Market Intelligence
THE BUSINESS AND FINANCE JOURNAL

BUSINESS CONFIDENCE INDEX

THE KENYA SCOPING STUDY REPORT

Prepared for: DFID Kenya

TABLE OF CONTENTS

EXECUTIVE SUMMARY

DFID engaged the principal consultants Prof. Nicholas Biekpe of the University of Stellenbosch in South Africa and Ochieng Oloo of Economic Intelligence to carry out a scoping study for an investor confidence index for Kenya. This initiative was developed as a follow up to the international investment conference held in Nairobi in March 2004 to attract more investments into Kenya and seek ways of improving the business climate for investors.

The principal objective of the scoping study was to ascertain the need or support for a measure of investors' perceptions and expectations in Kenya. Perceptions and expectations of business and economic activities in uence investor confidence and have a large impact on investment decisions. Confidence in the economy is widely accepted as a critical driver of business, particularly investment decisions. Regular measurements of investor confidence are well established in many developed markets with changes in confidence and sentiments closely watched as "leading" indicators of likely future investments.

The scoping study examined the basis for the development of a domesticated confidence index that would formally measure and monitor local and foreign investors' confidence throughout the economy.

The principal consultants held a series of meetings with key stakeholders and consulted widely with senior executives and managers drawn from a broad section of domestic and foreign investors. We then held an investors' consultative workshop to formally exchange views with representatives of selected firms, industry associations and market regulators.

We established the main concerns of local and foreign investors and particular issues that impacted most on individual sectors. We ascertained the "proxy indicators" that investors currently use for guidance on future business and economic activities. We have recommended inclusion of some of these concerns in the confidence surveys, especially in the sector- indices. We also examined and recommend the appropriate methodologies, survey techniques and data requirements for the confidence index and offer suggestions for an institutional frame-work and partnerships that can ensure wide acceptance of the confidence index.

We found clear and overwhelming support for a confidence index in Kenya. The key preferences of stakeholders are a quarterly confidence index computed from surveys of investor perceptions. Many executives and managers considered indices derived from surveys of investor perceptions superior to indices developed from hard economic and business data, mainly due to their predictive nature. They prefer a private- sector consortium including key industry associations to develop and own the index, under the overall control of an independent oversight board. Government involvement should be minimized and restricted to provision of data if required. The accuracy and credibility of the index and its sustainability were important considerations for stakeholders. They agreed on the need to secure a sound base of assured funding in the first 2-3 years to help establish the index, either through DFID or a consortium of donors. The market expressed support for charges and subscriptions for the index and specialized sector reports derived on the sectors years. These can help the index to pay for itself and make it sustainable and self financing beyond the initial seed-capital phase.

The results of the scoping study provide a clear basis for proceeding with the next phase of the project to develop an investor or business confidence index for Kenya.

1. INTRODUCTION

One of the major setbacks investors seeking investment opportunities in developing countries face is the lack of credible mechanisms for assessing the investment climate. Mostly, their decisions are based on hearsay, intuition and segregated socio-economic indicators and political sentiments.

The general belief is that Kenya is ripe for a broad-based Business Confidence Index. Market Intelligence followed through a discussion with the Department of International Development Kenya (DFID) on the initial idea of establishing a Kenyan Business Confidence Index and developed it into a concept that was presented to the DFID in April 2004, following the International Investment Conference held in Nairobi in March. On the 19th of July 2004, DFID formally contracted two consultants to commence a ten-day scoping study aimed at establishing whether Kenya needs a Business Confidence Index and to collate views from various stakeholders regarding the nature of this need.

As a first step, a scoping study, which entailed interviews with various stakeholders in order to assess their opinions and insights, was conducted. The scoping study was led by Professor Nicholas Biekpe of the Africagrowth Research and the University of Stellenbosch in South Africa and Mr. Ochieng Oloo, Chief Executive of Economic Intelligence Limited and Editor of Market Intelligence, a highly reputable business magazine in Kenya. The Principal Consultants were assisted by Mr. Alexander G Owino, a Financial and Economic Policy Adviser at Economic Intelligence.

This study was the first of three phases required for completion of the project which will also involves a position paper and the construction of the index. This is a report of the findings of Phase I – the scoping study.

2. STUDY DESIGN

The main objective of the study was to enquire from as many key industry chief executive officers (CEOs) and senior managers as possible to determine the feasibility and sustainability of a possible Kenyan Business Confidence Index (KBCI).

The first approach was to map out the key issues that would guide the study. The following were identified as potentially important for the success of the study:

1. The adoption of a multi-sectoral approach to the interviews by selecting from a broad list of possible stakeholders.
2. The need for the indices to re ect local Small and Medium Enterprises (SMMEs).
3. The possibility of using proxies including employment, equipment (e.g. machinery), information from purchasing managers, electricity, telephone, construction, and information from the Kenya Port Authority.

Seven key questions were constructed which were felt to be necessary in order for the study to assess the project's feasibility. The questions posed to the investors were as follows:

1. Does Kenya need a Business Confidence Index (BCI)?
2. Which economic sectors should be included?
3. Would you prefer a survey-type (qualitative) or economic-data-type (quantitative) BCI?
4. Would you be willing to provide information (including confidential) for the BCI?

5. Would you consider paying for the BCI or consider paying for an in-house project conducted for you as a result of the BCI?
6. Who do you think should host and maintain the BCI?
7. What frequency of the BCI will suit your needs?

3. WHAT'S IN A NAME?

One of the key issues the study had to deal with at the end of the field work was what the name of the index should be. The scoping study began with the name Investor Confidence Index (ICI). This elicited a number of comments from the potential stakeholders interviewed. The general contention is that in the Kenyan market, rightly or wrongly, the term ICI connotes emphasis on foreign investment as opposed to local investment.

At a workshop, the general consensus was that the index should be called a Business Confidence Index, because that was what the Kenyan market appeared to prefer. It was argued that such an index would cut across the board in terms of appeal and it would attract more buy-in from the local business community who would see it as more relevant.

4. KEY INVESTOR CONCERNS

Informal information is dominant

The study revealed that investors in Kenya place greater reliance on informal information than formal. Formal information is largely unstructured and difficult to get. Many businesses and investors historically relied on rumors, insider information and proximity or privileged access to government to profit from information "asymmetries".

The studied sample generally felt that historically Kenya's private sector has had very close links to government. They also felt that the strong links between government and the private sector has contributed to poor corporate governance practices in the private sector. It was argued that in an environment of poor governance there would be little need for market data and information. The interviews revealed that a large number of Kenyan private sector companies continue to profit from political patronage rather than hard market data and research.

The study also revealed that information asymmetries in the market are mainly driven by government agencies. These agencies, unfortunately, do not promptly or regularly issue or disseminate reliable vital market data for investors.

There is little information on investment opportunities

Many stakeholders pointed out that Kenya has a lot of growth potential relative to the region and that the country also has a service-driven economy with higher levels of commerce than its neighbours. Yet economic agents in Kenya have limited access to timely and accurate information on market and investment opportunities. The little information on investment opportunities that is available is not widely disseminated. Kenyan industries do not have compulsory disclosure laws. Data and disclosure laws available are at best weakly enforced. The overwhelming view was that executives would welcome better market information so that enterprises can thrive under a business environment that also creates opportunities.

The current business environment is more open and increasingly exposed to the outside world. Hence the need to move away from informal sources and rumors to good scientific data and reliable indicators, including respected confidence indices. Financial advisers, M&A corporate advisers and investment bankers are the main consumers of financial and economic data. Kenyan SMEs are not yet large consumers of information and the overwhelming view was that a Kenyan Business Confidence Index will benefit the SME sector significantly.

The political environment is poor

Nearly all investors consulted were concerned that Kenya is held back by poor governance and political interference in business. In the technology sector Tanzania has, in the space of a few years, leapfrogged Kenya in cell phones usage. Investors attributed the success of the horticulture sector in Kenya to the absence of government interference and regulation that allowed the industry free rein to thrive and innovate. Investors also cited government bureaucracy in itself as a problem that is more acute in Kenya than in neighboring countries.

The informal economy is very large, but is not well captured in economic management

A general view was that the informal sector, which plays a significant part in development of the Kenyan economy, is not captured in the “regular” key economic analysis. A very significant part of the economy is outside the formal sector and is not represented in the capital markets. While the firms listed on the NSE represent high profile sectors, their total contribution to GDP was described by a leading CEO as “insignificant”. With just 52 firms listed, the formal economy and the stock exchange (NSE) alone do not fully represent the real economy. Therefore, surveys of business confidence in the formal sector alone may not accurately track the whole economy or predict future economic activity in a meaningful way.

Market regulators are weak or ineffective

The sampled investors were very concerned about the underlying poor quality of regulation in key industries due to the inadequate enforcement of existing laws (e.g. under the Restrictive Trade Practices Act). The executives felt that government should do more to stamp out the many anti-competitive business practices and cartel-like groupings that are widespread in the economy.

Corruption

Almost all investors and executives consulted ranked corruption very highly and added that the combination of corruption with insecurity and growing crime was their principal concern. They indicated that corruption feeds costs directly into their inputs and is a direct cause of the high costs of doing business in Kenya.

