70-80% of sales in East Africa still go through informal enterprises, with only about 20% of sales going through formal outlets. In Kenya, for example, an estimated 88% of businesses in the distribution services sector are considered informal, employing 80% of the total labour force in the sector.

Not unlike the case for its regional counterparts, the wholesale and retail sector in Kenya is predominantly informal. It is characterised by many informal players, a large number of medium-scale retailers, and a few large supermarket chains located mainly in urban areas. The majority of informal sector employees operate within the wholesale and retail trade industry, and only 3% of trade employees operate in the formal sector (Figure 43).

![Figure 43: Employment in the wholesale and retail trade sector (000s)](source: Genesis Analytics, 2012 (adapted from KNBS data 2012)

Source: Genesis Analytics, 2012 (adapted from KNBS data 2012)
Approximately 30% of market share within this sector is held by a handful (less than five) of major retailers, with the remainder split across thousands of informal traders, and millions of individual street-side vendors (Table 8). In 2010, there were 13,987 registered establishments operating within the wholesale and retail trade industry, by far the largest number of establishments in any sector. Joint wholesale and retail establishments constituted 6.9% of the total, while wholesale trade accounted for 22.7% of establishments, and retail trade made up the remaining 70.4%. The high number of establishments and even higher number of informal retailers implies a high level of competition in retail trade, and in the informal sector specifically.

6.3.3. Dynamics Affecting the Sector

The wholesale and retail trade sector in Kenya is predominantly comprised of informal MSEs. Linkages between the formal and informal sectors in Kenya are limited, and while linkages between these two sectors are seen as means to develop a more robust private sector, little success has so far been achieved. There is a lack of business and management skills among business owners because of limited accessibility and affordability of training and skills development for MSEs and the insufficient priority given to these issues by government. In order to address this, the Ministry of Labour is currently designing a framework for private-public collaborations in the area of skills development for the informal sector. The Kenya Institute of Business Training (KiBT), located within Ministry of Trade, has also been established and offers business training at a lower cost, but take up has been slow.

The informal sector in Kenya is highly fragmented, leading to high levels of disorganisation and a lack of coherency within the sector, which is a further constraint to their formalisation and collective growth. This fragmentation and disorganisation also contributes to the lack of comprehensive and consistent economic data relating to the sector, making it difficult for fact-based policy making. While there are plans to develop a unified advocacy platform for MSE associations, this has been delayed for over two years.

The high level of informality in Kenya’s wholesale and retail sector has the potential to negatively impact tax revenues and labour conditions. Moreover, although the informal sector is the source of livelihood for many people who cannot access the formal employment market, the sector, when unregulated, comes with other social and environmental costs, such as environmental degradation, non-enforcement of health standards and infringement of copyright laws (e.g. in music and film industries).

<table>
<thead>
<tr>
<th>Table 8: Composition of Kenya’s wholesale and retail trade sector</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Key players</strong></td>
</tr>
</tbody>
</table>
| **Formal wholesalers and retailers** | • 3 large national retailers: Nakumatt, Uchumi, Tuskys  
• Many small to medium regional/city wholesalers and retailers with a few stores each  
• Many individual wholesalers and retailers in each town/city  
• A few large domestic retailers with approximately 30% market share and streamlined supply chains  
• Majority of market is fragmented across many suppliers  
• Prices slightly higher at large stores than at informal retailers |
| **Micro small enterprises – informal** | • Millions of micro enterprises either operating in markets or in make-shift kiosks  
• About 30 markets in Nairobi with approximately 9,000 stalls  
• Similar to hawkers segment (below), however, MSEs in markets pay certain fees and receive some benefits such as infrastructure and security  
• Typically low prices, but better quality than hawkers |
| **Hawkers – informal** | • Millions of individuals who sell goods on the street  
• Large number of hawkers selling similar products, resulting in low profits  
• Prices are usually negotiable, typically resulting in low prices overall, but quality tends to be low  
• No taxes provides a buffer for hawkers to undercut |

Source: Genesis Analytics, 2012 (adapted from Vision 2030 Document, 2007)
Recently, players in the retail industry have petitioned the Kenyan Government to consider formulating a retail sector development policy. Regional retail outlet, Nakumatt, has been a key driver of this call for strategic involvement in the sector and growth planning by government. The Government has responded and is actively engaging in dialogue with representatives of the private sector (such as KEPSA) on ways to increase the formalisation of informal sector players – with a particular focus on the development and support of MSEs in addressing the barriers to formalisation and costs of informality (Table 9).

<table>
<thead>
<tr>
<th>Table 9: Barriers to formalisation and costs of informality</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Barriers to formalisation</strong></td>
</tr>
<tr>
<td>• Tax burden and administration</td>
</tr>
<tr>
<td>• Labour regulations</td>
</tr>
<tr>
<td>• Skills</td>
</tr>
<tr>
<td><strong>Costs of informality</strong></td>
</tr>
<tr>
<td>• Limited access to formal finance</td>
</tr>
<tr>
<td>• Social and environmental costs resulting from under-regulation</td>
</tr>
</tbody>
</table>

The Government has passed a number of policy papers, laws and funds to facilitate small enterprise development, improve working conditions, and ease access to credit, basic utilities, and property rights. To date, inadequate scale, commitment and coordination of government MSE support, as well as the poor representation of MSEs in policy and regulatory reforms, has resulted in the policies having minimal impact – in terms of both failing to address the specific needs of the informal sector and lacking ownership by the sector.

There is optimism around the recently promulgated MSE Act, which will ensure that the resources that are allocated to the sector are done so with maximum impact. While this is a step in the right direction the pace and efficiency at which it is implemented will be the key determinants of its success.

<table>
<thead>
<tr>
<th>Summary of sector dynamics (strengths, challenges, opportunities)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Strengths</strong></td>
</tr>
<tr>
<td>• Competitive formal retail industry, due to the large informal retail sector.</td>
</tr>
<tr>
<td>• Low barriers to entry.</td>
</tr>
<tr>
<td>• Labour absorbing (largest informal sector employer)</td>
</tr>
</tbody>
</table>

6.4. Manufacturing

The Kenyan manufacturing sector has steadily contributed around 13% to private sector GDP every year for the past half-decade. Growth rates have remained positive (though relatively low) during this time period, hitting a low of 1.3% in 2009, peaking at 4.5% in 2010, and settling at 3.3% in 2011. In recent years, however, the manufacturing industry has been declining in importance as a source of overall economic growth, dropping from second in this category in 2000, to fourth in 2011.

Manufacturing activities tend to be concentrated in manufacturing ‘hubs’ such as Thika and the capital city, Nairobi. About 247,600 people (17% of formal employment and 2% of total employment137) are employed in private sector manufacturing activities across more than 5,500 formally registered establishments. However, the majority of

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137 Total recorded employment includes formal and informal sector employment
manufacturing employees (approximately 1.8 million people in 2011) operate in the informal sector.

In 2011, approximately 23% of Kenya’s goods export value was attributed to manufactured goods. In an effort to increase competitiveness and output value of Kenyan exports, the Government has recently invested in infrastructural developments and the improvement of general logistics systems (including the development of highways to connect manufacturing and commercial hubs, the expansion of airports and port systems to encourage regional and international trade of goods, and the reform of taxation regimes which have been indirectly increasing manufacturing costs). The issue of high energy costs and unreliable energy supply is still a major concern of manufacturers in Kenya. The Kenyan Government has made numerous commitments to increase consultation and cooperation with local manufacturers so as to encourage growth and development of the sector.

6.4.1. Economic Contribution

Private sector manufacturing has remained relatively stagnant over the past five years, and accounted for 9.6% of Kenya’s GDP in 2011 and made up 12.8% of total private sector GDP in that same year (Figure 44). This steady proportional contribution is arguably the result of consistent rates of growth within the industry, which have remained positive (though relatively low) during this time period, hitting a low of 1.3% in 2009, peaking at 4.5% in 2010, and settling at 3.3% in 2011. The sector was a major source of growth in 2008 – a year in which traditional sources of growth, namely agriculture and tourism, experienced notable declines – which suggests that the industry is less affected by exogenous shocks related to safety and security concerns.

The decline in the manufacturing sector growth rate from 2010 to 2011 has been attributed to an increase in the cost
of primary inputs and fuel, a depreciating Kenyan shilling which increased the cost of imported intermediate inputs, and unfavourable weather conditions that led to reduced availability of raw materials to agro-based industries.

In recent years, Kenya’s manufacturing sector (including public and private activities) has been declining in importance as a source of overall GDP growth, dropping from just over 22% in 2008 (though this large contribution may have been a function of the poor performance of traditional sources of growth such as agriculture and tourism during this year), to only 7.3% in 2011 (Figure 45).

Approximately 247,600 people were formally employed in private sector manufacturing in 2011. This amounts to 17% of total formal private sector employment, which is the average proportion of private sector employment that the manufacturing sector has accounted for over the past half-decade. Employment in this sector is steadily

Figure 45: Manufacturing sector growth rate and role as a source of overall GDP growth

Source: Genesis Analytics, 2012 (adapted from KNBS data 2012)
increasing, but the sector’s share of total employment has decreased slightly in the last few years.

Private sector real wages in the country have been steadily decreasing over time and over the past five years the average annual real wage earnings of a manufacturing employee have remained relatively low, at approximately 60% of those earned by the average private sector employee (Figure 46).

6.4.2. Composition and Character

There are approximately 5,553 formally registered manufacturing-based establishments[^139], making up an estimated 2,000 companies, currently operating in Kenya[^140]. Of these establishments, roughly one third have 50 or more employees. Almost 60% of registered Kenya Association of Manufacturers (KAM) members generate an annual turnover of above KSh 50 million, which research suggests is broadly representative of the characteristics of the firms in the industry (in terms of size).

Levels of formality within this industry are relatively low, and over the past five years, almost one fifth of informal sector employment has been concentrated in manufacturing activities (Figure 47).

Estimates suggest that productivity within the Kenyan manufacturing sector increased by 5.3% over the period between 2000 and 2007. This is comparatively low in relation to emerging Asian and African markets (including countries such as South Africa, which experienced annual labour productivity growth of 4% between 1988 and 2003; and Indonesia, which has experienced labour productivity growth of almost 3% per year over the past decade).

Primary research suggests that an estimated 40% of manufacturers operating in Kenya are foreign-owned. These foreign-owned companies absorb a relatively large portion of the market, and include recognised international brands.


[^140]: Certain companies may have multiple establishments of operation (for example, a head office and numerous warehouses), hence the greater number of registered establishments relative to companies
such as Unilever, Coca-Cola, General Motors, and the like. It is estimated that more than two-thirds of manufacturing companies are based in Nairobi and Thika, where access to necessary infrastructure and resources (such as labour and technology) is greater than is the case in less urbanised surrounding areas.

In 2011, manufactured goods accounted for 23% of the value of Kenya’s goods exports, equivalent to over KSh 100 billion, with the top 3 manufactured exports including articles of apparel, iron and steel products and lime and cement (Figure 48) and the quality of Kenyan manufactured goods being well regarded in the East African region. It is important to note that the data used for the ‘articles of apparel’ measure above (Figure 48), obtained from KNBS records, is based on a slightly different method of categorisation to that obtained from the International Trade Centre and used in Figure 49. The former includes multiple categories of apparel, such as men’s, women’s and children’s apparel as one single grouping. The data used below (Figure 49) is disaggregated to a greater extent, into smaller, more specific categories of apparel-related exports. As such, the ‘articles of apparel’ category does not appear as a major export in this later graph as it does in the earlier graph.

Kenya is marginally globally competitive in a few of its manufactured goods exports. Of Kenya’s top ten manufactured goods exports, six are increasing their global export market share, with pipe, chewing and snuff tobacco registering phenomenal growth between 2007 and 2011. Significantly, two of these six goods exports (cements and flat-rolled iron products) are operating in an environment of reduced global demand for those products. The remaining four goods exports are, however, losing global export market share (Figure 49).

Figure 48:
Export value (as % of total goods) and major manufactured exports (2011)

Source: Genesis Analytics, 2012 (adapted from KNBS data 2012)  
Note: Substantial data discrepancies exist between the export values recorded by KNBS and the International Trade Centre. This may be partly due to different classification and/or grouping of export products.

