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FOREIGN DIRECT INVESTMENTS IN KENYA:

The gains and losses of foreign involvement.

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Prologue

This thesis is the final project in my entire masters program at the Radboud University in Nijmegen. Writing this thesis is the perfect way for ending my student career. Producing this product tested my acquired knowledge in various ways. Conducting the research in Kenya not only provided a way to put my knowledge into practice but also contributed to my personal growth. After that, analysing the data and the writing of this thesis helped me in becoming a better researcher.

Before presenting my findings I have to thank some, who assisted me in this challenging process. First, I want to thank my supervisor Marcel Rutten for supporting me throughout this entire process and for given me advice and guidance when needed. Also, I want to thank Bethuel Kinuthia for supporting me in my first week in Kenya and for guiding me in this process.
Next, thanks to all the investors and interviewee's in Kenya and the Netherlands for giving me your honest opinions and making the time to talk to me. And last, thanks to Bennie, Eefje and my friends and family for supporting me throughout this process and being there for me when I needed you.

Ruth Voorpijl
April, 2011

Summary

In this thesis the effect of foreign direct investment on the economic development of Kenya will be discussed. Central to this study are the experiences and opinions of active foreign investors in two sectors. The main focus will be on identifying the strong sides as well as the improvement points of the investment climate in general, in order to improve it.

After the theories of FDI are examined the following concepts are identified that will help determine the overall effects: liberalisation, investment motives and technological spillovers. Liberalisation in this case is seen as a pre-condition for attracting FDI.

Before the findings of the study in Kenya are presented, the country's general characteristics are described. This will show that despite Kenya's international status and despite the many positive aspects present in the country, Kenya as a whole is an underachiever in attracting the right type of FDI. The chapter will also focus on the effects the latest post-election violence had on the country and express the concerns for the upcoming elections.

The strengths of the investment climate are analysed in accordance with the investment motives. This is necessary since the investment motives determine the economic stage of a country. This then is reflected in the type of FDI. The investors in this study can roughly be divided over the horticulture sector on the one hand and the service sector on the other. All investors made long-term investments.

The most important investment motives are the presence and access to a good infrastructural network and the presence of a highly educated and relatively cheap labour force.

A distinction should be made in the locational preferences of the two sectors. One important finding in this study is that the role of location should not be underestimated.

The most important improvement point for the investment climate is related to the political status of the country. Most investors argue that corruption and the licensing procedures are the daily issues an investor has to deal with. These procedures and the corruption increase the costs of doing business significantly, thus making the overall climate less attractive. These findings correspond with report from the World Bank and United Nations, and are partially the reason for Kenya's underachievement in attracting the right sort of investment.

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List of abbreviations

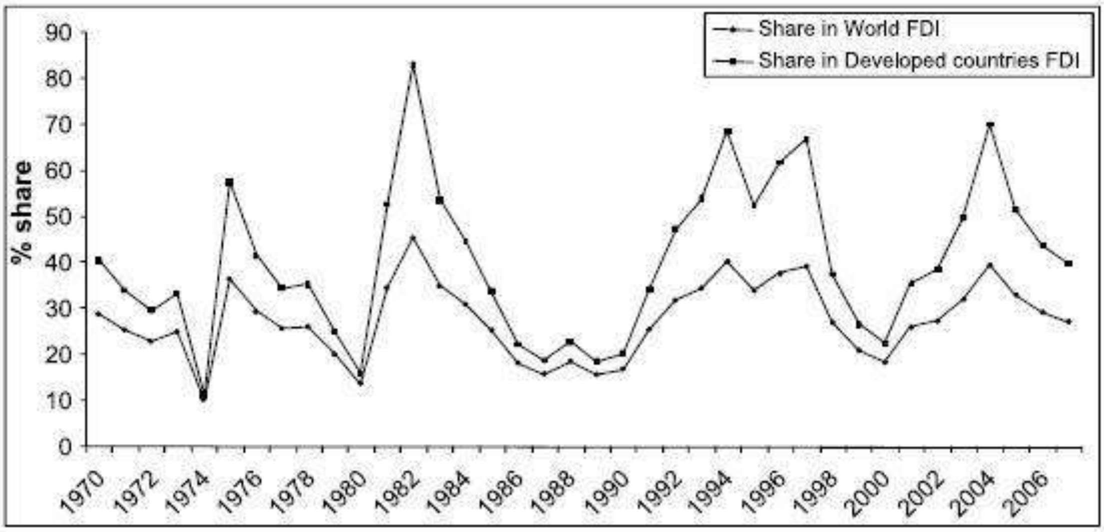
CBD	Central Business District
EPZ	Export Processing Zone
EU	European Union
FDI	Foreign Direct Investments
FPE	Free Primary Education
IMF	International Monetary Fund
ITC	The International Institute for Geo-Information Science and Earth Observation
KACC	Kenya Anti-Corruption Commission
KANU	Kenya African National Union
KIA	Kenya Investment Authority
KRA	Kenya Revenue Authority
Ksh.	Kenyan Shilling
NARC	National Rainbow Coalition
NEMA	National Environment Management Authority
NGO	Non-Governmental Organisations
R&D	Research and Development.
SAP	Structural Adjustment Program
SME	Small and Medium-sized Enterprise
U.K.	United Kingdom
U.S.	United States
UNCTAD	United Nations Conference on Trade and Development
VAT	Value Added Tax
WRMA	Water Resources Management Authority

Introduction

The past century witnessed an increased flow of Foreign Direct Investment (FDI) to developing countries. The impact of these increased investments differs extensively between countries. The contribution of FDI to the economic growth of developing countries has been discussed in length (Borensztein, De Gregorio & Lee, 1998; Hermes & Lensink, 2003; Lall & Narula 2004). The main question debated is: how can FDI help trigger economic growth in the receiving countries?[1]

There are scholars who suggest that FDI growth has mainly negative effects for developing countries, where others argue the effects are mainly positive. Advocates argue that FDI provides developing countries with the needed capital for investment, along with employment opportunities, knowledge, skills and new technology. Opponents on the other hand, suggest that the promised benefits of FDI have convinced many governments to remove restrictions on FDI inflows. Consequences of these removals are that multinationals can exploit the local capabilities more freely. Also, many international donors promote private investments rather than public investments, leaving the country with no benefits ones the companies leave.

Figure 1.1: FDI in world vs. FDI in developing countries



Source: Vadlamannati & Tamazian (2009), p. 300

[1] FDI in development is part of an even bigger debate in which many scholars try to understand the true workings of development and the substantial development differences between nations. This debate has been going on for some centuries now and started with the work of David Ricardo in the early 1800s.

Figure 1.1 shows the global FDI flow for the 1970-2006 period. Simultaneously, it shows the share of FDI to developing countries. Figure 1.1 captures the rise and fall of FDI inflows in developing countries for the 1970-2006 period. It shows the huge volatility in the percentage of world FDI invested in developing countries. There are several reasons for this. For example we can see a huge drop and rebounch in FDI inflows in both 1974 and 1980. Vadlamannati and Tamazian (2010) ascribe this decline to the oil and debt crisis. They also argue that the governments of developing countries began much needed policy reforms in the late 1980s and, as a result, attracted more FDI again from the early 1990s.
The serious decline of the late 1990s is due to the worldwide recession at the time.

This thesis argues that many factors need to be considered to determine the real effects of FDI within a country. Mutual differences between countries influence these effects substantially. Local characteristics, motives of investors and global market forces are some examples of factors that need to be considered when studying the effects of FDI.
The country central in this thesis is Kenya, an African country with great development potential, a vast share of foreign investors and simultaneously a turbulent history when it comes to FDI.
The focus will especially be on the strengths and the weaknesses of the country and on recommendations to improve the investment climate in the future, all based on the experiences of investors present in the country.

Before discussing the results obtained during the study in Kenya, chapter 1 and 2 will discuss the general framework of this thesis. In chapter 1 the structure of the thesis will be presented. It will focus on the objective of the study and introduce the specific research questions. Chapter 2 will discuss the theories and methodologies used in this research. The chapter will provide an overview of the key concepts in the FDI debate and also describe the main literature available. The last paragraph of this chapter gives general information drawn from the collected data and provided by the interviewee's who contributed to this research.
Chapter 3 is a brief introduction to Kenya, the centre of this study. We will focus on the country's geographical, economic and political characteristics. A selection is made covering only the relevant concepts and the most important changes throughout the country's existence.

Chapters 4 and 5 will focus on the research findings. First, all positive aspects as well as the investment motives will be described. All findings are based on the research conducted in Kenya, along with the relevant literature published throughout the years. Second, all problems and inconveniences are analysed and described. Again, these findings are mainly based on the experiences of the investors. After the current situation is described, the chapter concludes with some general remarks and a summary of data presented.
The final chapter will combine the findings of the entire thesis and draw some final conclusions.

Chapter 1: Thesis' structure

§1.1 Research goal and research questions

The general aim of this study is to understand the motives of the investment behaviour of Dutch investors. Fundamental to this is the identification of the underlying processes that influence this behaviour. The main goal of this research is to identify improvement points to the current investment climate in Kenya by identifying both positive and negative aspects the investors have experienced. An important issue is to identify the investment motives, to determine whether or not the investments will be beneficial to the country in the long run. A conceptual model has been designed that will serve as a guide for each step of this research.
Specific research questions have been formulated to cover all necessary subjects.

§1.1.1 Research objective and conceptual model

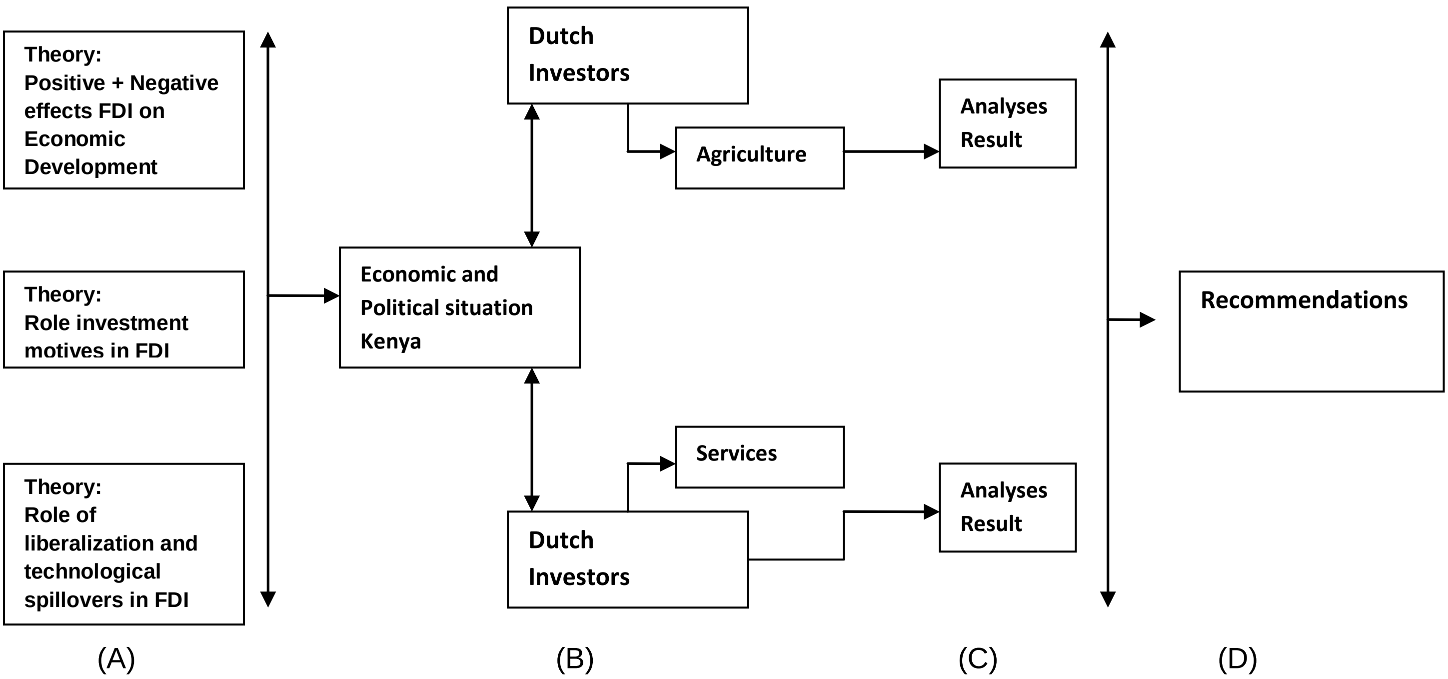
The following research objective is formulated for this study:

Find out how FDI affects the Kenyan society and identify the internal working of the current FDI policies; by identifying what motives Dutch investors have to invest in Kenya and by discovering the countries weaknesses in attracting FDI; in order to elicit future improvements to attract more FDI beneficial for the entire country.

Figure 1.2 is a schematic overview of the research model. This model identifies the necessary steps that need to be made and covers all relevant fields of the study. The figure is a theoretical framework and will serve as route map through the study. The first two steps will be completed prior to the study in Kenya. The third step comprehends the interviews with experts and investors, along with the analyses of the findings. The last step is the presentation of the results.

Conceptual model:
(A) Study the theories of FDI in economic development and the investment motives of foreign investors; determine the place of this research within the current debate around FDI and establish the framework of the research. Also, analyse the current political and economic situation of Kenya so that recommendations can be adjusted to the localities of the country.
(B) Formulate the interviews for the Dutch investors, adjusted to the sectors in which they are involved. Find out what motives these investors have for investing in Kenya, what strengths the country already has and what they feel should be improved in the current investment climate.

Figure 1.2: conceptual model



(C) Interviews with FDI/Kenya experts in the Netherlands. Analyse and compare the findings of the surveys and determine the key issues discussed during the interviews.
(D) Map out the conclusions of the interviews and compare the findings with the literature. Make recommendations based on the findings of the interview.

§1.1.2 Research questions

Following the research objective a couple of research questions are formulated, to support this study. The main question, central to this study is:

What motivates Dutch investors to invest in Kenya, how do these investments contribute to the Kenyan development and what sort of changes should take place in order to attract more foreign investments and to make FDI more beneficial for Kenya?
The sub-questions formulated to answer all relevant concepts of this study, and help formulate the answer to the main question are:

Chapter 4:

1) *What are the motives for Dutch investors to invest in Kenya and what are the positive characteristics of Kenya?*

2) *Does location play an important role in choosing where to invest and is location of any importance when deciding to invest in Kenya?*

Chapter 5:

3) *How do Dutch investors experience operating in Kenya?*
4) *What are the main risks or challenges when investing in Kenya and how should this be improved in the future?*

Chapter 6:

5) *How does Kenya benefit of the presence of foreign investors?*

§1.2 Societal relevance

Throughout this thesis the effects of FDI on a population and a country as a whole become clear. The debate around FDI in development makes clear that there are both negative and positive effects to the process and that each country reacts different to the workings of it. Also, countries are in different ways affected by FDI.

This study tries to discover how foreign investors influence the wellbeing of a community. The thesis tries to identify improvement points of the investment climate. These improvement points come from investors who work in this climate on a daily basis and the goal of the identification is to improve future investments so that the entire country can benefit from the investments.

§1.3 Scientific relevance

Most research conducted about FDI in development is based on quantitative analyses and trends throughout the years. When trying to determine the effects FDI has on a society most conclusion are drawn based on these numbers and statistics. Rarely, recommendations are made based on qualitative data or on country specific determinants. Also, the points of view differ distinctly between scholars.

One goal of this research is to combine qualitative data with the characteristics of one country to come up with custom made recommendations. By focusing on this one country there is more room to take its characteristics into account and to enforce the localities into the framework of the research. By focusing on the qualitative side of FDI and on the opinions and experiences of the investors and experts involved in this process, the recommendations will serve as a reflection on the true workings of the country. This increases the chances of success in future policies which, hopefully, are beneficial to the country as a whole.

Chapter 2: Theoretical framework

§2.1 Explanation and cohesion research concepts

This chapter provides insights into the key concepts used in this research. This chapter will elaborate on the substance of some individual concepts and the inherent cohesion of them. Since there is an ongoing debate about the role of FDI in development, different approaches and studies will be used to describe these concepts.

In chapter 1 the main research question was presented which emphasised the role of foreign investments, most notably from the Netherlands, in the development of Kenya. However, before analysing the country's characteristics and the direct impact of these investments on the country, some individual concepts need to be discussed.

There is an abundance of literature describing the role of *foreign direct investments* in the (economic) development of a country and the potential positive changes in this country as soon as the government successfully attracts different types of investments.

In his work Kojima (1975) makes a distinction between pro-trade FDI and anti-trade FDI. This distinction dates back to the work of Ricardo in 1817 and states that only the anti-trade FDI type can trigger development. In the case of anti-trade FDI, a capital abundant country transfers money to a capital-intensive goods producing country. Since the capital moves from the capital abundant country to the poorer country, the potential of exporting capital intensive goods for this country increases. This statement is the foundation of the comparative advantage[2] theory and is based on the assumed immobility of factors. It argues that production should take place in countries were (labour) productivity is highest. The only movement necessary to maintain this process would be the hollowing-out type, meaning that only the necessary (human) capital should be exported to the countries were opportunity costs are lowest (Ricardo, 1951). Even though this distinction between pro-trade and anti-trade FDI is a bit dated some FDI pessimists still apply it in their studies. These opponents mainly argue that anti-trade FDI gives local economies a change to develop their industries and benefit from exports. However, in this scenario some countries are bound to lose. For example, coffee producing countries face a lot of competition from other countries that have the same capacities. Given that these countries are often developing countries that posses only one or two strengths, some countries are bound to languish.

[2] The concept of comparative advantage: results from different endowments of the production factors, namely land, labour and capital. Due to these endowments a country should specialize its production and export those goods and services it can produce more efficiently. This scenario is based on an open-economy making trade beneficial to each country.

Based on the current global economic organisation this paper is based in a pro-trade FDI approach. Many FDI scholars argue that the first step in either studying or attracting this type of FDI is *liberalization* (Moyo, 2009; Singh & Jun, 2002; Büthe & Milner, 2008). The relationship between liberalization and FDI is not as clear-cut as one might suggest, in the sense that the one does not necessarily follow the other. The relationship works both ways, because liberalization opens the door for FDI as well as FDI can entice a government to open the borders. Since the FDI market is highly competitive, liberalization alone is not enough in attracting investments. Therefore, strong locational advantages and promotion are necessary. Once the foreign investments are attracted they can bring the benefits discussed later in this paragraph.

Table 2.1: Host country determinants for FDI

Host country determinants
I. Policy framework for FDI • economic, political and social stability • rules regarding entry and operations • standards of treatment of foreign affiliates • policies on functioning and structure of markets (especially competition and M&A policies) • international trade and investment agreements • privatization policy • trade policy (tariffs and non-tariff barriers) and coherence of FDI and trade policies • tax policy
II. Economic determinants
III. Business facilitation • investment promotion (including image-building and investment-generating activities and investment-facilitation services) • investment incentives • hassle costs (related to corruption, administrative efficiency, etc.) • social amenities (bilingual schools, quality of life, etc.) • after-investment services

Type of FDI classified by motives of TNCs	Principal economic determinants in host countries
A. Market-seeking	• market size and per capita income • market growth • access to regional and global markets • country-specific consumer preferences • structure of markets
B. Resource/ asset-seeking	• raw materials • low-cost unskilled labour • skilled labour • technological, innovatory and other created assets (e.g. brand names), including as embodied in individuals, firms and clusters • physical infrastructure (ports, roads, power, telecommunication)
C. Efficiency-seeking	• cost of resources and assets listed under B, adjusted for productivity for labour resources • other input costs, e.g. transport and communication costs to/from and within host economy and costs of other intermediate products • membership of a regional integration agreement conducive to the establishment of regional corporate networks

Source: World Investment Report 2003, *p.85*

Lall and Narula (2004) argue that the identification of *investment motives* is the first step in determining the impact of foreign investments in a country. This is necessary since each motive reflects the stage of economic development in the country of relevance. Naturally, not only the will and motives of the investors are of importance in attracting FDI. Key feature in attracting foreign investors and increasing benefits from them are national policies. According to the United Nations report (2003), the regulatory regime of a desired country can make a location more or less attractive for foreign investors. This regime can put policies in place for maximizing the positive development effects of FDI, while minimizing negative ones. The link between these national policies and the different motives for investing in another country are described in Table 2.1.

The “host country determinants” column shows an order of developments which decide whether or not FDI gets access to and stays in a country. Initially, the policies are decisive in preventing or enabling FDI. However, once an enabling FDI regulatory framework is in place, the economic factors become more dominant (United Nations, 2003). The economic determinants can be divided in various motives. These motives are summed up in the second column of Table 2.1 and will be described further in the next paragraph.
The third step in this process of attracting FDI is the facilitation of the right business climate. Even when the economic determinants are more dominant, the local government has to ensure that these investments bring benefits. In order to attract long-term, beneficial FDI the government has to provide certain incentives and try to meet certain demands of these foreign investors.