Corruption is probably the single greatest investor concern in Kenya

The comment below by a leading Automotive CEO summarizes their concerns very strongly.

“Until corruption is addressed, nothing else matters. No investor confidence index is ‘useful’ until all corruption matters are resolved.”- CEO, major automotive investor.

Investors consider the current political and business climate as discouraging to new FDI.

The Investment horizon of large investors is long term, sector-specific and regional

Large local corporations and real FDI investors have a long term investment horizon when it comes to heavy investments in plant and machinery. While their long term investment horizon drives their risk perceptions, investor risk appetites are low. Hence they attach a lot of weight to risks, especially political risks. This makes risks and risk perception an important driver of long-term investment and FDI.

The dilemma of these long term investors is that all market and investment information in Kenya is short-term and the KBCI will suit this environment. They want to take a long term view of the health of their sectors, especially trends in taxation of inputs, growth of the sectors, whether licensing is getting easier and profitability of existing players. All these factors determine their investment plans. They consider 3-4 month forecasts of limited utility and prefer longer term forecasts. Examples offered that illustrate their long-term orientation included: business plans typically take 1.5 to 8 months to revise; KBL's bottling line took 2 years to plan and install; and Bamburi's clinker plant at Athi River took 5 years to put in place. As the KBCI develops a credible history, biannual or even annual indices could be developed to satisfy long-term forecasts.

Large domestic corporations and multinationals increasingly take a regional outlook. The CEO of a leading firm in the technology sector summarized this view in the comment below:

"Can you really look at Kenya without taking an East Africa- wide view?"

This indicates that there might be the need for regional East-African indices.

Poor Record of Government in Delivering Promises

Investors were concerned that Government "talks" about attracting FDI and investments but does little to benefit investors in the country. This gives the government major credibility problems with investors who see weaknesses in implementation, or the sheer lack of implementation as negating progress made in policymaking. The feeling was that a poor record of implementation feeds into the perceptions of Kenya as a poor investment destination and a high cost location for doing business.

Most Important Sectors

Investors rated Agriculture as an important driver of the economy due to the number of people it employs and the export earnings it generates. Agriculture in particular sustains the bulk of employment outside the formal sector.

"If anything goes wrong in agriculture, the effects ripple through the economy."

They recognized that agro-processing contributes significant foreign currency earnings, principally from tea and coffee (22%) and horticulture (18.5%). Investors rated horticulture very highly as the majority of growers and exporters are Kenyan owned and success in the sector feeds capital into the economy. But many expressed concern at the lack of value addition locally and the continued export of unprocessed agricultural products. Potential areas of value addition in coffee, tea, cotton and sisal but also fish, livestock, hides and skins appear neglected. Rice production did not attract much investor interest as a "key" crop due to low production of rice locally.

A leading Investor suggested the sectoral indices place emphasis on agriculture and food crops, especially maize, as a separate category from export crops. This distinction can enable the sectoral confidence indices to track food crops separate from export sectors of tea, coffee and horticulture.

Manufacturers made strong representations on the importance of their sector. “Industry is our salvation because production adds value and has the highest potential for creating employment. It also offers the most in terms value addition and transfer of skills,” say the chairman of KAM.

Tourism contributes 14% of the nations foreign currency earnings but is heavily affected by insecurity. Tourism is sensitive to the exchange rate and through its in uence on the supply of foreign exchange impacts on domestic prices.

Investors rated the Banking and financial services sector as an important sector and the banking regulator (the CBK) as the “most successful regulator” in the economy. the insurance industry regulator attracted very poor ratings for maintaining an “opaque” insurance sector on minimal disclosures. An investor pointed out that Pension Funds and Cooperatives are important in part due to their vast property holdings.

Investors recognized that Kenya is exporting labor and has the best developed skills in the region, few cited education, training and skill development as key drivers of the economy.

5. THE BUSINESS CONFIDENCE INDEX

Investors and various stakeholders including the CBS, CBK and KAM gave a wide range of views regarding the potential uses of the confidence index , the content and areas it should track.

Main Users of the Confidence Index

Domestic and foreign Investors are clearly the main target group for the confidence index. The confidence index would be an important indicator targeted specifically at domestic and foreign direct investors (FDI). It would also be closely watched by foreign portfolio investors. While a fair amount of economic, business and market information is already collected in Kenya, very little is collated specifically for the needs of investors. The confidence index and associated reports would supplement data and information available from government and industry associations.

Key industry regulators: The exercise of developing the national Business Confidence Index is expected to lead to more regular collection of critical market information for regulators as well as investors. The main regulator expected to frequently use the confidence index is the Central Bank of Kenya. A confidence index will indirectly measure how well the bank discharges its legal mandates in monetary policy, price stability and overseeing a sound and stable banking system. The efficiency of the nation’s payments systems and whether they assist to deliver low transaction costs.

Other important regulators expected to use the confidence index are the Communication Commission of Kenya (CCK) in the technology sector (heavily dependent on market opening); the Commissioner of Insurance; Commissioner of Cooperatives; and the various produce and marketing regulators for tea, coffee, sugar and horticulture. With the notable exception of the Central Bank of Kenya and the Tea Board of Kenya, very few regulators routinely gather and disseminate industry information or collect feedback on their performance.

Government agencies in charge of trade, investments and exports: the key government agency expected to be the major consumer of the confidence index is the Investment Promotion Centre (IPC). The IPC expressed very strong support for the investor confidence index and would even be willing to help in financing the index. IPC collaborates with UNIDO on cross-country investor surveys in sub-Saharan Africa.

Other government agencies likely to use the index are the Export Promotion Council (EPC), the Export Processing Zone Authority (EPZA) and the ministries of Planning, Finance and Trade and Industry. The process of developing the national Business Confidence Index is expected to lead to more regular collection of critical market and investor information for these agencies and regulators.

Cooperatives are expected to use the confidence index heavily and to provide input during its preparation. They are a good source of information on the informal economy, SMEs, farmers and companies in the rural areas. While cooperatives form an important pillar of the economy they do not currently generate or issue individual or aggregated industry information on firms, output and employment levels. They clearly need more capacity building to generate and use information on their sector.

Pensions Funds and Institutional Investors: The Business Confidence Index would be a crucial decision-making tool for these investors. Pension funds, Fund Managers and Market Analysts, according to the NSE, are increasingly demanding more data and information of medium to longer term nature to help them make investment decisions. These institutional investors are expected to lead the drive for better data and market information of a predictive, forward looking nature like the confidence index. Indeed the index could well be a leading indicator for them in making portfolio and investment decisions.

The Main Areas to be captured by the Confidence Index

Confidence of domestic investors, including SMEs
Investors and managers expressed unequivocal support for an index that captures the perceptions and confidence of both local and foreign investors already on the ground.

The confidence index should therefore measure the perceptions and expectations of investors on
- Current and expected returns on their investments
- Security of their investments
- Broad current and expected business environment

Confidence should re ect primary drivers of the economy
Stakeholders were keen that the confidence index should be capable of tracking primary drivers of the economy and should include sector sub-indices, appropriately weighted; otherwise the measures of market expectations run the risk of only serving large and sophisticated investors.

Preference for forward looking and leading indicators of perceptions
Almost all investors surveyed preferred a confidence index derived from survey-based techniques that ask forward-looking questions against indices derived from “hard” economic and business data.

The confidence index should help provide market and investment information that points out areas where opportunities may lie.

Investor confidence by sector, size and type of firms
Equally strong was the need for sub- indices of investor confidence by sector, size and type of firm. Executives considered this information a crucial part of the main confidence index whether collected separately or at the time of the main surveys. Thus separate perception and confidence surveys may need to be developed specifically to target certain sectors and SMEs in the informal sector in order to meet these investors' needs.

Sector and industries outlook and expectations
Managers requested that the confidence index should capture the following information:

- Actual and expected growth in the economy
- Actual and expected growth in employment, or changes in unemployment
- Actual or expected performance of some of the "pillars of growth" identified in the Economic Recovery Strategy (ERS) including building and construction, investments and macroeconomic stability

The frequency of the confidence index
The frequency of the confidence index was an important consideration for investors. The overwhelming request was for a quarterly frequency. Many investors felt that the confidence index is likely to target (be pegged on) their planning horizons and investment decisions to roll-over or uplifting T-Bills on quarterly returns from the 90-day Treasury bills. Other stakeholders argued that quarterly indices will fit in neatly with companies' quarterly financial reviews.

Many important stakeholders, however, preferred less frequent semi-annual or annual releases based on practical reasons of cost. The latter believe that business and economic fundamentals in Kenya do not change often enough to warrant quarterly frequencies. the CBK echoed the view that the business environment in Kenya is not uid or fast-changing enough to warrant high frequencies (like monthly or quarterly confidence surveys). The factors that drive investor expectations only change slowly. While quarterly time intervals may coincide with local and foreign portfolio investors, they may be too short for FDI investors and large domestic corporations with longer investment horizons.

