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MAPS: KENYA

Private Sector Strategy: Phase V

FINAL REPORT

Bureau for Private Enterprise
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I. EXECUTIVE SUMMARY

USAID-Kenya, in preparation for its Country Development Strategy Statement, conducted a private sector assessment utilizing the methodology laid out in the Bureau for Private Enterprise document Manual for Action in the Private Sector (MAPS). The assessment included an articulation and analysis of the previous Mission's private sector strategy, a private sector description, the creation of a Kenya Country Reference Binder, a survey of over 700 Kenyan businesses, and a series of structured focus groups with private and public sector leaders. The results and findings from all of these activities are summarized in Appendices A-D of this report. Highlights of the findings and recommendations from the private sector assessment follow below.

USAID-Kenya has been a pathbreaker for Agency private sector initiative activities. During the mid- to late 1980s, USAID-Kenya developed a variety of programs to strengthen the private sector as an engine of economic growth. A large portion of the Mission's portfolio is in the private sector area and includes credit, training, technical assistance, policy dialogue and institution building activities. As a result, USAID-Kenya's credibility in the area of private enterprise development was found to be quite high among the other donors interviewed; in addition the Mission's private and public sector network of contacts is extensive. Credit, training, technical assistance and institution building initiatives directly supporting private enterprise have been important. Initiatives to date have laid the groundwork for the second and more ambitious phase of USAID private enterprise strategy in Kenya. These initiatives have established needed contacts and developed Mission expertise while being of enormous help to the private sector in Kenya.

In the absence of significant change in the macro-economic and institutional environment, USAID interventions such as credit, training and technical assistance will have only minimal impact in accelerating private sector led growth. The findings of the private sector description and private sector survey reports, included as annexes to this report, demonstrate that the Kenyan economy has nearly exhausted the per-capita economic growth potential inherent in its previous import-substitution, parastatal, government-led economic strategy. Government debt has mounted and external public debt has risen to 58 percent of GDP. Parastatal losses cannot continue to be absorbed. The private formal manufacturing sector has not been able to increase jobs substantially. Foreign investment has fallen off to relatively insignificant levels. Without major restructuring, it will be difficult for the Government of Kenya to achieve its economic growth goal of 5.6 percent of GDP or to generate jobs for one of

the world's fastest growing labor forces. Without the needed reforms, USAID assistance is unlikely to have a major impact on strategic targets or country goals.

The study recommends that USAID-Kenya focus its efforts on helping the Government of Kenya (GOK) and the Kenyan private sector make the transition to an outward-oriented, market-oriented, private enterprise driven economy. The study recommends that USAID-Kenya focus its efforts on aiding the Government of Kenya in implementing the economic strategy presented in its Sessional Paper No. 1 of 1986. While this bold, private enterprise and market oriented strategy may not enjoy unquestioned and unanimous support within the GOK, it is an official policy document. Significant steps have already been taken, further reforms are scheduled, and the country's highest officials continue to speak of their commitment to the full implementation of this strategy. The question is not whether all officials agree with it, but rather how USAID can be of service to the GOK as an enabler of this implementation and transition. USAID can also help the private sector to respond in a timely fashion to reforms as they emerge.

The recommended strategic objective is to raise the levels and productivity of private sector investment. The study has demonstrated that Kenya's problem is not so much with the overall level of investment but with the quality or productivity of investment. The objective will be to see higher levels of private investment along with higher levels of output per unit of investment. This will support the suggested overall country goal of achieving sustained and broad-based growth in Kenya's per-capita income.

The private sector assessment recommends USAID initiatives in three major strategic areas:

- An expanded base of domestic investment and entrepreneurship;
- Liberalized, deepened and broadened financial markets;
- Expanded and diversified export production and foreign private investment.

In order to promote domestic investment and entrepreneurship, the study recommends the following:

- Provide assistance enabling the GOK to look at the economic as well as the revenue consequences of tax reforms currently being contemplated.

- Allow for inflation adjusted or replacement depreciation costs.

- Consider a simple but well enforced tax system with corporate rates in the 30-35 percent area.

- Create and publicize an "S-Corporation" status, encouraging the creation of formal sector small businesses. Allow for lower tax rates up to a specified level (S-Corporations are taxed 15 percent in the USA) and for income to flow through to the owner(s) without double taxation.

- Follow carefully the implications of USAID's US$1 million funding of the UNDP-GOK tax reform effort. It could end up having a negative effect if not carefully managed.

- Review the legal, economic and institutional impediments to growth, particularly as they affect the small business sector. Work with the GOK to reduce these impediments.

For achieving liberalized, deepened and broadened financial markets, the study proposes the following:

- Support and follow the progress on the interest rate deregulation scheduled for 1992 by providing training and technical assistance on implementation of more sophisticated and market-oriented controls, such as reserve requirements and open market operations.

- Assist in the creation of a secondary market for T-bills with a variety of maturities. This could relieve some of the burden of holding T-bills currently placed on the commercial banking system, while broadening the savings appeal to individuals or institutions.

- Provide technical assistance, training and support for the creation of money market instruments. This would widen savings and investment opportunities to small scale savers and investors.

- Assist in developing mutual funds based on a basket of Kenyan Blue Chip stocks currently listed on the Nairobi Stock Exchange.

- Enhance the supervisory capability of the Capital Markets Development Authority in ways which help ensure the protection of small investors, without being so onerous as to discourage new issues and listings.

- Expand current credit programs to non-bank financial institutions as a way of expanding availability of credit.

For achieving a market-driven, expanded and diversified export base and raising the level of foreign private investment, the study recommends the following:

- Provide technical assistance and training in establishing an Export Processing Zone (EPZ) while encouraging private sector management (if not ownership) of the zone.

- Support GOK plans for the eventual elimination of quantitative restrictions on imports, progressive reduction of tariffs, and foreign exchange liberalization by assisting with training and technical assistance in implementation wherever possible and desirable.

- Fund a study at the request of the Investment Promotion Council (IPC) which would evaluate the competitiveness of the Kenyan business climate and Kenya's potential competitiveness in a variety of strategic export markets, both regionally and internationally.

- Contingent upon improvement of the business environment, encourage joint ventures using IESC (International Executive Service Corps), Africa-MDI, OPIC, IFC and African Development Bank resources to promote new investment, particularly related to the EPZ's.

Current USAID projects can be reoriented around the central strategic thrusts suggested in this study. The Rural Private Enterprise, Rural Enterprise Promotion and Private Enterprise Development initiatives currently undertaken by the Mission can be vehicles for implementing some of the training and technical assistance suggestions outlined in this report.

New initiatives will require a more flexible program approach. The study recommends a funding vehicle which allows the Mission to

target opportunities as they emerge. Many such initiatives are spelled out in this report. However, the timing of assistance will depend on some factors beyond the Mission's control. Therefore, a flexible program approach is recommended. This approach also implies that more staff time will be allocated for engaging GOK in dialogue, brainstorming, problem solving, and designing specially targeted assistance initiatives.

The GOK as USAID's Client. The Mission's portfolio is a small portion of overall donor assistance available to Kenya. An approach using conditionalities must be realistic in recognizing this fact. Also, the GOK itself has already voiced its support of the changes which would lead to a dynamic private sector. The study recommends a service oriented approach as helper and enabler to the GOK in implementing specific aspects of its restructuring program. This will require changes in allocation of scarce staff time. At the same time, USAID will continue and perhaps emphasize even more its dialogue with other donors whose efforts can help (or sometimes hinder) progress.

Provide specialized assistance to the private sector. In each area of reform, assistance to the private sector to respond to the new environment can speed the results and help ensure that the reforms are not reversed. Export and investment promotion programs could be helpful once the institutional and economic environment for trade improves. Credit programs for small business and training to entrepreneurs in developing feasibility studies and loan applications would enable more people to take advantage of a liberalized interest rate regime.

If it works, what can we expect? At the macro-economic level, a successful strategy will mean GDP growth rates over 5 percent (about 1.6 percent growth in income per capita). The export sector will get a boost and the gap will narrow between exports and imports. Investment will become more productive; instead of requiring 6 units of investment to produce a unit of output, the capital output ratio should drop to 5:1 or 4:1. Small manufacturers will experience strong growth. New joint ventures will be created as foreign investment rebounds. The environment for new African businesses in the formal sector will improve. Most importantly, Kenya will have made the transition to an outward-looking, market guided, private sector economy capable of sustained growth in per capita incomes. If USAID-Kenya is able to play an important helping role in restructuring the Kenyan economy, it will have once again played a path-breaking role for the Agency in pioneering effective initiatives for market-oriented and private enterprise solutions to the problems facing developing countries.

II. FINDINGS AND IMPLICATIONS

The following section highlights the main findings from the various private sector assessment activities carried out under MAPS[1], and discusses their implications. A subsequent chapter discusses the proposed strategy.

General Economic Characteristics

1. Savings and investment mobilization is high.

- Kenya's domestic savings rate was the 6th highest in Sub-Saharan Africa (SSA) at 20 percent of GDP in 1987 (according to World Bank figures).
- The number of bank branches in rural areas has grown by over 50 percent since 1980. Cooperative share capital now exceeds that of the Nairobi Stock Exchange.
- Discussions with the financial community revealed that deposits in local commercial banks have been growing at rates of up to 30 percent per year, though this growth may be tapering off (Banking Focus Group).
- Assets in the commercial banking sector have increased from 874 million Kenyan Pounds to 2.6 billion Kenyan Pounds from 1978 to 1987.
- Kenya's gross domestic investment was even more impressive at 25 percent of GDP in 1987, the third highest among 32 sub-Saharan African countries for which data is available (World Bank).
- Kenya's investment rates have consistently been high averaging 22-23 percent of GDP between 1982 and 1988 (IMF data).

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[1]The sources for each of the key findings highlighted in this section are provided in parentheses. The possible sources are the private sector description, which relies on secondary sources (primarily the World Bank, IMF and the Government of Kenya's own publications, including its Sessional Paper No. 1 of 1986), the private sector survey, and the various focus group dialogue sessions. Summaries of the results from these various studies and dialogue sessions are found in Appendices A-D of this report.

2. <u>Kenya appears to have a problem with quality rather than quantity of investment</u>.

- Given the high investment rates mentioned above, one would expect to find higher GDP growth rates. According to World Bank estimates, real GDP growth averaged only 3.8 percent per year during the 1980-87 period.

- GOK Sessional Paper No. 1 of 1986 states that in Kenya it has historically taken 6 units of investment to produce one unit of output, compared with a world-wide norm of 4 units of investment per unit of output. Had Kenya's productivity achieved this norm, the GDP would be growing at an average of 6 percent per year.

3. <u>The quality of investment (productivity) problem is mainly due to the macro-economic policy and institutional environment</u>.

- The institutional environment impedes efficient business operations, especially in the formal sector (focus group feedback).

- Macro-economic policies and the institutional environment have created a business climate and investor psychology which favor investment in relatively non-productive assets, such as land and real estate (which accounted for about 25 to 30 percent of investment). Investors may be turning to investments in real estate for psychological or speculative (rents) reasons rather than for productive purposes (Banking Focus Group).

- Productivity is low in the formal manufacturing sector due to the following factors:

  - Loss of African regional markets with demise of East African Community in 1970s has lowered capacity utilization and raised unit costs;

  - Import substitution has encouraged inefficient production relative to cost of imported goods;

  - Inflation in price of capital goods and imported inputs relative to other goods may have increased cost of investment required to produce each additional unit of output;

  - Use of transfer pricing, management fees, royalties, and other mechanisms by MNCs may inflate costs of local production (Government Focus Group).

- Credit is going primarily to larger established firms which have been less productive but which can meet collateral requirements; the small business and informal sector seem to get higher returns on investment but have difficulty getting access to credit (survey and description).

- Productivity of parastatal investment is low (Sessional Paper) because:

  - Although the data is difficult to disaggregate, much of GOK "investment" in parastatals may actually be a form of compensation or subsidy for losses. GOK investment in parastatals has continued to rise and by 1984 total GOK investment (in the form of grants, loans, subsidies and guarantees) in parastatals accounted for 39 percent of GNP. Parastatals accounted for about 20 percent of GOK's development (capital) budget in the mid 1980s. Parastatals contribute heavily to external debt borrowing, contributing approximately 35 percent to total external debt over the 1973-86 period.

- Productivity of government investment is low because:

  - Allocations of scarce capital have not always been made with productivity as the main priority (Sessional Paper).

  - Facing budget constraints, across the board cuts delayed investments, hence postponing the productive impact of that investment.

- Foreign assistance may have been subsidizing capital. Such underpricing of capital relative to labor may have contributed to inefficient utilization especially in import substitution industries (Donor Focus Group).

4. <u>Kenya's economy is inward-looking</u>.

- Merchandise exports are running at about US$1.1 billion while merchandise imports are running at about US$1.7 billion. The trade deficit has doubled since 1986. External debt as a percentage of GNP has been rising.

  - External debt service charges have grown from less than 5 percent of export earnings in 1974 to over 25 percent in 1987.

- Foreign exchange generated by services, tourism and

transport and donor aid have helped finance the trade deficit, but recent trends cast doubt on the prospects that tourism revenues will double over the next 5 years. It seems unlikely that donor aid can or will grow over its present US$ 800 million level. [Over the past 5 years, donor aid and soft loans have provided over US$ 3.5 billion in foreign exchange to Kenya. This aid has helped fund the growing trade deficit and supported the growth of government expenditure. In 1989 donor aid and loans will finance approximately 27 percent of expenditure.]

- Aside from some success in horticultural products, the country remains dependent on the two traditional crops, coffee and tea, for the bulk (47 percent) of its foreign exchange earnings. Non-traditional export growth has been slow and these products still account for only 20 percent of total export earnings.

- The regulatory environment affects export costs in a variety of ways:

  - High transaction costs associated with paperwork processing related to export licensing requirements, foreign exchange controls and the administration of the export compensation scheme (Exporter and Large Scale Enterprise focus group feedback);

  - Add-on costs of doing business (e.g. such as a 1.5 percent deposit for the import license; a letter of credit opening charge of 2-3 percent; a 1.5 percent port fee; charges on c.i.f; clearing and forwarding charges of 2 percent -- Large Scale Enterprise focus group feedback);

  - Interest rate and credit ceilings make financial institutions reluctant to finance riskier/untried export activities, even if the exporter has an export order and a letter of credit from a foreign bank in hand (Exporter and Large Scale Enterprise focus groups).

- The inward-orientation of the private sector was confirmed by data from the survey. On average, 96 percent of the companies' direct sales were in the domestic market. The percentage sold domestically was fairly constant for firms of all size categories, except for the largest firms which, on average, reported exporting 16 percent of their product. The number of firms in the sample interested in exporting was small (17 percent of the sample), though this percentage is substantially greater than the number of firms who were actually

engaged in any export activities (less than 10 percent of the sample were exporting any amount and only 3 percent were exporting over 50 percent of their product).

- Focus Group feedback confirmed the many obstacles facing would-be exporters in Kenya.

Implications/Conclusions (of points 1-4):

Without more significant progress in implementing the GOK's new economic strategy, current structural inefficiencies in Kenya's inward-looking economy will prevent the economy and the private sector from achieving the growth and employment targets set by the GOK.

- The economy has been creating jobs at a rate below that of population growth. Some 400,000 new jobs are required each year. By the year 2000 over 600,000 new jobs will be required. At current rates of employment growth, unemployment and underemployment will double by the year 2000.

- The distortions created by the policies associated with import substitution have lowered the efficiency of investment, implying lower economic growth. The challenge is partly to mobilize higher private sector investment levels but even more importantly to improve the efficiency and productivity of that investment in order to increase economic growth.

- Kenya must make the transition from an inward-looking economy, based on a strategy which favored parastatal investment, import substitution and increased government spending to an outward looking one based on market efficiencies and strong private sector growth.

5. The business climate in the country is not favorable.

- Foreign investor confidence in the economy has declined. There has been a marked decline in foreign direct investment in the country since the early 1980s. Though it bounced back slightly in the mid-1980s, it has not achieved levels reached in the late seventies. Preliminary IMF data for 1988 show direct foreign investment of only US$ 7 million.

- According to USAID's own estimates, in 1988 more private capital left the country than came in.

- Data from the survey supports the IMF statistics. Only

a third of the firms surveyed believed that there had been an improvement in the business climate over the last year.

- Lack of confidence in the economy and general environment is more pronounced among foreign firms and firms owned by Kenyans of non-African origin than for the African owned enterprises. In the survey, almost 70 percent of foreign firms felt that the environment had deteriorated, compared to 59 percent of firms owned by Kenyans of African origin.

Implications/Conclusions

Lack of private sector confidence in the economy and the general environment for business encourages speculative investment and capital flight. The economic and institutional environment is the single largest impediment to private sector growth.

6. <u>Much of the growth in the private sector has come from small and informal sector firms</u>.

- The share of the informal sector in wage employment has grown from about 10 percent to over 20 percent from 1977 to 1986.

- Small scale share of manufacturing GDP has grown from 10 percent in 1977 to 18 percent in 1986.

- Returns on investment are said to be high in the small scale sector, according to focus group participants, although many small scale business operators also report annoying difficulties and delays when dealing with institutions and regulations.

Implications/Conclusions

Informal sector growth confirms the presence of a potentially dynamic private sector which has had to work outside the established institutional environment. This sector is doing relatively well.

7. Survey results and focus group feedback indicated that the regulatory and institutional environment was the single largest obstacle to growth.

- Large firms were primarily affected by taxes and licensing regulations. Agribusinesses were most negatively affected by marketing controls which influence both output and raw material availability, referring to the distorting role of government marketing boards and import regulations. Small and medium size export oriented firms reported difficulties in marketing abroad due to limits on foreign exchange and other requirements.

- Dialogue results suggest that the high effective corporate tax rates (after accounting for a large number of add on taxes and duties) also may be having an adverse effect on firms' willingness to disclose financial information, with a subsequent limiting effect on equity capital markets.

- Data from the dialogue sessions noted recent progress in the regulatory environment. In particular, access to import licenses has improved, as has the manner in which many of these controls are administered through increased computerization. However, the number one message from firms was to simplify and streamline procedures.

Implications/Conclusions:

The regulatory environment is increasing the cost of doing business in the country and reducing the efficiency of capital markets. It may also be reducing GOK revenue. The high tax rate may discourage financial disclosure and encourage tax evasion. The regulatory environment causes business dissatisfaction and may be leading to increased speculative rather than productive activity. Dialogue sessions revealed however that not all private sector firms have an interest in actively promoting deregulation across the board. Local manufacturers would not look kindly on losing their protective barriers, for example. Banks may complain about credit ceilings or interest rates, but they have learned how to cope with their environment and are doing well enough so as to have little incentive to change. However, there is business consensus about the need to simplify some bureaucratic procedures, particularly those related to export licensing and foreign exchange, as well as lowering the tax rate and/or the other "add-on" taxes which raise the effective rate.

8. Firms lack adequate information of various types.

- Market information:

  - While 62 percent of respondents felt they had reliable information on the domestic market, only 17 percent felt that they had good information on international markets.

  - Official information sources for exporters, such as the Kenya Trade Authority, the Ministry of Commerce or the Horticultural Crops Development Authority, are currently providing information to less than 30 percent of all respondents who are exporting any significant amount. The majority of all firms continue to rely on personal contacts (90 percent) or trade journals and publications (33 percent) for information on markets.

  - Dialogue sessions revealed that firms also lack good information on the trade policies, preferential agreements, and product standards in potential export markets.

  - Responses to the survey suggest that there is substantial demand for market information services. Results from the dialogue sessions confirmed this.

- Procedural information:

  - Dialogue sessions disclosed that there was substantial confusion among the smaller entrepreneurs regarding credit application and various licensing procedures: e.g. how to apply for licenses or loans, how to fill out forms, and how to get access to available programs of credit and assistance.

Implications/Conclusions

Lack of information is often at the root of market inefficiencies. Increasing information flow and access lowers the cost of doing business, increases the rate of return, and facilitates efficient allocation of capital and resources.

Aside from regulatory constraints, the survey data suggests that part of the reason why export growth has been stagnant may be because entrepreneurs simply do not know how to go about marketing their product abroad, or finding the best markets for their products, or determining in which markets they can be competitive.

9. <u>Transport infrastructure is a serious constraint to export growth and agribusiness development</u>.

- Survey results showed that access to affordable transport was one of the top 4 resource constraints for firms operating in most sectors, and particularly for the larger exporting firms.

- Focus group discussions revealed that lack of good road infrastructure affected export trade, particularly within the PTA region.

Implications/Conclusions:

Dialogue and survey results suggest that part of the reason for high transport costs is poor road infrastructure. In addition, regulatory constraints increase the costs of vehicle maintenance (e.g. by increasing costs of transport equipment and spare parts).

10. <u>The key resource constraint affecting growth among small firms is access to credit, due primarily to their inability to meet collateral requirements</u>.

- The survey revealed that firms in this size category rely heavily on non-formal sources of capital, particularly personal funds and funds provided by family and friends.

- Part of the difficulty smaller firms have in obtaining credit is the lack of traditional loan security, such as a title deed. The survey revealed that less than 10 percent of the smaller (owner operated and microenterprise) firms have title deeds to the land they are occupying. Less than 75 percent of even the small and medium size firms have title deeds to the land. Almost one third of the owner operated firms have only squatter rights to the land they are occupying.

- Focus group discussions revealed that some banks might be willing to accept alternative forms of collateral, especially if interest rates are liberalized in mid-1992 as planned. However, few small entrepreneurs have the training to prepare the type of documentation necessary to assess credit worthiness and feasibility.

Implications/Conclusions:

The outreach potential of banks is great, given their well developed infrastructure, particularly in the more remote rural areas. This makes them appealing credit intermediaries. Survey results show that smaller firms, to the extent that they are using any formal source of capital at all, tend to use a commercial bank. But banks cannot be expected to meet all the demand for credit. Moreover, dialogue sessions with the banking sector suggest that banks are not very interested in active outreach activities aimed at the small scale enterprise and informal sectors. The banking institutions have learned how to cope well and profit from the current regulatory environment. Hence, other intermediaries must be found to fill this vast demand.

A surprising result of the survey is the relatively insignificant role cooperative societies play in small firm financing. It would be important to investigate the role of cooperatives in business lending further. Several donors reported working with these groups already and may have some insight into their potential role in promoting small enterprise growth.

11. <u>There is very little business or informal contact between the large and the smaller firms</u>.

- Survey results show that there are presently few subcontracting arrangements between small and large firms.

- The smaller firms generally do not belong to the same business associations as do the larger firms.

- Dialogue sessions suggested that the larger firms were aware of this linkage issue and were already taking steps to address it. Initiatives such as K-MAP as well as the Asian Development Foundation are currently providing contact points and networking opportunities through training to small firms by larger firms.

12. <u>Very small businesses have not yet formed effective business associations</u>.

- While small business associations do exist, only one out of 5 firms employing less than 5 people belonged to any association.

- Survey responses show that the organizations serving the smaller firms are less effective than those serving large enterprises (such as KAM).

- The KNCCI has the largest and most diversified membership base. Focus group discussions suggested that this organization, by virtue of its size and diversity, may be a good vehicle for delivery of outreach activities to the smaller firms.

Implications/Conclusions

The lack of organizational infrastructure makes it difficult to channel credit and training resources to the smallest firms. Donors have been working with a variety of NGOs as intermediaries, but dialogue sessions suggested that many of these organizations may lack the expertise in the business of credit, though they may be very good at providing other social services. In addition, their large overheads and lack of experience may be increasing the cost of credit provision to the informal sector. Strengthening business organizations such as KNCCI which already has a fairly broad based membership may be desirable. Using existing institutions such as the KNCCI or the Kenya Small Traders Society is appealing as well because many of its members are traders who may already be extending (supplier's) credit to some of the smaller firms. Thus the association could capitalize on its knowledge base and outreach potential.

There is substantial consensus among the larger firms about the need to increase their linkages to the smaller firms; and initiatives such as K-MAP, even if expensive (as the PED evaluation showed) are desirable from a standpoint of the potential networking opportunities it may provide in the future for the smaller entrepreneurs.

13. Access to quality skilled/supervisory labor was not perceived as a serious constraint by the firms sampled. Almost 8 out of every 10 respondents felt satisfied with the productivity of their workers.

- This was confirmed during the focus group sessions. Aside from some specific technical skills, large firms were satisfied with employee skills.

- Small firms may lack only basic business skills training and not require higher order managerial skills given the scale of the operation.

Implications/Conclusions:

Basic business skills training (bookkeeping, feasibility studies) may be the single most important type of training which can be offered because it provides the small entrepreneur with the tools to "graduate" to other credit services. Banks have expressed some willingness to extend unsecured credit if the applicant can produce adequate proof of credit worthiness. On the other hand, as long as the present interest regulations remain, the opportunity cost of lending to the smaller, riskier client will remain and no amount of training, either to the bankers or the applicant, will make more than marginal difference.

Some training activities could be reoriented towards providing public sector officials (at the lower levels) with the tools to facilitate business transactions.

14. The participation rate of women in business has accelerated, but they still face special obstacles to full participation.

- Description data show that the participation rate of women in the labor force has increased from 18 percent of the total in 1980 to 23 percent in 1985.

- Data from the survey show that the participation rate of women is almost 80 percent higher in small and micro firms than in large firms. This may be explained because:

  - Women-owned firms, which tend to be smaller, are more likely to hire women. (Some 68 percent of women-owned firms were either small or microenterprises, compared to 56 percent of all the firms in the sample.)

  - Labor laws, which restrict the shifts in which women can work, raise the costs of hiring women. These requirements may not affect those firms operating outside the regulatory environment. In addition, some smaller firms by their nature can be more flexible in terms of time and place of work, allowing women to work at home, or change shifts as their household responsibilities require.

- Survey data show that there are very few women in top management positions, particularly in the larger firms (women accounted for only 11 percent of the top management in medium and 5 percent of the top management in large enterprises).

- Survey data show that women-owned firms face not only the same resource constraints affecting microenterprises, but also face special constraints, such as a legal framework which makes it even more difficult for them to meet collateral requirements.

- Comments from various women entrepreneurs and institutions assisting and working with women entrepreneurs confirmed these findings. Representatives from the large scale firms confirmed that labor laws do increase the cost of hiring women.

- Data from the focus group discussions suggest that, in addition, women entrepreneurs lack adequate information regarding their legal rights.

Implications/Conclusions

The above data suggests that a blanket approach to microenterprise development may not effectively address the special constraints faced by women in business. Reaching them may require special access channels. There are already a number of intermediary organizations which are providing specialized assistance to women entrepreneurs. Data from the survey show that 23 percent of the women-owned enterprises belong to an association, such as Kenya Women's Finance Trust and women's cooperatives. There is at least one support group association for professional and business women. Such groups could help channel targeted assistance.

III. PROPOSED STRATEGY

This section begins by describing how the proposed strategy fits within the Mission's overall country development goals. It then organizes the implications of the findings and conclusions reported in the preceding chapter into private sector program subgoals, strategic objectives, targets, and a list of action options for each target area.

It is important to note that the action options outlined below are only suggested areas of effort. Most do not need to be implemented as discrete projects, but rather incorporated over time into existing and new projects when and where possible, and/or carried out in cooperation with other donors.

Country Program Goal and Sub-Goals (see Exhibit 1 -- Objective Tree)

1. The following modification is proposed for the USAID-Kenya Country Program Goal: **"SUSTAINED AND BROAD-BASED GROWTH IN KENYANS' PER CAPITA INCOME."**

   - The inclusion of "per-capita" links the goal more closely to the Health and Population Country Sub-Goal. While their program works on the "per-capita" side of the equation, the private enterprise and agriculture programs work on the income side.

   - It focuses on per-capita income rather than on economic growth in general and so differs only slightly from the Mission's earlier proposed goal statement.

   - The inclusion of "Kenyans" more clearly covers any subsequent programs directed at empowering women and other indigenous KENYANS to participate in a more dynamic, private sector oriented economy through entrepreneurship, training and other projects.

   - The country goal is easily measurable on an annual basis. While the Mission will decide on realistic targets, we would suggest a range of per-capita income growth of 1.6 to 2.0 percent. These figures are in keeping with the GOK's own targets as presented in current economic planning documents. They suggest annual growth rates of 5.6 to 6.0 percent in real GDP.

   - The term "broad-based" could be measured in a number of ways:

-- Income distribution effects of growth are positive;

-- The participation of women and indigenous Kenyans in business and in managerial positions has increased relative to percentages prevailing in the 1989 Private Sector Survey.

-- Percentage of women in the workforce has increased from 1989 level of 23% to 28% by 1994.

2. The Proposed Sub-Goal Statement for Private Enterprise Development is: **"INCREASED PRIVATE SECTOR OUTPUT AND EMPLOYMENT."**

- Though MAPS findings revealed that overall levels of investment are already relatively high in Kenya and that the quality of investment or productivity may be the key problem, productivity of investment is difficult to measure at the sectoral level given available data. Suggested targets for investment are difficult to define since it is impossible to disaggregate the proportion of total investment which comes from the private sector and that which comes from parastatals. Thus, it might be easier to simply monitor sub-goal progress by focusing on private sector production rather than the capital output rates. MAPS data have provided baseline estimates of the total contribution of private sector to GDP, at the sectoral and sub-sectoral levels.

- If the Mission wishes to monitor macro level productivity of investment we recommend a target of improving the capital output ratios from the current 6:1 to 5:1 or better. While levels of 4:1 or better are not unknown among developing countries, investment costs tend to be higher in sub-Saharan Africa. The figure cited would show demonstrated improvement and is consistent with countries where market forces are allowed to predominate.

- Employment targets will have been achieved if jobs have kept up with the growth rate in the labor force (approximately 400,000 new jobs are required per year);

- Baseline data on the above indicators have been included in the Kenya Country Reference Binder.

Strategic Objective (see Exhibit 1 -- Objective Tree)

3. The proposed Strategic Objective for Private Enterprise Development is **"INCREASED LEVEL AND PRODUCTIVITY OF PRIVATE INVESTMENT."**

   - Ideally, the focus of the strategic objective should be productivity in addition to private sector investment, in keeping with the findings of the various studies performed as part of the private sector assessment. Since it is impossible at the present time to disaggregate private from parastatal investment at the macro level, it is difficult to establish specific capital output ratio targets. Hence, numerical targets will only be established for overall private sector investment as a percentage of GDP, and will leave open the possibility of establishing specific productivity targets for a time when data availability permits more precise measurement of private/parastatal investment figures.

   - Suggested numerical targets include private investment rates of 15-16 percent of GDP, which would represent almost 70 percent of total investment figures for 1989.

4. In the absence of significant change in current macro-economic policies and institutional impediments, other activities such as credit, training, technical assistance and other USAID interventions will have only minimal impact in accelerating private sector led growth.

   - This in turn implies that the Mission's private enterprise development activities will focus on the central theme of **facilitating Kenya's economic transition** to outward oriented private sector-led growth.

5. Achievement of the strategic objective requires an **"IMPROVED ENABLING ENVIRONMENT FOR MARKET-LED, OUTWARD-ORIENTED, PRIVATE SECTOR GROWTH."**[2]

   - Successful implementation of the GOK's economic reforms and improvement in the institutional enabling environment are the two overwhelming requirements for **sustained** private sector growth. Thus, the Objective Tree stresses the overwhelming importance of macro-economic and

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[2]Chapter IV in this report defines more precisely activities in this regard.

institutional change as articulated in the GOK economic strategy.

- This in turn implies that the **central focus** of USAID strategy should be to assist the GOK in effective implementation of its re-orientation of the economy.

- As a result, providing assistance to the GOK on policy design and implementation, close donor coordination, and improving the institutional enabling environment will receive an even stronger emphasis than in the past.

6. Three Strategic Targets are Presented:

- Expanded base of private **domestic** investment and entrepreneurship.

- Liberalized and deepened financial markets.

- Expanded and diversified private export production and foreign private investment.

7. Strategic Target Achievement can be measured by the following:

- Expanded Base of Domestic Investment and Entrepreneurship:

  -- Estimates of private sector share of production and investment have increased.

  -- Estimated numbers of informal sector firms have decreased relative to formal sector.

  -- The number of Kenyans of African origin and women has increased as a percentage of entrepreneurs vis-a-vis their percentage measured in the 1989 private sector survey and women account for a higher percentage of the workforce and management as measured by Kenyan labor force statistics.

- Liberalized and Deepened Financial Markets:

  -- Interest rates have been liberalized and credit is being allocated more effectively by market forces. A higher share of credit is going to new companies and entrepreneurs where risks and returns are higher.

  -- Total equity and the number of companies on the Nairobi Stock Exchange have increased as has credit

available to the private sector.

- Expanded and Diversified Export Production and Private Foreign Investment:

  -- Export earnings have increased.

  -- Export earnings from non traditional exports (such as horticultural crops, manufactures) have increased.

  -- Export markets have diversified.

  -- Foreign investment in Kenya (as recorded by the IMF's International Financial Statistics) show new foreign investment running at an average of US$15 million, which is quite low. Suggested target levels would be US$50-$100 million per year.

  -- The introduction of an Export Processing Zone should stimulate foreign investment substantially. Since this represents a different form of foreign investment and its rise might even take place in the absence of substantial changes in the rest of the economy, targets should be set separately for the EPZ.

Criteria for Evaluating the Action Options

8. Given the above goals, objectives and overall strategic thrust, action options suggested below will be evaluated according to the following criteria:[3]

   - It must contribute directly to the development of a market-oriented and outward-looking economy.

   - It must contribute to the creation of an institutional enabling environment, i.e. a system of public and private sector services that expedite business growth.

   - It must encourage market forces in the financial system so that the system raises capital in sufficient quantity and allocates it in ways which enhance the quality (i.e. productivity) of Kenyan investment.

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[3]Each action option suggested below does not necessarily have to meet ALL criteria directly, but must at least be complementary to actions which do meet these criteria directly.

- It must contribute to the creation of broader based participation of Kenyans in private enterprise and in the benefits of private sector led growth.

