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USAID/KENYA

PRIVATE ENTERPRISE STRATEGY STATEMENT

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NAIROBI

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A. SUMMARY AND BACKGROUND

The Government of Kenya's Development Plan, 1984-1988 states, "Growth in the private sector ~~is~~ the core of the development process....Without growth in the private sector there can be no effective or widespread development in Kenya."[1] USAID agrees that a strong private sector must be the main source of economic growth and improvement in living standards for Kenya in the coming years. Kenya's private economic resources will have to be used to their fullest potential to achieve such desired growth, and this will be an absorbing and challenging task.

To support the shared objective of greater utilization of private resources, USAID/Kenya has developed a private enterprise strategy. This strategy will guide USAID's assistance efforts to Kenya's private enterprise during the period from 1985 to 1990. The strategy has been developed in the spirit of AID's recent policy paper on Private Enterprise Development (March 1985). That paper, which applies to AID programs worldwide, states that the goals of AID private enterprise development efforts should be:

- to encourage LDCs to open their economies to a greater reliance on competitive markets and private enterprise....
- to foster the growth of productive, self-sustaining income and job producing private enterprises in developing countries.[2]

As will become evident throughout this statement, these goals motivate USAID's private enterprise strategy for Kenya.

The strategy is based on a diagnosis of the needs of Kenya's private sector that is presented in the first half of the statement. This diagnosis frames Kenya's needs in terms of two challenges: first, to reorient government policies to provide a better growth environment for private enterprise, and second, to develop Kenya's present array of human, financial, natural and other resources.

These needs have been identified through a review of literature on Kenya's economy, including documents produced by the Government of Kenya (GOK), and by donor agencies. This has been supplemented by a series of interviews with business and financial leaders, aimed at determining their perception of constraints to and opportunities for private enterprise growth. We found a widespread convergence of views, both among written sources and between written sources and interview

1. Page 39.
2. Page 1.

responses. Particularly in the area of reorienting government policies, the agenda presented here is echoed in several GOK policy statements, and is consistent with structural adjustment negotiations carried out during the past few years between donors and GOK.

Following from this widespread agreement and the extensive documentation available on the status of Kenya's economy (see Bibliography), this statement reports results and organizes them into a strategic framework. It is not intended to substitute for a full economic analysis of the state of the private sector of Kenya.

In the area of government policies, the following have been identified as necessary for more rapid and sustainable growth: favorable macroeconomic policies such as positive real interest rates and realistic exchange rates; fewer restrictions on imports, particularly of intermediate goods; fewer price controls; less government investment in production; and a more favorable set of regulations and administrative mechanisms governing new investment. The changes required constitute a reorientation of government policy away from the promotion of large, capital-intensive industries concentrated in import substitution, and towards the promotion of industries that reflect the relative plenty and scarcity in Kenya of various inputs. These include plentiful labor and agricultural products and scarce capital and foreign exchange. Such a reorientation is called for in the Development Plan.

An overwhelming message is the need to rely on market-determined prices to allocate resources, because market prices reflect relative scarcity and abundance. Because of this attribute of market prices, free markets tend to produce the most that can be produced from limited resources. It will be crucial for the officials in the GOK to develop a trust in the ability of markets to allocate resources efficiently. AID is willing to work with the GOK to support and encourage such an reorientation.

No country's resource base is static. Therefore, a second aspect of the private enterprise strategy is to develop the productive potential of Kenya's current resource base. In some areas, such as natural resources, size of the domestic market and the quality of local inputs, constraints to growth cannot be altered or can be changed only slowly. Others however, such as human, financial and technical resources, can be improved through concentrated effort. Development of these resources is, in effect, creation of the pre-conditions for private sector growth. In addition, several sectors have been identified where growth potential is high. These are agribusiness, small manufacturing, export-oriented business and the informal sector.

The second half of this statement outlines USAID's strategy of assistance to private enterprise, based on these findings about Kenya's needs and potential. The overall objective of the private enterprise strategy is to promote growth of private enterprises, both by seeking to overcome the constraints that are a natural result of Kenya's current economic status and by promoting a government policy environment that allows market forces to operate more freely. It is expected that AID will assign priority to industries that are labor-intensive, local resource-based and foreign exchange-earning or saving. These are the characteristics that best reflect Kenya's assets and constraints. In addition, AID's strategy will tend to promote industries of smaller size, those located in rural areas and those owned by indigenous Kenyans. All of these are priorities for GOK, and are important for developing Kenya's economic balance and self-sufficiency.

AID will direct its resources towards areas in which its assistance can be most effective. It will employ both program assistance and projects as means to encourage government policy changes, and it will address the question of developing the resource base primarily through projects. AID's private enterprise projects and program assistance will address six areas.

In finance, AID has already developed the Rural Private Enterprise Project to supply term credit to small and medium-sized firms. It will further assist commercial lenders to make longer term loans by the creation of one or more discount facilities that will give lenders wide discretion in selecting borrowers and will include agricultural loans. It will also develop a loan guarantee fund to help ease collateral requirements for smaller firms and will work towards the creation of a venture capital fund or other source of equity capital.

In managerial and entrepreneurial skills, AID has developed the Agricultural Management Project, which will supply in-house training and technical assistance to firms in agriculture or related industries. This will be supplemented by the Training for Development project that will provide specialized training for selected individuals, many of whom will work for private firms. Finally, the need to develop stronger entrepreneurial attitudes will give rise to an entrepreneurial development component that is yet to be designed.

In technology and technical skills, AID will fund direct transfer of technology through the consulting services of the International Executive Service Corps (IESC). The Training for Development Project will also train significant numbers of specialized technicians, and there may be additional support to technical training institutions in Kenya.

In exports, AID will design a major new initiative that will cover the areas of export promotion, export finance and government policy towards exports. It will focus particularly on agribusiness and manufactures. Mechanisms to be investigated include a bills discounting system for short term export credit, an export trading company and government policies like manufacturing in bond and free trade zones.

In investment promotion, AID will support the activities of the Investment Advisory and Promotion Center (IAPC), and other government or private investment promotion groups. Possible areas of intervention for IAPC include improvements in the legislation affecting new investments, the role of IAPC, streamlining the investment approvals process and provision of industry-specific information for investors.

In the informal sector, AID is already sponsoring a major program of grants and technical assistance to private voluntary organizations with enterprise development programs serving the informal sector. Further developments will include a search for ways to provide informal sector firms with greater access to credit, either by creating links to formal credit institutions or by encouraging institutions such as savings and credit societies to work more effectively with the informal sector.

Throughout the implementation of these projects, liaison with GOK officials, business leaders and other donors will be essential.

USAID will use six main vehicles to provide the assistance just described. Two projects (Rural Private Enterprise and Agricultural Management) have already been developed. The provision of program assistance through the Economic Support Fund is a third means of pressing for policy changes described here, as well as for providing technical assistance to GOK. This is an ongoing part of overall Mission activities. Policy dialogue relating to the private sector has focused on macroeconomics, import liberalization, export promotion and agricultural input and grain marketing liberalization. These will continue to form the main policy agenda. The remaining three projects are yet to be programmed for the strategy. They include:

- Activities funded through counterpart funds in local currency, generated as a result of program assistance. Activities that may receive such funding in the near future are:

  - discount facilities
  - IESC (technical business advisory services)
  - loan guarantee fund
  - agricultural credit

- The Training for Development Project, slated to begin in FY 1986, many of whose recipients will be from private firms.

- The 1987 Private Enterprise Development Project, which will have five components:

  -- venture or equity capital development
  -- export promotion and finance
  -- investment promotion
  -- training and entrepreneurial development
  -- informal sector assistance

The 1987 project will be the largest in terms of both scale and coverage. The particular content of any of those activities will be subject to expansion or modification, as needed.

The target groups for this strategy should be noted at the outset. The purpose is to promote private enterprise development. The target private enterprise group covers any privately undertaken activity that is intended to generate enough income to make a profit or sustain itself.

While most such enterprises will be traditional profit-seeking firms, other modes of organization, such as cooperatives, are not excluded. The strategy does not, however, target private organizations that depend on outside contributions for their funding, such as private charities or other non-profit associations, except to the extent that they can be used to assist target enterprises (as in the Rural Private Enterprise Project informal sector component). AID's assistance to that sector will be provided through the PVO Co-Financing Project.

The private enterprise focus enunciated in this strategy statement will guide activities throughout USAID's Kenya program. USAID is strongly committed to the principle that assistance should be provided through the private sector whenever possible. Use of private enterprises can have the dual benefits of improving service delivery and relieving burdens on government, while at the same time it helps develop individual enterprises. This principle is reflected in the Agricultural Development (fertilizer) Program and in the Private Sector Family Planning Project.

A determination to involve the private sector wherever possible will be particularly important in guiding the development of USAID's agricultural development projects in the future. Agricultural enterprises are by far the largest component of Kenya's private sector. Projects now contemplated in areas such as agricultural research, small scale irrigation and grain storage, among others, will all use private enterprises as vehicles for implementation. Conversely, a major portion of the benefit from activities discussed in more detail in this document will accrue to agricultural enterprises.

B. TWO CHALLENGES FOR PRIVATE ENTERPRISE GROWTH

The fundamental imperative for Kenya's economic growth is set by the rate of population increase, estimated by AID at 4 percent annually. If standards of living in Kenya are to improve, economic growth must exceed this level. The burden is particularly heavy on private sector agriculture and industry. Agriculture must continue to support the vast majority of the population, though the use of the land base is fast reaching its productive limits. Industry, which now employs only two percent of the total workforce (while providing 13 percent of GDP), must absorb the workers who leave agriculture. Kenya's Development Plan 1984-1988 calls for 4.6 percent annual growth in agriculture and 5.9 percent in manufacturing.

Since independence Kenya has made substantial progress. During the period as a whole, its economic growth has exceeded population growth and accordingly, per capita income has risen. However, a long range trend toward slower growth has been in evidence throughout two decades. The trend has persisted despite cyclical swings, culminating in the early 1980's in at least a temporary halt in real per capita income gains. This trend serves as a warning that Kenya may have difficulty meeting its growth targets in the coming years. In order for the main productive sectors, agriculture and industry, to grow at the desired rates, Kenya must answer a number of challenges in two areas: improving its current endowment and revising government policies.