Timing of release of the confidence index
The actual time of release was important to public sector stakeholders who feared that "bad news on investor confidence needs careful "management and timing" so as not to alarm the government. In the section on concept note we recommend semi annual confidence indices with two quarterly updates. We further recommend the semi-annual index be timed for release after the months of March and September and the quarterly updates in June and December.

The base (or benchmark) period of the index.
Investors felt the issue of the "starting period" used as the benchmark (or base index that is normally set to 100) was critical. The public sector stakeholders considered the current period as full of political "noise" that may skew or bias the base confidence index.

The benchmark or base period depends largely on the methodology selected. For instance the starting period ceases to matter for a confidence index set to a scale of 0 to 100, where 0 is most pessimistic and 100 is the maximum optimism level.

Index of the quality of key institutions and market regulators
Many investors expressed strong support for producing an index of the quality of key institutions and market regulators side by side with the confidence surveys. They clearly indicated that better

regulation and higher quality institutions contribute to a better business environment and, indirectly, instill greater confidence in doing business. This could be generated from surveys that rate the services of key institutions like the port and could take the form of rankings of the "top 10 investor concerns" on a scale of 1 to 10.

Investors perceive Kenya as having weak regulators in key sectors that restrict freedom of entry and exit, particularly in the telecoms, insurance, coffee, sugar and shipping sectors. A major mobile network supplier recently raised charges with little or no comment from the regulator, the CCK.

Investors requested ratings be constructed to help monitor industry and market regulators. An index on the quality of city administration or local authorities would greatly help manufacturers.

An automotive investor requested a more general index of institutional quality that can prod government to "pull up its socks" and take corrective action on areas attracting poor ratings.

Investor concerns on key market regulators and institutional quality could be captured in supplementary questions that assess and rank areas that "negatively" impact business. This appears to be an area for other stakeholders to develop alongside the business confidence index.

6. IMPORTANCE OF A BUSINESS CONFIDENCE INDEX

A broad range of reasons for the rationale for the confidence index were put forward. The most common reason given by the managers consulted was that a confidence indicator can help investors and businesses anticipate and respond to change.

One CEO in the technology sector foresees the index as helping to make better investment decisions on the future "if I can know about it before reading it in the papers…" A senior executive of a leading media group believes a business confidence index can help to "distill facts from fiction. If trends are changing, why is it happening? Political trends can be overplayed" In his view the absence of credible confidence surveys generate a lot of "hearsay" about the health of the economy.

Managers and leading executives expect the confidence index to help keep the public regularly informed about the investment climate.

While the public sector may offer some initial resistance, investors expect the government to eventually respond to the index and offer explanation for adverse trends or even in uence policy changes.

7. MANAGERS AND INVESTORS PREFERENCES FOR CONFIDENCE INDEX

Main preferences expressed by investors for the confidence index are:

- One composite business confidence index covering the country.
- Sub-indices covering key sectors, types and size of firms.
- Forward-looking, "leading" indices as opposed to historical "lagging" indicators.
- Index methodologies based on surveys of the extent to which investors are bullish or bearish.
- Credibility and sustainability that makes the confidence index eagerly anticipated by the market and investors.
- Quarterly frequencies. The most common frequency requested was quarterly.

Preferences for a composite confidence index
Investors and senior managers consulted expressed a need for a composite, nation-wide measure of business confidence and investor perceptions. The forward looking indices have greater support. Few investors asked for lagging indicators, in part due to the perception that government data is of poor quality or even unreliable.

Investors expect to also capture perceptions and expectations of the large informal economy and to get indices of prospects by size of firms and SMEs. These require surveys to capture size and types of firms (e.g. by employees and turnover.)

Preferences for sector- specific indices
Investors requested sector-specific indices particularly in technology, manufacturing, banking, agriculture and tourism. Sector-specific business conditions and indices require surveys to gather information and perceptions on a broader range of indicators beyond those needed for the composite index. These may include current and planned investments; expected spending on plant and equipment; and revenue and employment levels.

The Investment Promotion Centre (IPC) made a case for a location-specific index generated by district or area.

The methodologies used to measure confidence need to capture important investor concerns while be kept simple and easy.

We recommend major semi-annual confidence indices be released after the months of March and September and quarterly updates to be released in the months of June and December. This structure gives enough lee-way to update the major index should there be a need and it also allows enough time for collecting comprehensive data, including factors that impact negatively on business or hinder investments. Surveys should also collect "positive" factors like how investors plan to grow their business

Will investors and the public trust the confidence index?
The response from our consultations is that people will trust the confidence index. But only if there is some distance between it and the government. If it is based on government data the index will be suspect.

8. PROXY INDICATORS THAT INVESTORS CURRENTLY USE

We encountered a broad range of proxy indicators used by investors and in-house "indicators" that drive investor decisions. Many are based on market information and address sector-specific concerns. Others aim to spot market growth or highlight opportunities. Many reveal the particular investment horizons of the investors. Below is a presentation of the main proxy indicators encountered during the consultations with Kenyan investors, interest groups and regulators in various sectors.

- IT spending, an indicator of market growth
- Spending on plant and equipment within the sector
- Registration of new vehicles, an indicator of consumer spending on durables
- Volume of trade credit issued
- Cement sales to track building and construction
- Tourists Arrivals

- Hotel and bed occupancy
- Tea Auction sales from Mombassa auction
- Fuel consumption, an indicator also closely watched by a leading Bank CEO
- Commercial advertising spend, an indicator for economic conditions and growth.
- Employment levels
- Trade credit expansion
- Cost of credit in the economy
- Trends of Non- performing loans (NPLs)
- Retail consumption trends (e.g. sales of Unilever, Cussons, Uchumi supermarkets)
- Deposits and Assets trends
- Oil imports which account for 22% of Kenya's import bill
- NPLs trends
- Interest rate spreads
- Trends in investments by banks themselves
- Building of new bank branches

Investors and market regulators used "proxy indicators" in a variety of ways. The CBK assigns weights to selected proxy indicators to derive an in-house "index". It uses the in- house indices to help it project economic growth and discharge its obligations on monetary policy, price stability and financial sector regulation. A public sector think tank, the IEA, combines soft and hard indices to project economic activities. Leading investors in banking and ICT sectors track rival firms' capital spending on IT and peer- group investments in bank branches to project likely economic and investment activity levels. The leading investor the advertising sector tracks overall advertising spend on the real economy by commercial clients (excluding donor-NGO adverts) to measure growth in the economy. That latter indicator is currently growing negatively and suggests the economy is declining.

9. INSTITUTIONAL FRAMEWORK AND PARTNERSHIPS

9.1 Overview of Institutional framework recommended

We sought stakeholders' views on the appropriate ownership and institutional settings. In overall terms they recommended a private sector framework but in partnership with carefully selected public sector agencies and industry associations that add credibility to the confidence index.

We recommend the following institutional structure for the index:

1. Principal Owner, the entity that owns the overall index and controls the method of computation and release the index.
2. An Independent Oversight Board responsible for key decisions and audits the computation process.
3. Collaborating Partners who represent industry interests and support the index

9.1.1 Proposed Principal owner(s)

We recommend that the owner(s) of the BCI must have significant economic in uence and be capable of bringing to the index the requisite high-profile standing with leading investors. They must not be sector-centric, but have a broad multi-sectoral representation or in uence and strong linkages to the private sector as well as government. Most importantly, they must be perceived as independent. These could include:

1. Market Intelligence, the leading business publication in Kenya
2. FKE – Federation of Kenya Employers or similar organisations.

Where more than one owner is perceived, it would be appropriate to have a principal owner commanding a majority shareholding. The Principal owner would own the intellectual property rights associated with the index that is necessary to secure a stream of revenues. Such an arrangement would minimize potential disputes and enhance efficiency and effectiveness in the running of the index.

DFID is expected to remain the main donor during the seed- capital phase and the lead donor if the index attracts funding support of a consortium of donors like CIDA, SIDA, and USAID. Investors recognized the crucial role of donor funding in the formative years but suggested this funding be restricted to about two to three years from the commencement of the index.

Market Intelligence, the agship of Economic Intelligence Limited, represents broad media and economic interests that would be perceived as un-biased. It also provides the media platform for coordinating and disseminating the release of the confidence index to a wide range of stakeholders and interested parties. The magazine is closely in tune with the business environment and stays in constant touch with the business pulse of the economy. It's uniquely placed to own and communicate the index.

The Federation of Kenya Employers (FKE) provides additional buy in from the apex employers' Association in a capacity and role similar to the Conference Board in Canada or the CBI in the UK.

We have placed all other special interest groups, industry associations and lobbies outside the core ownership structures. This should ensure the index has the support and participation of a wide range of special interests while maintaining a high level of independence from any one dominant lobby that could compromise its independence.

9.1.2 Collaborating Partners

Consulted and willing to be collaborate
KAM –Kenya Manufacturers Association
NSE – Nairobi Stock Exchange
CMA – Capital Market Authority
IPC –Investment Promotion Center
IEA – Institute of Economic Analysis
KBA – Kenya Bankers Association
ICPAK – Institute of Certified Public Accountants of Kenya
The East Africa Business Council

Not consulted yet, but expected to collaborate
KEPSA - the Kenya Private Sector Alliance
KIPPRA – Kenya Institute Of Public Policy Research and Analysis
KNCCI – the Kenya National Chamber of Commerce and Industry
KUSCCO – the Kenya Union of Savings and Credit Co-operative Organisations
UNIDO AND UNDP

We consulted most of the proposed partners and a large number are interested in becoming stakeholders of the confidence index. We believe the others not yet consulted during the scoping stage will agree to be partners if accorded the opportunity.

