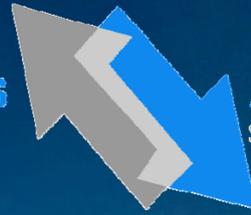


THE BUSINESS



ADVOCACY FUND

Supporting Private Public Dialogue

**BUSINESS LEADER PERCEPTIONS OF
THE INVESTMENT CLIMATE IN
KENYA
EXECUTIVE SUMMARY**

2008



The Business Advocacy Fund
is supported by
the Danish Government

The Business Advocacy Fund supports business member organisations to engage in private public dialogue and to advocate an improved business environment in Kenya by providing grant aid, training and mentoring.

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A copy of the full report is available at www.businessadvocacy.org and also at www.businessadvocacy.net

BUSINESS LEADER PERCEPTIONS OF THE INVESTMENT CLIMATE IN KENYA

1. Introduction

This report has been prepared to highlight priorities for action to improve the business enabling environment in Kenya. It has been commissioned by the Business Advocacy Fund whose role is to support business member organisations (BMOs) to engage in private public dialogue and to advocate change in public policy with an objective to improve the business environment in Kenya.

The World Bank asserts that improvements in the enabling environment lead to greater levels of investment by the private sector, more wealth and job creation, and ultimately more poverty alleviation. The best way for government to understand how to improve the enabling environment is to involve the private sector through consultation and dialogue.

This report provides a snapshot of Kenyan business leaders' views of the enabling environment and the government's role in making it easier to do business. The survey was undertaken by Steadman Group and the results analysed by David Irwin on behalf of the Business Advocacy Fund.

2. Rationale for the study

With organisations such as the World Bank and World Economic Forum undertaking research reviewing problems of doing business, it may seem that there is no need for further studies. This study is different, however:

- Perceptions influence the way that people act. Having an understanding of perceptions may not only convince policy makers that more needs to be done but also provide clues to the government about how to communicate messages about reality.
- It aims to isolate the factors important to specific sectors.
- It has analysed the results by sector and by factor.
- It has not only asked about the factors that are problematic but also asked business leaders to identify where the government is perceived to be making a positive effort to make a difference.
- It has asked about the factors that will deter future investment.
- It has attempted to quantify the costs to business of meeting the regulatory requirements imposed on them.

This first study has results that are revealing, identifying priority areas for action by the government if it wants to make a difference not only to the enabling environment but also to the way that it is perceived by business.

3. Priorities

Business leaders were asked about

- The enabling environment factors that are important to their business;
- The factors that make it difficult to do business;
- Their perception of whether and, if so, how, government is addressing each factor;
- Their view of whether each factor would be likely to deter future investment; and

- An assessment of the costs involved in meeting the requirement of regulation and red tape.

Most factors were seen to be important by most sectors. The one factor, more than any other, causing difficulty for all businesses, is the roads. The problem areas, in order of priority, are: roads, licensing, corruption, ports and airports, level of taxation, contracts and employment law.

If one takes into account whether government is perceived to be making the issue worse, then the issues in priority order are corruption, roads, employment law, contracts and level of taxation. These are the issues that the government should prioritise if it wishes not only to make a difference to the enabling environment but also to the perceptions held by business leaders. Ideally, it would also seek good quality media coverage to influence business perceptions. It is worth noting that licensing drops to seventh – still important but not amongst the priorities.

It should be noted that the cost of complying with regulation takes a high proportion of businesses’ expenditure. If it were possible to reduce this, then it would free up resources – both financial and managerial – which the businesses could then use for investment.

4. Results

In the first question, respondents were asked to indicate which of a range of issues were important to the success of their business and were then asked to indicate whether that factor made doing business very difficult, somewhat difficult, had room for improvement or was not a problem at all.

The results for whether issues were important are shown in figure 1. The main factor, identified by 57 per cent of respondents, is power. This is followed by roads, macro-economic policy, administration of taxation and availability of skilled labour. Taxation is often raised as an issue, but levels of taxation and administration of taxation were deliberately split – and it is interesting that there is less concern over the level of taxation than over its administration – and also interesting that it is seen as important, whereas one might have expected it to be relatively unimportant.