6.4.3. Dynamics Affecting the Sector

In 1990 Kenya introduced an Export Processing Zones Programme, with the objective to “catalyse industrial and economic development through investments in economic zones”\(^{142}\). The programme provides investors with a set of investment incentives, such as tax incentives and the accelerated processing of work permits and import and export cargo. There are seven Export Processing Zones (EPZs) across the country. The individual EPZs are located in the capital city Nairobi, Athi River, Mombasa, nearby Kilifi and Malindi along Kenya’s North coastline, Voi and Kimwarer in the country’s inland Rift Valley region. Together they are constituted under the umbrella of and managed and promoted by the Export Processing Zones Authority (EPZA). The EPZA is particularly focussed on developing projects and attracting companies in the manufacturing sector, such as food processing, packaging products, cosmetic and personal care products and textiles. The number of enterprises operating under the EPZs increased from 75 in 2010 to 79 in 2011, and the total sales from those enterprises grew by 21.6% in 2011 to KSh 39.2 billion. However, these zones are currently believed to be in a state of decline in terms of attracting investment as a result of rising costs of doing business\(^{143}\).

As part of the government’s strategy to address this

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\(^{142}\) Kenya Ministry of Trade

\(^{143}\) Muchira, J., Kenya moves to revive export processing zones, Engineering News, Sept 2011
problem, there are plans to move towards Special Economic Zones (SEZs). The idea behind SEZs is one of knowledge-based parks that produce innovative ideas to create jobs and spur economic growth. The establishment of SEZs in Mombasa, Kisumu and Lamu is one of the flagship projects under the economic pillar of Vision 2030.

Currently, over 60% of generated energy into the national grid is used in manufacturing enterprises. The current cost of electricity is discouraging new investments and constraining the expansion of industries, which is made worse by the frequent power fluctuations and unscheduled interruptions. This leads to lost time and equipment damage due to the poor power quality, thus making forward planning for manufacturers difficult.\footnote{Kenya Association of Manufacturers, Supporting Competitive Local Industry to Expand Employment in Kenya, 2012}

To ease the burdens on the industry, government has increased investment in infrastructure, which has yielded positive results, with companies such as Pepsi recently increasing investment in the country. To further encourage such investment, and as a means of improving efficiency in the manufacturing sector and the economy as a whole, the Kenyan Government has in the past few years spent over KSh 40 billion on the construction of Thika road, which connects major manufacturing sites to vital urban centres.

The continuing presence of non-tariff barriers to trade in Kenya and the EAC region is however, viewed as a limitation on the external market available to manufacturers, and restricts their ability to grow their exports. In addition, other challenges faced by the sector relate to the country’s poor logistics system, including weak infrastructure and inefficient processes, and the infiltration of the local market by counterfeit, contra-band and substandard goods. Competition problems and anti-competitive practices, particularly in the cement and beer industries, have also been noted as a hindrance to performance in the manufacturing sector (Box 13).

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### Box 13: Competition in manufacturing: Snapshots

#### Cement
- The main cement company has held a virtual monopolistic position in the Kenyan industry as a shareholder in two of the largest cement firms
- Competition in this industry is believed to be improving

#### Beer
- The beer market is dominated by one company (90% market share in 2011) - it has been alleged that abuse of its dominant position has resulted in the exit of an international competitor

### Summary of sector dynamics (strengths, challenges, opportunities)

<table>
<thead>
<tr>
<th>Strengths</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Pockets of excellence in certain product areas (e.g. soaps, cements, apparel, flat-rolled iron), resulting in competitive production and export (predominantly to African markets).</td>
<td></td>
</tr>
<tr>
<td>• Investment incentives offered by government.</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Challenges</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• High energy costs and unreliability of energy supply, reducing competitiveness.</td>
<td></td>
</tr>
<tr>
<td>• Non-tariff barriers to trade in Kenya and EAC, reducing competitiveness and limiting market access.</td>
<td></td>
</tr>
<tr>
<td>• Inefficient logistics systems and poor transport infrastructure, increasing transport costs and decreasing competitiveness.</td>
<td></td>
</tr>
<tr>
<td>• Out-dated management and production processes and low labour productivity (especially within Jua Kali manufacturing sector), reducing competitiveness.</td>
<td></td>
</tr>
<tr>
<td>• Unfair competition from counterfeit, contra-band and substandard imported goods.</td>
<td></td>
</tr>
<tr>
<td>• Reliance on EPZ incentives to generate export competitiveness.</td>
<td></td>
</tr>
<tr>
<td>• Competition issues in certain industries e.g. cement and beer (Box 13).</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Opportunities</th>
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<tbody>
<tr>
<td>• The establishment of Special Economic Zones (SEZs) in Mombasa, Kisumu and Lamu.</td>
<td></td>
</tr>
<tr>
<td>• EAC common market and COMESA.</td>
<td></td>
</tr>
<tr>
<td>• Linkages between formal manufacturers and informal Jua Kalis.</td>
<td></td>
</tr>
</tbody>
</table>
6.5. Financial Services

Kenya’s financial services sector is relatively well-developed when compared to regional and continental counterparts. The sector has grown incrementally in terms of its contribution to private sector GDP, culminating in a contribution of 5.7% in 2011. However, it has had the highest average growth rate (6.68%) out of Kenya’s major sectors over the 2007 to 2011 period. Almost 10% of overall GDP growth in 2011 was attributable to this sector, which holds assets valuing roughly 40% of total GDP.

Financial services employed roughly 94,000 people in 2011, which amounted to 6% of formal employment. The sector is dualistic, comprising of over 40 banks, about 50 insurance companies, and a large number of informal institutions such as Savings and Credit Co-operatives (SACCOs) and Rotating Savings and Credit Associations (ROSCAs).

Recent developments in the financial services industry have been linked to corresponding developments in the ICT sector – specifically in terms of mobile banking capabilities in the country and the impacts this has had on access to financial services for the population. Access to finance for MSEs remains a challenge, due to the risk-averse nature of financial service providers in Kenya and the financial literacy challenges of MSE clientele. Increasing attention is being paid by both the public and private sectors (often in collaboration) to increasing and improving access to finance for MSEs as a mechanism to encourage the formalisation of informal operations.

The Kenyan financial sector has recently undergone significant transformation, specifically in terms of decreasing barriers to entry for consumers; decreasing the cost of maintaining micro-accounts; the introduction of new instruments targeting lower income segments; and increasing networks across the country. Participation in financial services by the Kenyan population, and regulation of the sector (both formal and informal), remain issues to be addressed.

6.5.1. Economic Contribution

The Kenyan financial sector, in relation to the majority of African and other developing countries, is comparatively well-developed. Kenya’s Vision 2030 document identifies the financial services sector as critical to the development of the country. As a consequence of increasing consumer awareness and demand, this sector has been one of the fastest growing in the country, experiencing annual growth rates in excess of 7% over the last three years.

In a presentation made in February 2012, the Central Bank of Kenya (CBK) stated that while this sector was currently contributing approximately 5% to Kenyan GDP, it has the potential to increase this contribution to between 8% and 15%.

The financial services sector was responsible for 10% of GDP growth in 2009, but its importance as a source of growth decreased slightly (to 7.3%) in 2011. Overall, the rate of growth of financial services improved noticeably between 2008 and 2010 however, largely due to quantitative easing during the period, highlighting an impressive recovery from the 2007/8 global financial crisis.

The financial services sector currently holds assets equivalent to almost half of GDP, highlighting the importance of this sector to Kenyan economic growth and development.

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145 Sometimes referred to as ‘financial intermediation’ as per KNBS categorisation
146 Including finance, insurance, real estate and business services
147 Excluding public sector employment

Main indicators (2011)

- **Contribution to private sector GDP**: 5.7% (6% improvement since 2007)
- **Average growth rate (2007-2011)**: 6.68% (6% decline since 2007)
- **Employment (formal)**: 6.1% (unchanged since 2007)
- **FDI (net) inflows (2008)**: KSh 1,964 million
- **FDI stocks (2008)**: 20.1% of total
- **Key indicators**:
  - Improvement since 2007
  - Decline since 2007
  - Unchanged since 2007

94,000 people
Private sector finance, insurance, real estate and business services currently formally employ approximately 94,000 people, which accounts for 6% of total private sector employment. There has been a relatively high rate of employment growth in this sector (approximately 4% between 2010 and 2011).

The estimated average annual real wage earnings of formally employed private finance, insurance, real estate and business services\textsuperscript{148} workers are roughly double those of the average private sector employee (Figure 50). It is likely that these comparatively high wages are a direct reflection of the demand for highly skilled workers within this sector for which employers are willing to pay a premium.

6.5.2. Composition and Character

The CBK describes the financial services sector as comprising of banks, insurance companies, brokerage firms, pension funds, microfinance institutions, and savings and credit co-operatives (SACCOs). Also included in this dualistic (formal and informal) sector are building societies, development finance institutions (DFIs) and informal financial services. Financial sector participation in Kenya remains relatively low for formal financial services, particularly in terms of insurance products (Figure 51).

There were approximately 2,105 formally registered financial services establishments\textsuperscript{149} operating in Kenya in 2010, the majority of which (667) have five or fewer employees, followed by establishments with between 20 and 49 employees (589) – see Table 10\textsuperscript{150}.

In 2010, insurance services and financial services generated KSh 2.7 billion and KSh 9.3 billion in export value respectively. In the case of insurance services, this value was more than double that of 2009 (which was measured at KSh 1.2 billion\textsuperscript{151}).

\textsuperscript{148} This category, and the services included therein, is based on the KNBS classification.

\textsuperscript{149} Establishments should not be confused with companies. A single company may have multiple establishments. KNBS does not keep records on numbers of companies by sector or activity (subsector).

\textsuperscript{150} KNBS, Statistical Abstract, 2011

\textsuperscript{151} International Trade Centre data 2012
Banking

The banking sector consists of 43 banks occupying various market niches, and encompassing approximately 1% of formal employment in the country. The sector is currently experiencing rapid development in the form of consistently improving financial infrastructure and increasing levels of inclusion.

The banking sector is dominated by a handful of banks, the top 10 of which account for the majority of deposits (holding almost 80% of assets in the sector\(^{152}\)). Other smaller banks operate with limited outreach. As a result, genuine competition within this sector is limited and costs to consumers are high (especially in terms of credit). This is reflected in Kenya’s high value on the Lerner Index\(^{153}\), measured at 0.245 in 2009, which measures concentration (which in turn diminishes firms’ access to finance)\(^{154}\). Efficiency is highest in the case of foreign-owned banks, and is inversely correlated with bank size\(^{155}\). The geographic dispersion of banks is fairly limited to urban areas. The structure of the sector is depicted in terms of branch number by Table 11, and bank account distribution in Figure 52.

<table>
<thead>
<tr>
<th>Institution</th>
<th>Number of branches (in Kenya)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kenya Commercial Bank*</td>
<td>169</td>
</tr>
<tr>
<td>Equity Bank</td>
<td>116</td>
</tr>
<tr>
<td>Diamond Trust Bank</td>
<td>32</td>
</tr>
<tr>
<td>Commercial Bank of Africa**</td>
<td>19</td>
</tr>
<tr>
<td>NIC Bank</td>
<td>16</td>
</tr>
<tr>
<td>I&amp;M Bank</td>
<td>16</td>
</tr>
<tr>
<td>Fina Bank</td>
<td>15</td>
</tr>
</tbody>
</table>

* As of August 2010, the Government of Kenya owned 17% of Kenya Commercial Bank.
** The Commercial Bank of Africa is currently the largest privately-owned Kenyan bank.

Source: Genesis Analytics, 2012 (adapted from CBK, 2012)

Overall domestic credit grew by almost 21% in 2010, as a result of increased provision of credit to the private sector which offset declined levels of credit to central government\(^{156}\). Total commercial banks credit to the various sectors of the economy for the period 2007-2011 expanded substantially, with all sectors receiving increased credit. Credit to the private sector grew by 28.6% in 2011\(^{157}\).

