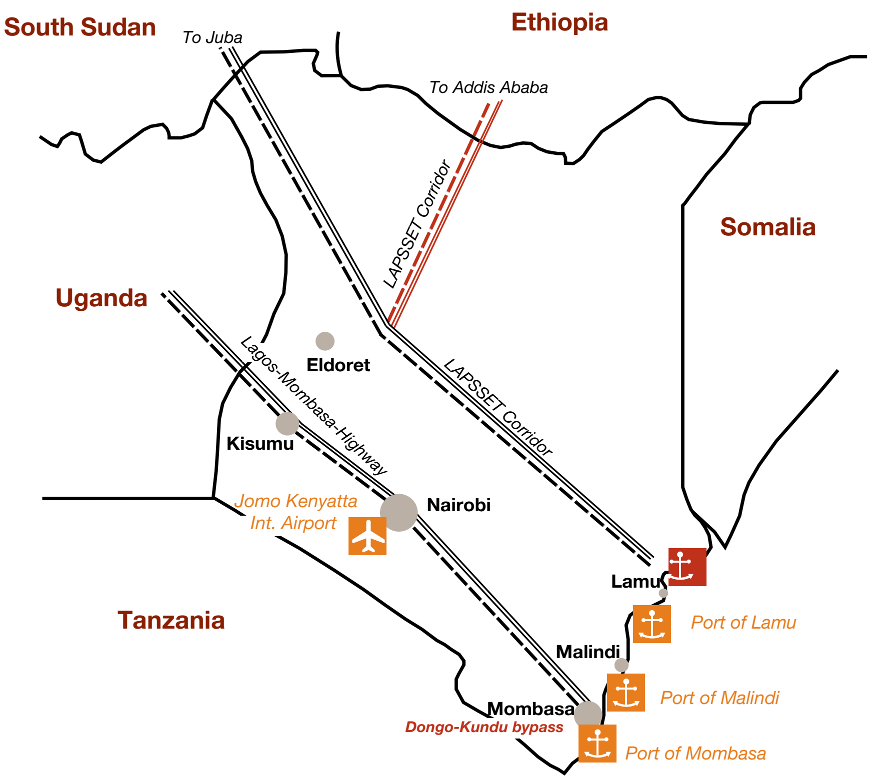
# Kenya

*Kenya's long-term growth prospects appear to be solid. Key supporting factors will be its increasingly broad-based economy, youthful population and strategic location in the East African Community (EAC).*

***Preferred entry point to East Africa***




These bubbles represent the cities of Kenya and the size of the bubbles indicates the population size of the city

Airport | Port | Future Airport | Future Port | Future Railway | Future Road | Railway | Road

Many companies looking to expand into East Africa are looking at Kenya as their preferred entry point. One of the country's biggest strengths is the relatively stable political environment at present.

While ethnically-based political rivalries and security concerns exist, Kenya is still one of the easier African countries in which to do business.

The Government has big plans. Kenya's 'Vision 2030' provides a blueprint for future development and there have already been some initial successes with institutional and business reforms to improve the business environment.

We believe that Kenya will consolidate its position as a regional leader and begin to play a larger and more influential role in the EAC.

*Kenya will produce commercial oil in 6-7 years*

*Per capita GDP expected to rise more than* **41%** *by 2015*

*Plans to spend* **US$1.4bn** *on geothermal power plants*

## Strong growth forecast, despite deficit

Kenya currently has large trade and budget deficits. Its biggest trading partners have traditionally been the UK and other EU countries, so a sluggish European economy has had a negative impact on Kenya's exports. This may be offset in the future by strong regional growth. Trade with the Common Market for Eastern and Southern Africa (COMESA) now outstrips that with the EU, with Kenya sending around half of its exports to its African neighbours.

Kenya has also signed a variety of economic pacts with other countries, notably China. The country's import tariffs combine national and regional rules and have been changing rapidly over recent years.

Kenya is currently reliant on imports of oil, but that looks set to change following the discovery of commercial oil deposits in March 2012. **The IMF believes that Kenya will begin producing commercial quantities of oil in 6-7 years**[i].

Real GDP growth is projected to average 6.2% between 2012 and 2017. This represents a significant improvement on the economic growth performance in recent years, which averaged 4.2% between 2002 and 2012, largely due to weak growth in 2008 and 2009.

**While per capita GDP is currently low, reaching just US$967 in 2012**, Kenya's demographic profile gives many reasons for optimism. Although population growth is expected to remain above 2% until 2022, the positive growth outlook means that per capita GDP will rise to US$1 365 by 2015.