Furthermore, it must do these things in ways which:

- Capitalize on local private sector leadership;
- Respond directly to GOK concerns and goals and hence enjoy strong GOK backing;
- Bring into play the unique competencies of U.S. foreign assistance in general and the USAID-Kenya Mission in particular;
- Complement, rather than duplicate, other donor efforts;
- Promise to have both long term structural, as well as short term benefits, within the 5-year time frame of this CDSS.

Target Options Menu

Below we identify and describe all those activities (action options) which will enable USAID to meet each of the targets proposed in point no. 7, and which meet the criteria suggested in point no. 8 above. The purpose here is to present the Mission with a full set of options for achieving the stated objective. For each target area, specific interventions can be classified into 5 types (see Exhibit 2):

- Actions which focus working with GOK on macro-policy design and implementation;
- Actions which focus on identifying and removing unnecessary institutional impediments;
- Actions which focus on identifying and strengthening enabling institutions;
- Actions which focus on the provision of assistance, such as credit, training and technical advice to private entrepreneurs to enable them to react efficiently to changes which will be taking place in the enabling environment;
- Actions which focus on coordinating assistance with other donors.

Final determination of which type of actions are finally chosen should depend on specific opportunities which arise in the environment (including actions by other donors and the GOK) and the Mission's own determination of staffing and financial support available. Chapter IV suggests which actions should receive priority, given the MAPS Team's understanding of the PRESENT environment, the CURRENT policy reform agenda established by the World Bank and the types of implementing vehicles currently available to the Mission.

9. To improve productivity and expand domestic investment and encourage investor confidence a number of activities are proposed focusing on the tax and investment codes.

- Interventions in Macro Policy

  -- Assist With Tax Reform. Further reduction of the corporate tax rate from its current level of 42.5% would improve the business climate and mobilize more domestic investment. Elimination of add-on taxes, some of which have an inherent anti-export bias, would further improve the situation. However, this reform would have to lead to an increase in voluntary compliance or better enforcement so that overall government revenues would not suffer. This will require technical assistance in an area where the U.S. has much expertise. AID-funded UNDP efforts are underway in this area but a more hands-on approach is warranted as this effort is scoped out and implemented. It is critical that such assistance looks not only at the revenue impact but also the economic impact on investment output. More transparency in corporate financial reporting could lead to strengthened equity markets with minority investors feeling greater confidence and protection. Research quantifying the effect of tax cuts on revenue could provide GOK officials with the "ammunition" to carry out these reforms; (e.g. show the effect on revenue of decreasing the effective tax rate).

  -- Revise Kenya's Investment Code. Assistance from the IFC is already underway, but should be closely followed.

  -- Assist with Fiscal Policy Reform. The GOK seeks to introduce greater budget rationalization, focusing on more productive government investments. This is understandably difficult, as it is subject to political pressures from various constituencies. USAID should explore ways to assist the GOK in these

efforts.

-- Assess Kenya's Competitiveness. Much may be accomplished by informing policy makers about Kenya's ability to compete with other countries. Producing a comparative analysis of the investment climate in Kenya relative to other countries could help improve the environment for both domestic and foreign investment by leading to specific changes to improve Kenya's competitiveness. One way would be to support training of GOK officials in policy analysis and in visits to outward-oriented, private sector driven economies.

- Interventions to Remove Institutional Impediments

  -- Finance a study which would review, simplify, standardize and communicate procedures for all permits, approvals, licenses, registrations, and other required interactions with government authorities.

  -- Involve key operational civil servants in reform and bureaucratic simplification so that by being involved in the planning, they will be committed to the implementation.

  -- Identify and strengthen those government offices most critical to the successful functioning of private enterprise. These offices could be strengthened to provide more timely support and more service-oriented assistance.

- Interventions to Strengthen Enabling Institutions

  -- Promote a clearinghouse, or informational network between potential U.S. investors and potential Kenyan partners.

  -- Catalogue all existing donor, NGO or other programs providing credit and technical assistance and disseminate information via mass media so that informal and micro firms can be made aware of the programs.

  -- Promote/continue support for institutions and mechanisms which create linkages between small/micro sector firms and larger firms:

  -Continued support to institutions such as K-MAP, and expansion of support to organizations which are not currently receiving assistance but which have

expressed interest in such types of activities, such as the Asian Fund for Development.

-Strengthen organizations, such as KNCCI, which already has a broad based membership, or the Kenya Small Traders Society, since many of their members are traders who may already be extending (supplier's) credit to some of the smaller firms. Capitalize on these associations' knowledge base and outreach potential.

-Support groups such as the Professional and Business Women's Organization or the Kenya Women's Finance Trust and women's cooperatives, for the provision of specialized information and outreach programs for women entrepreneurs (e.g. legal rights, collateral and credit).

-Support intermediary organizations which serve as a bridge between small businesses and the formal lending institutions, providing basic business skills training, creating alternative forms of uncollateralized lending and generally working to increase the outreach potential of lending institutions.

- Interventions in Entrepreneurial Assistance

-- Carefully designed and targeted private enterprise training and direct business "enabling" programs will continue to be important to USAID-Kenya strategy for at least six reasons:

They inform macro level and institutional reform efforts;

They add credibility to USAID dialogue efforts and expertise in design and implementation assistance;

They enable USAID to monitor implementation and assess micro-level impact;

They provide substantial and concrete material for positive feedback to reinforce public opinion and GOK policymakers regarding the positive impacts of market-oriented and private sector reforms, thereby increasing the likelihood that such reforms will continue;

They help speed and spread the micro level private sector response by enabling actors at

the micro level to respond more quickly and effectively to the opportunities presented and overcome the remaining bottlenecks;

It provides other donors, through USAID, with a window on the microeconomic impacts of macroeconomic reforms. These "case studies" of what is working or not working at the micro level were recently mentioned by World Bank officials as being essential to verifying critical assumptions and to fine-tuning the economic reform implementation.

-- These interventions will focus on activities which promote broader participation in the private sector. They will "enable" businesses in Kenya to respond efficiently to the changing institutional and policy environment and will increase their ability to compete in a liberalized economy.

-- Specialized training activities have a role under this component. Under a liberalized credit market, bankers will have an incentive to seek out and lend to new clients, and there may be incentives for the creation of new financial intermediaries, specialized and better equipped to assist a new "non-traditional" client base; assistance should focus on making small business/non-traditional clients better able to access the resources of these lending institutions through basic business skills training (e.g., bookkeeping, feasibility studies)

- Actions to Increase Donor Coordination

-- Rather than being one more donor involved with the micro-enterprise sector, the MAPS Team suggests a sectoral coordinating role for USAID to facilitate information flow on various donor assistance programs (see action options under "identify/remove institutional impediments"). Such actions might culminate in the creation of a Micro-Assistance Coordinating Committee which would eventually lead to the formation of a National Micro-Enterprise Association.

-- Encourage discussion on parastatal assistance policies, and discourage donor policies which continue assisting parastatals.

-- Increase other donor awareness of special problems of women in business, and coordinate assistance efforts in this regard.

12. For achieving liberalized and deepened financial markets a number of activities are proposed which will focus on making capital markets more dynamic and efficient and hence more responsive to the needs of an expanded base of entrepreneurs.

- Interventions in Macro-Policy

  -- Interest Rate Deregulation. Support for policy dialogue and technical assistance activities to promote the accelerated implementation of interest rates deregulation.

- Interventions for Removing Institutional Impediments

  -- Assist/support the development of diversified monetary policy instruments for the Central Bank (being undertaken by World Bank), to provide an alternative to the use of credit ceilings as a way of regulating the money supply.

- Interventions for Strengthening Enabling Institutions

  -- Strengthened Capital Markets Development Authority. Assist Capital Markets Development Authority by providing technical assistance with new financial instruments such as Mutual Funds, Employee Stock Ownership and others which could at the same time mobilize investment while broadening participation.

  -- Strengthen non-bank financial institutions. Actions in this regard can serve to diversify the lending services available to entrepreneurs, particularly non-traditional borrowers, such as women or small scale businesses who may lack a credit history or traditional forms of collateral.

- Interventions for Assisting Entrepreneurs

  -- Credit guarantee program using supplier's credit to extend their capacity to make working capital loans in the form of goods and materials to existing small enterprises.

- Interventions in Donor Coordination

  Work closely with The World Bank as liberalization in financial markets continues and offer to provide the "enabling assistance" (studies, technical assistance, training, etc.)

13. For achieving expanded and diversified export production and foreign private investment a number of activities are proposed which will focus on making local entrepreneurs more outward oriented by reducing the costs and risks of exporting activities and which will decrease the risks and costs of conducting business in Kenya for the foreign investor. However, it should be noted that activities to increase foreign investment are not likely to succeed until changes are made in the macro and institutional environment. The investment climate is not yet attractive.

- Interventions in Macro Policy

  -- Support for policy dialogue and technical assistance activities to promote implementation of trade deregulation, in particular accelerate the reduction of import restrictions.

  -- Accelerate implementation of EPZ concept, while encouraging Private Management.

  -- Reduce anti-export bias by reducing institutional controls affecting access to letters of credit, export licenses, customs clearances, imported inputs, etc. Elimination of the anti-export bias (addressed above) will help attract foreign investment on the basis of the potential for a larger market.

  -- Encourage more and better access to needed foreign exchange for those producing exports and reducing foreign exchange controls, approvals for travel and "allowances" for taking foreign exchange on trips for trade fairs and marketing activities

  -- Sponsor a study of Kenya's competitiveness in the world and of policies and conditions which make a country competitive in attracting foreign investment. Then publicize the results of the study. Also publicize the results of the recent Frost & Sullivan study detailing what investors are looking for.

  -- Encourage continued progress on liberalized repatriation of capital which will help the business climate.

- Interventions to Remove Institutional Impediments

  -- Work with GOK, and perhaps with, or through other donors, to determine which institutional controls most impede exporters unnecessarily and recommend eliminating them. Conduct a study of the institutional impediments facing a foreign investor and recommend elimination of those which do not serve a useful purpose.

  -- Work with GOK on neutralizing current anti-export bias, stressing Simplicity, Automaticity, and Speedy and Efficient Administration of government procedures.

  -- Work with GOK and perhaps with, or through, other donors to determine which institutional controls must remain in place but which are essential to expediting exports and recommend ways to improve the timeliness and efficiency of procedures.

  -- In the short to medium term "export compensation" will be required to offset disincentives such as import tariffs, high transport costs, and taxes. The efficiency of the current export compensation scheme must be enhanced. Research into the areas which are currently slowing processing of these compensations could lead to a simplification and streamlining of a system not working well at present.

- Interventions to Strengthen Enabling Institutions

  -- Direct Assistance to Business Associations to develop export market information services which should be accessed on a commercial and sustainable basis. In this context, support could be provided to such associations for the conduct of an assessment of Kenya's competitiveness in world markets so as to produce a short list of which markets and which products would lead to the highest volume and profits in the shortest period of time.

  -- Promote linkages with U.S. and European markets.

  -- Assist in developing backward linkages between export traders and larger companies in Nairobi and Mombasa and small producers in rural areas.

- Interventions for Assistance to Entrepreneurs

  -- Credit and technical assistance for exporters would be useful to "prime the pump". An export guarantee scheme could be a mechanism for reducing the foreign exchange risk, for example. As quantity restrictions on imports are reduced and other liberalization measures introduced, the environment for export-growth will improve.

  -- Once changes are made in the policy and institutional environment, USAID and Africa-MDI could conduct an inventory of potential projects and indigenous Kenyan foreign investment partners and communicate these to potential investors in the United States while promoting a trade and investment conference either in the USA or in Kenya or both.

  -- Again, once the investment climate turns positive, USAID could support a pioneering effort to establish a private sector services support industry for foreign and domestic services.

- Interventions for Donor Coordination

  -- Work closely with the African Development Bank which is sponsoring a trip of African investors to the USA to meet with potential U.S. investors. USAID-Kenya and Africa-MDI could help ensure that this is successful.

  -- USAID's exposure to private enterprise at the micro level through existing projects puts it in a unique position to assist the Bank and other donors in analyzing the impacts of reform at the operational level.

EXHIBIT 1
Proposed Objective Tree for USAID/Kenya

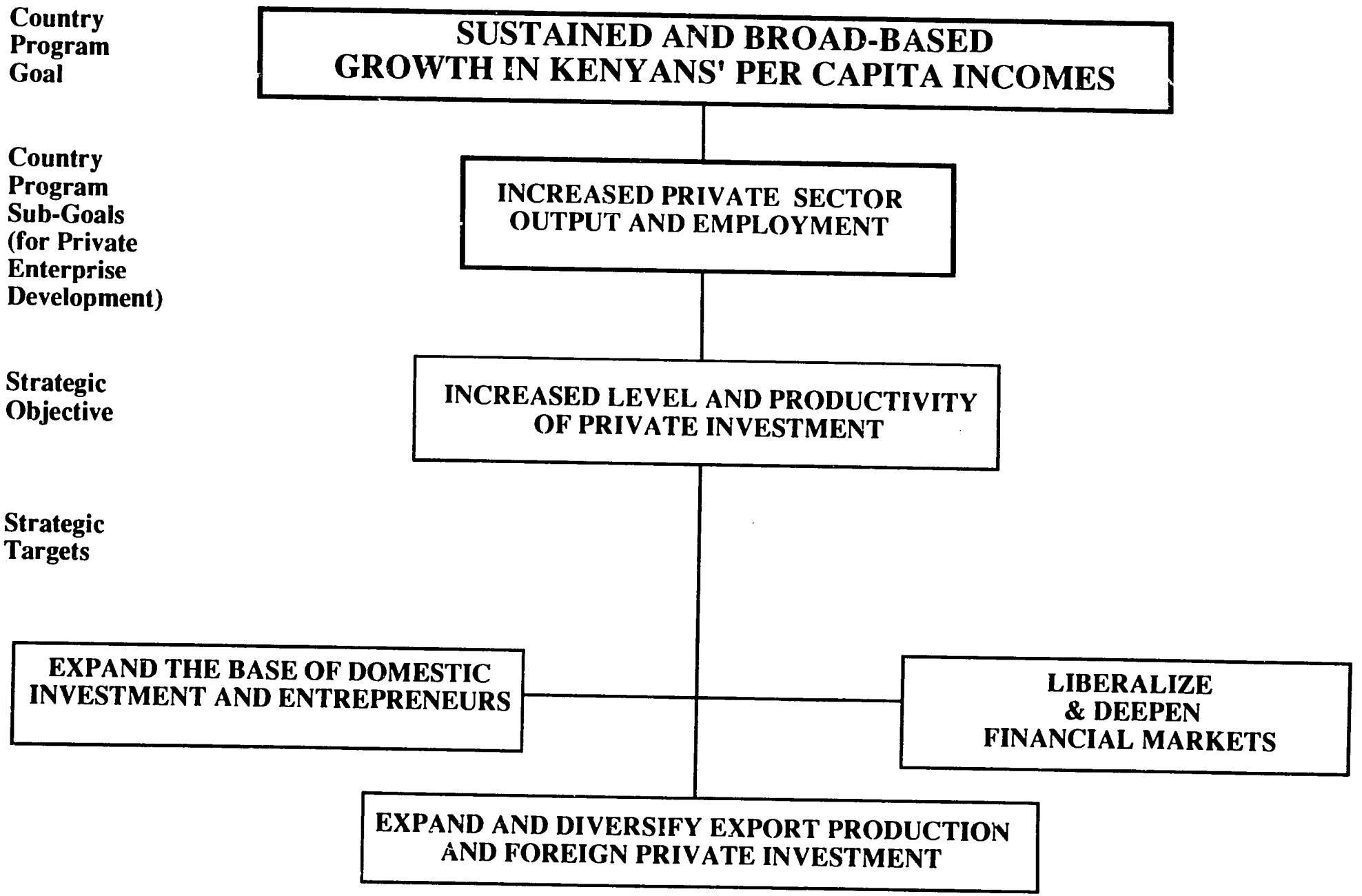

EXHIBIT 2
TARGET OPTIONS MENU

STRATEGIC TARGETS

ACTIONS	EXPAND THE BASE OF DOMESTIC INVESTMENT AND ENTREPRENEURSHIP	LIBERALIZE &DEEPEN FINANCIAL MARKETS	EXPAND AND DIVERSIFY EXPORT PRODUCTION AND FOREIGN PRIVATE INVESTMENT	
MACRO POLICY	•Assist with tax reform •Assist with fiscal policy reform •Assess Kenya's competitiveness •Assist revision of Investment Code	•Promote interest rate liberalization	•Improve export compensation •Eliminate anti-export bias •Assist in design of EPZ regulatory framework •Encourage reduction of import restrictions •Encourage foreign exchange deregulation	•Conduct/disseminate comparative study of Kenya's competitiveness
REMOVE INSTITUTIONAL IMPEDIMENTS	•Finance study to review, simplify, standardize, communicate procedures for permits, licenses, etc. •Involve Bureaucrats in reform •Strengthen critical GOK offices	•Support development of alternative monetary policy instruments (e.g. reserve requirements vs. credit ceilings)	•Identification/removal of unnecessay travel, foreign exchange, export licensing restrictions •Expedite/improve customs controls	
STREGTHEN ENABLING INSTITUTIONS	•Promote informational network •Catalogue existing NGO, Donor credit and TA •Promote institutions/mechanisms to create linkages between large and small firms	•Strengthen/encourage CMDA Independence from GOK •Strengthen NBFIs	•Promote market information services by private sector associations	•TA in implementing EPZ, streamlining procedures
ENTRE-PRENURIAL ASSISTANCE	•Direct business assistance programs to improve private sectos ability to respond efficiently to improved business environment	•Supplier's credit (promote backward linkages)	•Direct assistance (TA/credit) for EPZ set up •Study of competitive markets for Kenya •Leverage outside resources to promote/establish linkages with foreign markets/contacts	•Support "investor's services" industry in private sector •Conduct study of potential Kenyan co-investors •Promote trade conferences
DONOR COORDINATION	•Leadership in coordinating private enterprise promotion activities •Discourage donor parastatal assistance	•Activities in support of World Bank initiatives in financial system	•Coordinate efforts to strenghten/ expedite official GOK offices • Coordinate research/ dissemination of information on anti-export controls/regs	•Work with ADB, MDI sponsoring investor trips and linkages

IV. STRATEGY IMPLEMENTATION

In the preceding chapter the MAPS team identified a number of interventions which were necessary to achieve each of the private enterprise development targets. The menu of interventions, either in the area of policy design, enabling environment, institutional strengthening, direct assistance to entrepreneurs, or donor coordination, only highlighted actions which were possible and desirable, given the results of the private sector assessment carried out as part of MAPS. It did not attempt to prioritize actions, nor identify appropriate project or program implementation vehicles. At the Mission's request, this section addresses such implementation issues. In particular it:

- Sets an agenda in terms of specific policy and institutional interventions in which the Mission is suited to play a unique role, given the findings and observations made in preceding chapters and our understanding of what other donors are doing at this level;

- Places these activities in the context of existing and programmed projects and programs.

It is important to note that while priorities may be established, implementation will be as much a result of opportunities as the careful planning of the order and timing of elements in the strategy. Overall, USAID efforts may be prioritized as follows, though private sector development objectives may best be served by maintaining the flexibility to respond to targets of opportunity within the GOK and the private sector as they arise. In such cases, flexible and quick-response buy-ins such as PRE, AFR/MDI, HRDA, S&T and regional IQ's are available to allow the Mission to finance short-term quick response assistance to institutions or entrepreneurs.

The Agenda for Action: Policy Priorities and USAID's Role

We identify critical policy issues which must be addressed to meet the Mission's strategic objectives below. Within each policy area we suggest actions the Mission may undertake to address these issues and explain the rationale for recommending these actions.

1. EXPORT PROMOTION

General Goal: Trade deregulation; eventual elimination of quantitative restrictions on imports, foreign exchange controls, taxes on exports; progressive reduction in tariffs and simplification and expediting of export compensation scheme.

USAID Role:

A. Setting the "right" legal and regulatory environment for EPZs:

1. EPZs have the potential for quick results in stimulating exports, employment and investment.

2. They are less politically problematic in terms of implications of trade liberalization for domestic manufacturers, jobs, currency devaluation.

3. EPZs have a symbolic marketing value by drawing concrete attention to the GOK's commitment to export growth.

4. They attract a different type of investor who might not otherwise choose to locate in Kenya.

5. The success of EPZs could help generate natural pressure from traditional manufacturers for similar treatment, generating pressure for wider trade liberalization.

6. Other donors, World Bank, IFC, are already working on overall trade liberalization, and have obtained GOK commitment on the replacement of quantitative restrictions with tariffs. While there is a risk that EPZs could stall wider trade liberalization, we believe the risk is manageable.

The issue of ownership and management of the EPZs is critical. At the moment the perception is that EPZs will probably not be privately owned and/or managed. USAID has already sponsored tours of other countries with EPZs to illustrate the hazards of publicly managed facilities. It should use its credibility in the policy area and contacts in the IPC and with other GOK officials to encourage heavier involvement of the private sector in this activity, perhaps through management contracts.

B. Additional targets for policy support in the area of export promotion:

1. Effect of new VAT on exporters, particularly monitoring and ensuring exporter exemption of the tax through some automatic, simple and streamlined procedure.

2. Research/information on other taxes with anti-export bias (add-on taxes on letters of credit, licensing processing, export taxes).

3. Simplification of export licensing procedures and export compensation scheme.

C. Given successful implementation of above, USAID can target specific industries with large export potential, such as the small manufactures sector or the high value agro-export (e.g., horticultural) sector.

Implementation vehicle available: AIMS Program.

2. TAX REFORM AND IMPLEMENTATION

General Goal: Restructuring tax system to yield adequate levels of government revenue in ways which have positive impacts on investment levels and productivity.

USAID Role:

Promote consideration of such reforms in the tax system by increasing understanding of, and ability to analyze, the economic and productive implications, not just the revenue consequences of tax policy because:

1. UNDP has been taking the lead in tax policy reform (and USAID is about to contribute US$1 million via UNDP for revenue enhancement efforts).

2. This current AID-funded effort could have a negative effect if not carefully managed because its purpose is to increase the GOK's ability to tax. This could lead to negative impact on business, greater tolerance of loss generating parastatals, and less political will to tackle tough issues of fiscal spending rationalization.

3. A well structured, simplified, easy to enforce tax system could have the most impact on stimulating new investment in the formal private sector, especially if it allowed for lower rates (e.g., 15 percent) for small companies, much like the U.S. tax code makes provisions for sub-chapter "S" corporations.

4. A simple, well enforced tax system with corporate rates of 30-35 percent (versus 40 percent for local and 50 percent for foreign companies at present) could mobilize investment and also lead to stronger equity markets by encouraging more honest disclosure of company finances.

USAID assistance should focus on encouraging analysis of the revenue elasticity of changes in various taxes:

1. Reduction of overall corporate tax rate to 30-35 percent;

2. Allowing for inflation adjusted or replacement depreciation costs;

3. More equitable treatment of dividend withholding taxes which currently apply differently to nationals of different countries.

4. The introduction of an "S" Corporation status for small businesses to encourage more formal sector small business investment.

Implementation vehicle available: USAID already has a buy-in to the UNDP effort. USAID assistance can take the form of training for select income tax officials and/or sponsoring studies along these lines by KAM, IPC, and other organizations. The funds can be channeled through a vehicle such as AIMS, PED and existing HRDA training resources.

3. FINANCIAL MARKET DEVELOPMENT

General Goal: Liberalized interest rate regime and deepened financial market. Such a system will encourage households to channel savings into mechanisms which in turn allocate credit and capital to productive investment.

USAID Role:

Assistance in the design and implementation of instruments to improve the operations and flexibility of deregulated credit markets and a more diverse set of savings and investment instruments.

1. The GOK has already agreed in principle to interest deregulation with the World Bank, and the release of the Bank's third tranche in its structural adjustment program is contingent on this taking place.

2. The Bank is also providing technical assistance to support the implementation of this policy reform, but has not and is not contemplating assistance in the area of alternative financial instruments to increase/expand the capital market.

3. The development of a strong, deepened financial market is the most feasible way of approaching parastatal divestiture issues. The current GOK position is that issues of divestiture and restructuring of the parastatal sector remain pending until an effective capital market is established.

Types of instruments/actions that might attract savings into the system:

1. Creation of a secondary market for T-bills and government bonds to take some of the burden off the commercial banking system and provide a proxy for current short and long term market interest rates.

2. Money market instruments to increase the appeal and widen participation to include relatively small saver-investors.

3. Mutual funds based on a basket of Kenyan Blue Chip businesses.

4. Enhanced supervisory capability of the Capital Markets Development Authority (Kenyan SEC) which would add to the protection of investors and enhance credibility of these new instruments as well as new equity issues. It can do so by providing training and technical assistance in the development of operations and control manuals.

[Prior to interest rate liberalization, USAID can also expand present credit programs to NBFIs, which are not subject to credit ceilings and have in some cases larger outreach potential than formal financial institutions, especially at the rural and SSE level]

Implementation vehicles available: Some of the technical assistance to establish the CMDA is already being channeled through PED. PED (IESC) and RPE resources may also be used to fund some of the training aspects (working perhaps with the World Bank in the College of Bankers); resources in AIMS may also be used to fund policy analysis activities.

4. INCREASED LEVELS FOREIGN PRIVATE INVESTMENT

General Goal: To create a business environment capable of reversing capital outflow and attracting new foreign investment.

USAID Role:

Many of the actions which promote a good domestic business climate also make the market attractive for foreign investors and have been highlighted above:

1. Implementation of EPZs to show GOK commitment, encourage the "EPZ" investor.

2. Deepening capital markets, making it easier for foreign firms to raise local capital (hence neutralizing to some degree Foreign Exchange Regulation No. 19, prohibiting foreign firms from borrowing in the local market).

3. Reducing the tax rates, including many of the add-on taxes.

4. Simplifying or eliminating the current regulatory web of permits, licenses, and other direct controls of government on enterprise.

In addition USAID could also focus its efforts on:

5. Monitoring current activities related to the design of an investment code, focusing on those regulations which seem to have the largest impact on foreign investors, such as Exchange Regulation No. 19 and capital repatriation.

6. Encouraging joint ventures using IESC and AFR/MDI and ADF resources (contingent upon improvement of business environment).

7. Preparation and dissemination of studies on Kenya's comparative advantage and potential as well as the current obstacles which keep Kenya from realizing this potential.

Implementation vehicle available: PED for support of current policy and technical assistance to IPC; accessing resources through IESC in market intelligence, joint ventures. Africa-MDI assistance in joint venture development.

The Role of Existing Projects and Programs

Below we identify the types of changes in emphasis expected in the current portfolio of private enterprise development activities.

1. Rural Private Enterprise [RPE]:

Possible Reorientation of Activities:

* Reorientation of training activities currently aimed at training bankers in long term lending (which will never have more than a marginal effect under the current regulated financial market environment), to training and technical assistance activities related to developing more efficient and expanded financial markets. The training can be aimed at Central Bank and CMDA officers (e.g., training aimed at expanding the base of knowledge in alternative financial instruments, strengthening CMDA's supervisory functions, etc.).

2. Rural Enterprise Promotion [REP]

Possible Reorientation of Activities:

* Reorientation of REP, as a coordinating and clearinghouse vehicle for microenterprise assistance.

* Increase linkages between REP and the KNCCI aimed at establishing linkages and helping to broker subcontracting arrangements between small and larger firms.

* Increase contacts with NBFIs which have a larger base of experience and clientele in the rural areas as a way of channeling credit assistance to SSEs.

* Explore an alternative financial mechanism such as supplier's credit using existing institutions with a large SSE membership, such as the KNCCI and the Kenya Small Traders Society as brokers.

3. Private Enterprise Development [PED]

Possible Reorientation of Activities:

Since PED will run until FY'94, its various technical assistance and credit mechanisms should be linked directly to respond to training and technical assistance needs arising directly from new exporting, trade and investment promotion opportunities created by a changing and liberalized policy environment. In this sense, much of the PED resources can complement policy work supported by the Mission's AIMS Program scheduled for FY'91. For example:

* Strengthening KNCCI as a vehicle for the provision of marketing information services (by supporting the KNCCI's branch outreach programs, the financing of a trade and investment officer).

* Use of additional IESC resources in ways which support the strategy that has been outlined above, such as its market intelligence database, consulting services in the area of financial instruments, and IESC assistance to critical GOK departments responsible for implementing change.

* Use of KMAP assistance as a tool for increasing subcontracting activity with smaller firms, the provision of marketing assistance (especially in the area of exports), encouraging greater linkages between rural and urban based enterprises.

* Continued support for KAM, particularly in the area of policy analysis and design, in such areas as tax reform, investment climate/code, exporting policy, marketing support services for members.

* Continued support for IPC, particularly studies highlighting lessons learned from Asian export-led growth policies, design of viable investment code, etc.

* PVO co-financing support for a Junior Achievement type program, increasing linkages between the local business community and schools.

Communications and Dialogue

Some of the items in the strategy suggested in this as well as the preceding section will only be able to be implemented after additional research is conducted and designs have been discussed and agreed to with the private sector and the Government. Therefore, it is important to develop a broader and more structured communications and dialogue system. Materials communicating the intentions of USAID's private sector activities may be prepared and workshops/mini-conferences held to discuss implementation before activities reach the status of final design and implementation. This approach is consistent with USAID's development philosophy. Such dialogue and communications activities can also lead to better coordination among donors, an important point given increased donor interest in the area of private sector development.

The strategy suggested by the MAPS Team implies a need to increase the level and intensity of contact with the GOK and indeed the need to look upon the GOK as a "client." Part of the role of a new policy advisor could be precisely to maintain existing contacts and develop new ones with influential officials in key public institutions. These contacts need to be as strong and enduring as those which have been developed with the private sector. In addition, the Mission has a number of people on its staff with a long institutional memory and contacts with GOK which should be leveraged. A reorientation of project staff time to developing such contacts is clearly desirable.

Data Gaps

In the course of conducting its private sector assessment, the MAPS Team came across a number of serious data gaps. Such gaps make it difficult to reach concrete conclusions regarding economic trends or establish specific policy goals on the basis of those conclusions. As part of its own monitoring and evaluation activities, the Mission may want to address some of these gaps.

Good data regarding parastatal activities is scarce, particularly data which would allow analysts to disaggregate the proportion of private investment represented by parastatals and to estimate total parastatal investments. In addition, there is little information concerning the extent and impact of donor support to parastatals, and the overall performance of parastatal enterprises. There is also a need to increase information exchange and coordination on donor assistance activities related to parastatals.

There is relatively little data on the import intensity of various economic activities, particularly those activities which generate much of the foreign exchange. Additional work on the import intensity of the tourism sector for example, as well as its present linkages to the economy, is clearly desirable.

APPENDIX A

SUMMARY OF MAPS PROCESS AND PHASE I

APPENDIX A

SUMMARY OF MAPS PROCESS AND PHASE I

The Manual for Action in the Private Sector (MAPS) is a framework adopted by the U.S. Agency for International Development (USAID) for developing strategies to support and promote private sector development. The framework has been or is being implemented in over 10 countries in Africa. MAPS is a process, in which a number of activities, including primary and secondary data collection and discussion sessions with Government, other donors and private entrepreneurs (Exhibit A.1) are carried out to improve a USAID Mission's understanding of and contacts with the local private sector and to design a private sector development strategy based upon this information.

Private sector development activities cannot exist independently of the Mission's overall development objectives for the country, but must instead help to strengthen and support the Mission's overall development strategy. Accordingly, the first step in the MAPS process is to analyze the current Mission strategy and the role of private sector development activities and mechanisms within the Mission's portfolio of activities. In this way, subsequent research and final strategy design are matched to meet overall Mission development objectives. In Kenya, this first phase began in February 1989.

The strategy articulation details contained in the MAPS Phase I report of March 1989 show that private sector development already played a leading role in the Mission's total program in Kenya. USAID-Kenya's private sector development strategy under the PED program has several components, which may be grouped into three categories: policy dialogue, training and credit. Moreover many of the Mission's projects outside the private enterprise portfolio, particularly those in agriculture and human resource development, also include activities which directly affect and contribute to private enterprise development objectives.

Exhibit A.2 provides a graphic representation of the current Mission strategy as developed during the Phase I exercise in February 1989. Exhibit A.3 relates Mission objectives at that time to its portfolio of activities.

In addition to reviewing USAID-Kenya strategy, the MAPS team interviewed a range of entrepreneurs and Government officials. The information gathered from these interviews raised a number of questions:

- What other areas or opportunities exist in the country for AID assistance? What are private sector needs and constraints? What are the sources of growth and employment in the economy and in the private sector?

- Preliminary discussions with the business community suggested that there were a variety of constraints to entrepreneurial development. But more information was needed to assess the relative gravity of these constraints and how they were distributed among firms of different sizes or operating in various sectors in order to improve, if need be, the targeting of Mission activities. How had private sector firms performed over time? How did the performance of firms in agriculture compare to those in manufacturing and in services? How had smaller firms performed, relative to larger firms? How are the needs and constraints faced by the small entrepreneurs different from those faced by the larger firms? What type of linkages exist between large and small firms?

- Discussions with the business community also suggested that, Government papers and pronouncements to the contrary, the regulatory environment continued to affect business development and growth negatively. Moreover, perhaps as a reflection of this problem, foreign direct investment in the country had also been declining. Under the current private enterprise development portfolio USAID-Kenya been undertaking a number of dialogue activities with Government in this regard and had played a leading role in the deregulation of financial and capital markets (through the CMDA) and the fertilizer markets. The assessment sought to document and quantify the effect of changes in the business environment, in particular: How had the enabling environment for business changed over the last few years? How were firms of different types and sizes being affected by government regulations and taxes?

- Given Kenya's growing debt burden, what opportunities existed for increased foreign exchange generation, particularly in the area of agro-exports and in the development of export promotion zones; how interested where Kenyan entrepreneurs in pursuing export markets; what constrained export growth?

- Finally, the current private sector strategy was developed over 5 years ago, what aspects of the environment had changed, what did this imply for private sector assistance program in terms of funding and management priorities?