Multilateral Donors like **UNDP** and **UNIDO** can potentially act as partners beyond the initial seed-capital phase. A country confidence index is a natural extension to UNIDO's on-going programs of cross-country FDI surveys in sub Saharan Africa. They can thus support and guarantee its sustainability and funding for a longer period.

The **Kenya Bankers Association (KBA)** represents the interests of the banking industry, which is a key facilitator of investments. Many confidence indices are developed and financed by individual banks like the State Street confidence index in the USA. The leading confidence indices in South Africa are prepared in collaboration with major local banks.

We recommend the **Kenya Associations of Manufacturers (KAM)** in the first tier of collaborators largely due to the leading role they play in the economy. They expressed the strongest support for the proposed confidence index.

The **Institute of Certified Public Accountants (ICPAK)** brings many advantages to the index as a body of professional Accountants. The views of the Institute are authoritative and widely read and respected. ICPAK and its membership play a significant advisory and facilitative role with leading investors as public accountants and auditors. Its members are key advisers in finance, taxation and investment decisions with accounting firms frequently the first point of contact with investors.

The **East Africa Business Council (EABC)** brings together the leading investors and chief executives in the region. The council's annual meetings provide a good forum for discussing and marketing the business confidence index. The composite nation-wide confidence index would also complement the limited annual survey of perceptions that the EABC currently conducts among its member's (just 25 Questions limited to no more than 3pages). The key members we consulted in their individual capacity were willing to see the index associated with the EABC.

The **Kenya National Chamber of Commerce and Industry (KNCCI),** although essentially a moribund organization with serious and management problems would be worth associating with.

The local universities, potentially worthy partners, are not taken seriously by the private sector. It will be important to find a way of incorporating them in the project. In many developed markets leading university business schools (B-Schools) are the natural home for many research-based indices. Examples include Canada's technology triangle confidence index hosted by Laurier B-School; the UK retail confidence index at Templeton College, Oxford University and the respected investor confidence index from Michigan University. The theoretical foundations for a confidence index and the earliest such index were developed at the university of Michigan

9.2 Ownership of the confidence index

Investors were clear that the ideal home is a private sector initiative owned and led by the private sector independent of government. This allows the confidence index to be prepared professionally outside any government or quasi government agency.

Many recognized that this does not preclude a donor or consortium of donors providing the initial seed capital to establish the index in the first few years. The private sector body that owns and issues the index needs to have assured financial resources to be credible. But once the index is established its credibility would be hurt by significant control or ownership by government, quasi government agencies or donors. This means the index also needs to be eventually independent from donors.

9.3 Ownership of index and the method of computation

It is recommended that the index has clear owner with proprietary rights to the particular method of computation. This would confer on the principal owner's rights to the stream of future revenues that are ultimately the basis for sustaining the index. But the particular method of computation can be co-owned with the principal owner as a majority stakeholder through a special purpose entity controlled by the principal owner with rights to the computation of the index.

Independent Oversight Board

Managers and investors suggested the need for an Independent oversight board to provide peer review and oversee the integrity of the Business Confidence Index. The Oversight Board would help to balance the profit motive and other special interests that owners and collaborating partners may have.

The Oversight Board would need unlimited access to the survey and detailed records of the index. It would also retain rights to periodically "audit' and report on the fidelity of the index. Through periodic 'audits" it can recommend revisions to the index or its components, survey techniques and sample sizes as well as chart the development of additional products and improvements. It will be an advisory board whose credibility will be dependent on the profile of its individual membership.

9.4 Issuer of index

The principal owner of the index was preferred as the entity to issue the index. The principal owner and the collaborating partners can individually or collectively publicize the index and related reports after it is formally issued.

9.5 Summary of investors' recommendations on ownership

- Rule out ownership by government or government agencies
- Exclude from ownership and oversight institutions that do not add credibility to the index or raise its public profile.
- Enhance credibility by establishing an independent oversight board formally responsible for releasing the index and overseeing major decisions. The oversight board should comprise respected managers and business leaders

International Financial Institutions (IFIs) including the Bretton Woods institutions, command investor respect and have an international outlook. They are perceived as largely neutral but are probably more feared than authoritative. Managers considered them as "poor hosts" or partners for an index of "perceptions and expectations".

There was universal acclaim to get "buy in" from a wide spectrum of private business, investors, trade and industry associations but also acceptance by government. IPC made a strong case for government to be seen as a partner in improving the investment climate rather than an adversary to criticize as its actions feed into investor perceptions and decisions.

9.6 Wide dissemination of the Index

All investors agreed the index needs to be widely publicized. Hence the certain need to have media stakeholders. Market Intelligence was considered a natural partner as it also helped to develop the concept and conducted the initial studies. Consultations with a leading media house indicated the media would be more attracted to disseminate the detailed reports and the sector-indices that make up the composite, overall index.

10.0 SUSTAINABILITY OF INDEX

10.1 Sustainability of the Index

Investors offered a number of ways to make the confidence index sustainable. We have distilled and summarized their views below, together with our recommendations.

- The index should initially be “free” of charge to “consumers” and users.
- The index can be sold by subscriptions after the initial seed capita phase.
- Investors appear more willing to subscribe to tailored reports and sector- specific indices than paying directly for the composite national index.
- Subscriptions and sales of special reports and detailed sector-indices are the best way of sustaining the index beyond the initial seed capital phase.
- On-coming consultancy assignments instigated by the indices.

10.2 Funding of the Index

Investors recognized that donor- funding is crucial in the first two or three years. But they were keen on the confidence index standing on its own beyond that period. This is the reason the eventual “principal owner” from the private sector need to come on board from day one, and why we propose an arrangement that secures a stream of revenue to the principal owner.

Investors and managers were willing to pay for the index once the market accepts it and begins to rely on it. Its sustainability increases if it evolves into a closely watched and anticipated index with appropriate build up to its release. Certain stakeholders consulted specifically agreed to subscribe to it (e.g. IPC, NSE, and IEA). CMA also expressed readiness to be one of its partners. The CBK would be <u>unwilling</u> to fund the index as it directly does not fit into what it does. They see their role as providing inputs and data into the index but are willing to subscribe to the index.

11.0 SUMMARY OF CONSULTATIVE WORKSHOP

<u>11.1 Investor consultative workshop</u>

We held a workshop to allow broader consultations and discussions with investors and managers on the confidence index and gathered their views via a written questionnaire. The workshop supplemented the in-depth interviews held with selected executives.

Participants expressed strong support for an <u>investor</u> confidence index. They were also supportive of a <u>business</u> confidence index that covers a broad range of investors, not just the large corporations and foreign FDI investors. There was strong support for sector-specific indices. They expect the confidence index to contribute to better business and investment decisions in the market. Kenya already has an existing <u>public services satisfaction survey</u> that measures satisfaction with government performance in 25 areas.

Participants requested an index of regulatory quality (a “regulators index”) to supplement the confidence index as government intrudes heavily on business. Such an index can also rate performance of government as the custodian of economic and business information.

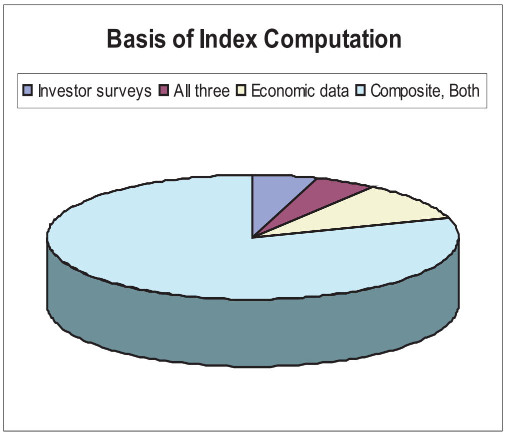
11.2 Base period for the index (index starting- point)

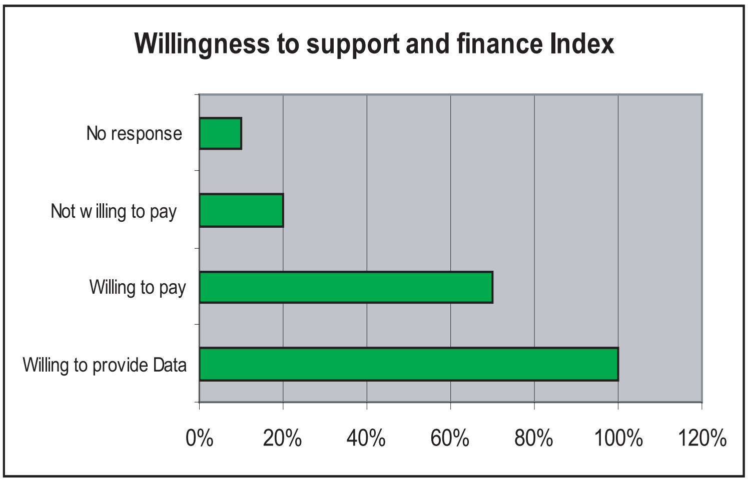
Some managers did not consider the current period as a “good” base date. A high level of “political noise” may adversely affect the base or initial starting point or lower the credibility of the index. But many investors accepted that any index must start somewhere. One way to meet this concern is to adopt a scale of 0-100, with 50 as a “neutral” measure. This largely then eliminates the problem of the base date.

