
SUMMARY OF FINANCIAL MARKETS IN KENYA: SECONDARY SOURCE SURVEY

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NOTE

This document was prepared by Arthur Young and summarizes existing literature describing the country. Secondary sources were obtained from the International Monetary Fund, the World Bank, the Inter-American Development Bank, the African Development Bank, the Asian Development Bank, the United Nations, and other relevant commercial sources.

KENYA

SUMMARY OF FINANCIAL MARKETS

A. ENVIRONMENT

1. Political climate

Kenya has had a very stable political history since achieving independence in 1963. Jomo Kenyatta spearheaded the independence movement, and led the country until his death in 1978. Kenyatta's vice president, Daniel Arap Moi, assumed power upon Kenyatta's death, and continues to lead the country today. Lacking Kenyatta's charisma and ability to unite a very diverse population, Moi has relied increasingly on coercive measures to hold power; for instance the Kenya African National Union (KANU) is now the only legal political party, and opponents have been imprisoned without charges. Unrest has been minimal, however: there has been only one coup which was implemented by the air force in 1982 and was easily contained by Moi; the only major unrest has been in the form of protests from the University of Nairobi.

2. Economic climate

Kenya's economy prospered during the first decade after independence. The economy has since slowed, with the exception of two boom periods: 1) in 1977-78 Brazil's coffee crop failed, resulting in high demand for Kenyan coffee which is of similar quality; and, 2) in 1983-84 increased tea prices created a mini-boom until the 1984 drought stunted crop production.

The main causes of Kenya's slump are reduced import substitution opportunities; imported oil price increases; increased interest rates on external debt; the collapse of the East African Community (EAC) and resulting loss of Tanzania as a major market for manufactures; and a heavy reliance on agriculture (33% of GDP and over 40% of foreign exchange earnings in 1982) in a country where only 15% of the land is arable (one third of that has only moderate agricultural potential) and rainfall is unreliable.

Kenya's economy has not yet recovered from the failure of the 1979 maize crop (the country's staple food), when food reserves fell below one month's needs. The 1984 drought has made recovery more difficult.

Prospects for recovery from the slump look good; international oil prices have plummeted, and tea and coffee (which account for approximately half of total export revenues) prices are at all-time highs. The futures market predicts that coffee prices will reach \$2.50 per pound by July, 1986.

3. Social climate

a. Ethnic and regional diversity

The Kenyan population is quite diverse. The African population (approximately 99% of total population) consists of 30-40 ethnic groups or tribes; even more languages are spoken. The Kenyan social order is defined by tribal ties to such an extent that all social, economic and political relations occur with respect to ethnic group. The lack of cohesiveness between ethnic groups has undermined social and political stability. Experience with self-governance has resulted in a national identity; recent political developments indicate decisions are being based more on national need than tribal alliance.

b. Distribution of wealth and power

There is an extreme disparity in the distribution of wealth and power. In 1976, 30% of the population earned less than 9% of total income. Currently, the Asian community (less than 1% of the population) controls 55% of industry and 90% of commerce. Although there are about 1.2 million smallholders who are successful in growing export crops, land redistribution programs since independence have failed; most large estates were merely transferred in full to wealthy blacks.

4. International assistance
Kenya receives substantial foreign assistance.

Countries: Denmark United Kingdom
Finland United States
Japan West Germany
Netherlands

Organizations: African Development Bank
Arab Bank for Economic
Development in Africa
Arab League
Badea
Commonwealth
EEC
GATT
IDA
ILO
IMF
OAU
UN
WHO
World Bank

B. ECONOMY

1. Parastatals
GOK involvement in the economy has increased since independence, primarily through the growth of parastatals. In 1982 there were 323 parastatals:
 - * 147 statutory boards
 - * 47 fully government owned companies
 - * 36 with majority government holdings
 - * 93 where GOK held minority interest

The parastatals have varied in the success of their operations. Since the early 1980s, parastatals have become an increasing drain on government coffers. In 1982 President Moi initiated a review of the growing public sector and use of investment funds, stating that many parastatals were inefficiently operated, and would be more profitable if run by the private sector.

2. Balance of trade
Kenya has maintained a consistently positive trade balance with its African trade partners; with the rest of the world, however, the deficit has steadily increased since 1974. The trade deficit has been caused primarily by the high costs of imported oil; the situation was aggravated by the need to drastically increase food imports after the 1984 drought. The current low and dropping international market price for oil, combined with increasing prices for Kenya's major exports, tea and coffee, should improve Kenya's trade position considerably.
3. In 1984, sectoral shares of GDP were broken down as follows:

Traditional Economy	5.8%
Monetary Economy	77.4%
Private Households	1.2%
Government Services	15.6%

4. Public debt
Kenya's external debt more than trebled between 1980 and 1984 (see graph.) This increase plus the depreciation of the Kenyan Shilling against other international currencies have caused Kenya's debt service charges to rise from KSh1.36 billion in 1980 to KSh5.18 billion in 1984, a serious drain on GOK revenues.

5. Manufacturing sector
 Kenya is the most industrially developed country in East Africa, and yet manufacturing accounts for only 13% of GDP. Kenya's industrial sector has been financed, in large part, by foreign capital. According to one 1972 estimate, 42% of total issued capital of large scale manufacturing and service firms was owned by foreign residents, and a further one third was controlled by foreigners.

6. Labor force analysis
 Population: 19.5 million (mid-1984)
 Population growth rate: approximately 4%
 Literacy: Males over age 15 ~ 65%
 Females over age 15 ~ 35%
 Unemployment rate: approximately 30% (1985)

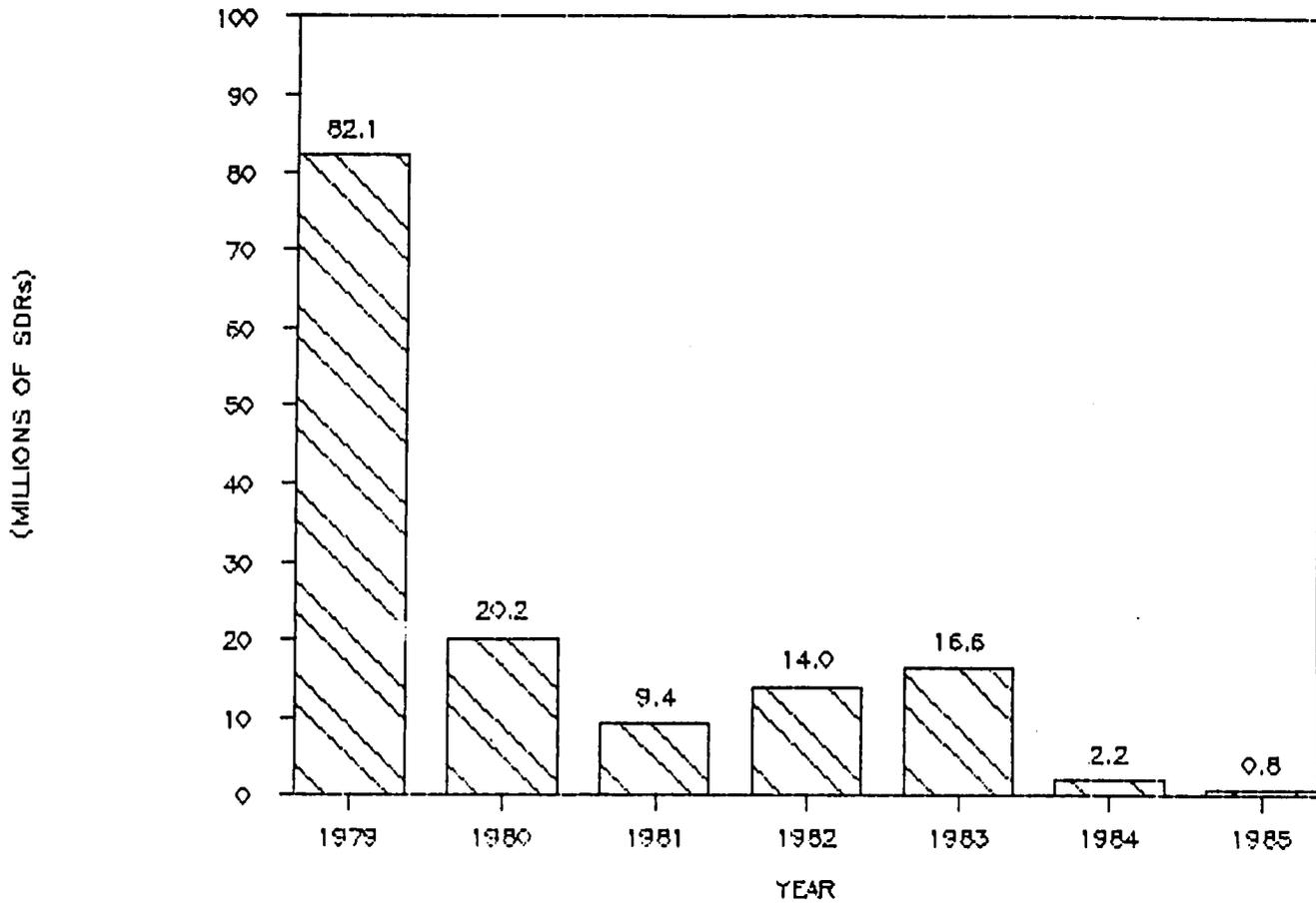
a. Overpopulation
 With the highest population growth rate in the world, overpopulation is a serious problem in Kenya. Improved health and sanitation has caused the infant mortality rate to fall. Because the birth rate has not fallen accordingly, Kenya has an extremely large young population - 48.5% of the population was under the age of 15 according to the 1979 census. Thus, the proportion of the population typically considered dependents exceeds that of the working force. Overpopulation is also a problem because wage employment in modern establishments is expanding at a much lower rate than is the labor force.

b. As indicated in the table below, the informal sector has grown steadily since 1981:

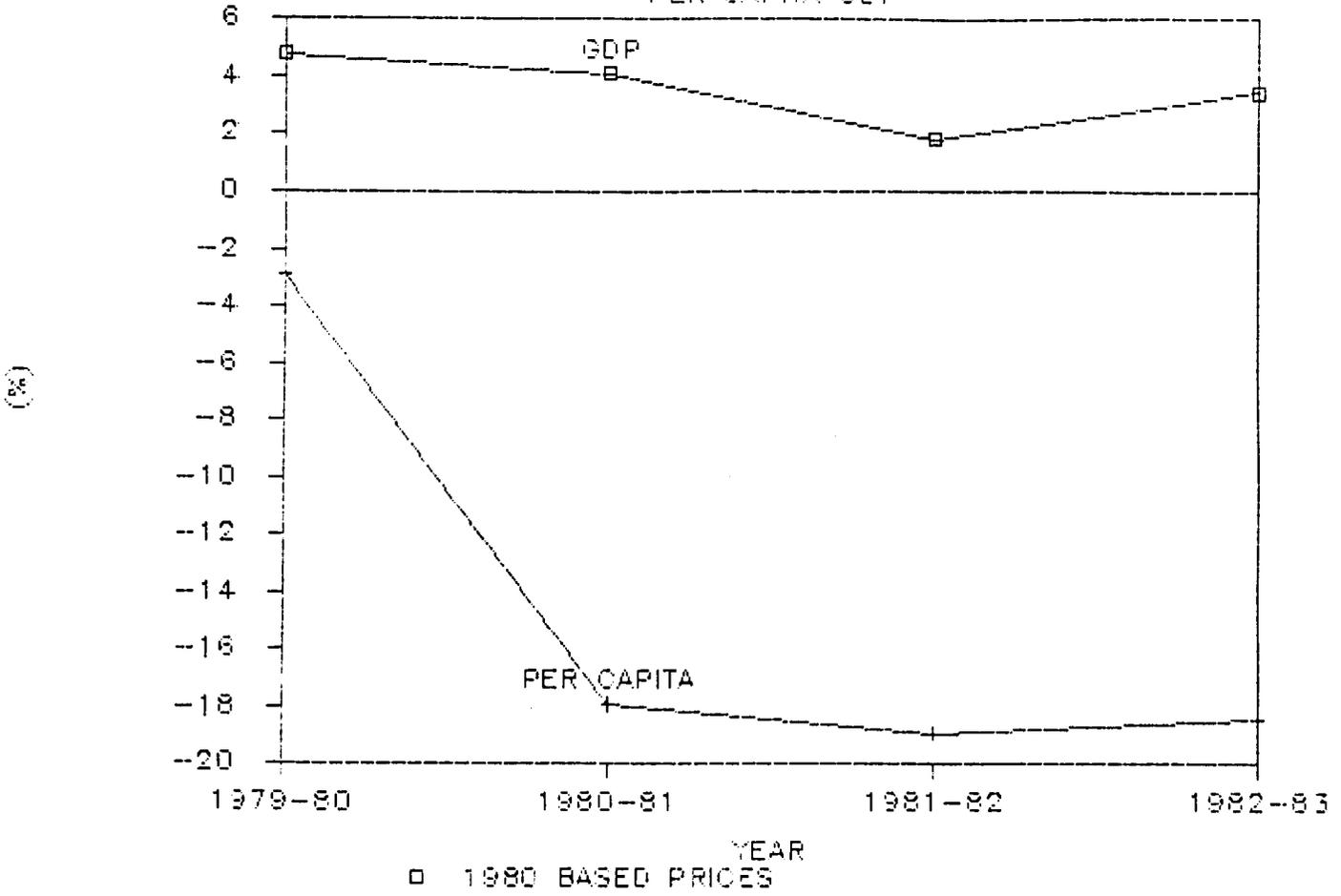
	Percent Employed			
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
Wage Employees (Urban & Rural)	82.4	81.7	81.6	82.9
Self-Employed	5.0	4.9	4.7	2.4
Urban Informal Sector	12.6	13.4	13.7	14.7

6. IMF Standby Agreement signed February, 1985 allowed Kenya to draw upon SDR 85.2 million during the 12-month period to February, 1986. The Agreement required GOK to reduce the public deficit from 10% to 5% of GDP; this goal was achieved.

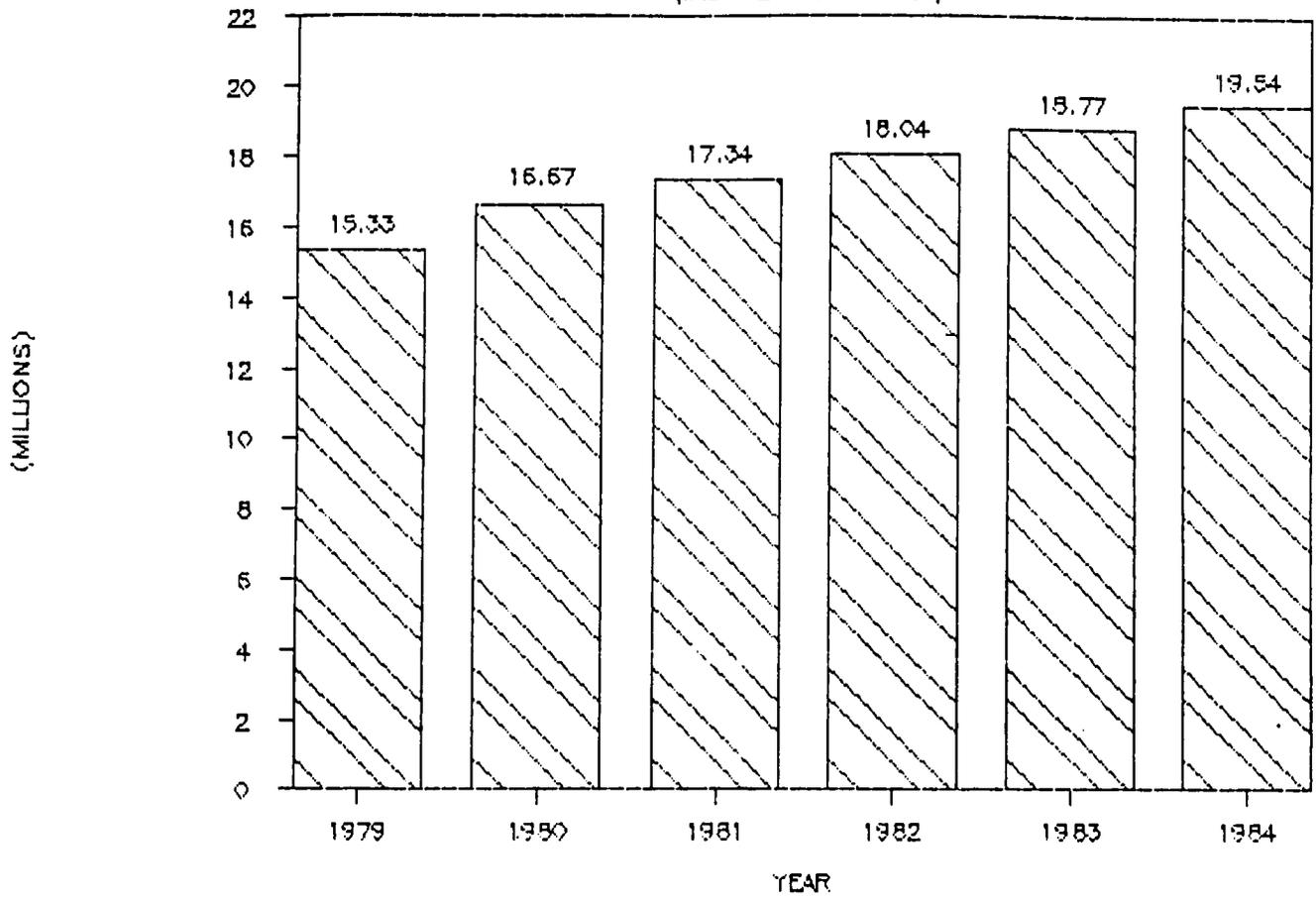
IMF SPECIAL DRAWING RIGHTS



PERCENTAGE CHANGE FOR GDP AND PER CAPITA GDP

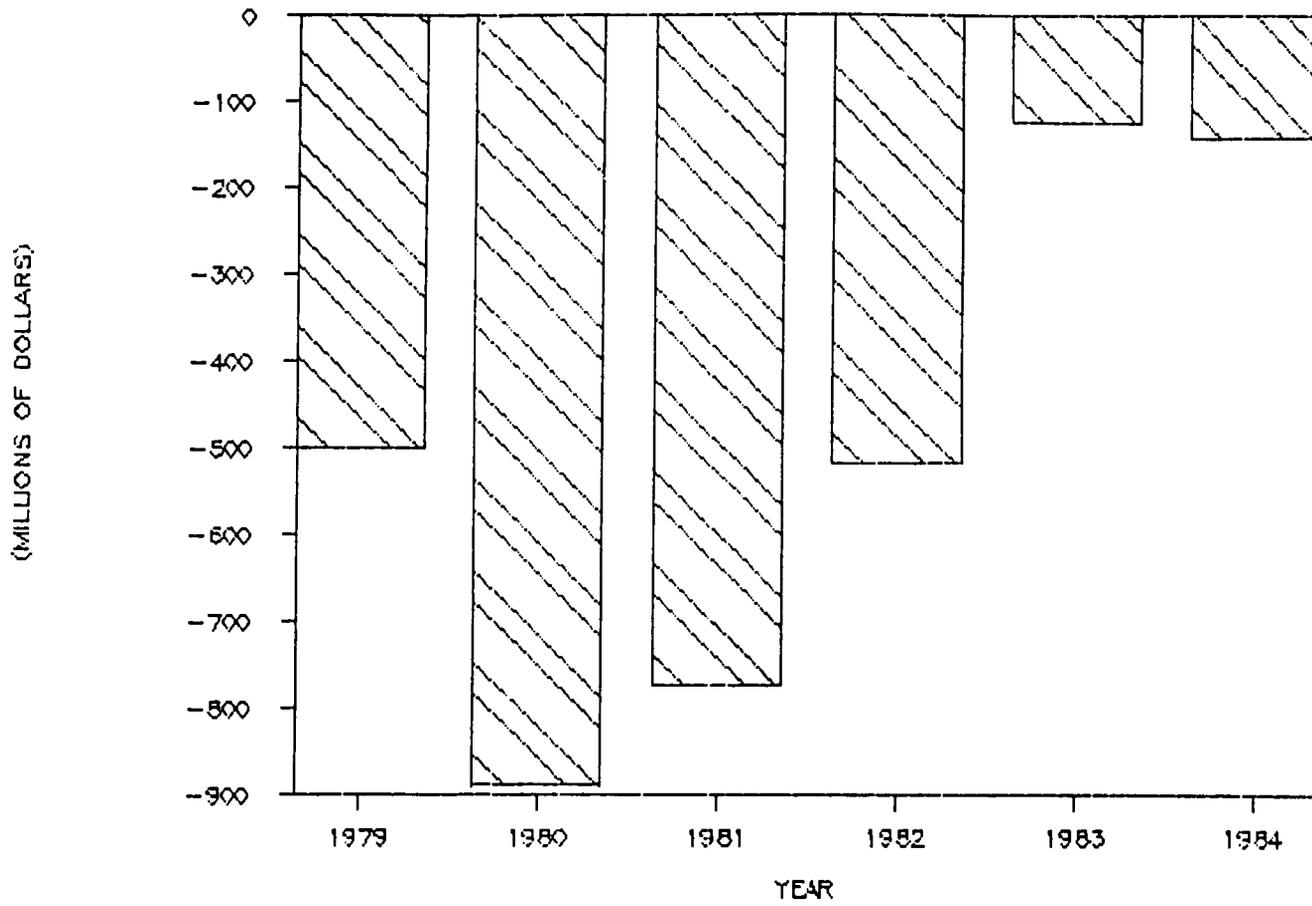


POPULATION
(MID-YEAR ESTIMATES)