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These questions helped guide the design of subsequent phases of MAPS. In particular, the team developed terms of reference for collecting and processing descriptive data on the private sector (Phase II) and for the survey (Phase III), conducted interviews with local consultants and firms who might be contracted to undertake the survey and description studies, and passed notes on proposals received to the Mission. The team also refined the private sector survey instrument and methodology planned for Phase III to address key issue in areas of interest to the USAID Mission. The key findings from these various data gathering activities plus the extensive dialogue with individuals and organizations operating in the private sector are presented in sections II through IV of this report.

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Exhibit A-1

MANUAL FOR ACTION IN THE PRIVATE SECTOR
(OVERVIEW)

PHASE	KEY QUESTIONS	ANALYTICAL TECHNIQUES	OUTPUTS
1. DEFINE CURRENT MISSION STRATEGY	* WHAT IS THE CURRENT MISSION STRATEGY? * WHAT DO AID & OTHERS BELIEVE WILL BE IMPORTANT COMPONENTS OF FUTURE STRATEGY? * HOW SHOULD MAPS BE TAILORED TO RESPOND TO MISSION NEEDS?	* STRATEGY AUDIT * PROJECT INVENTORY * BUDGET ANALYSIS * CONSENSUS BUILDING	* ARTICULATION OF CURRENT MISSION STRATEGY
2. DESCRIBE LOCAL PRIVATE SECTOR	* WHO IS THE PRIVATE SECTOR? * WHERE IN THE ECONOMY IS IT LOCATED? * HOW IMPORTANT IS THE LOCAL PRIVATE SECTOR? * WHAT IS THE SOE'S ROLE? * HOW STRONG ARE THE CAPITAL MARKETS? * WHAT IS THE IMPACT OF PUBLIC POLICY? * HOW HAS THE PRIVATE SECTOR PERFORMED OVER TIME? * WHAT ARE THE LEADING & LAGGING SECTORS?	* DATA GATHERING & ANALYSIS * PRIVATE SECTOR MAPPING	* DATA BASE * PRIVATE SECTOR MAP * PRIVATE SECTOR DESCRIPTION PRESENTATION

Exhibit A-1

MANUAL FOR ACTION IN THE PRIVATE SECTOR
(OVERVIEW)

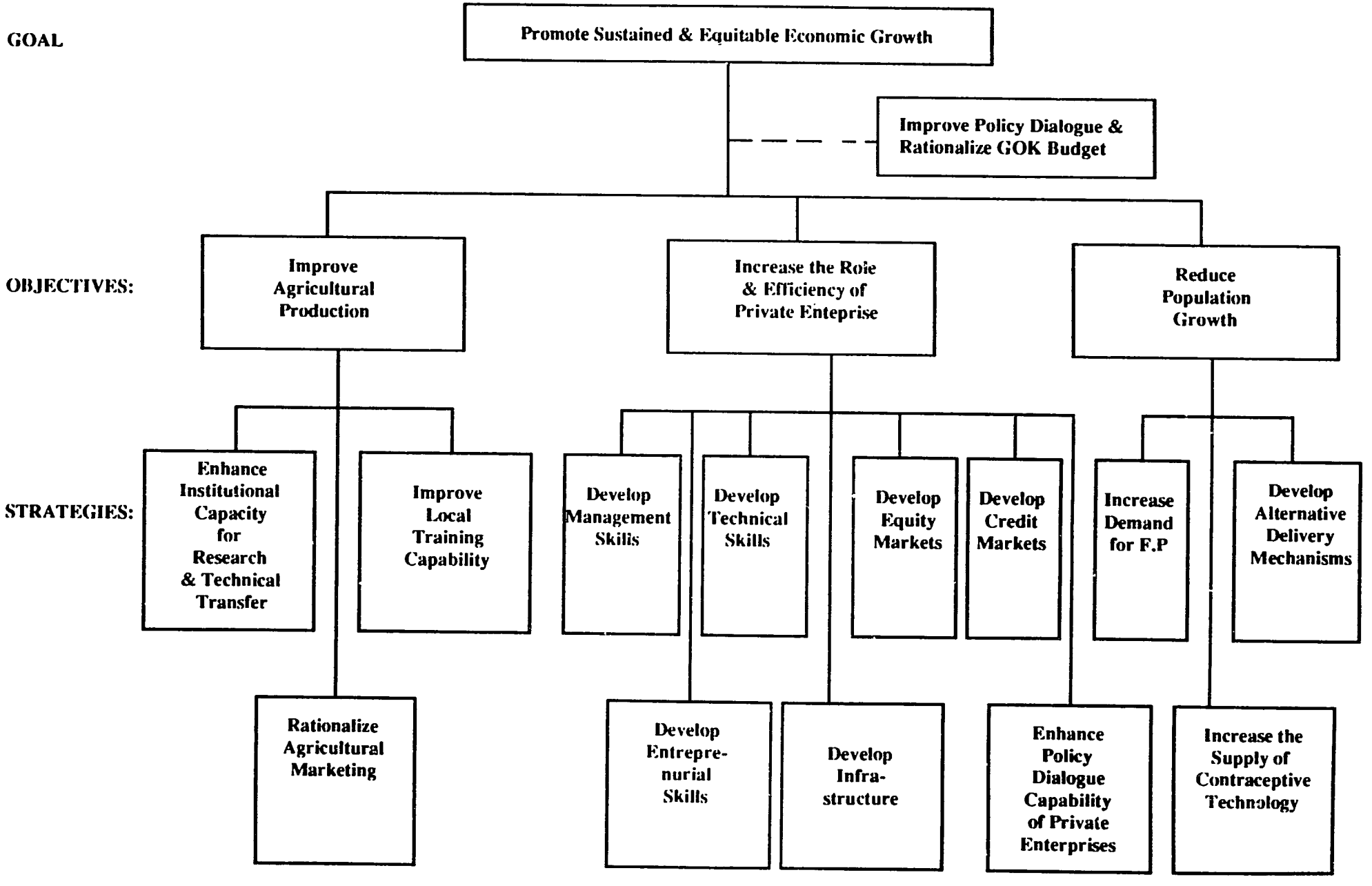
PHASE	KEY QUESTIONS	ANALYTICAL TECHNIQUES	OUTPUTS
3. DIAGNOSE CONSTRAINTS TO GROWTH	* WHAT ARE THE PRIVATE SECTOR'S PERCEPTIONS OF ITS OPPORTUNITIES & CONSTRAINTS? * WHAT ARE THE MOST CRITICAL RESOURCE CONSTRAINTS? * WHAT ARE THE IMPACTS OF PUBLIC POLICY ON THE PRIVATE SECTOR? * WHAT PRIVATE SECTOR INITIATIVES WILL RECEIVE GREATEST SUPPORT AMONG LOCAL LEADERSHIP? * WHAT IS THE IMPACT OF THE COMPETITIVE ENVIRONMENT? * WHAT ARE THE CAPABILITIES OF LOCAL CAPITAL MARKETS & FINANCIAL INSTITUTIONS?	* PRIVATE SECTOR SURVEY * CAPITAL MARKETS SURVEY	* PRIVATE SECTOR DIAGNOSTIC PAPER & PRESENTATION
4. DIALOGUE WITH PRIVATE SECTOR	* HOW DO KEY PRIVATE/ PUBLIC SECTOR DECISION MAKERS VIEW THE DIAGNOSIS? * WILL PRIVATE SECTOR SUPPORT AID INITIATIVES? * WHAT INITIATIVES IS LOCAL PRIVATE SECTOR ALREADY UNDERTAKING? * WHO ARE THE IMPORTANT POTENTIAL IMPLEMENTING AGENTS? * WHAT ARE OTHER DONOR GROUPS DOING? * WHAT FORMAL AGREEMENTS WILL BE REQUIRED & HOW LIKELY WILL IT BE TO GET THEM?	* INFORMAL DIALOGUE SESSIONS * FOCUS GROUPS	* MINUTES OF MEETINGS * SUMMARY REPORT ON DIALOGUE RESULTS

Exhibit A-1

MANUAL FOR ACTION IN THE PRIVATE SECTOR
(OVERVIEW)

PHASE	KEY QUESTIONS	ANALYTICAL TECHNIQUES	OUTPUTS
5. DESIGN STRATEGY	* WHAT ARE HOST GOVT'S PRIVATE SECTOR DEVELOPMENT STRATEGY OBJECTIVES? * HOW ARE GOVT GOALS RELATED TO AID'S OVERALL COUNTRY STRATEGY? * WHAT ARE THE PRIORITIES AMONG ACTION AREAS GIVEN CURRENT LEVEL OF RESOURCES? * WHOSE SUPPORT IN PRIVATE & PUBLIC SECTOR IS CRUCIAL & HOW CAN THE EXISTENCE OF SUCH SUPPORT BE DEMONSTRATED?	* OPTIONS MENU * STRATEGY MATRIX	* PRIVATE SECTOR DEVELOPMENT STRATEGY PAPER (FOR CDSS) * PRELIMINARY FEASIBILITY ASSESSMENT
6. DEVELOP NEW PROJECTS & PROGRAMS	* WHAT SPECIFIC PROGRAMS & PROJECTS WILL MOST EFFECTIVELY ACHIEVE GOALS? * WHO WILL IMPLEMENT THE PROJECTS? * DO THEY HAVE THE NECESSARY INSTITUTIONAL CAPABILITY?	* PIDS * PROJECT PAPERS * PAIPS * PAADS	* PROJECTS * PROGRAMS
7. DEBRIEF & EVALUATE	* WHAT HAVE BEEN THE FINDINGS & RECOMMENDATIONS OF MAPS FOR USAID PRIVATE SECTOR INITIATIVES? * WHAT RECOMMENDATIONS FOR ONGOING AID PROCESS SHOULD BE PRESENTED? * WHAT HAS BEEN LEARNED FROM THE PROCESS FOR SIMILAR FUTURE EFFORTS IN OTHER COUNTRIES?	* MEETINGS WITH AID	* FINAL REPORT

Exhibit A.2
Mission Goals, Objectives, Strategy--USAID/Kenya



STRATEGY MATRIX -- USAID / KENYA

	CAPACITY: RSCH & TECH TRNSFER	AG MKTG	IM-PROVE LOCAL TRNG	DEV MNGT SKILLS	DEV TECH SKILLS	DEV EN-TREP SKILLS	DEV INFRST	DEV EQUITY MKTS	DEV CREDIT MKTS	POLICY DIAL CAPACITY	DE-MAND FOR FP	SUPPLY OF FP TECH	ALT DELIVERY MECH	IM-PROVE LOCAL TRNG
HRDA				X										X
PRIM HEALTH (219)											X			
RPE (220)				X	X	X			X					
AG MNGT (221)			X	X										
PUB SECTOR FP (223)											X	X	X	X
NAT AG RSCH (229	X													
FPSS (232											X	X	X	X
TRNG FOR DEV (234)				X										X
PVO CO-FIN (236)													X	
PED (238)				X	X	X		X	X	X				
IDAT (239)			X											
SAP (213)		X						X	X					X
SAAP II (240)		X						X	X					X
CORAT (241)											X			
MKTG DEV (242)							X							
JUA KALI (227)						X			X					
PL 480		X												X
FPIA											X	X	X	
FP SERVICES											X	X	X	
PRITECH											X			
REACH											X			
DIARR. RSCH											X			
AFRICAN MANPOWER														X
PEACE CORPS						X	X		X					
E.A. RMT SENSING	X													
SMALL RUMINANTS	X													

Source: Semi - Annual Reports, ABS, Discussions with Mission Staff, Action Plan

APPENDIX B

SUMMARY OF PRIVATE SECTOR DESCRIPTION

SUMMARY OF FINDINGS

KENYA PRIVATE SECTOR DESCRIPTION

Much of the information contained below has been taken from research entitled "Kenya Private Sector Description" produced for J.E. Austin Associates, Inc. and USAID by Alexander Maclennan Trundell & Co. (AMT) of Nairobi in August 1989. The implications and conclusions drawn from the data are those of the authors of this report. The full AMT report can be obtained from USAID/Kenya. All exhibits referred to below can be found in Annex B.

1. Kenya has one of the largest economies in sub-Saharan Africa. Its relative position among these countries has improved as its economy outperformed the economies of many of the largest sub-Saharan African countries in the 1980's (Exhibit B.1).

   - Most of the recent growth in GDP has come from the services and manufacturing sector.

   - But small scale agricultural production, and the entire agricultural sector in general, continues to be very important to GDP.[1] Together the agricultural and traditional (subsistence) sectors accounted for over a third GDP in 1987.

2. Economic growth has not been sufficient to keep up with Kenya's growing labor force.

   - It is estimated that by the end of the century Kenya will have a work force of 14 million people. If the economy continues creating jobs at the present rate of 3.4 percent per year, the unemployment rate would increase from the present level of 13 percent to 20 percent by the year 2000 (Exhibit B.2).

   - By the year 2000 Kenya will need over 600,000 new jobs per year (Exhibit B.3).

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[1]The importance of agriculture in the economy may be understated in Exhibit B.8. Estimates of sectoral contribution are based on marketed value, which accounts for about 45-50 percent of total agricultural output. Marketed value excludes the value of own produce consumed which can be high for traditional crops like maize and dairy products. For example, 20 percent of small holders market maize, while over 90 percent grow it.

3. <u>Kenya must rely on the private sector for the creation of these new jobs.</u>

- GOK participation in the economy is not expected to increase as a percentage of GDP. Government expenditures are already high (Exhibit B.4), even compared to other countries in Africa, and it is unlikely that the Government will be able to undertake any major projects or increase expenditures substantially in the near future. Public debt outstanding has been climbing steadily to over 4.5 million Kenya pounds by 1987 (Exhibit B.5). GOK borrowing has increased to cover the growing debt. As a result, private sector share of credit has been declining since 1983 (Exhibit B.6).

- The private sector contributed an estimated 69 percent to GDP in 1987 (Exhibit B.7). In 1987 the modern private sector, including the urban and non subsistence farm informal sector establishments accounted for 60 percent of recorded wage employment.

- Private sector is estimated to account for approximately 95 percent of value added in agriculture (Exhibit B.8).

- The private sector accounted for approximately 84 percent of manufacture value added in 1986 (Exhibit B.9).

- In 1987 the private sector contributed approximately 82 percent to value added from the services sector (Exhibit B.10).

- Over three quarters (84 percent) of lending by formal banking institutions comes from private commercial banks. The Kenya Commercial Bank and the National Bank of Kenya are the two government owned banks in the country, accounting for 30 percent of total commercial bank deposits in 1988. Total private sector contribution in finance is estimated at 75 percent.

- Private sector's contribution to trade GDP is estimated to be 95 percent.

- The private sector is the major producer of exports and the major earner of foreign exchange. The major earners of foreign exchange over the 1983 to 1987 period -- coffee, tea and tourism -- are all produced primarily by the private sector.

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4. <u>Much of the growth in the private sector over the last 7 years has come from informal sector firms.</u>

- Informal sector share of wage employment has doubled since 1980 - from 10 percent in 1980 to 20 percent in 1987 (Exhibit B.12). During the same time period, formal private sector share of wage employment declined from 48 percent to 40 percent.

- Though in 1985 trade still accounted for approximately 60 percent of all informal sector employment, manufacturing activities have shown the strongest growth. Informal sector employment in manufacturing doubled between 1974 and 1985 (Exhibit B.13). Small firm contribution to manufacturing GDP has also doubled between 1977 and 1986. Most of the growth within manufacturing has come from the transport and equipment subsectors (Exhibit B.14).

5. <u>The growth achieved through import substitution policies in the 1970's slowed considerably by the 1980's.</u>

- Kenya is the most industrialized economy in East Africa but industry as a percentage of GDP is about average for countries in sub-Saharan Africa (Exhibit B.15).

  Expansion of the sector was stimulated in the 1970's by increasingly high levels of protection instituted both to encourage investment in industry and to protect balance of payments. Further impetus was provided by direct GOK participation in industrial ventures through loan and equity financing and by incentives to foreign investment. By the early 1980's most industries producing for the domestic markets were being heavily protected from foreign competition through a series of instruments ranging from quotas, to bans, to tariffs on imported inputs. Formal manufacturing share of output and employment had decreased relative to informal sector activity (see point 5 above).

- Most of the growth in formal sector manufacturing has been import intensive, particularly machinery and parts.

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6. Savings and investment mobilization has been high.

- Kenya's domestic savings rate was the 6th highest in sub-Saharan Africa, estimated at 20 percent in 1987 (Exhibit B.16).

- The number of bank branches in rural areas has grown by over 50 percent since 1980 (Exhibit B.17). NBFI's have grown impressively over the last decade as well. Cooperative savings societies' share of capital now exceeds that of the Nairobi Stock Exchange (Exhibit B.18).

- Assets in the commercial banking sector have increased from 874 million Kenya pounds to 2,600 million Kenya pounds over the 1978-1987 period (Exhibit B.19).

- Kenya's gross domestic investment was 25 percent in 1987, the third highest for the 32 sub-Saharan African countries for which there is World Bank data available (Exhibit B.20). Moreover, these investment rates have been consistently high, averaging 23 percent between 1982 and 1988 (Exhibit B.21).

7. Some of the investment may have been in relatively unproductive areas.

- Much of the investment over the last 14 years for which there is data available has been in the area of buildings and construction. And the share going to these activities has grown from 36 percent in 1980 to 44 percent in 1986. In 1986 about 35 percent of investment went to machinery and other equipment, 26 percent to residential and non residential buildings (with an additional 18 percent in construction), and 20 percent to transport equipment (Exhibit B.22).

- Private sector share of total investment represented about 58 percent in 1986 and its share has apparently been rising (Exhibit B.22). It is important to note however that some of the "private sector" investment in official estimates includes parastatals. It is impossible to disaggregate parastatal from total private investment.

- Much of the "investment" in parastatals may actually be a form of compensation or subsidy for losses. GOK investment in parastatals has continued to rise and by 1984 total GOK investment (in the form of grants, loans, subsidies and guarantees) accounted for 39 percent of GDP.

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- The GOK's return on investment in parastatals has been declining. On average during the 1970's, the inflow from the parastatals to the central GOK budget was only 27 percent of the total money paid out. On 1982 GOK investment in parastatals amounted to US$ 1,4000 million and received a return of US$ 3.5 million, or a return of just 0.2 percent.

- Not all parastatals are unprofitable. Parastatals involved in electricity and water and in finance, insurance and real estate have been on the whole more profitable than others. Parastatals involved in mining and quarrying, and in wholesale and retail trade, restaurants and hotels, are generally in deficit. Most serious problems involve agricultural marketing organizations.[2] The difficulties of other organizations (such as the National Cereals and Produce Board, formerly the Maize and Produce Board and the Wheat Board) stem from GOK pricing policies which fix consumer prices considerably below producer prices and to organizational problems in the purchase, transportation and storage of crops.

8. <u>Given high investment levels, GDP growth rates have been disappointing</u>.

- Despite investment levels of over 20 percent of GDP for the last 7 years, real GDP growth rates have averaged only 3.8 percent during the 1980-1987 period. And growth has been erratic (Exhibit B.23).

- GOK Sessional Paper No. 1 of 1986 stated that in Kenya it has historically taken 6 units of investment to produce 1 unit of output. The world-wide norm is about 4 units of investment per unit of output. Had Kenya's productivity achieved this norm, given the country's high levels of investment, GDP could have been growing at an average of 6 percent per year in the 1980's.

9. <u>Foreign investor confidence in the economy has declined.</u>

- There has been a steady decline in foreign direct investment in the country since the early 1980's. Foreign investment levels in 1987 (an estimated US$ 37 million) had grown over three fold since the low in 1982 (US$ 3 million), but have yet to reach levels

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[2]There is some debate in government about whether marketing boards are supposed to be profitable at all.

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achieved in the late 1970's (over US$ 75 million). IMF data for 1988 show a preliminary figure of only US$ 7 million (Exhibit B.24).

10. Export growth and diversification has been limited.

- The country has remained dependent on traditional agricultural commodities (coffee and tea) for its foreign exchange. Together these two products accounted for over 47 percent of Kenya's foreign exchange earnings in 1987 (Exhibit B.25). But the volatile nature of prices for these commodities has meant that export growth has been uneven over the years. What happens to export earnings has largely been determined by what happens to coffee prices and consequently earnings.

- While GOK has placed increasing emphasis in diversification of exports, the growth of non-traditional exports has been slow and in 1987 still accounted for less than 20 percent of total exports (Exhibit B.26).

- But some non traditional exports have shown strong growth over the last 9 years. Such is the case with horticultural products, whose export earnings have tripled since 1980.

- Kenya's trade balance has deteriorated steadily since 1985 (Exhibit B.27) and Kenya's average export trade growth was negative over the 1980-1987 period (Exhibit B. 28).

11. Tourism has increased in importance.

- Tourism has become the country's largest earner of foreign exchange (Exhibit B.29).

- Tourist arrivals (including holiday and business travelers) began growing again in 1984 after 7 years of slow or no growth in the late 70's and early 80's. Growth of foreign exchange earnings from tourism accelerated after 1986 (Exhibit B.29). The tourist industry experienced difficulties in the 1970's, as the increases in the price of oil put Kenya at a disadvantage compared with other short haul destinations. Other factors accounting for the industry's disappointing performance during this time period include political instability in Africa (including in Kenya itself in the early 1980's),

adverse publicity about wildlife preservation problems and AIDS, and increasing competition from Tanzania and Uganda. Part of the boom in the mid 1980's derived from the increased use of Kenya as a venue for very large conferences.

- Most of tourists arriving in Kenya (60 percent in 1987) come from Europe. Tourism in the coast accounts for the majority of total bed nights spent in Kenya and most of this also comes from Europe; tourism at the game lodges is dominated by residents of North America. The US has become an increasingly important source of foreign exchange earnings from tourism.

12. Kenya's main export markets have changed over the last 24 years.

- The most dramatic change has been in the share of exports going to African markets (dropping in 1986 to 16 percent from 33 percent in 1972). The share to Asia and the US have also increased. The share of exports going to Europe has varied only slightly (Exhibits B.30 and B.31).

13. Kenya's external debt ratio has grown considerably over the last 8 years (Exhibit B.32).

- Total long-term debt as percentage of GNP in 1986 was 56 percent, considerably less than the percentage for Ivory Coast or Tanzania that same year (107 percent and 82 percent, respectively), but more than the percentage for Zimbabwe (33 percent). External debt service charges have grown from less than 5 percent of export earnings in 1974 to over 25 percent by 1987 (Exhibit B.33). This high external debt service ratio will continue to claim a large share of private savings otherwise available to finance capital formation.

14. Capital markets have been stagnant. The Nairobi Stock Exchange has not grown for the past 15 years.

- In 1989 the NSE had 55 companies listed, compared with 62 for Zimbabwe, 92 in Nigeria, 82 in Jordan, 84 in Thailand, 200 in the Philippines, 288 in Singapore and 334 in Korea. There are only 6 brokerage firms at the moment.

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- At present, regulations governing the process by which the price of new issues is set as well as other restrictions have hindered trading, though the fact that recent issues by Barclays and the KCB have been oversubscribed indicates that there is a strong demand for a an equity market.

- In 1986 the GOK in its Sessional Paper No. 1 announced the establishment of a capital markets development authority to govern the NSE and devise a system of incentives to facilitate the evolution of the capital market in Kenya.

15. The inflation rate in Kenya has been held down below 10 percent since 1985, after it hit a high of 23 percent in 1983 (Exhibit B.34).

- GOK monetary policy has been successful in restricting the growth of money supply and curbing the inflation rate. The 1970's were characterized by liberal money supply policies. In part the growth in money supply reflected the increasing monetization of the Kenyan economy. But by the 1980's that monetization process had virtually reached its end, with consequences on the inflation rate. The government, under pressure from the IMF, began to restrain the rate of expansion of money supply and of GOK borrowing from the banking system in the 1980's. But by 1987 the end of 1987, broad money (M1 and M2) grew once more (by 32 percent from 11 percent over the 1980-1985 period) with some inflationary consequences.

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ANNEX B

GROSS DOMESTIC PRODUCT
Millions Of Current Dollars

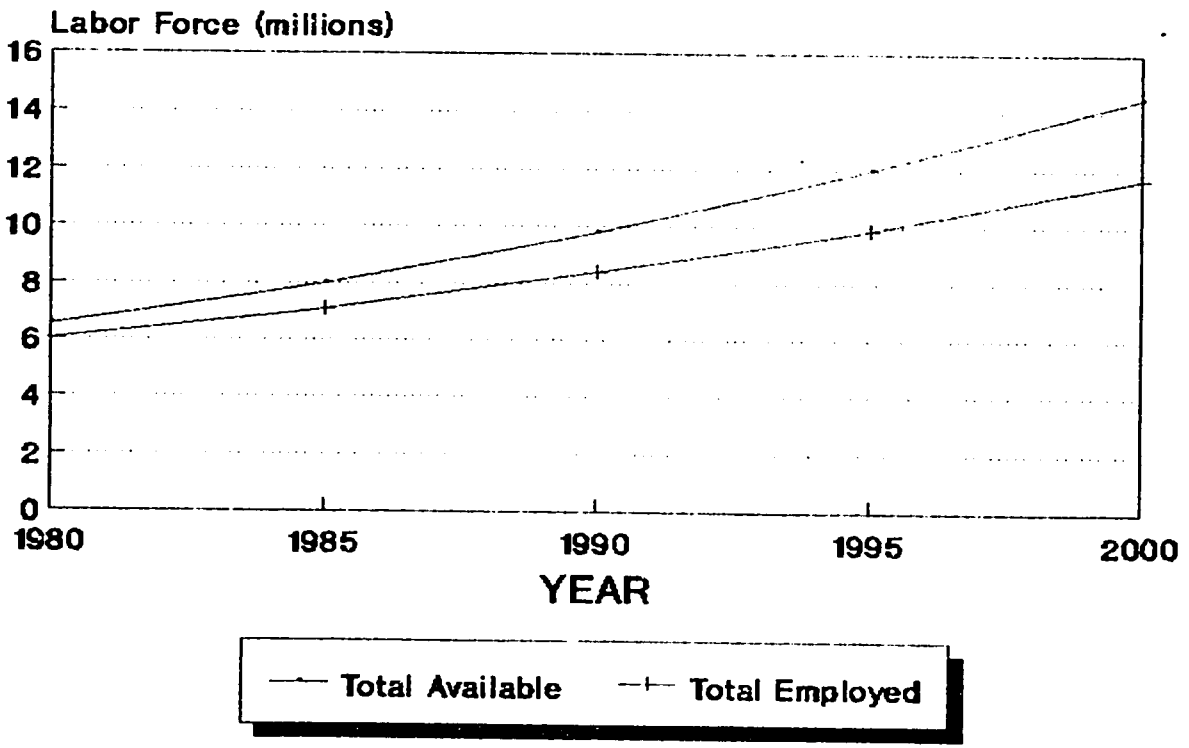
1965	
South Africa	10,540
Nigeria	5,850
Zaire	3,140
Ghana	2,050
Sudan	1,330
Ethiopia	1,180
Uganda	1,100
Zambia	1,060
Zimbabwe	960
KENYA	**920**
Senegal	810
Cameroon	810
Tanzania	790
Cote d'Ivoire	760
Madagascar	670
Niger	670
Guinea	520
Sierra Leone	320
Chad	290
Liberia	270
Mali	260*
Burkina Faso	260
Gabon	230
Benin	220
Somalia	220
Malawi	220
Congo	200
Togo	190
Mauritius	190
Mauritania	160
Burundi	150
Rwanda	150
Central African Rep.	140
Botswana	50
Lesotho	50

1987	
South Africa	74,260
Nigeria	24,390
Cameroon	12,660
Sudan	8,210
Cote d'Ivoire	7,650
KENYA	**6,930**
Zaire	5,770
Zimbabwe	5,240
Ghana	5,080
Ethiopia	4,800
Senegal	4,720
Uganda	3,560
Gabon	3,500
Tanzania	3,080
Lesotho	2,270
Niger	2,160
Congo	2,150
Rwanda	2,100
Madagascar	2,070
Zambia	2,030
Mali	1,960
Somalia	1,890
Burkina Faso	1,650
Benin	1,570
Botswana	1,520
Mozambique	1,490
Mauritius	1,480
Togo	1,230
Burundi	1,150
Malawi	1,110
Central African Rep.	1,010
Liberia	990*
Chad	980
Sierra Leone	900
Mauritania	840
Lesotho	270

*Figures for years other than specified.

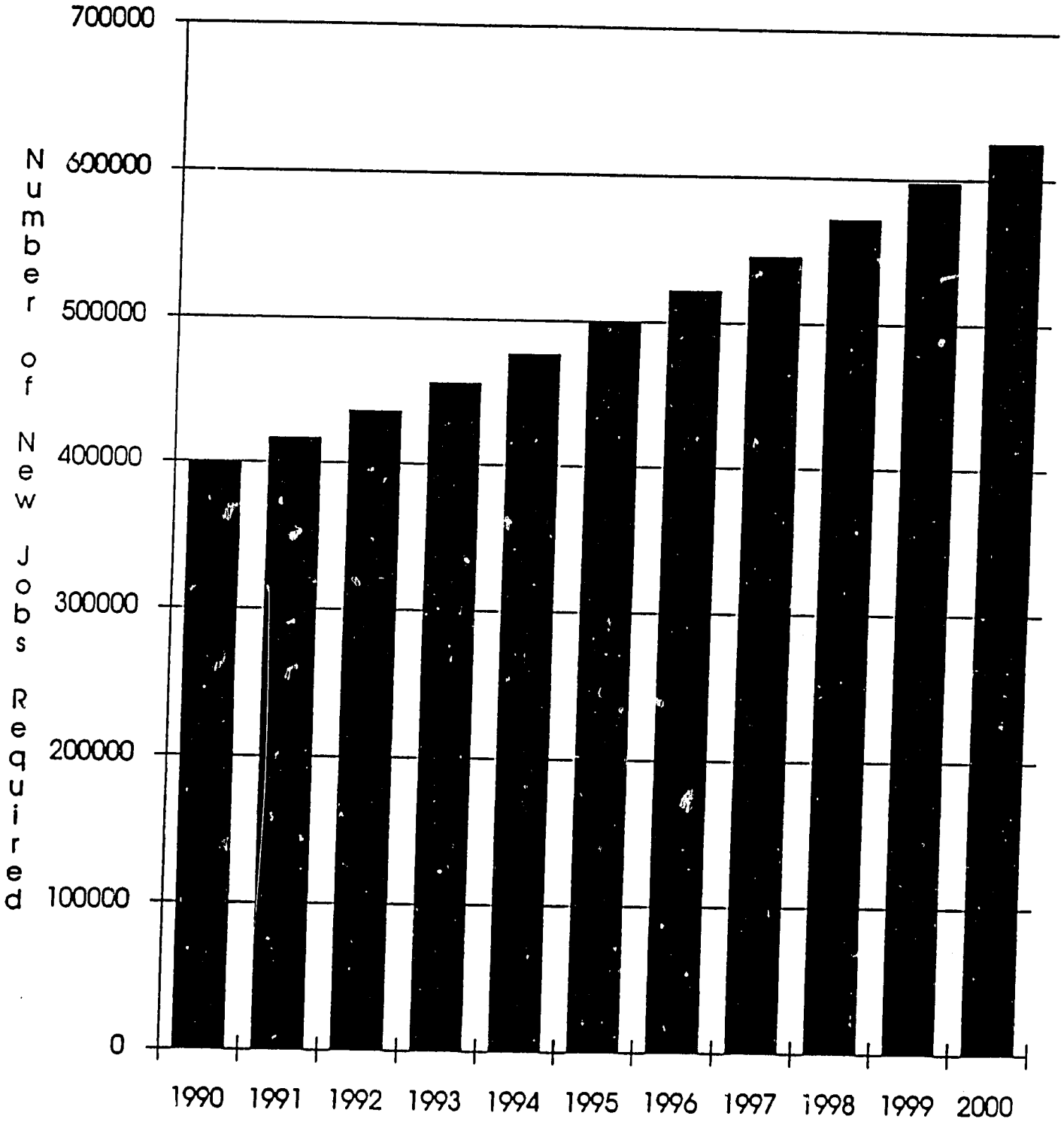
Source: World Bank, World Development Report 1989, Oxford University Press, New York, 1989; pp. 168-169.