First, Kenya's economy suffers from the inherent limitations that face most poor, developing nations. Factors such as natural resources, skill levels among the population, the business support system, infrastructure and the depth of the cash economy determine productive potential. These factors can be considered Kenya's current economic endowment. One challenge facing Kenya is to improve its endowment as quickly as possible.

The second challenge is to reorient government industrial policies towards greater reliance on market-determined resource allocation. The Government of Kenya (GOK) has followed a comprehensive industrial policy, that has used a variety of mechanisms to encourage the rapid development of import substitution industries, particularly large, capital-intensive ones. Many of the mechanisms used to implement policy, such as import restrictions and exchange rate controls, have in common the effect of altering relative factor and product prices from the level that the market would otherwise determine. While this policy appears to have achieved a rapid spurt in industrial growth, such growth cannot be continually sustained. It is costly to many elements within the nation.

As a result of the present policy focus, workers may find fewer jobs, consumers may pay higher prices and unprotected industries may experience biases against them.

The slower growth in manufacturing throughout recent years indicates in part that the import substitution strategy may be reaching its growth-producing limit. After increasing at more than 10 percent per year during the 1970s, and slowing to very low levels in the early 1980s, the rate in 1983, as the economy began to recover from the worldwide recession, was 4.5 percent. A related sign is the real (shilling) decrease in the value of Kenya's non-traditional exports, as against the continuing increase in the traditional products, coffee, tea and petroleum. This reveals how heavily oriented Kenya's industrial structure is toward producing for the domestic market.

If growth targets are to be achieved in Kenya, government policies will have to rely more clearly on markets to set prices, and several other government policy barriers to private enterprise growth will have to be removed. Such changes could encourage stronger industries, with greater self-sustaining capacity.

USAID/Kenya's private enterprise strategy aims to help Kenya meet its growth targets by assisting both the Kenya Government and the private sector to address these two challenges. The next two sections illustrate the nature of the challenges more clearly. Following this, USAID's strategy is described.

C. REORIENTING GOVERNMENT POLICIES

Almost two decades ago, the Government of Kenya (GOK) began to carry out a set of policies for private enterprise with two goals. One was to promote industrialization, largely through development of import substitution manufacturing. The other was to ensure that essential commodities, particularly foods, were available to all consumers at prices they could afford, through price and marketing controls. These policies appear to have succeeded in their immediate goals. It is becoming increasingly apparent, however, that in the long run the mechanisms used to implement them, and the resulting industrial mix are constraining Kenya's growth. The sections immediately following illustrate specific areas where government policies are believed to be constraints to growth. The summary conclusion to be drawn from them is that if Kenya's economy is to continue to grow at the required pace and to move toward greater self-sufficiency, it is essential that government policies allow the economy to proceed to greater reliance on local resources, and to prepare it for external trading.

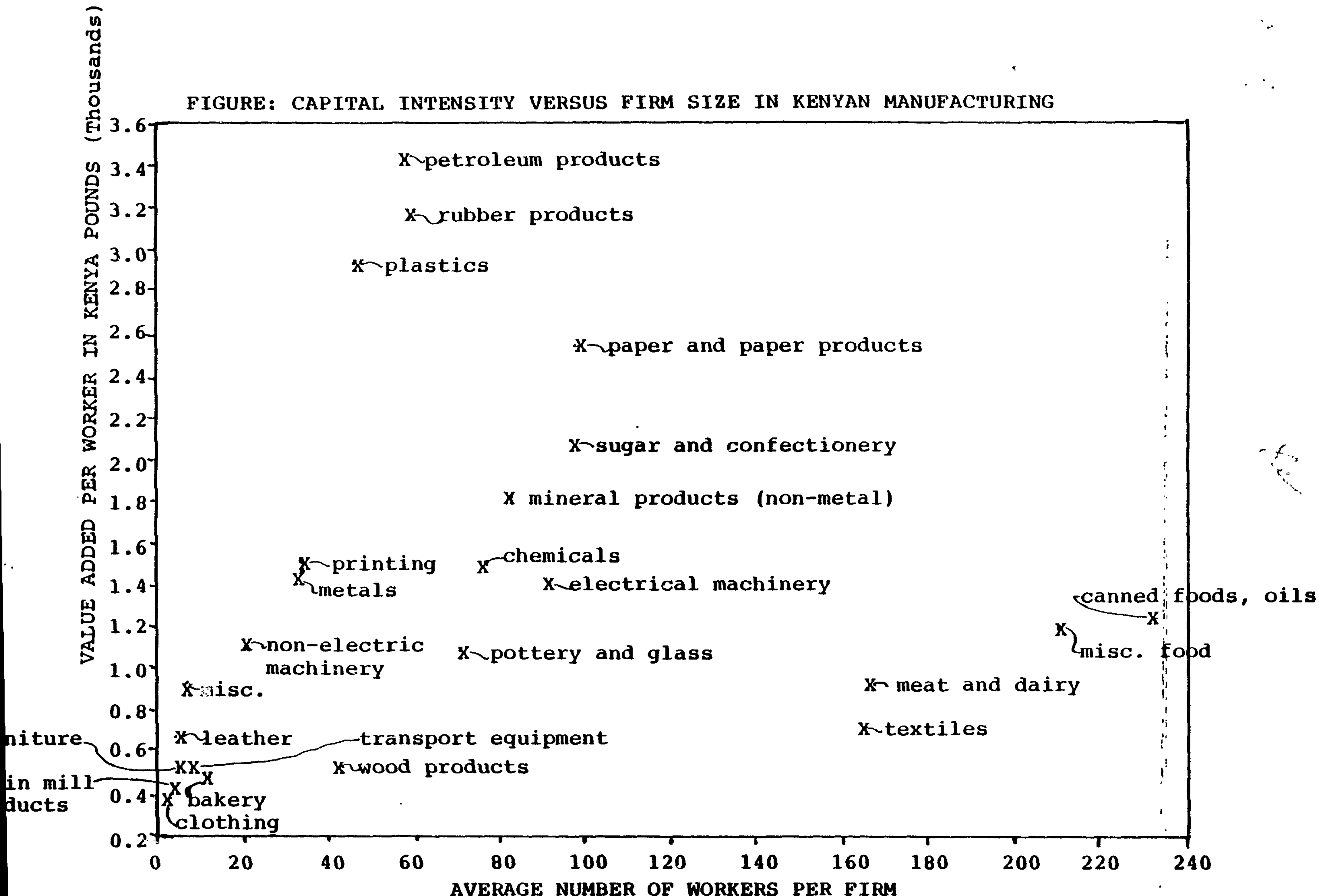
This is a theme that is frequently sounded in statements of Government of Kenya policy. To quote the 1985/86 Budget Speech, the focus should be "to mobilize domestic resources more effectively for investment."[1] In the current Kenyan context, and clearly reflected in other sections of the Budget Speech, this requires greater reliance on private markets and enterprises. The same theme has been at the forefront of structural adjustment negotiations between GOK and donor agencies, including the International Monetary Fund, World Bank and AID.

To effect import substitution and consumer protection policies during the past decades, the Government has used a wide variety of instruments. Most of them have a common effect: they tend to alter product or factor prices from the levels private markets would otherwise determine. While effective price changes may move investment and production in the desired direction, they nearly always have dangerous side effects. Import duties on finished goods relieve import substitution industries from the requirement to produce efficiently and maintain quality. Duties on imported intermediate goods reduce the competitiveness of goods produced for export. Prices legally fixed at disadvantageous levels reduce incentives to produce, and therefore induce scarcity. Historically, the Government of Kenya's direct investments and provision of low interest capital through development banks have encouraged the use of capital-intensive rather than labor-intensive activities. The negative effects of effective price alterations are clear: less is produced; fewer jobs are provided; industrial survival depends on continued subsidy or protection; and fewer industries generate foreign exchange than if markets were allowed to determine prices according to the true scarcity value of inputs and products. The tragedy of this is that Kenya's natural, human and capital resource base is used less productively than it could be.

The resulting structure of Kenya's industry is illustrated in the following figure. This plots the average number of workers in a firm against value added per worker. High value added per worker indicates capital-intensity. Several distinct groups can be noted. The most capital-intensive industries, beverages and tobacco, petroleum, rubber and plastics, are import substitution industries. At the next level of capital intensity are resource-based industries with heavy government involvement: paper, sugar and mining. A third group of industries, canned and other foods, meat and dairy, and textiles shows both large firm size and low value added per

1. Prof. G. Saitoti, Minister of Finance, quoted in <u>The Nation</u>, June 14, 1985, p.4.

FIGURE: CAPITAL INTENSITY VERSUS FIRM SIZE IN KENYAN MANUFACTURING



Omitted: Beverages and tobacco, average firm size, 416 employees, value added per employee, 3,800 KPounds.

worker. The low value added reflects both the nature of the agro-processing technologies, and the fact that several of the largest enterprises represented here, often backed by the Government, are known to be inefficient. Finally, a large group of industries, characterized both by low capital-intensity and small firm size, tends to represent indigenous industry and informal sector activity. Few industries in this category receive benefits from government industrial policies. These include furniture, leather, clothing, bakeries, wood and non-electric machinery.[1] Most rely mainly on domestic inputs and produce for the domestic market.

The problematic aspect of Kenya's industrial structure is the high proportion of production and employment in the large, import-dependent and capital-intensive segments. According to a World Bank report:

> When compared to that of other low or middle income countries, Kenya's industrial structure appears strongly skewed toward large scale units and toward commodity groups that are more capital-intensive. In Kenya, the share of the most labor-intensive industrial group is unexpectedly low, while that of the most capital-intensive group which includes paper, rubber, chemicals, petroleum, basic metals, machinery and transport equipment is high.[2]

The report goes on to say that the share of output produced by smaller firms in Kenya is below that of any of a comparison group of low and middle income countries.

Most businesses in Kenya have learned to maximize their returns within the existing policy framework. Therefore, enterprise development may still proceed along the lines suggested in the section on natural constraints and opportunities (below). However, if Government changes its industrial policies, it is expected that development will take a path of faster, more self-sustaining growth.