Next to the direct increase of capital formation in the host country, FDI may help increase growth by introducing new technologies, such as production processes and techniques, managerial skills, ideas and new varieties of capital goods. Grossman and Helpman (1991) argue that it is difficult to measure the direct contributions of technological progress to improvements in standards of living. However, together with Hermes and Lensink (2003) they emphasize the important contribution of *technological spillovers* in the process of development.
When focusing on the FDI in less developed countries the growth rate is perceived to be highly dependent on the extent to which these countries can adopt and implement new technologies available in developed countries.

§2.2 The relevant concepts

§2.2.1 Foreign Direct Investment

For many developing countries, economic development depends for a large extent on profitable investments. The first theory about FDI is derived from Stephan Hymer's work (1976) which explicitly recognizes so called firm-specific assets. This theory argues that it is illogical to assume perfect competition because FDI can only take place in imperfect markets. Hymer (1976, p.24) argues that FDI has to do with the desire to gain control over certain trade situations. In this situation the control over the foreign enterprise is desired in order to remove or regulate competition between that foreign enterprise and the enterprises from other countries. Another reason is to benefit fully from the returns of certain skills and abilities. This theory is derived in a time notorious for its dramatic changes in political ideologies and economic systems. During the early 1980s attitudes of governments changed towards multinational enterprises. In this period the term "globalization" appeared in many studies and was described as: "the increasing cross-border interdependence and integration of production and markets for goods, services and capital" (Narula & Dunning, p. 141). A more recent study of the United Nations (2003) also focuses on interdependence when discussing FDI. In this report FDI is defined as "an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate)(p. 231)."
According to both reports a long-term effect of this recognition of interdependence and the therefore following FDI-based development strategies is an increased competition between governments for such investments. This development shows that the flows of FDI only arise when there is a correlation between political interference on the one hand and economic determinants on the other. Both determinants are explained as attractive characteristics of the host country and are put in place to compliment the missing aspects of given domestic economies. These determinants will be explained further, in the section about motives for investments.

The role of economic determinants in the debate about FDI is relatively obvious. The role of political determinants on the other hand is not. Büthe and Milner (2008) argue that the role of influential political institutions is only discussed in recent studies. These studies show that not all types of capital inflows are desirable. Short-term investments, like portfolio flows and short-term bank loans, are often claimed to have serious adverse consequences, since they are often subject

to sudden withdrawals. Other criticised short-term investment, are so-called footloose foreign investments that often occur within EPZs. Generally, these footloose investments result from small export-oriented firms that are not rooted in the local community through supply and demand linkages. These firms are often highly sensitive to changing factor costs, like wages. As soon as the host economy is starting to develop and wages start to raise, these firms leave to invest in less developed country (Rolfe, Woodward & Kagira, 2004). The role of EPZs in relation to FDI will be discussed in more detail later on. Long-term capital flows on the other hand, and especially long-term FDI, are regarded as much more stable and therefore seen as a positive influence to development. Therefore, certain political interference is necessary and political risks have to be minimized to attract long-term investments. Political risks, in this respect can be described as "the risks that a sovereign host government will unexpectedly change "the rules of the game" under which businesses operate (Butler and Joaquin, 1998)."
Prior to any deposit, a company should consider the risks related to the investment. Sudden policy changes, instable institution and an increased risk of violence make a country less attractive and therefore affect the investment behaviour of international oriented companies.

In this whole debate about FDI and its role in development, there are some scholars that express concerns about the impact of FDI, especially in developing countries. The start of this critique is the notion that not all FDI, and therefore its impact, is alike. On top of that it is argued that many advocates of FDI tend to regard FDI receiving countries as a homogenous group, paying no attention to individual characteristics of a country (Rundle, 2009).

One likely occurrence of FDI in host countries is the crowding out of domestic investments. In this case local investment will be replaced with foreign investments because these investors have more capital to start a company and are able to offer services or produce goods against lower costs. In many cases host governments offer incentives to foreign investors such as tax holidays. In this case foreign investors are exonerated of paying taxes and government relies on the taxes paid by local entrepreneurs. However, when these local entrepreneurs are crowded out by foreign investors, the government will lose significant amounts of tax revenues, and thus the country will be damaged.

Other critiques on FDI rely on the damaging of local cultures and the maintenance of corrupt leadership. Several scholars argue that foreign investors often create a consumer culture in other countries (Smith, 2009; Mathur 2010). By commencing into a foreign market these investors often undercut traditional values by promoting new consumption habits to the people. Examples of such impositions are the presence of McDonalds and Coca-Cola in every corner of the world.

The relationship between corruption and FDI is more complex. Given that there are several types of corruption, for example expansive corruption and restrictive corruption, it is hard to determine how each type damages a country in relation to FDI. A detailed description of corruption and FDI will be given in chapter 5, since it is identified as a hindrance by several investors.

§2.2.2 Liberalization

Trade liberalization can be understood as “the opening up of markets to the free flow of goods and services” (Stiglitz, 2006, p.15). Notably, there are different types of liberalization. In addition to the free flow of goods there is capital liberalization, focusing on the free flow of money. This paper will focus on a combination of both, since the two forms coexist.

In the 1990s there was an increased focus on trade liberalization when the IMF, in cooperation with the World Bank and the U.S. Treasury, introduced a policy framework known as the Washington Consensus. The general goal of this policy was to offer a reform package to developing countries which would help them to trigger economic development. The policy was based on 10 recommendations. Two of these recommendations are relevant to this study and will therefore be described shortly.

The first recommendation entailed trade liberalization, lowering the import barriers and deregulation of rules designed to regulate the market forces. The argumentation behind this recommendation is the assumption that economic trends and relationships of the past will continue on in the future. At the time of the Washington Consensus the international economic changes of the 1990s were used to show that liberalization in combination with the right macroeconomic fundamentals works in triggering economic development. It was argued that in a globalising world all countries should rely on trade and the availability of external financial flows because of the increasing internationalisation of production systems. Countries choosing not to follow the Washington Consensus where warned that they would be penalized, in terms of being cut off and thus excluded from the intensifying global field of flows (Gore, 2000). Unfortunately, the statistics used for this argumentation only included macroeconomic data and filtered out country specific histories. Obviously, the failure of the Washington Consensus shows the importance of these country specific characteristics.

The basis of the second recommendation was liberalization of FDI, meaning that companies should be free to invest or settle in the given country without any restrictions. The idea behind these recommendations was that FDI brings capital and knowledge to a country. On top of that FDI is considered relative stable since it often comes from investors in developed countries. Unfortunately, studies (Gore, 2000; Stiglitz, 2000; Stiglitz, 2006) showed that only specific long-term types of FDI can trigger economic development. Short-term FDI could result in debts since

the host government invested a lot of money in unproductive uses like real-estate, and given the short period the possible beneficial aspects of FDI, like technological spillovers, are absent.
At the beginning of the new millennium the Washington Consensus had failed to succeed. Since then the policy framework is submerged with critique and left many developing countries with even more problems.

Despite the failure of the Washington Consensus, Ozawa (1992) and other liberalization supporters (Moyo, 2009; Singh & Jun, 2002) argue that, any developing country serious about raising its standard of living, must open its economy to benefit fully of the opportunities of trade, as well as interact with and learn from the already advanced. Simultaneously, there are several liberalisation critics (Stiglitz, 2006; Ocampo & Taylor, 1998) who argue that liberalization has mainly negative effects for less developed countries. The reason for this is simple: these developing countries lack competitiveness against developed countries since they are only capable of offering general location specific advantages. Lacking competitiveness increases the chance of exploitation by the foreign companies. Using several development countries as example, Stiglitz (2006) argues that competition between developing governments in attracting FDI can result in a race to the bottom, as foreign companies seek a home with weakest labour and environmental laws. This increased competition between governments was already mentioned in §2.2.1 were it was described as the result the interdependence between different countries.

In short, for many scholars multinational corporations and foreign investments have come to symbolize what is wrong with intensified trade liberalization. One main critique against this ongoing development is that many global investors drive out small, local businesses in developing countries, because these companies are more advanced and capable of producing against lower costs. Stiglitz (2006) emphasises the important role these local businesses have in local communities and the countries development by extension. Foreign investors often have the power to squeeze out these small firms and thereby weaken the development of a country. This crowding out has already be described as possible negative consequence in the previous paragraph.
In her book “Death Aid” Dambisa Moyo acknowledges some of hurdles and risks related to liberalisation. However, after studying the development of several African countries she argues that liberalisation and attracting FDI is vital. There are many advantages related to liberalisation and the attraction of foreign investors, like job creation, assist in the transfer of new technology, stimulation of the formation of capital markets, improvement of management expertise and most importantly the settlement of aid indigenous firms to open up to the international markets (Moyo, 2009).
This analysis is validated by Singh and Jun (2002), who make a clear distinction between short-term and long-term effects of liberalisation. Especially the long-term effects of FDI as a consequence of liberalisation are described as positive because they are regarded as stable. FDI

brings with it resources, technological improvements and improves the human capital. Also, long-term FDI are less volatile and therefore less disruptive then short-term money flows, like loans or aid. The only disputable negative long-term effect of FDI, is the environmental impact. Usually, this impact manifests itself not directly. Since these effects become visible when the investors are already active in the country, the consequences can be regarded as an indirect impact of liberalisation. The impact of FDI on the environment in Kenya will be discussed in more detail in chapter 4.

Consequently, one could argue that liberalization can have positive and negative effects for a country. In general, the eventual effects of liberalisation are very location and capital type bound. In order to decide the real effects liberalisation has, one needs to study the country characteristics. For the purpose of this paper, liberalization is regarded as inevitable in attracting FDI. Therefore, the underlying hypothesis for this paper will be that the advantages brought about by liberalisation and the following long-term FDI outweigh the negative effects of liberalisation. Despite the hurdles and negative effects of liberalisation, the process mainly affects a country in a positive manner.

§2.2.3 Investment Motives

Since day and age different regions have been trading and exchanging goods with each while trying to enrich themselves in the process. The underlying factor for this has been interregional differences in supplies of primary factors, technological or climatic conditions and different patterns of demand. Theories about the motives for FDI will demonstrate that these underlying factors for investment and trade have not significantly changed over the years. The theories merely classify the different motives into separate categories, which can be used as tools to reflect the stage of economic development for each country.

Before looking for reasons where and why companies decide to (re)locate one first needs to systematically analyse the drivers of internationalization. These drivers can manifest themselves in different ways. The United Nations report defines drivers as “factors that trigger a company’s internationalization or further expansion” (2006, p. 155). More general, a driver is either a push factor in the home country or a pull factor in the host country that triggers a company’s decision to (partially) move. The report describes a couple of these drivers in more detail but given the complexity and mixture of the investment motives for the investors in this study, a detailed description of different push and pull factors is irrelevant for this study.
Important to note is that these drivers merely trigger the initial idea to consider a foreign investment and never explain the entire reasoning behind these investments. Also, a combination of different

push and pull factors have to be considered when trying to discover the reasons for a foreign investment. This means that the reasons for companies to invest abroad are more complex than can be shown in a simple push and pull model. Consequently, explaining the investment reasons by indentifying the push and/or pull factors is not sufficient to explain the final choice of host locations and a better understanding of the motives and strategies is needed (UNCTAD, 2006).
Narula and Dunning (2004) argue that there are four main motives for investment, being: to seek natural resources, to seek new markets, to restructure existing foreign production through rationalization, and to seek new strategic assets. These motives correspond with the motives identified in Table 2.1, even though this Table identifies only three main categories of motives. After comparing the two sources one could argue that the motive to restructure existing foreign production through rationalization and the seeking new assets motive distinguished by Narula and Dunning fit into the resource/asset-seeking motive identified in Table 2.1. Reason for the United Nations to distinguish only three main motives is because the main focus in this report is on developing countries. Narula and Dunning (2004) explicitly identify the fourth motive as an asset-augmenting activity, whereby the firm wishes to acquire additional assets which protect or enhance the existing assets. They also argue that developing countries are unlikely to attract this type of FDI. This all leads back to the earlier argument that identifying the FDI motives is important, since they identify the economic stage of a certain country. The importance of this last statement will be described later on, refocused on Kenya and in relation to locational preferences.
In a later report of the United Nations, where the focus is on FDI in general, the subdivision of motives in four categories gets acknowledged, albeit in slightly different terms (2006).

§2.2.4 Technological spillovers

FDI influence the socio-economic welfare, growth and development of any host country. Clearly, these influences are visible throughout the entire host economy and evidently not all of them have to be positive. The effects of FDI are always influenced by country-specific characteristics, making cross-country comparison complex. Despite this complex nature, this paragraph will focus on one FDI effect in particular, namely technological spillovers. Technological spillovers are often described as a positive consequence of FDI in development and have a central role in recent debates about this subject. Several FDI advocates use technological spillovers to demonstrate the positive effects of FDI in a developing country (Lall & Pietrobelly, 2005; Lall & Narula, 2004;) For this paper technological spillovers are described as: “the benefits that arise from foreign firms demonstrating new technologies, providing technological assistance to their local suppliers and customers, and the training of local workers who may subsequently move to local firms.” On top of that local firms may learn by watching (Fan 2002; p. 1)

Technology and technological advances enabled many companies to invest abroad. Also, these technological advances have been a great motivator for developing countries to attract FDI, since the occurrence of technological spillovers is likely. There are even scholars who argue that development nowadays can only take place through technological spillovers and therefore FDI by extension. They argue that industrial and technological performance is linked to the country's capacity to absorb and use these transferred technologies efficiently (Lall & Pietrobelly, 2005).

This analyses shows that with the intensified globalisation and increased global interdependence, socio-economic development is closely linked to technological advances. This means that especially developing countries are highly depending on FDI since they lack the resources to implement these technologies. In their case FDI is the only way to obtain the right technologies and trigger development. Important to note here is that technological spillovers only take place when the right type of FDI is attracted. Countries that attract short-term, footloose FDI are unlikely to benefit from any spillovers, because the companies only invest in the necessary resources. In this case companies are likely to have left before any beneficial spillovers occurred. Only, long-term FDI is beneficial in this respect, because companies that invest for a longer period are likely to seriously train staff and invest in large plants and technologies.

Technological spillovers take place through a variety of channels that involve the transmission of ideas and new technologies. Examples of such spillovers are imports of high-technology products, adoption of foreign technology and acquisition and training of human capital (Borensztein, De Gregorio & Lee, 1998). This last example is in line with the United Nations report (2006) which argues that the turnover of employees is a channel through which knowledge can be diffused from foreign affiliates to the rest of the economy. In the company's point of view, the departure of trained employees is a loss. Therefore, the company will try its best to retain the trained workers. Hence, FDI could create more jobs, education and job security.

Lall and Narula (2004) note that the established linkages and the spillovers vary by industry. This argument is in line with that of Bell and Marin (2006), who argues that 'advanced' industries such as electronics are more likely to generate spillovers than 'traditional' industries, because they use more recent technologies, employ greater numbers of skilled workers and undertake more Research and Development (R&D).

Another determinant for generating spillovers is the absorptive capacity of the host country. The absorptive capacity is significant because it allows domestic actors to capture knowledge that exists in the foreign companies. If the absorptive capacity is lacking in the domestic firms, they may be crowded out of the local economy (Lall & Narula, 2004). Several studies have focused on this absorptive capacity and tried to identify certain characteristics which determine this capacity. Hermes and Lensink (2003) describe several of these characteristics. They argue that the input of the labour force is vital for the absorptive capacity, because high-level capital goods need to be combined with workers that are able to understand and work with new technologies. Therefore, technological spillover is only possible when there is a certain minimum, or threshold level of human capital available in the host country (Hermes & Lensink, 2003). This point gets also stressed by Borensztein et al. (1998) who argue that the application of advanced technologies require the presence of a sufficient level of human capital in the host economy. Therefore, the stock of human capital often limits the absorptive capacity of especially a developing country. The importance and impact of technological spillovers in a certain area will become apparent in this study, when the role of human capital in Naivasha, Kenya is discussed.

§2.3 Methodology

The following paragraph will focus on the methodological approach of this research. The methodology constitutes the fundamental base of why and how this research is conducted. The above described theory functions as a guideline for the empirical part of this research. This theoretical analyses is the basis of the research and functions as the framework wherein the empirical analyses will takes place.

This paragraph will start by justifying why a combination of empirical research and desk research is chosen as strategy to reach the objective. Also, the paragraph will describe why Kenya is chosen as unit of analyses and why this country is relevant to test the theories of FDI.

Finally, this paragraph will focus on the general results of this research, in terms of limitations, expected short-comings and the general information of the conducted interviews. The sections might show some overlap since they were written relation to each other.

§2.3.1 Research strategy

The chosen strategy in this research originates from a combination of semi-structured, in-depth interviews and desk research. The combination of FDI in development and the motives for investing abroad offers opportunities for both qualitative and quantitative explanations. The previous section discussed FDI and the effects on development already to some extent. The very essence of FDI studies is based on extensive quantitative and comparable research, leaving little room for representations, experiences and personal motives behind these deliberate investments.

In order to find out the reasoning behind FDI and analyse the influence of locational characteristics this study will focus on the qualitative side of FDI in one specific country. The aim will be to find patterns and irregularities in the investment behaviour of Dutch investors and to identify the underlying processes that influence this behaviour. Much of the empirical data is derived during a four month internship in Kenya. During this internship I had the opportunity to visit several Dutch investors and analyse the companies' investment strategies in this country. During these visits I conducted in-depth interviews with the managers or owners of these Dutch companies to identify underlying motives for investments and improvement points of the Kenyan investment climate.

The interviews where set up around three general themes, divided in sub-questions. The first and second theme where general sections focusing on the characteristics of the interviewee and the company respectively. The third theme was the main focus of the interviews, addressing the companies' motives for investing in Kenya and discussing the investment experiences of the investors. As the respondents where active in mainly two different sectors some questions where not relevant to all. Nonetheless, all sub-sections provided comparable information from all companies involved. By implementing semi-structured interviews, the respondents had ample opportunity to clarify the reasoning behind the investments.

After the study in Kenya and analysing the answers, two experts in the Netherlands where consulted to comment on the outcomes. One expert is a general director of a network platform for Dutch investors in Africa and provided feedback on the general FDI findings. The second expert is an environmental researcher, specialising on the environmental changes in the Naivasha basin. He provided feedback on the impact of the investors on the environment in Kenya.

The combination of this empirical research with desk research is necessary to provide the theoretical framework of this research and to place this research in a broader context. First, this desk-study provided the necessary information to formulate the research questions, choose a unit and country of analyses and to learn about the importance of investment in the development debate. Second, desk research is needed to position the through interviews derived information within the whole debate. Also, existing literature is needed for comparing the findings to other studies and when deciding which processes are responsible for the current situation. Some examples of the sources consulted for this study are articles, web-pages, NGO-reports and yearly company publications. Most literature is consulted before and after the internship in Kenya. During the internship a visit to the National Archives in Nairobi was made. Unfortunately, the articles were of a definite date or on a specific area, and therefore not relevant to this study. Most reports covered a certain process of authorization, barely relating to the relevant sectors.

The use of different sources is often termed triangulation. This method is chosen to identify similarities and to create the opportunity to draw conclusion and to form general statements.

§2.3.2 Selection of case study

As argued in the previous sections, foreign investments have a central role in the economic development of developing countries. Since the time available for this research was limited the unit of analyses for this study is fixed on one country, Kenya. Given the critiques described earlier in this paper, this fixation on one country is not seen as a problem. These critiques stressed the importance of country-specific characteristics and argued that these are often forgotten in multiple country comparisons. This study will be able to pay detailed attention to country specific characteristics. The rest of this paragraph will justify several choices, influencing the research and the results by extension.

Kenya

Kenya is chosen for several reasons. The first reason is of personal nature, namely the desire to conduct research in an English speaking African country in combination with the getting in touch with a Kenyan PhD-student who was willing to support me with my research.

The second reason is that Kenya is the hub of foreign investments in East-Africa and has a long history of FDI. Striking in this history is the general underperformance of Kenya in attracting FDI especially when comparing the country to its neighbours.

Table 2.1 shows the FDI flows to East-Africa in the period 1986-2003. Especially Kenya's direct neighbours, Tanzania and Uganda, attract an substantial amount of FDI. Even underperforming countries in 1986, like Ethiopia and Sudan, bypassed Kenya between 1996-2000.