EXHIBIT B.2
LABOR FORCE GROWTH AND PROJECTIONS



World Bank

NO. OF NEW JOBS REQUIRED IN KENYA FOR THE YEARS 1990-2000



Source: Kenya National Development Plan 1989-1993

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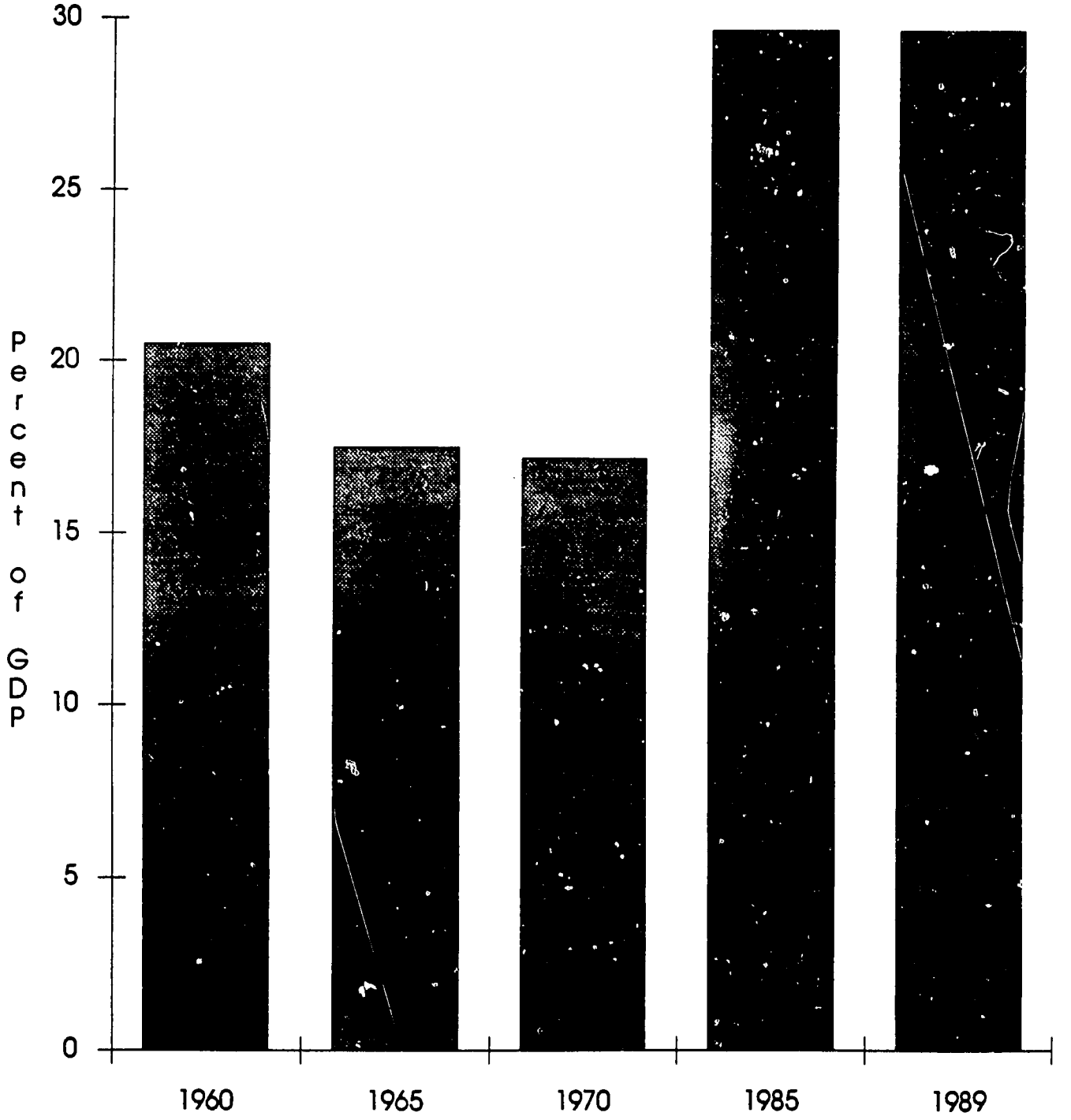
Government Spending as Percentage of GDP
Fiscal Years 1960-1989



Source: Central Bureau of Statistics - Statistical Abstract (Various Years)

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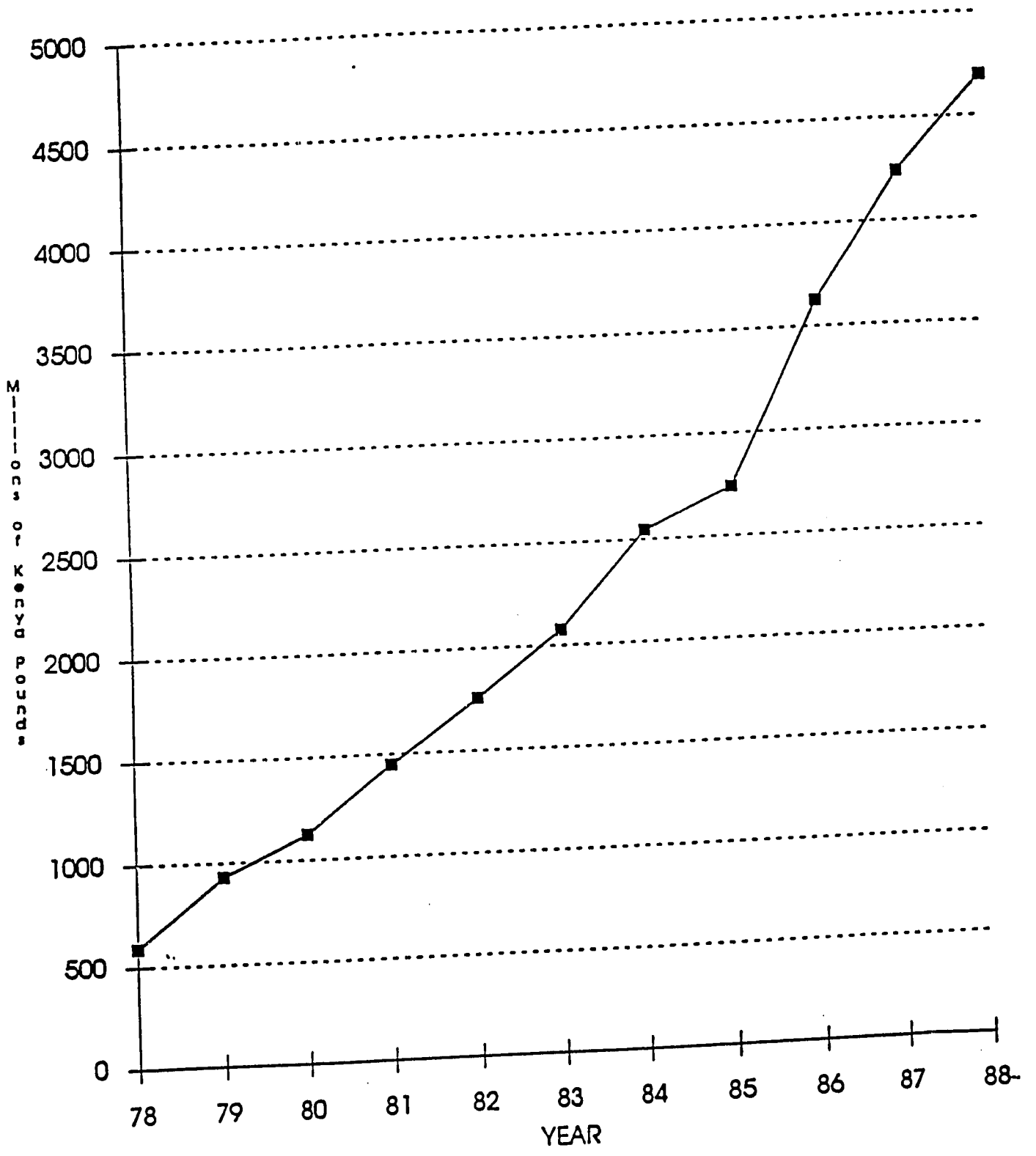
PUBLIC DEBT OUTSTANDING, 1978-1988
(millions of pounds - current prices)



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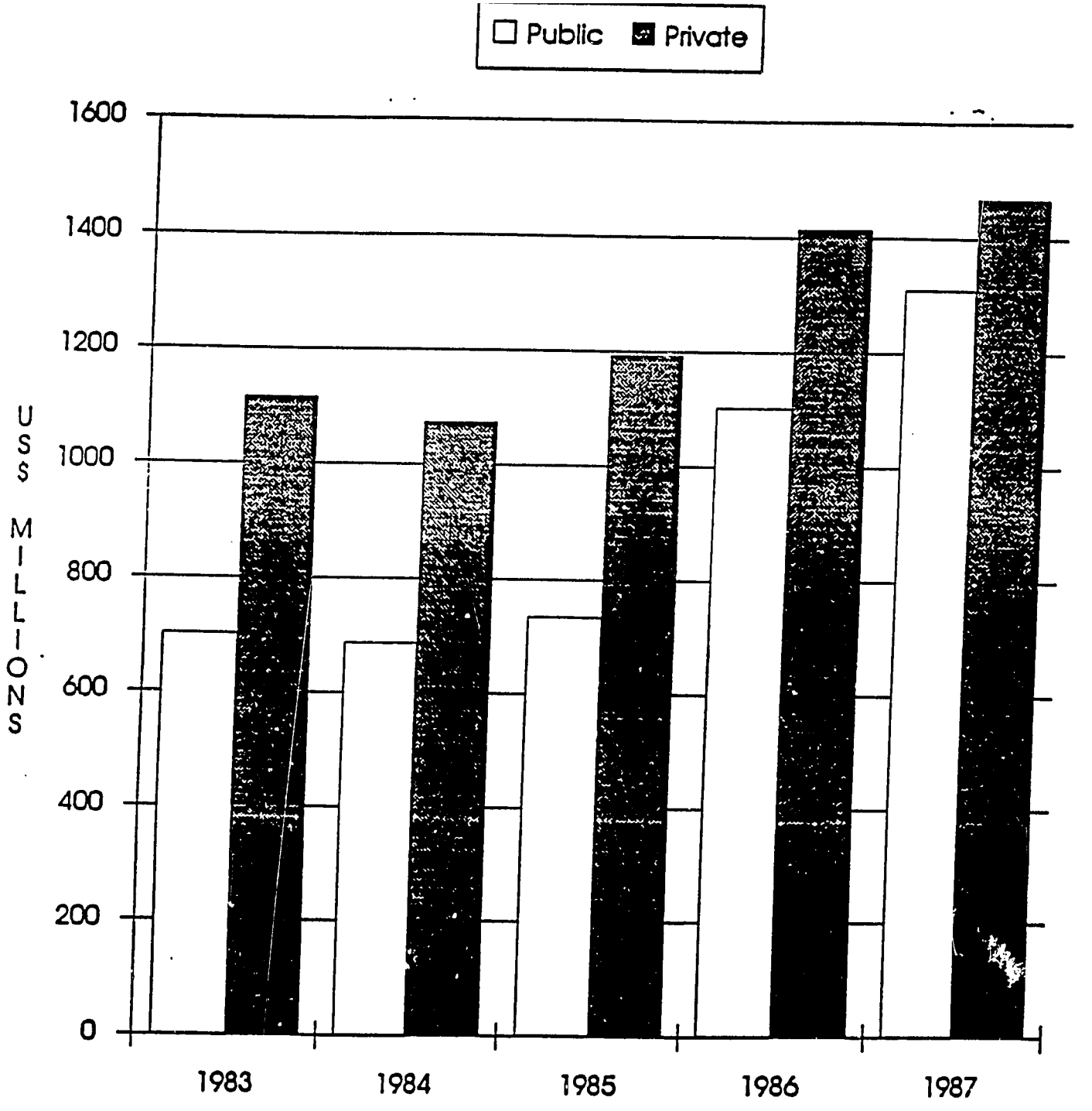
Source: Central Bank of Kenya

Credit Use 1982-1987



ource: World Bank, Kenya: Recent Economic Developments & Policy Issues 1988

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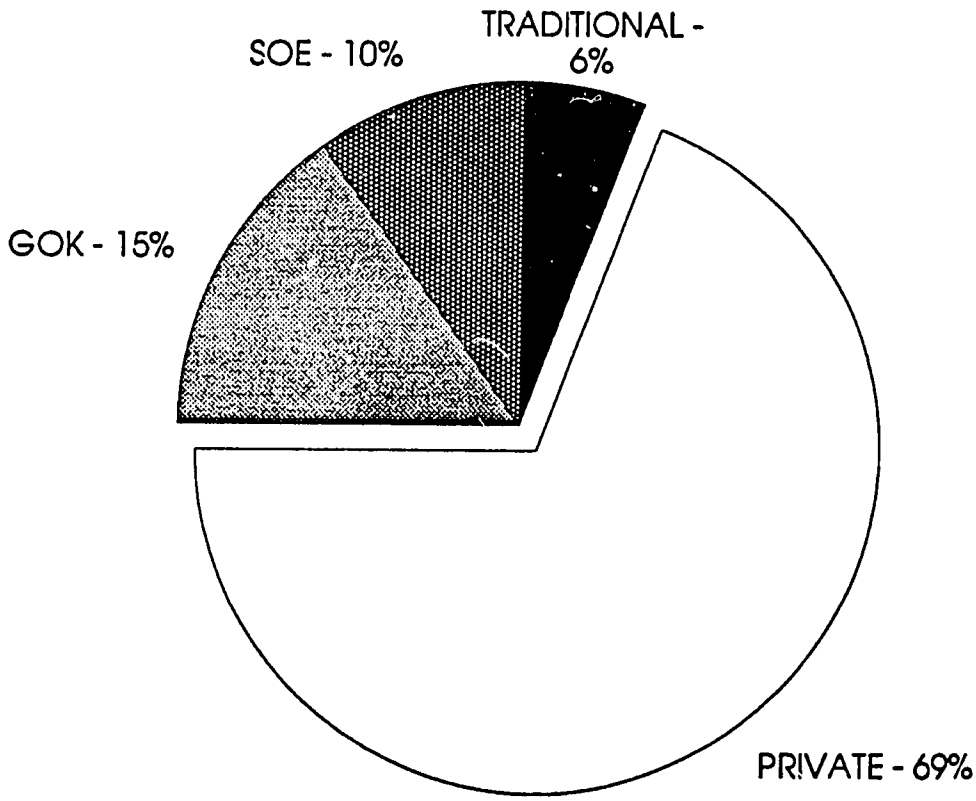
Kenya Private Sector Contribution to the GDP at Factor Cost 1987



Source: World Bank, Kenya: Recent Economic Developments and Policy Issues

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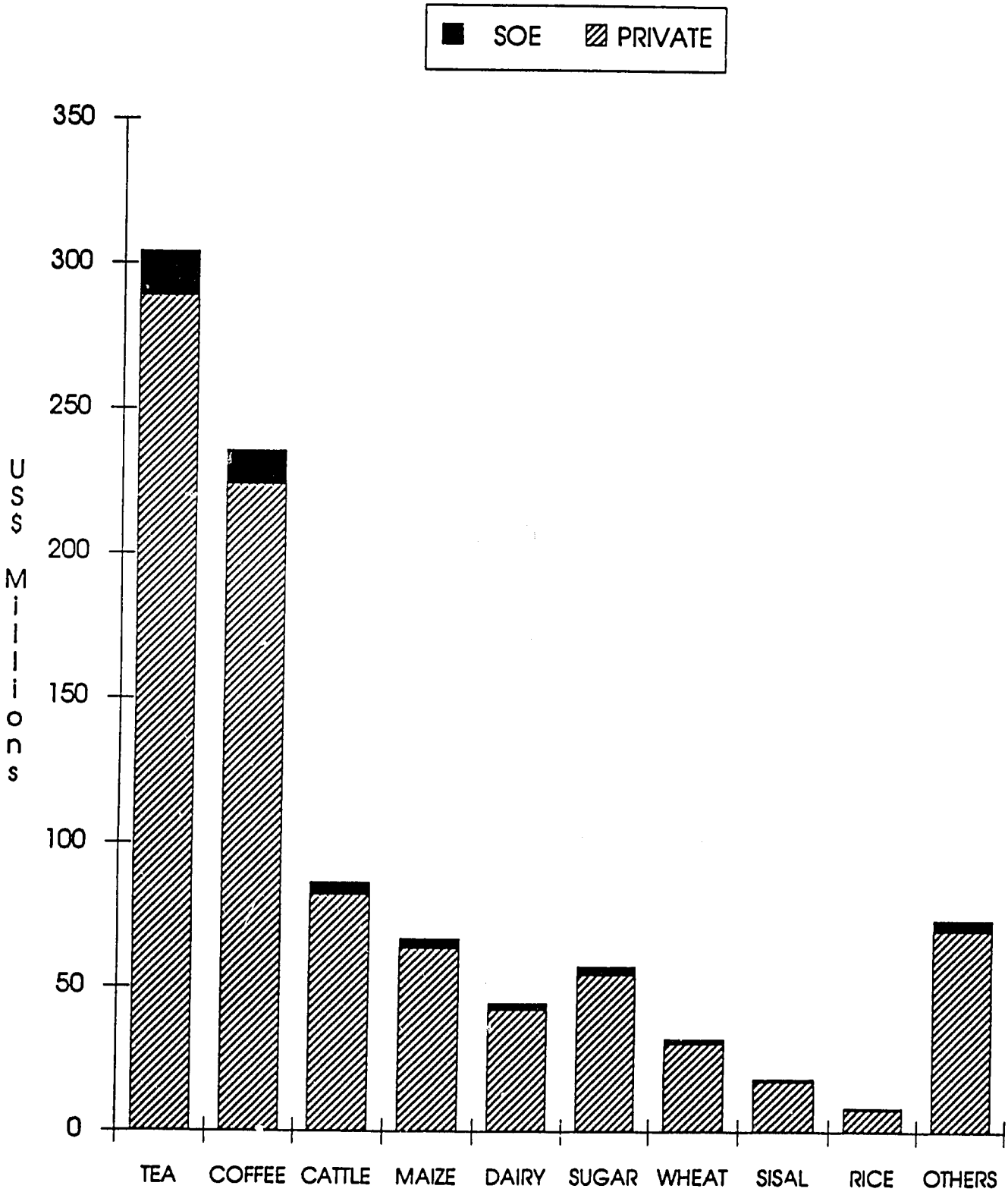
Marketed Agricultural Production 1985



Source: Statistical Abstracts Various Years

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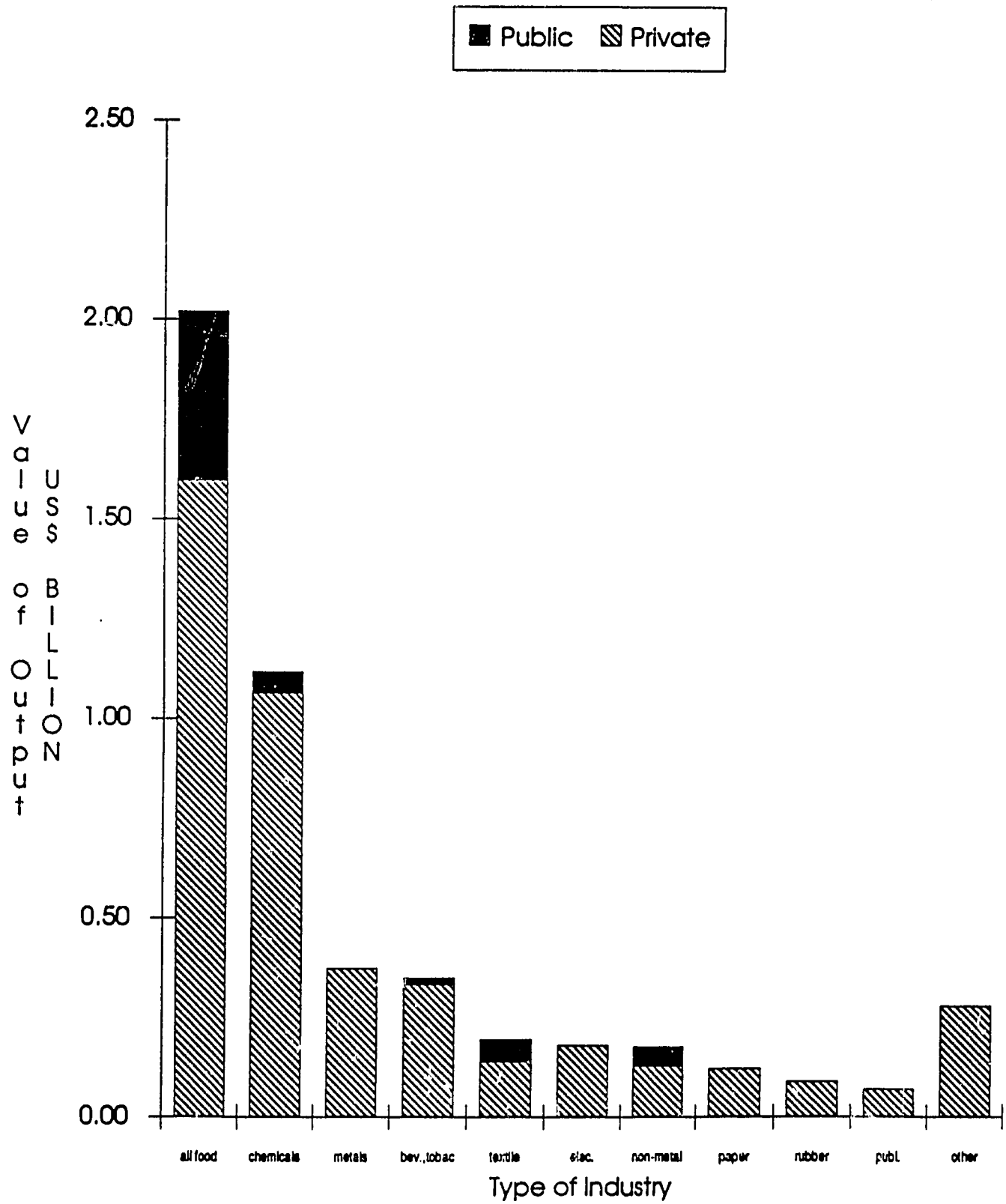
Private Sector Contribution to Manufacturing GDP 1986



Source: Statistical Abstract 1988

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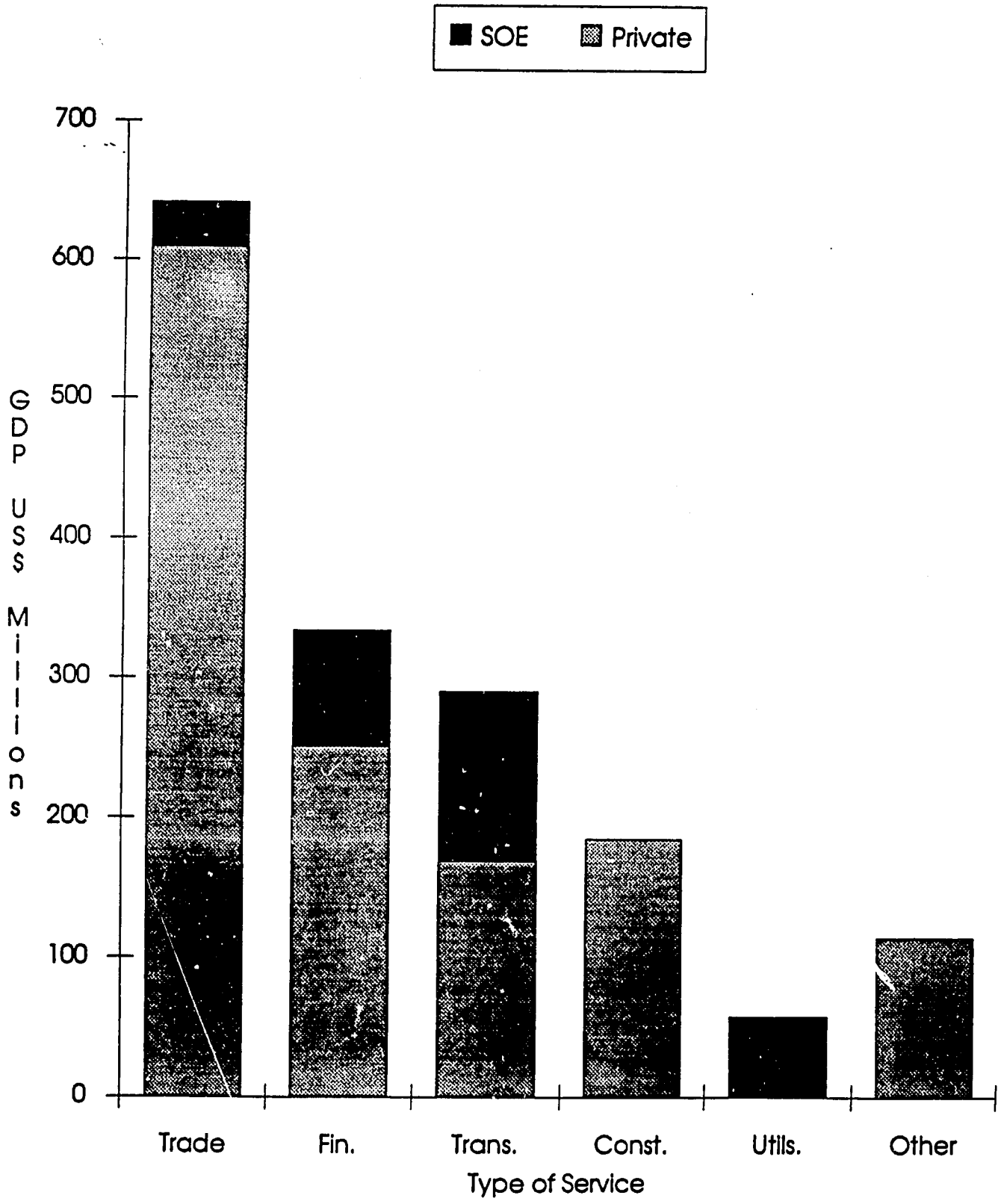
Private Sector Contribution to Services GDP 1987



Source: Statistical Abstracts Various Years

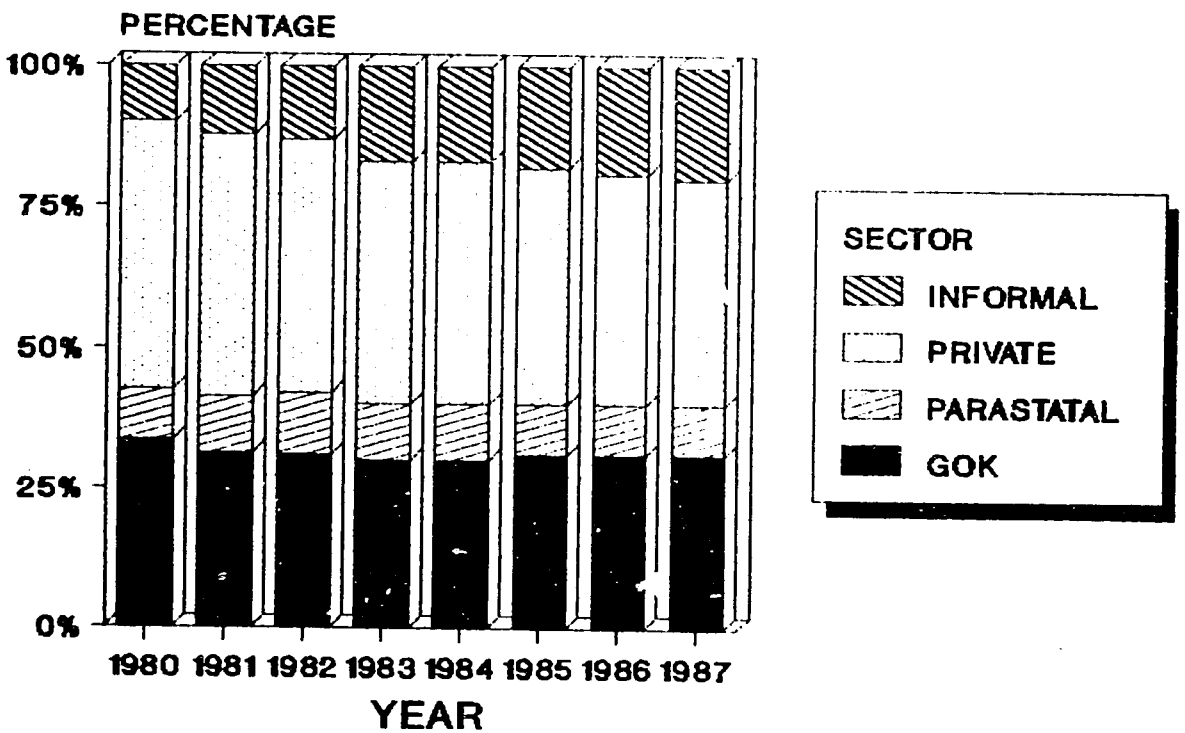
080889 - 016

CONTRIBUTION OF PRIVATE SECTOR
TO WAGE EMPLOYMENT (PERCENT)

	GOK	SOE	PRIVATE	INFORMAL	TOTAL
1980	33.6	8.8	48.0	9.7	100.0
1981	31.4	10.2	46.4	11.9	100.0
1982	31.4	10.7	45.0	12.8	100.0
1983	30.1	10.0	43.0	16.8	100.0
1984	30.4	9.6	42.7	17.2	100.0
1985	31.4	8.8	42.0	17.8	100.0
1986	31.1	8.8	41.3	18.7	100.0
1987	31.2	8.5	40.5	19.8	100.0

SOURCE: WORLD BANK
Employment in Kenya, March 31 1988

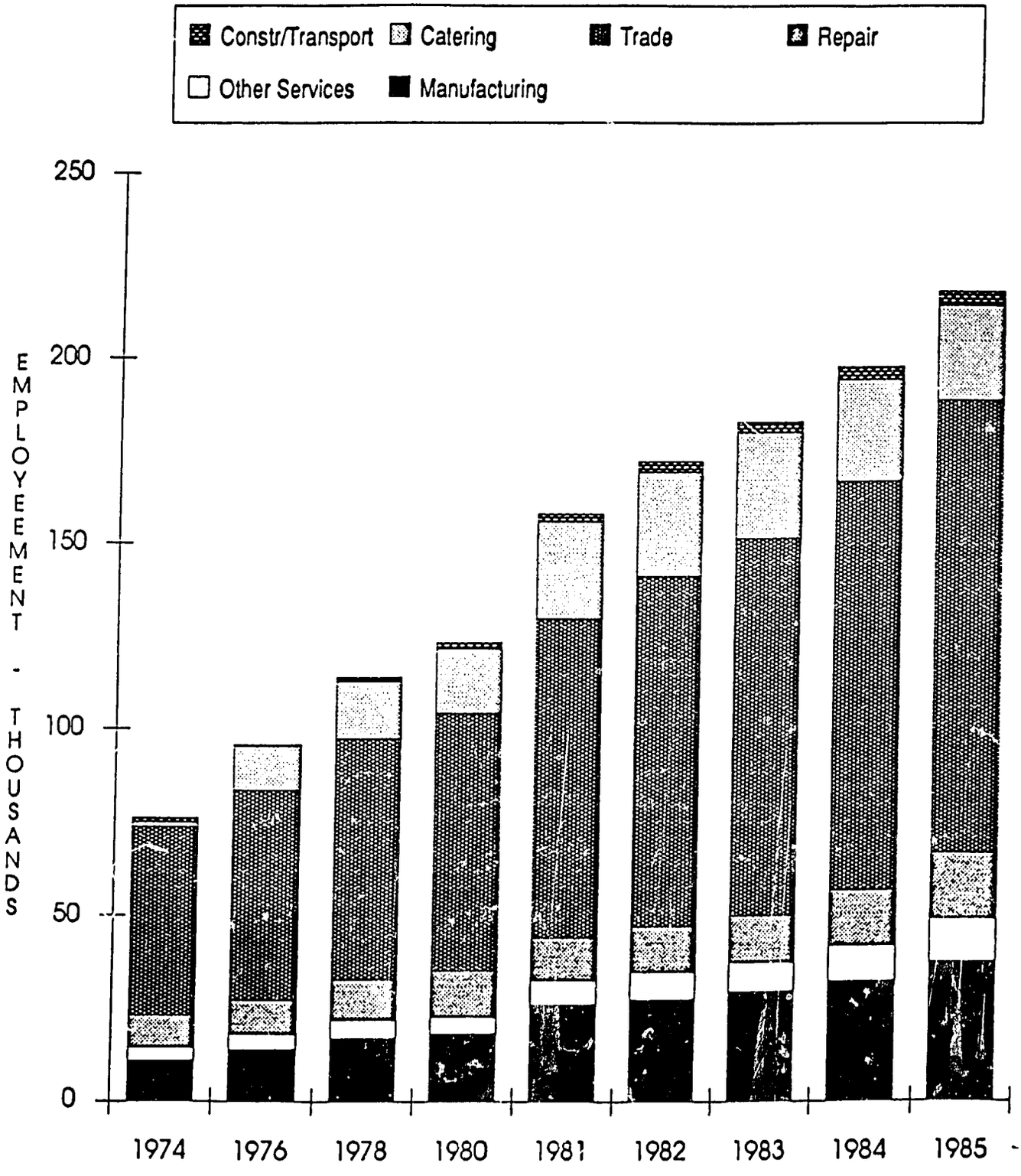
EXHIBIT B.12
CONTRIBUTION TO WAGE EMPLOYMENT



Source: World Bank, Employment in Kenya, 3/31/88.

Informal Sector Growth By Sector

1974-1985



Note: Measures growth of the urban informal sector only.

Source: World Bank Report No. 6711-KE

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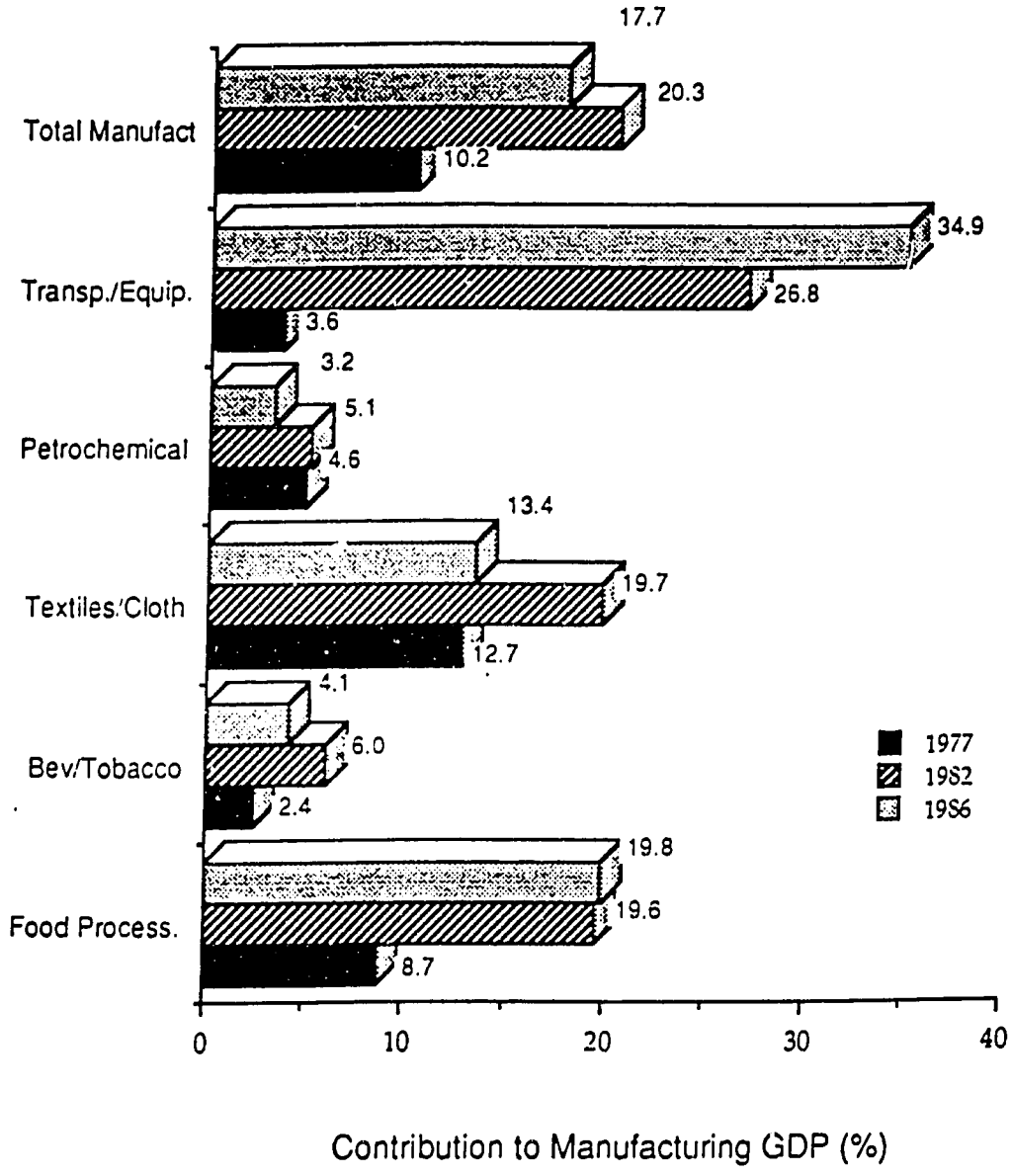
Small Firms Contribution to Manufacturing GDP



Source: Statistical Abstracts, various years. Description,

Taken from "Kenya Private Sector Description, August 1989". AMT Associates, Nairobi, Kenya.