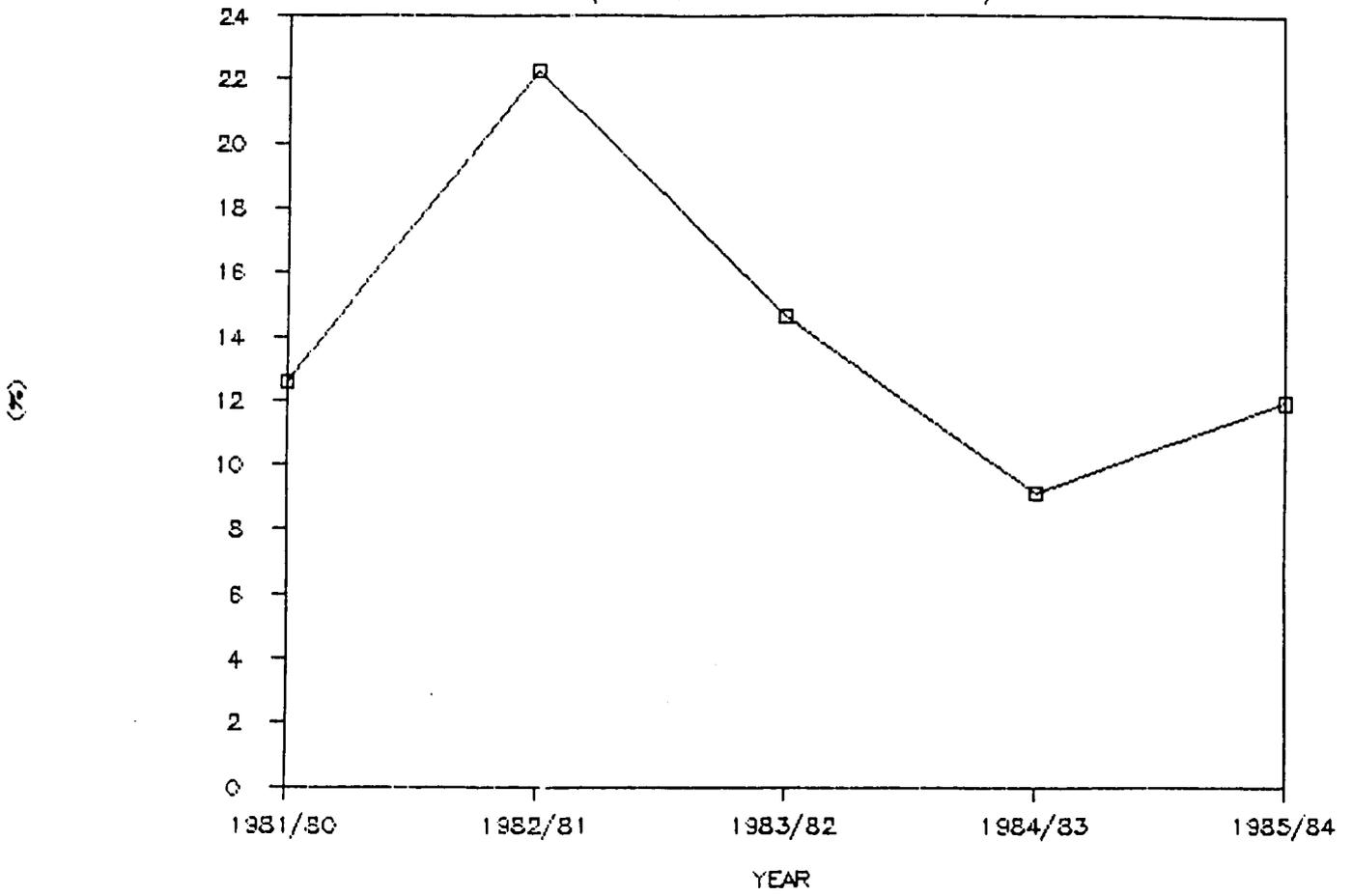
CURRENT ACCOUNT

IN US DOLLARS



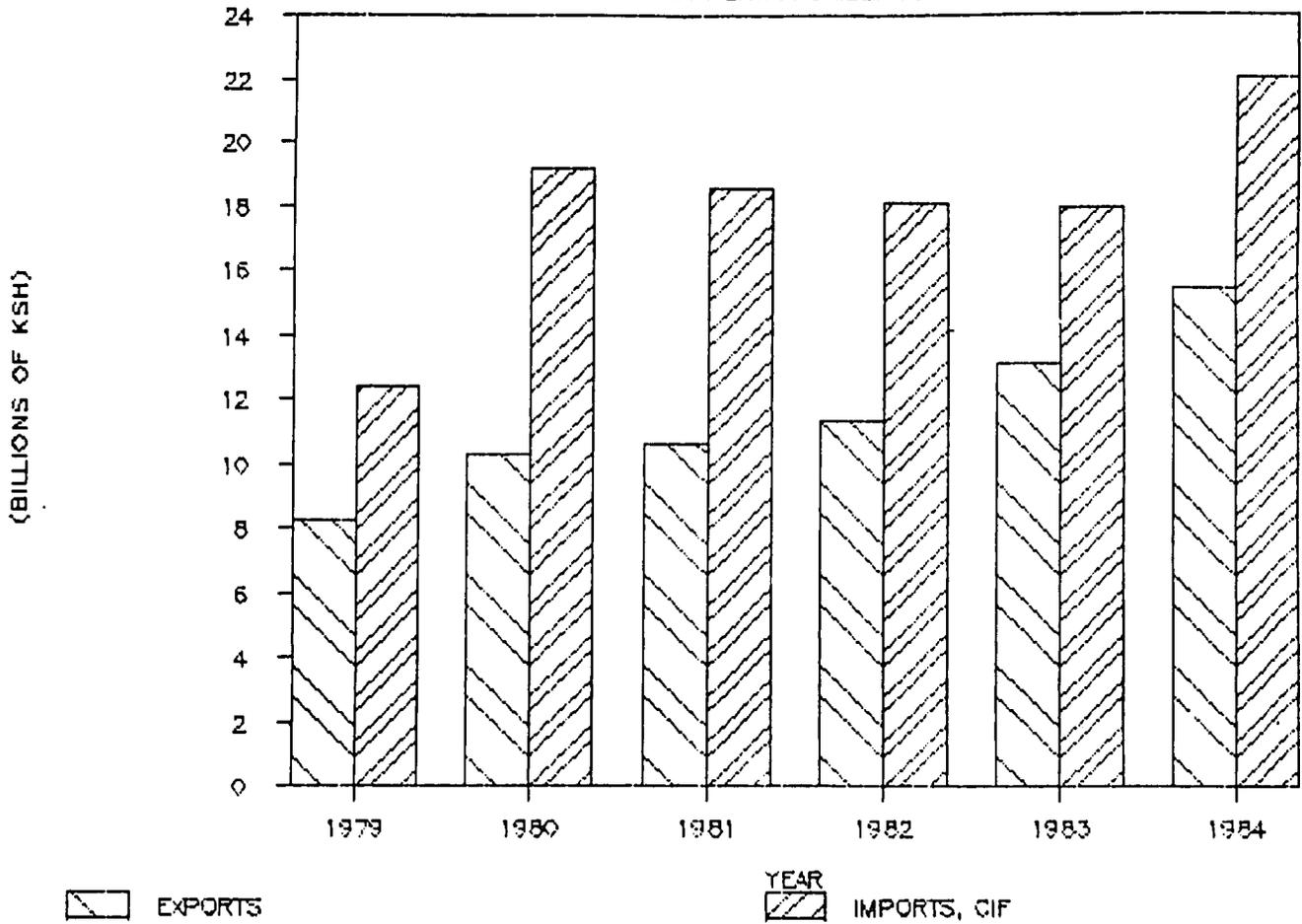
NAIROBI CONSUMER PRICE INDEX

(AVERAGE PERCENTAGE INCREASE)