Kenya’s banking sector’s assets stood at KSh 1.8 trillion, and loans and advances at KSh 1.2 trillion, in 2011, while the value of deposit liabilities was KSh 1.5 trillion. Over the same period, the number of bank deposit accounts stood at 13.7 million with the total number of branches reaching 1,114\(^{158}\). The Kenyan Banking Sector continued to register improved performance with the size of assets standing at KSh. 2.3 trillion, loans & advances worth KSh. 1.32 trillion, while the deposit base was KSh. 1.72 trillion and profit before tax of KSh. 80.8 billion as at 30th September.
During the same period, the number of bank customer deposit and loan accounts stood at 15,072,922 and 2,055,574 respectively.

A brief look at the ten banks listed on the Nairobi Securities Exchange show good performance by the top four banks, with Equity Bank exhibiting rapid growth and excellent profitability. This has made Equity Bank an attractive investment, with foreign investors now owning roughly 43% of outstanding shares.

**Table 12:**
Size distribution of financial services establishments (2010)

<table>
<thead>
<tr>
<th>Bank</th>
<th>Return on Assets (5-Year Avg)</th>
<th>Asset Growth (5-Year Annualised)</th>
<th>Non-Performing Loan Ratio</th>
<th>Price/Book Ratio</th>
<th>Dividend Yield</th>
<th>Overall Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Bank</td>
<td>3.45%</td>
<td>57.86%</td>
<td>2.86%</td>
<td>2.19%</td>
<td>4.94%</td>
<td>1</td>
</tr>
<tr>
<td>Standard Chartered Bank of Kenya</td>
<td>2.54%</td>
<td>15.15%</td>
<td>1.07%</td>
<td>2.34%</td>
<td>6.51%</td>
<td>2</td>
</tr>
<tr>
<td>Kenya Commercial Bank</td>
<td>1.86%</td>
<td>29.01%</td>
<td>6.15%</td>
<td>1.59%</td>
<td>7.79%</td>
<td>3</td>
</tr>
<tr>
<td>Diamond Trust Bank</td>
<td>1.58%</td>
<td>37.74%</td>
<td>1.06%</td>
<td>1.69%</td>
<td>1.70%</td>
<td>4</td>
</tr>
<tr>
<td>CFC Stanbic</td>
<td>0.77%</td>
<td>30.05%</td>
<td>1.98%</td>
<td>0.56%</td>
<td>1.91%</td>
<td>5</td>
</tr>
<tr>
<td>Housing Finance Company</td>
<td>0.89%</td>
<td>28.40%</td>
<td>6.26%</td>
<td>0.74%</td>
<td>5.69%</td>
<td>6</td>
</tr>
<tr>
<td>Barclays Bank of Kenya</td>
<td>2.86%</td>
<td>7.25%</td>
<td>5.53%</td>
<td>2.41%</td>
<td>6.95%</td>
<td>7</td>
</tr>
<tr>
<td>NIC Bank</td>
<td>1.96%</td>
<td>24.83%</td>
<td>4.81%</td>
<td>1.24%</td>
<td>1.59%</td>
<td>8</td>
</tr>
<tr>
<td>Co-operative Bank of Kenya</td>
<td>2.00%</td>
<td>23.88%</td>
<td>4.76%</td>
<td>2.29%</td>
<td>2.86%</td>
<td>9</td>
</tr>
<tr>
<td>National Bank of Kenya</td>
<td>1.96%</td>
<td>13.71%</td>
<td>4.28%</td>
<td>2.7%</td>
<td>2.01%</td>
<td>10</td>
</tr>
</tbody>
</table>

Source: Hoover, 2012 accessed at [http://investinginafrica.net/2012/05/kenyas-best-bank-stocks/#comment-5478]

Notes: ROA and annualized asset growth is calculated from 2006-2011. NPLs, P/B ratio and D/Y are based on 2011 figures.

**Insurance**

The insurance industry in Kenya consists of approximately 50 insurance companies and re-insurance companies. The insurance industry has been experiencing steady growth, but concerns remain regarding levels of efficiency and outreach within the sector. As of December 2011, assets in the insurance industry stood at KSh 233.2 billion, while investments by insurance companies measured KSh 181.2 billion. By the end of the first quarter of 2012, total premiums were recorded at approximately KSh 108 billion, representing a 20% increase from the last quarter of 2011.

**Pension Funds**

In 2009/10 the Kenyan retirement benefits sector experienced a 37.9% growth in assets. The Retirement Benefits Authority (RBA) has recently invested in a number of administrative and operational reforms to increase formalisation of schemes and increase efficiency of processes within the industry. As of 2010, there were approximately 1,300 registered retirement schemes operating in Kenya, providing coverage to roughly 15% of the formally employed Kenyan workforce. The National Social Security Fund (NSSF) comprises approximately 84 registered employers, covering less than 4,000 employees. The NSSF held KSh 113.5 billion in assets in 2011. The Kenyan Government has identified the need to increase savings levels as a priority in the achievement of development objectives.

**Capital Markets**

There are currently over 50 different types of shares, and over 60 bonds listed on the Nairobi Stock Exchange (NSE). This includes 10 banks, six insurance services...
providers, and four investment related firms\textsuperscript{167}. Performance of the stock market slowed during the 2010/11 period, with the NSE 20 Share Index dropping by almost 30% in December 2010. Market capitalisation dropped by 26% by the end of 2011\textsuperscript{168}. This poor performance has been attributed to the deteriorating conditions in the global financial markets, high inflation and interest rates as well as volatility of the Kenya Shilling against hard currencies during this period\textsuperscript{169}.

**Quasi-Banking Institutions - Savings and Credit Co-Operatives (SACCOs)**

SACCOs represent a considerable part of the Kenyan financial sector, especially with respect to access, savings mobilisation and wealth creation. SACCO societies are member-based organisations that are focused on meeting financial needs of their members for personal and enterprise development. They have membership across different economic activities in both rural and urban areas, and are engaged in Back Office Savings Activities (BOSAs); Front Office Savings Activities (FOSAs); or both. The SACCO societies operating FOSAs undertake near retail banking business operations.

There were 6,007 registered SACCOs as of December 2010, out of which 3,280 were active. Of the active SACCOs, 215 operated FOSAs, with a combined total asset base of KSh 171 billion. The total assets of all deposit-taking and non-deposit taking SACCOs were KSh 216 billion; implying FOSAs controlled 79.2% of the SACCO industry. The industry continues to experience accounting challenges; a lack of a uniform chart of accounts; unrealistic or lack of provisioning; and poor compliance with International Financial Reporting Standards (IFRS)\textsuperscript{170}.

**The Informal Sector**

Kenya has thousands of Rotating Savings and Credit Associations (ROSCAs) and Accumulating Savings and Credit Associations (ASCAs) that are a source of savings and credit services. 29% of the adult population use ROSCAs, while 5% use ASCAs. These associations are found in both rural and urban areas, either as registered social welfare groups or as unregistered groups, of friends and family members. These informal providers mobilise savings and offer credit, while also providing important social networks to the population.

### 6.5.3. Dynamics Affecting the Sector

Kenya has a large “unbanked” population (Figure 51), which presents a large potential market for formal financial institutions in the country. This is a result of a number of factors, including:

- Firms choosing to remain informal due to the burdens associated with taxation and labour regulation;
- Firms being unable to meet collateral requirements;
- Poor financial literacy, and a ‘fear’ or lack of understanding of the formal financial services industry amongst the unbanked; and
- The risk-averse nature of the Kenyan financial services sector.

\textsuperscript{167} NSE, 2012
\textsuperscript{168} KNBS, Economic Survey Highlights, 2012
\textsuperscript{169} British-American Investments Company, Sluggish NSE adversely affects performance of British-American, 2011
\textsuperscript{170} Kenyan Ministry of Finance, Kenya Financial Sector Stability Report, 2010
As a result of the Financial Sector Deepening (FSD) programme of 2005, the Kenyan financial sector has recently undergone significant transformation, specifically in terms of decreasing barriers to entry for consumers; decreasing the cost of maintaining micro-accounts; the introduction of new instruments targeting lower income segments; and increasing networks across the country. Increasing attention is also being paid by both the public and private sectors (often in collaboration, with a focus on PPPs) to access to finance programmes for MSEs as a mechanism to encourage the formalisation of informal operations. Investment in capacity building and financial education (also through PPPs) has been set as a national priority as per the objectives of the Financial Sector Deepening Trust. Regulation of the financial services sector is, however, currently fragmented, with SACCOs regulated by SASRA (under the Ministry of Finance); microfinance institutions engaging in self-regulation; and the setting of the interest rates employed by banks currently not a responsibility of the Central Bank.

In general, access to, and use of financial services by the Kenyan population is growing – in no small part due to advances made in mobile technologies which have increased the ease of transactions (Box 14). Increasing investment by development partners into financial literacy programmes (such as the DFID-funded Financial Sector Deepening Programme) is also going a long way to increase and improve interaction between Kenyans and financial institutions.

Recently, financial sector reforms have been initiated to balance the goals of financial efficiency and stability of the economy with increased levels of financial inclusion. The structural transformation of the financial sector is intended to encourage innovations and the development of strong institutions, to deepen the financial sector and to ensure financial inclusion. The reforms initiated by the Central Bank since 2007 include:

- The rollout of mobile phone financial services. Through the use of innovative technological platforms, such as mobile phones, more Kenyans have access to financial services.
- Licensing Deposit Taking Microfinance Institutions (DTMs). DTMs focus on the lower end of the market, which is concentrated in the rural and peri-urban areas. This aims to increase lending and saving activity by including more people in the formal banking sector.
- Introduction of agent banking mechanism in May 2010. Banks are now able to engage third parties to provide certain banking services. This is intended to extend banking services to the large proportion of under-banked and unbanked Kenyan people.
- Licensing credit reference bureaus to collect, collate, analyse and disseminate credit information among credit providers. By sharing credit information it is possible for banks to rely on credit history (information capital) as an alternative form of collateral to tangible assets. This will enable more individuals to secure credit facilities from banks.

It is believed that this will result in a stable, efficient and accessible financial sector.
**Box 14: M-Pesa**

**M-Pesa** is a mobile-phone based money transfer and microfinancing service for Safaricom and Vodacom, and the largest mobile network operator in Kenya. M-Pesa is currently the most developed mobile payment system in the developing world and allows users with a national ID card or passport to deposit, withdraw, and transfer money with a mobile device. This has gone a long way to improving financial inclusion in Kenya.

The service was launched in 2007; by 2010, the programme had been used by over 50% of Kenya’s population.

For people who live in isolated areas, the service means no longer having to carry cash to markets or towns, risking losing huge amounts to banditry and theft. For people without permanent addresses or bank account, the service means they can pay what cash they have to M-Pesa, in exchange for mobile credit, making payments and transfers and building up savings — so becoming participants in an economy from which they had previously been excluded. For migrants, the service allows them to send money home to their families and villages safely and simply. Safaricom’s international money transfer service uses a similar system for international immigrants, coordinating webs of remittances and payments across the world. For Kenyan businesses, the service means payments for stock or repairs can happen almost instantaneously, wiping out the need to rely on bank clearances and flawed infrastructure which had clogged the economy with inefficiencies and delays.

M-Pesa relies on a network of small shop-front retailers, who register to be M-Pesa agents. Customers come to these retailers and pay them cash in exchange for loading virtual credit onto their phone, known as e-float. E-float can be swapped and transferred between mobile users with a simple text message and a system of codes. Recipients of e-float can take their mobile phone to the nearest retailer when they want to cash in, and swap their text message codes back for physical money. There are already more M-Pesa agents in Kenya than there are bank branches.

Unsurprisingly, such a system requires intermediaries to get the cash to M-Pesa agents, and ensure cash movement keeps up with e-float exchanges. In this way, the system has created new jobs, with some intermediaries and retailers earning $1000 a month in commission from M-Pesa transactions. As of M-Pesa’s fifth birthday — March 6 2012 — it had been used by 15 million people. The system was employed by the ‘Kenyans for Kenya’ campaign to raise money for Kenyans suffering from the Horn of Africa drought — just one way in which it has contributed to independence and innovation in Kenya’s economy.

In response to M-Pesa’s success, the model has been imitated in other countries. Africa’s biggest mobile operator, MTN, has rolled out schemes elsewhere, the most ambitious being in Kenya’s neighbour Uganda. Central banks in some countries, such as Brazil, have created financial inclusion teams, with a vision for using similar systems to bring financial access to the poor and isolated. The Indian government has also shown determination to increase financial inclusion, and analysts predict, with its strong IT infrastructure and dense population, India too could be on the road to becoming a cash-light, financially inclusive economy in the near future.