INDUSTRY AS A SHARE OF GDP

Percent

1965		1987	
Zambia	54	Botswana	57
South Africa	42	South Africa	44
Liberia	40	Zimbabwe	43
Mauritania	36	Nigeria	43
Zimbabwe	35	Gabon	41
Gabon	34	Zambia	36
Sierra Leone	28	Congo	33
Zaire	26	Zaire	33
Mauritius	23	Mauritius	32
Togo	21	Cameroon	31
Cameroon	20	Liberia	28
Burkina Faso	20	Lesotho	28
Cote d'Ivoire	19	Senegal	27
Ghana	19	Cote d'Ivoire	25
Congo	19	Burkino Faso	25
Botswana	19	Niger	24
Kenya	**18**	Rwanda	23
Senegal	18*	Mauritania	22
Central African Rep.	16	Sierra Leone	19
Madagascar	16	**Kenya**	**19**
Chad	15	Ethiopia	18
Tanzania	14	Chad	18
Ethiopia	14	Togo	18
Uganda	13	Madagascar	16
Nigeria	13	Ghana	16
Malawi	13	Sudan	15
Mali	9*	Benin	14
Sudan	9	Burundi	14
Benin	8	Central African Rep.	13
Rwanda	7	Malawi	13
Somalia	6	Mali	12
Lesotho	5	Somalia	9
Niger	3	Tanzania	8
Mozambique	3	Uganda	5

*Figures are for other years than specified.
Source: World Bank, World Development Report 1989, Oxford University Press, New York, 1989; pp. 168-169.

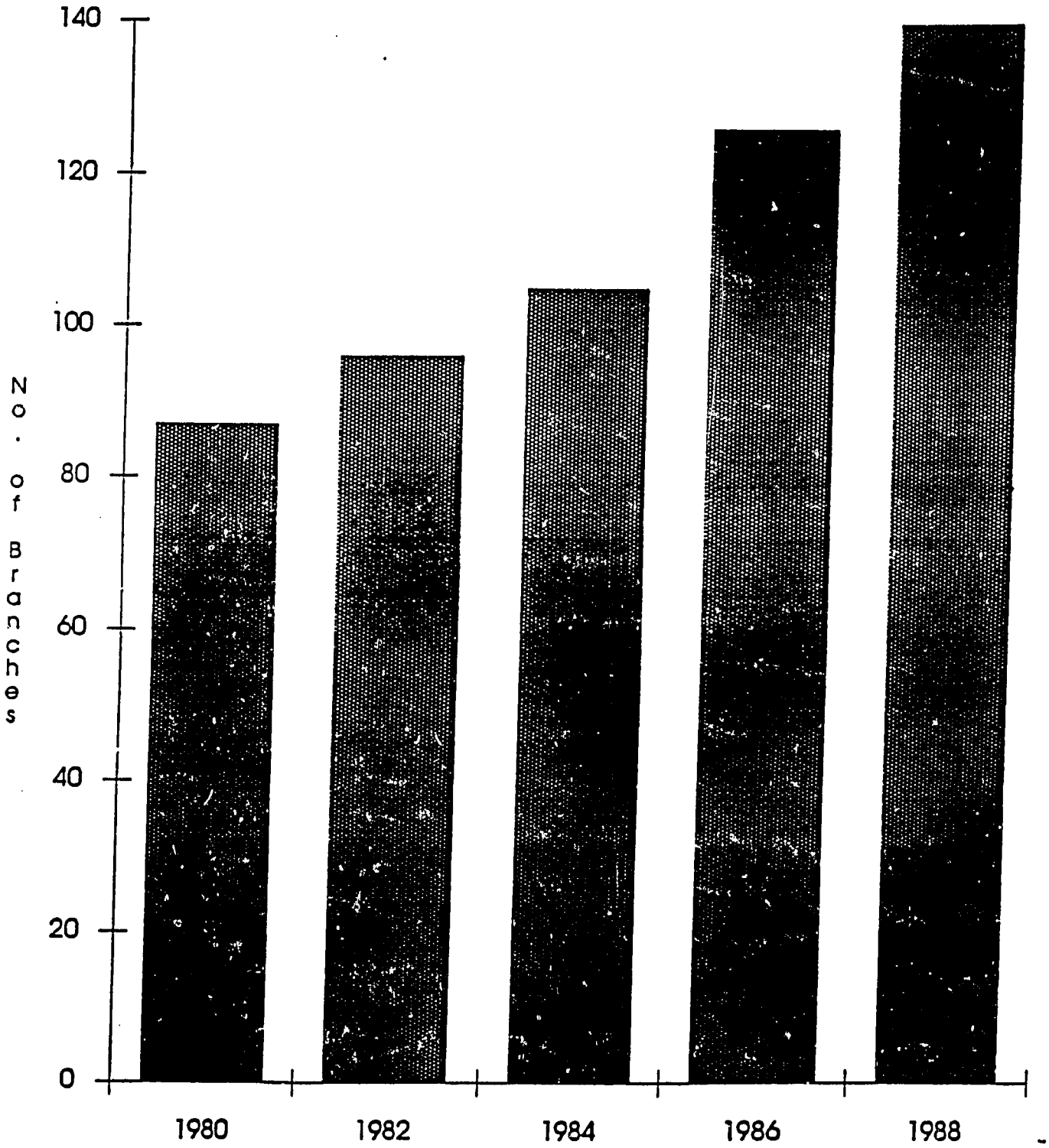
GROSS DOMESTIC SAVINGS AS A SHARE OF GDP

	1987
Gabon	34
Mauritius	29
South Africa	28
Zimbabwe	22
Congo	21
Kenya	**20**
Nigeria	20
Zambia	20
Cote d'Ivoire	19
Liberia	18*
Cameroon	15
Mauritania	14
Malawi	12
Zaire	10
Sierra Leone	10
Burundi	8
Madagascar	7
Sudan	6
Senegal	6
Niger	5
Rwanda	5
Uganda	5
Ghana	4
Benin	4
Ethiopia	3
Burkina Faso	1
Mali	0
Central African Rep.	-2
Tanzania	-6
Mozambique	-10
Chad	-12
Lesotho	-73

*Figures for years other than specified.

Source: World Bank, World Development Report 1989, Oxford University Press, New York, 1989; pp. 180-181

NO. OF BANK BRANCHES IN RURAL AREAS CONSOLIDATED FIGURES 1980-1988



ource: Annual Reports (1980 1988) of commercial banks w/rural branches

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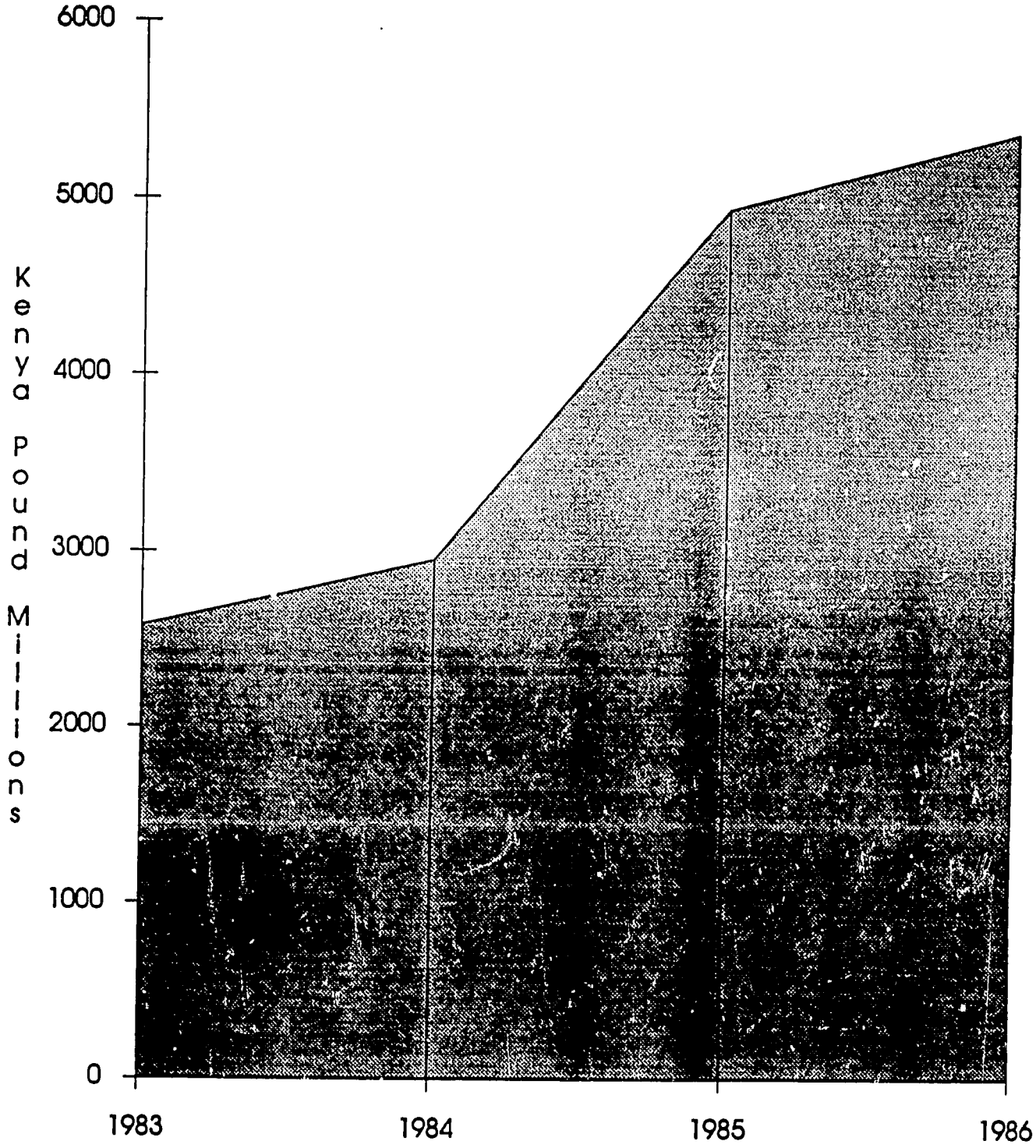
CO-OP Share of Total Capital
1983 - 1986



Source: Central Bureau of Statistics

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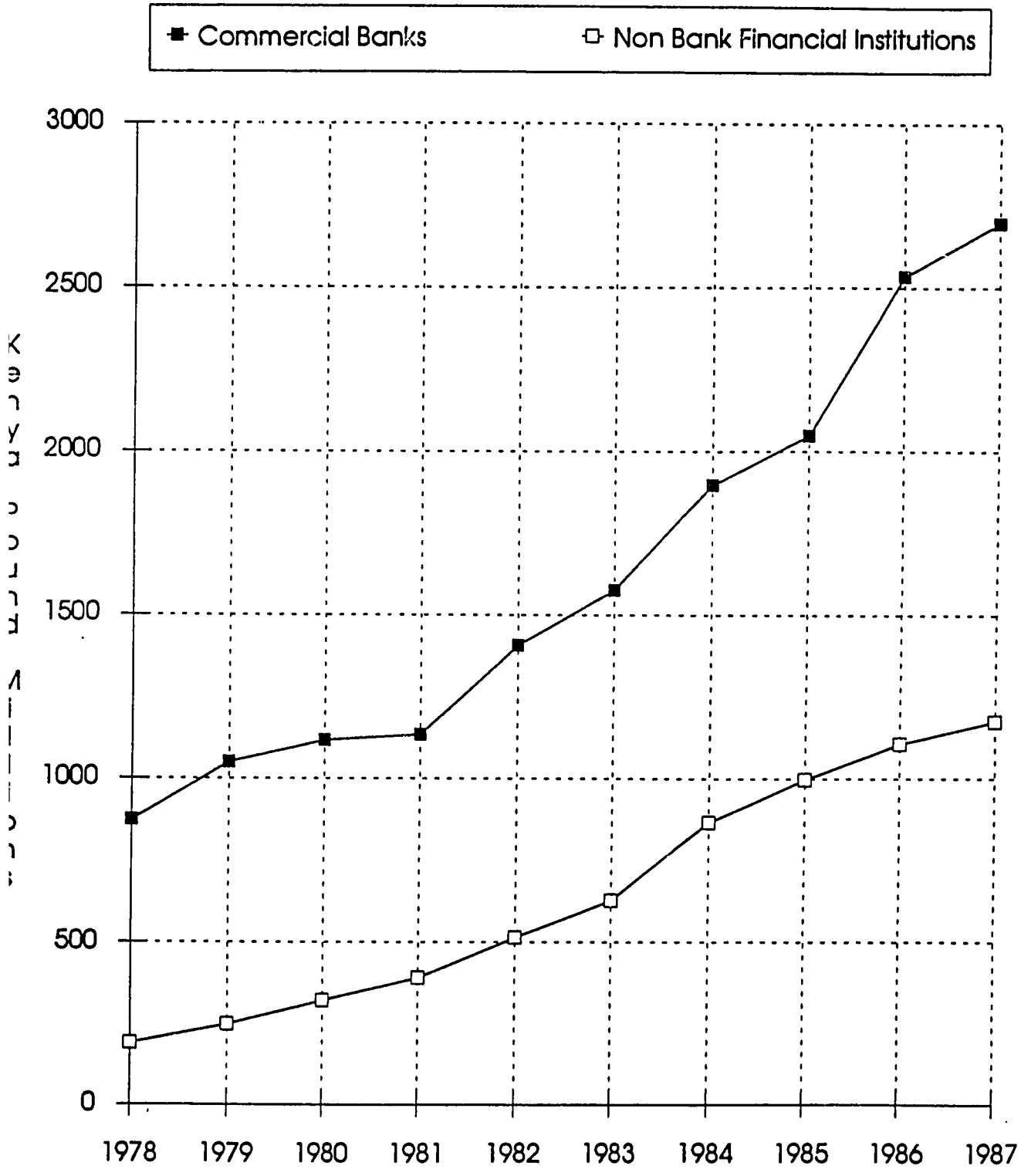
Assets of the Financial Sector 1978-1987



Source: Central Bureau of Statistics

080889 - 041

GROSS DOMESTIC INVESTMENT AS A SHARE OF GDP

Percent

	1987
Gabon	31
Mauritius	26
Kenya	**25**
Lesotho	25
Burkina Faso	24
Congo	24
Mozambique	22
South Africa	20
Mauritania	20
Burundi	20
Chad	18
Zimbabwe	18
Cameroon	18
Rwanda	17
Tanzania	17
Nigeria	16
Mali	16
Zambia	15
Malawi	14
Benin	14
Ethiopia	14
Madagascar	14
Central African Rep.	14
Zaire	13
Cote d'Ivoire	13
Senegal	13
Uganda	12
Sudan	11
Ghana	11
Liberia	10*
Niger	9
Sierra Leone	9

*Figures for years other than specified.
Source: World Bank, World Development Report 1989, Oxford University Press, New York, 1989; pp. 178-179.

CAPITAL FORMATION
AT CURRENT PRICES
(US$ MILLION)

	1974	1976	1980	1985	1986
Residential Buildings	96.35	106.79	246.91	188.36	242.76
Non Residential Buildings	85.59	77.28	195.51	149.82	148.83
Construction & works	136.27	182.33	237.82	220.63	264.67
Land improvement	17.50	17.54	17.81	17.21	19.21
Transport Equipment	75.85	97.76	261.15	165.60	311.38
Machinery & other equipment	158.95	235.60	499.15	376.50	524.67
TOTAL	570.52	717.30	1458.35	1118.12	1511.53

CAPITAL FORMATION
PUBLIC SECTOR CONTRIBUTION

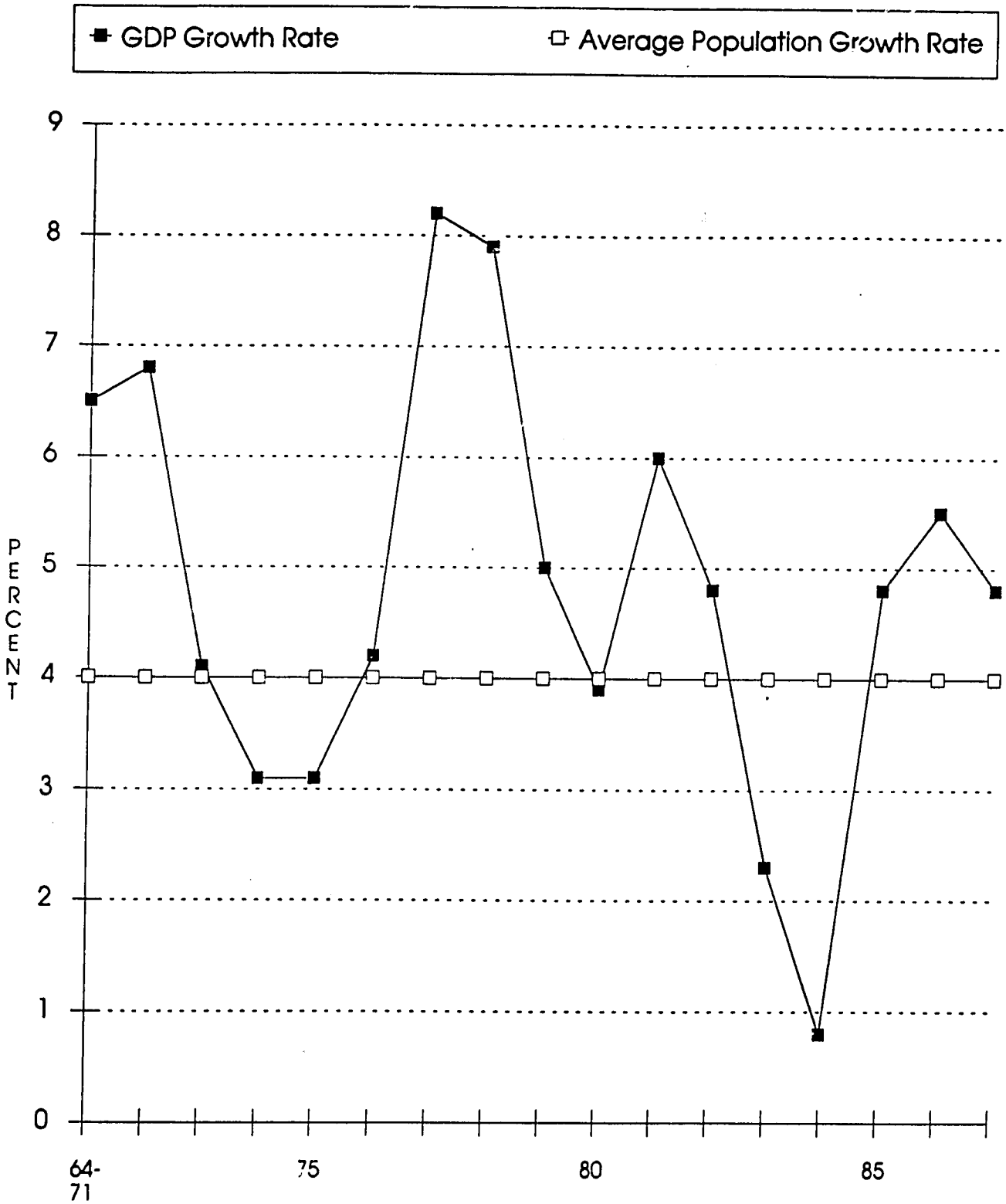
	1974	1976	1980	1985	1986
Residential Buildings	16.41	17.35	55.44	22.35	39.82
Non Residential Buildings	47.43	47.94	142.94	70.93	74.60
Construction & works	122.33	173.81	211.31	200.49	242.85
Transport Equipment	48.05	48.66	98.28	44.07	154.91
Machinery & other equipment	12.32	16.68	85.91	80.66	116.36
TOTAL	246.54	304.45	593.90	418.50	628.54

CAPITAL FORMATION
PRIVATE SECTOR CONTRIBUTION

	1974	1976	1980	1985	1986
Residential Buildings	79.94	89.43	191.46	166.00	202.94
Non Residential Buildings	38.16	29.34	52.56	78.89	74.23
Construction & works	13.94	8.52	26.51	20.14	21.82
Land improvement	17.48	17.54	17.81	17.21	19.21
Transport Equipment	27.80	49.10	162.87	121.53	156.48
Machinery & other equipment	146.63	218.92	413.24	295.85	408.32
TOTAL	323.96	412.85	864.45	699.62	882.99

Source: Statistical Absract
various years

GDP GROWTH RATE 1964-87
(CONSTANT PRICES)



Note: GDP from '64-'71 is in '64 constant prices, from '72-'87 in '82 constant prices.

Source: GOK National Development Plan 1989 - 1993 pg 5

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FOREIGN DIRECT INVESTMENT IN KENYA 1977-8

YEAR	US$ (millions)
1979	78
1980	78
1981	8
1982	3
1983	9
1984	4
1985	13
1986	27
1987	37
1988	7

Source: IMF, International Financial Statistics, October 1989, p.320

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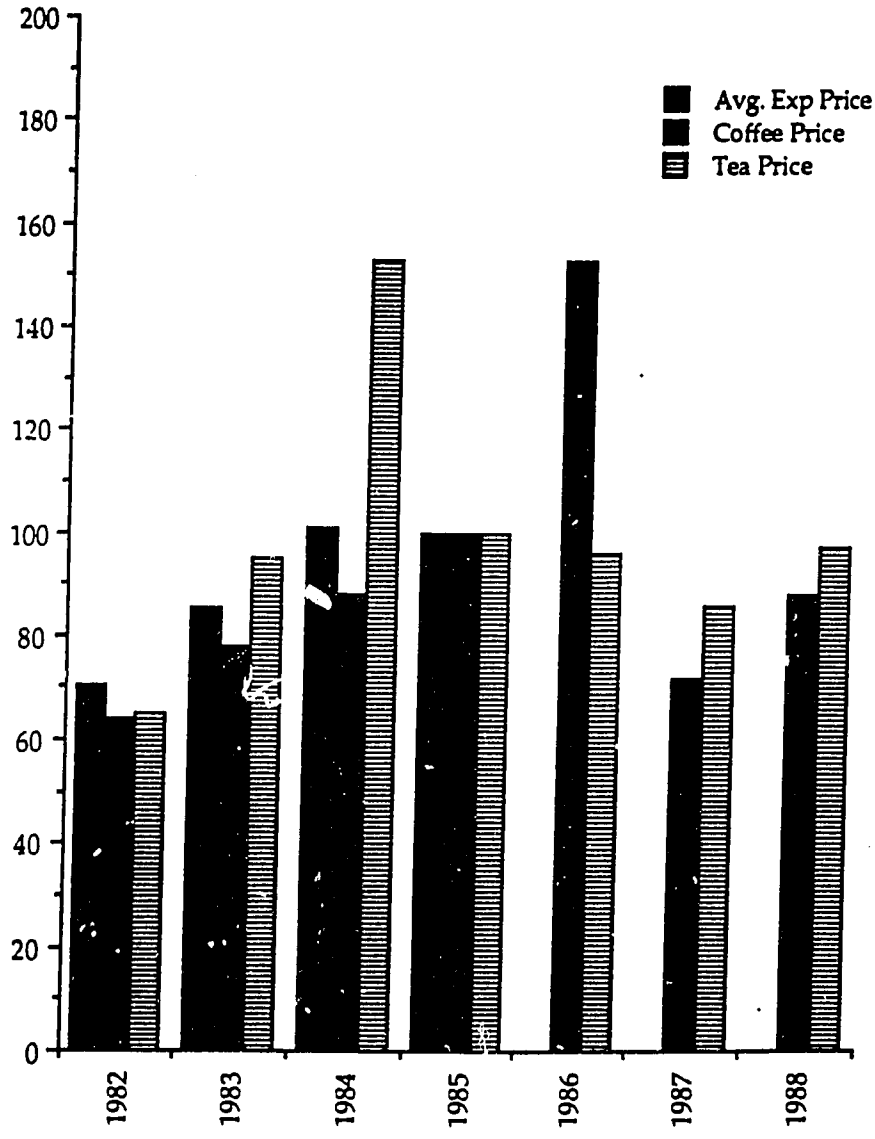
Major Agricultural Exports, Price Behavior, 1982-1986

Index 1985 = 100



Source: International Financial Statistics, October 1989, International Monetary Fund Washington, D.C., 1989.

KENYA'S FOREIGN EXPORT BY COMMODITY

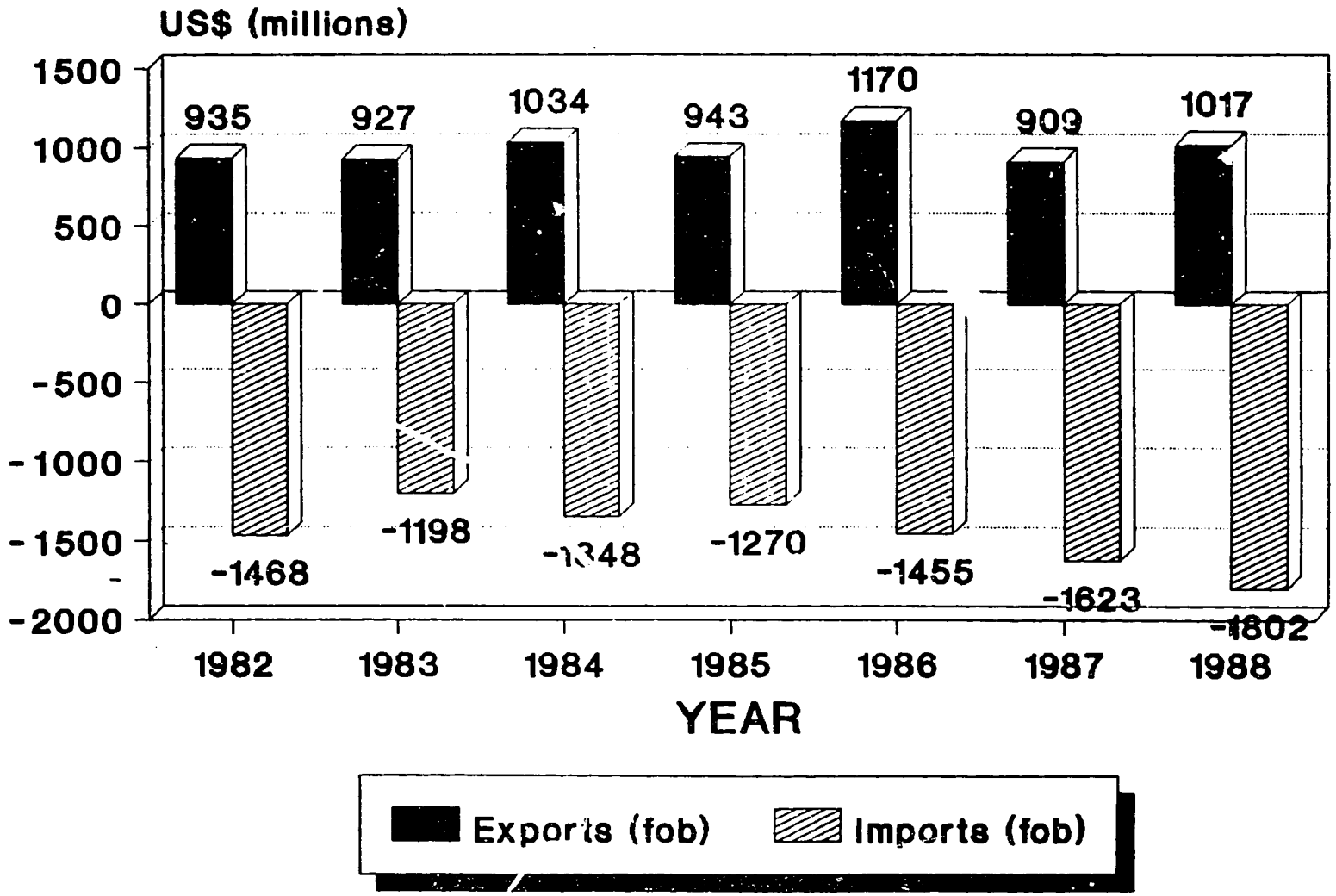
1972 - 1987

KSH - Million

	Unroasted Coffee	Tea	Petroleum Prod	Sisal	Meat & Pre.	Pyreth -eum	Maize	Fruit & Veget	Cement	Hides & Skins	Soda Ash	Others	Total
1972	495	330	388	41	104	76	10	117	55	76	40	825	2,557
1973	716	339	426	96	79	59	128	115	55	104	57	1,315	3,488
1974	768	388	912	339	94	91	49	149	91	89	42	1,565	4,575
1975	704	459	1,171	149	103	70	101	205	120	108	49	1,064	4,303
1976	1,866	635	1,379	84	168	115	113	315	161	171	61	1,305	6,373
1977	4,088	1,436	1,533	79	152	124	13	458	171	160	54	1,194	9,461
1978	2,495	1,264	1,368	78	54	82	14	403	180	196	74	1,174	7,383
1979	2,214	1,257	1,560	96	54	110	107	430	169	275	107	1,348	7,726
1980	2,164	1,160	3,254	177	32	181	0	505	203	191	147	1,741	9,753
1981	2,197	1,225	2,796	175	52	127	1	1,651	288	184	116	1,371	10,182
1982	2,893	1,551	2,985	217	91	200	7	769	386	158	155	1,502	10,914
1983	3,202	2,468	2,689	242	80	94	243	1,099	493	127	192	1,691	12,719
1984	4,073	3,789	2,852	250	148	206	119	1,084	350	142	237	1,846	15,095
1985	4,613	3,828	2,385	282	137	203	25	1,058	308	200	329	2,152	15,520
1986	7,769	3,456	2,050	216	32	246	293	1,323	268	252	328	2,825	19,056
1987	3,892	3,267	2,010	193	4	202	389	1,543	197	338	272	2,750	15,058

Sources: 1972 - 1978 Statistical Abstracts, Central Bureau of Statistics; 1979 - 1987 Custom and Excise Department, Government of Kenya.

KENYA'S BALANCE OF TRADE



IMF, Internat'l Financial Stat., 10/89

GROWTH OF EXPORT TRADE

Average Annual Growth Rate of Exports

Percent

1965-80		1980-87	
Niger	12.8	Mauritania	11.2
Congo	12.5	Mauritius	11.1
Nigeria	11.4	Cameroon	9.7
Mali	11.0	Burundi	8.3
Gabon	8.1	Senegal	6.7
Rwanda	7.7	Mali	6.6
Burkina Faso	6.8	Burkina Faso	4.9
South Africa	6.1	Sudan	4.2
Cote d'Ivoire	5.6	Congo	3.9
Benin	5.2	Cote d'Ivoire	3.4
Cameroon	5.2	Malawi	3.4
Zaire	4.7	Uganda	2.7
Togo	4.6	Rwanda	2.5
Liberia	4.5	Central African Rep.	1.0
Malawi	4.1	Zimbabwe	0.9
Somalia	3.8	Benin	-0.1
Zimbabwe	3.4	South Africa	-0.1
Mauritius	3.1	**Kenya**	**-0.6**
Burundi	3.0	Ethiopia	-0.6
Mauritania	2.7	Ghana	-1.6
Senegal	2.4	Gabon	-1.9
Zambia	1.7	Sierra Leone	-2.1
Madagascar	0.7	Liberia	-2.6
Kenya	**0.3**	Togo	-3.0
Sudan	-0.3	Madagascar	-3.1
Central African Rep.	-0.4	Zambia	-3.3
Ethiopia	-0.5	Zaire	-3.4
Ghana	-1.8	Niger	-4.8
Sierra Leone	-3.8	Nigeria	-5.1
Uganda	-3.9	Tanzania	-7.4
Tanzania	-4.0	Somalia	-7.7

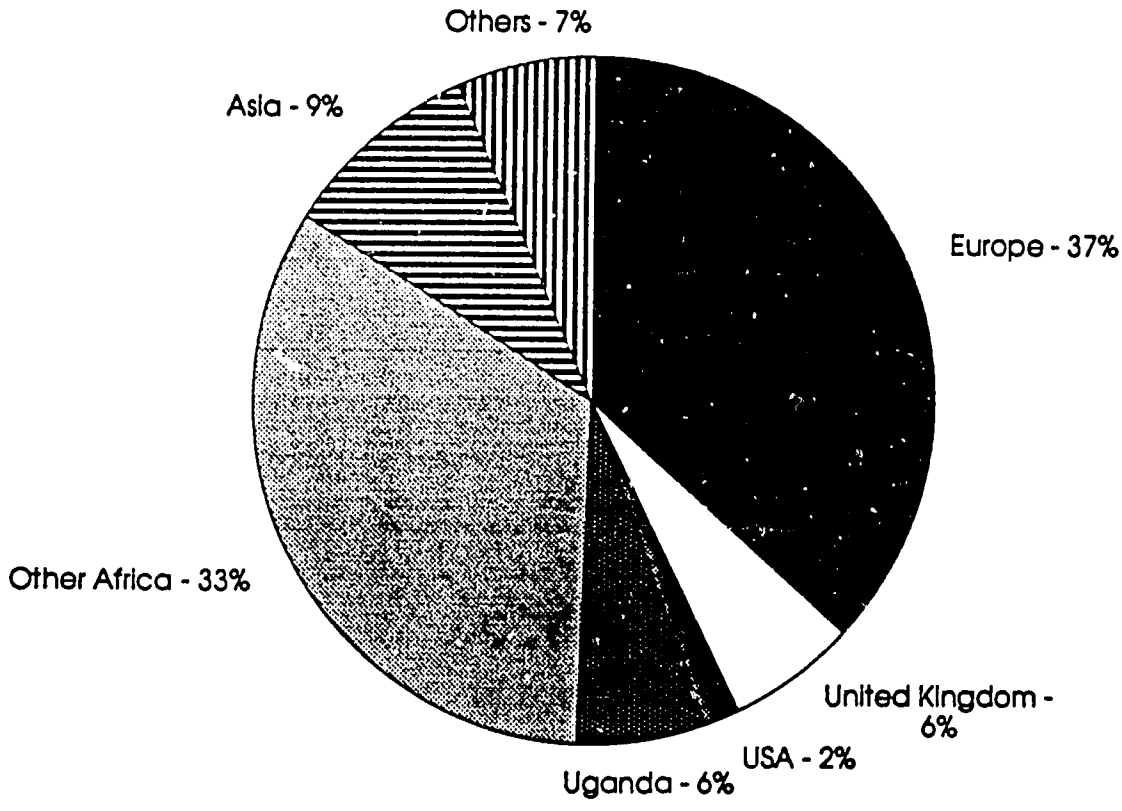
Source: World Bank, World Development Report 1989, Oxford University Press, New York, 1989; pp. 190-191.