Some of the major government policy constraints are discussed below. In reaching the conclusions on constraints given here, we have drawn heavily on comments by 43 business, financial and government leaders interviewed in preparation for this paper. A summary of interview results is given in the Appendix.

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1. Transport equipment and grain milling are heterogenous categories, including a large number of small or informal enterprises and a few large publicly-sponsored firms.

2. World Bank, pp 81-2.

1. <u>Macroeconomic Policies</u>. Basic macroeconomic policies, including exchange rates, interest rates and monetary policy, are of the highest importance in determining whether growth will be possible, and what form it will take. At present, the policies followed by GOK are productive; the Government has made significant progress during the past few years in reorienting its macroeconomic policies to encourage growth. The exchange rate has been devalued, interest rates are positive in real terms and the Government has achieved some reduction in its own borrowing demands on credit markets. Inflation is held at manageable levels.[1] All of these policies encourage savings and investment and help allocate resources to their most productive uses. It should be noted, however, that such policies were not in effect throughout much of the past decade. In particular, the over-valued exchange rate during the 1970s contributed to the orientation of industry towards domestic production. One of the most growth-inducing steps GOK can take will be to continue the current set of macroeconomic policies.

2. <u>Import Duties and Licensing Procedures</u>. There are no constraints, governmental or otherwise, that are felt more keenly by the business community than those connected with import duties and licensing. In recent interviews, Kenyan businessmen repeatedly listed import duties and licensing requirements as the most important problems they faced.

Import duties and restrictions are a major means through which the Government protects certain industries. Some manufacturers note that they benefit from, and may owe their existence to, high duties on the consumer goods they produce. These protect them from competing with international products. Consumers suffer from these policies in the form of higher prices and poorer quality goods. However, duties on consumer goods do not significantly reduce dependence on foreign exchange, because most firms must import machinery or intermediate goods in order to produce, making their levels of production and employment dependent on availability of foreign exchange.

In the past few years duties have been imposed on such intermediate goods. This move, which became necessary as a result of foreign exchange shortages, is the point of difficulty for most enterprises. Many firms that do not benefit from protection for their products must nevertheless suffer the cost of duties and restrictions on their inputs,

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1. Berg, et. al.

resulting in negative protection.[1] Prospective exporters are especially hard hit. When the final prices of Kenyan products contain a high level of duties, the products become uncompetitive against international products whose prices are duty-free. The consequences are evident in the fact that few Kenyan manufacturers, outside agribusiness, have plans to develop an export line.

The import licensing process is the object of many of the business leaders' complaints. At present, the process is often quite lengthy. The time of higher level managers is diverted from productive uses to the pursuit of import licenses. The delays involved in getting approval for import licenses may hold up production, while carrying costs continue. The uncertainty surrounding the licensing process makes planning difficult. In response, firms may avoid planning for expansion and smaller firms may be shut out of the import field completely.

Kenya has made some progress in this area. Duties have been lowered slightly, and administration has improved. Nevertheless, a significant portion of the import requests are still denied,[2] and this is at a time when foreign exchange is relatively available.

3. Price and Marketing Controls. The effect of price controls on businesses is second to import duties as an industrial constraint only because a smaller range of firms is affected. These are concentrated in agriculture. The most important effect of price controls is to reduce incentives to produce, resulting in lower output. This occurs whenever prices are set below the level producers could otherwise obtain. In Kenya, many of the controlled prices are close to market levels; these may still create difficulties for producers because of their inflexibility. Increases in factor costs cannot be passed through to consumers until a new control price is set, usually months later.

The effect of government marketing boards on private firms is similar to that of direct price controls. If the Government is the sole purchaser, the price it chooses is in effect a control price. This affects both producers and suppliers of services

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1. An AID-funded study for GOK on effective rates of protection by industry should shed more light on the extent of this and related problems, when results are released in late 1985.

2. Berg, et. al., p. 23.

such as transport and construction. Moreover, payments from many parastatal boards are frequently very late. In response, producers must often pay interest on overdrafts for long periods.

One of the most important drawbacks to price and marketing controls is the huge administrative burden they place on the Government. The Government attempts to set prices that reflect international competitive conditions as well as local costs. In reality, this means that it attempts to duplicate the results that the market would achieve on its own. This process absorbs the time of a large number of civil servants, and even so, prices are only readjusted to market conditions once a year on average. By contrast, market-determined prices adjust to changing costs and demands very quickly, without any administrative superstructure.

During the past few years, prices have been controlled at more or less realistic levels. Nevertheless, there has been little indication that GOK is willing to relinquish control in any major areas by allowing greater flexibility or full decontrol.

4. Government Involvement in Production. A large part of the GOK's industrial policy has been led by parastatal corporations or corporations that have received much of their finance from Government-owned development banks (often at below-market interest rates). In fact, a very high proportion of large industries in Kenya have received a substantial share of their financing from the development banks. According to the International Monetary Fund, the Government owns a majority share in major enterprises in the following industries, among others: motor vehicle assembly, cement, petroleum refining, mining, textiles, ceramics, meat packing, sugar processing, oilseeds, a variety of other agribusiness, beverages, photography, tourism, supermarkets, transport and communications. Once established, those firms have a special relationship to the Government, which wishes to see its investments succeed. The Government will be strongly tempted to take steps to keep such investments alive, even if they prove to be inefficient or money-losers. In particular, it may not wish to be associated with a loss of jobs due to plant closure. The development banks, for example, hold large numbers of delinquent loans without foreclosing, in hopes that they will eventually recover. Several of Government's direct parastatal investments require annual subsidies from the GOK budget in order to maintain operations.

One of the negative effects of government participation in production is that because of Government's reluctance to divest when necessary, investment remains tied to less productive uses. An additional problem is that potential competitors cannot match the special government benefits, which tend to reinforce a monopoly position for Government-supported enterprises. The economy is directed towards large firms while most smaller firms receive few benefits. Direct government participation is almost wholly concentrated in large firms.[1] While GOK has indicated a willingness to reduce government investment in productive enterprises, this has generally meant only fewer new investments. The portfolio of existing investments continues to receive GOK support.

5. Investment Climate. It is important that the Government create a business environment that is conducive to new investments. Many of the businessmen we interviewed praised the Kenya government for its basically favorable attitude toward private enterprise. On the other hand, the recent history of U.S. firms in Kenya suggests that the investment climate is not seen so favorably. The total number of U.S. firms in Kenya has dropped slightly since 1981, and only a handful of new productive investments have been made.

The investment climate involves all the factors described above, as well as the legislation and administration governing investment approvals. Those interviewed expressed several specific complaints about these areas. A new investment, particularly by a foreign firm, must obtain a complete series of approvals before work is begun. These cover items from approval for the investment itself to permission to purchase or occupy tracts of land. No centralized unit handles all the approvals; the new investor often faces a bewildering array of names and offices from which the approvals must come. This can be especially confusing to foreign firms. Concerns have also been expressed about the array of legislation that affects investors, including taxes, rules governing repatriation of profits, protection against nationalization and restrictions on activities of foreign firms.

6. Effect of Reorientation. As a result of historical and current Government policies, Kenya has an industrial sector that is biased in favor of large, capital intensive firms, producing for the domestic market and heavily supported by the Government. USAID believes that if government policies turn towards a less controlled, market price approach, there will be a shift in investment flows. In such an economy, investments with the following characteristics would predominate.

o Labor-intensity would rise, as would employment. Capital-intensity would fall. This would reflect the fact that labor (increasingly educated) is one of Kenya's most abundant resources, while capital is

1. World Bank, p. 418.

scarce and must often be imported. A lower capital/output ratio could produce additional growth from Kenya's limited investment resources.

- Local resource-based industries would receive a larger share of investments, as a result of lower prices relative to imported inputs. As agricultural products are Kenya's greatest natural resources, this would mean more agricultural and agribusiness production.

- Exports and foreign exchange savings would increase. This is a natural response to the problem of Kenya's small domestic market, and it is a crucial factor in reducing Kenya's vulnerability to the boom-bust cycle brought on by dependence on coffee and tea exports. While the development of export markets would be difficult under any circumstances, a policy reorientation could create greater incentives to try.

- Less Government ownership or sponsorship of productive industries would occur.

Industries with these characteristics are not only the types that would prevail under market-determined resource allocation; they are also the types that would provide a sound basis for long-term, self-sustaining growth, as they would use Kenya's resources most productively.

It is difficult to show in advance that investments will flow in these directions, and too early to see changes that may be resulting from recent macroeconomic policy improvements. However, the imbalances between Kenya's resources and the current industrial structure are clear. First and most clearly, unemployment is high, showing that labor resources are underused. Second, as shown above, when compared to other countries of similar income, Kenya's industrial structure is skewed towards products that are capital intensive. The declining performance of non-traditional exports has also been mentioned. Each of these imbalances can be ascribed, in part, to government policies, and it is likely that they would tend to correct themselves if policies were changed.

Such a shift in policies would bring a more competitive setting to industries now benefiting from protection. Not all could be expected to adjust successfully. Transitional difficulties can already be seen to some extent in the severe arrearage problem in development bank portfolios, resulting in part from exchange rate devaluation during the early 1980s. However, the prospect of transitional difficulties should not stop the move to a more market-priced economy; rather, it indicates that policy change should take place over several years. Moreover, investment in resource-based and unprotected industries should begin now, to establish a sound foundation of businesses that would be competitive in a more open environment.

7. Government of Kenya Response. The GOK has officially called for a shift in the pattern of production. The Development Plan, 1984-88, and many other official policy statements, repeatedly emphasize exports, stimulating private savings and better use of industrial capacity as priorities. The Plan cites the need for Government's active role to diminish and for the private sector to expand. It promises to maintain a favorable macroeconomic climate for private investment, to relax import restrictions, and to curtail new government investment in enterprises that could be fully private.[1]

While the publicly-stated intent is positive, effective translation of the statements into institutional change is proceeding slowly. Changing an industrial orientation that has existed for twenty years (if not more) is difficult in the best of circumstances because it requires the withdrawal of favorable treatment from a large, powerful group, both inside and outside the government, and a reorientation of major government bureaucracies. In Kenya this array of strong interests is coupled with ideological reserve.