M-Pesa demonstrates the potential in the rapid dissemination of mobile phones and other flexible, adaptable technologies on the African continent. M-Pesa is not an attempt to recreate developed countries’ banking systems in Africa. Instead, it’s an idea which has been tailored to the Kenyan environment. Rather than giving up on poor, isolated communities as ‘unbankable’, it has extended financial services to the most unlikely customers. Rather than giving up on sophisticated economic transactions in countries with poor infrastructure, it has found a way to circumvent that infrastructure, creating a virtual mobile one of its own.

Source: Adapted from O’Sullivan, 2012
6.6. Tourism (Hotels and Restaurants)

Over the past five years, the hotels and restaurants sector has contributed an average of 2% to total private sector GDP. The broader tourism sector is comprised of a number of industries including those based on safari and coastal activities, business tourism, niche products and entertainment among others. Tourism is closely linked with other economic activities, such as agriculture and transport, and through these linkages and the corresponding multiplier effects is estimated to contribute approximately 10% to total GDP. The industry is an important source of foreign exchange, with the exportation of travel services contributing KSh 75 billion to export earnings in 2011.

There are more than 2,000 tour operators currently registered in Kenya, the majority of which are locally owned MSEs. The hotel industry is an area in which larger international companies exhibit greater presence.

After a sharp decline in the rate of growth of the sector in 2008, following the internationally publicised post-election violence, the sector experienced a rapid and notable surge in growth facilitated by an intensive government-led country marketing initiative. However, visitor numbers only returned to their 2007 level in 2011. Visitor growth rates are currently positive and steadily increasing, and measured 5% in 2011.

Though the importance of this sector is widely acknowledged, it is vulnerable to exogenous factors, such as national security associated with political instability and terrorism, and as such strategic government support is necessary to mitigate the related volatility.

At present, the quantity and quality of data capture regarding Kenya’s tourism performance is below desirable standards, and as a result it is difficult to accurately assess the industry’s economic contribution and subsequently to design policy in a way which adequately supports the development of this sector. The recent development of a new Tourism Act and

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**Summary of sector dynamics (strengths, challenges, opportunities)**

**Strengths**
- A well-developed financial system, relative to most African countries.
- Reforms led by the Central Bank that have enhanced sector efficiency and stability, and improved access to finance.

**Challenges**
- Low financial literacy of consumers and preference of many MSEs to remain informal limits the market for financial services providers.
- Risk-averse nature of financial services providers reduces access to products by MSEs.
- Genuine competition within banking is limited, increasing the cost to consumers.
- Prevalence in quasi-banking institutions (e.g. SACCOs) of low adherence to best practice in accounting, provisioning and reporting, increasing risk exposure.

**Opportunities**
- Access to enabling technologies (e.g. mobile technology for access to insurance services and for other financial transactions).
- Financing of PPPs.
- Opportunities for consolidation within the banking industry.
- The 47 county structures represent a big opportunity for the financial services sector, in terms of deposit taking, lending and financial instrument structuring.

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171 Vision 2030 Document, 2007; the tourism sector’s contribution is likely to be higher than suggested in this report due to the underreporting of tourism-related activities. Only hotels and restaurants are collated in official statistics. In 2007, Vision 2030 estimated that tourism accounts for 10% of Kenya’s GDP; whereas in 2009, KIPRA estimated a 5% GDP contribution.

172 International Trade Centre data 2012
the Ministry of Tourism’s new tourism strategy is an attempt to address this and other challenges currently facing the industry, such as the perception of inadequate marketing of the country, and is hoped to assist in the maximisation of potential of this sector which, while performing comparatively well at present, has the potential to perform considerably better.

6.6.1. Economic Contribution

It is estimated that the tourism industry as a whole is responsible for anywhere between approximately 3% and 10% of GDP\(^{173}\).

The most accurate recordings of economic contributions related to tourism are available for the hotels and restaurants subsector. As such, for economy-wide indicators, this subsector will be used as a proxy for tourism as a whole in certain instances within certain sections of this report. Wherever possible, data that is further disaggregated will be applied.

Figure 53 below illustrates the contribution of the hotels and restaurants industry to private sector GDP. The contribution of this subsector to private sector GDP is relatively minor at 1.8% and displays a slightly decreasing trend.

The vulnerability of the sector is evident in its volatile growth rate. The tourism sector as a whole grew rapidly in 2007, but the negative impacts of political instability and the global financial crisis in 2008 translated directly into severe decreases in output and growth in the sector.

The dramatic revival of output and growth rates in 2009 is largely attributed to the implementation of government-supported initiatives aimed at catalysing the recovery of the tourism sector, which included a dramatic increase in the marketing of Kenya as a top tourist destination.

The recent stabilisation and steady growth in the tourism industry has been attributed to increased promotion in new markets (specifically Asia), the repositioning of the country as a high value destination, increasing political stability, and improvements to security and infrastructure.

Kenya’s Vision 2030 document, published in 2007, stated that the tourism industry is responsible for approximately 9% of employment. This is double what is officially recorded for the hotels and restaurants proxy. Calculations suggest that the hotels and restaurants sector formally employed approximately 67,000 people in 2011. A recent World Bank report\(^{174}\) estimates that tourism-related

\(^{173}\) 10% suggested by Vision 2030 Document, 2007; 5% suggested by KIPPRA, 2009; 3% suggested by World Bank, 2010

\(^{174}\) Source: Genesis Analytics, 2012 (adapted from KNBS data 2012)
activities (of which hotels and restaurants would represent only a portion) resulted in the direct employment of approximately 200,000 people, and that the number of simultaneously created indirect jobs was roughly double that of direct employment.

The steady growth of the tourism industry and the increasing focus of Kenyan policymakers on diversification and development of the country’s tourism offerings, has kept the demand for and the supply of locally-sourced employees in the industry at generally consistent relative levels. Accordingly, while exhibiting a noticeable decrease over time (which is aligned to economy-wide trends), the estimated average annual real wage for employees in the trade, hotels and restaurants industry has generally remained slightly higher than the average real wage for private sector employees in general.

6.6.2. Composition and Character

Kenya’s tourism sector is made up of a variety of activities and products including wildlife safari attractions (such as wildlife parks and sanctuaries), coastal tourism attractions (such as beaches, marine parks and water sport activities), business tourism services (relating to conferencing events), and niche tourism products (such as cultural tourist attractions, eco-tourism, forests, water-based activities and mountain-based activities).

Over the past five years, more than 80% of tourism-related activities have been based on ‘holiday’ tourism. The average length of stay in Kenya by tourists has been 12 days (Figure 55). By comparison, South Africa, another African economy looking to maximise tourism, measures an average stay duration of 8.3 days. In the South African case, just as in the Kenyan case, leisure tourism dominates the activities of visitors. Holiday tourism relates most directly to safari tourism and coastal tourism – two services which have traditionally received prioritisation in advertising and marketing by relevant agencies, including the Kenya Tourism Board (KTB).

![Figure 55: Disaggregation of common tourism-related activities (number of visitors per year and average length of stay per trip)](image)

Source: Genesis Analytics, 2012 (adapted from KNBS data 2012)

174 World Bank, Kenya’s Tourism: Polishing the Gem, 2010
Between 2008 and 2011, the number of annual visitor arrivals in Kenya rose steadily (from 1.2 million to 1.8 million), and associated earnings saw an increase of over KSh 40 billion (to levels over KSh 100 billion). South Africa’s total arrivals for 2011 measured at 8.3 million. The export of travel services has consistently maintained its position as a major source of service export value, contributing KSh 75 billion to export earnings in 2011.

There are approximately 2,000 tour operators operating in Kenya, about 400 of which belong to local trade associations. The Kenya Association of Tour Operators (KATO), one of the country’s leading tourism trade associations, represents over 350 of the most experienced professional tour operators in Kenya. Tour operators are required by law to subscribe to an official registry and to meet certain codes of conduct in terms of the services they offer. As such, the vast majority of these businesses are formally operated, with informal sector players in this industry existing as a relatively rare phenomenon.

Using KATO membership profiles as a proxy, it is estimated that the majority (80%) of the tour operators in Kenya are locally owned companies and are classified as small- or medium-sized enterprises (with annual turnover below KSh 50 million). About 10% of tour operators generate over KSh 120 million in turnover annually. The operation of large international hotel chains within the tourism sector in Kenya is common and the entrance into the market of global brand service providers is on the increase. Wildlife parks and conservation areas make up a large portion of the tourism sector in terms of demand and output generated. These parks may be publicly or privately owned, and are in some cases publicly owned but privately managed. The Kenya Wildlife Service (KWS) is a parastatal which exists to assist in the effective management of natural resources and conservation areas within the country.

The overwhelming demand for safari and coastal tourism activities in relation to other activity types results in a certain degree of geographic convergence of business operation in areas near to these resources. Within the country there tends to be a higher concentration of tourism activity in areas such as Tsavos, Amboseli, Maasai Mara, Nakuru, Aberdares, Mt. Kenya, Samburu, Mombasa and Shaba. Approximately 63% of tourist activity is concentrated along the coastal region, and around 20% is focused on Nairobi.

6.6.3. Dynamics Affecting the Sector

This sector produces many benefits for the economy as a whole. These include:

- direct economic participation by the population in tourism-related activities;
- participation in supply and service sectors (such as agriculture and transport);
- increased state revenue from national park fees;
- non-financial gains such as those related to physical, infrastructural and cultural change and opportunities to participate in decisions;
- and dynamic effects resulting in local economic development in terms of skills and market development, improved communication links, and increased policymaker attention in rural areas (due to the localised nature of many tourism activities, opportunities for engagement and development on a community level are high).

Its high degree of dependence on natural resources, which exist for the most part as state-owned resources, means that state involvement in the tourism sector is at a comparatively (compared to other sectors) high level. The Ministry of Tourism states that there are currently ten tourism-related parastatals in operation. These bodies serve a wide range of functions, ranging from the provision of conferencing facilities to foster business tourism, to the creation of skills development and training centres focused on tourism-related expertise, to the provision of funding for viable tourism businesses.

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175 International Trade Centre data 2012
176 SNV, Tourism and Development: Agendas for action, 2007
These parastatals have, however, not been perceived as successful in achieving their stated objectives. For example, the national-level prioritisation of safari tourism and wildlife conservancies has created unprecedented pressure on Kenya Wildlife Service (KWS) to provide assistance to publicly and privately owned parks in terms of business start-up, day-to-day operations, and crisis management. In light of increased demand for its services, which has not been matched by increased investment in its capacity; it is currently under-resourced and consequently overstretched, which increases the opportunity for the mismanagement of Kenya’s wildlife resources. Another example of ineffective state involvement is the mismanagement of the Kenya Tourist Development Corporation (KTDC), which ran out of funds early in its operation. Also negatively impacting the sector, is that demand for tourism products has been particularly vulnerable to issues related to crime, terrorism and political instability and has experienced declines during the post-election violence in 2008 and the riot-related violence in Mombasa in 2012.

The recently released new Tourism Act has been designed to address these and other constraints currently facing the tourism sector, by providing the industry with a clear set of rules and regulations for best practice, as well as by reforming designated institutions so that they are able to more efficiently perform their supportive functions. For example, inefficient government bureaucracy and the lack of comprehensive and consistent economic data is believed (by industry stakeholders) to have led to insufficient prioritisation and ineffective policy design and implementation relating to the tourism sector. As a result, the tourism industry is inadequately represented in the national priority setting and development strategy, and consequently is insufficiently supported in terms of direct government investment. Amongst its many features, the new Tourism Act makes provision for the establishment of a dedicated research centre, which will seek to fill in the data gaps to better direct policymakers in terms of development prioritisation; an independent regulator to monitor levels of competition within the industry and to enforce codes of conduct; a funding agency to provide start-up capital to MSEs to further catalyse growth and competition within the industry; and guidelines for infrastructure development, skills development, marketing and technology-sharing partnerships between the public and private sectors.