GROSS RECEIPTS FROM KENYA'S MAJOR FOREIGN EXCHANGE EARNERS
1972-1987 (US$ Millions)

	COFFEE	TEA	TOURISM
1972	69.7	46.2	74.6
1976	224.9	76.5	99.0
1977	517.5	181.8	147.8
1980	284.5	152.2	217.1
1984	257.7	239.8	192.4
1986	485.6	216.0	310.0
1987	235.8	198.0	353.9

SOURCE: CENTRAL BUREAU OF STATISTICS
Economic Survey (various years)

Total Exports by Destination 1972



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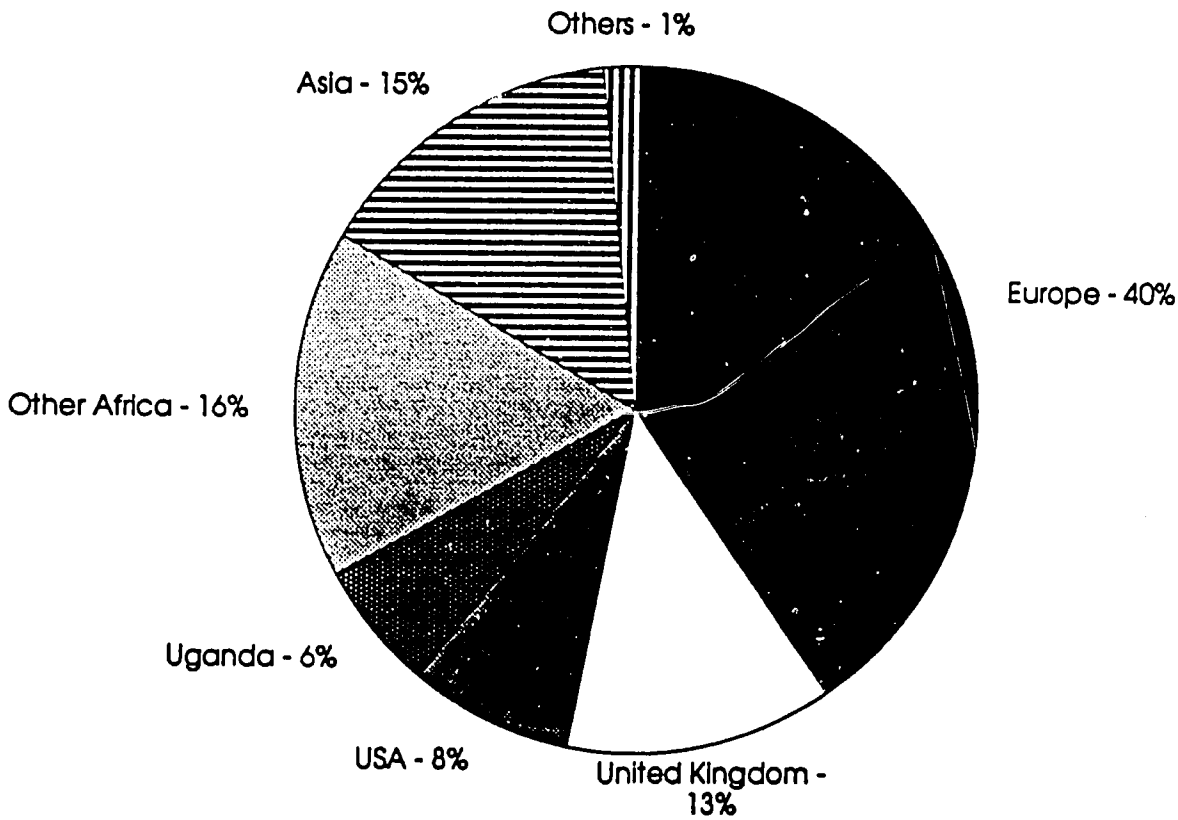
Source: Statistical Abstract Various Years

Total Exports by Destination 1986



Source: Statistical Abstract Various Years

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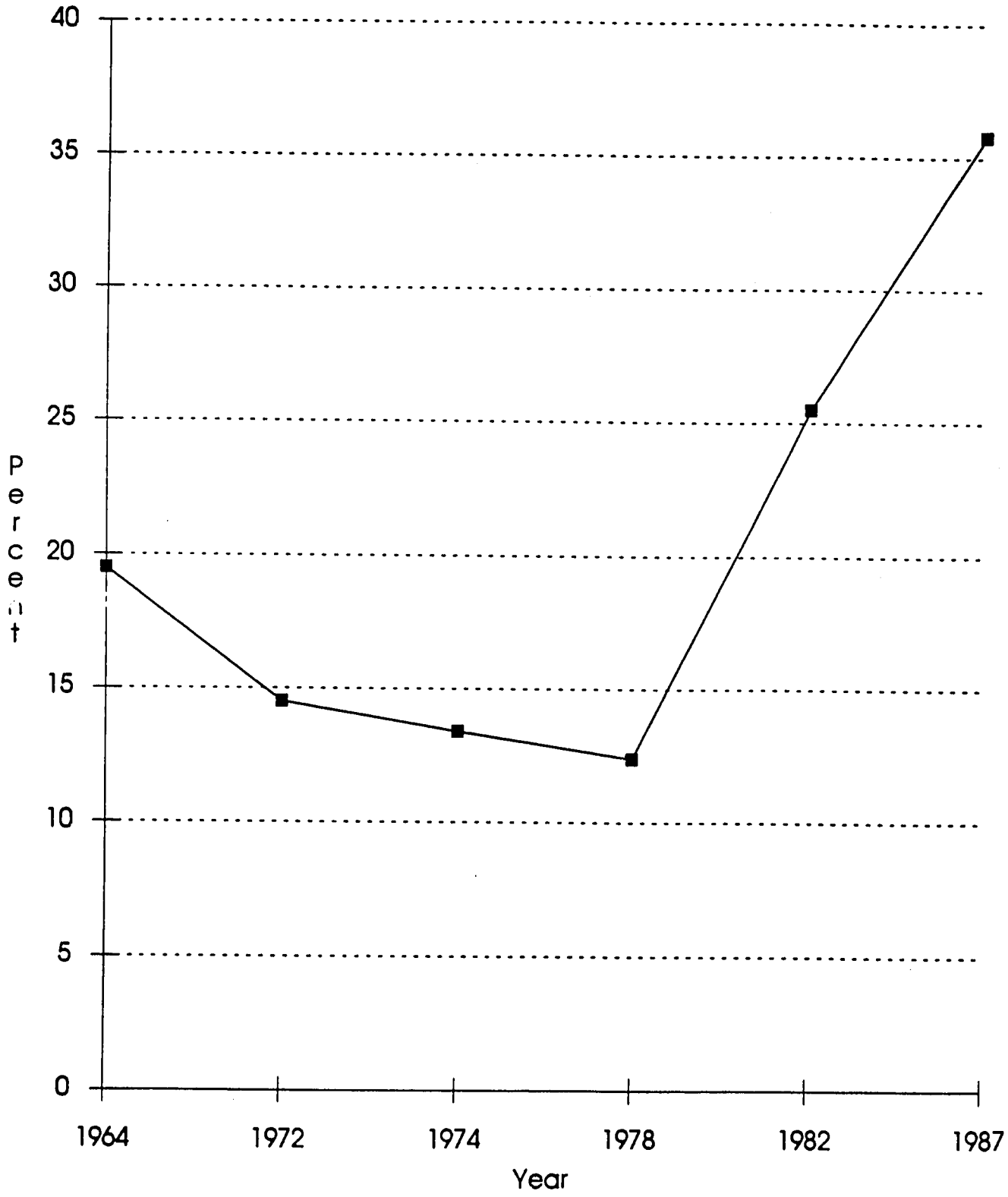
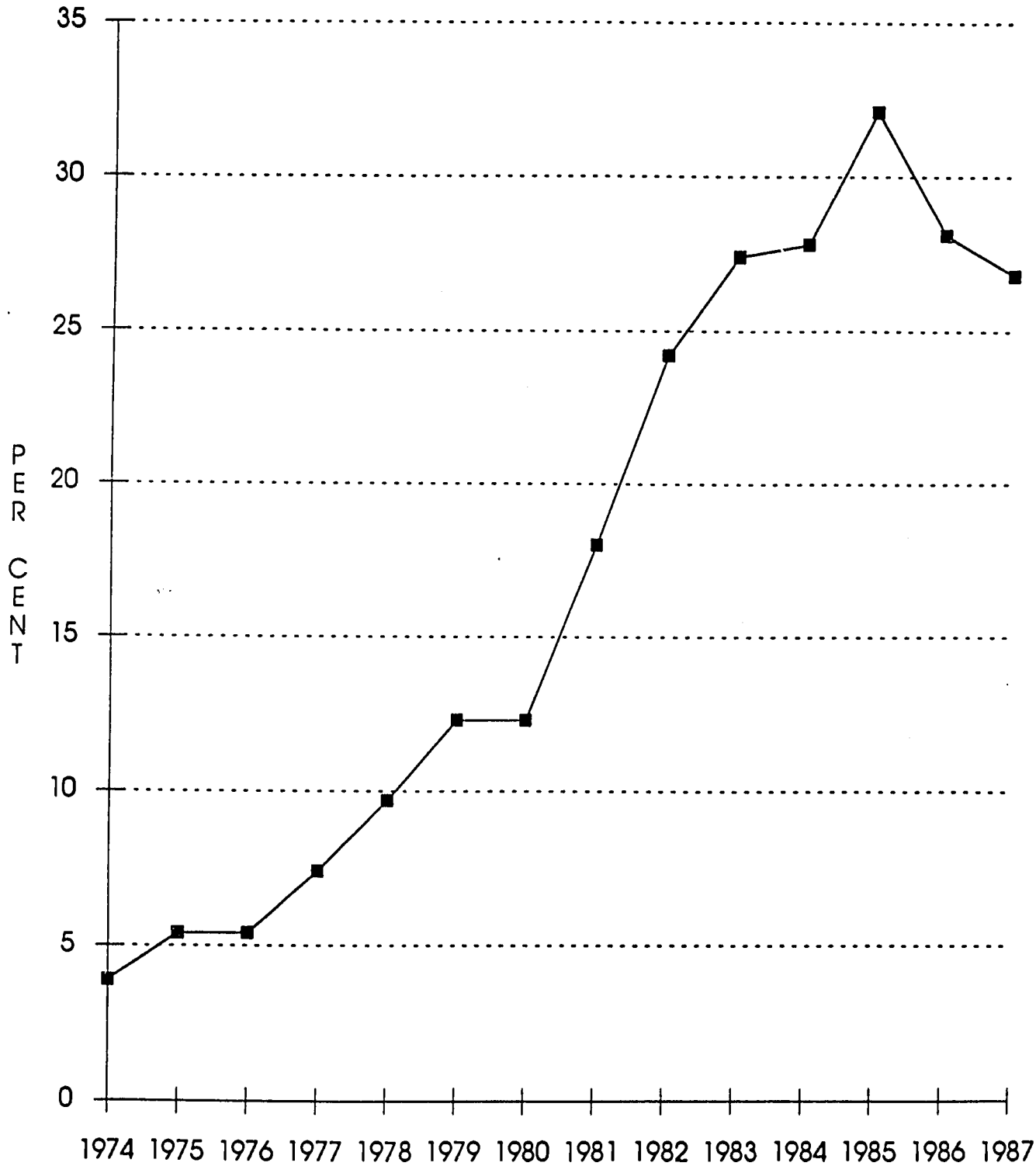
RATIO OF EXTERNAL DEBT TO GNP 1964-1987



Source: Kenya National Development Plan 1989-1993 pg 5

EXTERNAL DEBT SERVICE CHARGES AS % OF EXPORTS OF GOODS & SERVICES



Source: Central Bank of Kenya

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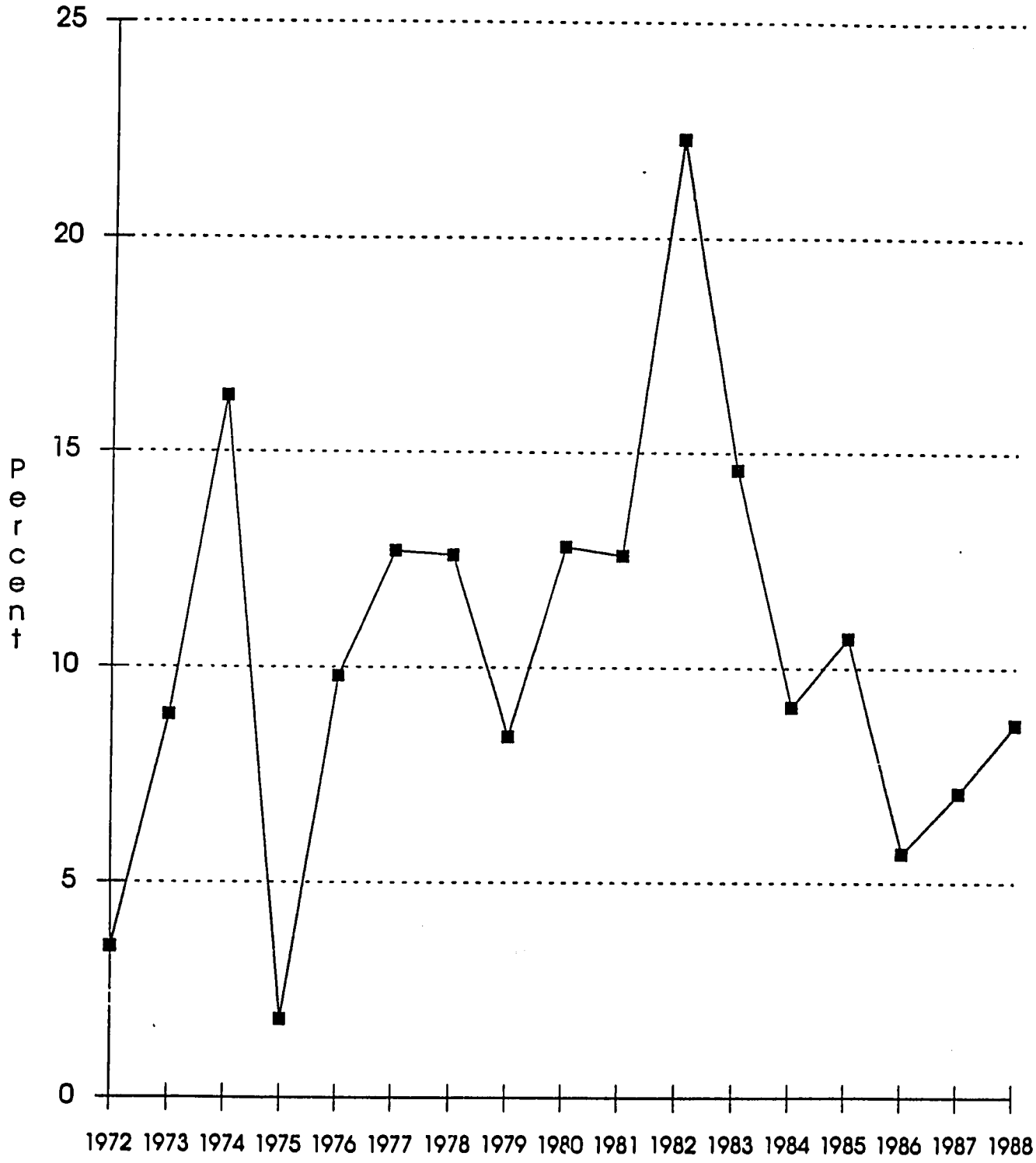
Inflation Rate 1972-1988



Source: Central Bureau of Statistics

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APPENDIX C

SUMMARY OF PRIVATE SECTOR SURVEY

SUMMARY OF FINDINGS

KENYA PRIVATE SECTOR SURVEY

The information contained below has been taken from research entitled "MAPS: Kenya Phase III - Private Sector Diagnosis" which contains the full findings of the survey of 778 private sector firms designed by J.E. Austin Associates (JEA) and implemented over the period of March to May 1989 by Alexander Maclennan Trundell & Co. (AMT) of Nairobi. The survey covered both formal and informal sector firms in all regions of the country. The implications and conclusions drawn from the data are those of the authors of this report. The full JEA report can be obtained from USAID/Kenya. All exhibits referred to below can be found in Annex C.

Perceptions Regarding Business Environment, Firm Performance and Business Opportunities

1. Only 37 percent of the firms sampled believed that there had been an improvement in the business climate over the last year.

   - But perceptions regarding the business climate in Kenya varied by size and sector (Exhibit C.1):

     - Firms operating in the manufacturing sector were more likely to perceive improvements than other firms.

     - Smaller firms in almost every sector were less likely to perceive an improvement than larger firms, with the exception of the manufacturing sector, where smaller firms were more likely than the larger firms to feel that the environment had improved.

2. Firms generally believe that the regulatory environment has had a negative effect on their past performance.

   - Exhibit C.2 shows the rank order for the four factors believed by respondents to have had the most negative effect on their past sales performance. Firms of all sizes and operating in all sectors perceived that government regulations, whether they be related to work permits, import licensing or taxes, had been primarily responsible for poor performance over the last year.

   - Regulations affecting prices of raw materials, either through import controls or direct pricing intervention

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seem to have the largest effect on businesses (Exhibit C.2):

- Manufacturing establishments felt most negatively affected by import controls (leading to spare part shortages and high production costs);

- Agribusinesses felt most negatively affected by marketing controls and regulations, particularly those imposed on raw material prices, while manufacturing firms generally felt they had **benefitted** from marketing controls.

- Larger firms generally felt far more affected by Government regulations than the smaller firms (Exhibits C.3A and C.3B).

3. <u>The majority of the firms sampled are oriented almost exclusively to the domestic market.</u>

- The survey found that firms sell on average about 96 percent of their production in the domestic market. The mean amount sold domestically varies only slightly among all size categories, except for the larger firms, where the average proportion of the total product marketed domestically drops to 84 percent.

- The number of firms interested in exporting was small (17 percent of the sample -- see Exhibit C.4), though this percentage is substantially greater than the number of firms which were actually carrying out any exporting activity (less than 13 percent of the sample was exporting any amount and only 3 percent were exporting over 50 percent of their product).

4. <u>But there is considerable interest in exporting among those firms who are not now engaged in substantial exporting activity.</u>

- Over 50 percent of those who thought exporting activity offered the best return on investment are not exporting any amount (Exhibit C.5A).

- Those firms which expressed an interest in exporting were on average larger than those who were not interested in export markets; 50 percent of the firms in the total sample employed over 6 people, while 76 percent of those who thought exporting provided the best return employed over 6 people (Exhibit C.5B).

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- Exhibit C.6 shows that the EEC and the PTA are believed to be the most potentially profitable export market. But few of those exporting any significant amount now were among those which expressed an interest in these market. For example, of the 14 firms exporting over 10 percent of their product to the PTA, only 4 believed that this market offered the best prospects; of those exporting over 30 percent to the PTA, none felt that this was the most profitable export market. These results suggest that the difficulties experienced by those exporting in general and to the PTA in particular (due to transport and various regulatory bottlenecks -- see points below) may be discouraging current exporters from increasing or continuing their exporting activities.

5. <u>Respondents have little information available on international markets.</u>

- While 62 percent of respondents felt they had reliable information on the domestic market, only 17 percent felt that they had equally good information on international markets. But those now exporters are far more satisfied with their sources of information. Of those firms who reported exporting over 10 percent of their goods and services, 67 percent felt that they had good information on international markets and 70 percent they had good information of the domestic market.

- Official information sources such as the Kenya Trade Authority, the Ministry of Commerce or the Horticultural Crops Development Authority, are currently providing information to less than 10 percent of all respondents. The majority of firms continue to rely on personal contacts (90 percent) or trade journals and publication (33 percent) for information on markets (Exhibit C.7).

- Those firms exporting over 10 percent of their goods and services were less likely to rely primarily on personal contacts and far more likely to rely on associations and official government services however. Firms exporting over 50 percent of their product (on average employing over 50 workers) were much more likely to rely on foreign partners and the Kenya Association of Manufacturers for their market information (Exhibit C.7).

- While business associations are playing some role in the provision of market information, particularly for the larger, more sophisticated firms which are most likely to be exporting, few of the smaller, less sophisticated firms are able to access sources other than their

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personal contacts. Responses to the survey (see Exhibit C.8) suggest that there is substantial demand for market information services among firms of all size categories.

6. Many firms see prospects and profits in agribusiness and tourism.

- Though only 4 percent of the sample operated in the agribusiness sector, 18 percent of the firms sampled believe that agriculture, either for domestic consumption or for export, offers the best prospects for the investor (Exhibit C.4).

- Though only 4 percent of the firms sampled operated in the tourist sector, five times as many respondents (20 percent) believe that tourism is a potentially profitable area.

7. There is very little contact between the large and the smaller firms.

- The smaller firms generally do not belong to the same business associations as do the larger firms, and even when they do belong to the same association, they tend to think that these organizations have been less effective in serving their interests (Exhibits C.9 and C.10).

- The smaller firms (under 10 employees) sell most of their product (on average 87 percent) to retail customers, and to a lesser extent to other small firms. They also procure most of their raw material (on average 45 percent) from other small firms.

- Smaller enterprises by and large do not belong to any business association (Exhibit C.11). While virtually all large enterprises interviewed (almost 90 percent) report belonging to some association, only 17 percent of owner operated, 22 percent of the micro enterprises and 30 percent of small enterprises do.

Perceptions Regarding Resource Constraints Affecting Productivity.

8. Perceptions regarding resource constraints vary considerably across size categories and sectors.

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- Exhibit C.12 shows the rank order for the four resource constraints believed by respondents to have had the most negative effect on their productivity. The rank order of factors changes appreciably as the size of the enterprise increases. It also varies by sector and geographic location.

9. The lack of affordable transportation (primarily land transport) was perceived as a common constraint by firms operating in most sectors and in most size categories.

   - While there were few complaints regarding transport availability, the majority of firms in all sectors of the economy view the lack of cheap transport as major constraint to business development.

   - The exception to this are firms operating in Western Kenya. For firms in this region, availability of transport, not just price, seems to also be an issue.

   - Firms exporting over 10 percent of their goods and services were most hurt by transport (both price and availability) constraints.

   - Survey results suggest that the transport problem may be linked to import controls (causing shortages for spare parts and inflating the price of vehicles). In the case of firms operating in more remote sections in the country, far from large primary markets such as Nairobi or Mombasa, such as those firms in Western Kenya, survey results suggest that transport costs may also be related to lack of appropriate road infrastructure (which increases the wear and tear on vehicles).

10. For larger firms, access to spare parts, affordable transport, and raw materials are the most important constraints to business operations (Exhibit C.12).

    - Difficulties accessing raw materials and spare parts may be at least partly rooted in government regulations affecting import permits.

11. For owner-operated and micro enterprises, the key constraints affecting productivity are access to credit, suitable premises and land.

    - The survey revealed that firms in this size category rely heavily on non formal sources of capital, particularly

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personal funds and funds provided by family and friends (Exhibit C.13). The only formal source of capital playing any kind of a role among the smaller enterprises are the commercial banks. Cooperatives, development banks, and other sources seem to be reaching only a very small percentage of the smaller firms. This has hindered appreciably expansion/production plans for these firms. The lack of credit has also hindered access to inputs for firms in this size category (see Exhibit C.14).

- Credit issues are linked to land tenure constraints. According to survey responses, the key factor affecting their access to credit was the inability of these entrepreneurs to meet lenders' collateral requirements. Exhibit C.15 shows that only a small proportion of all but the largest firms have the type of tangible security (title deed) necessary to meet collateral requirements. Almost one of every three owner operated establishments had only squatter rights to the land they were occupying.

- But the problem of security of land tenure for the smaller firms goes beyond its implications for lending. The overwhelming majority of the smallest enterprises simply lack stable access to a place in which to conduct business which at least a lease would provide. This too has implications for the willingness/ability of these entrepreneurs to expand their businesses operations. For example, lack of security makes entrepreneurs very short term oriented and may inhibit willingness to undertake any improvements in business operations. Survey results show that smaller entrepreneurs were generally less interested in investing in any type of firm improvement than the larger firms. The smallest firms (owner operated) are the least interested in any sort of investment to improve their productivity (Exhibit C.16).

12. <u>Women-owned business tend to be much smaller than other businesses.</u> Exhibit C.17 shows that as the size of the enterprise increases, the percentage of firm owners who are women-owned decreases.

- The rank order of factors affecting the performance of women-owned enterprises was found to be generally no different to that affecting the sales of micro-enterprises. Hence size is more important than the gender in determining perceptions regarding factors affecting sales.

- Survey results suggest however that the resource constraints faced by microenterprises (problems accessing

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credit, lack of market information, low management skills, insecurity of tenure) in general are felt far more acutely by women.

13. Access to quality skilled/supervisory labor was not perceived as a serious constraint by the firms sampled. Almost 8 out of every 10 respondents felt satisfied with the productivity of their workers.

- The degree of satisfaction was fairly constant across sectors. Most firms sampled did not believe that they had to either invest a lot in training their employees, or that skilled labor was difficult to find. These responses were fairly constant across most size categories, with the exception of the largest firms, which were twice as likely to feel that they have had to invest a lot in worker training (52 percent) than the smaller firms (22 percent).

- But perceptions regarding availability of labor skills in Kenya do vary by sector. Exhibit C.18 shows that agro-processing firms are more likely to experience difficulty finding good managers, while service sector operations are more likely to find it hard to get good technical personnel.

Implementing Agents

14. The Kenya National Chamber of Commerce (KNCCI) and the Kenya Association of Manufacturers (KAM) were rated as the most effective business associations in the country.

- These associations were rated as "effective" by a majority of members in all size categories (Exhibit C.10).

- In general, those organizations to which the majority of the firms in the sample belonged, the Chamber of Commerce and the Kenya Association of Manufacturers (KAM), received lower effectiveness ratings from the smaller member firms (Exhibit C.10).

15. Micro and small enterprises want and require different things from the organizations than the larger firms.

- The large firms primarily believe a business organization should serve as a vehicle to lobby government and assist

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with the provision of market information.

- Small firms believe these organizations should assist by providing them with credit and technical assistance and feasibility studies (Exhibit C.8).

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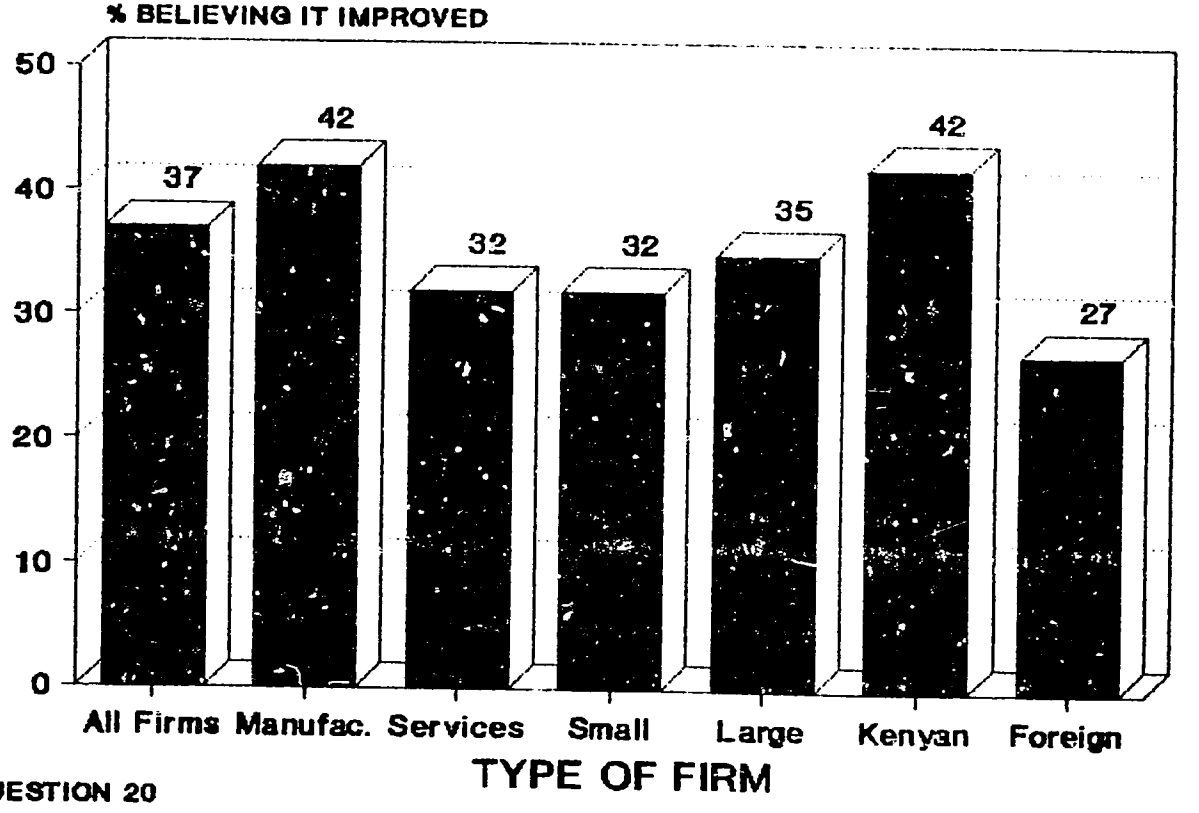
ANNEX C

EXHIBIT C.1

PERCEPTIONS REGARDING THE BUSINESS ENVIRONMENT



QUESTION 20

EXHIBIT C.2

FACTORS HAVING THE MOST NEGATIVE EFFECT ON PAST SALES

By Size Category:

	Owner-Operated Firms	Micro Enterpr.	Small Firms	Medium Firms	Large Firms
1.	Local Competition	Local Competition	Local Competition	Local Competition	Import Reg.s
2.	Lack of market infrastructure	GOK regulations	GOK regulations	Tax Policies	GOK Reg.s
3.	GOK regulations	Tax Policies	Tax Policies	Import Reg.'s	Local Comp.
4.	Production Technology	Import Regulations	GOK Marketing Controls	GOK Reg.s	Tax Policies

By Sector:

	Agric. Production	Agro-Processing	Services	Manufac.	Commerce
1.	GOK Regulations	GOK Regulations	Local Compet.	Local Compet.	Local Compet.
2.	Import Regulations	Local Competition	GOK Reg.'s	GOK Reg.'s	Import Reg.'s
3.	Tax Policies	Foreign Competition	Tax Policies	Import Reg.'s	GOK Reg.'s
4.	Local Competition	Market Infrastr.	Import Regulations	Road Transport	Tax Policies