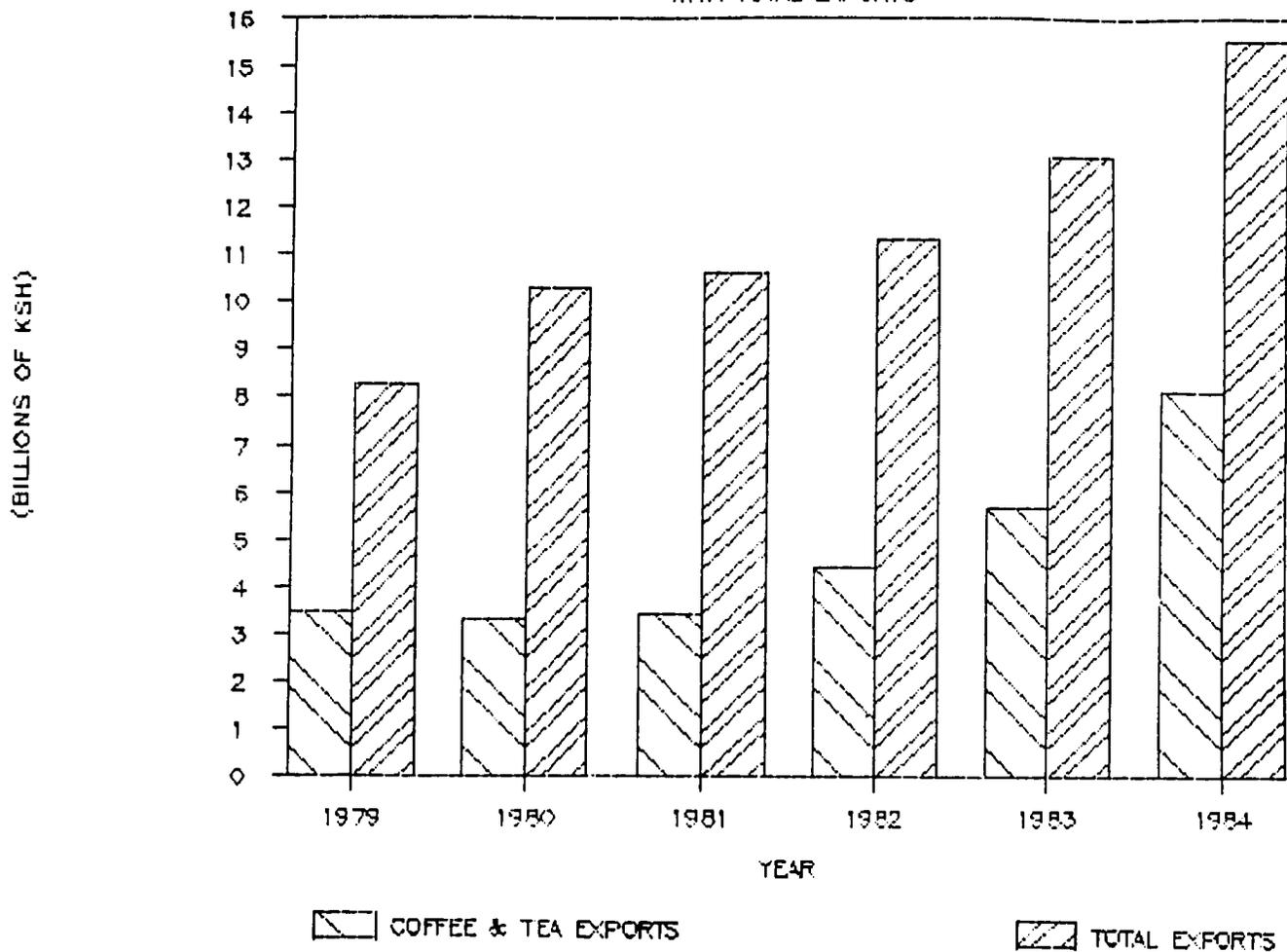
EXPORTS AND IMPORTS, CIF

IN KENYAN SHILLINGS



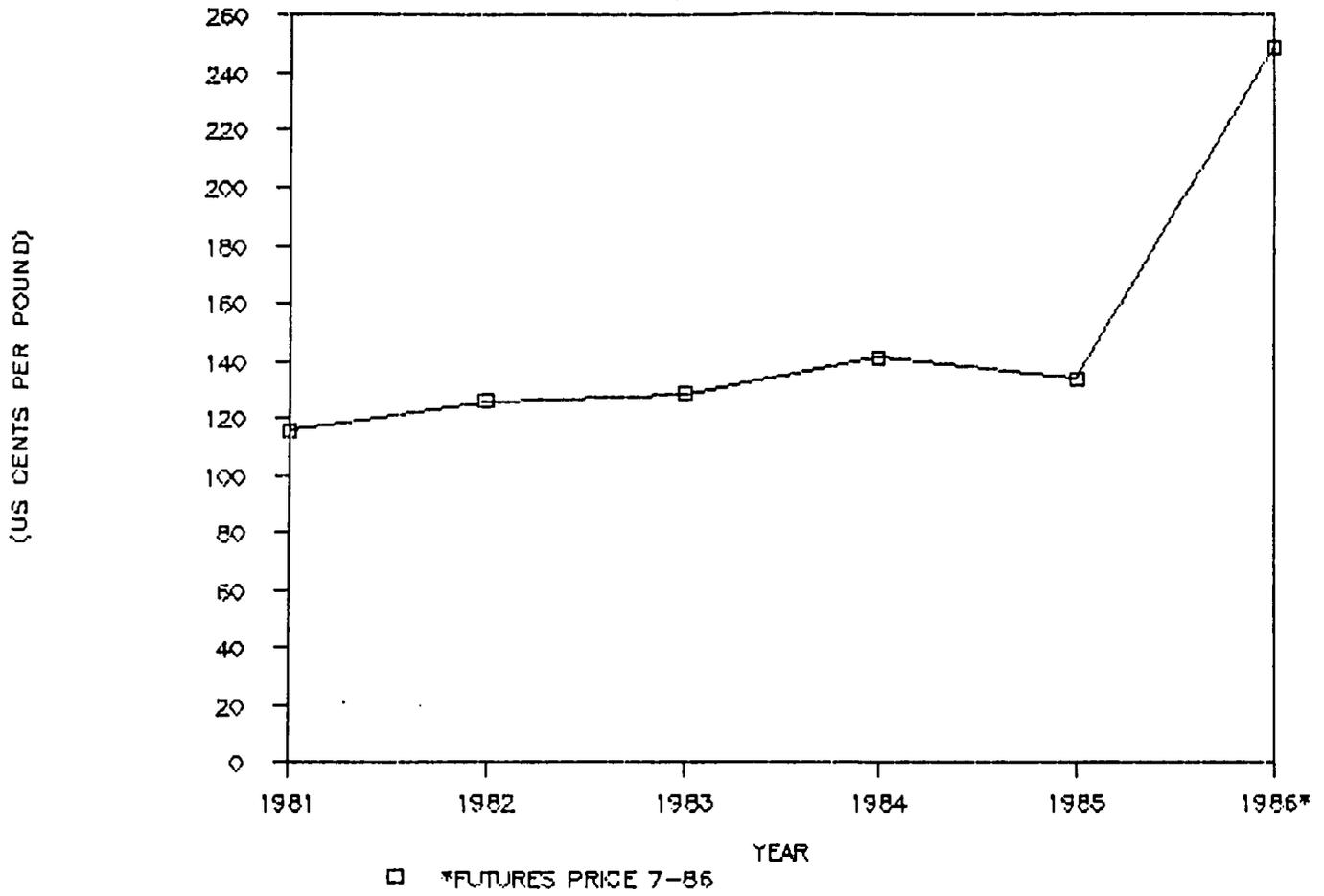
COFFEE AND TEA EXPORTS COMPARED

WITH TOTAL EXPORTS



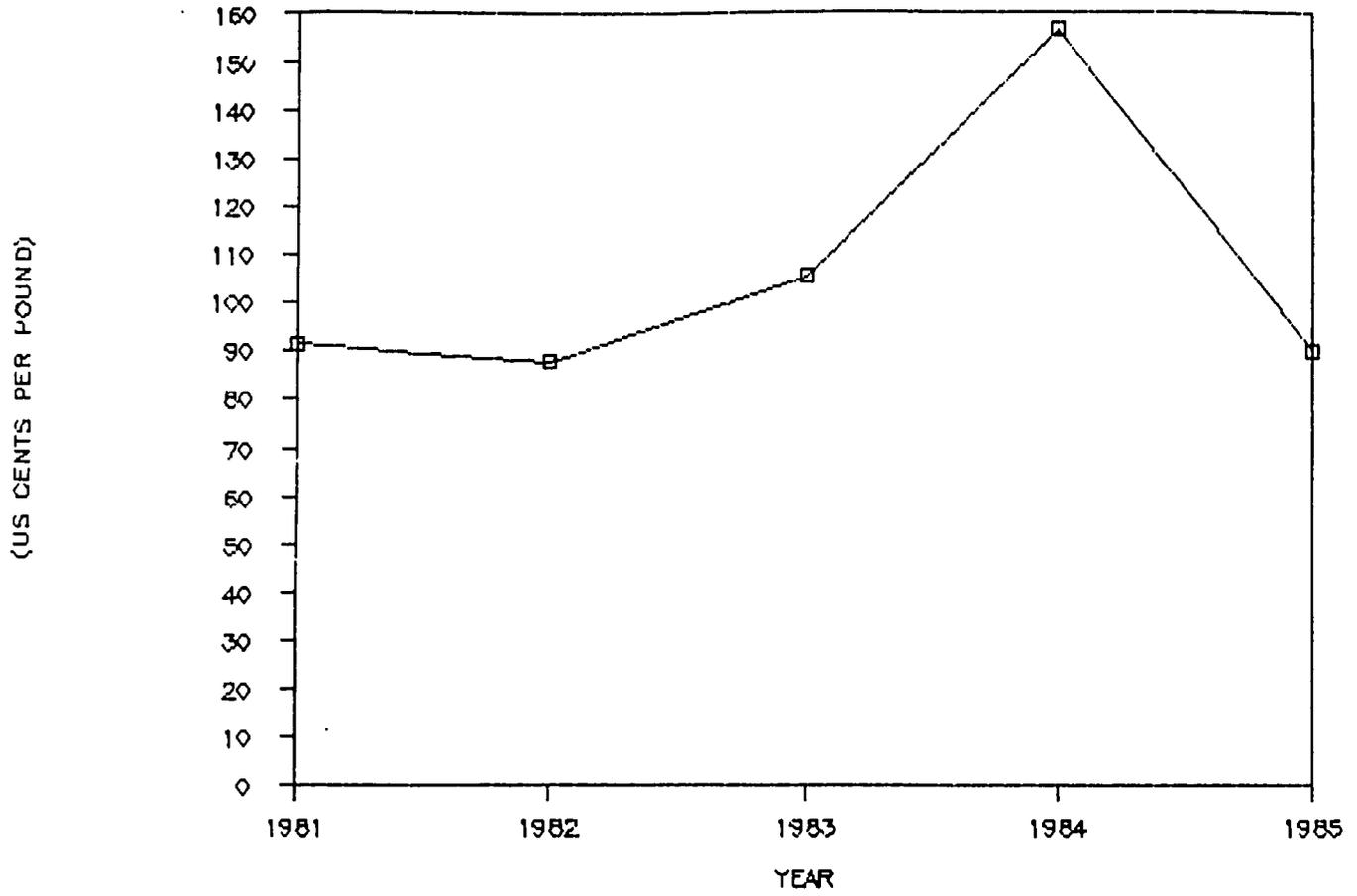
WHOLESALE COFFEE PRICE

US CENTS PER POUND



WHOLESALE TEA PRICE

US CENTS PER POUND



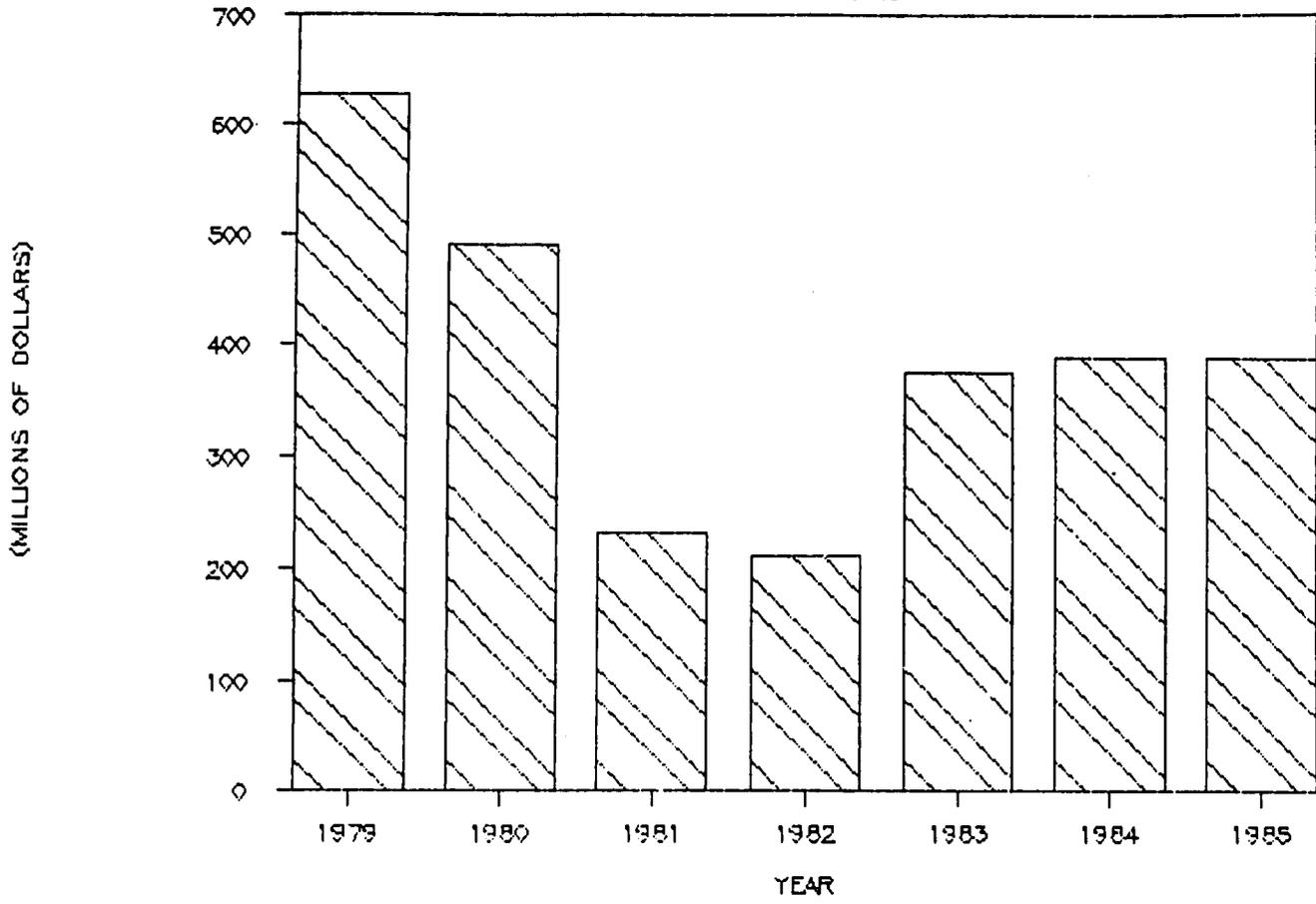
C. GOVERNMENT ATTITUDES

1. Private sector
Unlike many other sub-Saharan African countries after independence, GOK has emphasized the role of the private sector in developing the economy. To this end, GOK has taken steps to develop a modern, monetized economy, including introducing private ownership of agricultural and pastoral land through registered title, and decreasing GOK domestic borrowing to make more domestic savings available to the private sector. Further, GOK has implemented an attractive investment incentives policy to encourage growth of the private sector, and has provided large amounts of credit to the private sector for investment.
2. Parastatals
Recently, GOK has been taking measures to improve the efficiency of parastatals. The Minister of Finance and Planning, Mr. Saitoti, has threatened disciplinary action to force parastatals to reduce waste and improve profitability in order to repay their debts to the government. President Moi has indicated that privatization would be desirable in the case of some parastatals. GOK is currently limiting involvement in new ventures to providing appropriate incentives and suitable regulation to prevent unfair business practices.
3. Population growth
GOK has made control of population growth a major priority, and has attempted since the late 1960s to control population growth through family planning clinics. Family planning efforts have failed in this country where the average woman bears eight-plus children. Resistance to family planning efforts stem from suspicion of contraceptive methods, and deep-rooted cultural attitudes where a large family is a sign of status and security. Further, GOK has been unsuccessful in reaching many women, especially the rural population: a 1978 survey revealed that only 6% of Kenyan women were using birth control, and 12% had never even heard of it.
4. Foreign policy
Kenya has maintained a policy of nonalignment since independence, but has strong ties with Western nations as sources of capital and development aid.