Table 2.2: FDI flows to East-Africa 1986-2003

COUNTRY	1986–1990		1991–1995		1996–2000		2001		2002		2003	
	in $ per $1,000 of GDP	in $ millions	in $ per $1,000 of GDP	in $ millions	in $ per $1,000 of GDP	in $ millions	in $ per $1,000 of GDP	in $ millions	in $ per $1,000 of GDP	in $ millions	in $ per $1,000 of GDP	in $ millions
	Annual average											
Burundi	1.0	1.2	0.7	0.7	3.8	2.8	0.0	0.0	0.0	0.0	0.0	0.0
Ethiopia	0.3	2.0	1.5	8.2	24.2	155.1	3.0	19.6	12.4	75.0	9.0	60.0
KENYA	***4.7***	***38.4***	***1.5***	***12.8***	***3.8***	***39.8***	***0.5***	***5.3***	***2.2***	***27.6***	***5.9***	***81.7***
Rwanda	7.1	15.9	1.9	3.6	2.4	4.3	2.2	3.8	4.3	7.4	2.8	4.7
Sudan	- 0.4	- 4.4	2.7	22.1	21.5	246.4	42.6	574.0	46.9	713.2	77.1	1 349.2
Tanzania	0.1	0.3	9.0	46.4	31.6	260.4	50.0	467.2	25.5	240.4	25.8	248.0
Uganda	- 0.3	- 0.6	12.5	54.2	33.0	200.9	40.5	228.6	43.0	249.3	45.7	283.3
Zambia	35.5	112.5	16.0	53.7	47.9	161.4	19.7	71.7	21.7	82.0	23.6	100.0

Source: UNCTAD, Investment Guide to Kenya, p. 17

Despite these numbers, Kenya has several advantages which set the country apart from its neighbours. First of all the country has a central location in both East-Africa and the world. On top of that Kenya has a big harbour in Mombasa, which makes the country accessible to foreign investors. Third, the country has a large and educated workforce. The general importance of this characteristic in attracting FDI is already discussed in the previous section when contributors to technological spillovers were described.

All in all Kenya shows some conflicting developments when it comes to attracting FDI. This makes the country an ideal unit of analyses, especially since the main focus of this research is on the qualitative aspect of FDI. In other words, investors in Kenya are the ideal target group when it comes to identifying improvement points of the investment climate, because clearly the country is not living up to its potential.

Dutch investors

For this research the origin of the foreign investors was not very significant. Possibly, the motives from British investors may differ from those of other investors since Kenya has been a colony of the U.K. These ties may influence the choice of some to invest in Kenya.
The main characteristic important for this study is that the investor needs to come from a developed country in order to determine the real effects of FDI in the development of Kenya.
Since my own nationality is Dutch it was easier to get in touch with fellow Dutch people and to get information from the Dutch embassy. Not surprisingly, the embassy was the first information point and agreed to contribute to this research. After interviewing the first Dutch investors it was easier to contact other investors since all the investors are part of the same network.
In the end there where two exceptions. Even though all respondents were of Dutch origin, they were working for German companies. Nonetheless, the interviews showed similar results which made the findings useful for the study.

Naivasha vs. Nairobi

The focus on two specific places within Kenya was not deliberate. After extensive research it turned out that most investors where located in either one of these places. Since the limited time in combination with the available contacts the focus gradually turned to Naivasha for investors in the horticulture sector and Nairobi for investors in the service sector. In the grand scheme of the research there where exceptions, being two flower farms near Limuru.
The choices of location where premeditated and the division of the two sectors in the two places is not surprising. Naivasha has many locational benefits for flower farms, for example the altitude and the lake. Nairobi on the other hand has a good infrastructural network and is close to the higher educated population and therefore attractive for companies in the service sector. The role of these locations in deciding to invest in Kenya will be discussed more thoroughly in the next chapters.

Map 2.1: location sectors within Kenya

Source: google (maps)

Generally, most investors in Kenya are involved in either the horticulture or the service sector. Only a small percentage is involved in the manufacturing sector. Throughout this paper the term horticulture sector will be used to describe: "The cultivation of fruit, flowers, vegetables and shrubs, also used to describe the commercial production of such crops on general farms" (University of Reading, 2011). Given that most investors in this sector are export-oriented, most products need to be packed and shipped for transport. Despite that these activities are of a manufacturing nature the activities are allocated into the horticultural sector and therefore the agricultural sector by extension. The term service sector entails: "Companies that provide both public as private services and work in commerce, insurance, finance and business services, transport, communications and storage, public administration, as well as tourism." Most service investors in this study are active in of these fields. Since most investors deal with the same offices and bureaucratic hurdles and since most of their answers correspond, they are all placed in the same category. In the case that a relevant answer deviates from the overall group, this answer is described separately.
The choice to focus on the two sectors only is because it makes comparison easier. After visiting an EPZ in Nairobi it became clear that no Dutch investors are located within these areas. Only one respondent was involved in this sector and had a plot within an EPZ. However, this respondent was also involved in the horticulture sector. For this reason the focus shifted to the horticulture and service sector and this makes end comparison easier since the number of respondents is roughly even in both sectors. Finally, the location of all investors and the division between the sectors is displayed in map 2.1.

§2.3.3 Method of analyzing

This paragraph will focus on the unit of analyses, explanation of the conducted interviews and the expected challenges and shortcomings of this research.

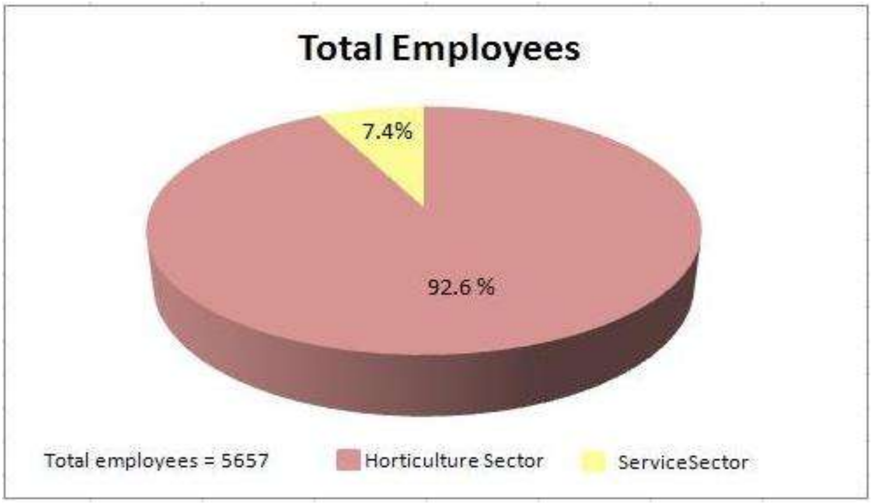
Starting point for the research was an interview with an employee of the Dutch embassy and a director of an EPZ near Nairobi. After these interviews a selection was made and the main focus shifted to investors in Naivasha and Nairobi.
In the end 20 useful interviews were conducted, on top of the two interviews described earlier. Nine investors are located around Lake Naivasha and are mainly active in horticulture. Two respondents are located near Limuru and are active in horticulture as well. The remaining nine investors are located in and around Nairobi and working in the service sector. Two investors are active in micro-financing. These companies provide funds and technical assistance for local investors and small-scale enterprises. Several other investors are active in hospitality and run restaurants, hotels and travel agencies in and around Nairobi. Their clientele consists of tourists, expatriates and local

people and their focus is mainly on upper-class activities. Finally, the remaining investors are responsible for starting up micro-health insurance projects and the development and introduction of new technologies to schools, hospitals and agriculture.

The focus on only two places in Kenya makes generalisation of conclusions difficult. The number of respondents is sufficient to draw conclusions to some extend but will not apply to the entire country. There are some areas within the country that attracted foreign investors as well. However, since the limited time and the lack of contacts, these investors are not included in the research.
This is also the case when looking at the role of FDI in development. The study is based on one country only. This makes general conclusion about the role of FDI in all development impossible. During the interviews there was some focus on Kenya's direct neighbours. However, since own research is missing in these, or other, countries the results will only be discussed briefly and they will be based on literature, the experiences of the respondents and the comments of the two experts.

The remainder of this chapter will focus on the general information of the interviewed companies.
The information is obtained during the interviews in Kenya and the Tables are based on the numbers provided by the respondents. The analysis is the first step towards generalisation of the obtained information and will serve as the backbone for the upcoming chapters.

Table 2.3: total employees 2010



The employees selected for this analysis are people working for the companies in question. This includes all levels of employment, including managerial functions. Table 2.3 shows that the companies in the horticulture sector employ more people than companies in the service sector. Reason for this is the type of work and the size of the companies. Most people employed here are hired for tasks like harvesting and spraying of flowers. Additional information to Table 2.3 is that the educational level in the horticultural sector is relatively low. Most people employed in this sector are either uneducated or finished only primary school. The exception is people hired for managerial functions, secretaries and necessary legal representation. Comparing the number of employees to the World Bank report (Snapshot Kenya, 2006), it becomes apparent that the Dutch companies are relatively small. This report states that, on average, horticultural farms employ 1.500 people.

In the service sector the majority of the employees are educated and many employees finished university. This has to do with the tasks and responsibilities of the employees. Apart from necessary computer skills most companies require business and economic knowledge. The majority of people employed by both sectors has the Kenyan nationality. Comparison of this sector with the World Bank report (Snapshot Kenya, 2006), is more difficult because the sector is divided into the different activities.

Table 2.4: Employees Horticulture sector; men – women ratio 2010

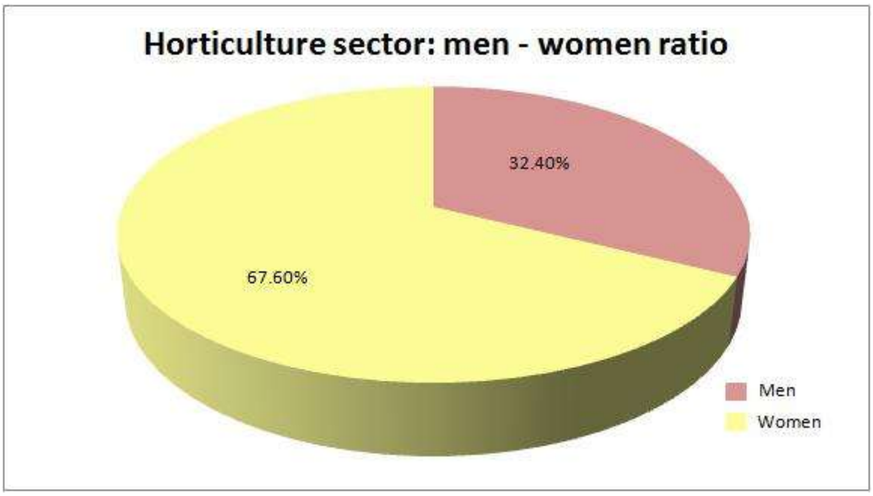


Table 2.5: employees service sector; men – women ratio 2010

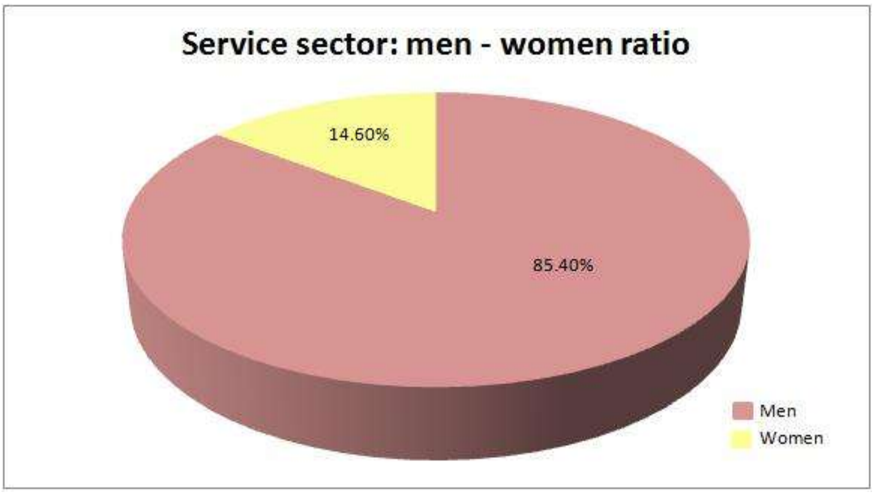


Table 2.4 and 2.5 focus on the work division between men and women. The results differ distinctly between the two sectors. The majority of people working in the horticultural sector are women, whereas the majority working in the service sector are men. The reason for this is the type of work. According to the respondents in the horticultural sector women are better executing tedious tasks and are better suited for the precise tasks, like cutting flowers. In the service sector the reason for this division was not always clear. In many companies there was no specific reason for hiring more men than women.

One important comment by Table 2.4 and Table 2.5 is that the analyses is based on the estimations given by the respondents. All companies gave an estimated percentage on the men – women ratio working within their company but no actual numbers. The entire analysis can be found in appendix 1.

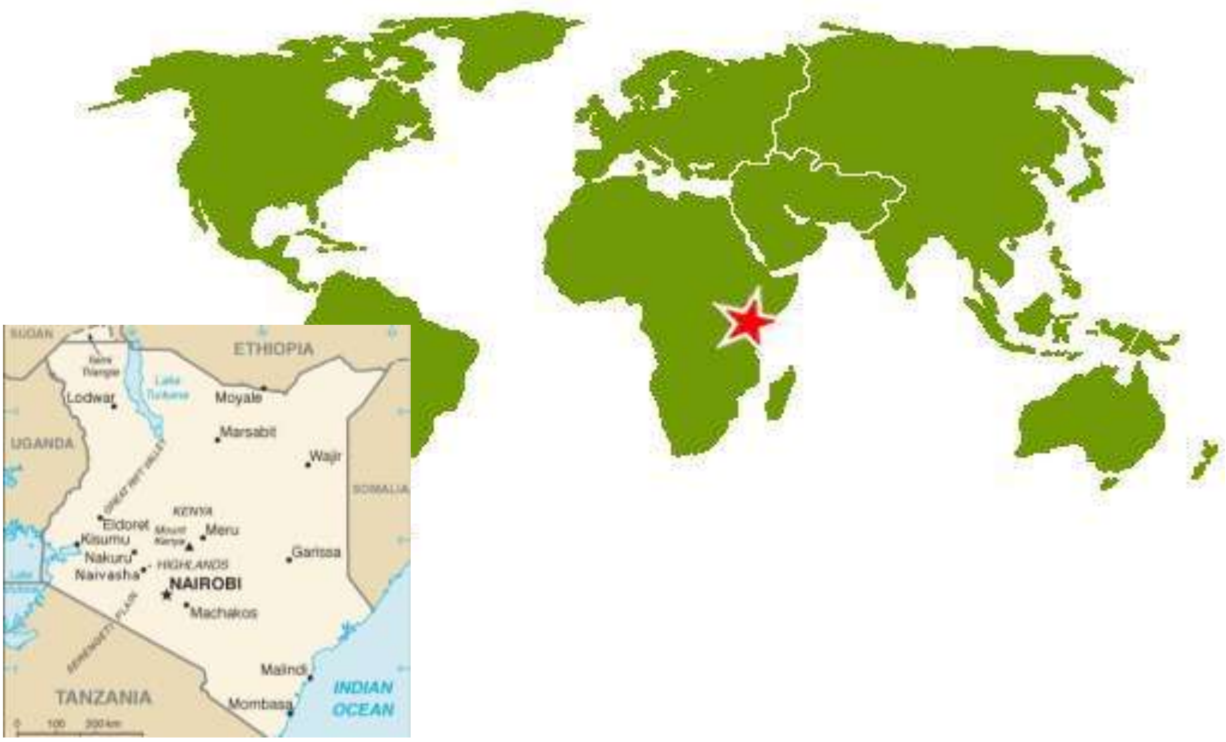
Chapter 3: Introducing Kenya

Before turning to the findings of the research conducted in Kenya, the country's political and economic history need to be described shortly. This chapter will focus on the most notable changes within the country's history and will serve merely as an overview. The main purpose of this chapter is to provide background information, relevant to the analyses in the upcoming chapters. Therefore, it is by no means a complete overview of the country's history up to today.

<u>§3.1 Kenya: the geographical context</u>

Kenya is a relative big country with approximately 40 million people living on 580,370 sq. km. The capital city, Nairobi, is known a central city of East-Africa. The city serves as a home to various international businesses and organisations, like the United Nations Office.
As shown on map 3.1 Kenya is located in East-Africa, bordering Somalia, Tanzania, Uganda, Ethiopia, Sudan and the Indian Ocean.

Map 3.1: Geographical location Kenya



Source: CIA World Factbook & Permanent mission of Kenya to the UN office in Geneva

Kenya has two formal languages, English and Kiswahili, and over 40 indigenous languages all linked to the numerous ethnic groups living in the country. Important feature of the country is its location on the equator and diverse climate. The climate varies from tropical at the coast to arid especially in the northern parts, whereas the landscape ranges from low plains to central highlands in the Great Rift Valley. The combination of climate and landscapes make Kenya the ideal location for agricultural and horticultural activities. Despite these lakes the country has severe problems with droughts in the dry seasons forcing the government to interfere with the water management. During the wet season on the other hand, the country is confronted with flooding. After the extreme droughts of 2005 and 2008-2009, Kenya faced extreme rains in the beginning of 2010. The unpredictability of rainfall or droughts causes many Kenyans to lose their homes to flooding or lose their livestock due to a lack of pasture.

Kenya's geographical location is very important in building its international status. Kenya's infrastructural connections are key to its international status. Compared to its direct neighbours it is known to have to best international connections. Since these connections are part of a great international network, they are crucial to many foreign investors. Kenya owns the biggest seaport of East-Africa in Mombasa, which supplies the entire region with imported goods. The port offers several specialized facilities like warehousing and cold storage and is responsible for safe navigation of goods and services. The presence of the port makes Mombasa the second biggest city, after Nairobi, in terms of population and business. However, a recent report of the World Bank (2009), shows that the government should pay extra attention to the Mombasa port, if it wants to maintain its status. The report found that the port, in contrast with statements of the board, is plagued by poor infrastructure and great bureaucratic hurdles. As a result of these negligence's it takes approximately two weeks to clear a container at the port. In 5% of the containers it can take up to 4 weeks to get clearance. In general, the costs of importing a container exceed \$1300, while the costs for importing in both Tanzania and South-Africa are under \$1000. Obviously, if the government fails to improve these hurdles the country might lose its good international status, and foreign investors might choose to relocate to neighbouring countries like Tanzania. The above negligence in importing products gets confirmed by at least one horticultural and one service investor. Both investors argue that the paperwork and the following holdup in the harbour are the biggest disadvantages of importing products into Kenya. The further role of infrastructure in attracting or discouraging FDI will be discussed in detail later on.

§3.2 Kenya: the economic context

In the 1950s most countries in sub-Saharan Africa, including Kenya, were at the same economic development level as most countries in Southeast Asia. Today, some of these Asian countries are termed as newly industrialized because they have shown a remarkable economic and industrial development over these last 60 years. Their African counterparts on the other hand are still seen as underdeveloped and have remained poor.

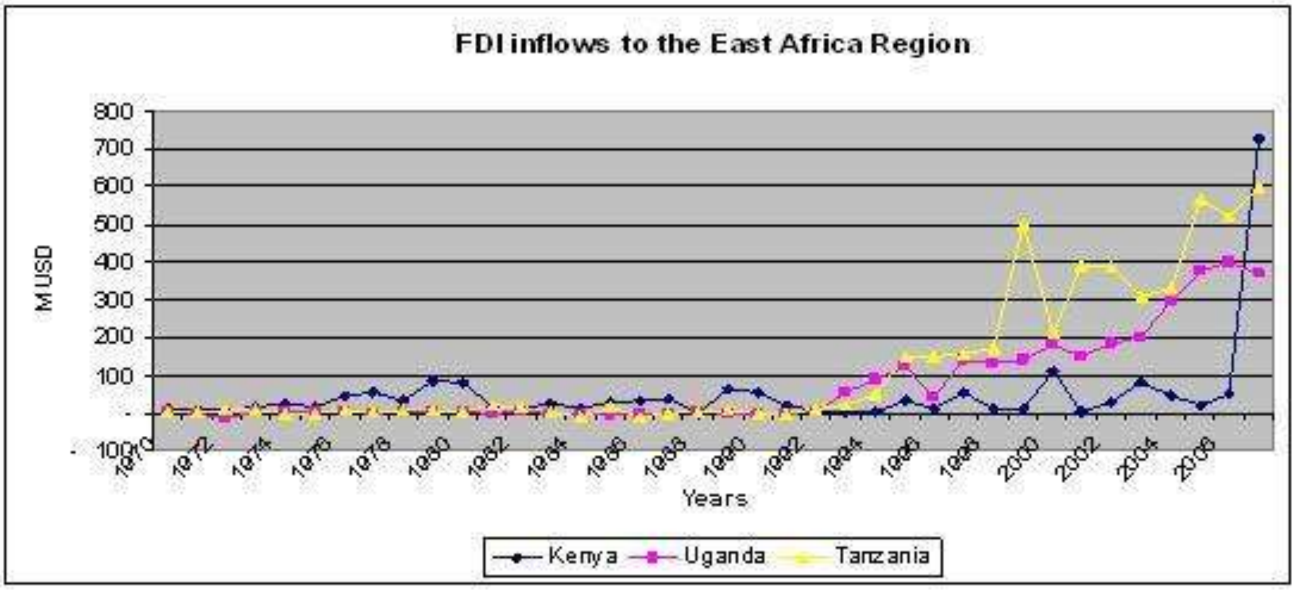
Prior to its independence in 1963 Kenya's GDP was largely dependent on agriculture. An occurrence that was natural to many developing countries, especially those that had been occupied by European settlers. Today, the GDP shows a somewhat different composition with agriculture accounting for 22%, manufacturing for 16% and services for 62% of the GDP (CIA, 2010). However, contributing to GDP and employment numbers are not necessarily related. The labour force per occupation shows that in 2007, 75% of the population were employed by the agricultural sector, while 25% of the population was active in the industrial and service sector combined. The difference in statistics can partially be explained by the number of people working in the informal, service sector. These people are often missing in official statistics. Therefore comparison between the sector composition and employment numbers is necessary. This data gets confirmed by this study as well. Like displayed in Table 2.3, the interviewed agricultural investors are, with a total of 5400 employees, responsible for 92.6% of the employees whereas the service investors employ, with 417 employees, only 7.4%, . Kenya's overall GDP experienced a significant growth of 4.9% across all sectors in 2010. The World Bank expects GDP growth rate of 5.3% in 2011 if current developments continue (Kenya Economic Update, 2011).

