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Improving public policy making for economic growth and poverty reduction

Improving the Enabling Environment for Business in Kenya

An enabling environment for business improves investment climate and competitiveness of a country, thereby enhancing economic performance for eventual poverty reduction. In this regard, the Government of Kenya in its Economic Recovery Strategy for Wealth and Employment Creation (2003-2007) has emphasized on improving the environment for doing business to facilitate growth of private sector activities and achieve the targets set for economic growth of about 7 percent. However, despite various efforts made to improve the business environment, there are still issues that constrain the growth of investment and the country's competitiveness.

The enabling environment for business comprises locational-specific factors that shape the opportunities and incentives for local and foreign firms to invest, innovate, create jobs and expand. At the country level, these factors include policy, regulatory and legal frameworks that attract investment, while specific area factors may include the state of infrastructure, security, and existence of backward and forward linkages. All these play a key role in shaping the business environment as they impact on costs, risks, profitability and incentives to private firms. The business community in Kenya has consistently raised issues with the state of infrastructure, high taxation, insecurity, cost of capital, governance, delays in implementation of policy reforms, political wrangles as some of the factors that constrain the enabling environment for business growth.

Trends and Experiences

Experiences from Asia have shown that continuous improvement of the enabling environment (good investment climate) for doing business is one of the most effective strategies for enhancing fast economic growth and thus poverty reduction. For instance, improvements in the investment climate in the 1980s and 1990s doubled private investment in China and India. Research findings on the role of investment climate and competitiveness, indicate that the business environment is affected by macroeconomic management and stability, access and cost of financial services, state of infrastructure, quality of human capital, state of security, environment management, and governance issues.

The factors that constrain the enabling environment are diverse but the key ones include the following.

Infrastructural constraints

Low government development expenditure has serious implications on the provision of adequate and quality public infrastructure. In Kenya, the situation is made worse by the fact that ministries charged with the provision of infrastructure, particularly roads, have consistently returned large unspent portions of their budgets to Treasury, mainly due to procurement bottlenecks. This has led to the poor state of infrastructure, which significantly increases business operational costs. There is also minimal allocation for maintenance, and

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poor infrastructure management. Port productivity in Kenya is reckoned to be between a third and half of the international norm, and perhaps six times as costly. Additionally, research indicates that electricity hook-ups and usage are very costly in Kenya relative to her East African counterparts. Kenyan firms experience an average of 33 outages in a year and lose nearly 10 percent of their production time and sales to power outages. Two out of every three firms in Kenya lose capital equipment to power surges. All these constrain the efforts to reduce the cost of doing business.

In addition, Kenya's fixed-line telephone and Internet services are relatively costly and of poor quality. Although mobile communications have dramatically improved access, they remain expensive as per minute charges are typically two to ten times that faced by rich nations.

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Insecurity, corruption and the justice system

Insecurity remains a major concern to the business community. The crime and insecurity image of Kenya among the international investment community is poor. About 40 percent of Foreign Direct Investments are deterred by insecurity. Locally, crime management is rated as poor and is ranked as the second most common complaint among firms. Firms lose an average of between4 and 10 percent of annual sales revenue in terms of property loss and damage. Indirect costs, which include expenditures on provision of security measures, are estimated at between 2.7 and 7 percent of sales.

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Investment climate perceptions

The World Bank Doing Business indices that provide countries' indicators of the cost of doing business that may enhance or constrain investment, productivity and growth, indicate that while the average time taken to start a business in Kenya has reduced from 61 to 54 days in years 2003 and 2005, respectively, the average number of procedures has increased from 11 to 13 (see Table 1). This improvement to 54 days compares unfavourably with the regional competitors: Tanzania's and Uganda's 35 and 36 days, respectively. This is despite that Kenya's overall ranking at 68 is better than for the other two countries.

On the basis of firms' perceptions about severity of investment problems, as per the 2004 World Bank's Investment Climate Survey, Kenya performed poorer than her East African counterparts. For instance, corruption, crime and policy uncertainty were perceived as more severe in Kenya than in Tanzania and Uganda (see Table 1). Policy instability and uncertainty limit investment because of the extra premium that investors demand. Additionally, even if severity of access to finance is marginally lower in Kenya (44%) compared to Tanzania (48%) and Uganda (45%), the severity of cost of finance is very high in Kenya (73%) compared to 60 and 58 percent in Uganda and Tanzania, respectively. Perceptions are particularly important as they have major implications on forward-looking investments.