## Corruption, contracts and taxes

Kenya also has a fairly restrictive tax regime. The total tax rate payable by businesses is 44.4% and includes a profit tax of 28.1%.[ii]

Although the political risk in Kenya is regarded as being low, security is an issue, with violent crime a problem in some areas and signs of terrorist activity and piracy in coastal regions, resulting for the most part from Kenya's proximity to Somalia.

## Favourable labour and investment climate

Kenya presents a relatively more conducive business environment than its regional peers. It has flexible labour regulations and investment laws that allow foreign investors to receive the same treatment as local ones.

**Kenya's financial sector is rated as the most developed in East and Central Africa.** This facilitates greater ease in accessing capital markets for businesses looking to support growth through debt and capital market funding.

Kenya is also one of the most innovative countries on the continent, with only South Africa rated ahead of it in the World Economic Forum's Africa Competitiveness Report 2013.[iii]

## Power problems and solutions

One major risk facing Kenya is its power infrastructure. While Kenya performs above average compared to its African peers, it ranks poorly on businesses' ability to get electricity in a global comparison. Inadequate electrification rates are a major constraint to the wider business environment. Furthermore, since Kenya relies heavily on hydroelectric generation, less power is available during periods of drought.

This situation is set to change, as **Kenya plans to spend US$1.4 billion on new geothermal power plants, with total installed generation capacity of 280MW.** The goal is to establish Kenya as one of the largest generators of geothermal energy, aiming for 5GW of capacity by 2030. [iv]

## Demographic dividend

Kenya has a large population of 43.2 million, growing at around 2.6% per annum. Only around a quarter of the population currently lives in cities, but urbanisation is on the increase. Kenya is also a young country, with two-thirds of the population under 24. The Government has an ongoing drive to provide free secondary education and boost technical and vocational skills, which means Kenya's workforce is relatively well-educated compared to other countries in the region.

There's still room for improvement though, as labour productivity is currently quite low and Kenya's human development indicators are also fairly low.

*Most developed financial sector in East and Central Africa*

*Large population of* **43.2m** *with $^{2}/_{3}$ under 24*

## Agriculture

Agriculture is very important to Kenya's economy, especially in terms of ensuring food security and employment. All of Kenya's top merchandise exports are agricultural commodities and the sector provides jobs for around 75% of the country's labour force.

Kenya is the largest tea producer in Africa and is also Africa's largest exporter of flowers, but overall Kenya's export base is fairly narrow. Logistics service providers have focused heavily on serving the agricultural sector so far, but with drought an ever-present threat, there is significant risk involved.

## Retail

**For logistics companies, prospects in the retail and manufacturing sectors are the most critical.**

The outlook for the retail sector is strong and Kenya is starting to be seen as an ideal point of entry for launching retail outlets and consumer goods distribution into East and Central Africa.

Kenya has a growing local market with a wealthier consumer base from which to launch into other regional markets. Only about 16.8% of the population currently falls into the middle class, but that should grow strongly.

The dynamism in the consumer market has also sparked strong growth among local producers, increasing competition. Local supermarket chain Nakumatt's 'blue label' packaged food line and Interconsumer Products' popular feminine hygiene and diaper lines, for example, are rapidly gaining market share.

Once they develop traction in Kenya, firms have ample opportunity for expansion to the rest of the East African Community, which includes Uganda, Tanzania, Rwanda and Burundi. In addition, fragile recent conflict countries in which consumer demand is rapidly rising and consumer goods are in short supply like South Sudan and Somalia are easily accessible due to strong historical trade links.

Kenya's retail market comprises a mixture of modern retail outlets that supply consumer goods from major international firms and informal traders or family-run concerns that sell more basic goods.

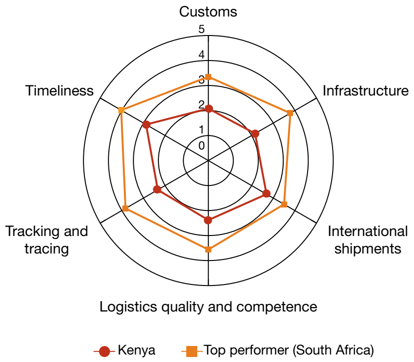
The country's Vision 2030 includes plans to improve the efficiency of the retail market and once the formal retail expands, there should be significant opportunities for logistics service providers.