A recent study by the World Tourism Organisation compared countries of the world in terms of global share of international tourist arrivals and international tourism receipts\footnote{UNWTO, Tourism Highlights: 2012 Edition, 2012}. The study revealed that compared to other African countries for which 2011 data is available, Kenya’s tourism industry lags behind its African competitors (Table 13). The country represented only 2.7% of international tourism receipts in 2011, compared to Morocco’s 22.4%, South Africa’s 29.3% and even Tunisia’s 5.5%.

\begin{table}[h]
\centering
\begin{tabular}{|l|c|c|}
\hline
Destination & Share (%) of international tourist arrivals in Africa in 2011 & Share (%) of international tourism receipts for Africa in 2011 \\
\hline
Cape Verde & 0.9 & 1.1 \\
Kenya & 3.6 & 2.7 \\
Mauritius & 1.9 & 4.6 \\
Morocco & 18.6 & 22.4 \\
Seychelles & 0.4 & 0.9 \\
South Africa & 16.6 & 29.3 \\
Tunisia & 9.5 & 5.5 \\
\hline
\end{tabular}
\caption{International competitiveness of Kenya’s tourism industry}
\end{table}

Source: UNWTO, 2012; KNBS, 2012
Note: countries highlighted (excluding Kenya) are those for which both sets of data were available for 2011. Kenyan arrivals figures based on data based on KNBS Economic Survey 2012. Inconsistency of sources means that percentage share is an estimate only.

In addition to the new Tourism Act, the Ministry of Tourism has developed a revised strategy for the growth of the tourism industry which will focus on the expansion of development programmes to include a wider range of tourism activities. The Ministry believes that while the sector is regionally competitive (in terms of product offering and affordability) at present, this renewed focus on offering a
more extensive collection of products to international consumers will increase the country's global competitiveness. For example, an international convention centre is planned for Mombasa to boost tourism in the area. The new strategy also aims to increase and improve linkages between the tourism industry and other industries, to increase sector efficiency and to promote both direct and indirect employment creation.

6.7. ‘Budding’ Sectors

6.7.1. Construction and Real Estate

Overview

Construction and real estate have recorded strong growth in last decade as the Government and private developers have increased investments in infrastructure and housing. According to the Kenya National Bureau of Statistics (Economic Survey 2012 Highlights), the construction sector contributed 4.1% to GDP and recorded a growth rate of 4.3% in 2011. Real estate sector output grew at 3.6% in 2011, representing a 4.5% contribution to GDP. Cement consumption, a key indicator of growth in the sector rose by 10.6 per cent from 3.1 million tonnes in 2010 to 3.4 million tonnes in 2011.

Key Sector Dynamics

Credit Expansion

Credit expansion has been a major driver of growth in construction and real estate. Kenya has a well-established, strong and growing financial sector, which contributes to growth of the sector through provision of mortgage finance. Loans and advances to the sector from commercial banks increased by 55.8 per cent from Ksh 32.6 billion in 2010, to Ksh 50.8 billion in 2011 (KNBS, 2011). Following a high interest regime triggered by tightening of monetary policy that saw the Central Bank raise its benchmark rate to 18% in December 2011, growth of the construction and real estate sector slowed down in the first half of 2012, with mortgage lenders and developers recording slowed sales and borrowers struggling to meet high financing costs. According to Central Bank’s Credit Officer Survey (2nd Quarter end 2012), applications for credit in building and construction dropped from 800 in March 2012 to 428 in June 2012, while credit applications for real estate development dropped from 611 in March 2012 to 402 in June 2012. In its first quarter report for 2012, the Kenya National Bureau of Statistics noted that the construction industry grew by 3.2% compared to 7.0% in 2011.

In addition to reduced demand for credit and tighter lending standards to reduce non-performing loans, commercial banks curtailed lending to the sector following the signing of three land bills into law in May 2012. Commercial banks fear that the implementation of new land laws may result in changes in land ownership rights and have reacted negatively to the envisaged lengthy and more complex credit appraisal procedures.

Since September 2012 the outlook is positive for borrowers. The Central Bank lowered the base lending rate to 13%, which is expected to stimulate higher credit demand. However, the high cost of mortgage financing...
and collateral requirements remain the biggest credit barriers for most investors and potential home owners.

**Access to Housing**

Growth in the construction and real estate sector has largely been attributed to housing supply not meeting the demand imposed by rapid urbanization. According to the Ministry of Housing strategic plan 2008-2013, it is estimated that out of a total 150,000 housing units required annually in urban areas, only 35,000 units are produced. As a result of this mismatched supply and demand, housing prices and rental charges have continued to increase over the years, pushing lower income residents out of the formal housing market and into the slums. According to Hass Property Index (Quarter Two, 2012 Report) the rise in rentals is now running at 10 times the rate during 2010 and 2011. The recent hike in rental prices has been attributed to a number of factors including increasing cost of construction materials, high cost of finance, increasing tax burden for property owners, and increased demand for housing.

The increasing level of activity in the construction and real estate sector has fuelled an increase in cost of land coupled with an increase in cost of building materials resulting from high inflation rates and the weakening of the shilling in the recent past. These factors further reduce accessibility of decent housing for the low income earners and stimulate development of self-constructed, poor quality houses.

**Infrastructure Developments**

The construction and real estate sector is expected to continue growing steadily boosted by Government’s increased spending on infrastructural development. According to the KNBS (2012 Economic Survey Highlights), overall expenditure for the Ministry of Roads in 2011/2012 is expected to rise by 34.4% from Ksh 61.2 billion to Ksh 82.3 billion. The on-going and planned infrastructural developments are expected to open up new avenues for growth and development in the sector. Major developments expected to drive growth in the sector include:

- Massive road construction projects including the recently completed Thika Super Highway which is part of an elaborate plan to ease traffic congestion in Nairobi. The government is also scheduled to begin expansion of Uhuru Highway and establishment of a rapid bus transit and commuter rail system. The government is also putting up a bypass in Mombasa, aimed at de-congesting Mombasa by providing an alternative to the Likoni ferry by linking the mainland with the south coast.
- Rehabilitation of airports including the on-going expansion of Jomo Kenyatta International Airport (JKIA) expected to facilitate handling 9 million passengers each year, up from the current traffic of about 6 million passengers.
- Upgrading of informal settlements including construction of 400 houses; primary school and other social facilities for Mavoko Municipal Council at Mlolongo under Sustainable Neighborhood Programme (SNP).
- LAPSSSET (Lamu Port-South Sudan-Ethiopia-Transport) corridor project is a crucial project of Vision 2030 intended to establish a Lamu-Ethiopia-South modern highway; Lamu port; Lamu-Juba-Addis Ababa railway line; an oil refinery and a 2,240 km oil pipeline connecting oil fields in South Sudan to the refinery at the Lamu Port; construction of three resort cities at Lamu, Isiolo and Lokichoggio; construction of airports in the resort cities and development of associated infrastructure such as a 1,100MW power line and a 185 km water supply line.
- Construction of Konza Technology city identified as one of the key drivers towards achievement of Vision 2030. The technology park will be built on a 64 square-mile stretch covering about 5,000 acres of land in Machakos County.
- The Kenya Railways is seeking for investors to develop Golf Cities on land surrounding the railway stations in Nairobi, Kisumu and Mombasa. This includes plans to build office blocks, shopping malls, hotels, parking bays.
and a manufacturing park on the massive land that is currently sitting idle. The project estimated at KSh 256 billion is scheduled to kick off next year.

6.7.2. Oil and Gas

Overview

Energy is one of the key drivers of a modern economy, with petroleum as a major input cost. The Kenyan economy is highly dependent on petroleum as a source of energy, specifically for power production, transport, agricultural production and processing, and (kerosene and LPG for) household use. The transport sector consumes the largest amount of petroleum products^{179}. Petroleum accounts for 22% of Kenya’s primary energy sources. Kenya allocated US$4.1 billion to oil imports in 2011, or four times more than the value of Kenya’s largest export earner, tea^{180}. This is approximately 11% of GDP. Until recently, Kenya did not have any known oil reserves and oil demand has grown steadily in the last decade at over 10 per cent per annum. The country leads in oil consumption among the East Africa states, as seen in the discussion below^{181}.

The sector is faced with regulation and supervision challenges. Quality assurance in construction is lacking, as evidenced by increased cases of buildings collapsing while still under-construction. According to the Architectural Association of Kenya, 6 out of 10 buildings in Nairobi do not have the necessary approvals. The Association recently proposed mitigation measures including evaluating quality of building materials in the market as stipulated by the Kenya Bureau of Standards, involving construction professionals in the audit of all buildings in urban areas to determine their ‘structural integrity’ and outsourcing planning and management of developments within cities to professionals in the private sector. The lack of a reliable title registry has been a major hindrance to growth of the sector. This has contributed to multiple allocations and slow pace of property transactions.

The government is however in the process of implementing reforms expected to change governance and regulation in the sector, including implementation of the new land laws and digitization of property records and title searches, all aimed at strengthening property rights and protection.

Impact on the Economy

Since mid-2011, Kenya’s earnings from its top four exports have not been sufficient to pay for its oil imports. In 2011 alone, the ballooning oil import bill rose by 23 per cent on account of high oil prices, which widened the current account deficit and threatened macroeconomic stability^{182}. Currently, petroleum is Kenya’s largest import item at 27% of the total import bill. Any drop in crude prices props up the Kenyan shilling against the US dollar as oil marketers require fewer US dollars to import petroleum.

Recent upstream activity

Oil discovery in Kenya is likely to translate into a long term reduction of the petroleum import bill and cheaper oil for local consumption. Kenya’s first oil discovery has drawn huge international interest in new oil exploration licenses by oil companies such as Italy’s Eni and Total^{183}. Tullow discovered oil in March 2012 and has subsequently stated that “prospects in the Turkana region have exceeded expectations with net oil pay found in the Ngamia-1 explo-
ration well being more than double that of any exploration wells drilled to date in East Africa.” The country’s oil reserves estimate is now around 4 billion barrels, the largest in the region and significantly larger than Tullow’s oil find in neighbouring Uganda estimated at 2.5 billion barrels184. The total number of exploration blocks has been revised upward from 37 to 46; the 9 new blocks comprise eight ultra-deep offshore blocks and one onshore. In July 2012 exploration licences were issued for seven of the remaining 12 unlicensed petroleum blocks (Reuters, Nairobi). The entry of the ‘oil majors’ brings along immense value addition due to deployment of modern data acquisition technologies such as 3D seismic by Apache Corp., Anadarko and BG Group and FTG data in Tertiary Rift Basin by Tullow. Apache is drilling Kenya’s first deep-water oil. At the same time, Kenya and Somalia are locked in a row over maritime boundaries, as oil exploration goes offshore.

**Midstream activity**

Significant oil facilities are currently located in Mombasa: fuel import jetties at Kipevu and Shimanz; the Kenya Pipeline Company fuel transport grid head station; oil marketing terminals operated by Shell, GAPCO, Chevron, Solvochem, Gulfstream and Oilibya at Shimanz; and the jointly operated Mombasa Joint Terminal in Changamwe and the Moi International Airport.

The proposed Lamu Port-South Sudan-Ethiopia Transport Corridor (LAPSSET) project includes an oil refinery project with a pipeline linking Kenya to South Sudan and Ethiopia. The Kenya Petroleum Refinery will be modernised and critical infrastructure (import, storage, transport and distribution facilities) expanded through a public private sector partnership (PPP). This PPP approach is part of a broader push for the private sector “to partner with the public sector to expand the existing capacities or investing in new ones185.” Lastly, a new LPG import and storage facility in Mombasa is expected to be commissioned in 2012 to complement new storage and distribution depots in Nairobi and other major towns.

**Downstream activity**

Kenya has a countrywide retail network of over 1,000 petrol stations operated by multi-nationals (Total, Shell, Oil Libya, etc.) and smaller Kenyan OMCs. Ownership of the retail network as at early 2012 was shared with multinationals having 73%, National Oil 8% and Independents (19%). National Oil has recently expanded its share to 11%. In December 2010 the Energy Regulatory Commission (ERC) started regulating the consumer prices of petroleum products, using a retail pricing formula that incorporates all petroleum supply chain cost elements. Access by the poor to affordable modern cooking fuel, specifically LPG, is among Kenya government objectives.

Annual consumption levels of liquefied petroleum gas (LPG) increased by approximately 59% between 2003 and 2008 from 40,000 to 80,000 metric tons. Kenya currently consumes around 90,000 metric tons of LPG each year, originating from the Kenya Petroleum Refinery (KPR) and imports. Annual consumption is expected to reach 200,000 tons in the next five years.