In terms of financial support Kenya received sizeable amounts of lending to balance its payments. These programs where first described as program lending and in the 1980s identified as the Structural Adjustment programs (SAP) provided by the IMF and World Bank (O'Brian & Ryan, 2001). Kenya received the first of these loans in the early 1970s as a response to the oil crisis. After this first loan the lending took place in a stop-go form depending on the economic management of the country. Overall, the implementation of economic reforms and the economic development of the country has been a mix of success and disappointment. Between the 1970s and the late 1990s the lending of the IMF and World Bank have been a mixture of granting loans and suspending loans, depending on the success gained with the implementation of SAPs.

In terms of FDI inflows in Kenya, there is a long history prior to current developments as well. During the 1970s Kenya was one of the most favoured destinations for FDI in East-Africa. After the 1970s the East-African relationship with foreign investments has been turbulent and the region lost its overall appeal to foreign investors due to political unrest and corruption. Table 3.1, and Table 2.2, show that Kenya's achievements in attracting FDI have been similar to those of its neighbours until the mid 1990s. Up until 1995 there are some minor fluctuations, but the overall trend between the Tables corresponds. One reason for the poor performance between the 1970s and 1990s in the entire region is the constant political instability in Kenya's neighbours. This instability affected the entire region in terms of drawing FDI away from East-Africa, including Kenya. However, after 1996 Kenya performed significantly inferior compared to its neighbours. One important reason for this poor performance is the suspension of loans by the IMF due to corruption, which will be described further in paragraph 5.2.2.

After 2000 Kenya has witnessed a small improvement in attracting FDI, followed by a significant growth after 2006. In 2007, the Economic Recovery Strategy paper expired and was replaced by the Kenyan Vision 2030. With this vision the Kenyan government hopes to reach global competiveness and there is a special focus on attracting more FDI. Examples of reforms to attract more FDI are the establishment of free trade zones, improvement of infrastructure and the development of incentives (Kinuthia, 2010). Table 3.1 already shows a significant growth in FDI in 2007, which can be partially explained with the reforms implemented that year. Other reason for the big upsurge in FDI in both 2000 and 2007 are new investments in mobile telephone companies, an accelerated offshore borrowing by private companies to finance electricity generation and the privatisation of telephone operator Telkom Kenya (Mwega, 2010).

Table 3.1 FDI inflows to the East Africa Region



Source: Kinuthia (2010, p. 4)

§3.3 Kenya: the political context

From 1896 to 1963 Kenya was under British rule, until after which it became an independent country. In 1964 Jomo Kenyatta was appointed as first president of Kenya until his death in 1978. From 1968 till 1978, Kenya's second president Daniel Arap Moi served Kenyatta as vice-president. He became president after the death of Kenyatta. At first Kenya's political system comprised of a single-party state, meaning that since independence the country was mainly shaped by KANU. Originally, Kenya had two leading parties at the time of its independence. In 1964 KADU dissolved itself and joined KANU. During Kenyatta's rule KANU did not provide any opportunities for political advancements. During elections it only nominated people that where loyal to the party, excluding any possible competition. Given the lack of intra-party competition, KANU only served as the façade of Kenyatta's power, who primarily relied on the civil service to maintain political power (Mwangi, 2008). In 1966, KANU experienced some competition from the left opposition party KPU. However, this party was banned shortly after its formation and its leader was banned.

In 1978, KANU under Moi transformed into a powerful player in the political process. Examples of such transformations were the amendment of the constitution establishing KANU as the only legal party in Kenya, imposing censorship on the media and repression of society. Human rights abuses in the form of torture and killings are often used to describe Kenya under Moi.

Due to both internal protests and external international pressure and a series of mistakes by the governing elite, the political system of Kenya changed significantly. In 1992 Kenya held multi-party elections again. These multi-party elections were heralded to be a substantial change in the political system. Unfortunately, right from the beginning, the entire electoral process was manipulated and comprised by the ruling party. This substantial electoral malpractice ensured the outright victory of KANU.

After 24 years of ruling Kenya, the parliamentary lost elections to Mwai Kibaki's party NARC, in 2002. During these election NARC won 125 of the 210 seats in parliament, leaving only 85 seats for KANU and numerous smaller parties. Almost directly after the 2002 elections, tensions within NARC increased, due to internal altercation within the ruling party. Up until new election in 2007, Kibaki had to rearrange or replace members of his party several times, as a result of ministers opposing the new constitution, corruption allegations expressed against ministers, and ongoing quarrels between different party members. Elections in Kenya are held every five years. During elections the people are able to elect the president directly. The new elections of 2007, unfortunately resulted into great civil unrest and violence. On December 29 2007, incumbent Kibaki (Kikuyu) was announced winner of the presidential elections, by a narrow margin over the presidential candidate Raila Odinga (Luo). This announcement resulted into a widespread violence in several parts of Kenya during January and February 2008. The elections in 2007 and the violence direct after damaged Kenya’s status as being a political stable country severely. Partially responsible for this civil unrest are the politicians themselves, because they used ethnicity to mobilize votes, which created a division between the Kikuyu and other tribes. Other, circuitious causes of the violence where the rumours about fraud during the elections, the use of governmental force during relative peaceful demonstrations and clashes between gangs.

The violence resulted into in about 1,200 people death and approximately 500,000 people displaced from their homes. After weeks of negotiation, a power sharing agreement was finally signed on February 28, and general calm was restored.

Today, 4 years after the election, Kenya still counts several thousand IDPs living in transitional camps. During this study both Kenyans as well as several investors expressed their worries for the upcoming elections in 2012. Whether or not these elections will result in violence again is unpredictable. The role of this risk of political instability will be discussed in detail in chapter 5.

Chapter 4 Kenya’s strengths

§ 4.1 Investment motives vs. locational preferences

The theoretical reflection showed that investment motives lie at the essence of FDI. The type of investment motive determines whether or not the contributions to development are long-term. This chapter is based on the data collected in Kenya and will focus on the positive aspects of the investment climate according to investors active in the country.

The findings show that besides investment motives, locational preferences matter as well. Analyses showed a close relationship between the choice of location and the motives for investing. The main reason for choosing a certain country or region is not always clear. After interviewing the investors it became clear that the main distinction between choosing a location and the investment motives lies in the initial intention to invest abroad. When a company decides to move to or invest in another country the motives for doing so matter. After the decision to move is made, a combination of locational determinants becomes important. Dunning (2009) argues that the locational preferences of FDI will not depend on the types of activities in which the investors are engaged, but on the investment motives. This statement raises some doubt in the case of resource-seeking FDI. Nevertheless, this study is not entirely contradicting this statement. It will show that locational preferences are certainly related to the type of activities, especially in the horticulture sector. However, it will also identify some overlap between the locational preferences and the investment motives and it will show that many investors, especially in the horticulture sector, have the possibility to move to another country. At last the study will show that it is the combination of locational advantages and investment motives that made investors choose Kenya. This finding is in line with Noorbakhsh, Paloni and Youssef (2001), who argue that foreign investors are more and more attracted to countries that offer adequate combinations of locational determinants.

By distinguishing between the investment motives and locational preferences it is possible to analyze the macro-level qualities separately from the local-level or regional qualities. Both are equally important because the macro-level analysis strengthens the international position whereas the local-level analysis protracts an overview of the specialized fields.

Before describing the locational preferences of the sectors it is important to emphasize the relationship between locational choices and investment motives, because the two influence each other and the division is not always clear. A study of the United Nations (1998) shows that the locational determinants of FDI are strongly dependent on the motivation of the investors. The categorization of the different investment motives is already described in chapter 2. In the United Nations report (1998) it becomes apparent that despite certain preferences, some investors are somewhat forced to invest in a certain area, since their type of activity can only take place in that location. For instance, resource-seeking investors need to choose a location with an abundance of that specific natural resource and preferably low initial investments like building costs. With this type of FDI the relation between investment motives, finding natural resources, and the locational preferences, namely the place where these resources are present, is strong. The other investment motives show a similar relationship, although in most cases the activity could take place elsewhere. All the motives identified by the Dutch investors are of an asset-exploiting nature, meaning that their main purpose is to generate rent through the use of firm-specific assets. Location is important because this type of FDI is particularly attractive in less developed countries.

The locational preferences of the horticulture sector differ from those of the service sector. Since the general focus is on the role of FDI in development the investment motives will be described first. The two most important motives for investing in Kenya are the same for almost all respondents across the two sectors. Only the third motive differs between the horticulture and services sector. Because of these similarities the sectors and the motives are combined in one paragraph. The differing motives are described separately in the same paragraph.
The locational preferences are discussed separately because they differ from the motives and they enable to differentiate between macro-level and regional qualities. The role of locational preferences should not be underestimated. These preferences will stress the importance of a combination of locational advantages and how these influence certain companies in their decision to stay. It is the combination of investment motives and locational advantages that initiate long-term investments.

§ 4.2 Investment motives

When analyzing the investment motives by means of a simple push- and pull model, the initial incentive differs distinctly between the two sectors. The decision of the investors in the horticulture sector is based on mainly push factors. In this case the push factors are the limited space, increased costs of labour and the stricter (environmental) rules in the Netherlands.
For the service sector it are mainly pull factors that initiate the decision to invest in Kenya. These decisions are mainly based on the possibilities that Kenya, as an up and coming market, has to offer. However, like already described in chapter 2, investment motives usually are more complex and a simple push and pull model is hardly sufficient to determine the entire reasoning behind these motives. Despite the differences between the two sectors, the research in Kenya showed

that the ultimate motives between the sectors correspond with each other. The initial decision to invest abroad might differ in terms of reasons of being pushed out or pulled in. Still, analyses showed that overall, both sectors are attracted to the same qualities of Kenya.

Table 2.1 suggests that the motives for entrepreneurs to invest abroad can be divided into three separate categories. It also suggested that in terms of investment motives, only economic determinants are important.

After discussions with the Dutch investors it became clear that the main motives to invest abroad are indeed based on economic determinants. The investors argued that political factors are taken into account but the final decisions are based on economic factors. Political factors become more important once the investors are settled and are acquainted with the country. Political factors often determine further investments. Table 2.1 suggests that the investment motives can be placed in either one of the categories. However, after analyzing the interviews it became clear that the actual investment motives cannot merely be divided into three separate categories. Most investors argued that the decision to invest abroad rely on a mixture of motives. Comparison of the investment motives with Table 2.1 shows that most decisions are based on a combination of market-seeking motives and resource/asset-seeking motives.

Overall, the resource/asset-seeking motives are more important to the horticulture sector, whereas the market-seeking motives are more important to the service sector. Nonetheless, the overall analyses shows that roughly the motives are consistent between the sectors.

Both sectors argue that the main motive to invest in Kenya is because of the low costs of labour in combination with the high level of education. Both the low costs of unskilled labour as the presence of skilled labour are resource/asset seeking motives. Obviously, the low costs of labour are more important for the horticulture sector and the education level is more important for the service sector.

Table 2.3 showed that the horticulture sector evidently employs more people than the service sector, making low labour costs vital to this sector. Investors in this sector repeatedly emphasized that most activities in this sector are labour-intensive and require little training or education. Harvesting cut-flowers is highly labour-intensive because it has to be done frequently, by hand and up to three times a day to ensure high quality. Kenya has a large labour force consisting of a lot of women. This last aspect turned out to be of high importance since most of the work is tedious and precise. Women tend to work more cautious making them better suited for this type of work. Most investors also argued that women tend to focus on the future and are therefore reliable on the long term. Men are mainly hired for the heavy activities like maintenance and spraying. Since most activities are tedious, men tend to get bored making them unreliable on the long run.

Another positive aspect is the education system in Kenya. In the 1970s the Kenya government implemented a free primary education (FPE) system for the first time. According to

Nishimura and Yamano (2008) this initiative brought a dramatic increase in primary school enrolments from 47% in 1963 to 115% in 1980. Unfortunately, after the global oil crisis and the introduction of the SAPs, a cost sharing system was introduced which resulted in a drop of primary school enrolments. Since 2003 primary school in Kenya is free of charge for everyone again. These FPEs have been criticized by scholars (Tooley, Dixon & Stanfield, 2008; Sawamura, N. & Sifuna, D, 2008) as well. However, the introduction of these free primary school programs makes that most Kenyans can read and write. Secondly, Kenya is a former colony of the UK, making English the native language. Since most Kenyans posses these basic skills, cooperation with the investors is easier. Overall Kenyans around Naivasha, primary school is the highest degree of education. Clearly, this degree is sufficient for most tasks, like harvesting.

However, recently some public universities (Egerton University; Jomo Kenyatta University) started to offer specialized programs to train people to work in this particular sector. Clearly, these schooling programs are currently only accessible for people with sufficient schooling and resources and are a result of the presence of the sector around Naivasha. Despite this, additional schooling to increase managerial and business skills for this particular sector along with the practical skills transferred by the investors, increase the chances of Kenyan people running this sector, without the foreign investors in the future.

Another result of the presence of this sector is the population increase around Naivasha. With the growth of the horticulture sector in the 1980s, the population in this area increased significantly. Along with this sector and population growth the pressure on the land increased as well. The consequences of this increased pressure will be discussed in the next paragraph. The interconnection between the sector and the population correspond with the study of Ramasamy (2010), who argues that low wages should attract FDI, especially in labour-intensive industries. However, when a country is able to offer specialized labour, the costs tend to be less important. The presence of skilled labour offers the investors to strengthen the ownership advantages they posses and adapt these to the local environment using local talents. According to Ramasamy (2010, p. 581) this would allow them to expand their market in the entire region.

This is clearly the case in Naivasha. Compared to other East-African and especially East-Asian countries the labour costs are relatively high. However, since the people in the area around Naivasha are specialized for the horticulture sector, the competitiveness of the investors increases, making this area the ideal place for this investment.

Higher education and university degrees are of even greater importance to the service sector. Around Nairobi many people completed secondary school or are in the possession of a university degree. Since many employees need to work with computers and have organizational responsibilities this is an important asset to the service investors. Noorbaksh, Paloni and Youssef (2001) confirm that the presence of these relatively new technological advances and FDI shift

towards more capital, knowledge and skill-intensive industries become increasingly attractive for investors.
Several investors also argue that the English language and the general motivation of the workforce are of great value to their firms. Many respondents have experience in working with or in neighbouring countries. These investors argue that Kenyans are pro-active and pleasant to work with, especially compared to the employees in neighbouring countries. Table 2.3 shows that the share of people employed by the service sector is small in comparison the horticulture sector. However, the service sector requires a more specified labour force and pays higher wages.

The second motive for investing in Kenya for both sectors is resource/asset seeking as well. The availability and structure of the infrastructural network is a positive aspect for both the horticultural and service sector. Like already mentioned in the introduction of this chapter, there is some overlap between the investment motives and locational preferences in some cases. In the development of the infrastructural network the overlap is very obvious. For the respondents in horticultural sector the development of this network is a motive to invest in Kenya specifically. For the respondents in the service sector, the development of the infrastructural sector is one reason to locate in Nairobi specifically. Companies in the service sector are generally small-scale and flexible. Therefore they can be located in several places, since they are not depending on aspects like the climate. The main activities of these service investors are the provision of funds and technical assistance, exploitation of restaurants, hotels and travel agencies, and introducing insurance projects. Given their relative small-scale in combination with the businesslike characteristics, most companies need to be located in office buildings in Nairobi. These demands stem from being located near clientele, competition and supplies. Additive demands are the availability of Internet and being in range of airports.

Before elaborating on this motive, the meaning of the concept “infrastructure” needs to be understood. In some literature about FDI, the role of infrastructure includes the development of the healthcare and education system. In this study the education and healthcare system are separate issues and the infrastructure is limited to roads, ports, railways, airfreight and the communication network, including electricity.

The development of a good infrastructural network is not to be underestimated. Whenever companies, who intend to move to developing countries to take advantage of lower labour costs, have to deal with higher transport costs and disrupted service due to inadequate transportation, they will choose not to move (Khadaroo, 2010). In 2007, the wages and the costs of transportation made up 40% of the total costs in the horticulture sector (Snapshot Africa-Kenya, 2007, p. 18). It is more than likely that these numbers have grown in the past years. These costs are probably even higher in the Netherlands. The horticultural investors left the Netherlands because the production costs surpassed the eventual profits. Additional costs in the Netherlands include the central heating of greenhouses, higher costs of land and properties and higher wages.

The horticultural investors in Kenya stress the importance of the infrastructural network repeatedly. Their products need to be transported immediately after harvesting. Cargo transports need to be fast and reliable, because the speed of the transportation determines the vase life of the product, and therefore the price offered to the producers (Whitaker & Kolavalli, 2006). Kenya offers the best road and airfreight system of the entire East-African region. Especially after the election of Kenya's current president, the improvement of the infrastructure has become a bullet point on the agenda. The president stressed the importance of a good network at numerous occasions and argued that infrastructure development remained his government's priority in promoting the country's economic growth (Kenya Private Sector Alliance, 2010). The investors argue that even though there is still room for improvement, many promising changes have been made these past years. Especially, the transportation from Naivasha to the airport in Nairobi and the shipment of the products to Europe are well organized. The development of the infrastructure has for some investors been amongst the initial motives to invest in Kenya. Since the country is front runner in terms of the development of the necessary infrastructure they choose Kenya instead of Uganda or Tanzania.

When looking at the future some investors are anxious about the rising transportation costs. At first, the increased air travel for tourism resulted in lower prices for airfreight to Europe. Unfortunately, the transportation costs have been rising, due to rising oil prices. Subsequently, East-Asian countries offer cheaper transportation from and to Europe making the business and leisure climate more attractive. Respondents argued that this resulted in a relative decline of flights to Europe, which drives up the transportation costs even more. One investor argued that the low capacity of airfreight made the transportation costs rise with 20% in the low season of 2009.

The third and final motive for investing in Kenya differs between the two sectors. For the businesses in the service sector Kenya is attractive because it is an up and coming market and there are numerous possibilities for foreign investors. Table 2.1 classifies this motive as a market-seeking motive. Since most these investors are involved in micro-financing, insurances and hospitality, access to the local market is important. The majority of the investors decided to invest abroad for the opportunities this up and coming market had to offer. Kenya, and Nairobi specifically, is regarded as a growth market. Unlike the horticulture sector, the decision is not based on lack of opportunities in the Netherlands.

Kenya has a lot of potential for the business life. Respondents argue that Nairobi already developed itself as the hub of East-Africa for expats. One hospitality investor argues that: "There are a lot of foreign companies and other investments in this country which proves the stability of the country. There is a lot of variation in the country with a pleasant population."

The investors in hospitality are especially drawn to these expats and tourists, since their service is specialized to the needs of foreigners and upper-class people. For the investors in financing and insurances the presence of other companies and highly educated people is important. Since the people in Kenya are relatively high educated cooperation is easier, making the country ideal for this type of FDI.

Related to these opportunities is the diversification of the Kenyan market which is reflected in the variation of services present in the country. According to the investors it is the combination of different opportunities in various fields that makes the country attractive. This becomes visible when the different respondents and the fields they work in are analyzed. The respondents are all classified in the service sector, even though there is a broad spectrum of activities in which the investors are involved. Striking is how, despite the diversification of activities, the motives for investing in Kenya are similar.

In the horticulture sector the third motive is market seeking as well. Many investors argued that the organization and licensing system of the country is a main motive for choosing Kenya. This system is especially attractive compared to the Netherlands or the EU by extension. The licensing system of Kenya and the main challenges in obtaining them will be discussed in the next paragraph. However, since the organization is the third investment motive for the horticulture investors the positive experiences in comparison to the international market will be discussed here.

Most products produced within this sector are exported to other countries. The EU is the main importer of Kenya's fresh horticultural products with countries like the UK, The Netherlands, Germany and Belgium leading the way (Snapshot Africa-Kenya, 2007). Over the years several policies have been designed to increase the contribution of agriculture to the economic development of Kenya. Horticulture, being a part of the agricultural sector, profited widely of these reforms. Since the 1980s increasing emphasis was placed on this sector when state interference was reduced and the solubility in the liberalized market increased.