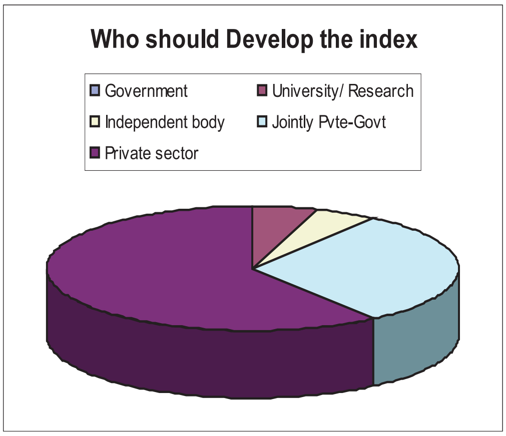
Some representatives of the public sector, including a key regulator, opposed the index if it measures “bad news”. They suggested negative investor confidence be “covered up” or the release of the results carefully timed to minimize the impact of bad news. Energy sector participants requested inclusion of a measure of political risk because investments and returns in the sector suffer more from the political climate and adverse effects like donor aid suspensions.

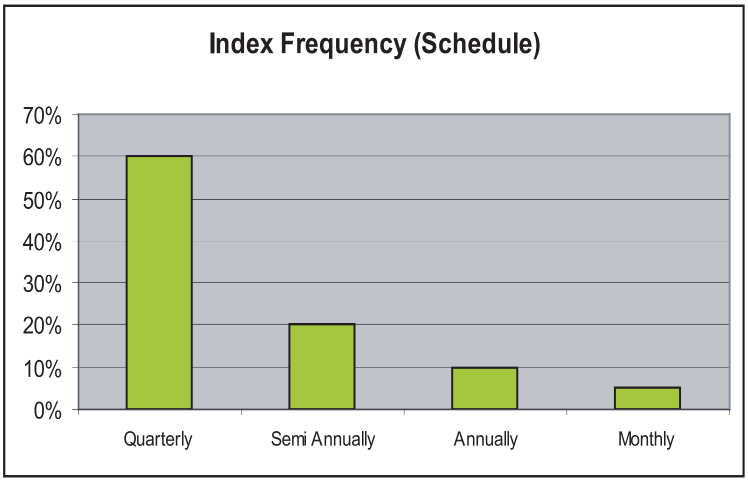
Summary results of workshop questionnaires

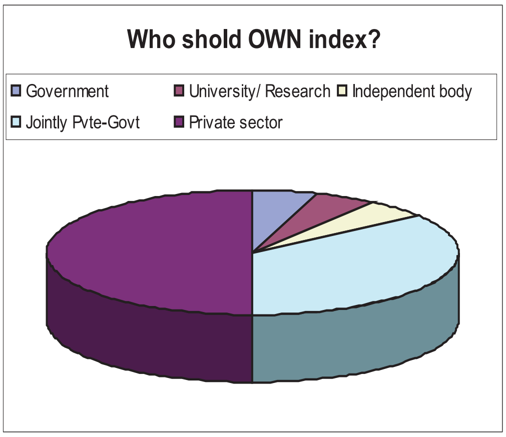
Issue	Responses by Participants (% indicates proportion responding)
Need for Index	All participants were overwhelmingly in favor of the index
Firms to survey	95% favor a survey of all firms; only 5% selecting medium & large firms

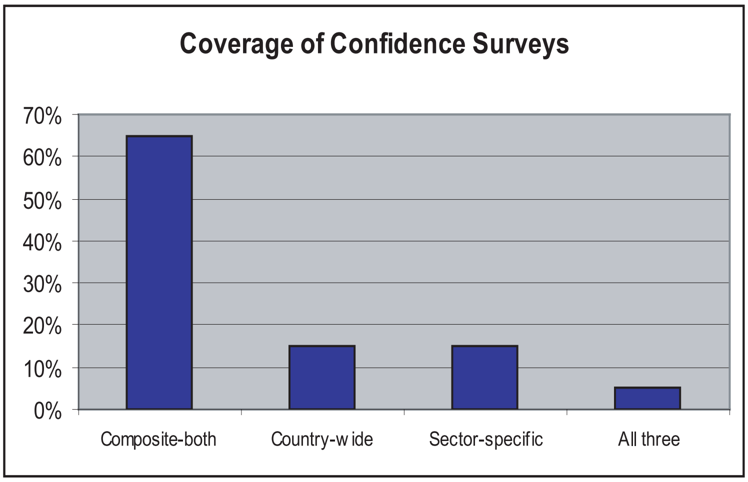

Basis of Index Computation
Investor surveys
All three
Economic data
Composite, Both


Willingness to support and finance Index
No response
Not w illing to pay
Willing to pay
Willing to provide Data
0%
20%
40%
60%
80%
100%
120%


Who should Develop the index
Government
University/ Research
Independent body
Jointly Pvte-Govt
Private sector


Index Frequency (Schedule)
70%
60%
50%
40%
30%
20%
10%
0%
Quarterly
Semi Annually
Annually
Monthly


Who shold OWN index?
Government
University/ Research
Independent body
Jointly Pvte-Govt
Private sector


Coverage of Confidence Surveys
70%
60%
50%
40%
30%
20%
10%
0%
Composite-both
Country-w ide
Sector-specific
All three

"key sectors for inclusion in the confidence indices
The table below presents the sectors that participants would like to be included in composite or sector specific confidence indices. Percentages indicate respondents listing them as most important.

	Key sectors for inclusion in index by investor preference	% Response
1	Agriculture (export crops, food crops, horticulture)	17%
2	Manufacturing	15%
3	Banking & Financial services	12%
4	ICT	9%
5	Services	7%
6	Transportation	6%
7	Tourism	5%
8	Infrastructures	4%
9	HR-Knowledge-based skills	4%
10	Healthcare	3%
11	Roads, Government Services, SMEs, Housing,	2%
12	Horticulture, Building & constr., Water, Mining, nvironment	other

"Negative" Factors That Impact on Business
The table below presents the areas participants considered as the two most important "negative" factors that affect business and investor confidence in Kenya. Percentages indicate respondents listing them as top two concerns)

	Factors that impact most on Investor Confidence	% Responses
1	Political climate (current wrangles, coalition woes)	21.0%
2	Insecurity and crime	19.0%
3	Corruption	14.0%
4	Infrastructure –Bad or expensive infrastructure	14.0%
5	Government Fiscal and monetary policy	7.0%
6	High costs of doing business in Kenya	4.8%
7	Governance concerns in general	4.8%
8	Political risks	2.3%
9	Government bureaucracy	2.3%
10	Regulatory climate	2.3%
11	Poor performance of the economy	2.3%

11.3 Participants comments on workshop Questionnaire

- The confidence Index is a good initiative
- The index needs the support of both the public and private sectors and can be used to foster closer links and coordination between government, academia and business.
- critical factors to its credibility are accuracy and reliability
- The index needs to capture representative indicators in the key sectors and should also cover the informal economy and SMEs.
- Some representatives of the public sector consider the timing of the index "bad" due to the current adverse political climate. This response is however balanced by the view of the CEO of the leading government investment promotion agency "not to fear the confidence index even if its initially negative"

12. CONCEPT NOTE AND POSITION PAPER

The need for the confidence index was demonstrated in the field interviews with senior managers and the consultative workshop held.

12.1 Review of applicable methodologies

Confidence indices can be constructed from surveys of investors' perceptions and expectations. Experience in developed markets indicates that these soft indicators track business and economic activities remarkably well. They are invaluable as "leading" indicators and complement indicators "lagging" based on hard economic data.

12.1.1 Available Methodologies for Confidence Index

There are three main methodologies available for developing investor and business confidence indices.

Confidence index based on surveys of perception and expectations (soft Indices)
These Surveys of investor perceptions, expectations and opinions are "soft" confidence indices based on responses to written or telephone interviews, questionnaires and other techniques of collecting opinions and views of senior managers and executives. The responses are analyzed using standard statistical techniques and software packages to generate a composite or main index, and various sub indices. The main strength of survey based confidence indices is their forward looking, predictive nature that makes them a "leading indicator". The BER business confidence index in SA and the Michigan investor confidence index are widely respected indices that implement survey-based methods.

Confidence index based on economic and business data (hard indices)
Confidence indices can be generated from carefully selected macro- economic, business and financial indicators. They may or may not incorporate surveys of investor perceptions and opinions. Their main strength is the authority they derive from being based on hard economic and business data. Their main weakness is their backward- looking nature and weakens their predictive power. At best they are "lagging indicators" of economic activities. The business confidence index of the South African Chamber of Business (SACOB) is based on hard economic and business data.