Table 1: Country comparisons on ease of doing business and perceptions on severity of investment climate problems

Country	2006 Easiness of Doing Business			2004 perception on severity of investment climate problems (Proportion of firms indicating severity of problem)				
	Ranking (Out of 155 countries)	Starting a business						
		No. of Procedures	*Time taken (Days)*	*Corruption*	*Crime*	*Policy uncertainty*	*Access to finance*	*Cost of finance*
Kenya	**68**	**13**	**54**	**74**	70	52	**44**	73
Uganda	72	17	36	38	27	28	45	60
India	90	11	71	37	16	21	18	20
Tanzania	140	13	35	51	25	31	48	58

Source: World Bank's Doing Business Indices (2006) and Investment Climate Surveys (2004)

Competitiveness

A country's competitiveness is an indicator of how constraining or enabling the business environment is. With a political commitment to revitalize economic growth, Kenya has an opportunity to exploit its competitive advantage. It also has a widening market scope in the neighbouring countries, especially with implementation of various peace initiatives. However, the country seems to be loosing in terms of its competitiveness. On the basis of overall Growth Competitiveness Index (GCI), which is composed of quality of the macroeconomic environment, the state of a country's public institutions and a country's technological advancement, all of which are critical to economic growth, Kenya ranks low among its competitors. In 2003, Kenya's overall GCI ranking at 83 out of 104 surveyed countries compares unfavourably with Tanzania at position 69. While South Africa and Mauritius rank among the top 50 with an index of 4.37 and 4.12, respectively, Kenya has an index of 3.21 (see Table 2). This is largely explained by the weak public institutions where public institutional index, composed of contracts and laws and corruption sub-indices, ranks Kenya at 75 compared to South Africa at 35 in 2004. The macroeconomic environment index, composed of macroeconomic stability, country credit rating and government waste ranks Kenya at 86 in 2004 compared to South Africa at 48. The technology index, composed of innovation, information and communication technology, places Kenya at position 72 compared to South Africa at position 40. The minimal research and development expenditure may explain the limited technological advancement. It is also important to note that Kenya's overall GCI ranking did not improve between 2003 and 2004.

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The Business Competitiveness Index (BCI) looks at the quality of input conditions, the context of firm strategy and rivalry, quality of local demand conditions and presence of the related and supporting industries. It also evaluates the

Table 2: Competitiveness indices among selected countries, 2003-2004

Indices	Score and ranking	Kenya		S. Africa		Mauritius		Egypt		Uganda		Tanzania	
		2003	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003	2004
Growth Competitiveness Index (GCI)													
Overall Growth Competitiveness Index *(Out of 104 countries)*	*Score*	3.21	3.21	4.37	4.37	4.12	4.12	3.84	3.84	3.25	3.25	3.49	3.38
	Global Ranking	83	83	42	42	46	46	58	58	80	80	69	82
Public Institutions Index *(Out of 104 countries)*	*Score*	3.16	3.87	4.69	5.15	4.61	4.16	4.18	4.1	3.3	3.61	4.15	3.54
	Global Ranking	92	75	43	35	44	65	57	70	90	86	59	88
Macroeconomic Environment Index *(Out of 104 countries)*	*Score*	3.1	3.18	4.08	4.11	3.66	4.08	3.7	3.86	3.2	3.41	3.12	3.47
	Global Ranking	77	86	40	48	57	50	56	57	71	75	76	72
Technology Index *(Out of 104 countries)*	*Score*	3.36	3.31	4.35	4.33	4.1	4.19	3.64	3.68	3.27	3.22	3.22	3.12
	Global Ranking	74	72	40	40	49	44	68	65	77	77	81	84
Business Competitiveness Index (BCI) - 2004													
BCI overall ranking *(Out of 103countries)*	*Global ranking*	63		25		53		66		71		90	
Business Competitiveness Index (BCI) - 2004													
Company operations and strategy ranking *(Out of 103countries)*	*Global ranking*	56		24		49		57		75		92	
Quality of the national business environment *(Out of 103countries)*	*Global ranking*	63		25		54		68		69		87	

Source: The Global Competitiveness Report (2004/5)

underlying microeconomic conditions defining the sustainable level of productivity. Specifically, BCI evaluates the sophistication of the operating practices and strategies of companies and the quality of business environment in which the nation's companies compete. On the basis of overall BCI index, Kenya ranks 63 out of the 103 surveyed countries and performs better when compared with Uganda (71) and Tanzania (90). However, the country is still worse off compared with South Africa (25) and Mauritius (53).