## Manufacturing

The World Bank has identified significant opportunity for growth in light manufacturing in sub-Saharan Africa, but contends that feasible, low-cost, focused policy initiatives aimed at enhancing private investment will be needed to enable the region to realise its potential. Kenya currently has a small manufacturing industry dominated by food and consumer goods processing. The Government's trade strategy now looks to encourage greater exports of processed goods, so there's potential for growth. Still, inadequate power and transport infrastructure and poor trade logistics are major obstacles to growth in the sector.

## Logistics performance

### Logistics Performance Index




*Source: World Bank*

Kenya's logistics performance has deteriorated in recent years. From an overall global ranking of 76th in 2007, it is now 122nd out of 155 countries on the Logistics Performance Index. Although international shipments, infrastructure and logistics competence have improved marginally since 2007, customs, track & trace and timeliness have all declined significantly over the period.

While the time to import goods, as well as the number of documents necessary, are comparable to the average in sub-Saharan Africa, the cost to import is significantly higher. These values are all considerably higher than OECD benchmarks, as are similar indicators for exporting.

Low logistics efficiency is a key concern and business risk for companies importing to or exporting from Kenya as well as the logistics service providers involved.

## Transport

Despite having made significant progress in infrastructure development in recent years, Kenya's transport infrastructure is

**US$53m** *to be invested in Port of Mombasa*

*New facility will add* **1.2m** *TEUs to Mombasa's capacity*

inadequate to meet the country's needs. The country's infrastructure indicators may look relatively good compared to other low-income countries in Africa, but they remain below the levels found in Africa's middle-income economies, like Egypt or Nigeria.

Bringing Kenya's infrastructure up to the level of the region's middle-income countries could boost annual growth by more than three percentage points. [v]

Kenya's development plans include significant improvements to roads, railways, seaports, airports, water and sanitation, as the country attempts to increase its competitiveness in the global market. Road and rail connections with neighbouring countries are still limited, but Kenya could be an important regional hub for air transport, railways, and ports in the years to come.

Kenya's population and agricultural activity are heavily concentrated in the southern half of the country, along the corridor linking Mombasa to Nairobi and then on to Kisumu and into Uganda.

Kenya's infrastructure backbones – including the country's principal road artery and its major power transmission and fibre-optic backbones – have followed this route. The northern half of the country, by contrast, is sparsely populated and characterised by fragmented infrastructure coverage.

## Ports

**Mombasa is growing in importance as a port, but congestion is a major problem.**

Ports stand out as one of the keys to Kenya's future growth. There are currently major ports at Mombasa, Lamu and Malindi. Mombasa is the main port, serving not only the Kenyan hinterland, but also markets in neighbouring countries such as Uganda. With almost 800 000 TEUs and 3.7 million tons of cargo handled each year, Mombasa is the second-largest port in sub-Saharan Africa after Durban in terms of tonnage and containers handled.

Together with Dar es Salaam, Mombasa is one of the key trading centres for the East Africa region. The port is also a natural trans-shipment centre for East Africa.

But Mombasa is facing serious capacity constraints and congestion. Delays in cargo clearance as well as congested and insufficient rail and road feeder systems are contributory factors to this situation. The World Bank considers the port the major infrastructure constraint in Kenya, particularly given its potential to be a major link between the East African market and global shipping services.

Over the last decade, Mombasa has steadily seen total cargo volumes grow by an annual average of 11.6% compared to a global average of 7.1%.

In terms of performance, Mombasa fares relatively well compared with other ports in eastern and southern Africa. However, its container crane productivity, at 10 containers per hour, is far behind Dar es Salaam (20) and Durban (15).

Kenya is ranked 88th out of 155 countries in the international shipments category of the 2012 Logistics Performance Index, while competitor Tanzania's rank is much better at 59th.

**Kenya-based Trademark East Africa (TMEA) is investing US$53 million in the Port of Mombasa over the 2012-2016 period.** TMEA has suggested specific technical and

## Key indicators

| | |
|---|---|
| Population size (million, 2012) | 43.2 |
| Population growth (2012-2020, avg p.a.) | 2.6% |
| GDP (US$ billion, 2012) | 40.7 |
| GDP growth forecast 2012-2017 (avg, y/y rate) | 6.2% |
| GDP per capita (US$, 2012) | 967 |
| Global competitiveness index 2012 (global rank/144, (score 1-7)) | 106 (3.75) |
| Corp. Income Tax (CIT) rate | 30.0% |
| Top exports | Black tea (fermented) and other partly fermented tea (18.6%), Cut flowers fresh (13.1%), Coffee, not roasted, not decaffeinated (6.1%) |
| Logistics Performance Index 2012 (global rank/155, (score 1-5)) | 122 (2.43) |
| Global Competitiveness Index 2012 - Infrastructure (global rank/144, (score 1-7)) | 103 (3.09) |

*East African rail corridor requires*

**US$2.1bn**

*investment*

grant support, including a port-wide productivity improvement study, upgrading rail links and space rationalisation within existing port land, along with improving port access, yard facilities and stacking areas at berths.