Kenya's economic policy after independence has been formed in accordance with strongly perceived needs and beliefs, relating to the objective of establishing a measure of economic independence to accompany political independence. Among the goals have been the desire to Africanize industry, to keep growth moving quickly, and to protect consumers. It was felt that the Government should play a central role in accomplishing these aims, first because the private sector was not well enough developed, and second because much of it was in the hands of Europeans and Asians. The colonial administrators had already begun to set the course toward centralized industry and a large role for Government in the administration of production. The concept of African socialism continued this course. Although the private sector is both more developed and more African than it was at independence,[2] a general

1. Chapter 2, "Strategy for Future Development."
2. Hazlewood, p. 90.

mistrust of unregulated business remains, undoubtedly still related to a fear that foreign and Asian-owned businesses will dominate the economy if controls are lifted.

It is important that decisionmakers within the GOK place more trust in markets as allocative devices, and as the best way to spur growth in Kenya. Such a change in attitudes, with accompanying change in practice, would not only benefit the economy, it would also remove a burden from the Government bureaucracy, freeing it to concentrate on tasks that the private sector cannot perform well.

D. GROWTH OPPORTUNITIES AND CONSTRAINTS: IMPROVING THE ENDOWMENT

The ability of Kenya's private enterprises to grow is dependent not only on the policies set out by Government; it is also shaped by the resources and talents available to them. There are some aspects of that current endowment of resources over which Kenya has virtually no control. These include its relative lack of natural resources (apart from agriculture) and its poor geographic location relative to the most promising markets. In most other areas, however, Kenya has the potential to improve its chances for increased growth.

Through the interviews carried out for this study, and reviews of other studies, a picture has emerged of the set of attributes Kenya now has to work with. Some of these were perceived as constraints. They include the size of the domestic market, the quality, price and supply of domestic inputs, investment capital, technical skills and technology adaptation, and managerial and entrepreneurial skills. Others were seen as areas of future growth opportunities, including agribusiness, small manufacturing, exports and the informal sector.

The constraints are discussed first, followed by areas of high potential. It is important to note that Kenya has been improving the quality of its resources. It has developed manpower, technological, financial and other resources far beyond the level of two decades ago, and in some cases beyond the level of other countries of similar economic standing. Thus, it occupies a position of significant accomplishment in each of the five areas. Constraints exist now in the sense that further progress in each area is needed to support future growth.

Constraints:

1. Size of Domestic Market. One unavoidable fact of economic life in Kenya is the small size of its internal market. Kenya's population is not large compared to that of most industrially successful nations. More importantly, incomes and purchasing power are low. As a result of the small effective market, many higher technology production processes cannot be used profitably in industries directed at domestic production. This affects any industry with a production process that involves significant economies of scale. Examples are steel mills and auto spares. In this situation, product diversity cannot be very great if production is to be profitable. In addition, the small market creates a propensity towards monopoly and monopsony in such scale-related industries.

The size of Kenya's market will change only slowly, as incomes rise. Because the growth of incomes results from profitable production, progress in production techniques and market size will occur simultaneously and in a mutually reinforcing way. One step that can lead to some faster growth in market size is to integrate an increasing proportion of the rural population more fully into the cash economy.

In the meantime, there are several ways a country can circumvent a small domestic market. First, it can concentrate on exports, particularly for those industries requiring large scale production. Successful exports can reach a much larger, more affluent market than is available within Kenya. Second, Kenya should concentrate its domestic-oriented production on industries with few scale economies and industries providing basic goods for which demand is high, in other words, firms that produce for a small, low income market. These will tend to be small firms, in high competition industries, and labor intensive firms, which often have few economies of scale.

2. Quality, Price and Supply of Domestic Inputs. A large proportion of business people interviewed stated either that they could not rely on the supply and quality of local inputs or that local inputs were too expensive. These include raw materials, intermediate goods and services such as transport. Inputs appear to be a particular problem for agro-processing firms, which tend to use higher proportions of domestic products than other industries. For manufactured items, the problems are sometimes related to the fact that the supplier has a monopoly or is in a highly protected industry. Examples cited included packaging products of several varieties. However, most often these problems are a function of Kenya's relatively small and undiversified economy.

Because of the many interrelationships involved, improvement in the supply of local inputs and services is another change that can only occur gradually, as the economy grows. In the short term, some progress could be made by changes in government policy regarding imports and agricultural pricing/marketing (see above). Most progress must come, however, from the efforts of interested firms, working either alone or jointly, to solve the particular problems they encounter. Outgrower schemes for agro-processing industries are one highly promising, though industry-specific solution to this problem. Under such schemes the purchasing firm takes on-going responsibility to assure that the product grown by independent farmers will meet its requirements.

3. Capital for Investment. The major sources of investment capital in Kenya are retained earnings of existing firms and foreign investment, both through multinational firms and donor agencies (via the Kenyan development banks). A large number of domestic firms report difficulties locating sources of longer term funds suitable to support new projects or project expansion. One of the primary reasons for the shortage of capital is, again, the low income level in the country. Therefore, despite a savings rate which has averaged 17 percent in recent years,[1] Kenya alone cannot supply a great volume of funds.

The second major reason for the lack of capital is the condition of the financial system. Although Kenya's financial system is well developed for a country with its other economic characteristics, it still lacks several desired features relating to investment finance. The stock market, while substantial, is largely confined to well-established firms, most of them originally colonial ones. During the past decade it has been a source of equity for only a few newer firms. The banking sector is constrained by traditional practice and current market conditions to offer only short term finance. Moreover, it relies heavily on collateral as the basis for lending, particularly real estate. Heavily collateral-based lending limits the leverage and hence productivity of a firm's own equity.

The chief drawback to such problems in the financial system is that savings are not mobilized to the greatest possible degree. Rather than being directed to the most productive uses, they tend to remain in the hands of the original savers. In order to mobilize savings more effectively for investment, the banking system should be encouraged to make business loans for longer terms, through the introduction of greater stability into the system. It should be encouraged to lend more on the basis of prospective project success and less on collateral. The newly developing non-bank financial institutions may prove

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1. Berg, et. al.

to be a source of innovation in banking practice. The market for equity should also be improved, and sources of long term capital, such as insurance companies and savings and credit societies, should be drawn increasingly into productive investments. Finally, instruments to serve the investment capital needs of the smallest businesses should be fostered, for example, through savings and credit societies.

4. Technical Skills and Technology Adaptation. Kenya's modern sector is not lacking in literate, semi-skilled and unskilled workers. However, shortages of high-skilled technicians are often cited as a business constraint. In particular, people who can maintain, repair, adapt or design machinery are in short supply. The shortage hurts firms directly by making it difficult to keep machinery functioning. Some have claimed that firms choose more capital intensive modes of production as a way to work around the shortage of skilled technicians. This tendency hinders Kenya generally because the adaptation to Kenyan circumstances of new technologies proceeds quite slowly. For the most part, the larger firms have simply copied technology they or others have used elsewhere. This keeps Kenya highly dependent on imported machinery, most of which carries high import duties. It is presumed that more technological innovation occurs among smaller firms, reaching into the informal sector. However, little systematic information is available about technology adaptation at these levels.

An ability to adapt technologies has been a characteristic of most successful industrialization efforts, particularly those in East Asian countries. Such an ability is essential for self-sustaining growth and diversification of the economy. Kenya could make a concerted effort to improve its fund of technology and technicians. The most obvious vehicle for this would be technical training institutes. However, interviewees reported gaps between the skills such institutes produce and job opportunities and the needs of industries. Many of the larger firms have developed in-house training programs. It is clear that new approaches to technical training are needed, directed more to the requirements of existing firms.

The other main vehicle for Kenya to improve its technology is to continue to seek the help of those outside Kenya with access to technology. This can be done through consultancies, joint ventures or direct investment by foreign firms.

5. Managerial and Entrepreneurial Skills and Attitudes. Most studies of the needs of Kenyan private enterprise identify inadequate management as one of the most important constraints to development. The interviews carried out for this study have helped to identify the precise nature of the problem. Interviewees with a wide variety of perspectives agree that while specific skills, such as accounting, may be needed, the central task is one of changing attitudes.

- The expatriate general manager of one large firm reported difficulty inducing middle-level managers to take responsibility and initiative, particularly over staff.

- Several African small businessmen chided their colleagues in business for not reinvesting profits in the business and for not keeping closely involved with their firms' daily operations.

- An outside consultant concluded that firms with management problems frequently do not perceive either the problems or the potential benefits of solving them. This is confirmed by the known reluctance of firms to pay for consulting services.[1]

Each of these comments refers to a need for what could be termed an entrepreneurial attitude. It includes both personal characteristics, like initiative or willingness to delay rewards, as well as the ability to apply managerial skills like marketing and personnel management. Many current entrepreneurs in Kenya are the first generation in business, and are therefore unfamiliar with the business world. There may also be cultural reasons why more Kenyans have not fully absorbed a managerial and entrepreneurial outlook. These may include the tradition of successful individuals supporting many extended family members and cultural preferences for cooperative organization rather than competition and hierarchy.

The task of changing attitudes toward business and management is more difficult than that of providing specific skills. It will require creative approaches to training and business advisory services. There is clearly an entrepreneurial drive in evidence throughout Kenya. This drive needs to be supported, disciplined and encouraged, both through training and through an environment receptive to entrepreneurial efforts. The latter involves the creation of a positive policy framework. The former requires creation of entrepreneurial development programs at training institutes, among other things.

Opportunities:

1. <u>Agribusiness</u>. There is a widespread belief among observers of the Kenyan economy that agribusiness, particularly the processing of agricultural products, is an area with high growth potential.[2] Products identified as showing promise are horticultural products, edible and non-edible oils, meat

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1. Radnor and Chapman.

2. World Bank, Coopers & Lybrand.

and fish products and leather goods. The prospects tend to be best in industries not dominated by government marketing or producing parastatals nor affected by price controls.

Many of the prospects for agribusiness development involve exports. At present, agribusiness accounts for 40 percent of Kenya's non-traditional exports (that is, exports not including coffee, tea and petroleum), and another 10 to 15 percent of exports are raw agricultural products that could at some stage be exported in more highly processed form. Development of such potential export items should be encouraged. The higher visibility agribusiness exports are preserved horticultural products sold mainly in Europe. These are led by the success of pineapples and green beans. There may also be a market for fresh produce in Europe and the Mid-East, (although only in the winter months).