Administrative barriers also limit competitiveness. Not only do they make entry and exit into the market difficult, but they also create uncertainties with the procedures and enforcement of contracts.

Trade barriers and taxation

Apart from the relatively high cost of doing business in Kenya, worsening terms of trade indicate that there are limits to the country's export market access, especially because of non-tariff barriers. For instance, although tremendous progress has been made as average clearance time at the port of Mombasa has decreased from 17 to between 5 to 7 days, when the system fails, clearance time increases to unacceptable levels – in extreme cases of up to 4 months. These clearance times are also unfavourable when compared to 1-2 days in Tunisia and Morocco.

Moreover, although the government has significantly liberalized trade, a number of regulatory and legal impediments continue to frustrate investors within the domestic trade sector. For instance, there are numerous Acts of Parliament and by-laws administered by various bodies with divergent objectives, governing licensing of business enterprises. As a result, multiplicity of trade licenses has become an impediment to business growth in a liberalized market.

The business community still perceives Kenya's tax system as being prohibitive compared to international standards. Research findings place the issue of tax as the third most constraining obstacle to doing business in Kenya after infrastructure and insecurity. Further, majority of the tax incentives are only enjoyed by the productive firms and only a few, if any, are enjoyed by the service firms.

Cost of capital and labour productivity

Other factors that constrain businesses include high interest rate spreads that make the cost of capital high and high cost of, and low productivity of labour. Wages of unskilled production workers, at spot exchange rates, are higher in Kenya than all its neighbours and strategic competitors.

Non-implementation of reforms

A key concern in Kenya has been non-implementation of reforms or delayed implementation of reforms. For instance, despite stakeholders agreeing upon, in May 2005, nine priority specific measures to boost investment that were to be implemented by May 2006, only a few of the measures have been implemented to date.

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Efforts in Improving the Enabling Environment for Business

The Government has put several measures to improve the business environment with a view to restoring investors' confidence so as to reverse the downward economic trends witnessed in the last two decades.

The 2003 Interim Investment Programme aimed at addressing concerns related to the high cost of doing business, the high cost of capital, and the essence of a good environment required for productive economic activities and for a thriving private sector. In addition, the 2004 international conference aimed at increasing inward flow of Foreign Direct Investments and engaging the private sector and development partners with a view to making Kenya an attractive investment destination in areas like agro-processing, rehabilitation of infrastructural facilities, and privatization of strategic state corporations. In these forums, the government affirmed its commitment to implementing reforms, fighting corruption, and improving the legislative and policy environments to increase efficiency and transparency.

Additionally, a process of review and harmonization of Kenyan laws has been reinvigorated under the reconstituted Law Reforms Commission in charge of updating several important laws, including company and investment laws intended to improve the investment climate. Further, to reduce average clearance time at the airports and ports, the Commonwealth's Trade Facilitation Project developed, in October 2003, an 11-point plan, including creation of one-stop processing of documents, which was piloted at Jomo Kenyatta International Airport. To address security issues, measures such as implementation of police reforms including the concept of community policing have been taken in the last three years.

To further improve the business environment, the government promised, in the 2006/07 Budget, to deepen priority structural reforms in the areas of governance, public expenditure and financial management and private sector competitiveness. The tax measures therein aim at removing administrative and legal barriers to create an enabling environment for private sector growth. The Budget also provided for introduction of a Business Regulatory Reform Bill in Parliament. Additionally, a Business Regulatory Reform Unit in the Ministry of Finance will be created to liaise will all regulators and ensure that future regulations conform to international best practices. Further, an Electronic Consolidated Regulatory Registry will be established. As a follow up to the 17 licenses that were eliminated in the 2005/06 budget, the 2006/07 budget proposes elimination of 118 more licenses considered burdensome and unnecessary, while 7 more are to be simplified. About 700 more licenses will be simplified during 2006/07 fiscal year through harmonization and reduction of fees and charges. Indeed, Local Authorities are to submit by 30th September 2006 all their licenses, fees, permits and other charges they wish to retain for approval by the Minister for Local Authorities by 31 December 2006.