LPG is gaining wider use in the country especially in the urban areas where about 11.9% cook using gas compared with rural areas where usage is as low as 0.7%. In 2006, the Government lowered related taxes (through the Finance Bill of 2006) to encourage wider use of LPG and to reduce pressure on biomass.

Despite liberalisation of importation policy for gas, availability in rural areas remains relatively low, and the country hosts only a single small LPG handling facility in Nairobi187. The introduction of small-size gas cylinders and the standardisation of cylinders and valves has however had positive impacts on the expanded use of LPG.

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184 Bloomberg, 2012
185 Minister for Finance, Keynote address at the first quarterly luncheon of the year of the Petroleum Institute of East Africa, 2012, Intercontinental Hotel, Nairobi
186 A 6kg cylinder of LPG retails for about Ksh1,300 ($15.29) and the 13 kg cylinder goes for Ksh2,400 ($28.23) in Nairobi, though prices are highly unstable due to erratic supply.
In 2008 National Oil launched its SupaGas brand of cooking gas into the Kenyan market, to compete with established brands such as Total. Towards the end of 2011, National Oil introduced a 3kg cylinder (in addition to the standard 6kg, 13kg and 50kg cylinders), as part of a broad strategy to ensure the affordability of LPG for the majority of Kenyans. LPG is also supplied to commercial customers in bulk. In November 2011, National Oil commissioned a small-scale LPG plant at its Nairobi National Terminal situated in Industrial Area. This state-of-the-art filling plant is the first of its kind in the country. National Oil plans to install similar mini plants in different parts of the country.

Kenya’s first substantive natural gas deposits were discovered in 2012 near Malindi, at the Mbawa deep-water well, by Pancontinental, an Australian oil prospecting company. In 2012, a new $142.8 million privately-owned offshore bulk import handling and storage terminal with a storage capacity of 14,000MT was set up in Mombasa by Africa Gas and Oil Ltd (AGOL) to serve sea tankers ferrying over 5,000 tons of LPG from the Middle East. Marketing firms importing LPG for distribution in East Africa will be allowed to use the bulk offshore depot at a fee. It is expected that retail LPG prices will fall as a result of bulk imports, reduced stock-outs and elimination of demurrage charges previously caused by low handling and storage capacity at Shimanzo in Mombasa (which has a capacity of just 1,400 MT). Recently, a Kenyan inventor developed a regulator gauge (now manufactured in China) which allows gas users to estimate remaining gas supplies.

### Sector legislation

The petroleum sector in Kenya is governed by the 1986 Petroleum Exploration and Production Act Revised Edition. This arguably out-dated policy empowers the Minister for Energy to sign Petroleum Sharing Contracts without signature bonuses. Currently all contracts are based on a Model Production Sharing Contract (PSC) document and Heads of Agreement. The Act provides the legal framework and regulates the negotiations and conclusion of PSCs with potential investors. The PSCs are in addition subject to negotiations and are governed by The Petroleum (E & P) Regulations, The Income Tax (Amendments) Act, and Environmental Management & Coordination Act 2000 under the National Environmental Management Authority (NEMA). Key PSC terms that have to be negotiated include the contract term, minimum work and expenditure obligations, guarantees, cost recovery, oil profit splits, windfall profit, signature bonus, community development project commitment, training fees, annual surface fees, and government participation.

The licensing of exploration blocks is conducted on basis of open door policy, as Kenya has hitherto been ranked a frontier area. Following the discovery of oil, this will in the near future be changed to other methods of licensing, such as bidding rounds (MoE, May 2012).

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187 Ibid.
While there are still many blockages that prevent the private sector from reaching its full potential; the view of this report is that the Kenyan private sector is generally in good health and that Kenya is a promising place to do business. Below is a summary of the main strengths and challenges of the Kenyan private sector and the environment in which it operates; followed by a selection of emerging opportunities that, if capitalised upon, would contribute to stronger private sector growth and development.

7.1. Strengths

The diversified nature of the Kenyan private sector bolsters its ability to weather external shocks (although still vulnerable) and bodes well for future resilience in a competitive global market. It is clear that the private sector drives growth and employment in the economy.

The private sector is vibrant and it benefits from a well-educated and entrepreneurial workforce. The private sector is more developed, in terms of scale and sophistication, relative to Kenya’s neighbours. This has contributed to Kenya’s status as a net exporter to all other East African Community (EAC) countries. In the global market, the private sector is competitive in a variety of export products, especially tea, cut flowers, leguminous vegetables and cements.

Government has invested, and continues to invest, in the improvement of transport infrastructure. Kenya’s infrastructure advantage, relative to its neighbours, combined with its strategic geographic position, affords the country the status of a regional trade and transport hub. The tertiary sector is growing in importance as a value adder and employer. Notably, Kenya has an innovative and fast-developing ICT industry that also enables the financial services sector (e.g. M-Pesa), which in turn is growing rapidly.

Finally, it appears that there is widespread intellectual appreciation within the Government of Kenya that the private sector is important and should be developed, as well as a genuine commitment to dialogue and partnership. This augurs well for positive, collaborative outcomes in private sector development.

The table below summarises the key strengths per main sector in Kenya.

<table>
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<tr>
<th>Sector</th>
<th>Strengths</th>
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| Agriculture                | • Pockets of excellence in certain product areas (e.g. tea, cut flowers, leguminous vegetables), resulting in competitive production and export (predominantly to European markets).  
                              | • Labour absorbing (largest formal and rural employer).                  
                              | • Extensive government support (financial and technical).                |
| Transport                  | • Regional dominance in transport services, with well-regarded brands (e.g. Kenya Airways placed 4th in Africa at 2012 World Airline Awards).  
                              | • Superior transport infrastructure, relative to the region, with ongoing government investment in road, rail, air and ports. |
| Communications             | • Reduced costs and greater penetration (especially mobile telephony and internet data) due to improved ICT infrastructure and industry competition.  
                              | • Source of growth and innovation (e.g. enabling greater access to financial services).  
                              | • Focused government support for BPO and ICT innovation.                |
| Wholesale and Retail Trade | • Competitive formal retail industry, due to the large informal retail sector.  
                              | • Low barriers to entry.                                               
                              | • Labour absorbing (largest informal sector employer).                  |
| Manufacturing              | • Pockets of excellence in certain product areas (e.g. soaps, cements, apparel, flat-rolled iron), resulting in competitive production and export (predominantly to African markets).  
                              | • Investment incentives offered by government.                          |
| Financial Services         | • Highest average growth rate between 2007 and 2011.                      
                              | • A well-developed financial system, relative to most African countries.  
                              | • Reforms led by the Central Bank that have enhanced sector efficiency and stability, and improved access to finance |
| Tourism                    | • Significant foreign exchange earner.                                   
                              | • Well known and regarded tourism products e.g. Masai Mara safaris and Mombasa coastal resorts.  
                              | • Strategic support from government e.g. national marketing.            |
7.2. Challenges

Kenya has a disruptive political cycle, with a mediocre, but improving, business climate. Political uncertainty, especially around elections, and the associated volatility is arguably the main handbrake on sustained private sector investment and growth. Without long periods of stability and peaceful transitions of government, private sector performance will continue to underperform against its long-term potential.

There is widespread perception of corruption, political interference and patronage in business, which hinders small businesses in particular.

Macro-economic volatility has been cited as a challenge to doing business. The cost of capital is high and a variable exchange and inflation rate is challenging to business operations and planning. The macro-economy has been more stable in recent years. Critical enabling infrastructure remains below par: Transport infrastructure and logistics systems (including customs, goods clearance and weigh-bridge processes) are persistently weak for a regional trade and transport hub. High energy costs and weak and interrupted supply of power are crippling to business, especially manufacturing businesses.

A possible outcome of the aforementioned political uncertainty, macroeconomic volatility and high costs of doing business is a low level of foreign direct investment (FDI) - an anomaly for a pre-eminent regional market. This FDI status quo could also be a function of company and land ownership restrictions, a closed and protective political economy with strong local vested interests and anticompetitive behaviour by dominant firms. However, early indications are that FDI might be increasing, primarily driven by opportunities in oil.

There is a reported mismatch of skills of those leaving the education sector and those attractive to the private sector, particularly in new and fast-paced industries such as ICT.

The private sector is bifurcated between the formal sector and mostly informal MSE sector with weak linkages between the two. The informal sector is poorly understood and documented, and is not supported by coherent government action. There is limited empirical evidence for the factors that give rise to a large, fragmented and delinked informal sector in Kenya. Anecdotal evidence suggests that the main barriers to growth and formalisation include low skills and access to technology; high effective tax rates; an unfriendly regulatory environment for small business (e.g. trading restrictions and minimum wage regime); inadequate access to financial services; and a poor collective voice of small business, particularly in policy decisions.

There is a lack of comprehensive and consistent economic data for the tourism and ICT (including Business Process Outsourcing (BPO) sectors, as well as FDI, which inhibits evidence-based policy decisions. There is a perception by business that the pace of government reform is too slow and the administration is characterised by fragmentation and duplication of effort, compounded by unnecessary bureaucracy and red tape (e.g. the burden of inefficiencies within the tax system).

Finally, the impact on business of devolved government is still unclear but may be mildly negative overall, at least during the transition period. The ability to maximise county-level opportunities and foster a business friendly environment will greatly depend on the vision and capability of county leadership, which is still untested.

The table below summarises the key challenges per main sector in Kenya.
**Agriculture**
- Shortage of arable land for crop agriculture, exacerbated by historical land ownership policies and changing land use patterns (e.g. due to urbanisation), limiting growth potential.
- Reliance on rain fed agriculture and poor water storage rates, increasing exposure to climatic conditions.
- Fragmentation and informality in the bulk of agricultural activity, reducing competitiveness.
- Vulnerability to social/political unrest, increasing risk to production.
- Dependence on imported inputs (e.g. fertilizer, seeds and agro-chemicals), increasing exposure to price inflation and fluctuation.
- Low productivity due to small plot sizes and outdated technologies and processes.
- Inadequate diversification of exports (heavily reliant on tea and cut flowers) and limited value addition to agricultural produce presents a risk and hampers greater growth and wealth creation.
- Competition issues in certain industries e.g. maize and sugar.
- Unclear practical outcomes on details of constitutional provisions on land management and ownership, especially regarding devolved government authority and foreign land ownership.

**Transport**
- Lagging transport infrastructure development and inefficient national logistics increases the cost and time associated with freight and passenger transport.
- Air passenger transport, and to a lesser extent road passenger transport, relies on a healthy tourism industry, which in turn relies on a conducive national image and environment (e.g. safety and security).
- Local ownership requirements in shipping industry, creating a disincentive for foreign investment.

**Communications**
- Rural penetration is still relatively low, which handicaps the development of rural business.
- Skills development in ICT lags behind demand for qualified workers.
- No baseline exists against which progress in BPO industry can be measured. Responsibility for measuring progress is also unclear.
- Local ownership requirements in telecommunications industry, creating a disincentive for foreign investment.

**Wholesale and Retail Trade**
- Predominantly informal nature of the sector increases the potential for social and environmental costs, such as environmental degradation, non-enforcement of health standards, tax evasion and infringement of labour and copyright laws.
- Rent-seeking behaviour by government officials who seek to exploit the “grey area” in which MSE traders frequently operate.

**Manufacturing**
- High energy costs and unreliability of energy supply, reducing competitiveness.
- Non-tariff barriers to trade in Kenya and EAC, reducing competitiveness and limiting market access.
- Inefficient logistics systems and poor transport infrastructure, increasing transport costs and decreasing competitiveness.
- Out-dated management and production processes and low labour productivity (especially within Jua Kali manufacturing sector), reducing competitiveness.
- Unfair competition from counterfeit, contra-band and substandard imported goods.
- Reliance on EPZ incentives to generate export competitiveness.
- Competition issues in certain industries e.g. cement and beer.

**Financial Services**
- Low financial literacy of consumers and preference of many MSEs to remain informal limits the market for financial services providers.
- Risk-averse nature of financial services providers reduces access to products by MSEs.
- Genuine competition within banking is limited, increasing the cost to consumers.
- Prevalence in quasi-banking institutions (e.g. SACCOs) of low adherence to best practice in accounting, provisioning and reporting, increasing risk exposure.