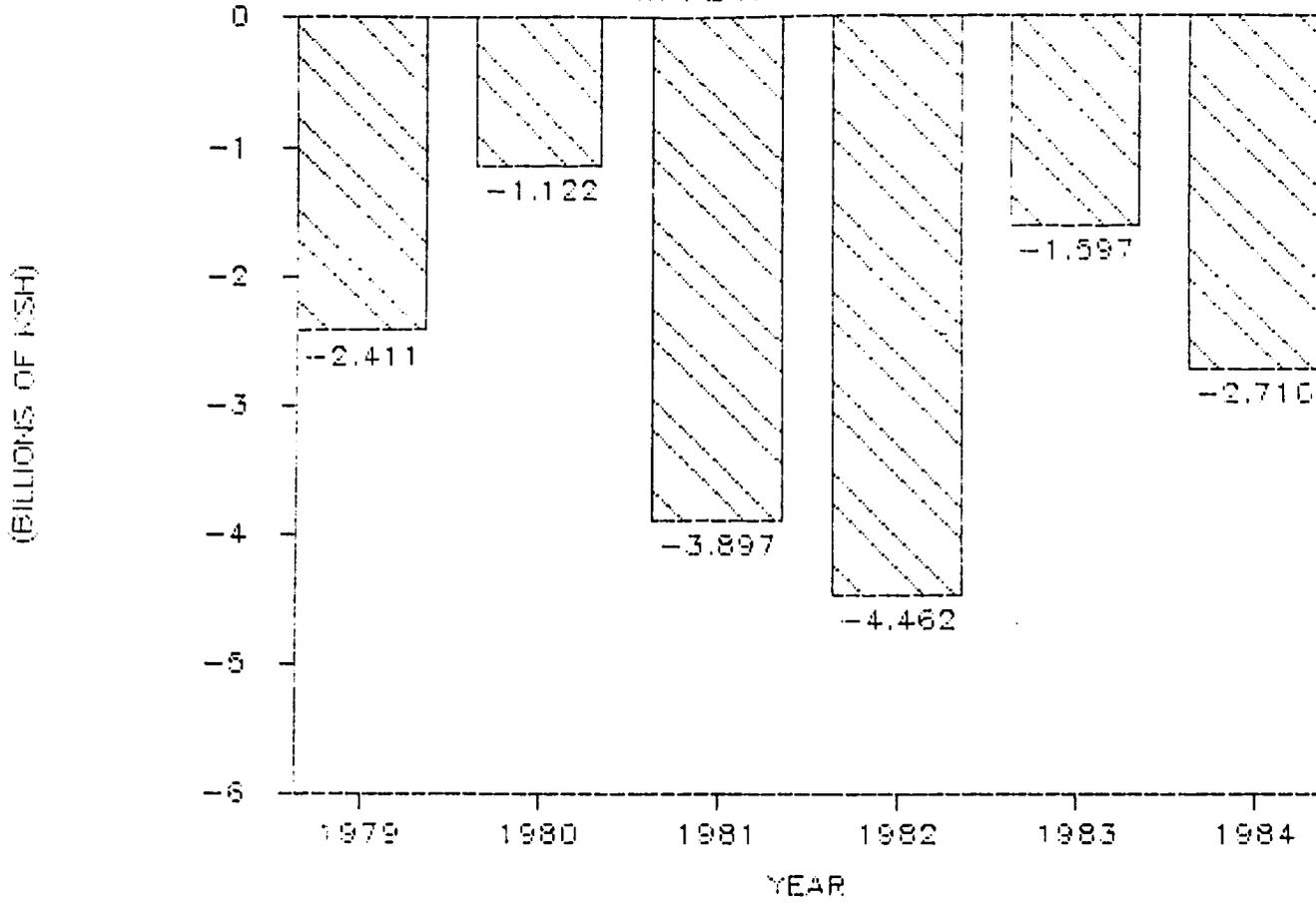
5. **Agricultural diversification**
Since the severe food shortages of 1979-80 (failure of the maize crop) and 1984 (drought), GOK has made self-sufficiency in staple foods a major policy. Thus, although a shift from staple food crops to coffee and tea crops would yield higher value crops, GOK is encouraging farmers to continue raising staples in addition to cash crops.

TOTAL RESERVES MINUS GOLD

IN US DOLLARS

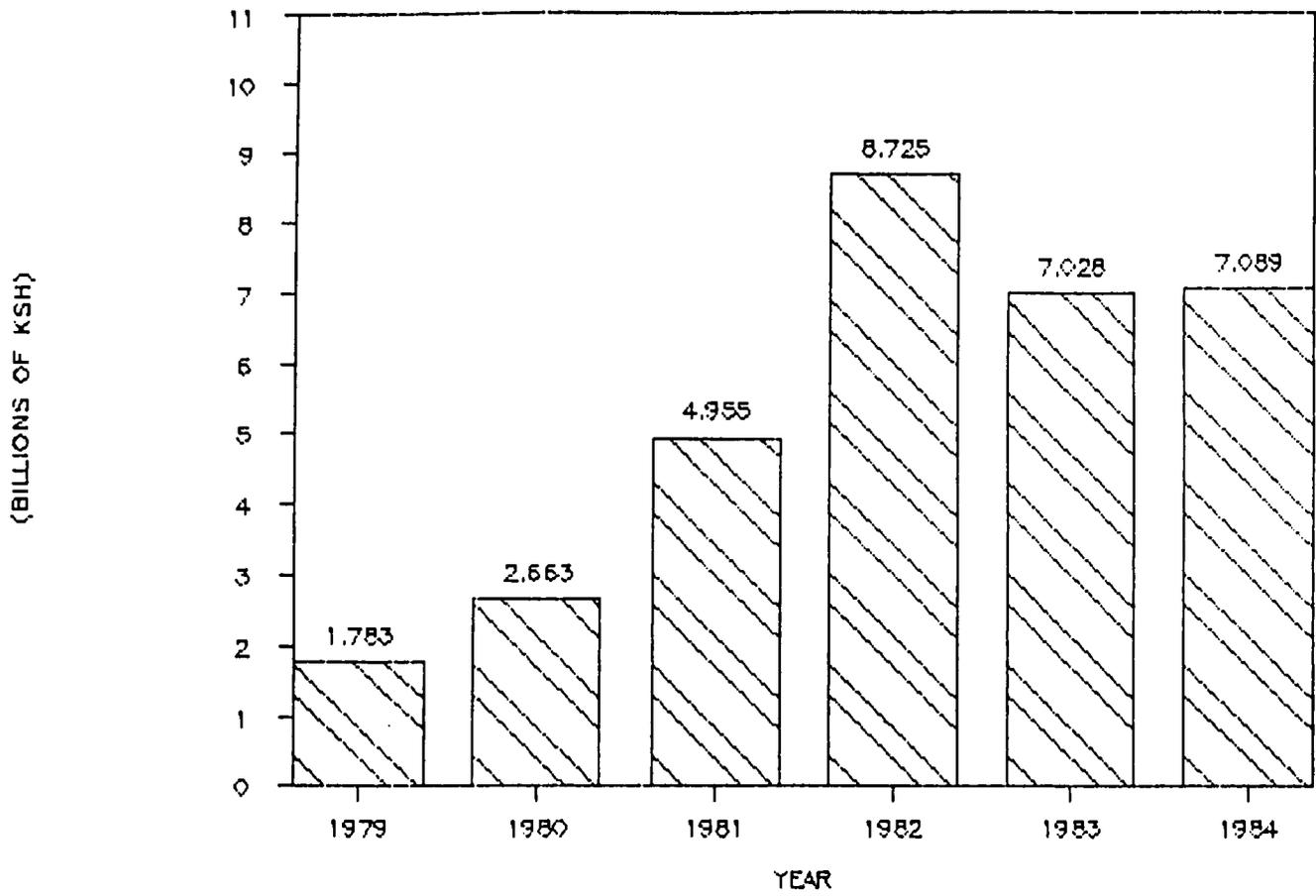


OVERALL GOVERNMENT OF KENYA DEFICIT
IN KENYAN SHILLINGS



CLAIMS ON GOVERNMENT

IN KENYAN SHILLINGS

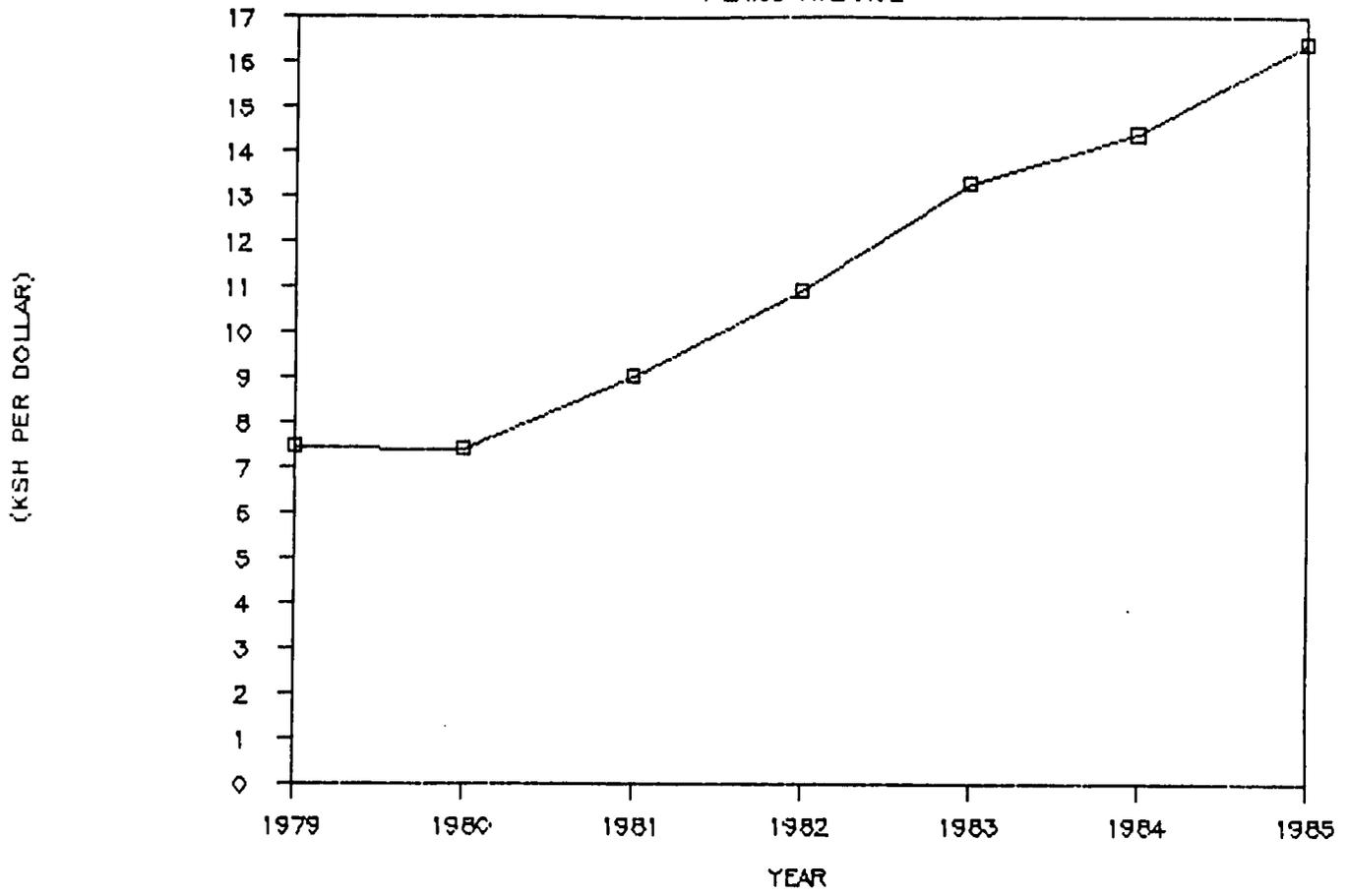


D. REGULATORY CLIMATE

1. Price control
GOK has implemented an elaborate price control system which affects commodities such as essential foodstuffs, cigarettes, tires, toothpaste, and soap. Producer prices for domestic foodstuffs and some export crops (excluding coffee and tea) are set in annual price reviews. Marketing of all agricultural commodities is performed by statutory marketing boards. The World Bank has recommended a reduction in GOK intervention in pricing and marketing to allow the market to provide incentives to farmers.
2. Exchange control
Foreign exchange controls are administered by the Central Bank. Since 1981 Kenya, with IMF and World Bank guidance, has followed an active exchange rate policy, adjusting the rate frequently to provide incentives to exporters. The import and export of currency is prohibited to prevent speculation. As of 1983, visitors must pay all expenses in foreign currency.
3. Import control
Since 1980 policy has shifted from protected import substitution to trade liberalization and export promotion.
4. Foreign investment
GOK policy is favorable toward foreign investment. Foreign investors can obtain a certificate of approved enterprise which ensures the eventual repatriation of capital, although GOK does not guarantee repatriation of capital gains realized on liquidation of an investor's assets.
5. Labor
Since independence Kenya has legislated minimum-wage scales; wages above the minimum must be agreed upon by collective bargaining or wage councils appointed by the Minister of Labor.