Despite businesses regularly complaining about access to finance, it is 13th of the 15 factors reviewed, though this may reflect the survey sample.

Figure 1: Importance of issues (all respondents)

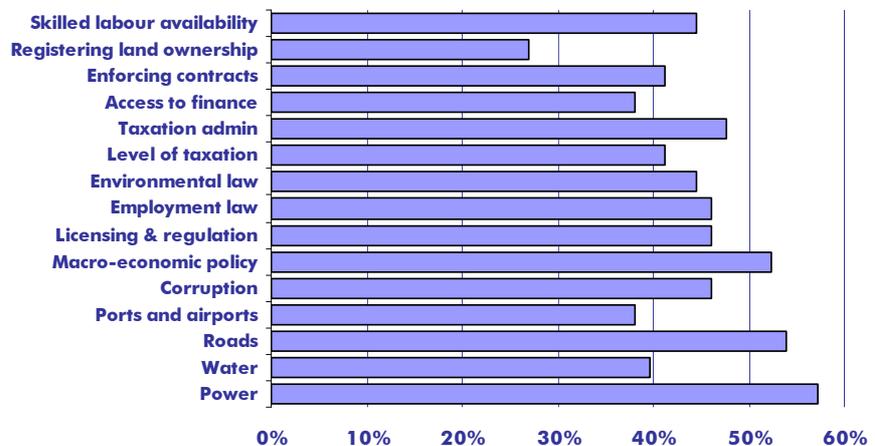
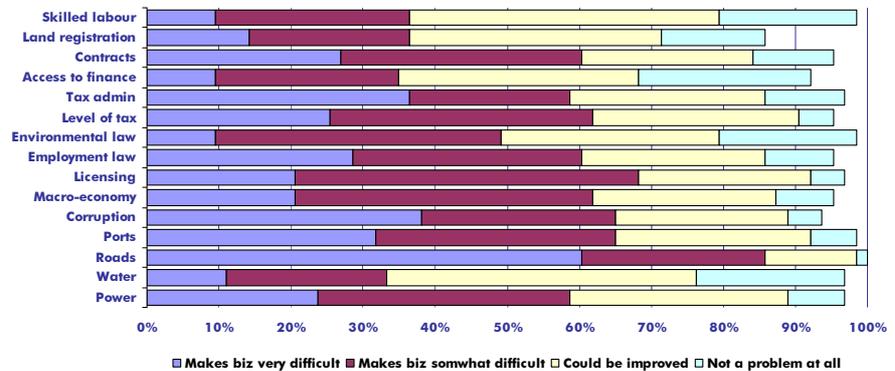


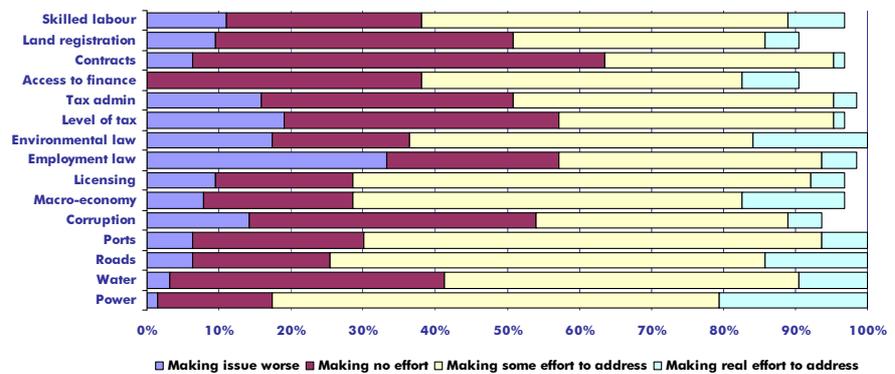
Figure 2 shows the factors that businesses say make life difficult. Factors that 'make business very difficult' are, in order, roads, corruption, administration of taxation, ports and airports, employment law and enforcing contracts. One might have expected power to be top, but it is seen as less of an issue, presumably because of the relative ease of making alternative arrangements. However, it is more difficult for businesses to do much about the other factors.