FACTORS AFFECTING BUSINESS PERFORMANCE BY SIZE CATEGORY

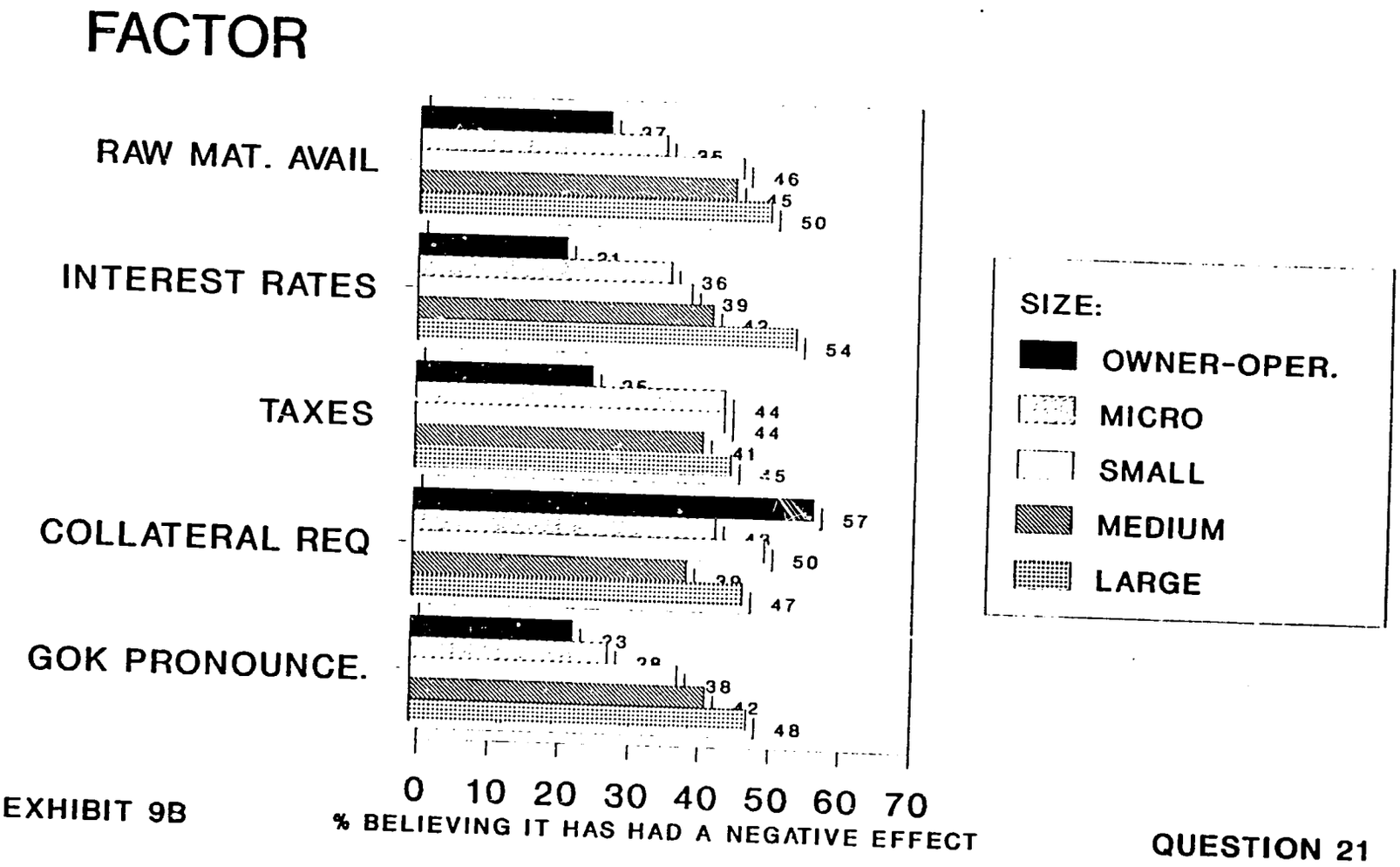
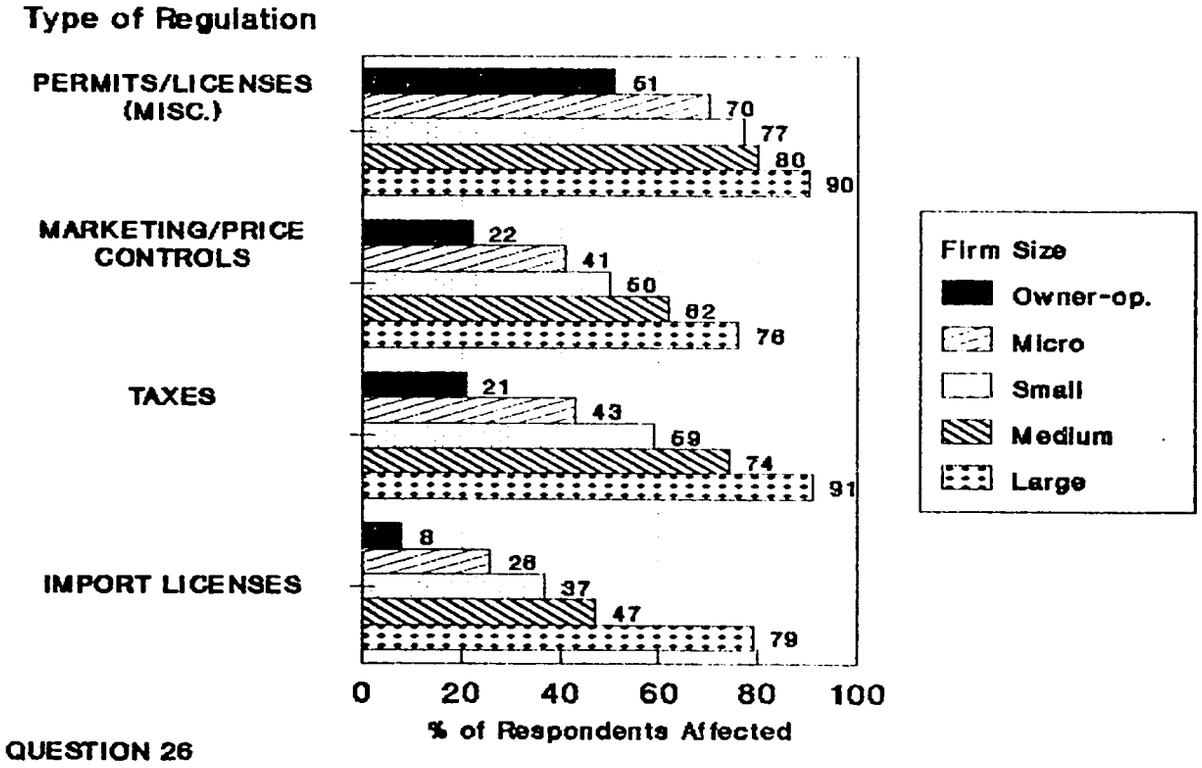


EXHIBIT 9B

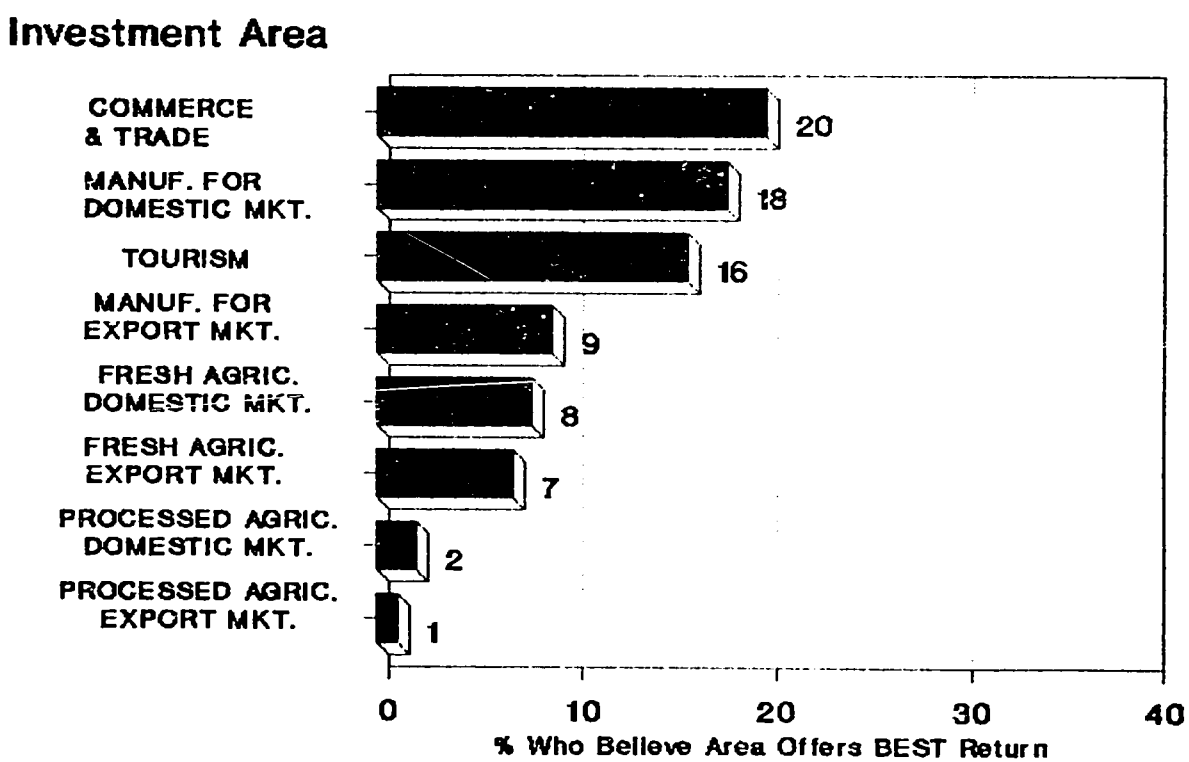
QUESTION 21

Exhibit C.3b
EFFECT OF GOK REGULATIONS BY FIRM SIZE



QUESTION 26

Exhibit C.4
Areas Believed to Offer Best Return



Question 53

EXHIBIT C.5A

CHARACTERISTICS OF FIRMS INTERESTED IN EXPORTING

	Mean	Median	Mode
% sales domestic	89 (96)	100 (100)	100 (100)
% sales to EEC	6 (1.2)	0 (0)	0 (0)
% sales to PTA	3 (0.7)	0 (0)	0 (0)

NOTE: Figures in parentheses are the responses for the total sample of 778 firms).

EXHIBIT C.5B

Size distribution of those firms expressing an interest in either the PTA or the EEC, compared to that of the sample:

	Size Category				
	Owner Operated	Micro	Small	Medium	Large
Total Sample (N=778)	11%	39%	17%	24%	9%
Firms interested in PTA	0	12%	25%	47%	16%
Firms interested in EEC	2%	30%	17%	34%	17%

MOST PROFITABLE EXPORT MARKETS

N = 144

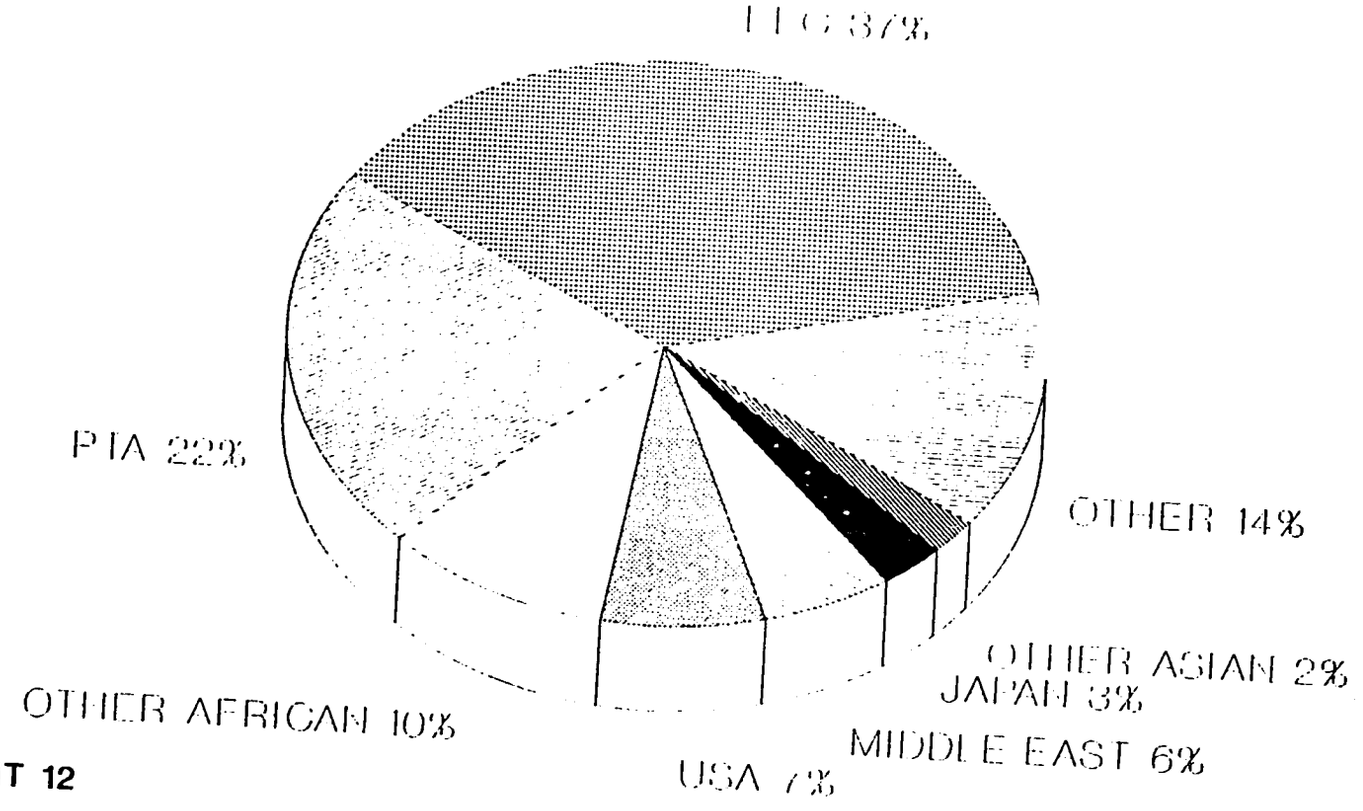
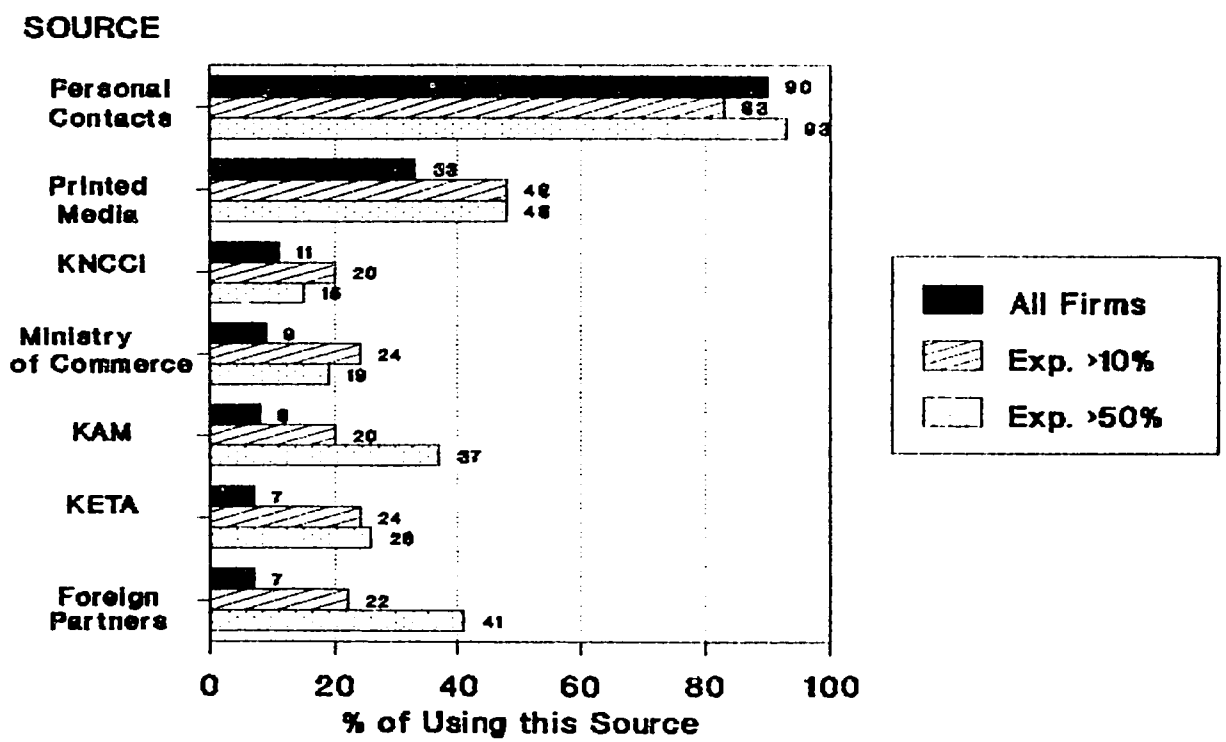


EXHIBIT 12

QUESTION 54

Exhibit C.7
Market Information Sources



Question 48

DEMAND FOR ASSOCIATION SERVICES

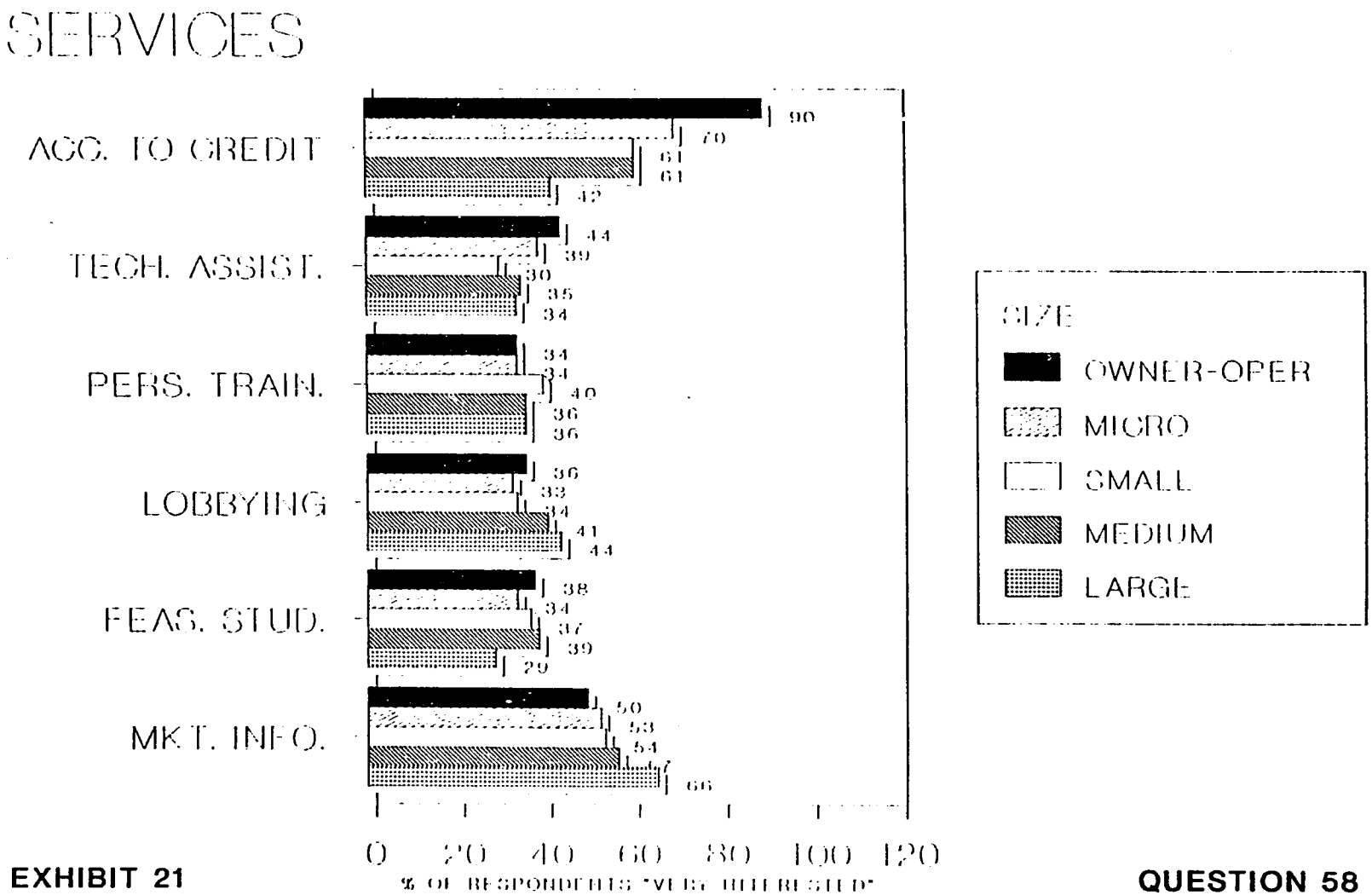


EXHIBIT 21

QUESTION 58

Exhibit C.9
Membership in Selected Associations

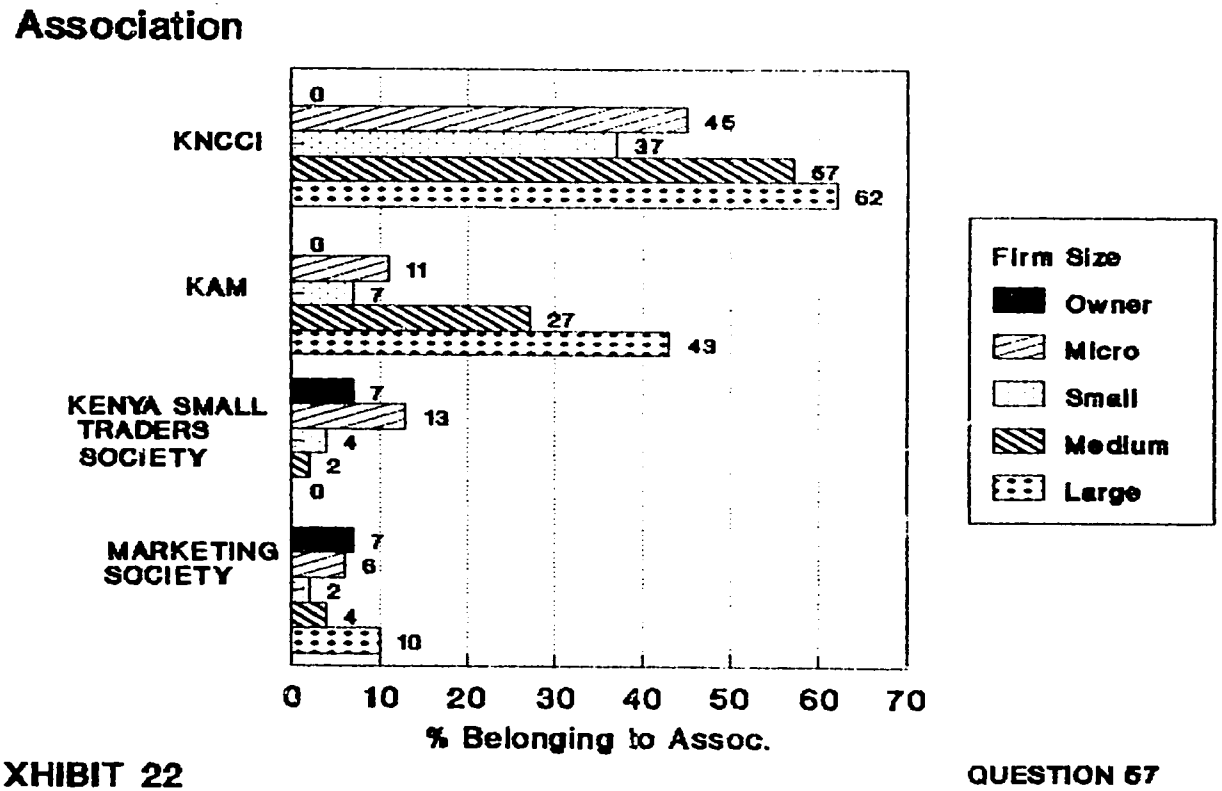


EXHIBIT 22

QUESTION 57

MEMBERS RATE EFFECTIVENESS OF ASSOCIATIONS

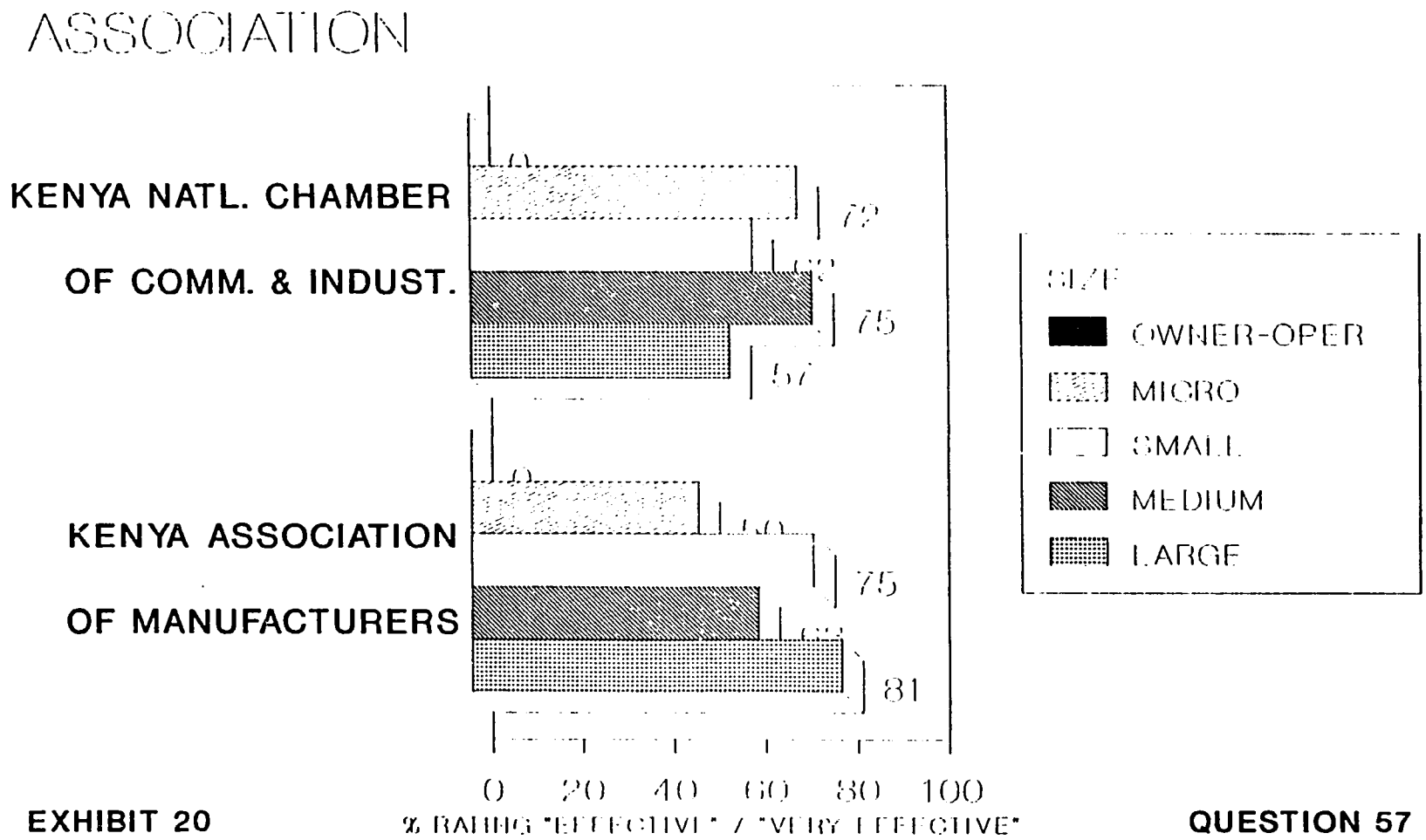


EXHIBIT 20

QUESTION 57

MEMBERSHIP IN ASSOCIATION
(BY SIZE CATEGORY AND OWNERSHIP)

QUESTION 55

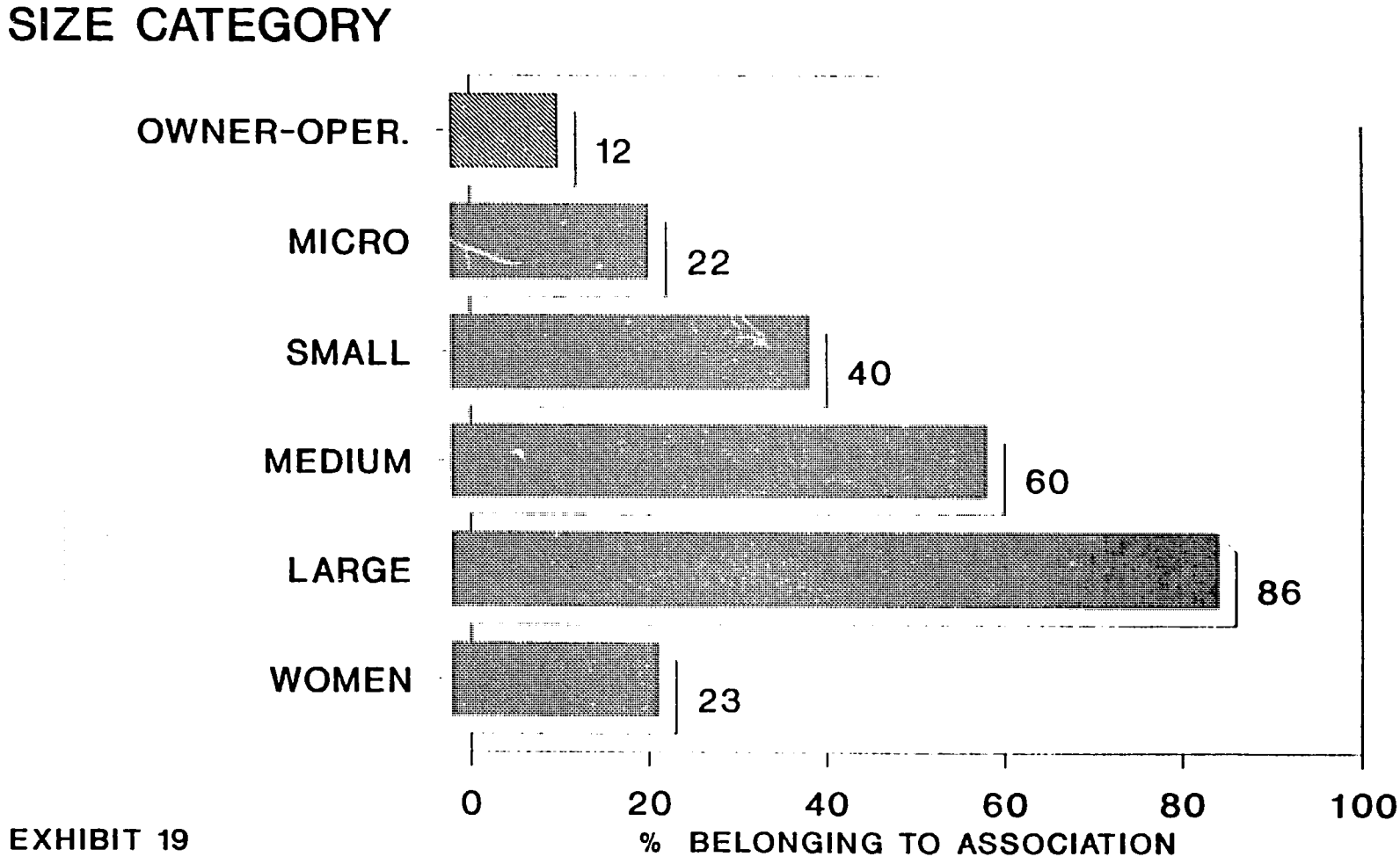


EXHIBIT 19

EXHIBIT C.12

MAJOR RESOURCE CONSTRAINTS

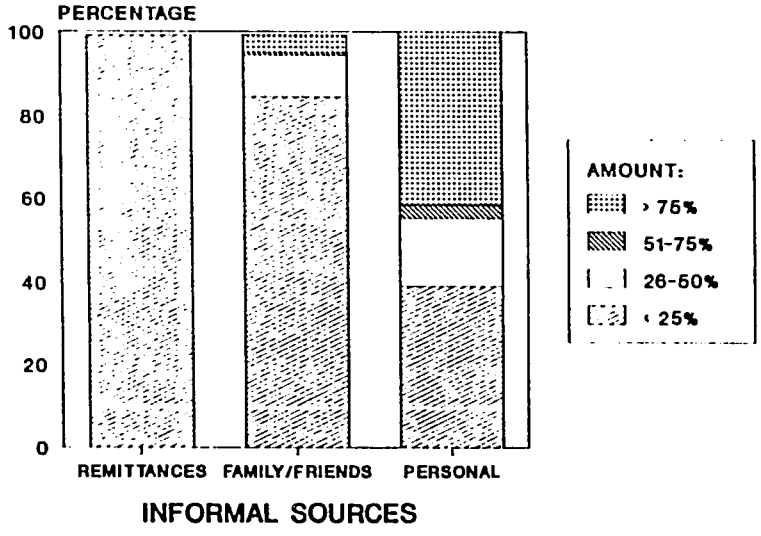
By Size Category:

	Owner-Operated Firms	Micro Enterpr.	Small Firms	Medium Firms	Large Firms
1.	Access to Credit	Access to Credit	Access to Affordable Transport	Access to Spare Parts	Access to Spare Parts
2.	Access to Suitable Premises	Access to Suitable Premises	Access to Credit	Access to Credit	Access to Affordable Transport
3.	Access to Land	Access to Land	Access to Land	Access to Land	Access to Raw mat.'s
4.	Access to equipment/ Technology	Reliable/ Cheap Power	Access to spare parts	Access to Affordable Transport	Access to Equipment/ Technology

By Sector:

	Agric. Production	Agro-Processing	Services	Manufac.	Commerce
1.	Access to Affordable Transport	Access to Raw materials	Access to Spare Parts	Access to Credit	Access to Credit
2.	Access to Reliable/ Cheap Power	Access to Credit	Access to Affordable Transport	Access to Affordable Transport	Access to Affordable Transport
3.	Access to Technology/ Equipment	Access to Affordable Transport	Access to Land	Access to Spare Parts	Access to Raw Mat.'s
4.	Access to Raw Materials	Access to Spare Parts	Access to Afford/Rel. Power	Access to Land	Access to Land