MARKET EXCHANGE RATE

PERIOD AVERAGE



E. FINANCIAL SYSTEM

1. Financial institutions

- a. Central Bank of Kenya
The Central Bank of Kenya was established in 1966 and performs typical central bank functions, including the issue of currency and administration of exchange control.
- b. Commercial banks
There are 23 commercial banks in Kenya, with over 360 branches; a listing of commercial banks appears in Appendix A. The trade (26%), manufacturing (17%) and agricultural (13%) sectors were the major recipients of commercial bank loans in 1984. Public sector borrowing has been increasing, in spite of GOK policy to reduce domestic borrowing to free up funds for the private sector. In 1984 the public sector accounted for 21% of total loans and advances, compared to 10% in 1980 and 13% in 1981.
- c. Non-bank financial institutions
There are 44 non-bank financial institutions with over 50 branches and 31 building societies.

* Public institutions
GOK created several public non-bank financial institutions to promote development by providing financing to the private sector. Due to the importance of agriculture to the economy, and the inability of banks to meet the financing needs of the sector, there are three public institutions serving the agricultural sector:

- Agricultural Finance Corporation - provides credit to farmers from public sources
- Cereals and Sugar Finance Corporation - provides funds to cooperatives and to the National Cereals and Produce Board for the purchase of maize
- Agricultural Development Corporation

Other public non-bank institutions include:

- Housing Finance Company of Kenya, Ltd. - funds the housing industry
- Industrial and Commercial Development Corporation - assists/initiates establishment of industrial and commercial ventures and facilitates participation by the public in commerce and industry
- East African Development Bank - provides industrial development finance to Kenya, Uganda, and Tanzania
- Post Office Savings Bank - collects deposits from small savers
- Kenya Posts and Telecommunications Corporation - administers Post Office Savings Bank

* Private institutions

Most private non-bank financial institutions are licenced under the Banking Act, and are closely associated with the commercial banks. Private non-bank institutions provide medium- and long-term financing, and tend to specialize. Activities include mortgage lending, leasing, and merchant banking.

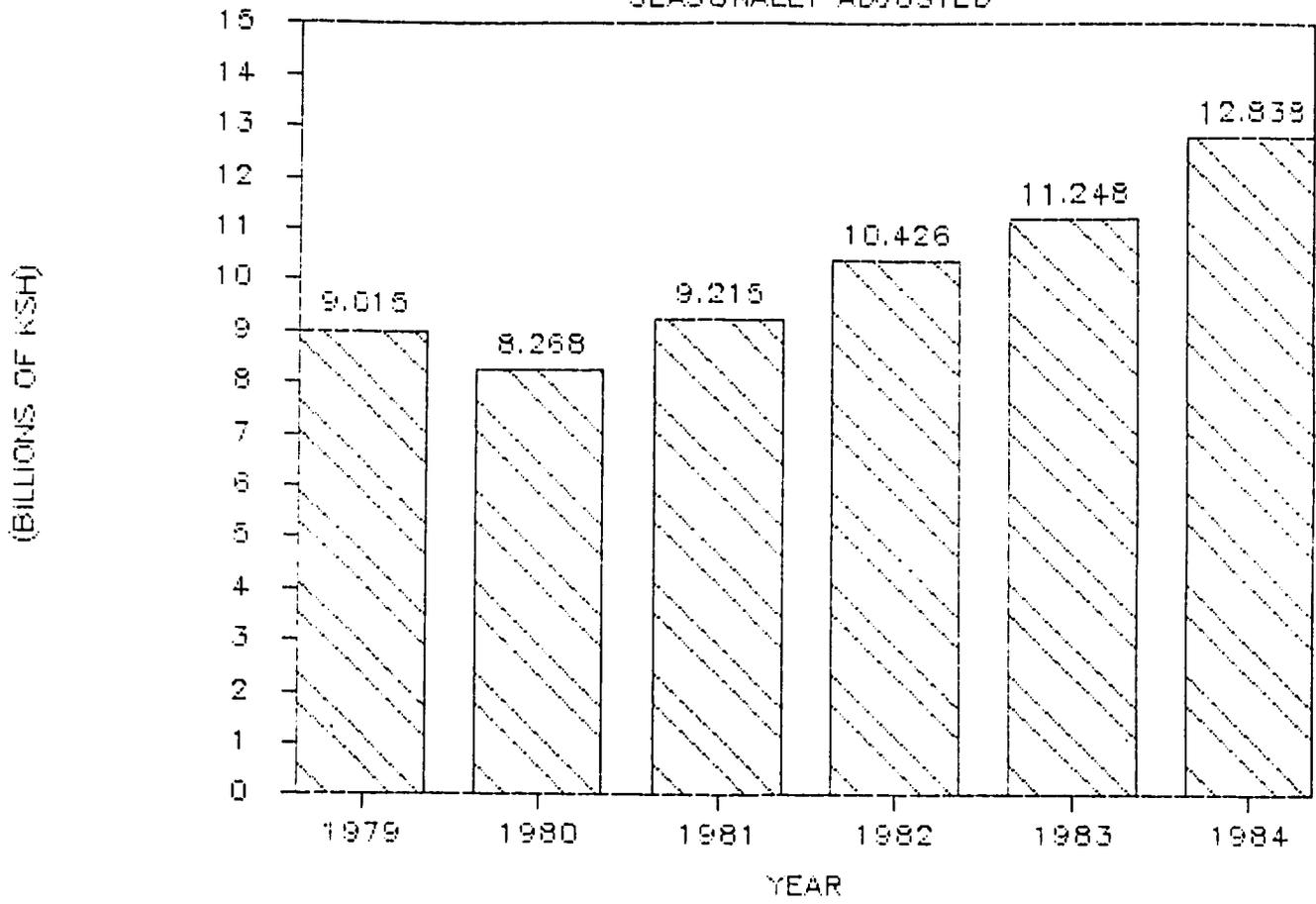
Non-bank financial institutions are expanding at a much faster pace than are commercial banks. Non-bank total assets and liabilities increased approximately 40% in 1984; total bills, loans and advances extended by commercial banks rose 16.5% in the same period. The shift of deposits from commercial banks to non-bank financial institutions (ratio of non-bank to commercial bank deposits was 54.9% in 1984, 34.7% in 1980, and 39.0% in 1982) is due to the fact that non-bank institutions are more competitive in attracting deposits. This is due, in part, to discriminatory regulation on the part of GOK: non-bank institutions are allowed to purchase Treasury bills at 15% interest, banks are not; and banks are only allowed to offer 14% on fixed-deposits while non-bank institutions may offer 19%.

- d. Insurance companies
There are several insurance companies, most are subsidiaries of foreign companies. Insurance companies have operated in Kenya for years and their operations are stable. Life insurance, especially, has expanded recently.

2. Financial markets

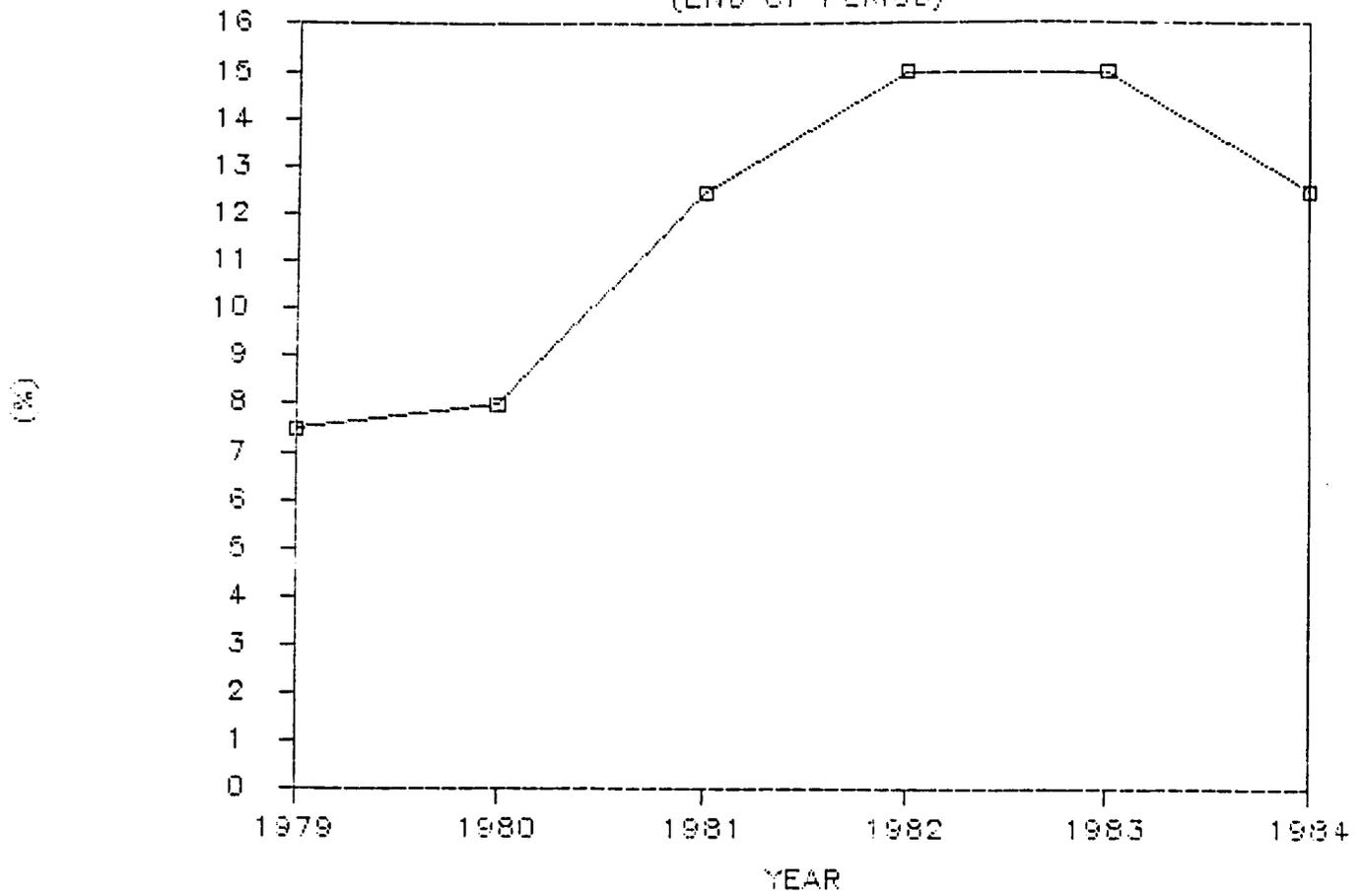
- a. Nairobi Stock Exchange (NSE)
Established in 1954, the operations of NSE are limited when compared to European or American exchanges. The majority of traders are insurance companies, investment trusts and semiofficial bodies. The volume of shares traded rose considerably in 1979-80, with the value of shares traded increasing from KSh 389 million to KSh 3,333 million during the period. However, after the 1979-80 mini-boom, the market levelled off at KSh 1,857 million in 1984, a little over half the volume traded four years prior.
- b. Money market
Although there is a wide network of financial institutions in Kenya, the money market has been slow in developing. Commercial banks have not aided in the expansion of the money market as they have tended to prefer direct financing over the use of commercial bills and other short term lending instruments. Since treasury bills are eligible liquid assets in meeting the liquidity ratio requirement commercial bank holdings of them have increased. However, the money market has not developed significantly beyond the trading of treasury bills.
- c. Capital market
In Kenya most companies are privately owned family businesses and subsidiary firms. These firms have typically resisted going public for fear of losing control; this has hindered the growth of the capital market. In addition to the NSE, private non-bank financial institutions, insurance companies, and building societies have been prominent in issuing long- and medium-term loans for capital expansion and mobilization of savings.