Figure 2: Factors which make business difficult



The second question asked about respondents' perception of government efforts to address these aspects of the enabling environment. Answers ranged from 'the government is making real efforts to address the issue', through 'some effort' and 'no effort', to 'government actions are making this issue worse'. Figure 3 shows the results. Some 33 per cent think that government is making employment law worse.

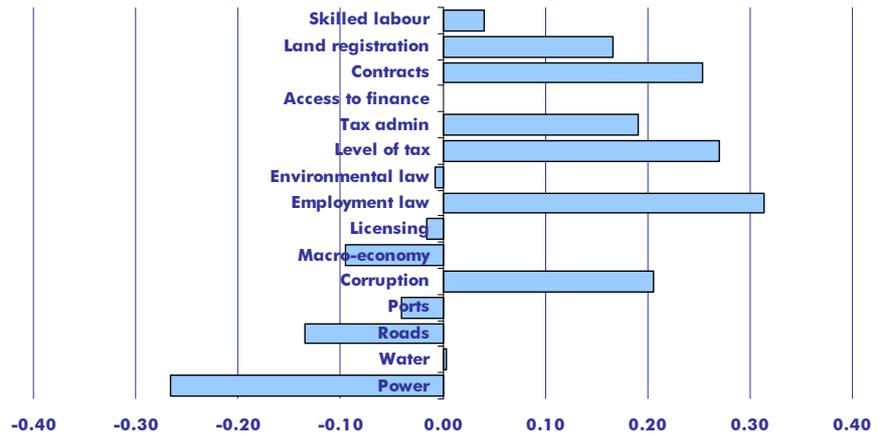
Figure 3: Government performance in addressing key factors



Some 40 per cent complained that the government is making no effort to tackle corruption; 57 per cent think that it is making no effort to improve the enforcement of contracts; 38 per cent think that it is doing nothing to improve access to finance (though no-one thought that the government was making the situation worse); and 38 per cent thought that it was making no effort to change the levels of taxation. Governments these days are more likely to raise taxes than lower them, but they can aim for simplicity (which keeps down the administrative burden). They can also ensure that they are getting maximum value out of tax receipts – which means eliminating corruption – and provide better communications about expenditure plans and better transparency.

There were very few factors where a significant number of respondents thought that the government was making a real effort to make a difference, though a large number thought that the government was making at least some effort. In an effort to seek more insight, an 'index of perceived government performance' has been prepared. The results are shown in figure 5. Note that the scale runs from -1 (every respondent thinks that the government is making a real effort) to +1 (every respondent thinks that the government is making the issue worse).

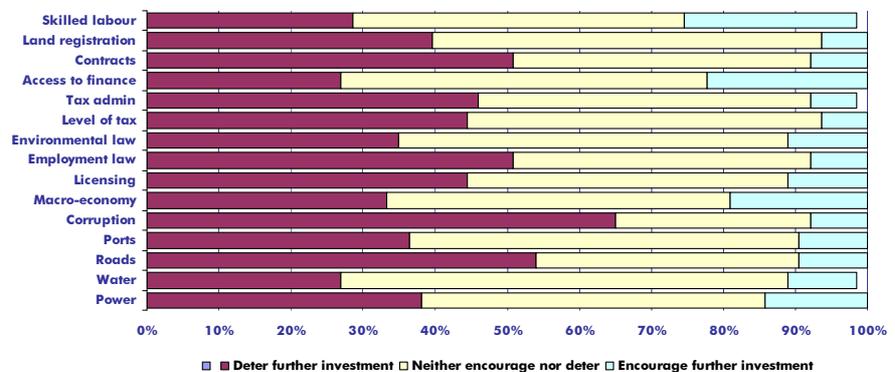
Figure 4: Index of perceived government performance



This suggests that the government should be commended for the effort that it is making to improve power and roads, but needs to make more effort on employment law, level of taxation, enforcement of contracts and corruption.

The third question asked respondents which factors were likely to influence investment decisions and how. Corruption is the biggest deterrent to investment, with 65 per cent of respondents saying that it would negatively affect their investment decision. Some 54 per cent said that the state of the roads was a deterrent; 51 per cent thought that contract enforcement was a deterrent; and 51 per cent stated that employment law was a deterrent (though in time they may realise that employment law often provides an incentive to make capital investments and to reduce reliance on labour).