One reason agribusiness is seen as having high growth potential is that it uses domestic resources. Another is that it is labor intensive. While the processing itself may be only of average labor intensity, the labor involved in the related agricultural production makes the industry as a whole quite labor intensive. For these reasons, agribusiness is the area where Kenya's international comparative advantage is most likely to lie.[1]

2. <u>Manufacturing: Small Industry and Exports</u>. Kenya's manufacturing sector is now characterized, relatively speaking, by large, capital intensive firms that produce for the domestic market. This condition is a result of government policies that have deliberately protected such products by means of import duties and restrictions on entry for competing products. As discussed above, such protected and favored industries are often inefficient and are, therefore, not the best sources of growth that can be sustained in the long run.

Better prospects in manufacturing are being identified among smaller industries and among industries oriented toward exports. Smaller industries tend not to be protected or to benefit from special government favoritism. Hence, they may be more efficient. The figure showing value added per worker against firm size identifies industries where small and labor-intensive firms predominate. These include traditional products such as grain mill products, furniture, clothing and bakery goods. At a slightly higher level of labor productivity they include non-electric machinery, printing and metal working. These are areas where indigenous industry is

1. We will know more about the international competitiveness of agribusiness in Kenya when the results of the study on effective protection by industries are presented.

developing. Their labor intensity shows that they supply more jobs per shilling invested than industries such as paper, beverages and tobacco and petroleum products. It is believed that such firms are more likely to innovate in products and technologies, and the sheer numbers of firms involved gives more opportunities for experimentation. Smaller manufacturing firms are also training grounds for entrepreneurs and managers. In interviews, we identified the following as projects small firms wanted to undertake: ice cream, high gauge wire, cables, steel and plastic furniture, vehicle spares, optic fibers, and electrical fittings. This is only a small indication of the potential dynamism of the sector.

A particular source of growth is the development of manufacturing by firms now occupied in other business such as construction or trading. Enterprises that are already successfully operating have proven managerial competence and the strategic point of view required to identify market opportunities. We talked with several firms engaged in such a transition. This paradigm for development in manufacturing has been identified in many developing countries.[1]

Manufactured exports are a more difficult area to develop, and may require longer lead times. However, they offer access to larger markets. The Government wishes to promote exports within the Eastern and Southern African Preferential Trade Area. This is probably the best target area for items made in Kenya. At present, few firms in Kenya seem to be considering new manufacturing for export seriously. This is particularly true in industries where raw materials and machines must be imported. Despite this general reluctance, manufactured goods accounted for 37 percent of the non-traditional exports in 1982. Some observers believe that greater export activity would result if manufacturing in bond or some system of import duty forgiveness were allowed. Related to exports is the tourist industry, which also generates foreign exchange. Growth prospects for this industry are expected to be good, particularly at the coast.

3. Informal Sector. Enterprises in the informal sector are characterized by very small size, labor intensity, the use of simple technology, as well as by lack of access to the formal business support system, including financial institutions. This sector is a major source of employment. Estimates of the amount of employment provided by the informal sector vary over a wide range depending on definitions and survey methods. Despite controversy over its size and growth, however, it is

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1. Robert Nathan Associates.

clear that the informal sector provides the first source of employment for the growing number of workers unable to support themselves in agriculture. As such, the potential to increase production through more effective use of abundant labor resources is great. The informal sector is also important in entrepreneurial development.

Within the informal sector, manufacturing and repair enterprises should receive the greatest attention. These industries function as both import substitution and export industries for the poorer subset of the Kenyan economy. Whether they produce directly for poor consumers, or 'export' to more wealthy consumers or producers, they bring more income into the hands of the poor, thereby contributing to deeper penetration of the cash economy. As discussed above, this is a long run necessity for the development of a larger domestic market in Kenya. Informal sector manufacturing is also a source of technological adaptation, at the simplest levels.[1]

For these reasons, it is appropriate to regard the informal sector as an area of high potential source of growth. The difficulty lies in assisting such enterprises. Their small size, informal management systems and lack of financial assets make them difficult to reach by commercial methods. Possible approaches are discussed in the following sections, as USAID's strategy for private enterprise is described.

1. King.

E. STRATEGY

1. Objectives.- The primary objective of AID's private enterprise strategy in Kenya is to promote the growth of the economy through private enterprise. This growth should not be based on short-term policies but should be sustainable in the long run. The strategy proposed embodies AID's assessment of the steps most likely to produce sustainable growth in Kenya, and of its own ability to provide meaningful assistance.

In keeping with the two challenges outlined in the previous sections, the overall goal implies that several more specific objectives should guide the strategy.

- First, AID will seek to promote a policy environment conducive to long-term, self-sustaining growth. It will continue to press for government policies that do not distort prices or stifle incentives. In short, USAID will seek to promote policies that allow private markets to operate more freely.

- Second, AID will seek to help overcome the constraints to growth that are the natural result of Kenya's current economic status, including small domestic market, inadequacies of local inputs, lack of managerial and entrepreneurial skills, incomplete adaptation of technology and shortages of investment finance. The aim is to help create the endowment base within Kenya that can support continued and accelerated growth.

These first two points are the keys to USAID's private sector strategy.

In pursuing these objectives we will promote investments with the characteristics of labor-intensity, use of local resources and foreign exchange earning or saving potential. We believe these to be the high potential areas of growth for Kenya; they use what Kenya has most of and conserve scarce items. As government policies are increasingly reoriented in the directions outlined above, these will be the industries best suited to survive. During the transition, many more such industries will have to be born, and this will have to occur smoothly to absorb the effects of closure among some of the less efficient existing industries. While the economy should turn toward labor-intensive and local resource-based and export industries naturally if market incentives are given, it will be desirable to help ease the transition by developing such industries in the near term. USAID's strategy will be more directed at improving markets than at choosing specific industries. However, to the extent that projects require selectivity, the directions above are those we will favor.

Finally, several other characteristics will be helpful in promoting self-sustaining growth. More growth is needed in the provincial towns and rural areas, that are closer to the supply of labor and can help bring more Kenyans into the modern economy. This continues to be a high priority for the GOK. More growth is needed among small and medium sized businesses, because they are sources of replicable innovation, managerial training and economic diversity. Ownership and management of enterprises by indigenous Kenyans is also a positive characteristic. Not only is this a long-standing goal of the GOK, it is also necessary for private sector growth, because non-indigenous sectors of the population are too small to supply the needed increase in owners and managers. None of these three attributes are exclusive: urban, large or foreign-owned firms all will continue to play important roles in Kenya's growth. In our strategy, a focus on small, rural or indigenous firms will be a matter of emphasis rather than exclusively.

It is AID's expectation that Kenya as a whole will benefit from the private enterprise programs and projects through faster and steadier economic growth. Improvement in economic growth rates can have multiplier effects, and can spread benefits throughout the nation. One of the most important results of such growth will be additional employment opportunities. The strategy is diverse enough that it should result in increased employment at a wide variety of skill levels. For example, programs that help develop agribusiness, a target area, will not only employ factory workers, but also the producers of agriculture products used as inputs, that is, farmers. The owners of small scale and informal sector enterprises, especially in rural areas will also benefit from the targeting of assistance towards them. Finally, GOK will benefit if the private sector grows, in the form of higher tax revenues. If GOK embraces free-market principles, it should also be able to lessen its own burden of administration in areas such as price controls.

It is important to note the nature of the linkage between the two main objectives of the strategy, to promote reorientation of government policy toward the private sector and to help Kenya improve its resource base. In Kenya's mixed economy the private sector is allowed to operate relatively freely, at least by comparison with many more thoroughly planned economies. Government policies set limits on private incentives, but do not completely override them. In this setting, growth can be encouraged by improving the endowment directly - in management, technology and the like - even if current government policies are unchanged. However, if policy changes of the types described here are carried out, the same improvements in the resource base are likely to yield greater returns, because they would take place in an environment that provided stronger growth incentives. In other words, the second objective of USAID's private enterprise strategy can be pursued even if progress on the first proceeds slowly, but the best results will come from successful progress in both areas.

2. AID Resources. In seeking to respond to the problems, needs and opportunities identified in the previous sections, AID possesses a specific set of capabilities and does not possess others. It must direct its assistance towards areas that are both important to Kenya and within its own realm of competence. At the same time, it must acknowledge that the overall levels of assistance it can supply are limited, and are in fact quite small when compared to Kenya's private sector as a whole. This means that AID must deploy its resources where they will have greatest effect.

It quickly becomes clear that AID's ability to relieve the constraints posed by government policy will be limited and indirect. AID has traditionally used its program assistance as the main vehicle for dialogue with GOK on policy issues. In the efforts to support structural adjustment in the Kenyan economy it has worked closely with other donor agencies, including the International Monetary Fund and the World Bank, to establish a coordinated agenda for change. The items on that agenda that relate to the private sector are similar to those discussed above as policy changes needed. They include macroeconomic policies, improving import policies, export promotion, and increasing private sector participation in agricultural input supply and grain marketing.

The structural adjustment program has met with mixed success. The record suggests that GOK is willing to move only slowly when policy changes require institutional reorientation. The most successful area has been macroeconomics; real interest rates are now positive and exchange rates realistic. Areas of some progress include rationalization of the import regime and its administration and private involvement in agricultural input supply. Efforts to improve export incentives and to allow private involvement in grain marketing have as yet shown no results.

For the near future this list of priorities will continue to lead the structural adjustment agenda. GOK will be asked to maintain the progress it has already made and to move forward. AID will provide technical assistance where needed. AID will keep its efforts coordinated with those of the other donors.

Policy change will also be sought through individual AID projects. Projects in the areas of finance, exports and investment promotion will have strong policy change emphases. Particular attention will be given to priorities already expressed by GOK, such as improving financial system operations (See below).