MONEY SUPPLY
SEASONALLY ADJUSTED



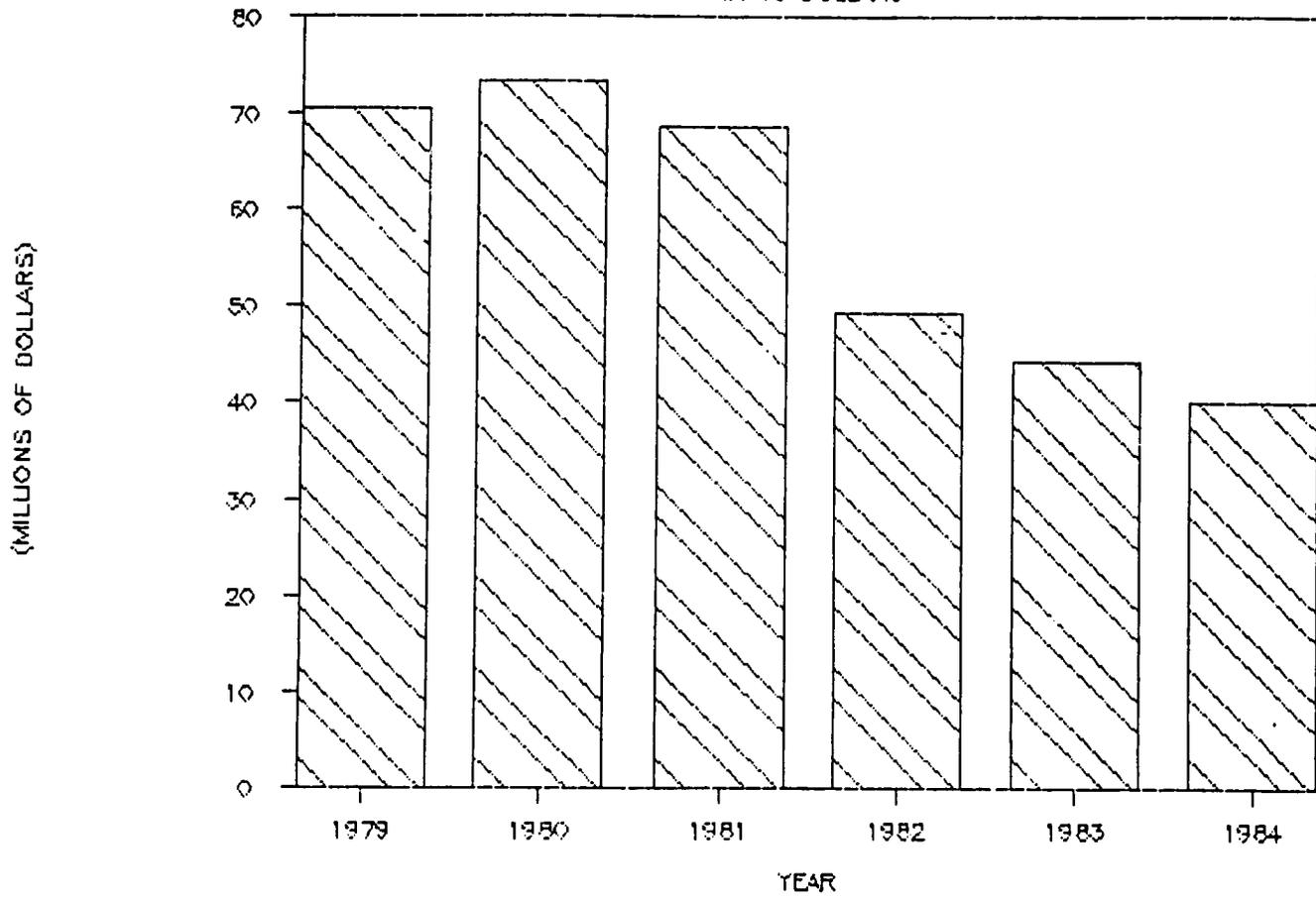
DISCOUNT INTEREST RATE

(END OF PERIOD)