**Tourism**
- Lack of comprehensive sector-specific data, limiting fact-based policy decisions.
- Inefficiencies in government support e.g. KTDC.
- Low national marketing budget, relative to competitor African countries.
- Limited tourism product offering (or awareness thereof), limiting growth potential.
- Transport-related access constraints to certain geographies, inhibiting unlocking further tourism products.
- Vulnerable to exogenous factors e.g. reality and image around poor safety and security, negatively impacting demand.
7.3. Opportunities

The Constitution is likely to be a positive force for the private sector, if it is upheld and if constitutional institutions are properly empowered. It should promote a more transparent and stable economic environment in which the private sector can confidently invest.

Much of the vision for a more inclusive, growing and wealth-creating private sector depends on the government’s ability to implement stated policies and plans in a timely fashion. That said, it is also incumbent on the private sector to leverage the opportunities within the country and region, and to play a role in holding government to account and bridging the gap between the formal and informal sectors.

Opportunities include an increasingly attractive domestic market, with improving appeal to foreign investors, particularly in the ICT, manufacturing and financial services sectors, and a rapidly urbanising Kenyan population, which may present further opportunities in sectors such as retail trade, construction and real estate.

The technological innovations emerging from the ICT industry, such as those that improve access to, and functionality of, mobile phone and internet services have the potential to catalyse growth and improve efficiencies.

Government’s intention to increase public-private partnerships (PPPs), particularly in large infrastructural projects presents an opportunity for private sector involvement in national development, and the multiplier effects of these developments will improve growth across the economy. Infrastructural developments will also assist in the facilitation of increased regional trade in goods and services resulting from increased access to the EAC common market.

Government actions emerging from the Micro and Small Enterprises (MSE) Act will present opportunities for the inclusion of small enterprises in the formal economy.

Possibilities for growth exist in Kenya’s “budding sectors”, namely oil & gas and real estate. The discovery of oil in the Lake Turkana region can play a transformative role in the economy, accelerating the growth trajectory of the private sector and providing a boost to the fiscus. If handled poorly it may also bring the attendant problems of “Dutch disease” and escalate the extent and magnitude of corrupt activity and civil unrest.

The table below summarises the key opportunities per main sector in Kenya.
### Sector Opportunities

<table>
<thead>
<tr>
<th>Sector</th>
<th>Opportunities</th>
</tr>
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| Agriculture             | • Increased collaboration between the informal sector and the formal sector (large producers, manufacturers, retailers and exporters).  
• Access to new technologies (e.g. M-Farm) increases the ease of doing business in this sector.                                                  |
| Transport               | • Opportunities for PPPs in transport infrastructure and services.                                                                                                                                              |
| Communications          | • Leveraging opportunities from the establishment of digital villages and other initiatives such as Konza City.  
• Provision of ICT infrastructure and services at the county level could provide more opportunity for private sector suppliers and service providers than was afforded through Central Government procurement. |
| Wholesale and Retail Trade | • The establishment of Special Economic Zones (SEZs) in Mombasa, Kisumu and Lamu.  
• EAC common market and COMESA.  
• Government efforts to escalate formalisation of the informal sector (made up mainly of small-scale traders) through the development of policies, regulations, and institutions aimed at supporting the growth of MSEs and the linkages between the formal and informal sectors. |
| Manufacturing           | • The establishment of Special Economic Zones (SEZs) in Mombasa, Kisumu and Lamu.  
• Linkages between formal manufacturers and informal Jua Kalis.                                                                                                                                                  |
| Financial Services      | • Access to enabling technologies (e.g. mobile technology for access to insurance services and for other financial transactions).  
• Financing of PPPs.  
• Opportunities for consolidation within the banking industry.  
• The 47 county structures represent a big opportunity for the financial services sector, in terms of deposit taking, lending and financial instrument structuring.                                             |
| Tourism                 | • New Tourism Act provides guidelines for the diversification of activities, skills development, regulation, marketing, finance and more.  
• Government support to unlock a broader range of tourism products.                                                                                                                                            |
A number of insights and recommendations emerge for developing the private sector further and faster, the responsibility for which are shared by policy makers (Government of Kenya), development partners, and the private sector itself. The recommendations are grouped around six topics:

- Improving the business and investment climate;
- Understanding and supporting MSEs and the informal sector;
- Mitigating possible negative consequences of devolved government, and upholding the Constitution;
- Encouraging further public/private co-operation;
- Supporting sector growth and competitiveness; and
- Improving the collection of economic data relating to the private sector.

Below are the detailed recommendations per topic area.

8.1. Improving the Business and Investment Climate

8.1.1. Eliminate Corruption and Political Patronage in Government Decision Making

Corruption has long been a challenge for private sector development in Kenya. Corrupt behaviour from both private and public representatives (especially in public procurement, licensing and land administration) increases the cost of doing business, creates unfair competition, favours inefficient and larger firms to the detriment of smaller players, and generally impedes private sector investment.

- Fast-track the computerisation of government processes (relating for example to fees, tax and procurement) to increase transparency and close avenues for corrupt behaviour.
- Fully implement the existing ethics policy and strengthen other policies on declaring interests transparently and managing conflicts of interest in relation to politician/public servant participation in business. Strengthen whistle-blower protection.
- Strengthen the capability and monitor the work of the Public Procurement Oversight Authority, Ethics and Anti-Corruption Commission and Land Commission.
- Finalise, activate and monitor adherence with the Kenyan Private Sector Alliance (KEPSA)-led private sector Code of Conduct, to tackle private sector participation in corrupt behaviour.
- Create and support a non-aligned private sector-funded non-governmental organisation (NGO) “Corruption Watch” entity, which has the resources to investigate and publish instances of both private and public sector corruption.

8.1.2. Accelerate Investment in Critical, Enabling Infrastructure

This infrastructure deficit particularly relates to energy and transportation. Lagging infrastructure increases the cost of doing business, and lowers the country’s private investment appeal and competitiveness.

- Continue government’s infrastructure investment programme in energy, telecoms, roads, ports, rail, airports and associated mass transit services (goods and passenger).
- Accelerate implementation of infrastructure plans by activating public-private partnerships (PPPs), ideally starting with small/medium-sized projects to build experience and confidence. Proactively improve understanding within government of the benefits of PPPs, and a clear understanding of their complexity, long-term nature and cost and risk implications.
- Fast-track the finalisation of a policy to promote and regulate competition in the electricity market.
- Review procurement policies and regulations for government infrastructure projects to identify and remove bottlenecks.
8.1.3. Investigate and RemEDIATE Anti-Competitive Behaviour

Abusive firm-level behaviour creates barriers to entry for competitors and leads to business inefficiencies. If anti-competitive behaviour occurs in a major input sector, higher prices than necessary are pushed throughout the economy.

- Finalise and implement the planned privatisation of state-owned enterprises, especially in cement, sugar and hotels.
- Revise the role of marketing boards to remove bottlenecks and address instances of market failure, for example, in pyrethrum, coffee, cereals and produce.
- Instruct the Competition Authority of Kenya (CAK) to investigate and resolve potential competition problems in a timely fashion, prioritising major input sectors and those sectors with strong linkages to multiple sectors. Industries for possible review include: cement, trucking, banking, petroleum, beer, maize, fertilizer, sugar, pay TV, and domestic air passenger transport.
- Require private sector participants in government infrastructure projects to disclose in tender submissions that there was no hard core cartel conduct, collusive tendering or bid rigging in preparing the tender.

8.1.4. Address Mismatch of Skills Between Education Sector and Private Sector

A supply-demand skills mismatch affects new and fast-paced industries, resulting in extra investment training of new recruits or the ‘importing’ of skills, and thus higher labour costs.

- Establish effective mechanisms for dialogue between the public and private sector to ensure that skills development is demand-driven – rather than driven by the educational institutions.
- Undertake joint public-private sector planning to improve effectiveness in the use of training levies (for example, industrial and tourism training levies) to improve skills.
- Formulate as a PPP a framework for interaction between teaching professionals and the private sector, to ensure the currency and relevance of skills and knowledge of educationalists.
- Commission a review of the funding and operating model of the National Industrial Training Authority (NITA) and Utalii College to improve their effectiveness.

8.1.5. Foster a Business-Friendly Regulatory Environment

Challenges in the regulatory environment relate primarily to outdated company legislation, business permit procedures and local ownership requirements in selected industries. Furthermore, by not including Regulatory Impact Assessments (RIA) into the legislative process to ensure regulatory rigour and consistency across national and county government, the result may be the “Balkanisation” of business regulation across 47 counties. This perpetuates investment uncertainty and increases the complexity and cost of doing business.

- Prioritise the revision and passing of the Business Regulation Bill, Statutory Instruments Bill (RIA legislation) and various new companies’ legislation e.g. Companies Bill, Insolvency Bill, Partnerships Bill that seek to co-ordinate and reduce the red tape in doing business.
- Drive the wholesale replacement of various local level business permits with a Single Business Permit.
- Undertake a study to evaluate the impact of local ownership requirements in relevant industries; and share information on the global experience of indigenisation policies.

8.1.6. Improve the National Logistics System

A poorly developed and maintained national logistics system increases the cost of doing business, diminishes
a natural advantage in the region as a central trade hub, and impinges on Kenyan business’ ability to maximise EAC common market opportunities.

- Drive continuous improvement in the Single National Window to harmonise ministry processes and create electronic systems in import/export; and ports efficiency and goods clearance procedures.
- Accelerate the replication of the Malaba border pilot one-stop goods clearance programme.
- Drive the removal of all remaining non-tariff barriers (NTBs) with the EAC e.g. cumbersome weigh-bridge processes and police road blocks.

8.2. Understanding the Informal Sector & Linking MSEs with Bigger Business

8.2.1. Define, Understand and Address the Large Informal Sector

Large-scale informal sector activity leaves families without formal protection from job loss, ill-health and natural calamity, creates a drag on productivity and growth, and erodes the functioning and legitimacy of market- and equity-enhancing institutions. Furthermore, a large informal sector presents an overly large burden on the formal sector by unfairly reducing the tax base.

A poor understanding of the informal sector limits the ability of government to design and implement appropriate and effective policies.

- Clearly define what constitutes formal and informal enterprise in Kenyan terms.
- Support the Kenyan National Bureau of Statistics’ (KNBS) planned implementation of an MSE survey. Explicitly seek to understand the drivers of informality in Kenya and the barriers to small business of becoming formal.
- Implement the MSE Act, ensuring that those responsible for its implementation have the necessary authority and resources. Create a clear avenue for informal enterprises to register with the proposed MSE Registrar so that such enterprises can formalise and access business development benefits afforded to formal MSEs.

8.2.2. Create programmes to Link MSEs With Government Business and Large Private Sector Business

A bifurcated private sector with poor links between major buyers (government and large business) and suppliers (MSEs) means lower and less inclusive private sector growth.

- Provide government support to corporate business linkage efforts by better directing government finance and business development services to MSEs that are actively competing for or executing corporate business.
- Design and implement a programme to support government’s intent to procure 25% of goods and services from MSEs, without compromising value for money, independence of procurement decisions and eroding local content.
- Understand barriers to successful business linkages by assessing and sharing the experience, or consolidating the assessed experience, of donor linkage initiatives (e.g. USAID, UNIDO SPX and DANIDA) and existing/historical corporate linkage initiatives (e.g. GM, EABL, Unilever and KTDA).
- Commission an evaluation of the funding and operating model of existing government-led business development agencies (e.g. Kenya Institute of Business Training and the Productivity Centre of Kenya) to improve their effectiveness.
- Business associations (BMOs) to provide members with best practice tools and knowledge in developing business linkages and develop effective business linkage programmes.

192 World Bank, 2007. The Informal Sector: What Is It, Why Do We Care, and How Do We Measure It?
• Adopt a Financial Sector Charter to encourage formal lending institutions to improve access to financial services for MSEs, building on the work of Financial Sector Deepening (FSD) Kenya.