Beyond policy changes, the constraints and opportunities of Kenya's current economic endowment remain. These are the areas that will receive most of AID's project resources. Some aspects of the endowment, such as natural resources, climate and location are not subject to change by any means. Others, including small domestic market and problems with local inputs can be addressed only very slowly, primarily as consequences of economic growth in general. Thus, AID's project resources will be concentrated in the final three constraint areas: managerial and entrepreneurial skills, technology adaptation and investment finance. In addition, AID projects will be directed at the areas of opportunity identified: agribusiness, small manufacturing, exports and the informal sector. Specific projects are directed at exports and the informal sector. Agribusiness and small manufacturing will be afforded high priority within several of the project areas.

Thus, AID's private enterprise strategy does not address all of the challenges facing Kenya, nor does it address all selected targets through project assistance. Rather, it focuses its assistance according to priority of need, potential for benefit and ability of AID to contribute.

The principle of involving the private sector in AID project activities will guide future project design in all areas, not only those described below. Because of the important position of agriculture in Kenya's private sector, this will be a particularly important principle for the design of future agriculture projects such as agricultural research and extension. While considering specific interventions described in the next section, it is important to keep in mind this broader implication of the strategy.

3. Operating Principles. Several principles will guide the development of projects arising from the private enterprise strategy. These are derived both from AID's diagnosis of needs and from the lessons learned in previous and on-going AID projects.

The first set of principles involve AID's intention to work directly with and through private enterprises whenever possible, rather than through Government entities. This aim is consistent with directives given in AID's worldwide policy paper, "Private Enterprise Development". In working through private firms, certain guidelines will be followed, and these are also implicit or stated in the general AID policy. First, investments will not be subsidized. It is important that any investment in an enterprise funded as a result of an AID project be able to survive on its own merits. However, AID is willing to provide grant funds for associated services, such as feasibility studies, training or technical assistance to help give the project as good a chance as possible. Compatible with this is AID's intent to allocate services by demonstrated demand whenever possible and to require at least some contribution by recipients to the costs of any service it provides. Also, AID will seek projects that have the potential to support themselves eventually and that can be replicated. This principle will naturally involve AID in helping institutions to develop into stronger, more independent entities.

Projects will be designed flexibly, so that they can adapt to new information about specific needs and opportunities as they progress. Such flexibility is already embodied in the design of the Rural Private Enterprise project. Under that project, AID can select institutions to act as lenders whenever a promising lender is identified.

A second set of principles involve coordination with other important institutions: GOK, business leaders and other donors. In carrying out the private enterprise initiatives the support of the Government of Kenya will be essential. Not only is the GOK responsible for maintaining the current positive macroeconomic setting, but further progress will also depend on its reorientation of basic policies and government institutions towards reliance on markets and market prices. Moreover, though most of the projects outlined above work directly with private institutions, Government support is almost always important in obtaining satisfactory operational progress. Therefore, in addition to the specific policy items outlined above, AID will work closely with GOK officials to explain the intentions and reasons behind its stress on the private sector, and to learn more about the areas of congruence in aims. It will seek to develop a stronger constituency for private enterprise initiatives within the Government.

Similarly, constituencies will be sought among private sector representatives. AID needs the guidance of those most closely involved in private enterprises, the business leaders themselves. The cooperation of many private sector institutions will be required to design and implement the projects AID is proposing. Moreover, the long run interests of economic growth will be served by the development of a more active, vocal private sector that can take joint action and speak before the GOK on the common concerns of business in Kenya.

The development of a dialogue on private enterprise issues with other donors will also be stressed. Several donors have expressed interest in increasing their private sector activities or in adopting new approaches. This would be a positive step, as most industrial assistance in the past has been heavily Government-directed. It has been allocated either directly to Government-sponsored projects or through the development banks. In this way, some donors have been instrumental in the implementation of the focus on large, import substitution enterprises that now characterizes the manufacturing sector. USAID endorses the need for donors to continue their assistance to Kenyan industry in such a way that it becomes more consistent with structural adjustment goals, such as those outlined earlier. The goals of such adjustment are shared by a large portion of the donor community. We will engage in discussions to share information on various approaches, to ensure that activities that encourage the private sector in Kenya are compatible, and that other activities do not inadvertently undercut private ventures. Donors that have shown an intent to pursue private enterprise development include the International Finance Company, World Bank and Canadian International Development Agency. West German agencies have particular expertise in small scale and informal enterprises.

F. COMPONENTS OF THE STRATEGY

This section describes components of AID's private enterprise strategy, focusing on both current and planned projects. Activities to be guided by the strategy cover six target areas: 1) finance, 2) management and entrepreneurship, 3) technology and technical skills, 4) the informal sector, 5) exports and 6) investment promotion. The first three target areas address constraints to growth, while the last three are directed more at high potential sectors. Several projects falling mainly in one area may have a beneficial impact in one or more of the other areas as well. Most of the areas involve one or more important policy issues as well.

1. Finance. The financial sector in Kenya was identified as needing sources of and mechanisms for investment capital, that is, term credit and equity.

AID's Rural Private Enterprise (RPE) project addresses the need for term credit. It encourages commercial banks to make loans of three to eight year maturity to smaller firms in rural areas and to agribusinesses. It does this by supplying a long term source of local currency, allowing banks a spread sufficient to cover excess costs, and providing them with technical assistance in developing the loan program and evaluating loan applicants.

The project will make $24 million in loan funds available and is expected to continue through 1989. It is hoped both that a significant number of enterprises will be reached, and that the banks will become more positively oriented towards term lending, especially in rural areas.

At present USAID is negotiating with several non-bank financial institutions over the possibility that they will become intermediaries under the program. This would widen the potential for the program to affect lending practices of private lenders in the provision of project finance.

As part of the Rural Private Enterprise Project, USAID is also negotiating with the GOK to set up a discount facility in the Central Bank. This facility would use the reflows from loan repayments from banks to the GOK as its main source of funds. Participating financial institutions would be able to draw from the facility amounts equal to their loans under RPE, thus gaining access to double the amount of funds for lending. Eligibility for loans made under the discount facility will be broader than under the primary RPE project. Because of the delay between establishment of the discount facility and the accumulation of reflows from the private lenders, an initial capitalization will be needed. This will be provided by using some of AID's counterpart funds in local currency.

In the area of credit, a few issues still remain that the RPE program does not address. One of these is collateral. The heavy reliance on collateral as the basis for lending was identified above as creating an inefficiency in the use of credit resources. It makes access to adequate amounts of credit difficult for many, especially smaller firms. To relieve this constraint for small firms, AID will develop a loan guarantee program, using counterpart funds. The guarantee will be aimed specifically at inducing banks to lower collateral requirements; to rely more on assets other than land; and to use expected performance as the most important basis for lending. Banks and a guarantee fund established by AID will share the risks. The collateral problem affects both short and longer term credit; therefore, the guarantee will be available for either.

Agricultural credit is another need not currently covered under the RPE project. The need for term credit is clear. Eventually the discount facility created through the RPE project will be able to handle term agricultural loans. However, in the facility's initial years as funds are accumulating it may be advisable for AID to capitalize a parallel discount facility designated for agricultural lending.

Debt is not the only type of finance needed in Kenya; additional sources of equity are also required. One of th major components of the 1987 private enterprise project will be the development of a venture capital firm. Such a firm would identify promising new projects or expansions among locally-owned firms, and would develop financing packages consisting of both equity and debt. The venture capital firm would take an equity stake in any new investment it sponsored and would also be a conduit for funds from other investors. Because of the shareholder position of a venture capital firm, it has both rights and interests in how the firm is managed. A venture capital company is therefore a good vehicle for provision of managerial and technical assistance in a setting where advice is seriously given and seriously considered.

There is a great deal still unknown and untried about whether and how to adapt the venture capital model prevalent in the United States to conditions in Kenya. Questions include, for example: how to locate equity investors, what effect the recent abolition of capital gains taxation would have, and how Kenya's relatively closed stock market would affect the design of a venture capital company. At present, only one venture capital firm, Investment Promotion Services, operates in Kenya. It will be the source of much information, and has already expressed interest in working with AID on such a project. Other private financial institutions will also be sought as partners. Before proceeding, USAID will commission a study on how best to develop such a source of equity in Kenya.

In the final analysis, the continued stability and development of the financial system will be one of the most important assurances that the system will promote economic growth. For that reason, in its policy dialogue, AID will continue to stress the need for positive real rates of interest and restraint in government absorption of credit resources. The GOK has commissioned several studies on improving the financial system. Topics include reform of the stock market and money market, deposit insurance and regulation of financial institutions. These studies have all been completed, and the GOK is now contemplating the steps it will take to implement some of the recommendations. AID believes these efforts to be important and will support them in whatever way proves most desirable.

2. Management and Entrepreneurship. It is widely accepted that there is a need in Kenya for better management in enterprises and for more entrepreneurs who know the requirements for starting and building a business. In particular, the need described in our interviews was not so much for individual skills such as accounting, but for an

understanding of the value of good management, that is, for more positive entrepreneurial attitudes both at the top and at other levels within firms. The spread of entrepreneurial attitudes should be seen not only as a condition for faster economic growth generally, but also as a condition for increasing the participation of Africans as owners and managers throughout the private sector.

One method is to help existing firms improve their management. That approach will be followed in the Agricultural Management Project, now awaiting final GOK approval. The project will create a management consulting team that will assess the need for management changes in firms that request assistance. It will then assemble technical assistance and implement staff training to solve the particular problems identified. Firms involved in agriculture, agro-processing or agricultural services will be eligible. Half of them will be private. An important principle guides the project: entities needing services should demonstrate a willingness to assume responsibility for a substantial proportion of costs. This assures that assistance will go to firms that recognize the value of assistance, and it will give recipients greater incentives to make use of the assistance, once provided.

Another method for increasing managerial and entrepreneurial skills is to train individuals. This can be done through financial support for those wishing to study, by direct support to training institutions or through special entrepreneurial development programs. AID is now beginning to plan a Training for Development project. As currently envisioned, individuals already working (half in public, half in private sectors) will receive specialized training relating to their jobs. In many cases, this will involve technical skills as well as business skills (see below). As now planned, the training will take place in both Kenya and the United States.

As part of the planning for this aspect of the project, AID will review the status of management and technical training institutes in Kenya to assess the capability and quality of each. It will then decide which institutes to use as sources for training, and whether to supplement individual training with support for the further development of the institutions themselves. Such support for further development could either fall wholly within the framework of the Training for Development Project, or could be included as a component of the Private Enterprise Development Project planned to begin in fiscal year 1987. This will be determined as planning proceeds.