Confidence index based on calculations of investors holdings of risky assets
Investor confidence can be measured directly and quantitatively by techniques of modern portfolio analysis, including measuring holdings of risky assets compared to safe investments.

The confidence of investors is then calculated directly from their purchases and holdings of risky assets and their risk appetites. The leading example of this method is the proprietary investor confidence index issued by the State Street Bank in the USA. We do not consider it appropriate for Kenya to implement this approach simply due to its undeveloped financial and capital markets.

12.1. 2 Method of Computation and confidence scale(s)

A scale of 100 index points may be the best for Kenya. This scale extends from a minimum of 0 (least optimism) to 100 for maximum optimism. On this 0-100 scale, an index level of 50 represents a "neutral" stance, with investors neither optimistic nor pessimistic. Using this scale it's easy to highlight the sectors and areas where optimism, or the lack of it, lies, are strongly positive, mildly positive or strongly negative. This scale also resolves the issue of the base period selected for the index that is normally set equal to 100. A section of public sector stakeholders were alarmed that the current period is characterized by excessive political “noise” that may drown all other fundamentals and serve as a non- representative year to serve as a basis for future confidence levels.

<u>12.1.3 Timing Schedules of Investor Confidence Index And Surveys</u>

We recommend a Semi Annual frequency for the main investor confidence index with 2 updates in quarter following the main index.

Timing schedules for Kenya’s confidence index

Preliminary fieldwork, survey design	2-4 weeks
Data collection	4-8 weeks
Data Analysis, index calculation and reports	2-4 weeks
Total cycle time for index	10-16 weeks (2-4 months)
Optimal frequency	semi annually
Optimal timing schedule	March and September
Quarterly updates schedule	June and December
Start of Index preparation cycle Release of index, sub indices and reports	February 1st and August 1st April 30th, October 31st

The semi annual March and September release dates avoid the excessive “noise” and seasonality associated with the national budget in June. They shift fieldwork away from the heavy workloads at the financial year ends and the holiday month of December when key executives in the local market may not be available. Full year results for most firms and investors firms are ready by March. Senior executives and owners would be well informed at that time on prior year results and well placed to comment on the outlook for their financial year. September is a good point for investors to re ect on expected full year results, and the outlook for the next financial year, after nine months of the calendar and financial year are completed. We consider March and September as relatively quieter periods that may allow much better confidence surveys to be taken with minimal interference from “budget noise” and the December holiday month.

The index revision in the two quarters proceeding the semi-annual release will mitigate against any changes that might arise, given that some of the parameters used in calculating the index may be volatile. This frequency combination can be maintained for the first two years (2005-2006). Thereafter it can be increased to a quarterly frequency as the index gains market acceptance and its components settle down, especially the sub indices of sectors, firm sizes and category of investors. The surveys for the quarterly BCI index in South Africa (BER) takes about 3 weeks fieldwork to survey 3000 participants in 5 broad sector categories. The results are analyzed and released about 2 weeks after completion of surveys.

We recognize that many stakeholders during interviews and in the consultative workshop requested a quarterly index frequency. But a small but significant group asked for a semi annual or annual tenor for practical reasons. Greater quarterly frequencies have a cost implication that may initially harm the sustainability of the index, and its ability to become self financing eventually. High quarterly frequencies from the beginning may also harm accuracy and completeness. For many firms a quarterly frequency may mean that no sooner is one cycle completed than surveys and questionnaires are dispatched to CEOs and senior executives for the next cycle. In South Africa, instances of senior executives progressively delegating responsibility for surveys to junior managers or personal assistants if they become swamped with frequent surveys, have been experienced.

12.2 Design Criteria For Kenya's Confidence Index

The comments and views of all managers interviewed suggest adoption of the criteria below. They are a minimum set of agreed or common points that the Kenya Business Confidence Index needs to have. They also include practical options that the consultants have distilled from their fieldwork and other consultations with stake holders in Kenya

12.2.1 Simplicity

A sophisticated confidence index may ounder simply due to the poor quality of data locally on the population of business and investors. Precise information on the "population" of firms and businesses will be hard to get as many are not captured in conventional databases.

12.2.2 Easy to calculate

The confidence index needs to be easy to calculate. Survey based techniques fit this goal.

12.2.3 Re ect a forward looking, "leading" indicator

A forward looking, leading indicator of current and future business, investments and economic activities was preferred to lagging indicators of the past based on economic

12.3 Confidence survey design

12.3.1 Index computation

The most basic confidence index is conceptually computed as below:

Confidence Index= 100 x [Number of YES responses / Sum of YES and NO responses]

Various adjustments and weights can be applied to the current and expectations. E.g. Taiwan's attaches a 40% weighting to the "current assessments and a 60% weight to the "expectations" or forecasts. Confidence indexes are then set to a base starting value of 100=base year.

The method would yield a confidence index with the following numbers:

- An index value of 0 for the minimum, least pessimistic level
- An index value of 50 for "neutral"
- An index value of 100 the maximum, most pessimistic level

This method has the advantage of not being "biased" to any base year. It also indicates the strength and degree of investor and business confidence, or the lack thereof.

12.3.2 Sample Sizes For the Confidence Surveys

The confidence indices in most markets aim to achieve statistical accuracy levels of ±3% ±5% at 95% confidence levels. Where the survey sample is not required to meet a fixed size of the population (i.e. there is no population-size factor) the survey sample sizes can be reasonably small from 400 to 1100.

The sample size is estimated from s=1/ (acceptable error^2)

In Kenya the data on potential firms in most sectors is poor, incomplete or outdated. Only formal-sector trade and industry associations are likely to have reasonably useable information on their members. The KAM directory of members for instance contains about 450 manufactures. Associations and regulators in banking, insurance, tea, owers, and coffee should also have reasonably accurate details of firms that can help in surveys sampling.

Estimates of sample sizes for investor confidence surveys

Sample Accuracy 95% Confidence	Best sample sizes (1)	adjusted for small population of firms in Kenya (2)	increased to account for poor response rate (3)
±3%	1110	526	785
±4%	625	384	673
±5%	400	285	567

<u>Notes on table of recommended sample sizes:</u>
(1) The sample sizes are estimated by s=1/ (acceptable error^2)
(2) FDI investors / firms in Kenya from latest UNIDO surveys are about 304.
The KAM membership is about 450 manufacturers. The number of banks in Kenya (from MI Banking Survey 2004) is 43. The number of listed public firms in the Nairobi Stock Exchange is 52. The insurance firms are less than 50. The likely "population" of formal sector firms (for purposes of estimating likely sample sizes) is about 1000.

The adjusted sample sizes for a target population, p, of 1000 firms is s/ (1+s/p)

(3) The expected response rate in Kenya is estimated at 30% from comparable responses rates in latest UNIDO Survey of Investors in Kenya. Of ten countries surveyed in Africa by UNIDO Kenya had the lowest response rate at 30%, trailing Tanzania with 44.7% and far below Ugandan firms' response rates of 57.2%. There is no reason to expect a larger survey including local firms will have a better response rate.

<u>12.3.3 Un-useable Responses Increase Requirements For High Data Quality</u>
As the BCI is a survey of perceptions and expectations there is need to ensure a high data quality. Some survey responses inevitably will omit answers to key questions or be discarded as un-useable. The survey responses expected to be un-useable could range from the 8% level experienced by UNIDO in its investor survey to as much as 10% - 15%. The rate of un-useable responses places further pressures on small surveys.

<u>12.3.4 Small Sample Sizes May Impact On Accuracy Of Sector Indices</u>
The criterion of small, simple surveys imposes restrictions on the ability of the confidence index to capture accurately other sub indices and sector-specific indices. Therefore only limited accuracy sector indices can be generated, though most managers requested these as a "must have" feature. A general investor confidence index with 5- 7 distinct sectors and 70 firms per sector can only achieve limited sector surveys. We therefore recommend that specialized sector indices be designed and conducted separately (as sector business confidence indices -BCI). Sector-wide surveys of 180 – 250 firms can generate more accurate and useful confidence indices to underpin the country-wide confidence index. They also give policymakers, investors and the private sector more targeted feedback.

Sectors that expressed strong support for their own indices include manufacturing, tourism, Banking and financial services and services sector in general. These indices could later extend to areas like tea and coffee, building and construction and retail.