A new berth next to the old container terminal is making it possible for larger ships to dock. Work is also being undertaken on a new container terminal. Once the final phase has been completed (by 2019), the new facility will have added 1.2 million TEUs to Mombasa's capacity.

A new access road and a railway link will also be constructed to connect the container terminal and existing port network to the proposed Dongo-Kundu bypass and the Mombasa-Nairobi Highway.

## Port mega project

**Multi-modal mega project is planned in Lamu, but questions remain.**

Kenya is also looking to develop a new mega port project in the north of the country at Lamu. According to BMI the new facility will include a 10-berth container terminal, three bulk cargo terminals and an oil terminal. The site will also be home to a new international airport. In total, price estimates for the multi-modal project range from US$16 bn to 26 bn.[vi]

The port will serve as the maritime entry point to the Lamu Port-Southern Sudan-Ethiopia Transport (LAPSSET) Corridor, which will include rail, road, oil pipeline and fibre-optic cable connections with South Sudan and Ethiopia.

Aid for Somalia and transit cargo for northern Uganda, South Sudan and Ethiopia could all be shipped through the new facility. In April 2013, Kenya awarded a construction contract for the first three berths to a Chinese firm, but questions about financing for the overall project remain. Environmentalists have also raised concern about the impact on marine life.

## Aviation

Kenya is well served from an airport and airline perspective and is a regional leader in air transportation. According to 2007 figures, Kenya has 225 airports, with 15 of these having paved runways. There are four runways longer than 3 000m.

Jomo Kenyatta International Airport in Nairobi is a major international gateway in sub-Saharan Africa. A major fire caused extensive damage to the airport terminal in August 2013, but the Kenya Airports Authority (KAA) announced normal service would resume by the beginning of 2014.

The domestic air transport sector in Kenya is thriving, and is the fourth-largest in sub-Saharan Africa according to the World Bank.

Kenya Airways is among the top three international carriers in Africa and one of the most respected. Its extensive network across Africa and safety record is on par with international standards. The airline is one of the few African flag carriers to have been successfully privatised.

**Much of the company's success is attributable to an innovative public-private partnership with a key investor, KLM.** KLM only has a minority stake in the company, but is fully responsible for its management. Kenya Airways currently flies to 59 destinations worldwide, 47 of which are in Africa, and carries over three million passengers per annum.

## Railways

**Railways are strategically important, but major investments are needed.**

Kenya's rail corridor, linking the Port of Mombasa to Nairobi and continuing onward into Uganda, is of strategic importance to the region. It is a key conduit for bulk freight, easing pressure and providing additional capacity along the northern corridor. But the corridor is still poorly developed, and there is an urgent need to improve the rail-port interface at Mombasa.

Improving rail infrastructure is also critical to increasing trade throughout the East Africa Region and the **EAC estimates the corridor requires US$2.1 billion in investment**.

However, Kenya's national rail carrier, Kenya Railways Corporation (KRC), is reportedly insolvent, and although it registered a profit of US$13.2 million in 2012, it could be extremely difficult for the company to lead the planned revival of the railway sector.[vii]

In 2012, KRC signed a landmark US$2.6 billion contract with a Chinese construction company to build a new standard-gauge railway running from Mombasa to Nairobi to Malabi.

Currently the Rift Valley Railways Consortium (RVR), a group led by South African companies, runs much of the rail system in Kenya and Uganda under a 25-year concession contract. RVR runs trains on old narrow-gauge track that won't be compatible with the new standard-gauge line. While RVR has been upgrading – in June 2013 it announced it had completed repairs to 73km of track between Mombasa

**New Nairobi-Thika superhighway reduced time to traverse from 3 hours to 30 minutes**

and Nairobi – Kenya's new transport secretary has already noted that the country is dissatisfied with RVR's performance and wants to encourage more competition.