The government also extended various tax incentives like elimination of duties on agricultural exports and a zero-rating policy of all imported inputs used in the sector (Ronge, 2005).

Since almost all products in the sector are designated for export, these incentives help to regulate the costs per unit. Not only are the investors exempt of paying taxes over the exported products, they are also able to produce cheaper products since necessary resources, like fertilizer, are duty free. The biggest issue is the regulation system put in place by the EU. Despite the accommodating rules of the Kenyan government towards exports, the EU has high standards for imports coming from outside the EU. In order to import horticultural products into the EU, a company has to meet various standards. All products need to be supported by various certificates, licenses and documents. Examples show that these regulations often have negative consequences for small-scale companies and local farmers, since they are unable to meet all necessary requirements. One horticultural investor in particular described how his company, after new rules were implemented, was forced to end cooperation with several small-scale Kenyan farmers. The requirements and standards are set too high for these local farmers, and they are unable to meet them. In order to meet the requirements the investor currently cooperates with several large, international farms. These farms have the necessary resources to meet the standards set by the EU. Only this way the investor is able to export sufficient products to stay in business. This example shows just how interconnected the global market is. Obviously, the host government has to put the right regulations in place. However, even when the right regulations are in place, the international market can still affect these developing countries negatively.

§ 4.3 Location horticulture sector

According to the World Bank (2006) report on Kenya, Europe is the main importer of Kenya's fresh horticulture products. After observing the region it became clear that Naivasha was preferred by this sector, especially for growing flowers. The report states that flowers account for 53% of horticulture export volume in 2004, followed by vegetables (35 %) and fruits (12%). The top three of foreign investments in this area are from major flower producing countries, including the Netherlands. The investment policy review (2005) states that the horticulture sector in Kenya is the world's leading exporter of high-value products to the European market.

The analyses of the interviews showed that two locational preferences are linked to each other and that the third can be seen as a consequence of the first two. It became clear that these preferences are mostly unanimous throughout the sector. Except for two respondents, all farmers are located around Lake Naivasha. The locational preferences of the other two differ slightly from the others. These differences will be discussed when necessary in the relevant section.

The most important reason for flower farmers to locate themselves near Naivasha is because of the agro climatic situation of the area. Naivasha lays 1.890m above sea-level and has a semi-arid climate. Specifically, the annual rain distribution varies from 600mm to 1700mm, depending on the specific location, and the temperatures are persistent between 7 degrees at night and 22 degrees during the day. This climate offers the best circumstances for the natural production of roses. The production of flowers is highly depending on the right agro climatic conditions and may be damaged by stresses like high winds, rain and pests or diseases. Occasionally, the pests and diseases have been mentioned as threat to the sector. However, this threat is not locational bound and can occur anywhere.

The farmers argue that especially the altitude is important for producing a good product. Because of the altitude the maximum temperature during the day range between 24^{0}C to 28^{o}C and the minimum temperature range between 15^{o}C to 18^{o}C. The climate enables them to produce the entire year and is especially important to farms that produce roses. Some respondents argue that for their production, for instance chrysanthemum, a lower altitude is preferred. Clearly, when basing a decision on the best combination, not all preferences can be met. Another aspect of this area is the availability of space to the investors. The lake covers about 140 km^2, creating sufficient space to expand properties when necessary.

Outstanding in the analyses is how the locational preferences between the respondents in different areas correspond. The two farmers outside Naivasha also choose their location, close to Nairobi, for the agro climatic characteristics of the area. Because of the higher altitude the temperature is lower. Therefore it is easier to produce perennial plants, instead of roses.

Space on the other hand is a problem in this area. Approximately a decade ago Nairobi started to expand rapidly, increasing the pressure on the land. This expansion could have drastic consequences for these companies, in the future.

Closely linked to this first locational preference is the availability of water. The production of all fresh products is highly depending on the supply of water. Without the availability of fresh water, the sector could not persist. The water of the lake is used to irrigate the crops produced at the foreign farms. Several farmers argued that the presence of the lake is less important than asserted. These farmers use boreholes and the intake of rainwater to irrigate their products. These methods are also applied on the two farms outside Naivasha.

Over the past years the sector also attracted a lot of negative attention from the media and the international community. The essence of this critique, along with the hydrology of the lake will be discussed later on.

It is important to stress the combination of these two locational preferences. Analysis showed that it is the combination of agro climatic characteristics and water supply that made the investors chose Naivasha. Overall, there are several micro-climates throughout Kenya. These climates vary from tropical and humid at the coast, arid in the interior to warm and rainy in the east near Lake Victoria. On top of these various climates the altitude varies from 0m in the Indian Ocean as the lowest point of elevation and the highest point being Mt. Kenya at 5.199m.

These differentiations make that a single locational preference can be found in several areas in and outside Kenya. For instance, in Uganda around Kampala and Entebbe the climate is already perfectly suited for the production of sweetheart roses. Since these areas are situated at a lower altitude then Naivasha the climate is not suited for other types of roses. Still, if the government would invest in roads and better transportation leading to the higher situated areas the competition with these might increase, since the areas would become more attractive to investors. The combination of both the agro climatic situation and the availability of water make Naivasha unique and therefore attractive for the investors. However, long-term improvements are necessary. Especially with the reinforced debates about water management.

It is estimated that around 60 percent of the country's flower industry is concentrated around Lake Naivasha (Becht & Harper; Bolo). This development is for many investors the reason to be situated close to the lake as well. Many investors argue that being close to the other investors is vital. Several investors are active in licensing and selling new types of roses to the big farms. For these investors being close to the big farms means being close to the market.

The area developed into being the horticulture area of Kenya and East-Africa by extension. Consequently, a lot of expertise and information is already present. Analyses showed that the main information source used before investing in Naivasha was the sector itself.

It is argued that before starting the business, every investor should undertake two steps. First, the investor should have some informal meetings with the investors present in the area. Second, a local accountant and lawyer should be hired to take care of the legal issues.

Information is often ill-defined and imprecise, making it harder to meet certain requirements. These requirements are met by the present investors already; therefore cooperation is at the core of a successful corporation. The importance of cooperation becomes especially clear when visiting the farms. Only a few operate alone. Most farms are active within designated areas, renting plots from bigger corporations and using their expertise and licenses. One investor describes this cooperation in detail. He argues that: "leasing a plot and cooperation with three other investors brings with it a lot of possibilities and answers. Starting a business is complicated because it comes with numerous bureaucratic hurdles. Working together makes dealing with these hurdles easier. After 8 years the land becomes your property. This timeframe offers sufficient time acquire the needed knowledge to run an individual business." Other investors argue that applying for (water) permits is easier, when the plots are bigger and it is easier to protect the plots when there are more investors involved. In these cases cooperation is especially of a practical nature. Cooperation in this area offers a certain protection and makes operating in a foreign country easier.

Obviously, this third locational preference, the concentration of knowledge and competition, is a consequence of the prior two. Without the specific agro climatic characteristics the sector would be located elsewhere, making the third preference irrelevant for Naivasha. Naivasha has several distinctive features which are ideal for the horticulture sector. The area surely benefits from the presence of the sector. In terms of technological spillovers the area benefits in numerous ways. The UN (2005) estimates that the farms in this area invested around $50.000 per hectare to set up the right facilities. These facilities include land preparations, setting up irrigation systems and greenhouses, building refrigerated storage and wellness facilities for the staff. On top of that the

communication technologies are improved by companies to ensure that products reach Europe within 24 hours (UN, 2005).
All these techniques and facilities are of great value to the sector, but to Kenya as well. These types of investments mean that the investors intend to stay for a long period, in which case the local people have guaranteed jobs and learn the right skills. The investors themselves argue that besides from investing money, they build secondary schools for the children of their employees, they pay the wages of the teachers, provide all care for the employees, donate money to HIV clinics, maintain the roads around Naivasha, train people to work in the sector and offer housing to the employees. That FDI can have such positive effects on an area gets confirmed by the FDI expert in the Netherlands. He quotes an example of a horticulture farm that is still in the hands of a Dutch investor. However, all functions are filled by local people, who run the company entirely. The only role this Dutch investor plays is sending a consultant on a regular basis to communicate with the local managing director.
Unfortunately, there are aggrieved parties as well. Foreign as well as local investors and the effects on Naivasha have been criticized various times. The negative consequences as well as the critique will be discussed in the next paragraph.

§ 4.3.1 Environmental impact horticulture sector

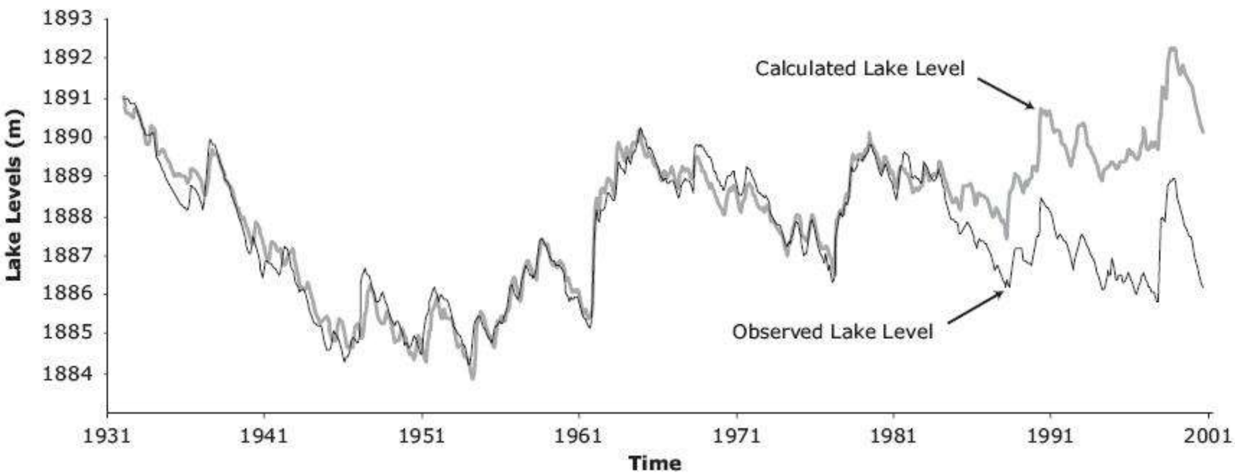
Above paragraphs focused mainly on the choices of horticulture investors to invest in Kenya and described the positive characteristics of Kenya. After finishing the research in Kenya it became clear that there is some critique on the presence of the horticulture sector. After studying the literature (Becht, 2002; Loukes, 2008; Smith, 2009) and consulting with an expert on the environmental impact it was decided that the critiques should be mentioned in this study.

One marginal note should be placed before discussing the impact of the horticulture sector on the ecological situation of Lake Naivasha. At the time of writing there was no organized data on the suggested impact on the ecology. Several studies have been conducted, by several interested parties (Becht, 2002, 2006; Harper e.a. 2009; Verschuren 2000). These studies have only been covering certain fields of interest to the parties concerned. Therefore it is not always easy to determine whether or not the build-up and results of such studies are biased. Currently, a group of researchers is active in studying the relationship between all these fields. This group is trying to design a complete overview of the water system. Also, this group tries to determine the impact of the horticulture sector and they are trying to determine the severity of this impact on the environment. This study needs to be completed before the statements can be verified. The water allocation plan will serve as guideline for this paragraph, along with the expert interview and some of the older studies.

The main reasons for critique are the decline in water levels and the impairment of the water quality. Lake Naivasha is made up by four distinct basins that are all connected by surface and by groundwater seepage. Any water level fluctuations that occur are visible in all the basins. Throughout the years the lake has experienced large changes in water levels, mainly caused by climate change or heavy weather events.

The hydrology of Lake Naivasha consists of a complex system and is depending on water-influx and reflux of the whole of the Rift Valley. Responsible for the water supply of the lake are on the one hand rainfall and on the other two perennial, which means continuously flowing, rivers. The drainage on the other hand is not so clear. Partially responsible for the drainage is one river on the east side of the lake. However, this stream is ephemeral, meaning that it only flows a couple of months a year. Another important factor is the groundwater. Overall, groundwater plays an important role, especially when studying the reflux or leakage from the lake. Unfortunately, there is no completed study about the construction of the groundwater system surrounding the lake. Nevertheless, Becht et al, (2002) argue that groundwater plays a more important role than realized by many of the stakeholders. Another important source of water outflow is evaporation and the increased pressure on the land. The evaporation of water in Lake Naivasha accounts for about eighty percent of the water loss (Loukes, 2008, p. 22). The Kenyan population is estimated to grow with almost a million people a year. This increases the pressure on the land substantially. This increase is especially visible in already highly populated and prosperous areas. The expected impact of this increase on the two horticultural investors near Nairobi is already described. The impact of the increase around Naivasha will be discussed later on in this paragraph.

Figure 4.1: Water levels Lake Naivasha



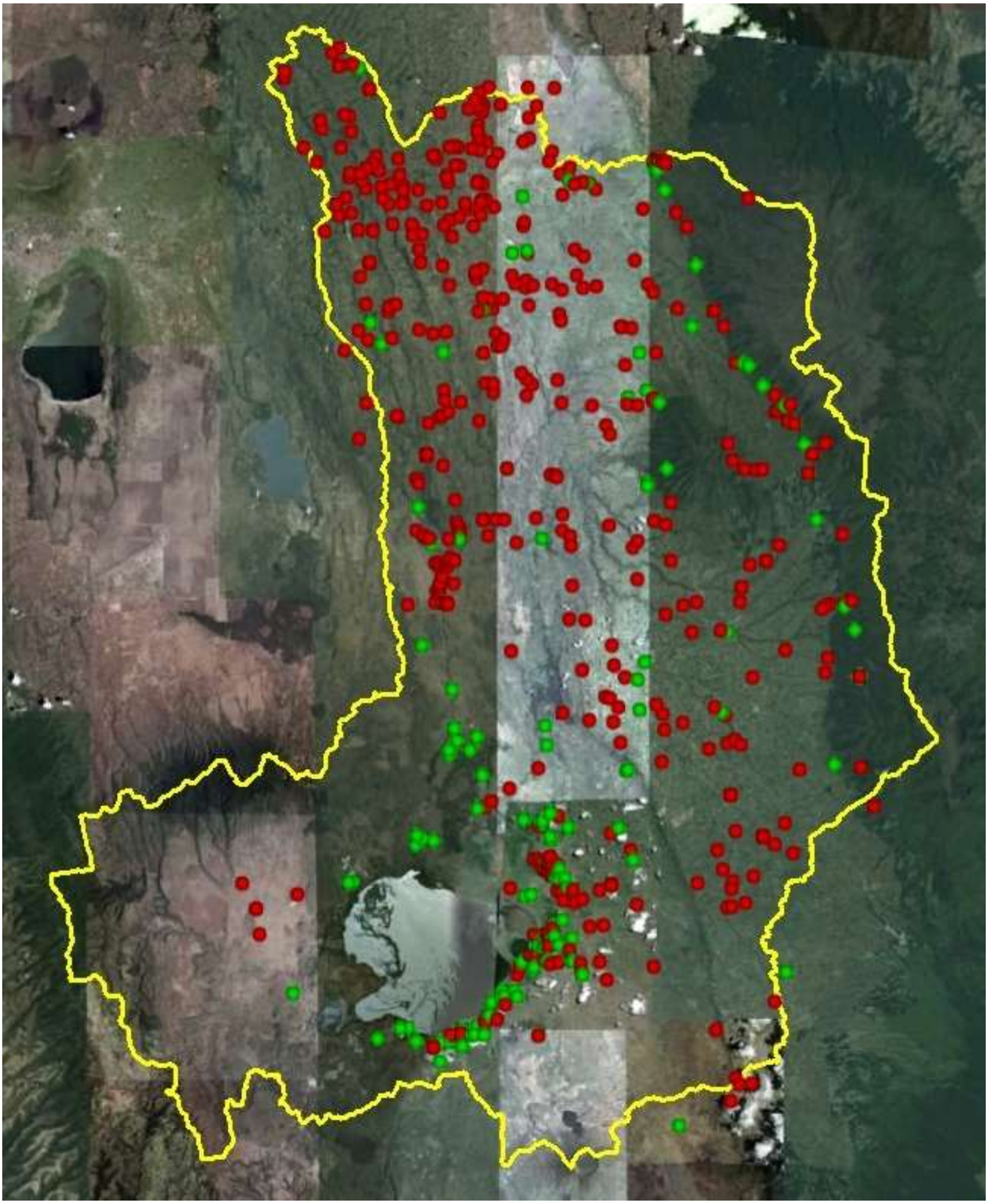
Source: Becht, Odada & Higgins, n.d.

The fluctuations of the lake are displayed in figure 4.1. The figure not only shows the observed water levels between 1931 and 2001, but also the water levels calculated by a model designed by ITC. For this period the model was able to reproduce the water level almost accurately. Up until 1982 all calculated lake levels differ less than 0.52 meters from the observed levels. The changes after 1982 are the most striking. The decline after this year corresponds with the onset of the horticultural activities in the area.

Whether or not the fluctuation of the water level has severe consequences for the ecosystem is yet to be determined. Fact is that the ecosystem is a home to many bird species, papyrus fringes, different types of mammals and a lot of fish and crayfish. On top of that it supports important economic activities like horticulture, tourism, livestock production and power generation. Finally, it is the home of many Kenyans of various tribes (WRMA, 2010). All these groups are directly or indirectly affected by the environmental changes. Verschuren (2000) studied the fluctuations of the lake over 1000 years and identified four periods in which the lake was almost entirely dry. After these dry spells the ecosystem seems to have flourished again. Clearly, the horticulture sector was not active in this area during these periods. Therefore, the sector is not held responsible for these occurrences prior to 1982. This suggests that other factors are influencing the water fluctuations as well. However, as shown in figure 4.1 the sector is accountable for the intensified process after the 1980s.

After consulting an expert on the hydrology of the area it became clear that not only the direct extraction of water from the lake is causing a problem but that extraction from its feeding rivers and groundwater is adding to the decrease of water levels as well.
The problems with the horticulture sector and the declining water levels are not only from the direct extraction of water for the crops. As already described two rivers and the groundwater feed the lake. Several farmers pump water directly from the rivers or groundwater, before it even reaches the lake. This method affects the lake indirectly, because a decline in water supply also leads to a decline of the overall water level. The eventual impact of this extraction is not clear yet, but if the extraction continues on the current rate it is expected to be disastrous. The WRMA (2010) argues that the combined impact of high (and as yet unlimited) abstraction, high nutrient loading, loss of aquatic vegetation (due to introduced species) and loss of terrestrial lakeshore vegetation has resulted in lower lake levels and a higher risk of the lake becoming eutrophic (p.1). Currently, there are some methods put in place to stop this unlimited abstraction of water. Investors argued that all farms need to apply for water permits which grant them permission to abstract a limited amount of water from the lake. All investors claimed to be supportive of these measures, since constant water availability is a known problem and has been considered a risk by most investors prior to the investment.

Figure 4.2: Abstraction points Naivasha basin



Source: Field survey WRMA 2010

Overall, the investors claimed to possess such permits, which in most cases was argued to supply them with enough water. When comparing these statements with figure 4.2, some irregularities show. Figure 4.2 provides an overview of the Naivasha basin. In the figure all legal (green dots) and illegal (red dots) water abstraction points are displayed. The figure is the result of a 2010 field survey by the WRMA. The amount of illegal boreholes and abstraction points displayed in this figure is almost double the amount of legal ones. The only aspect missing in figure 4.2 is a clear indication of which boreholes belong to what individuals. The figure provides an overview of the total amount of (il)legal boreholes, belonging to both local as foreign investors. Nevertheless, these illegal abstraction points affect the environment severely and figure 4.2 explains the falling water levels to a great extend.

Another factor contributing to the increasing environmental problems is the rise in population around the lake. The population of Kenya stood at 35 million in 1997 and is rising with an estimated million people a year (Everard & Harper, 2002 p.193). Since Lake Naivasha is one of the most prosperous regions in Kenya with numerous employment opportunities in power generation and horticulture, the increase is especially visible here. This rising population has led to an increased pressure on the water supply of the lake and the lakeshore. Overall, the increased pressure manifests in illegal fishing, cattle defecation, degradation of papyrus, and water pollution. (Harper et.al. 2009) The declining water levels could partially be caused by this increase as well. Secondly, the rising population results in increased tension between local tribes, investors and the rest of the population. Partially, the people live close to the lake because the foreign investors offer employment opportunities. However, before this sector started to grow, the land was home to several tribes and their nomadic way of life. Due to the growing firms and the growing towns of employees, these nomads are pushed of their lands and have to reside, with their cattle, to less fertile lands. Secondly, the access to the lake is limited because large farms block the passage, making it harder for these nomads to obtain sufficient water.