In order to address the issue of entrepreneurial attitudes more clearly, AID will include an entrepreneurial development component in the 1987 private enterprise project. One form this component might take would give young Kenyans operational experience in business, thereby teaching the requirements for business success in a structured setting. Possible models for such projects include Junior Achievement, a business incubator, or an internship project. Each of these projects would best be implemented in conjunction with an existing Kenyan business education program, such as at the University of Nairobi. One of the tasks of the review of existing Kenyan institutions will be to assess the suitability of such institutions as the location of an entrepreneurial development effort. Alternatively the entrepreneurship component could involve the creation of a center for entrepreneurial development, whose target would be owners and managers of new and existing businesses.

3. Technology and Technical Skills. Lack of full integration of technology into an economy results in slow growth and innovation among indigenous industry, dependence on foreign firms for technological advances and perhaps even a tendency to select technologies that require a smaller and lower skilled labor force than would otherwise be used. The development of technology and technological skills proceeds similarly to that of management and entrepreneurship; learning occurs both through training and education outside the workplace and within enterprises.

AID's approach to technology development will likewise be twofold. First, it will fund the International Executive Service Corps (IESC), which transfers the technological expertise of retired U.S. executives to help solve problems in local firms. IESC locates an executive experienced in the same industry as that of the firm that has requested assistance, and pays his expenses during a consultancy with the Kenyan firm. The Kenyan firm in turn pays IESC a share of expenses. The IESC program already exists in Kenya. AID funding, which will be given through counterpart monies in local currency, will help expand the number of consultancies and lower their price to Kenyan firms. In training, AID will support individuals to study in the U.S. and Kenya and will give assistance to selected technical training institutes in Kenya, partly through the Training for Development Project.

One additional aspect of technology development will occur through the Agricultural Research and Education Project. Technological adaptation is as essential in agriculture as it is in industry. A portion of the agricultural research the project will support will be directed at the development of crops and techniques for agro-processing.

Finally, several other projects, including venture capital, export promotion and investment promotion, are likely to make significant contributions to technology transfer.

4. Exports. The importance for Kenya of developing export industries has been stressed throughout this strategy statement. Export industries, particularly in an economy dominated by a few traditional exports, require a long and careful planning process, because the import, transport and marketing problems confronting them are more challenging than they are for domestically oriented industries. At this stage, Kenya needs to lay the groundwork for the growth of export industries. That groundwork includes appropriate incentives (or lack of disincentives) for exporting, a smooth export approval process, development of marketing links, solution of transport and handling problems, and financial services to meet the specialized needs of export transactions. A few of these facets of export development are tasks for the Government. Most are best undertaken by the private sector.

Export promotion and finance will be one of the cornerstones of AID's 1987 Private Enterprise Development Project. The project will, for the most part, work through private institutions, but an important aspect will be dialogue with the GOK on improving the policy environment for exports. In addition to pressing for a smoother export approval process, AID will urge development of a mechanism to overcome the disadvantage to exporters caused by import duties on inputs and machinery. This could be improvement in the administration of the export compensation scheme, a system of duty drawbacks, the establishment of manufacturing in bond, or a free trade zone.

The financial side of the export project will address, among others things, the problem that exporters can now receive credit only if they have sufficient collateral capacity in traditional forms, such as land. However, in much of the world, export industries need and receive preparatory short term credit to enable them to produce for specific orders. A direct solution is to devise a bills discounting system whereby firm orders from purchasers can become the basis for obtaining short term credit. It is possible that a bills discounting system would be funded in Kenya shillings from AID's counterpart funds.

The promotional aspect of the export project will have several parts. Information for exporters and purchasers will be developed that will cover technical aspects of production and costs, production capacity in Kenya, competitors in other countries, worldwide demand, and prospective purchasers. AID will work to involve current purchasers of Kenyan products in efforts to expand, improve and diversify those products. It will also seek to address common problems exporters face, such as transport. One key question will be the institutional mechanism to use in providing this assistance. The development of an export trading company will be considered.

The export project will place a strong emphasis on agribusiness industries, particularly horticulture. These industries have been identified as having the greatest export potential for Kenya. As the project is developed, first priority will be given to the needs of this sector.

USAID/Kenya is new to export promotion, though AID worldwide is well experienced. Therefore, the first step will be a review of AID activities in export promotion in other countries. Additional study will be needed to adapt such experiences to Kenya.

5. Investment Promotion. Government policies and attitudes can have a crucial impact on whether investors, both at home and abroad, will perceive Kenya as a promising place to invest. A responsive policy framework can help bring foreign capital into Kenya and can persuade owners of local capital to make use of it within the country. The investment promotion component of the private enterprise strategy seeks to help the GOK attract more investment to Kenya.

Under the strategy USAID will provide assistance to the GOK's Investment Advisory and Promotion Center (IAPC) and other similar groups to develop an active investment promotion effort. This may involve the provision of staff, either to carry out specific studies or as longer term contractors. One of the outputs will be an improved body of useful information for prospective investors. Another goal will be to streamline GOK's now confusing network of approvals required of prospective investors, particularly foreign ones. AID may help identify U.S. firms interested in investing in Kenya or starting a joint venture with Kenyan firms. Selection of such firms will be in keeping with the goals of reorienting growth in Kenya. By the very nature of contacts with foreign firms, the potential for export joint-ventures should be particularly important.

Another task will be a review of Kenya's 'investment code', the legislation affecting investors, particularly foreign. Particular problems with current legislation include items such as restrictions on local borrowing and timing of repatriation of profits. Investors are also concerned about the import and export regimes. An effort to review the legislation is now beginning, with participation from several Government agencies as well as AID.

The success of an investment promotion effort is highly dependent on supportive macroeconomic policies. Continued realistic exchange rates, positive real interest rates and political and economic stability are necessary for persuading investors to put funds into Kenya. Therefore, policy dialogue on these subjects will be an important aspect of investment promotion. The improvement of the import regime is also of crucial importance. USAID is now funding a study, to be completed in 1986, on current effective rates of protection of Kenyan industries. The GOK has stated a willingness to use the results of that study as an empirical basis for revising import duties and quantitative restrictions. Furthermore, it is hoped that as IAPC develops, it will become an effective advocate within Government for policies favorable to the private sector. Support to IAPC and review of the investment code will begin shortly, using both counterpart funds and funds for studies. It is anticipated that support to investment promotion will also be an important component of the 1987 project.

6. The Informal Sector. The smaller enterprises in Kenya have as much potential to grow as do larger enterprises, and they tend to have other particularly beneficial characteristics. They use abundant local labor and locally-supportable technologies. They are an important source of managerial and entrepreneurial training for Kenyans, some of whom will go on to run larger enterprises. Thus, AID's assistance to the informal sector can be regarded in part as a way of approaching the managerial and entrepreneurial training needs of Kenya. Such assistance gives more people the chances they need to learn business strategies by first-hand experience. The smaller enterprises are also relatively efficient producers, because, in general, they benefit very little from the special protection afforded to larger firms by the Government. One of the most important characteristics of informal sector enterprises is that they lack access to most business support services, especially credit. Therefore, they need particularly intensive and specially designed assistance.

AID is now directing a major effort to help informal sector enterprises grow, through the informal sector component of the Rural Private Enterprise Project. This project, administered by World Education International, provides grants and technical assistance to private voluntary organizations (PVOs) that serve the informal sector in their enterprise development programs. The PVOs in turn provide technical assistance and in some cases credit to very small enterprises in rural areas. Where possible, assistance is directed towards the more productive of such enterprises, such as those in manufacturing and repair.

World Education, under AID sponsorship, is now investigating ways to link informal sector enterprises to more formal sources of credit as a means of increasing the overall flow of credit into the sector. Loan guarantees are one possible mechanism, though not the only one, being considered. The results of this study will assist AID in developing follow-on assistance to informal sector enterprises, which will be a part of the 1987 Private Enterprise Development Project.

Cooperatives and savings and credit societies are another potential means of reaching informal sector enterprises. These societies have a significant proportion, estimated at 25 percent, of all domestic savings in the financial system.[1] They have the advantages of member participation and wide coverage. However, they have usually focused on personal rather than business loans and have also suffered accountability problems. AID has commissioned Technoserve, Inc. to study the potential for using the cooperatives and societies as financial intermediaries for informal sector enterprises. After analyzing that report, AID will decide how best to work with these organizations.

G. IMPLEMENTATION

1. Mechanisms for Assistance. The private enterprise strategy will provide guidelines for a wide variety of USAID's activities, as evidenced by the broad coverage of its components. This section views the activities described in the previous section, using the organizing framework of project activities rather than functional sectors. Some of the activities already exist; others are being planned. To view the strategy as a whole, both must be considered. The existing projects represent a significant portion of the total strategy, and also provide a base of experience that will be useful in designing future activities.

The strategy involves three major new activities, programming of local counterpart funds reserved for private sector projects, the Training for Development Project and the 1987 Private Enterprise Development Project. This section shows how the project ideas that were described in the previous section as strategy components will be applied to several existing and future projects.

The AID strategy begins with the existing Rural Private Enterprise Project (RPE), which has two parts. First, term credit to small and medium-sized firms in rural areas or agribusiness is provided through private financial institutions. Second, grants and technical assistance are given to private voluntary organizations working with informal sector enterprises.

1. Technoserve, Inc. p. 105

The strategy extends to AID's new Agricultural Management Project, which is now awaiting GOK approval. This project would provide management assistance and training to entities involved in agriculture or agribusiness, half of which will be private firms. Thus, the Kenya private enterprise strategy that has developed as the result of earlier activities consists of a term credit, an informal sector and a managerial skills component. The remainder of its elements are yet to be designed.

AID and the GOK have designated a portion of the shilling reflows from other projects as counterpart funds for private sector uses. These funds will be programmed in accord with the strategy. The first set of local currency funds will begin to become available for use near the end of calendar year 1985. Additional funds will become available in each successive year. The amount reserved for private sector projects will depend in part on the success of the initial projects, as perceived both by GOK and by AID.