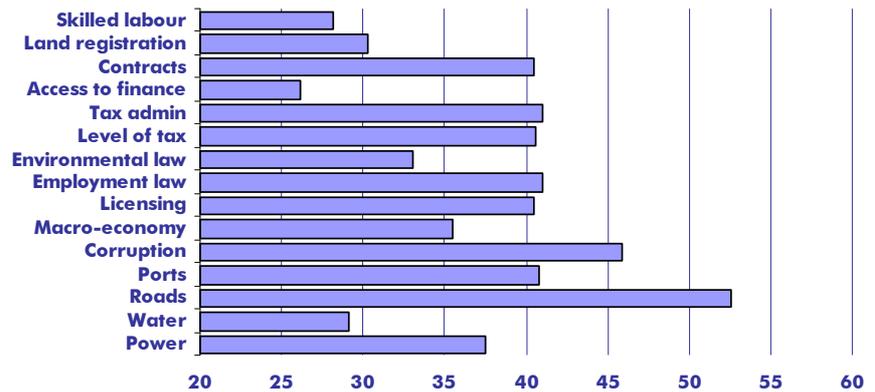
Figure 5: Factors which affect investment decisions



Some 46 per cent are deterred by the administration of taxation and 44 per cent by licensing and regulation.

Our 'enabling environment priority index' takes into account both how much the factor make business difficult and how the government is perceived to be addressing the issue. This suggests that the issues to be addressed, in priority order, are roads, corruption, employment law, licensing, enforcement of contracts and taxation (both administration and level).

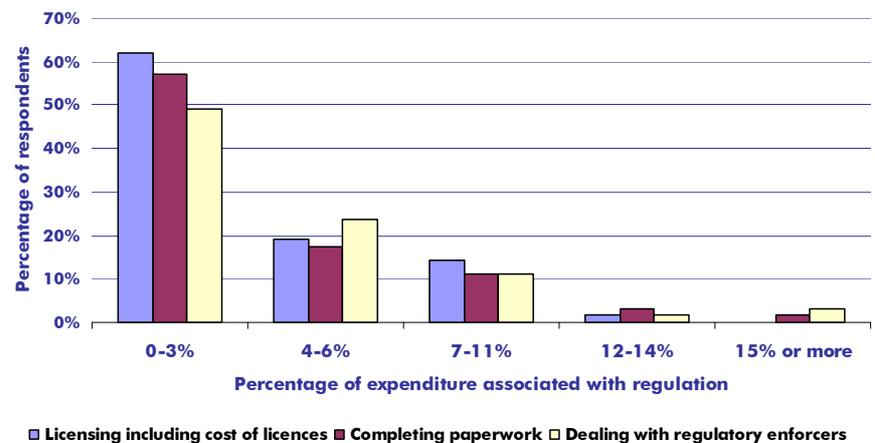
Figure 6: Enabling environment priority index



5. Cost of red tape

Respondents were asked about the costs of red tape and regulation – with costs split into three groups: the direct cost of licensing including the cost of the licences themselves, the effective cost through the staff time required to complete paperwork associated with regulation and the effective cost through staff time of dealing with the enforcers of regulation. Respondents were asked to say in which of a number of bands they believed that each of these categories of cost fell.

Figure 7: Cost of red tape and regulation



As can be seen from figure 7, most respondents thought that each required expenditure of less than three per cent. This is fairly modest, though when you

add the three together they can quickly mount up, with the average total cost for each business being around 10 per cent. If respondents have answered accurately, this is a high proportion of costs to be spending on red tape and regulation.

Getting this down would not only make businesses feel that the government was really trying to make a difference, but would free up a lot of resource that could be invested in business expansion. Furthermore, regulation and licensing is an area where governments can involve the private sector in effective dialogue and where they can make changes quite quickly, thus improving private sector perceptions of government efforts to improve the enabling environment and building confidence in the private sector that the government really does want to make a difference.

A copy of the full report is available at www.businessadvocacy.org