8.3. Manage Impact of Devolved Government and the Constitution

8.3.1. Foster Business Confidence Around the Impact of Devolved Government

Uncertainty around the implementation of the highly complex devolution process may result in a slowing of private sector investment as investors take a “wait and see” approach. To mitigate this risk and maximise a positive outcome, recommended actions revolve around supporting government entities charged with the implementation of devolution:

• Deliver a systematic campaign to educate county politicians and government officials on the importance of:
  o County cooperation in crucial economic development initiatives that transcend county boundaries and achieving economies of scale in county services;
  o Being guided by business-sensitive principles in the levying of county taxes, user charges and license fees;
  o Avoiding a rural allocation bias that fails to stimulate and support sustainable private sector growth i.e. low recognition of the benefits to agglomeration;
  o Avoiding a ‘Balkanisation’ of the business environment through variable rules and procedures, adding complexity and cost to doing business, by ensuring regulatory rigour and consistency across national and county government – as well as policy making that is based on due assessment of costs and benefits, intended and unintended.

• Create a forum for communication of upcoming business opportunities to the private sector in order for business to prepare and compete fairly at a county-level. This should be closely monitored, for example through a transparent database that lists contracts awarded.

• Assure effective implementation of anti-corruption efforts at the county level, for example, produce a transparent database that lists contracts awarded.

• Private sector to work together with development partners to initiate and maintain an equivalent “Doing Business” ranking of counties and recognise top achievers.

8.3.2. Support Implementing the Constitution

Adherence to the letter and spirit of the Constitution may be constrained by the ingrained behaviour in politicians and public servants, and in the manner that constitutional provisions are interpreted and translated into law. For example, the Constitution stipulates that a body corporate only be classed as a citizen if its entire shareholding is held by Kenyans, while land ownership is to be restricted to Kenyan citizens. This may have unintended consequences for instance negatively influencing investment flows and the transparency of shareholdings.

• Commission a study on the likelihood of unintended negative consequences pertaining to constitutional provisions, especially those restrictive landholding and what measures could be taken to mitigate them.

• Build up the capacity and strength of key Constitution-supporting entities, such as the Public Procurement Oversight Authority, Ethics and Anti-Corruption Commission and Land Commission.

• Create a private sector-funded legal “war chest” for business associations to defend the Constitution in the Constitutional Court in test cases, and hold officials and politicians to account.
8.4. Public-Private Cooperation and Dialogue

8.4.1. Streamline Public and Private Sector Interaction and Hasten Decision-Making and Action

Inefficient interaction, unnecessary bureaucracy and red tape increases transaction costs for both the public and private sector. Fragmentation of private sector representation also results in partial representation of the private sector in policy discussions.

- Drive continuous improvement in the functioning of Sector Working Groups; revise and refresh the Prime Minister’s Roundtable in the context of the new government structures and consider establishing county-level roundtables.
- Strengthen and maintain momentum on performance-based contracting and rapid results initiatives in the public service.
- Continue and update the Private Sector Development Strategy (PSDS), but restructure the implementation for better results:
  - Increase both the profile of the PSDS Secretariat and strategy, providing the PSDS’ institutional home and leadership with the necessary authority.
  - Build capacity of, and secure strong leadership that is proactive and attuned to the private sector.
  - Ensure that PSDS activities are relevant to, and within the control of PSDS Goal Managers; followed by deep integration of the PSDS activities with those of the Goal Managers.
  - Simplify complex management structures and clearly prioritise activities.
  - Establish and implement a monitoring and evaluation framework to effectively track progress and inform future implementation revisions.
  - Provide technical assistance to support the execution of the planned consolidation of ministries and public entities (e.g. entities listed in the Agriculture, Livestock and Food Authority (ALFA) Act; all investment climate entities; various ministries’ “MSE desks”).
- Assist business associations to increase capacity for more strategic and focused interaction with government and to deliver value-adding member services, e.g. DANIDA support to KEPSA.
- Ensure broader representation of business associations (BMOs) in public-private dialogue.
- Facilitate the creation of a public-private sector platform to resolve ongoing issues around VAT refunds and the tax burden (taxes and fees additional to company income tax).
- Rationalise and improve MSE representation through the mechanisms of the MSE Act.

8.5. Sector Growth and Competitiveness

8.5.1. Improve Competitiveness, Increase Value Addition and Export Diversification

In order to improve Kenya’s trade balance, drive sustainable economic growth and create a level playing field, certain general actions should be taken across the Kenyan private sector (note- this is not a sector specific study, thus detailed sector recommendations have not been included).

- As mentioned in further above, the Competition Authority of Kenya to investigate and resolve potential competition problems, prioritising major input sectors and those sectors with strong linkages to other sectors. Industries for possible review include: cement, trucking, banking, petroleum, beer, maize, fertilizer, sugar, pay TV, and domestic air passenger transport.
- Confirm the validity of and implement the National Export Strategy, along with finalising the National Trade Policy.
- Given the relatively insignificant size of the BPO industry, and the general entrepreneurial drive, growth and
technological innovation in the ICT sector as a whole, the Government should consider elevating priority support from BPO specifically to the ICT sector more generally.

• Provide focused support to increase value addition, especially in agribusiness (e.g. UNIDO standards and market access programme).

8.5.2. Effectively Manage “Budding Sectors”

The discovery of oil in the Lake Turkana region, if managed well, could play a massive transformation role in the Kenyan economy, accelerating the growth trajectory of the private sector and providing a boost to the fiscus. If handled poorly it may bring the attendant problems of “Dutch disease” and escalate the extent and magnitude of corrupt activity. Deliberate and careful thought and action is needed to promote sustainable, shared benefit from oil extraction, distribution and refining, including transparency and stewardship.

The construction and real estate sector is expected to grow steadily boosted by government’s increased spending on infrastructural development and Kenya’s rapid urbanisation. However, the sector is faced by regulation and supervision challenges, including quality assurance and the lack of a reliable title registry.

• Sign the global Extractive Industries Transparency Initiative (EITI); and create and strengthen government institutions tasked with managing oil resources and revenues in highly transparent manner.
• Support the design and implementation of market linkage programmes between oil companies and local MSEs.
• Remove key construction bottlenecks, for example, reducing delays in property transactions by reforming and digitising the title registry and increasing capacity at land registry offices to speed up land valuations and processing capability.

8.6. Improving Economic Data

8.6.1. Generate Comprehensive and Consistent National Economic Data on Private Sector Output and Investment

While KNBS collects comprehensive national statistics, there are gaps that make it difficult to fully understand the private sector and therefore to design evidenced-based policy-making around private sector development and the best allocation of public resources. Good private sector development policy. There is also contradictory data on levels of foreign direct investment193.

• Provide capacity building support to local government agencies responsible for development planning, building approvals and construction supervision, especially in view of the new county dispensation.
• Relevant industry bodies to commit to stronger industry self-regulation measures in construction.

193 The FDI values obtained from World Bank data differ from those made available by KNBS (Foreign Investment Survey, 2011) and also from those obtained from KenInvest Computations (which estimate substantially higher FDI inflows, based on investment approvals as opposed to actual investments).

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**Appendix A: Interview List**

List of Ministries, government agencies, development partners, associations and business people consulted:

<table>
<thead>
<tr>
<th>Ministries/ Government Agencies/ Development Partners</th>
<th>Associations</th>
<th>Business people</th>
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<tr>
<td>• Office of the Prime Minister</td>
<td>• Kenya Association of Manufacturers (KAM)</td>
<td>• Isaac Awuondo, Group MD of Commercial Bank of Africa</td>
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<tr>
<td>• Ministry of Finance</td>
<td>• Federation of Kenyan Employers (FKE)</td>
<td>• Dr Titus Naikuni, CEO of Kenya Airways</td>
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<tr>
<td>• Ministry of Information and Communication</td>
<td>• Kenyan Federation of Agricultural Producers (KENFAP)</td>
<td>• Mary Okello, Director of Makini Schools</td>
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<tr>
<td>• ICT Board</td>
<td>• Kenya Flower Council (KFC)</td>
<td>• Dr. Manu Chandaria, Chairman Mabati Rolling Mills Ltd.</td>
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<tr>
<td>• Ministry for Planning, National Development and Vision 2030</td>
<td>• Kenya Private Sector Alliance (KEPSA)</td>
<td>• Bob Collymore, CEO of Safaricom</td>
</tr>
<tr>
<td>• Ministry of Transport</td>
<td>• MSE Association of Kenya</td>
<td>• Julius Kipng’etich, Kenya Wildlife Service</td>
</tr>
<tr>
<td>• Ministry of Industrialisation</td>
<td>• Kenya Chamber of Commerce and Industry (KNCCI)</td>
<td>• Mahmud Jan Mohamed, Serena Hotels</td>
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<tr>
<td>• Ministry of Labour</td>
<td>• Kenya National Hawkers Association</td>
<td>• Paul Kukubo, ICT Board</td>
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<tr>
<td>• Ministry of Trade</td>
<td>• The Kenyan National Federation of Jua Kali Associations</td>
<td>• Naseem Devji, MD, Diamond Trust Bank Ltd</td>
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<tr>
<td>• Ministry of Tourism</td>
<td>• Kenya Association of Hotel Keepers and Caterers (KAHC)</td>
<td>• John Ngumi, Head of Investment Banking East Africa, Standard Bank</td>
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<tr>
<td>• KNBS</td>
<td>• Kenyan Association of Tour Operators (KATO)</td>
<td>• Patrick Obath, Chairperson, KEPSA</td>
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<tr>
<td>• KRA (unsuccessful)</td>
<td>• Kenya Tourism Federation (KTF)</td>
<td>• Betty Maina, CEO, KAM</td>
</tr>
<tr>
<td>• Competition Authority of Kenya</td>
<td>• Confederation of Informal Sector Organisations (OISO) East Africa</td>
<td>• Chris Wambua, CEO, MSE Assoc. of Kenya</td>
</tr>
<tr>
<td>• Development partners</td>
<td>o EU</td>
<td>• Polycarp Igathe, MD of Tiger Brands East Africa and Chairman of KAM</td>
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<tr>
<td>o EU</td>
<td>o DFID</td>
<td>• James Mwangi, Group CEO of Equity Bank and Chairman of Vision 2030</td>
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<td>o IFC</td>
<td>o UNIDO</td>
<td>• DfID</td>
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The functions and powers of the county are—

1. Agriculture, including—
   (a) crop and animal husbandry;
   (b) livestock sale yards;
   (c) county abattoirs;
   (d) plant and animal disease control; and
   (e) fisheries.

2. County health services, including, in particular—
   (a) county health facilities and pharmacies;
   (b) ambulance services;
   (c) promotion of primary health care;
   (d) licensing and control of undertakings that sell food to the public;
   (e) veterinary services (excluding regulation of the profession);
   (f) cemeteries, funeral parlours and crematoria; and
   (g) refuse removal, refuse dumps and solid waste disposal.

3. Control of air pollution, noise pollution, other public nuisances and outdoor advertising.

4. Cultural activities, public entertainment and public amenities, including—
   (a) betting, casinos and other forms of gambling;
   (b) racing;
   (c) liquor licensing;
   (d) cinemas;
   (e) video shows and hiring;
   (f) libraries;
   (g) museums;
   (h) sports and cultural activities and facilities; and
   (i) county parks, beaches and recreation facilities.

5. County transport, including—
   (a) county roads;
   (b) street lighting;
   (c) traffic and parking;
   (d) public road transport; and
   (e) ferries and harbours, excluding the regulation of international and national shipping and matters related thereto.

6. Animal control and welfare, including—
   (a) licensing of dogs; and
   (b) facilities for the accommodation, care and burial of animals.

7. Trade development and regulation, including—
   (a) markets;
   (b) trade licences (excluding regulation of professions);
   (c) fair trading practices;
   (d) local tourism; and
   (e) cooperative societies.

8. County planning and development, including—
   (a) statistics;
   (b) land survey and mapping;
   (c) boundaries and fencing;
   (d) housing; and
   (e) electricity and gas reticulation and energy regulation.

9. Pre-primary education, village polytechnics, homecraft centres and childcare facilities.

10. Implementation of specific national government policies on natural resources and environmental conservation, including—
    (a) soil and water conservation; and
    (b) forestry.

11. County public works and services, including—
    (a) storm water management systems in built-up areas; and
    (b) water and sanitation services.

12. Fire fighting services and disaster management.

13. Control of drugs and pornography.

14. Ensuring and coordinating the participation of communities and locations in governance at the local level and assisting communities and locations to develop the administrative capacity for the effective exercise of the functions and powers and participation in governance at the local level.