AID's access to local currency is an important asset in the design of private enterprise projects. Most donors have only foreign exchange. This requires that the borrowers in projects they finance assume foreign exchange risks, which investors in Kenya are loath to do. Another advantage of counterpart funds is that they can be programmed quickly and are therefore useful in the short run. Hence, they can provide an important way to maintain the momentum of the strategy, particularly as perceived by businessmen and government officials. Counterpart funds will be considered for the following purposes, all of which were described above.

- o Initial capitalization of a discount facility to provide term funds for private lending institutions,
- o Creation of a loan guarantee fund,
- o Technology transfer (through International Executive Service Corps), and
- o Agricultural credit.

Other uses will also be considered as opportunities arise.

Another activity under the strategy, the Training for Development Project, is due to begin in FY 1986. This project will train Kenyans, half of whom may be from the private sector, in specialized skills, both business and technical. As yet, the project is in the early planning stages.

The largest new activity to be guided by the private enterprise strategy will be USAID's Private Enterprise Development Project. This project, together with the RPE project, will be the core of AID's assistance to private enterprise. The project will cover several major areas and will begin in 1987. Design work will begin in July 1985. The 1987 project will have five components:

- Creation of a venture/equity capital firm,
- Export promotion and finance,
- Investment promotion,
- Informal sector assistance, and
- Technical and/or entrepreneurial training.

Each of these was discussed above. The content of the final two areas will be determined as the lessons from other projects in the same fields become apparent.

AID's program assistance will be guided by the strategy to the extent that it includes issues affecting the private sector. Through the whole period of coverage of this strategy statement, from 1985 to 1990, USAID will continue to press for government policies favorable to the private sector through its policy dialogue with GOK. Policy dialogue will be carried out through a combination of discussions, joint GOK-AID task forces, project conditionality and technical assistance. As stated above, items on the top of the agenda will be in the areas of macroeconomics, import liberalization, export promotion, and private participation in agricultural input supply and grain marketing. The specific content will be determined when Economic Support Fund assistance is planned, because most of the resources for policy dialogue will come from that source. It is recognized that while policy dialogue relating to the private sector will take a high priority, there are other policy issues of pressing importance, and all must be placed in strategic balance.

Finally, AID's Bureau for Private Enterprise, which has been instrumental in developing private sector projects in Kenya (investment in Leather Industries of Kenya and loans to Kenya Commercial Bank) will, it is hoped, continue to pursue such projects in selected areas, in accordance with the strategy.

2. Studies and Other Steps in Preparing Private Enterprise Projects. Planning for the portions of the private enterprise strategy that are not already prepared will begin in July 1985. In some areas enough background work has already been

done so that project implementation activities can begin right way. In others, however, studies will be carried out, generally with outside assistance. In addition, some of the projects themselves require studies to be commissioned as part of the project. Most of the local counterpart activities require relatively little further study. By contrast, the 1987 Private Enterprise Development Project will probably involve three or more studies. This section outlines the studies and other steps that need to be taken as the strategy develops.

Activities that Can Be Started without Additional Studies. Several of the uses for counterpart funds can be implemented fairly quickly, providing that GOK approval is forthcoming where needed. The Mission is already quite familiar with IESC, and therefore, extending a new source of funding for it will be straightforward.

A study has already been prepared on the subject of loan guarantees for collateral relief; it will provide the basis for development of a loan guarantee fund. The mechanism will have to be designed and decisions made about both target borrowers and participating lenders.

Support to IAPC can begin without any additional preliminary studies. Discussions have previously been held with IAPC staff, at which requests for assistance were made. Topics under study could include legislation and policy affecting the investment climate, the administration by GOK of investment approvals and the role of IAPC. If a study on investment promotion is undertaken for IAPC in a timely fashion, it can serve as the basis for design of the investment promotion component of the 1987 project.

World Education is now directing a study on linking informal sector enterprises to more formal sources of funds. The results of that study will be used in planning the informal sector component of the 1987 project. No other studies are contemplated, except as the need becomes apparent through the current review.

Under the RPE project, a study is being prepared by Technoserve, Inc. on the feasibility of using cooperatives or savings and credit societies as intermediaries for loans to small rural enterprises. When this study is presented, AID will have to decide what types of project activities will enable these entities to serve informal enterprises better.

AID can begin taking action right away in the crucial area of liaison with private sector representatives, other donors and GOK officials regarding the private enterprise strategy. In the case of the GOK, this action should be linked to a broader plan for policy dialogue. It can include discussions of areas of potential technical assistance, for example in capital market development. Further work is needed at USAID/Kenya to design objectives and tactics for the liaison activities.

Projects Requiring Studies Before Implementation. The 1986 training and 1987 private sector projects will require the completion of four background studies before design is finalized: institutional training capabilities, entrepreneurial development, equity capital and export promotion. The Training for Development Project and the training component of the 1987 Private Enterprise Development Project will be based in part on a survey of the existing training capacity in Kenya, both managerial and technical. A review of local training institutions will assess the quality of the institutions and will inventory the programs of instruction they provide. This survey will have three purposes. It will locate sources of in-country training for Training for Development participants. It will identify institutions that both need and can benefit from institutional support. Finally, it will evaluate institutions that provide management training as potential partners for USAID in establishing a practical entrepreneurial development program. A decision remains to be made as to whether to pursue entrepreneurial development as a separate activity with a separate study (e.g. on Junior Achievement).

The venture/equity capital component of the 1987 project will require a study, using external resources. The study will address financial and ownership structure, legal framework, investment identification and support, and potential co-investors. AID has little experience with venture capital. For this study it will be crucial to link experts familiar with venture capital operations in the U.S. and elsewhere together with someone knowledgeable about AID and Kenyan requirements.

The export promotion and finance component of the 1987 project will also require studies, as it is a new area for USAID/Kenya. A first step will be to review AID support to exports worldwide, where there is considerable experience on which to draw. A broader export promotion study will follow. It will include four components: 1. export finance: current practices, current deficiencies 2. government policies affecting exports and prospects for improvement (e.g., free trade zones) 3. potential for horticultural exports and steps to promote them; and 4. administrative mechanisms for AID provision of export promotion assistance.

USAID/Kenya will have to come to a decision in the next few months about whether to provide a line of credit for seasonal agricultural needs. At present, there is disagreement within the Mission concerning the need for such an activity. If it is decided to pursue it, a study may be needed before proceeding.

<u>Studies to be Undertaken as Part of Projects</u>. Information on selected industries will be prepared as part of both the export and investment promotion projects. Such information would include current production capabilities and potential in Kenya as well as market identification. The format of such studies and the target industries will be selected later. Horticultural crops are almost certain to be included.

For several of these studies, the assistance of AID/PRE will be sought, as that office already has significant experience in these areas.

APPENDIX

RESULTS OF INTERVIEWS WITH PRIVATE ENTERPRISE REPRESENTATIVES ON ACTIVITIES IN KENYA

To identify factors hindering growth of private sector activities in Kenya we interviewed 43 private sector representatives in Nairobi, Nakuru, Thika, Kisii and Kisumu. Interviews were distributed by sector and firm size as follows:

Sector	Small 1-50 Employees	Medium 51-100 Employees	Large 101 & Over Employees	Total
Agro-Processing	2	2	5	9
Manufacturing	5	1	5	11
Trading	3	2	-	5
Professional/Commercial Services	5	2	2	9
Finance	2	1	-	3
Parastatal Organization	1	1	1	3
Government	3	-	-	3
TOTAL	21	9	13	43

Potential for growth was cited by interviewees in almost all the sectors interviewed. A significant number of companies had expansion programs underway or being planned.

The major impediments to growth cited in the interviews were:

Finance

- Lack of short and long term credit
- Difficulty raising equity
- Interest rates too high
- Collateral requirements too stringent
- Poor regulation of financial institutions
- Stock market needs improvement.

Labor and Management

- Shortage of dedicated small scale enterprise, middle level and professional managers
- Shortage of skilled technical workers
- Lack of care, long range planning among managers
- Labor regulations too inflexible regarding lay offs
- Shortage of professional services.

Technology

- Frequent machine breakdown caused by improper usage or age
- Production hampered by stoppages caused by low quality local raw materials inputs
- Some machines too complicated for the Kenyan market
- No technical research and development done: multi-national companies only replicate what they have done elsewhere.

Import/Export

- Import duties too high
- Exports compensation scheme involves delays in payment up to eight months
- Export transport facilities limited for horticultural products.

Foreign Investment Climate

- Limitation on local borrowing a burden
- Difficulty getting work permits
- Long wait on repatriation of profits
- Investment code needs changing
- Information needed for prospective investors.

Government Policies, not already cited

- Price controls
- Taxes
- Marketing through parastatals
- Delayed payment on GOK contracts
- Inconsistent treatment of industries--favoritism
- Bureaucratic inefficiency.

Other factors also mentioned

- Local inputs: quality poor or supply inadequate
- Markets too small to support industry
- Local transport problems
- Too much foreign influence in economy
- Quality standards needed
- Too few investment ideas
- Little adaptation of technology
- Infrastructure a problem outside Nairobi and Mombasa.

Of the above-listed items, those cited with greatest frequency or vehemence were these:

1. Import duties are too high and import licensing too restricted.
2. Export compensation scheme is inefficient.
3. Interest rates are too high.
4. Long term credit is lacking.
5. Collateral requirements are too stringent.
6. Management and technical skills are lacking.
7. Investment 'code' needs overhaul.
8. Price controls are burdensome.
9. Quality and supply of local inputs are poor.

Project Ideas for USAID Involvement

Suggestions were made during the interviews on how USAID can provide assistance to private enterprise in Kenya. Here are a few of the suggestions:

- Assist in identifying appropriate technology for use in Kenya.
- Provide business advisory services to make enterprise owners aware of credit usage and availability.
- Set up more loans with softer terms and flexible collateral requirements.
- Influence GOK to set clear industrial investment Policy in the rural areas, with incentives.
- Support development of small business entities in Kenya.
- Continue policy dialogue with GOK to expand private activities and lower interest rate.
- Fund projects which mobilize domestic resources to create more jobs.

- Provide grants to improve horticultural extension services.

- Confine activities to areas where indigenous Kenyans will benefit most.

- Influence GOK to plan long term and care about quality.

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