Overall, these critiques against the environmental impact of FDI are often raised by anti-globalization scholars. These intellectuals argue that FDI merely embodies a “race to the bottom” in wages and long-term environmental damage (Smith, 2009; Stiglitz, 2000) Undeniable, the ecological problems of Lake Naivasha are alarming. Future studies are necessary to determine the long term consequences and the impact of horticulture on the environment. Nonetheless, it is not to assume that the overall intentions of the farmers are wrong. The present farmers make long-term investments into the area and benefit from a healthy ecology. This healthy environment contributes to the quality of the products. The increasing pressure from the international community on fair-trade products makes a healthy environment a must. Still, this assumption alone is not sufficient to ignore the problems that are going on. The data provided by the WRMA (2010) alone is reason enough to criticize some of the activities in this area. FDI can be beneficial to a country, but it should not undermine the rights of local people or the environment. The pushing away of local people by investors and employees from elsewhere, is wrong in every aspect. Secondly, the environment should be made a priority to everyone involved. The main aim of all investors in Kenya is to make profits. The horticulture investors came to Kenya for several reasons. The main reason is the making of profits by selling agricultural products. Another, additional reason was to get around certain rules. The Netherlands have such rules for a reason, and that is to protect the environment. This should also be respected in other parts of the world.

§ 4.4 Location service sector

Throughout the years there has been a significant shift towards service FDI in developing countries. The world investment report (2005) states that in 1970 services FDI accounted for a quarter of the global FDI stock. This share increased to about a half in 1990 and in 2005 the share rose to nearly two-thirds of the global stock (Ramasamy, 2010).
Ramasamy (2010) states that in the service FDI literature there seems to be a lack of focus on this type of investments. Reasons for this are twofold. First, the literature about determinants of FDI seems to focus on manufacturing. Often, services FDI is regarded as a part of this sector and therefore not described separately. Second, when trying to define the determinants for services FDI scholars tend to focus on the sector-specific preferences, like the needs for banking or insurances. When comparing the basic information of the respondents with the statistics above, the numbers get confirmed. All companies started operations in Kenya within the last 8 years. The first and second investors came to the country in 2002 and 2004 respectively. All others came between 2006 and 2008. Note that these are the years in which the firms started doing business. Many of the investors where already living in Kenya or elsewhere in Africa.

Different from the horticulture sector the investors in the service sector are mainly interested in the local market. Their businesses are hardly affected by the weather or climate and therefore location is of particular interest to them in terms of access to local connections.
With the exception of one investor, all respondents own a business close to Nairobi. The main reason for this is that Nairobi, especially in comparison to other African cities, developed itself into a central hub.
Even though the activities in which the respondents are involved vary distinctly, the demands and needs for a location seem to be consistent. Some of the respondents are active in financing and their main activity is the provision of growth capital to local entrepreneurs. The capital provided by

these companies contributes to the profitability, sustainability and economic growth of the local companies in which they invest.

Generally, the investors provide capital for Kenyan entrepreneurs but all respondents express an interest in other East-African countries. Since these countries lack the infrastructure, especially in terms of phone connections and the Internet, the investors choose a central location, namely Nairobi. Subsequently, these investors cooperate with local businessmen in the neighbouring countries, who provide the necessary information.

Other investors are active in the tourism and leisure business. These investors provide a high-end service and need to be close to a certain clientele. Nairobi is not only a hub in terms of location. Part of its status is acquired through the presence of expats in combination with the highly educated local population. These businesses provide trips, safaris, transport and accommodation for both tourists and locals that generally arrive in Nairobi. Also, most embassies, the United Nations office and several international banking and insurance firms are located in this city. These firms are accompanied by expatriate workers from the entire world. These expats are the target group of many investors, active in hospitality and tourism.

Related to the attractiveness is the connection of the city to the rest of the world. The presence of Jomo Kenyatta International Airport simplifies travelling from and to Europe and the rest of the world. This airport, situated at 15 kilometres of the CBD in Nairobi, is the 6^{th} biggest airport in Africa and the busiest airport in entire East-Africa. In many cases the firms in Kenya have a main office elsewhere. Being located nearby an international airport enables partners to visit the firms in Kenya.

Related to this aspect and partially responsible for the popularity of Nairobi is the development of the rest of the infrastructural network. The connection of the city to the rest of the country and the world is already discussed in a previous paragraph. The development of the infrastructural network was an important investment motive for the horticultural sector. For the service sector this development is important in terms of locational preferences. For these investors it was an important reason to choose Nairobi. The network is a plus in terms of Internet connections and flights to and from Europe. Many firms are depending on these connections and need to stay connected in order to maintain their activities. Outstanding are the concerns many investors raised about the traffic and the infrastructure directly in Nairobi. The road and airfreight network are a positive aspect of the country for the horticulture investors. For the service investors the road network in particular is reason for concerns and described as an improvement point. These concerns will be discussed in the next chapter.

The biggest reason for choosing Nairobi over other cities in East-Africa is because of the potential and expectations. Obviously, when this image persists more foreigners will invest here in the future. Most investors indicate that other foreign investors are the most valuable information sources for new businesses. This indication concurs with the horticulture sector. The investors argue that it is important to look around before starting up a business. Many of the investors lived in Kenya for a couple of years before starting the business, familiarizing themselves with the bureaucracy and procedures of doing business. One service investor clearly states that: “before I started this business, I looked around in Kenya for two years. This turned out to be vital in starting up a successful business, because it takes time before one can overcome all bureaucratic hurdles. One advantage is the relative small size of the market, which makes it easier to meet the other investors in the field. Within the personal and professional network there is a lot of expertise about the inner workings of the country. One investor states: “networking is the most important thing. You can learn a lot from talking to other people. A lot of Dutch people are located in Nairobi. These people can help you.” Analyses shows that the information stems from a combination of international investors in the related field and from fellow countrymen, who are often part of the informal network. After the business is initialized these information sources transform into healthy competition.

One extra activity in which some service investors are involved in is the breeding of cows and the production of milk for the local market. Theoretically this is an agricultural activity. It is mentioned here because the main activity of these investors is still service sector related. The breeding of cows is more a side interest. Compared to other East-African countries, Kenya holds the largest herd of dairy cattle. Kenya is generally self-sufficient in terms of milk and dairy production, except in periods of extreme drought (Omiti, et al, 2008). Due to policy regulations and national development goals in food security, employment and income regulations, the dairy production and marketing have changed in the last years, attracting the foreign and the private sector to invest in this sector. Especially the Holstein-Friesian cows are popular among the foreign investors. Reason for this popularity is the increased demand of dairy products due to the higher population pressure. These cows in particular are known for their good milk production but not considered to be well suited for the harsh conditions in Kenya. This activity is not necessarily related to the locational preferences of the investors. However, involvement in such extra sectors shows the long-term commitment these investors made to the country. The local population can learn from the methods of breeding and maintaining cows, which can be seen as an extra beneficial spillover.

§ 4.5 Obtaining licenses

This paragraph will focus on the various steps investors need to take before they can start an operation. Part of this analyses is the comparison of the findings with other studies and literature, like the World Bank report (2011) and the work of Daude and Stein (2007). The study showed that obtaining licenses became easier throughout the years. The findings of this study are compared to the Doing Business Report 2011 in order to determine the international status of the country and to provide some statistical data for Kenya. Closely related to the licenses system is the tax-system. This system will be discussed in the next chapter since most investors cite that this system needs to be improved.

The World Bank annually presents a report in which the ease of doing business for each country is discussed. Kenya ranks 98 out of 183 global economies in 2011. In comparison to its neighbours the country scores acceptable. Only Rwanda surpassed Kenya by ranking 58 out of 183 economies. The next country after Kenya is Uganda, which ranks 122.

The investors argue that the licensing system improved significantly throughout the years. Simultaneously, the horticulture investors argue that the number of licenses needed to start a business increased. Especially the number of environmental licenses and water permits increased and inspections are stricter than before 2006. This increase is partially the result of the related negative impact on the environment, already described in paragraph 4.3.1. Contrary to the horticultural investors, the service investors argue that obtaining the majority of the licenses is relatively easy. The hardest license to obtain here is the work license, which needs to be renewed every two years, causing pending insecurity. Before being able to work in Kenya, expatriates have to issue a request for a work permit. Since these permits are valid for only two years, investors have to apply for them regularly. The fees for obtaining a work license are Ksh 50.000/= per year and are only issued after several other requirements, like proof of landownership, are met. The general consensus is that the business climate of Kenya improved throughout the years. This analyses corresponds with the recent findings of the World Bank (2011), which state that the process of starting a business retrenched.

Table 4.1 is put together by the World Bank and shows the bureaucratic hurdles an investors must overcome before starting a business in Kenya. It shows that the number procedures only declined with one. The total time in days needed to register a firm declined with 11 days. This means that, on average, in 2008 applying for one license took about 4 days per license. In 2011 this declined to 3 days a license. The costs, recorded as a percentage of the economy's income per capita, declined from 46.1% in 2008 to 38.3% in 2011.

Table 4.1: Historical data: ease doing business in Kenya

Starting a Business data	Doing Business 2008	Doing Business 2009	Doing Business 2010	Doing Business 2011
Rank	..	..	126	125
Procedures (number)	12	12	12	11
Time (days)	44	30	34	33
Cost (% of income per capita)	46.1	39.7	36.5	38.3
Min. capital (% of income per capita)	0.0	0.0	0.0	0.0

Source: Doing Business Report 2011 (World Bank)

Several investors argued that it is relatively easy to obtain the necessary licenses when you have access to money. This statement corresponds with the report of the World Bank. Only 4 out of the 11 steps are free of charge. All other steps require a payment, pending between Ksh. 100 to Ksh. 3.500. Once a business is established the licensing procedures get easier. All in all respondents are content with the way procedures improved and none are thinking of leaving soon. All respondents made some suggestions about future improvement points, which will be discussed in the next chapter.

One big improvement is the reduction of ministries involved in the licensing process. In 2004 the government introduced the KIA, to centralize the investment procedures and to cut all unnecessary processes. Before the introduction of this authority investors had to visit all different ministries and local authorities for all the different licenses. The main objective of the KIA is the promotion of foreign investments. The authority is mainly responsible for offering assistance to new and established investors in obtaining the necessary licenses and permits. One of the remaining problems on the other hand is corruption. Since the problems with corruption are reoccurring throughout the entire process of starting and managing a business, it is mentioned here. In the next chapter the problems with corruption will be described in more detail.

One phenomenon often presented in developing countries are certain incentives offered by the government to attract more FDI. The Kenyan government often offers fiscal incentives, such as tax holidays and reduced tax rates, to investors. Most incentives are presented to companies that are located within an Export Processing Zone (EPZ). In the last decade, trade liberalization, through regional or global free-trade agreements, was seen as the answer to economic development in developing countries. The EPZ initiatives are an example of such a free-trade agreement. The main objective of these zones, the promotion of export and stimulation of FDI, makes them different from other types of free zones. The main feature within the zone includes a 10-year tax holiday and the removal of import tariffs on production inputs, which otherwise serves as an disincentive to export-oriented production (Rolfe, 2004). According to a board member of the EPZ: Athi River, there are currently 40 EPZs in Kenya which involve 99 companies.

Throughout the years a lot of scholars expressed critique about the contribution of EPZs to economic development (Rolfe, Woodward & Kagira, 2004; Büthe & Milner, 2008). This critique is part of the even bigger discussion about the contributions of FDI in economic development and already discussed in chapter 2. Wages of the (un)skilled production workers, at spot exchange rates, are higher in Kenya than all neighbours and strategic competitors (World Bank, 2004). In fact, real wages have doubled or tripled since 1994, whilst the productivity has remained stagnant. These rising wages have resulted that most investments in the EPZ are short-term and footloose. Generally, footloose plants result from short-term direct investments that are not rooted in the local economy through supply or demand linkages (Caves, 1996). These footloose investments make that all the money coming into Kenya does not spill over, leading to temporal economic development not reaching the rural population, excluding them from this process and increasing the gap between the urban and rural population.

The investors in this study were not offered any incentives since most of them are not located within an EPZ. Several investors cite that certain incentives would make the investment climate more attractive. Overall, incentives are argued to make a desired country more attractive but are not enough to persuade a company into investing abroad. Investors stated that the investment motives of the company matter along with the development of the locational strong points. The board member of the EPZ Athi River argued that most Dutch investors are rarely interested in cooperating with an EPZ because they are mainly active in horticulture. By law, agriculture is not allowed within an EPZ. Thereby, enterprises located within an EPZ have to be focused on the export of products. Only 20% of the production is allowed onto the local market. Obviously, the service investors are not active in the production of goods nor in exports and are therefore located outside an EPZ. At the time of writing only one respondent has a hanger and packaging office on an EPZ. This respondent argued within this EPZ the licensing procedures are well organized and the board offers assistance in applying for the necessary permits. According to the board member of Athi River, it takes between 3 and 8 months to complete the application process. This depends on the activity the investor is involved in. Overall this time is acceptable but not at all convincing. Analyses showed that the licensing procedures of all investors took between two months and one year. Compared to the EPZ this is not significantly longer. The EPZ can only make the whole procedure less difficult since it is familiar with the procedures, but this first needs to be examined more thoroughly.

Within the horticulture sector the environmental permits, issued by NEMA, are indicated to cause the most problems. NEMA is established by the Kenyan government as the principal instrument to implement all policies relating to the environment. Especially the water permits, that allow irrigation from the lake, are hard to get. The investors argue that they are in possession of the needed permits which enables them to use water from the lake and to extend their businesses in the next years. At the same time these investors cite that it will be hard for new companies to receive the needed permits. Without these necessary permits it will be impossible for any new company to locate themselves nearby the lake. Every company applying for a water permit needs to conduct an environmental study and calculate what the expected impact on the ecosystem will be. After this report is handed over it can take up to a year before the permit is distributed. One year is a relative long period before the licenses are granted, especially since they could also be denied. Still, overall the investors stated to be contend about the new water permit procedure, since they are best served with a healthy environment.

§ 4.6 Concluding on the Strong Sides of Kenya

In contrast to the statement of Dunning (2009), the type of activity in which investors are engaged most certainly influences the locational preferences of FDI. This chapter showed that the preferences of the horticulture investors are closely related to the activity in which they involved and that the comparative advantage of the Naivasha region lies solely in its climatic characteristics along with its position at the lake. The analyses also showed that the role of locational preferences should not be underestimated when trying to determine the reason to invest abroad. Investment motives in this case play a role when the initial decision to invest abroad is made. In Kenya's case the large and educated workforce is important together with the development of the infrastructural network. In both sectors this played an important role. It is even crucial to their firms. Undeniable, the country needs to keep paying attention to these aspects to maintain the status on both issues.

Especially important are the concerns raised by the horticulture investors about the rising costs of the airfreight and transportation of the products. Overall, the country has little influence over the rising oil prices. However, the long-term problems manifest themselves especially when the rising transportation costs are combined with the higher wages of the employees.

Many countries, in East-Asia as well as Kenya's direct neighbours, offer cheaper labour with the same productivity. On the long run this can mean that investors decide to move to a neighbouring country, that partially offers the same advantages. For some horticulture investors the prices are rising even more due to rising land prices caused by the expansion of Nairobi.

This concern is in line with the study of Khadaroo (2010), who argues that whenever companies, who intend to move to developing countries to take advantage of lower labour costs, have to deal with higher transport costs and disrupted service due to inadequate transportation, they will choose not to move. Obviously, the respondents to this study are already active in Kenya, but they can still decide to move. Clearly, the locational characteristics play an important role because without these the firms might have chosen to invest in a different country right from the start. Several neighbouring countries possess the comparable characteristics, but it is the combination of climatic conditions and the access to water that make the investors choose Kenya. In order to maintain the status of preferred investment country for horticultural activities, the country must make concessions to the investors in terms of costs, incentives and especially keep improving the infrastructure.

The future for the service sector has a lot to offer as well. Clearly, Kenya has a status of up and coming market, which attracts a lot of foreign investors. Nairobi in particular portrays stability and safety which is attractive for this type of FDI. Several investors argued that the market is still relatively small, making it easier to accumulate the necessary information.

When the country keeps attracting more service FDI it needs to work on its transparency and the communication of information. In both sectors the investors argued that the Kenyan government is hardly involved in the provision of necessary information and that the available information is often imprecise. This provision starts with the licensing system, which improved significantly the past years.

All in all, a lot of improvements have been made in several areas. However since the competition is high, future improvements are necessary. The next chapter will focus on these improvement points derived from discussion with the Dutch investors.

Chapter 5 Improving the investment climate

§ 5.1 Introduction

This chapter examines the experienced risks related to FDI and Kenya. It will also focus on the general improvement points identified by the investors. These points will help to determine which changes need to be carried through in order to attract even more foreign investors. In the previous chapter several determinants for FDI in Kenya where identified. All of these determinants, even the climatic ones, were economic by nature.

The risks and improvement points consist of a mixture of economic and political factors. These are identified as factors that make the overall investment climate less attractive. Important to note is that all comments come from investors currently active in Kenya.

Paragraph 5.2 discusses the considered risks prior to investing in Kenya as well as the current inconveniences experienced by the investors. Overall, the considered risks followed after the initial decision to invest abroad was made. All investors, anywhere in the world, are confronted with certain investment risks. For example, fluctuation of the exchange rate is a natural economic occurrence. Severe fluctuations can be caused by various unforeseen factors such as political instability, economic depression or a natural disaster. These factors then affect companies regardless of locations or sector. Other risks or inconveniences like corruption and political instability can occur anywhere as well. However, the chance of having to deal with these risks is higher in developing countries than it is elsewhere.

Paragraph 5.3 deals with the reoccurring challenges for investors in cooperating with the KRA. All investors, regardless of sector, identified the KRA as the most corrupt and the most unreliable factor in the investment climate of Kenya. The role of this authority and the effects of the corruption on the investors will be discussed in more detail. This is necessary because improvement in this area would mean a big improvement in the entire investment climate and therefore the international status of Kenya.

Chapter 5 will conclude by describing the general improvement points of the overall investment climate. The problems discussed here are identified by the investors as most pressing and are based on experiences, inconveniences and expected future problems. Since paragraph 5.3 is based on the concluding remarks of the investors there might be some overlap with problems described in paragraph 5.2 as well as chapter 4.

§ 5.2 Risks

Busse and Hefeker (2007) demonstrate that political risk is related to the risk that a sovereign host government will unexpectedly change “the rules of the game” under which the businesses operate. Looking at the host country determinants displayed in Table 2.1, both economic as political stability are an important factor in attracting FDI. When the right policies are in place, they can induce faster upgrading of technologies and skills, raise local procurement, secure more reinvestment of profits, and protect the environment and consumers (UNCTAD, 2003).

Fear of political or economic instability discourages investors to make any long-term commitments to a country and entices them to make footloose investments only. In random order, the three main risks are political instability, according to the investors, are corruption and the (in)stability of the shilling.

The investors in this study are all engaged in long-term investments and many described their future plans. Naturally, some risks are considered before a company decides to invest abroad. However, with the post-election violence in mind and the upcoming elections of 2012, the investors are aware of the sudden changes that could occur.

The three risks identified here are of either economic or political nature. Political instability in this case includes the risk of crime against investors by local people. The instability of the shilling on the other hand is closely related to the stability of the euro and dollar, which makes it an international issue.

§5.2.1 Political instability and violence

The first risk considered by investors is the risk of political instability and violence. Dupas and Robinson (2011) argue that there is a close relationship between political instability and economic growth. This statement makes sense because political unrest increases uncertainty and therefore the risk that investments made by both foreign as local firms could get lost. Often, political unrest merges with social unrest making the country unsafe for the investors themselves.

Before the elections in 2007 Kenya was perceived as a relative stable country, attractive for both investors as tourists. Since independence the country’s economy flourished and, despite minor disturbances, the country was regarded as political stable. Both this economic development and the political stability were two assets that made Kenya the example of Africa for a long time. Most of the investors where already active in Kenya at the time of the last elections. Especially the investors in the horticulture sector argue that there was some tension between employees of certain tribes. When the riots reached the climax, some of the investors were forced to send some of the employees home in order to protect them against the stronger groups. This increased tension and the forced sending home of employees were the most tangible effects the violence had on the companies. Overall, the respondents in both sectors argued that the consequences the post-election violence had on their firms remained to a minimal.

The investors argue that political instability should be considered in every country a company wants to invest in. The investors in the service sector argue that their size is the biggest advantage in terms of future unrest. The relative small size enables the companies to move to another country. During the interviews some investors in both sectors described the upcoming referendum on the new constitution as a test for the upcoming elections in 2012. This new constitution is not considered a great risk and most investors think some dispute is natural. One horticultural investor argued that discussion about the constitution, and the elections by extension, is “inevitable since Kenyans are relatively high educated and therefore capable of forming an opinion.” None of the respondents expects the new constitution to raise any big problems or violence. However, the expectation or fear for violence during the upcoming elections of 2012 differs between the investors. Some argue that the government realizes that new violence will damage the international status to such a degree that they will try to prevent it. Others on the other hand fear that the ethnic divisions and the remaining IDPs are two factors that need to be considered as possible risks. Therefore the upcoming elections, to some investors, are a reason for concern. Fortunately, the new constitution recently passed in the absence of any violence.