In an effort to enhance dialogue, a symposium of the Government of Kenya and the Kenya Private Sector Alliance was held in March 2006 with the objective of taking stock of the implementation status of the Economic Recovery Strategy. The Symposium noted that a Public Sector Reforms and Development Secretariat had been established within the Cabinet Office with the mandate of, among other things, improving service delivery to the public. The introduction of Performance Contracts and Results-Based Management in July 2005 was rated as a breakthrough in the government's reform process. The Symposium resolved to establish Government of Kenya and Kenya Private Sector Alliance ministerial forums within 100 days in all ministries. It also recommended speedy removal of impediments or barriers to efficient and effective operation of business, including review and update of outdated legislations.

Other efforts that have been made to improve the business environment include development of the Private Sector Development Strategy, whose core focus is to create a competitive and enabling environment for business to thrive and encourage dialogue between the private and public sectors, simplification of tax administration, enactment of the Privatization Act, and Public Procurement and Disposal of Assets Acts. Further, the government is currently developing an economic model akin to that followed by the East Asian Tigers to boost economic growth.

Policy Recommendations

Although it is the primary role of the government to improve the enabling environment for businesses for the private sector to lead in investment and thus enhance Kenya's competitiveness, success will quickly be achieved where there is collaboration of all players under the framework of partnership between the public and private sector. Priorities to improve the business environment include upgrading the quality of infrastructure, addressing insecurity, improving competitiveness, access and cost of capital, and implementing reforms.

Infrastructure

Since infrastructure is the bedrock of the enabling environment, there is need for its expansion and speedy rehabilitation and continuous maintenance. In this regard, the lengthy procurement processes should be rationalized in line with the Public Procurement and Disposal of Assets Act, 2005. Further, utility companies including Kenya Generation Company (KenGen), Kenya Power and Lighting Company, water companies, and Telkom Kenya need to develop focused strategic resource efficiency programmes, complete with consumer awareness programmes on the need for efficient utilization of their services.

Insecurity, governance and the justice system

The policy, legal and regulatory frameworks that directly or indirectly affect security of persons and property need to be strengthened. In particular, the Community Policing initiative ought to be enhanced as it is showing early signs of success. Further, a strong information and research infrastructure ought to be established to harness information gathering and management for mapping of criminal activities.

The current public sector and governance institutional reforms should be strengthened and sustained by focusing on implementation, monitoring and evaluation. On the other hand, the private sector should be encouraged to embrace concepts of corporate governance and social responsibility.

To achieve efficient justice administration, there is need to strengthen the capacity of commercial courts and simplify court procedures. This can be achieved through expansion of the specialized commercial court to other regions and strengthening alternative dispute resolutions mechanisms, such as tribunals, to ease the pressure on courts.

Legal and regulatory framework

To further improve the enabling environment, it is important to encourage information disclosure for all procedures and documents required to do business and ensure they are updated. The initiative of reviewing the business licenses should be enhanced with a view to reducing the number of licenses from the current 1,335 to an acceptable international level of about 150.

Competitiveness, trade, and taxation

To boost her trade competitiveness, Kenya should use the available multilateral, bilateral and regional trade agreement initiatives to increase demand for her products in world markets by taking sectoral strategic decisions in multilateral trade (WTO and ACP-EU) negotiations. Further, to enhance international trade efficiency at the entrance and exit points and trade facilitation institutions, massive investment is required in the information technology systems. Additionally, tax incentives like lower corporate tax rates and tax holidays given to productive firms should be extended to service firms.

Cost of capital and labour productivity

There is also need to put in place a strong and comprehensive financial policy framework to guide the financial sector development path, which ensures access to affordable long and short-term financial services. Specifically, there is need to address issues of access and cost of finance, legal and regulatory constraints that face non-traditional financial service providers like MFIs and SACCOs, while at the same time encouraging the traditional commercial banks to downscale to serve the small enterprises. Also, credit information sharing among all financial service providers should be encouraged.

To increase labour productivity, efforts should be enhanced to strengthen linkages between education and industry, for example by encouraging internship programmes for students.

Research and development

The government should put in place incentives to promote research and development and therefore innovativeness by the private sector. This could be in terms of tax incentives and strengthening of government departments that deal with science and technology.

Fast track Implementation of reforms

Generally, there is urgent need to fast track the implementation of agreed programmes and legislative reforms by instituting implementation timelines, so us to create the necessary enabling environment for doing business in Kenya. Approaches to improve the enabling environment ought to be adapted to local conditions for their efficient implementation.

About KIPPRA Policy Briefs

KIPPRA Policy Briefs are aimed at a wide dissemination of the Institute's policy research findings. The findings are expected to stimulate discussion and also build capacity in the public policy making process in Kenya.

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