## Roads

Most of the burden of freight transport currently falls on roads and while Kenya has a reasonably well-developed road network, the condition of most roads is only fair and few roads have been tarred. Kenya has enough trunk roads, but lacks decent roads connecting rural and urban areas, so it is hard for farmers to deliver food directly to city markets.

Investments are being made. The new Nairobi-Thika superhighway, located at the very heart of Kenya's economic engine, is a good example. **The time taken to traverse Thika town and Nairobi has dropped from 2-3 hours to 30-45 minutes, greatly improving transport connections throughout the area.** This is an important development since the Nairobi Metropolitan Area accounts for more than 30% of national GDP.

There are plans to improve road connections at Mombasa to help handle growing freight traffic, some of which are being financed by a Japanese Official Development Assistance (ODA) loan.

The Governments of Kenya and South Sudan have started consultative talks with several international donors to finance the US$1.08 billion Juba-Eldoret development corridor. The road, linking the north-west Kenyan town of Eldoret with the South Sudanese capital Juba, is an integral part of the LAPSSET Corridor.

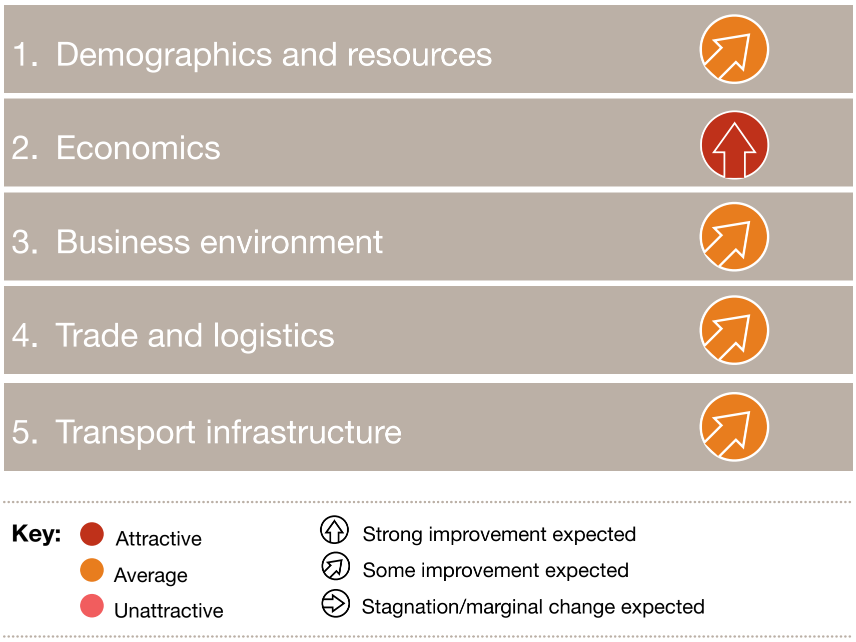
Kenya has established a sound system for funding road maintenance and has made great strides with institutional reforms. The country's road fund meets most of the good practice design criteria and the fuel levy is set at a level (around US$0.12 per litre) adequate to fund the country's road maintenance requirements. Associated revenues are also being fully captured by the sector.

Despite these positive strides, the quality of public investment still needs to improve and a major rehabilitation backlog remains, which needs to be addressed before the trunk network can be considered to be in a maintainable condition

## Conclusion

Based on our analysis, we've assessed the investment potential for Kenya's transportation and logistics sector as shown in the graphic below.

**Kenya – Investment potential assessment**




### End notes

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ii PwC, "Paying Taxes 2013:, http://www.pwc.com/gx/en/paying-taxes/index.jhtml

iii World Economic Forum, "Africa Competitiveness Report 2013". http://www3.weforum.org/docs/WEF_Africa_Competitiveness_Report_2013.pdf

iv "AfDB Facilitates Energy Diversification and Access to Clean Energy." Lake Turkana Wind Power, http://ltwp.co.ke/press-room/news-overview

v "Briceño-Garmendia, Cecilia and Shkaratan, Maria, "Kenya's Infrastructure: A Continental Perspective." World Bank, https://openknowledge.worldbank.org/bitstream/handle/10986/3361/WPS5596.txt?sequence=2

vi Jorgic, Drazen, "Kenya says Chinese firm wins first tender for Lamu port project," Reuters, http://www.reuters.com/article/2013/04/11/kenya-port-lamu-idUSL5N0CX38D20130411

vii James Waithaka, "Kenya Railways now back to profitability", the Star, http://www.the-star.co.ke/news/article-386/kenya-railways-now-back-profitability