Another considered risk for investing in Kenya is the criminal activities in the country. Criminal activities means the general presence of criminal networks or crimes committed against investors. Larossi (2009) shows that crime can add significantly to the costs of doing business in Kenya. These costs arise directly from theft and indirectly from preventing measures like security and protection costs. None of the investors explicitly mentioned additional costs due to bribes or safety measures. However, one horticultural investor explicitly argued that: “as a foreign investor it is a matter of time before you get robbed. There is a lot of violence in this country and you need a lot of security measures. We invested in security people, 5 watch-dogs and electric fences.”
On top of that, the Kenyan police force ranks as the most corrupt organization within Kenya. This means that investors have to bribe many officers to get any service and that this force is just as easily bribed to tolerate crimes. One investor argued that in case of an emergency, a person first has to agree to pay for fuel before the police are able to come. He states that: “there is a lot of harassment from people that do check-ups and from people that control your books. This goes for government officials, police and delivery companies. For example, the police won’t even come if you don’t agree to pay for the gas.” There is significant risk of robbery or violence against the foreign investors, given their wealthy status. Overall, all investors experienced some degree of violence throughout the years.

§5.2.2 Corruption

One factor that has drawn a lot of attention in the FDI literature (Habib & Zurawicki, 2002; Okado & Samreth, 2010; Egger & Winnes, 2006. e.a.) and is listed as an inconvenience by all investors as well is corruption. The occurrence of corruption is no direct risk related to FDI, but it creates a lot of inconveniences. Understanding the role of corruption in FDI is important because it produces a lot of pitfalls, distortions by providing falls information and it heightens the uncertainty (Habib & Zurawicki, 2002). Unmistakable, corruption is used to describe all sorts of misuses and inconveniences which make defining it hard. For the purpose of this paper the term corruption will be used to describe misuse of one's office for a private or unofficial end. Corruption mostly involves monetary benefits but non-monetary benefits also take place. Unless specifically mentioned, corruption in this paper means for monetary benefits. In chapter 2 a distinction was made between expansive corruption and restrictive corruption. Expansive corruption involves activities that improve the competitiveness and flexibility of the market, whereas restrictive corruption limits opportunities for productivity and socially beneficial exchange (Ngunjiri, 2010). This paper focuses of restrictive corruption, which is characterised by redistribution of income and wealth in favour of individuals or groups. The investors in both sectors argued that every procedure costs money. All payments can be divided into official costs of the procedure and the unofficial costs, namely the bribes demanded by officials. This type of corruption is not only experienced by foreign investors but by the public as well. A study of transparency international (2006) shows that 47 percent of the Kenyans had to deal with the bribing of officials in 2005. Compared to 2004 this index shows an increase of 13 percent. The role of corruption and bribes in the cooperation with government officials will be discussed in the next paragraph more thoroughly. Most investors identified the KRA as most corrupt and since investors have cooperate with this authority on a regular, basis the continuing challenges will be discussed in detail.

Corruption has been high on the agenda of NARC in 2002 and is being fought ever since. In 2003 the party appointed the KACC to fight corruption by investigating reports of suspected corruption. Despite this attention and all sorts of reforms the country still ranks inadequate. Unfortunately, the latest report of the KACC (2010) states which organizations are investigated but fails to formulate clear steps for the future prevention of corruption. Overall, the general goal and vision of the authority is well stated, only the necessary steps to achieve these goals are absent.
In 2010 Kenya scored a 2.1 on the corruption perception index (transparency international, 2011). This score, on a scale of 1 to 10, means that Kenya is highly corrupt. The index measures the overall extent of corruption, in terms of frequency and the size of the bribes, in both the public and the private sector. These findings correspond with the study of the Heritage Foundation (2009), where Kenya ranks 146th out of 180 countries in the Transparency International Corruption

Perception Index. Appendix 3 shows the evolvement of the corruption over the years in comparison to the world average and Kenya's neighbours. It clearly shows that between 1995 and 1997 Kenya scored above world average. The country was not perceived as free but it scored acceptable compared to its neighbours. After 1997 its status changed significantly, and the country still seems unable to recover from its corrupt status.

Investors argue that corruption is infiltrated in all levels of the governmental system. Especially bureaucracy makes procedures unnecessary hard. The investors in both sectors argue that with every permit or procedure the officials complete one step before explaining the next, and demand money for each step. An additional problem is the expertise of the officials, meaning that many officials are hardly acquainted with the entire process. Therefore they are often unable to provide the necessary or complete information. One investor in the horticulture sector argued that this uncertainty and lack of information makes it hard to make a yearly budget. The total costs are depending on the officer and the number steps needed to complete procedures, including the demanded bribes. Since this is never clear from the beginning, it is hard to calculate all costs up front. These statements are verified by The Kenya Bribery Index (Transparency International, 2008, p. 7). This study argues that "public servants and employees of the government are by far the most bribed, accounting for 99 percent of the bribery transactions, and 97% of the value." These are the officials that the foreign investors in this study have to deal with on a regular basis. The study also states that bribes can fluctuate between the Ksh. 200 and Ksh. 50,000 (Transparency International, 2008) One investor argues that: "corruption is high and the height of the bribe is uncertain. It depends on the controlling officer. The only certainty is that you have to pay a bribe. People have to accepts this. It is the way of life here." Overall, the investors all described corruption and bribery as an inconvenience. In the end, none of the investors would leave Kenya for the corruption alone.

§5.2.3 (In)stability shilling

The third risk influencing the decision of foreign investors is the stability of the Kenyan shilling. Exchange rates and inflation are an issue for all businesses involved with trade. Several investors argued that an unstable currency is a risk in each country they considered. Since the effects are global and simultaneous to all investors, regardless of the sector, this risk will be discussed in a general matter. In general the exchange of any currency is either expressed in euros, dollars or the yen. Reason for this is that the majority of trade takes place in the areas where these are the national currencies.

For the last decade the Kenyan shilling has been a relative stable currency. Due to higher inflation and a downturn in tourism after the post-election violence the Kenyan shilling lost 13% to the U.S. dollar in 2008 (Bertelsmann Stiftung, 2009). Obviously, after the post-election violence Kenya was regarded as political unstable which made tourists decide to go elsewhere. This then resulted in a decline of international demand for Kenyan shillings. Currently, the shilling is relatively stable again. However, if these fluctuations would occur regularly, future investments would be unreliable and insecure.

All investors involved in international businesses will be confronted with the adverse effect of the exchange rate. This means that all investors run the chance that their profits will be negatively affected by the changes in exchange rates. The Dutch investors in Kenya are highly dependent on the euro-shilling exchange rate. The money these investors invest in Kenya needs to be exchanged from euros to shillings. All these investors will benefit when both the currencies are stable. The risk in terms of devaluation became clear in April and May 2010 when the euro devaluated[3] compared to all major currencies, including Kenyan shilling. All horticulture investors are highly dependent on a stable euro. Their income is in euros since it is generated from the exports to Europe. When the euro devaluates the relative price paid per product and the ultimate profits are lower. Since the investors still need to exchange these euros into shillings to pay the wages, products and maintenance of buildings there is less money to spare. Especially the horticultural investors stress the importance of a stable currency. One investor argues: "The fluctuation of the shilling is a risk. The shilling is linked to the euro-dollar relationship. This then is linked to the costs of the airfreight and the eventual profit per product." Obviously, when the shilling devaluates the profits in terms of property investments decline, also affecting the investments. Anorther investor argues that: "the instability of the shilling is not a direct risk. The shilling is relatively stable. The exchange rate mainly creates uncertainties because it is depending on bot the euro and the dollar. This dependence makes people often anxious."
Another economic risk considered before investing is inflation, which means the annual percentage change of the consumer prices. Inflation is a normal occurrence in any stable economy and is usual accompanied by rising wages. The rising wages are necessary to keep the purchasing power up to standard. In the case of Kenya the rising wages can cause problems for future FDI since low wages in combination with the high education level are an important FDI determinant. If the wages increase too much the country loses its comparative advantage and investors might consider moving elsewhere. High inflation also reduces the attractiveness of a country for foreign

[3] Devaluation means a value decrease of one currency compared to another. Thus, more of the devaluated currency like the euro is required in order to purchase the same amount of other currencies, in this case the shilling.

investors. In the case of high inflation companies will be less attracted to invest in another economy since it is unlikely that the investments will be profitable in the future, due to the increasing costs.

Another effect of inflation is the increase of costs for present investors. The prices of the resources purchased in Kenya increase due to the general inflation[4]. Especially the horticulture investors face a lot of competition on the international market. When investors located in other countries are able to keep the prices low, the Kenyan investors will be confronted with a declining turnover. When inflation occurs in the Netherlands the sales of horticultural products might decline as well. In this case the general price level of primary necessities increases. For consumers, this leaves them less money for luxury goods like flowers, which then again affects the horticulture investors. However, not only the horticulture investors will be affected. The service investors, active in micro-financing, are dependent on investments from banks and businesses in the Netherlands. In the case of high inflation in the Netherlands these corporations will be less interested to invest elsewhere. In the case of high inflation in Kenya the service investors will be affected as well. In that case the investors will have to attract more money from donors in the Netherlands, otherwise the costs of their services will increase. However, like already described, high inflation in another country affects the attractiveness of that investment climate negatively. In this case it will be harder for service investors to attract more money from its donors, thus forcing them to increase the prices.

Deflation on the other hand is disadvantuous as well. In the case of deflation the annual percentage of consumer prices will decline. As already discussed, investors in Kenya are located nearby their competitors in both sectors. In the case of deflation these competitors are likely to reduce the prices of their products or services, forcing others to reduce prices as well. This again will affect the profits made by that company.

Overall, investors and the economy as a whole benefit the most from a stable currency and exchange rate. A stable currency enables investors to budget future costs and makes future investments reliable. Also, a stable currency improves the international status of the country, making it more attractive for future companies and investors.

[4] Inflation here means that the costs per unit will increase since it is more expensive to produce the products or to deliver a service. In this case the investor is forced to include such costs in the prices of the products.

§ 5.3 continuing challenges (role KRA)

The effects of corruption and its role in the daily life of the investors have already been described. This paragraph will elaborate on this subject, but with a special focus on the role of corruption when cooperating with the Kenya Revenue Authority (KRA).

The KRA is the official office responsible for the collection of revenues on behalf of the Kenyan government. This authority is the direct link between the tax-payers, including the foreign investors, and the government. The authority is divided into five departments all responsible for the revenue collection in all designated areas. For this study one department in particular is off interest, namely the Domestic Taxes Department. This department in particular was mentioned frequently in relation to corruption by the foreign investors.

The Domestic Taxes Department is responsible for the collection of income taxes and the value added tax (VAT). The income tax is a direct tax that is calculated over income derived from businesses, employment, pensions, rents and other types of income. VAT is levied on consumption of taxable goods and services supplied or imported into Kenya and is collected by registered persons at designated points who then remit it to the Commissioner (KRA, 2004).

All foreign investors are confronted with both types of taxes and therefore with the KRA on a regular basis. Analyses shows that especially horticulture investors have identified problems in the cooperation with the KRA. Examples of such problems are the refund of VAT after importing products, demanding of bribes after inspections and the individual power of each KRA official.

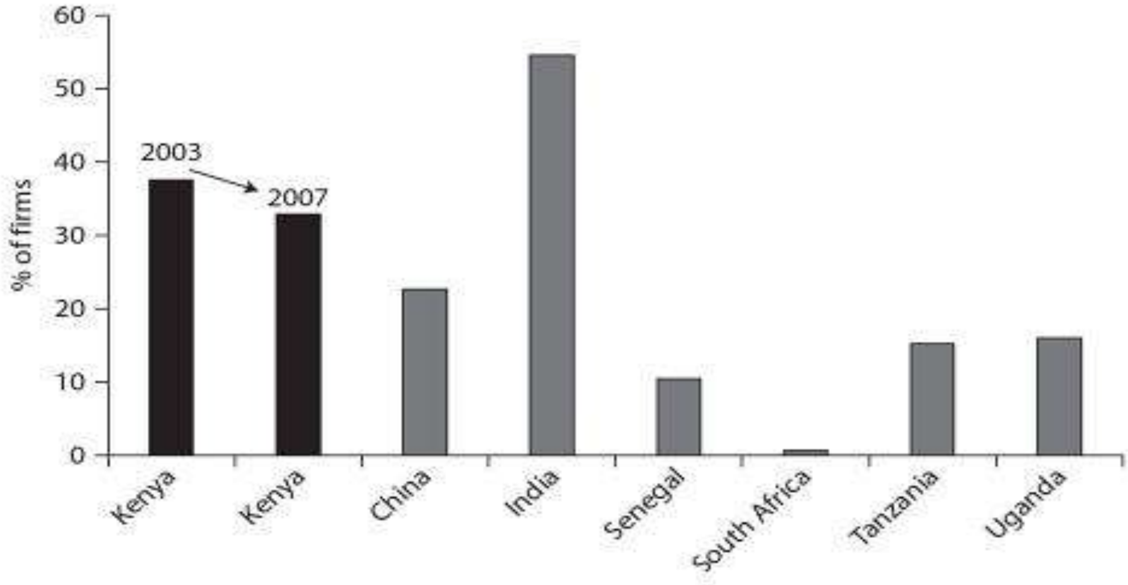
As defined in The Value Added Tax Act all exports, farm inputs and agricultural machinery fall within the scope of zero-rated goods. This means that no taxes have to be paid when exporting products or when purchasing said goods. According to this act (p. 121) every taxpayer, in this case the foreign investors, is authorized to claim back the withheld VAT, provided he is in possession of withheld VAT certificates. Several horticulture investors argued however, that it can take up to three years before taxes are paid back and even then some money is being withheld. In the act there is no indicated timeframe of refunding the taxes. However, in the Netherlands for example, it will take approximately a month to until taxes are refunded.

An issue related to this and corruption are the unannounced inspections by VAT inspectors. Several investors cite that officials are often absent in the first years in which the business is started. It can take up to five years before the first inspection takes place. Given the long time between the start of the business and the first inspection it happens that there are certain irregularities or faults in the books or records of the companies. One explanation for these shortcomings is the red tape around the permits and licenses described in the previous chapter. A result of this red tape and lack of transparency is that, often unaware, mistakes are made. The

investors argue that in these cases the individual officials have a lot of power and often demand bribes in order to validate the inspection. There is no system in place that verifies the decision of the inspector, making his decision final. This forces the investors to pay the bribes in order to pass the inspection without an even higher confinement. According to the Value Added Tax Act (2004) any authorized officer may enter every premise without a warrant, given it is a reasonable time. The official is free to examine all books and the occupier has to assist the official when needed. All in all, it seems necessary to enable officers to inspect firms at any given time. Especially when there is cause for suspicion an unannounced visit is reasonable. When comparing the Value Added Tax Act (2004) to the tax law of the Netherlands (2011), most of the regulatory processes are corresponding with each other. In both countries officers are permitted to inspect firms unannounced. However, in the Netherlands the times wherein these inspections are allowed to take place are specified between 8am and 6pm on weekdays (Overheid.nl, article 50 AWR, e.a.). Clearly, the challenge identified by the investors lies in the corruptive nature of the individual officers, who are said to formulate the rules for personal benefits. If, in any case, the formulation of the regulation should be a problem, the completeness and formulations of these regulations are comparable to those in the country of origin and are therefore no Kenya specific problem.
Obviously, the problem lies in the corruptive nature of the officials and the bribes they demand at each inspections. The investors describe several occasions in which an official keeps examining the books until a mistake is found and a bribe can be demanded. One investor states: “the duration of a book-control is unclear. Every time an official visits, he stays as long as needed, in order to find a mistake and he can demand a bribe. Every time these officials find some sort of a mistake and every time they demand a bribe.” Another investor feels that the irregularity of visits is the reason these officials find mistakes. He argues that: “book controls should be regulated. The controls should take place every 1-3 years. Now these officials come every 5-7 years. This timeframe is too long and a small error is likely to occur in this time.”

These findings are in line with other studies (Larossi 2009; Heritage Foundation 2011) which show that Kenyan taxes in general are still very high and that bribes produce a lot of secondary costs that make the business climate less attractive for FDI. Table 5.1 shows that the overall corruption is improved the last years but that it remains to be a major problem.

Table 5.1 Bribe request from Tax Inspectors – Cross Country Comparison



Source: Larossi 2009, p. 33

Table 5.1 shows that in 2003 close to 38 percent of the firms where requested to pay an informal fee to the tax inspectors. This number decreased with approximately 3 percent in 2007, but stayed high compared to the international standard. Overall, the Kenyan revenue authority ranks second, after India, in terms of corruption. In the other East-African countries, Tanzania and Uganda, only 15 percent of the firms identified this type of corruption. On the long run this makes them more attractive to investors and if corruption remains to be a problem it will damage Kenya's international status. On the other hand, corruption alone is not enough to discourage investors to come to Kenya or to damage Kenya's economic development. In Table 5.1 India ranks as most corrupt country. Currently, this Asian country has one of the highest growth rates in the world. India's economy is booming and a lot of foreign investors are attracted to this country. This country shows that corruption alone is not enough to negatively influence the economic development of a country.

§ 5.4 Improvement points Kenyan investment climate

At the end of every interview the respondents were asked to identify the general improvement points for the investment climate in Kenya. The answers were based on a combination of the considered risks, disadvantages and expected future problems. This paragraph will describe the mentioned improvement points combined with the conclusions of this chapter.

The infrastructural upkeep and the transportation around Nairobi has been indicated to be a problem by both sectors. This indication is ironic since the infrastructural network, in terms of airfreight, ports, roads and Internet connections, has been indicated as investment motive as well. The infrastructural network of roads and its connections have been described as an advantage by the horticulture investors, especially in terms of connections to the airport and airfreight to and from Europe. These connections with Europe are a big advantage for the service investors as well, along with the telephone and Internet connections. However, pollution by cars, traffic jams and chaos are the reality of infrastructure in and around Nairobi. Therefore, the problem identified by the investors mainly refers to the traffic and roads surrounding Nairobi. On top of that, many investors expressed their concerns about the rising transportation costs, especially in terms of airfreight to Europe.
Many service investors are located around Nairobi because the competition and clientele are located here. Also, the telephone and Internet connection are present and well developed in this area. Downside however is the lost time many investors experience when travelling to work and in between appointments, due to the traffic obstructions. This is expected to become an even bigger problem in the future, since car use is likely to increase. This increasing use of cars also effects the environment and results in an increased air pollution. Obviously, this pollution is a health hazard affecting both the investors and the local people.
As described in paragraph 4.1 the development of a good infrastructural network is not to be underestimated. The same applies for the relative costs of transportation. Especially the horticulture investors are affected by rising costs of transportation. When the costs keep rising the investment climate as a whole will be less attractive. If the transportation costs surpass the advantage of low labour costs the investors might leave.

Another future concern as well as improvement point according to the investors is the high level of corruption. Even though the current government argues to take action against corruption it is present in every level of the society. Starting point for anti-corruption measures is the creation of good governance. This means that the distribution of power should be equally rearranged through every governmental level of society. Currently the necessary resources to put the needed programs in to place are often lacking due to misuse and mismanagement by a handful politicians. Rearranging the power means an increase of participation of civilians. The power of the Kenyan people should be increased in terms of making the government accountable to the local governments, who in turn are accountable to the people in the regions. Obviously, this solution is mainly theoretical since responsibility and therefore accountability are not always clear. Corruption

in Kenya is infiltrated in all levels of society and it will take years before it can be really eliminated. An entire change in the mindset of people is needed to really tackle corruption. This analyses gets supported by the managing director at the NABC who argues “that governmental corruption is a historical process that occurs in every country, in a certain development phase. The developed countries, including the Netherlands, have been confronted with this process as well. In order to tackle corruption, governments have to shift their secondary responsibilities to local governments, and focus on their primary responsibilities only. This way they have to train and employ less officials and are able to keep a better record of their actions, thus reducing corruption.” Obviously, proven corruption in that case should be met with penalties against the given officials. When this system along with the accountability of the government is put in place, corruption can be tackled over time.
Another aspect that might help tackle the corruption of policemen and officials is an increase in wages. So far, especially the police, are paid a relatively low salary for the tasks they have to fulfil. For example, the road controls in and around Nairobi are dangerous, unhealthy and tedious. If the wages of these officers would increase and the penalties for corruption would be more severe, officials would be less tempted to demand bribes, because they then can easily provide for their families. Naturally, an increase of wages alone would not be sufficient since officials would still be tempted to increase their earnings. An entire system should be put in place that includes incentives and protection for whistleblowers as well.