12.4 Main considerations in carrying out the Confidence surveys.

12.4.1 Keep Survey questions to a minimum (Ask just a few simple questions)

The established confidence indices in many markets including developed markets
Cover on average no more than 4 – 6 questions. These are designed to elicit informed opinions of the most senior executives and managers and to capture their perceptions of current conditions and expectations going into the future

In outline most survey-based confidence indices follow the broad design below:

Perceptions general to the economy

1. Current business conditions compared to last quarter or six months
2. Expected or forecast business conditions in next quarter or six months

Perceptions specific to the firm surveyed)

3. Current business conditions (or key indicator) compared to last quarter or six months
4. Expected or forecast business conditions (or key indicator) in next quarter or six months

Employment (within firm or in economy)

5. Current staff numbers or employment levels compared to last quarter or six months
6. Expected or forecast staff numbers or employment levels in next quarter or six months

12.4.2 Examples of Survey Questions

Poor								good
1	2	3	4	5	6	7	8	9
			No	Same	YES			
			Worse	Neutral	BETTER			
			Improve	Unchanged	NOT IMPROVED			
			Bad time to buy		good time to buy			
			Bad time to invest		good time to invest			
	Much lower		Lower	Stable	Higher		Much higher	
	Fall considerably		Fall somewhat	Don't know	Rise somewhat		Rise considerably	

12.4.3 Survey Questions: Overview of AREAS and type of questions

Category	Conditions or Indicators	Current Coincident	Expectation Forecast
Economic Conditions	Indicator or Condition	Current perception	future expectation
In-Firm Conditions	Indicator or Condition	Current perception	future expectation
Employment	Number of staff	Current perception	future expectation
Sector Condition	Flowers sector	Current perception	future expectation
Industry condition	Horticulture industry	Current perception	future expectation

12.4.4 Confidence Surveys: examples of AREAS and questions covered

Category	indicator	Perception in current Period /Coincident	Investor Expectation Forecast /next period
General Business & Economic Conditions	General economy inflation level interest rates exchange rates	Indicator has improved, not improved or same	indicator in next period better, worse or same
In-Firm Conditions	Revenues or Profits Capital spending P&E Investment Spending	Indicator has increased, decreased or stayed same	Indicator expected to increase, decrease or stay the same
Employment	Number of staff	staff levels have increased, decreased or remained same	staff levels expected to increase, decrease or stay the same
Sector Condition	Flowers sector	Sector conditions improved, worsened or unchanged	Sector conditions expected to improve, worsen or stay same
Industry condition	Horticulture industry	Industry has improved, worsened or unchanged	Industry expected to improve, worsen or stay unchanged

12.5 Other information that needs to be collected or surveyed

The confidence index needs to collect additional information to support its findings and generate value-added services to help pay for the index. These include analyzing the index further by sector, firm size, location and ownership.

The extra detailed information includes:

- Sector (from a list of key sectors in Kenya)
- Size of firms (by employees and turnover in selected bands eg firms with 1-10 employees or sales exceeding KSh 10m. More detailed firm data may be collected on exports, planned capital investments in plant and equipment, total investments planned and expected investments in training
- Year of establishment (for age of firms, years in Business)
- Age of Chief Executive (or estimated decade like Age 40-50 years)
- Principal location
- Ownership of firm
- Top ten areas that impact most “negatively” on business factors
- Top ten “positive” changes and policies required by businesses

12.6 Profile of Investor Confidence Survey Respondents

The surveys need to target the highest decision making managers and executives in selected firms who are knowledgeable about general business conditions in the economy and their individual firms. Only the highest levels can provide informed perceptions and expectations to make the index meaningful and useful. The surveys should therefore target respondents from the following positions:

- Chairman, Managing Director, Owner and Proprietor
- Chief Executives (CEOs)
- Finance Directors (CFOs), Finance Managers or Chief Accountants
- Company Secretary or Senior Management in equivalent capacity

12.7 Distinguishing between Local and Foreign Investors Confidence

Kenya does not yet have sophisticated financial and capital markets. The equity, debt and bond markets are underdeveloped compared to larger bourses like the JSE in South Africa. Market transactions in securities of listed firms and other issuers are characterized by "thin trading". The absence of developed capital and financial markets makes it impractical to design a pure investor confidence index targeting firms and investors of publicly traded equity and debt securities.

In practical terms the proposed investor confidence index (ICI) for Kenya Defaults to a Business Confidence Index (BCI).

The requirement to "domesticate" the investor confidence index nevertheless does not fully eliminate the need to collect information that can allow analysis of confidence levels among local and domestic investors and foreign investors. The surveys should capture information that enables production of "sub-indices" of confidence among FDI Investors and purely local and domestic investors. The surveys hence need to collect information on equity ownership of firms.

An outline of categories of firms and investors by ownership may include:
- Long term FDI (foreign equity greater than 30%)
- Short term Portfolio FDI investments (foreign equity between 10%-30%)
- Local and domestic investors with foreign equity less than 10%

This allows the index to distinguish confidence among purely local and domestic investors compared to foreign FDI investors. This information can help to generate sub indices that distinguish confidence (even if crudely) among long-term FDI investors and the speculative, short term FDI. Large foreign portfolio and fund managers can generate destabilizing capital movements when they cut and run from an emerging market. A sub index that measures their confidence can give policymakers and the private sector an early warning signal.

12.3.1 Information on the Informal Economy

The large size of the informal sector and Jua-kali firms in rural and urban sectors and the large number engaged in subsistence agriculture places great difficulties in reaching this sector. Firstly, accurate, complete and up to date information and data is not readily available. Truly representative sector confidence indices that target the informal and jua kali sector in a meaningful way may require separate and more extensive surveys of SMEs and informal firms, particularly in the rural areas.

A baseline survey of confidence among SMEs, jua kali firms and informal sector players, can serve as useful complement to the index surveys.

Sources of Information and Data For Investor Surveys

Sector	Primary Organizations Umbrella /Industry bodies	Data and information sources(est. number firms)
Manufacturing	Kenya Assoc. of Manufacturers - KAM Kenya Apparel Mfg & Exporters Assoc. Export Processing Zone Auth. - EPZA Kenya Industrial Estates –KIE Marketing Society of Kenya –MSK Nairobi Stock Exchange - NSE	Directory of members (450) Directory of members (34) Licensed EPZ firms (89) Directory of members firms (150) Directory of corporate members Listed Public firms, Funds
Tourism	Kenya Tourist Dev. Corp. - KTDC Msa. & Coast Tourist Assoc – MCTA Kenya Tourist Board – KTB Catering Levy Trustees - CLT	Directory of member firms Directory of members Licensed tourist hotels (2-5 star) Contributing establishments (list)
Services: Banking Insurance Telecoms Shipping Advertising Accounting Professional serv.	Market Intelligence - Banking Survey Kenya Bankers Assoc. – KBA Commissioner of Insurance Communications Commission - CCK Custom and Excise , KRA Advertising Practitioners of Kenya- APA Inst. Certified P. Accountants –ICPAK EA Professional Association body	Licensed banks (43) Licensed insurance firms (50) Licensed telecoms firms Licensed shipping agents directory of members Directory of practicing members Directory of practicing members
Automotive	Kenya Motor Vehicle Institute - KMVI Registrar of Motor Vehicles	Directory of member firms Vehicle registrations (new & used)
Agricultural: Exporters tea, coffee, flowers	Tea Board of Kenya East Africa Tea Trade Assoc. - EATTA Coffee Board of Kenya Kenya Flower Council – KFC	Directory of members (producers/plantations, buyers, exporters, packers, roasters)
Food Crops	National Cereals Produce Board -NCPB	Maize, cereals millers and buyers

12.4.1 Consumer Confidence as a vital input into Business Confidence

We encountered also mild support for a consumer confidence index. In many developed markets surveys of consumer confidence or are closely watched as predictors of the likely level of business and economic activities. One leading investor's confidence index takes consumer confidence as one of its key inputs.

While outside the scope of the current assignment the development of an appropriate consumer confidence index for Kenya is a vital part of a well functioning investor or business confidence index.

<u>12.4.2 Business Confidence closely watched as "proxies" for Leading Indicators</u>

In developed markets the surveys of consumer and business confidence are closely watched as complements to the leading indicators. They are monitored as leading predictors of economic indicators. Kenya does not at present have any well established or widely disseminated index of leading indicators (LI) based on hard economic and business data. An appropriate and carefully developed set of leading economic indicators can form a critical component of an investor confidence index. Developing an index of leading indicators is a vital complement to an investor's confidence index.

Components of Leading Economic Indicators Compared To Investor Confidence

Components of investor confidence	Components of leading economic indicators	
<u>Perceptions and expectations of :</u> Business conditions Economic conditions Intra-firm Conditions Employment Capital spending (equip Investments planned	*<u>Economic and production data</u>* GDP growth New businesses started Number of liquidations Economic output volume/value • Manufacturing • Merchandise Exports • Merchandise Import New vehicle sales New vehicle registrations Real retail sales Building plans approved Tourist arrivals	*<u>Prices & Financial indicators</u>* Inflation (CPI, underlying) NSE share index Real credit (private sector) Prime overdraft rate Key export prices (tea, coffee) Exchange rate with USD market rates, trade weighted

13.0 APPENDICES:

13.1 TERMS OF REFERENCE

DESIGN MISSION FOR DESIGN OF INVESTOR CONFIDENCE INDEX PROJECT

Background

Investments (both local and foreign) have continued to fall in Africa over the last 15 years. Africa is generally viewed as a high-risk investment destination, competing badly with other continents such as Asia and Latin America. This view is supported by the existence of persistent and unpredictable con icts (2/3 of Africa in con ict situation at any one time), macro economic instability, policy inconsistency, excessive bureaucratic obstacles coupled with corruption, lack of confidence in legal protection and costly and dilapidated infrastructure among others. Despite these negatives, Africa is home to more than 740 million potential consumers, many multinationals operating on the continent continue to make high profits, and the business environment tends to apply more relaxed rules and standards for large and foreign investors.