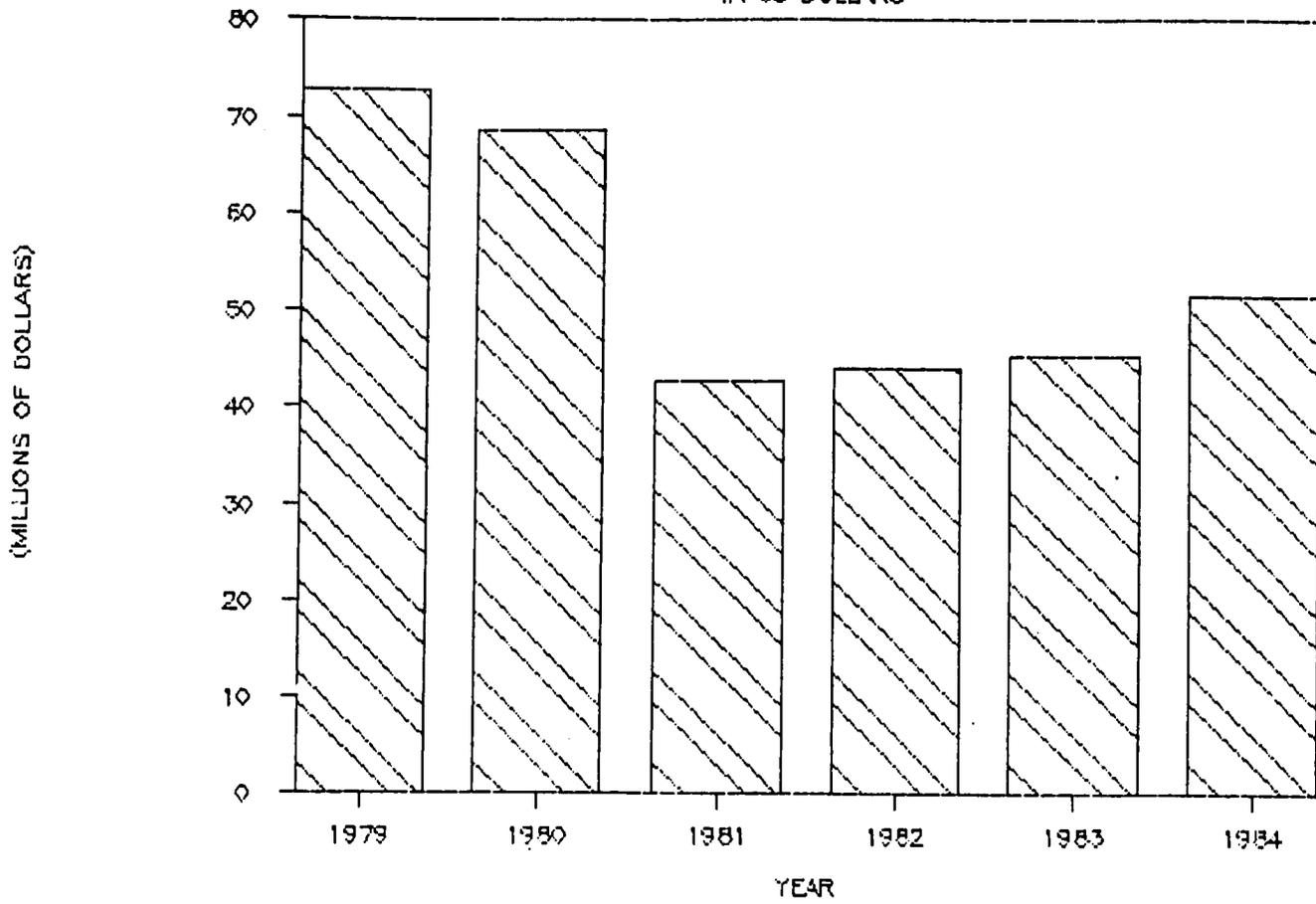
COMMERCIAL BANKS: ASSETS

IN US DOLLARS



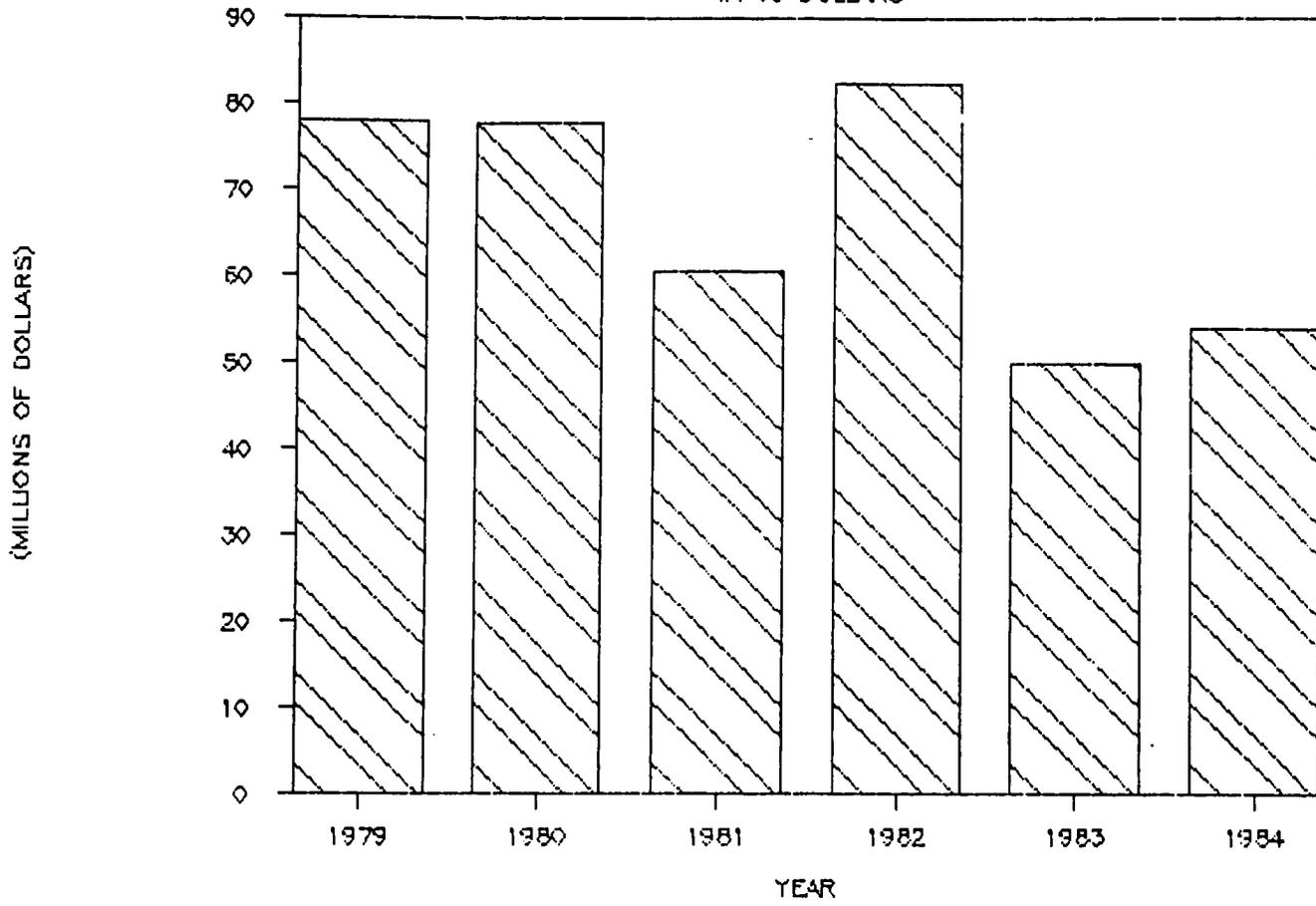
COMMERCIAL BANKS: LIABILITIES

IN US DOLLARS



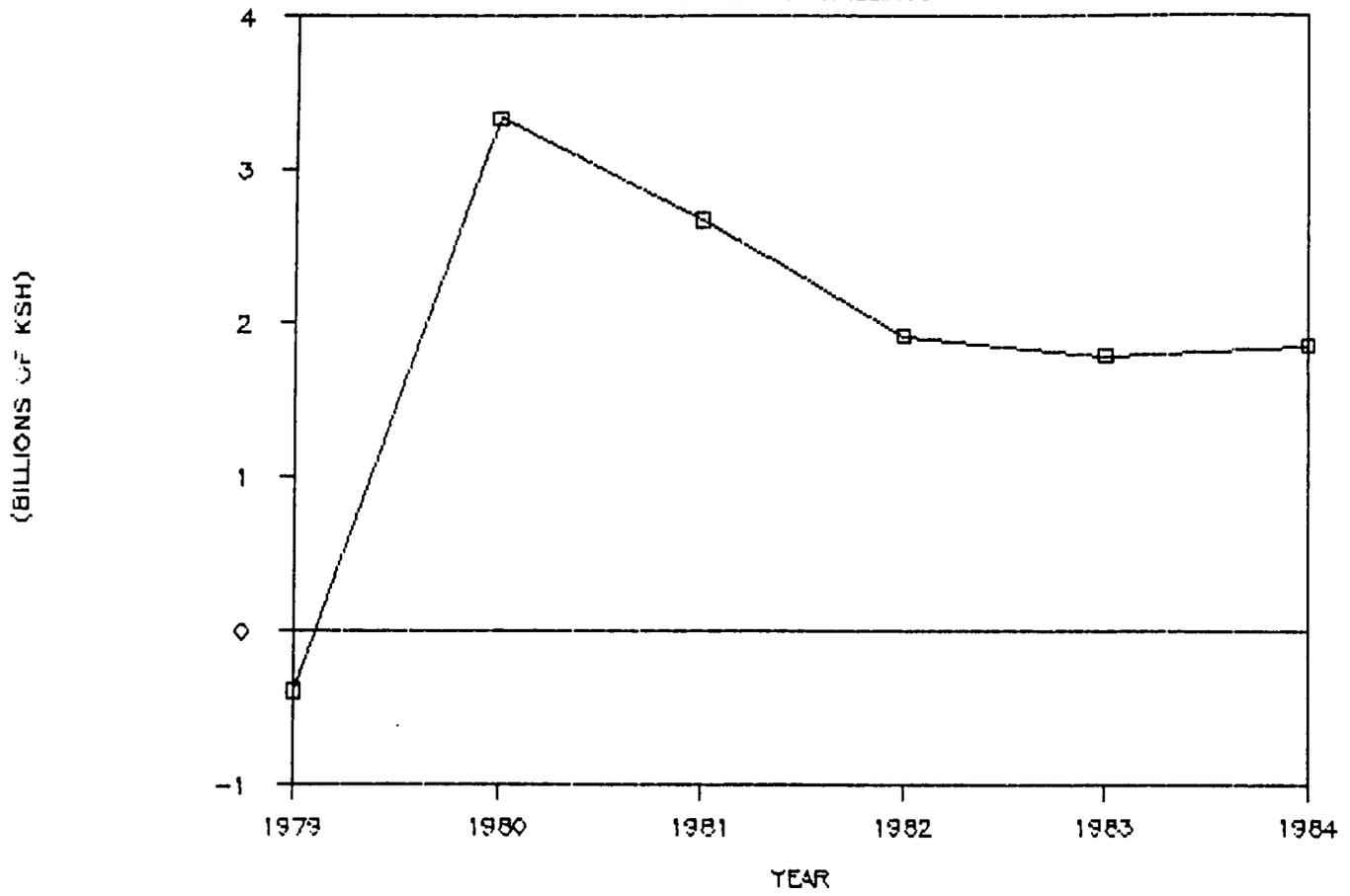
DIRECT INVESTMENT

IN US DOLLARS



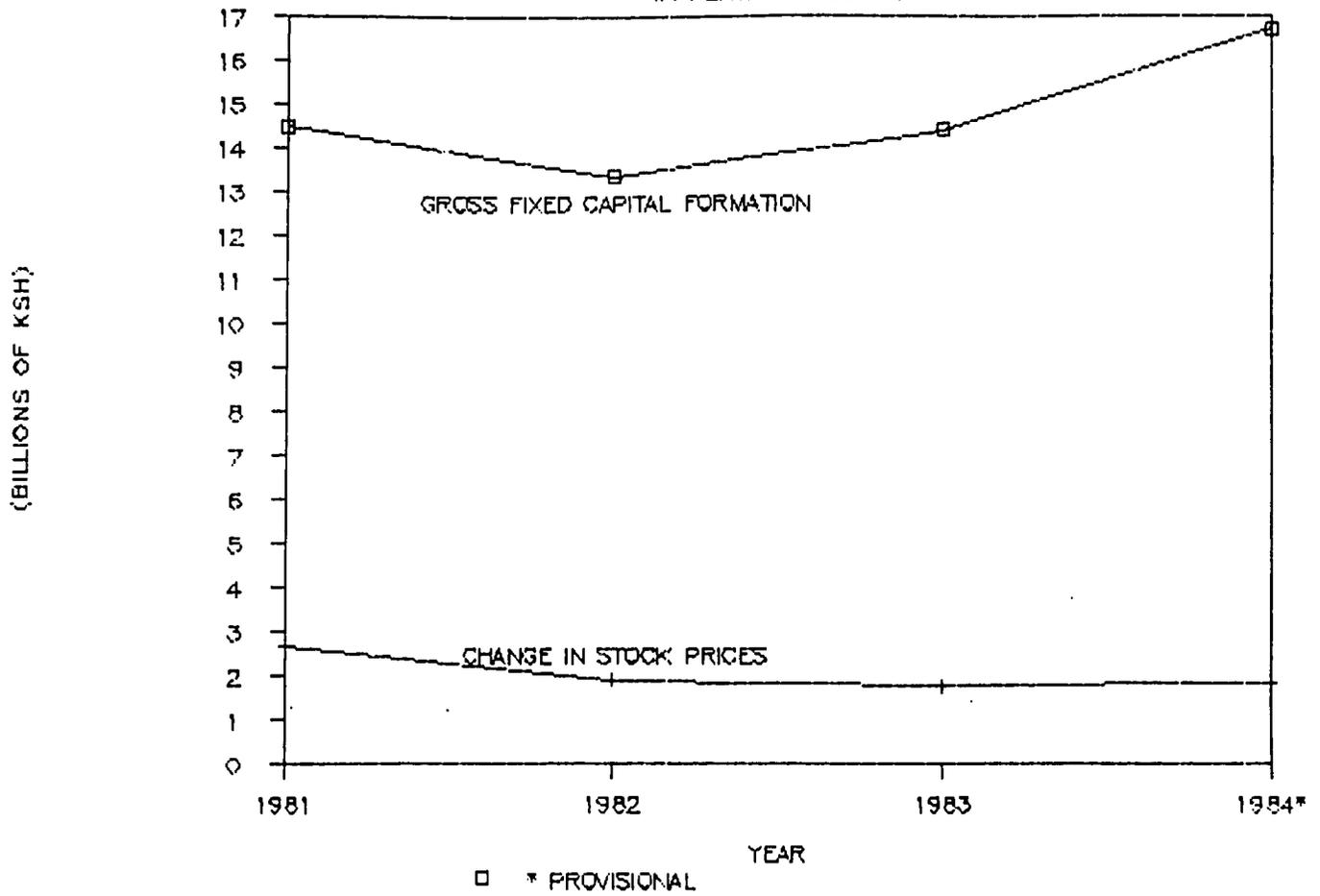
NET CHANGE IN STOCKS

IN KENYAN SHILLINGS



GROSS CAPITAL FORMATION

IN KENYAN SHILLINGS



F. TAX SYSTEM

1. As indicated in the following table, indirect taxes consistently contribute the majority of tax revenues to GOK.

KENYA'S TOTAL TAX REVENUE

	(KSh millions)					
	<u>1980/81</u>	<u>%</u>	<u>1981/82</u>	<u>%</u>	<u>1982/83</u>	<u>%</u>
Direct Taxes	3,965.2	(33)	4,022.4	(30)	4,635.6	(33)
Indirect Taxes	8,206.6	(67)	9,500.6	(70)	9,429.8	(67)
	-----		-----		-----	
Total Tax Revenues	12,171.8		13,523.0		14,065.4	

2. As detailed in the table below, the income tax is the biggest direct tax revenue earner, consistently accounting for over 99% of total direct tax revenue.

DIRECT TAX REVENUE

	(Percent of Total Direct Tax Revenues)		
	<u>1980/81</u>	<u>1981/82</u>	<u>1982/83</u>
Income Tax	99.7%	99.3%	99.8%
Other	0.3	0.7	0.2
	----	----	----
	100.0	100.0	100.0

3. The following table illustrates the importance of the sales tax and import duties as sources of revenue.

INDIRECT TAX REVENUE

	(Percent of Total Indirect Tax Revenues)		
	<u>1980/81</u>	<u>1981/82</u>	<u>1982/83</u>
Sales Tax	43.7%	41.0%	41.5%
Import Duties	35.5	38.7	35.0
Excise Duties	14.7	13.5	15.7
Export Duties	0.8	1.1	1.5
Licences and Fees under Traffic Act	1.6	1.2	1.6
Other	3.7	4.5	4.7
	----	----	----
	100.0	100.0	100.0

G. ACCOUNTING SYSTEM

Information was not available describing the accounting system of Kenya.

APPENDIX A

COMMERCIAL BANKS IN KENYA

Algemene Bank Nederland
Bank of America
Bank of Baroda
Bank of India
Bank of Credit & Commerce International
Bank of Oman
Bank of Nova Scotia
Banque Indosuez
Barclays Bank of Kenya, Ltd.
Biashara Bank
Citibank
Continental Bank of Kenya
Cooperative Bank of Kenya
Grindlays Bank International (Kenya)
Habib Bank
Kenya Commercial Bank
Middle East Bank Kenya, Ltd.
National Bank of Kenya
Pan African Bank
Societe Generale de Banque
Standard Chartered Bank
Trade Bank
Union Bank of Kenya