The last improvement point is mainly identified by service investors. These investors argue that it should be easier for new investors to start a business in Kenya and the government should be more involved is this process. Related to this aspect is the improvement of loans provided by Kenyan banks to SMEs. Some investors take Rwanda as example while they elaborate on this point. They argue that Kenya should copy the Rwandan system as a solution to the problems many new investors face. The World Bank and other media (Afribiz 2010, IDA 2010, and Africa Report 2010), support this by stating that Rwanda is the top business reformer in 2010. In the annual doing business report (2010), Rwanda jumped from a rank number 143 to number 67. Reasons for this improvement are the cutting of procedures and days necessary to start a business, reduction of days in registering a property, privatization of banks which makes provision of loans easier and government involvement during each step of the bureaucratic process.

The Kenyan investors argue that currently only big and wealthy investors can start a new business in Kenya. The interest rates on loans are high, up to 15% (Kamau, 2009) and banks never pay out the entire amount. Recently, several non-banking institutions are established in Kenya, which provide loans at a much lower interest rate. However, some caution is necessary when lending at such organization because these institutions are not regulated like banks (Kamau, 2009).

Chapter 6 FDI in Kenya's development

This thesis focused on the role of Foreign Direct Investments in the economic development of Kenya. The main objective was to determine if and how far the experiences and opinions of active foreign investors correlate with previous studies. Second, the goal was to determine which aspects make the overall investment climate (un)attractive. The identification of these aspects are useful in improving the climate for future FDI.
The main focus of this last chapter is to combine the theoretical concepts with the experiences of the investors in order to provide a clear overview of the current investment climate. On top of that this chapter provides an answer on the research question, formulated in chapter 1.

§ 6.1 Contribution FDI in the economic development of Kenya

The annual report of the World Bank (2011) stated that Kenya ranks 98 out of 183 in terms of "the ease of doing business". Overall, this is an acceptable score, especially compared to Kenya's direct neighbours. However, in comparison to the reports and statistics about attracting FDI, Kenya is still an underperformer. Both Table 2.2 and 3.1 show that Kenya did poorly in attracting FDI up until 2005. After 2005, a great upsurge is visible which can be explained by several policy reforms and infrastructural improvements. The goal of this thesis was to identify exactly which factors contributed to this underperformance before 2005 and which changes will help in attracting more FDI in the future. The paragraph will focus on answering the research question, central to this study. This answer consists of FDI theories on the one hand and acquired data on the other. Foreign investments and its role in economic development has been discussed extensively. Given the expanse of this debate and the time available for this study, a selection of relevant concepts was made at the very beginning of the study. Using studies from different authors and analysing the different insights helped in selecting one country to test the theories on. The desk research prior to this study in combination with the selection of the unit of analyses helped formulate the following research question:

What motivates Dutch investors to invest in Kenya, how do these investments contribute to the Kenyan development and what sort of changes should take place in order to attract more foreign investments and to make FDI more beneficial to Kenya?

To answer this question the selected concepts needed to be studied before any field research could take place. These concepts helped in invigorating the broad scale of theories onto the unit of analyses, Kenya. Secondly, these concepts served as a guideline during the interviews conducted in Kenya. The theories of FDI elaborated on the different types of investments and determined which kind is preferable for Kenya. The second concept, liberalization, is seen as a precondition in attracting FDI. The other two concepts, investment motives and technological spillovers, are necessary in determining the extend of positive effects FDI have on a country. These last two concepts will therefore be used in the remainder of this thesis in determining how Dutch investments affect Kenya's economic development. Besides these concepts, some sub-questions were formulated to gradually help answer the main research question. Overall, two sub-question were formulated for each of the chapters in which the findings of the analyses in Kenya were analysed. This division will now serve as structure of this conclusion.

Chapter 4:

1) *What are the motives for Dutch investors to invest in Kenya and what are the positive characteristics of Kenya?*
2) *Does location play an important role in choosing where to invest and is location of any importance when deciding to invest in Kenya?*

Turning to the investment motives it is striking how little these deviate between the different sectors. The most important motive in both sectors is the presence of the relatively cheap but highly educated workforce. The low costs are in this case most attractive for the horticulture sector since this sector employs significantly more people, whereas the level of education is especially important to the service sector. The second motive is the availability and structure of the infrastructural network. Again, there is a small differentiation between the sectors since the horticulture sector is attracted to the road and airfreight aspect whereas the service sector is attracted to mobile and internet connections. The eventual difference between the sectors lies in the locational preferences both sectors have. The horticulture sector is located in one specific area since all climatic conditions are right here. The service sector on the other hand has no climatic preferences but is attracted to the hub-status of Nairobi. These locational preferences along with the initial investment motive turned out to be most decisive in determining the eventual future effects of FDI in Kenya. This means that on the long run Kenya is best off in focusing on attracting service FDI over horticulture FDI. Namely, the initial decision to invest abroad in horticulture sector is based on mainly push factors. Since the Netherlands are not profitable anymore, Kenya turned out to be the best choice for this sector, given its cheap labour force and good climatic conditions. However, due to rising educational level, government interference and international pressure, the prices of both the wages as well as environmental licenses are rising. The horticulture sector is dependent on these low costs in order to compete with other international farms. On top of that, the costs of airfreight and transportation to the airport are rising due to rising oil prices. It is unlikely that these prices decline in the future.

Obviously, these rising costs in airfreight are a global issue. The Kenyan government could try to compensate these costs by providing better roads and perhaps a direct rail connection from the lake to the airport. This way the overall transportation costs can be counterbalanced somewhat and the horticulture sector might expand.

The initial motive for service investors is based on mainly pull-factors. This means that these companies are drawn to Kenya specifically. Given that these companies are not dependent on climatic conditions, they could invest anywhere in the world. This initial motive is important because it determines the type of FDI to some extent, namely long-term FDI. Second, this sector employs and trains mainly people with a higher level of education. At the short run this might not be regarded as beneficial, since the majority of people is still at a low level of education. However, at the long run this is definitely beneficial since these people are paid better wages and can invest in a better future for themselves and their families. If the country would focus on attracting more service FDI, more people would be employed and to push the economy. Then the technological spillovers of these investors, in terms of business knowledge, would help Kenyans in starting up their own business.

If the Kenyan government were to invest in service sector, the current horticulture investors would benefit as well. Lake Naivasha and its surroundings have been under great pressure, both nationally as internationally. Most of the concerns expressed are based on current impacts and conditions, as well as environmental threats. Since the impact on the environment and the social construction of the area is severe it would be better if the sector would not extend in the future. This means that the investors would keep the current competition as well as enough water and space. Secondly, since researchers are currently collecting more data about future investments the impact could be better monitored and the environment could be sustained. Fact is that the Naivasha area benefitted a lot from the presence of this sector, at least economically. The technological spillovers are visible in terms of specific training and schooling programs. If international companies would relocate themselves in the future, the local people might be able to take over these businesses. The knowledge and skills are definitely present. The Kenyan government should only interfere in making the resources available for the Kenyan people to take over.

Chapter 5:

3) *How do Dutch investors experience operating in Kenya and what role does the local government play in this?*
4) *What are the main risks or challenges when investing in Kenya and how should this be improved in the future?*

In order for this to take place a couple of changes would have to be carried through. One important change has already been mentioned, and that is the interference of the Kenyan government. Better said, the lack of interference by the Kenyan government should change significantly.

During the interviews one respondent argued that the government should promote the country and invest in advertising and attracting foreign investors. Kenya, and Nairobi especially, is a modern country and has all facilities necessary for investors and tourists.

This lack of involvement by the government also came up when the investors identified the sector as biggest source of information. All investors identified either the sector or informal networks, along with personal experience as most valuable and accurate information providers. On top of that, these investors argued that it is crucial to hire a local accountant and lawyer in order to deal with all bureaucratic hurdles.

This finding is in line with an earlier study, which also found that most companies relied on their own individual network for information and argued that the role of the government in encouraging FDI in largely missing (Kinuthia, 2010). Most investors perceive the government as hostile and the constant corruption discourages them from contacting them. Several investors argued that in the current system, the lack of governmental interference is preferable. With the current system government interference means more bureaucratic hurdles and increasing costs. Several investors took the Rwandan system as example of an ideal system with the right amount of governmental interference.

Another improvement point alongside the government interference would be reducing the licensing procedures. Most investors argued that this system improved a lot throughout the last years. However, this aspect still needs some work. The core problem lies in the completion of the procedures. Currently, the investors lose a lot of time since officials only complete one step at the time. After a step is completed another official needs to be consulted to begin with the next step. The information provision needs to be better and people need to know the entire procedure not just a step at the time. One step in the right direction is the centralization of investment procedures by the KIA. The biggest improvement is the reduction of time to execute the entire process.

Analyses showed that all companies were able to start operation within a year. Overall, this is still acceptable but there is room for improvement. This time could at least be reduced by half. Again, government interference is necessary to achieve these goals. On top of that, work licenses need to be given for a longer time. Validity of two years increases insecurity by the investors, which is harmful in attracting the right type of FDI.

The last point that needs to be mentioned here are the improvements in the infrastructural network. In this thesis, the infrastructural network has been identified as a strong point as well as a weak one. Investors argued that the government invests a lot in the improvement of the network over the last years. This aspect is very obvious when driving from Nairobi to Naivasha, since construction is going on everywhere. On top of that, several horticulture investors maintain the roads around Naivasha themselves. The biggest improvement point identified by service investors in particular is the traffic in and around Nairobi. Not only during rush-hour but almost the entire day the city is plagued with traffic jams and chaos. These traffic jams and chaos affect the safety feeling of many investors in two ways. The first is the increased risk of carjacking, since people are forced to stop on a regular basis in all sorts of areas. The second is the loss of time between every appointment or even just driven to work. It takes a long time to cross the city and the number of traffic jams keeps increasing. This traffic chaos is identified as one of the biggest inconveniences of Nairobi. Given that car ownership and car use is likely to increase, the government needs to address this problem as soon as possible.

Chapter 6:

5) *How does Kenya benefit of the presence of foreign investors?*

This thesis mainly focused on the economic benefits of FDI. Before briefly describing these benefits it is important to note that, given a selection of areas, these benefits are not for the entire country. The main benefits, economic and other, are limited to Nairobi and Naivasha and the direct surroundings of both areas. Therefore, future research is necessary in more regions to determine the effects of Kenya as a whole. Secondly, it would be wise to compare FDI coming from other countries with that of Dutch FDI because it might affect the country differently. Lately, a lot of attention is paid to FDI from East-Asia. This type of FDI often manifest itself in projects and manpower, instead of monetary flows, so the effects and technological spillovers might differ.

The, mainly economic, benefits of Dutch FDI on Kenya are described throughout the entire thesis. These effects are mainly termed as technological spillovers and are manifested in various ways. The first benefit, takes place directly through the payment of wages to the Kenyan people. All employees, in both sectors, are paid wages for the work they do in the companies. The employees in the horticulture sector are paid less money than the highly educated people in the service sector. However, Table 2.3 showed that the horticulture sector employs significantly more people than the service sector and therefore affects a bigger group of people.

Secondly, all investors argued that besides paying wages they support sporting events, provide medical care and schooling for employees and their families and donate money to HIV clinics. All these projects affect the families of the employees, and since they are educated they face a better future. Also, the employees safe more money to invest in the future because they have to pay less to educate their children.

Beside these direct effects, the regions on the long run benefit the most from the knowledge and technological transfers. In both sectors, a lot of knowledge and skills are transferred onto Kenyan people. This can be seen as an indirect effect but is definitely one of most significant ones. This training in combination with the increasing wealth in the region might enable local people to take over the businesses or start own businesses in the future. When this happens, the country can compete internationally, without having to depend on foreign investors.

The last indirect effect manifests itself in the supply chain, providing goods for the investors. Not only, do the investors pay wages to employees, they also buy products from local suppliers. This upsurge in FDI, indirectly keeps a lot of smaller local companies in business.

Overall, these two particular areas benefit a lot direct and indirect from FDI. However, despite these benefits, the country is also negatively affected by these investors. One big impact in visible in Naivasha area, especially in terms of the water problems. The Kenyan government needs to attract more FDI in future in order to develop economically. Still, the government needs to address the problems caused by FDI as well and has to make sure that the benefits way out the negative effects on the long run.

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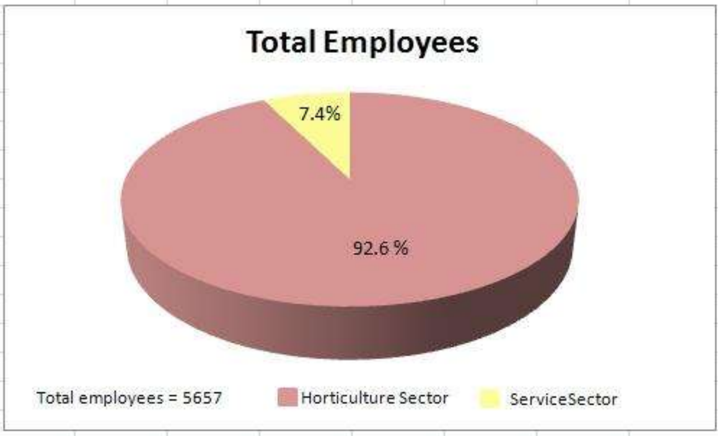
Appendix 1: Analyses Table 2.3 – 2.5

Total Employees	Horticulture Employees	Service Employees
350	350	9
600	600	70
300	300	5
1400	1400	18
210	210	4
170	170	300
270	270	8
75	75	3
1000	1000	
265	265	
9	600	
70		
5		
600		
18		
4		
300		
8		
3		
5657	5240	417

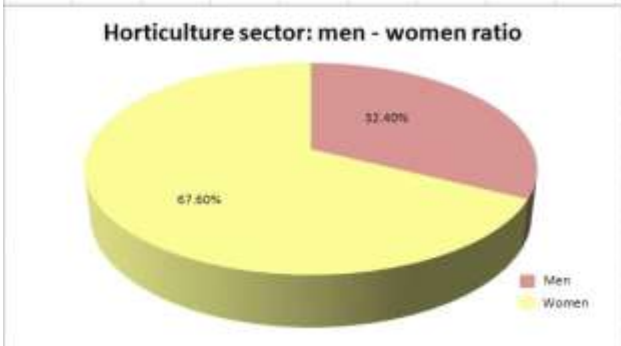


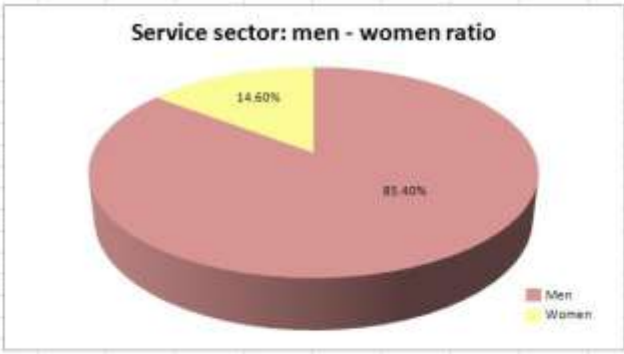
Men - Women ratio
Horticulture sector

men	women	Total	Men	Women
25%	75%	600	150	450
15%	85%	300	45	255
60%	40%	1400	840	560
13%	87%	210	27	183
25%	75%	170	42	128
30%	70%	270	81	189
10%	90%	75	8	67
15%	85%	1000	150	850
34%	66%	265	90	175
25%	75%	600	150	450
		4890	1583	3307
		100%	32,40%	67,60%

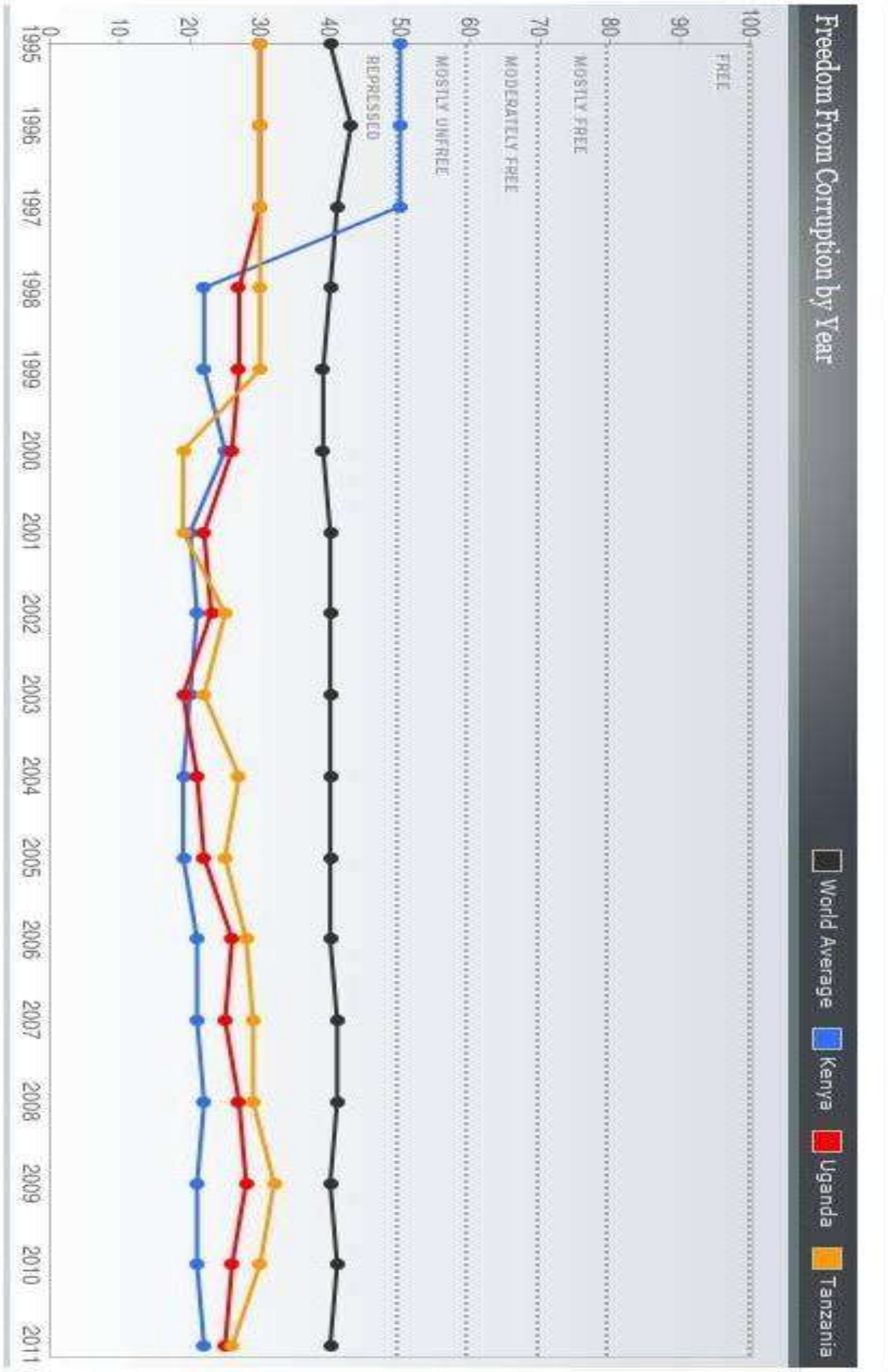
Men - Women Ratio
Service Sector

men	women	Total	Men	Women
50%	50%	9	5	4
50%	50%	70	35	35
60%	40%	5	3	2
60%	40%	18	11	7
75%	25%	4	3	1
97%	3%	300	291	9
75%	25%	8	6	2
66%	34%	3	2	1
		417	356	61
		100%	85,40%	14,60%





Appendix 2: Freedom from corruption index



Source: The Heritage Foundation

(consulted on: 01-02-2011)

Appendix 3: Questions Interviews Dutch Investors

Basic information interviewee

1. What is your job title?
2. Are you an expatriate (= living outside his own country)?
3. Which countries apart from Kenya have you lived & worked in?
4. How long have you worked for the entity?
5. Were you involved in the establishment of the entity in Kenya?

Basic information on the company

1. Where is the parent company located?
2. Does your company have any sister companies in other countries?
3. What are the main services offered by your company?
4. What's the entities market share in Kenya and what is designated for exports?
5. What are your main export partners?
6. How many employees does your company count?

a. What's the ratio male-female?

b. What's the level of education?

c. Local or international?

7. Can you describe why the company is located here? What are the advantages?

Motives for investing in Kenya

1. In what year did the parent company start the legal procedures to start in Kenya?
2. How much time past between starting these procedures and starting operations in Kenya?
3. Can you describe the main challenges in obtaining licenses in Kenya?
4. What where the most valuable information sources when making (the initial) decisions?
5. What where the main motives for investing in Kenya?
6. Did the Kenyan government play an important role for your company (initially) and
7. what are the views on the new constitution/elections?
8. What are the main risk, challenges and disadvantages when investing in Kenya?
9. In general: what do you think should be improved in the investment climate of Kenya?
10. Other than investing money, how do you think the country benefits from the presence of your company?
11. Did the Dutch government or embassy play an important role for your company?
12. In the light of the recent events in Europe. Did the erupting Island volcano effect your company is any way?