SOURCES OF CAPITAL:
SMALL FIRMS



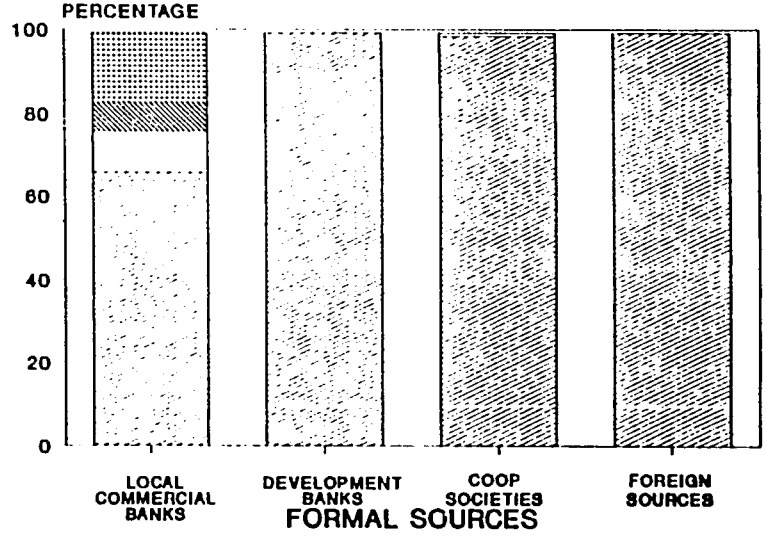


EXHIBIT 14A

QUESTION 40

FACTORS ACCOUNTING FOR DIFFICULTY IN ACCESSING INPUTS

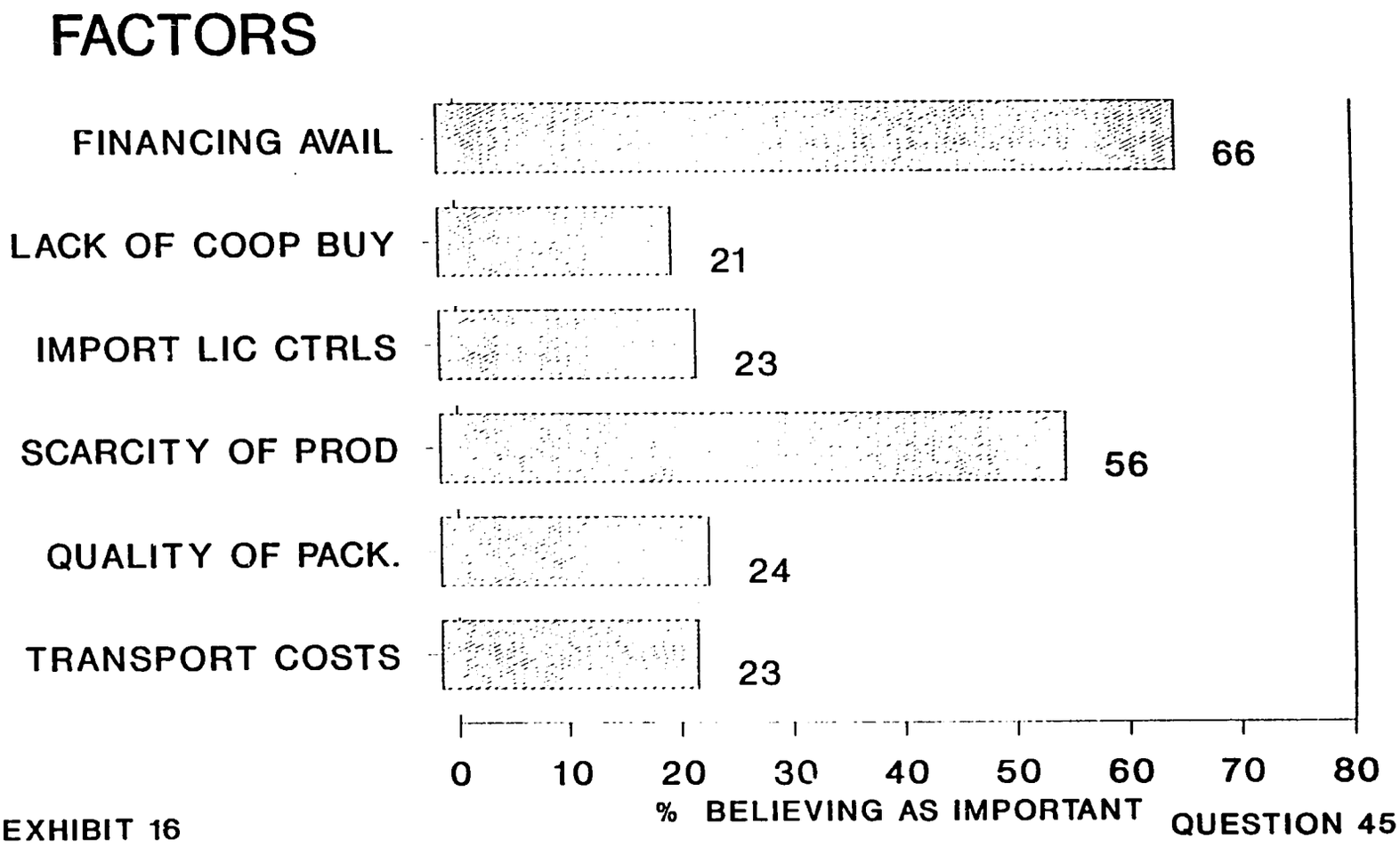


EXHIBIT 16

DISTRIBUTION OF TENURE RIGHTS
BY SIZE OF FIRM

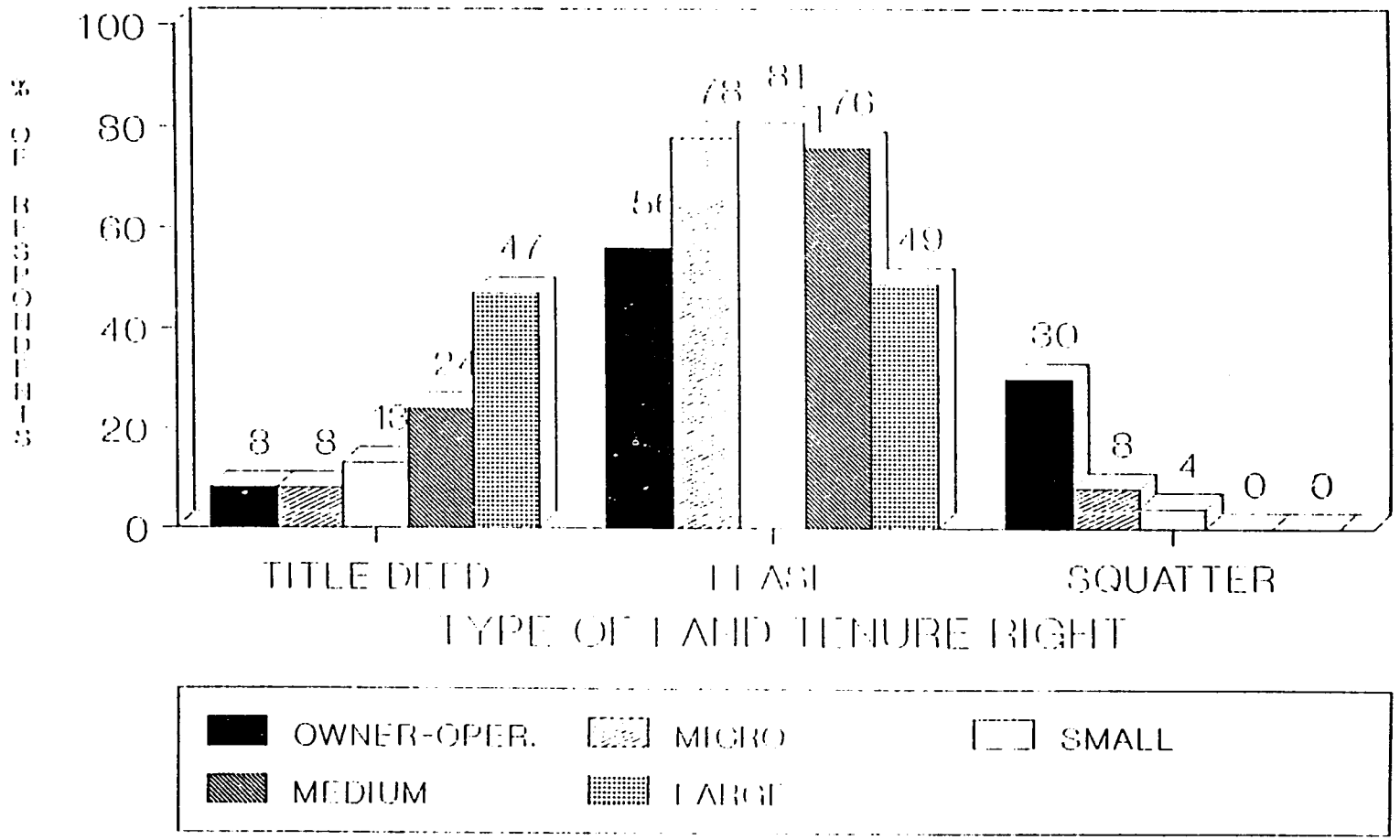


EXHIBIT 10

QUESTION 28

AREAS TO INVEST IN TO IMPROVE BUSINESS OPERATIONS (BY SIZE)

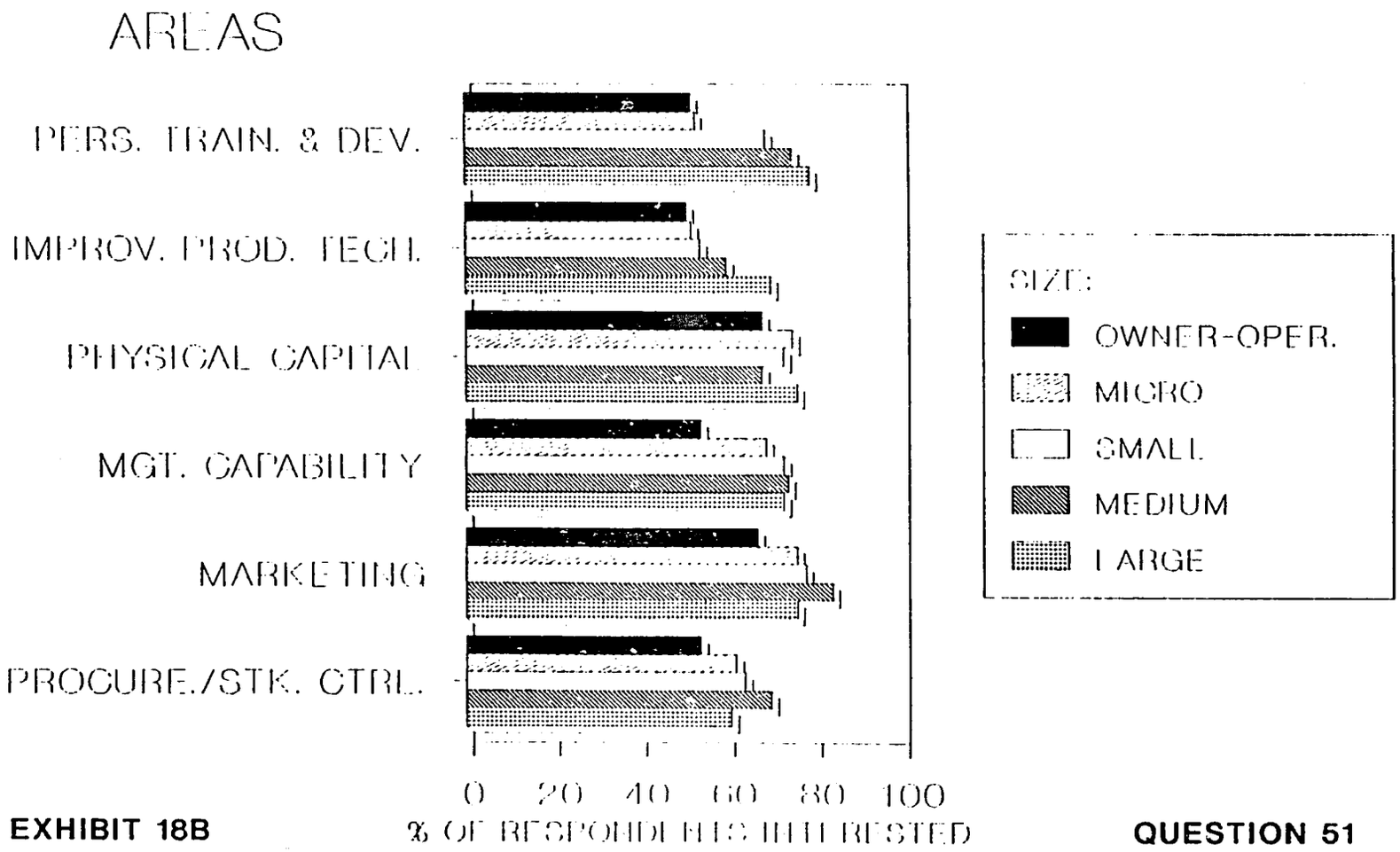


EXHIBIT 18B

QUESTION 51

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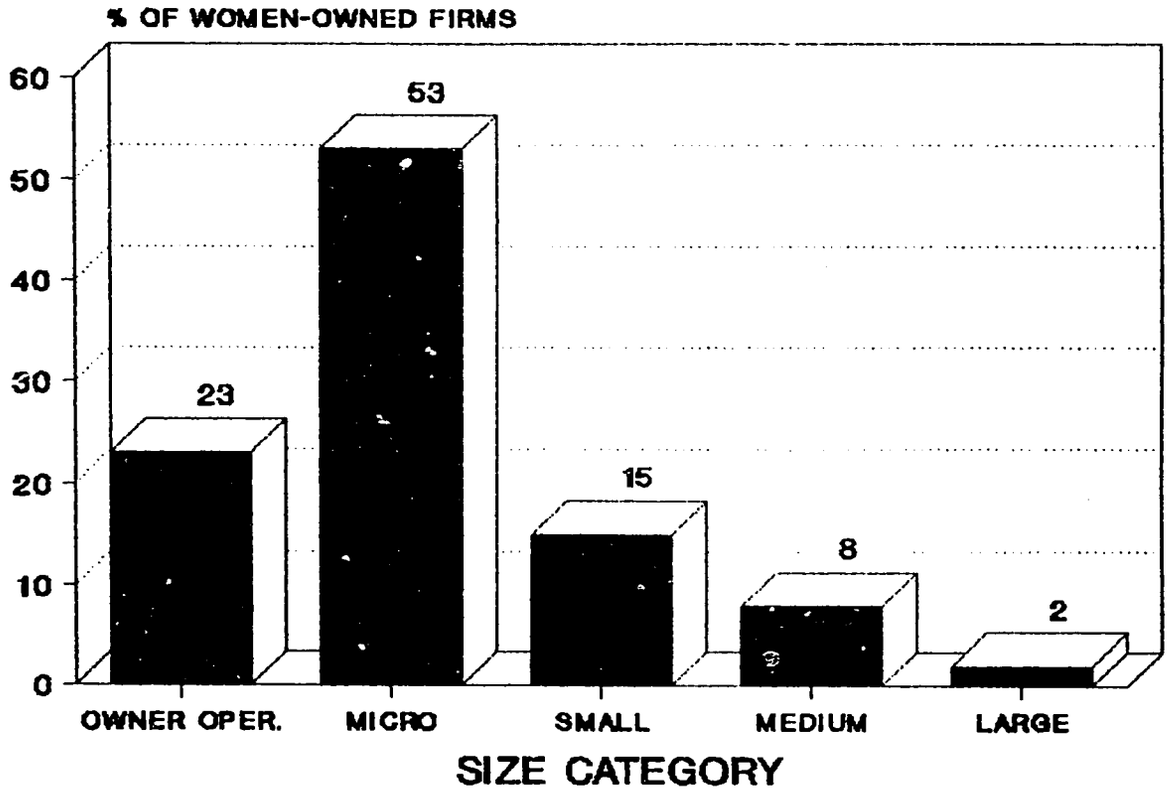
EXHIBIT C.17

SIZE DISTRIBUTION OF WOMEN-OWNED FIRMS



QUESTIONS 5 AND 10

PERCEPTIONS REGARDING AVAILABILITY OF LABOR SKILLS (BY SECTOR)

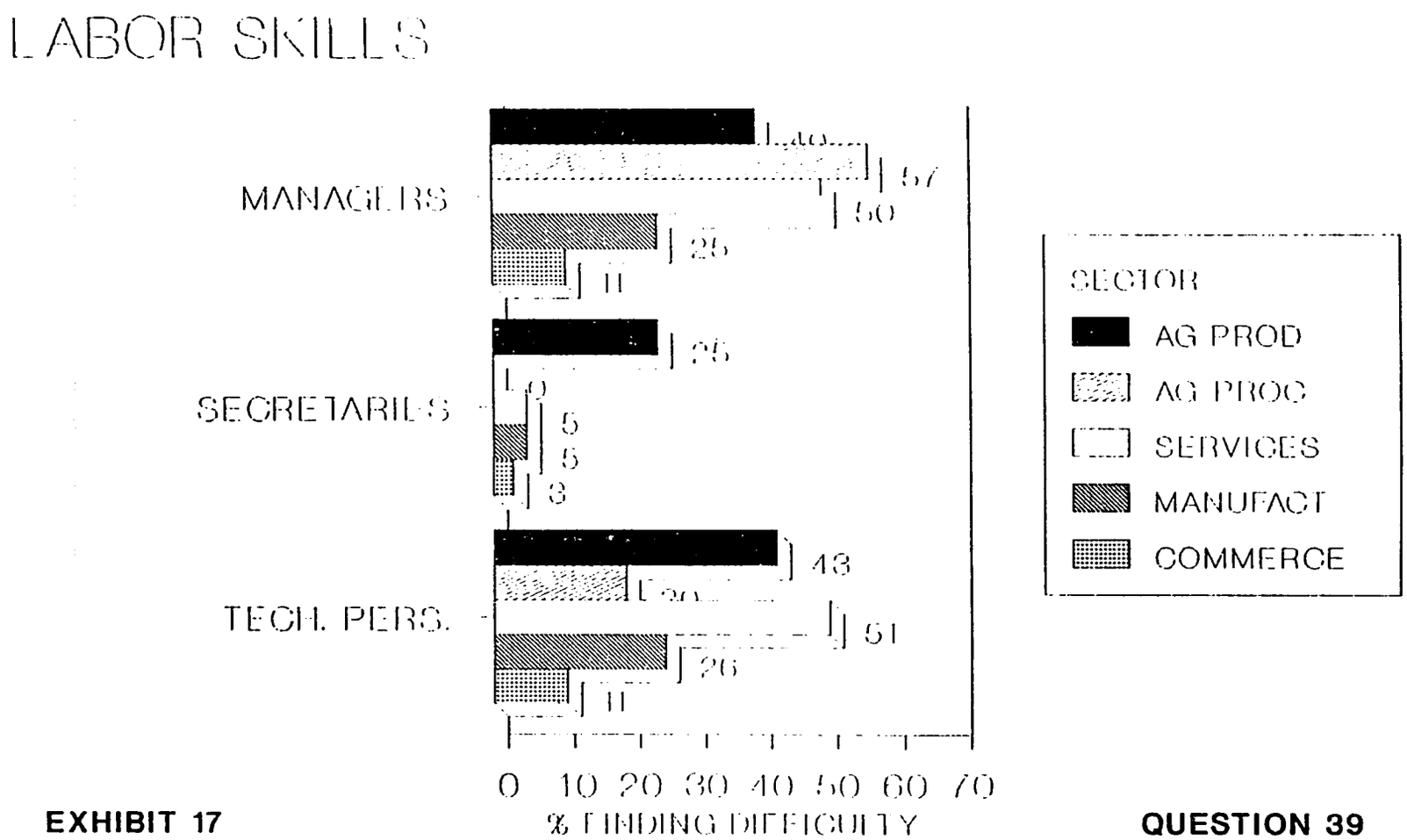


EXHIBIT 17

QUESTION 39

APPENDIX D

SUMMARY OF DIALOGUE SESSIONS

GOVERNMENT, DONOR, AND PRIVATE SECTOR CONVERSATIONS

APPENDIX D

SUMMARY OF DIALOGUE SESSIONS

GOVERNMENT, DONOR AND PRIVATE SECTOR CONVERSATIONS

The MAPS Team held dialogue sessions starting in early 1989. The first round took place during the first visit of MAPS consultants in February 1989. These meetings served to orient the consultants and the Mission regarding current key constraints and opportunities to private sector promotion. The information gathered was used to design the two studies described above on the role of the private sector and constraints to private enterprise growth in the country.

Additional rounds of discussions were held in April and October 1989. In October 1989 the results from the MAPS studies were distributed and discussed with small groups of entrepreneurs, Government officials and donors****. These subsequent discussions confirmed many of the findings from the studies, as well as clarified a number of points regarding opportunities and constraints to private sector growth. The following is a summary of the key findings from all the dialogue sessions conducted by the MAPS consultants with representatives from the GOK, donors and private sector entrepreneurs.

1. <u>Constraints</u>

<u>Finance</u>

- A conservative financial system which is not interested in innovation and offers only heavily collateralized credit.

- Inability of the banking sector to determine the credit-worthiness of applicants due to:

  -Poor basic business skills -- many applicants cannot even prepare balance sheets. Loan applicants lack knowledge of marketing, doing projections and good feasibility studies.

  -Disincentives to full financial disclosure as a result of high tax rates in the country (between different sorts of levies the effective corporate tax rate may be as high as 65 percent).

****A full list of representatives from these various sectors who attended the October sessions is provided in Appendix E to this report.

- Banks willing to lend unsecured, but they simply see too few good project proposals.

- Financial directors of companies lack knowledge in capital products and are unwilling to try what has never been done in the country.

- Crowding out of private credit by increased Government borrowing.

- Lack of venture capital for local entrepreneurs and poor possibilities for equities markets expansion because:

  -Small and medium firms do not want outside equity, preferring to leverage their own as much as possible; or

  -They will allow outside equity only as long as they remain in the driver's seat.

  -There is no protection for the minority partner/investor.

  -There is little support for venture capital markets even by the larger firms, except for one person who sees the venture capital mechanism as a way of easing relations between different ethnic communities--making Africans share owners in SOEs or firms owned by others.

- Essentially conservative/reactive versus pro-active nature of banking institutions who may not be interested in deregulation because they have learned to live with and thrive in the current business environment.

Access to Information

- A lack of information on sources of assistance tailored specifically for the needs of women and small scale entrepreneurs.

- A lack of knowledge about marketing, particularly international market opportunities and financing for export orders.

- Lack of information regarding various documentation and reporting requirements by GOK, resulting in high transaction costs in terms of paperwork for even the simplest transactions.

- Lack of information on trade policies of export markets such as preferential access, special tariff treatments,

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barriers and non-tariff barriers.

General Government Policies

- Essential lack of trust between the Government of Kenya and the business community, leading to over regulation and excessively restrictive regulations (e.g. the Government dictates narrow interest rate spreads because officials assume banks will cheat on that spread and charge fees which are actually illegal).

- Confusing and overly burdensome regulations, particularly in the area of import licensing and taxation.

- Excessive administrative and bureaucratic controls, examples of which include:

  -Barriers to getting business allowances for foreign travel, making it difficult to service clients abroad;

  -Excessive documentation required for obtaining export and other licenses;

  -For manufacturers in bond: Cost of paying customs officials overtime at manufacturing in bond plant if shift works overtime;

  -Add on costs of doing business (e.g. there is a 1.5 percent deposit for the import license; 2-3 percent LOC opening charge; 1.5 percent port fees; charges on c.i.f.; clearing and forwarding charges of 2 percent);

  -Costs of corruption;

  -Transportation delays if goods are not perishable;

  -Poor treatment of businessmen by low and middle level civil servants;

- Import licensing and other restrictions lead manufacturers to hold large inventories, driving up their unit costs (Kenya manufactures frequently cost up to 35 percent more than substitutable imported ones).

- Key impediment for foreign investors: Exchange Control Regulation no. 19 which prohibits foreign companies from borrowing on the local credit markets unless they have a percentage of Kenyan participation or are investing in certain sectors. MNCs are willing to contribute their technology and expertise but are reluctant to commit their own capital in the current Kenyan environment.

- Lack of transparency in equity market transactions inhibits investor activity in the Nairobi Stock Exchange.

- Credit ceilings and interest rate regulations favor the larger established businesses and increase the opportunity costs of lending to smaller and newer entrepreneurs.

- Excessive regulation of agricultural marketing, making it difficult to get indigenous raw materials and resulting in the need to import various items which could be produced in the country. Payment delays to farmers by GOK marketing boards act as a disincentive to production.

- Total elimination of tariff barriers protecting local industries cannot/should not be expected as this would be too socially and politically disruptive.

Export Growth

- Kenyan firms continue to be inward looking.

- No local institutions are willing to finance exports and provide short term financing to obtain raw materials, pay labor, etc.

- There are excessive documentation requirements.

- There are excessive processing delays in paperwork for obtaining export licensing (excluding the PTA).

- There is a lack of export incentives (neither rebates, nor duty draw backs or duty free entry of imports for re-export).

- Export incentive policies are poorly implemented. For example, export compensation is received only after considerable delays.

- There are too many regulations for manufacturing in bond.

- There is a lack of cheap transport, both land and air. Land transport is too expensive and slow due to poor road infrastructure. This affects export growth to PTA countries in particular--making Kenyan products less competitive in the regional markets.

- The PTA clearinghouse is not very useful, due primarily to the fact that settlements must be done in hard currency.

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Market Constraints

- The size of market in Kenya does not allow for economies of scale in existing industries.

- Loss of markets in neighboring African countries in years past meant overcapacity in manufacturing facilities which were built with the regional market in mind.

- PTA arrangements include countries with little foreign exchange or counter-trade capability (e.g. Rwanda) and accounts must be settled bimonthly in hard currency.

Educational Resources

- There is a lack of quality business executive training facilities in the country, particularly for executives in middle and senior management positions.

- Some large scale firms feel specially constrained by lack of quality technicians and engineers, but managerial skills are not in short supply and generally the quality of the labor force is good.

- There is a lack of linkages between the business sector and the formal educational system. Business has little input in curriculum development of training institutes and offers few possibilities for internships.

Microenterprise Development Services

- NGOs assisting the microenterprise sector are reaching very few customers because their costs are too high, they are oriented towards the provision of social services, and consequently lack expertise in much demanded credit assistance.

- Lending to microenterprises has a high cost because of the need to provide training in business operation and/or use of credit with each loan.

- There is a lack of linkages between the small entrepreneurs and the larger companies.

General Business Climate

- There is a lack of trust between private enterprises, leading to unwillingness to disclose too much information on their operations to outsiders and transparency in business dealings with each other.

Role of Women

- The legal status of women decreases their participation in the productive economy.

Agricultural Enterprise and Productivity of Investment

- Traditional tenure systems promote minifundism and inefficient scale resulting in reduced production.

Infrastructure and Transport

- Road infrastructure is poor, making land transport slow and expensive and impeding growth or greater regional trade.
- Air transport is expensive making exports less competitive.
- Maritime freight is too slow and infrequent to some regional markets.

2. Opportunities

Promote Entrepreneurial Development

- Promote business school to develop highly skilled business executives, which could serve not only Kenya but the region.

- Strengthen/Revitalize Kenya Institute of Management and help develop it into a business skills center.

- Provide courses in feasibility study preparation and marketing.

- Focus publicity and attention of success stories of Kenyan entrepreneurs (case stories--dramatizations) so that they may serve as role models to young Kenyans.

Mobilize Equity Capital

- Capital Markets Authority is unlikely to have intended effect. A structure which put Government in control of Board of Directors, and made the CMDA subject to day-to-day regulation from the Board, is unlikely to attract large levels of domestic capital, since many people are reluctant to invest visibly under the eyes of the Government.

- In the wake of a number of country funds, there will be a Commonwealth Fund which will invest US$100 M in Commonwealth developing country stock markets.

- IFC is encouraging a group of large companies to take a small percentage of their overall equity and pool it together in a form of Mutual Fund which would allow them to raise equity capital without giving up control.

- Employee stock ownership schemes should be promoted through the sale of equity shares in the stock market.

Promote Training and Education

- Student internships in firms should be encouraged (at the moment these opportunities seem limited and geared primarily to polytechnics).

- Linkages between the local business community and the educational institutions can be developed so that these

produce graduates with the attitudes, values and skills which are in demand.

Enhance Role of Women in Private Sector Development

- Specialized education through women's business associations should be promoted (e.g. legal education, family planning).

Expand and Enhance Efficiency of Credit Allocation Via Formal Credit Markets

- Credit markets should be deregulated. Banks would prefer if this were done by lifting credit ceilings, rather than liberalizing interest rates. Banks are most concerned with spreads, not the actual rates. At the moment GOK dictates narrow spreads, assuming that the institutions will cheat.

- Banks should be permitted to charge fees in lieu of other types of deregulation.

- (Editorial Comment: Banks are not necessarily allies of liberalization; they've learned to deal well in the current environment).

Improve the Institutional Enabling Environment for Business

- Strengthen and deregulate the local capital market.

- Encourage greater participation and involvement of private sector leaders in top government positions.

- Promote education of GOK leaders in how to deregulate and create a more positive environment for business. Top level GOK personnel are committed to deregulation but lack knowledge in implementation and specific areas which need to addressed. Increasing policy analysis capability of GOK would be one training option.

- Promote a conference of Asian and Kenyan business leaders, leading to the creation of a joint business advisory council to improve dialogue between the two communities.

- Undertake a comparative analysis of the Kenyan Investment Code to increase the awareness among GOK officials that the investment climate is not currently not as attractive as is thought.

- Reduce the tax rate further (currently at 42.5%) to encourage further investment and more accurate income statements which in turn will encourage minority equity participation. Businesses reported that the effective tax rate is much higher than 42.5%. When all the ancillary taxes and fees are added on the effective rate is probably closer to 60-70%. When Zaire reduced its sales tax from 17% to 3% more taxes were collected. Increased voluntary compliance under a more moderate tax regime could generate greater absolute levels of government revenues.

- Promote the establishment of an export bank.

- Focus on technical assistance and training to modernize and improve key government agencies such as Lands Office, Company Registry and External Trade Authority where such assistance can have most marked impact (Donor Focus Group).

- Provide training seminars for middle level civil servants. Determine who the critical civil servants are (those who interface most with private sector) and target training to them.

- Review, simplify, standardize and communicate procedures for all permits, approvals, licenses, registrations, and other required interactions with government authorities.

- Involve operational people in civil service in operational reform and bureaucratic simplification. By their involvement in planning they will be committed to the implementation.

Provide Direct Assistance to Small Scale Enterprises

- Use guarantors to enhance informal access to credit. A German funded program is using this approach, using a means test (eligibility test met if 3 months income covers loan amount) and trying to issue up to 400 loans to assist a small percentage of the estimated 350,000 informal businesses.

- Support activities which promote linkages between small and large firms, such as K-MAP and the Asian Fund for Development.

- Increase cooperation and exchanges of information between business associations serving small and those serving large firms and among those operating in different

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sectors.

- Channel credit to small entrepreneurs through existing mechanisms, such as cooperatives or other non-bank financial institutions with experience in credit assistance (rather than NGOs).

- Promote a national level micro-enterprise association which could access larger chunks of formal credit and pool technical assistance resources to SSEs.

- Support establishment of a coordinating body for NGOs providing assistance to the SSEs.

- Use business associations with high outreach potential, such as the KNCCI or the Kenya Small Traders Society, to channel funds and training assistance.

- Note: Dutch are financing a management assistance program for SEFCO and the ABC (Assistance for Business Creation) to be executed by the ILO. They will be giving guarantees to Commercial Banks to lend to informals and credit to NGOs that will on-lend to informals.

Mobilize Foreign Investment

- Until changes are made in the macro and institutional environment, any project in this area is unlikely to succeed because the investment climate is not attractive.

- German project called "Advisory Services for Business Co-operation Program" failed because "the investment climate is bad. It's OK to sell something but it's not worth investing."

APPENDIX E

LIST OF PARTICIPANTS

FOCUS GROUPS 10/23/89 TO 10/25/89

APPENDIX E

List of Participants
Focus Groups 10/23/89 to 10/25/89

Kenyan Large Scale Enterprises

Ashok Chandaria	Orbit Chemical
Chris Malavu	4M
Mrs. Naomi Muniu	
John Mbogua	

Banks and Non-Bank Financial Institutions

W. Wood	Director of Operations	Thabiti Finance
J.K Murungi	Sr. Manager	Diamond Trust
S.H. Poonawala	Project Director	IPS
G.L. Thomas	Director	Barclays Bank

Large Exporters and Foreign Investors

Narong C.	Managing Director	Kodak (Kenya) Ltd.
Simuyu M.	Operations Manager	Kodak (Kenya) Ltd.
D. White	Managing Director	Colgate-Palmolive
L.R. Ndungu	Managing Director	Nestle Foods Kenya Ltd
George Maiko	Managing Director	Cargill

Business Associations

Arun Devani	Director	KAM
Lulu Kahia		Kenya Kiondosh Cooperative Society
G.N. Konditi	Dep. Exec. Director	Federation of Kenya Employers

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Informal Sector

Victor Pratt		K-MAP
Jonathan Campaigne	Managing Director	CID Kenya
Mohammed Uerre	Program Director	CID Kenya
Wilson Muchiri	Nat'l Chairman	Kenya Small Traders Society
Teresa Mami	Program Coordinator	Kenya Women's Finance Trust
Richard Undeng'	Deputy Gral. Sec.	NCCK
Virginia Kirumba	Vice Chairman	Kenya Business and Professional Women
Kimathi Mutua	Dep. Director	Kenya Rural Enterprise Program
Richard Yuder	Managing Director	Kenya Rural Enterprise Program
Alfred Amisis	General Manager	PFP Kenya

Donors

J. Tomecko	Team Leader ISP/KIE	GTZ
Klaus Lidy		Embassy of FRG
Howard Sumka		RHUDO/USAID
Hans Wieman		Embassy of Netherlands
John Macgregor	Sr. Operations Officer	World Bank
Steve Sinding	Mission Director	USAID
Carol Steele	Program Office	USAID
Ernest Kepper	Regional Rep.	IFC
U. Gatabaki		CDC

Government of Kenya

Luka G. Kioko	U.S. Desk Officer	Treasury
W.A. Onono	Director GID	Treasury
A.M.R. Odilo	Deputy Secretary GID	Treasury
T.P.O. Aridi	Assistant Director External Trade	Commerce
I.B. M'rabu	Industrial Dev. Officer	Industry
C.S. Mo	Planning Assistant	Agriculture
S.M. Ita	Managing Director	IPC

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