Kenya is no exception to the declining investments pattern in Africa. Over the last decade, bad governance leading to a high risk and high cost environment, has diminished these figures even further. Kenya has significant economic and political in uence in the East African Region and as a result investing in Kenya attracts a lot of attention. But this has not translated into a net in ow of investments. It is now established that investors' perceptions about the economy have a direct impact on their future investment decision. Investor confidence is a result of the interaction between perception and expectations. The movement of these two actually determine, to a large extent, the movement and direction of investments.

An Investor Confidence Index attempts to measure the direction and is a function of perception and expectation. Given that Africa desperately needs to attract investments, it is surprising that there are very few Investor Confidence Indices (ICI) in Africa. South Africa is perhaps the only country with credible indices, and even these have their own weaknesses. Most African countries utilize the externally driven indices such as the World Bank's World Business Environment Survey (WEBS); the World Bank's Investment Climate Assessments as part of the PSD strategy; Institutional Investor's Country Credit Ratings; Euromoney's Country Risk Rankings; Global Competitiveness report – more recently the World Economic Forum has produce the Africa Competitiveness Report; the PriceWaterhouseCoopers Opacity index, measuring the adverse effects of opacity on business; Moody's Sovereign Ratings Index, and others. DFID Kenya seeks to scope the feasibility and institutional framework of a domesticated ICI which could, in time, be replicated across the region. It is crucial that this exercise demonstrates the value addition of a domesticated index developed and executed locally. In addition, the consultants should comment on the sustainability of such an index in Kenya.

DFID Kenya proposes to support a private sector led initiative that would measure and monitor investor sentiments and confidence throughout the economy. In order to achieve this DFID Kenya wishes to engage a consultant to facilitate a consultation process with stakeholders (mainly private sector) which would feed into the design of an Investor Perception Index Project. This task will also involve assessing proposals which have been presented to DFID Kenya, building on such proposals where possible.

Article I. The scoping study

DFID Kenya has received some preliminary proposals on how this study could be conducted. These will be confirmed in an initial round of discussions with DFID staff as well as local stakeholders. In particular the consultants will:

- Consult widely with stakeholders including the private sector, government and government agencies, and donors to understand key local and foreign investor concerns.
- Develop a set of indicators (indices) that the investor confidence index should aim to highlight. This should include non-traditional indicators, which highlight investment trends. Where comparative and/or alternative indicators exist, the consultants should discuss the merits and demerits of each one.
- Consult with a range of players to explore an appropriate institutional framework and partnerships necessary to ensure wide acceptance among potential users of the indices, and recommend a framework and strategy to ensure wide buy-in.
- Facilitate a workshop of selected private sector players to discuss issues arising from the consultation process and agree a common approach.
- Work with the local consultant to finalise the proposal for the Kenya ICI.

Expected output:

- A stakeholder's workshop held and a report produced and disseminated widely.
- A position paper, including a concept note, prepared outlining how to develop an investor perception index, including methodology and instruments.
- A costed project proposal for support to the development of an Investor Perception Index for Kenya, including detailed budgets and a proposed institutional framework.

Timeline:

This assignment will be executed in three phases:

	Output	Effort (man days)	Start date
Phase I	Kenya ICI scoping mission	**10 days** - including preparation, travel time, consultations and report writing	19th July 04
Phase II	Position paper	**30 days** - including preparation, consultation, workshops and report writing	Sept 2004
Phase III	Kenya ICI project design	**10 days** - including further consultation and stakeholder workshop, if any, and project document preparation	Nov 04

Phase I of the assignment will commence on 19th July. Phases II and III are predicated on the outcome of phase I. Timing will be discussed with key internal and external stakeholders nearer the time.

Article II. The Consultants

Two consultants, who have been involved in the initial thinking around the concept, will be engaged to undertake this assignment. Prof Nicholas Biekpe of the Africa Growth Research Centre of the University of Stellenbosch in South Africa will lead the team. Prof Biekpe comes highly recommended by DFID South Africa, who have worked with him on similar assignments. Mr Ochieng Oloo Of Market Intelligence, a highly reputable business magazine is the local consultant. Mr Ochieng' first developed the idea into a concept which he presented to DFID Kenya in April 2004 following the International Investment Conference held in Nairobi in March. Both have considerable experience and networks in the private sector in their respective countries.

On this basis, and on account of the size of the contract, we will seek a waiver of competition for the assignment.

13.2 FIELDWORK SUMMARY

Meetings with a cross-section of stakeholders:

18th July 2004:
Strategy meeting between Prof. Biekpe and Mr Oloo at Serena Hotel:

Issues discussed:
The plan for the scoping study was discussed. It was decided that we meet Catherine and Collins the following day.

1. 19th July 2004:
1.1 Meeting with DFID: Mr.Collins Apuoyo and Dr. Catherine Masinde

Mr Oloo, Prof. Biekpe together with assistant to the consultants, Alexander G. Owino, met with Dr. Catherine Masinde and Mr. Collins Apuoyo of DFID. At the meeting, Dr. Masinde briefed the team on the role of DFID in the project. She also outlined some key pointers that would potentially enhance the indices. This includes the need for the indices to re ect local SMMEs. The also suggested that the team could proxies including employment; equipment (e.g. machinery); information from purchasing managers; electricity; telephone; construction; and information from Kenyan port authority. She emphasised on the need to consult broadly with stakeholders. She also wanted to know whether there was reason for our choice of companies.

After the meeting with the DFID team, it was decided to meet up with some key industry CEOs and senior managers to access the feasibility and sustainability of a possible Kenyan Business Confidence (ICI).

The meetings centred around seven key questions which will be necessary to access the project's feasibility. The questions were as follows:

(a) Does Kenya needs ICI?
(b) Which sectors will you want to be included?
(c) Will you prefer a survey-type (qualitative) or economic-data-type (quantitative) ICI?
(d) Will you be willing to provide information (including confidential) for the ICI?
(e) Will you consider paying for the ICI or consider paying for an in-house project conducted for you as a result of the ICI?
(f) Who do you think should host and maintain the ICI?
(g) What frequency of the ICI will suit your needs?

1.2. Meeting with IT Sector Representative: Henry Njoroge (MD: UUNET)

(a) He thinks Kenya needs ICI and feels that will give investors a real sense of the economic direction;
(b) Suggested the inclusion of the following: Agriculture, Tourism, Building and Construction, Manufacturing and Mining Sectors. He, however, preferred sector related indices rather than composite index;
(c) He has preference for survey-based indices with economic data support where necessary;
(d) He will be prepared to provide information for the construction of the ICI;
(e) He will not pay for the index but would consider paying for an in-house report relevant to his sector;

(f) Feels strongly that the ICI should be privately hosted and maintained; Against government involvement in any form;
(g) Prefers quarterly ICI frequency.

2. <u>20th July 2004</u>

2.1 Meeting with Insurance Sector Representative: Mr. Ashok Shah: APA Insurance

(a) Feels Kenya needs ICI; Also feels that ICI will bring issues such as corruption and crime to the forefront of public debates. He also feels that corruption and crime should be incorporated into the construction process;
(b) Suggested the inclusion of the following: Manufacturing, Financial services sector and Agriculture;
(c) He has preference for survey-based indices;
(d) He will be prepared to provide information for the construction of the ICI;
(e) He will not pay for the index but would consider paying for an in-house report relevant to his sector.
(f) Feels strongly that the ICI should be privately hosted and maintained
(g) Prefers quarterly ICI frequency. Feels that it would difficult to maintain a monthly index roll-out.

2.2 Meeting with Mr. Robert Mathu (CEO, Francis Drummond & Co Ltd)

(a) Feels Kenya needs ICI; Explained that Kenya seriously needs credible instruments of governance and that the ICI "make the government take notice of issues like crime and corruption seriously". Also feels that ICI will bring issues such as corruption and crime to the forefront. Explained that the ICI will represent a better direction (compared to NSE index) on where the economy in moving in the short-term and strongly recommended that both crime and corruption have to be factored in;
(b) Suggested the inclusion of the following: Tourism, Agriculture, Construction and Manufacturing; Cautioned that for the indices to be credible will require timely, reliable and unbiased data;
(c) He has preference for survey-based indices; He also added that responses from CEO and Senior Managers from industry will trusted and respected by local and international investors;
(d) He will be prepared to provide information for the construction of the ICI;
(e) He will not pay for the index but would consider paying for an in-house report relevant to his sector. Feels, however, that he could purchase the indices once credibility has been established as is the case with S&P, Financial Times and other respected international indices;
(f) Feels strongly that the ICI should be privately hosted and maintained;
(g) Prefers quarterly ICI frequency.

2.3 Meeting with Mr. Sridhar Srinivasan (General Manager,Citigroup)

(a) Feels Kenya needs ICI; Was of the opinion that current indicators use old and unreliable economic data which does not provide current economic trends.
(b) Suggested the inclusion of the following: Tourism, Agriculture, Construction and Manufacturing, Energy, Financial Services and Horticulture;
(c) Prefers survey-based indices but cautioned that there should be no government or government agent's direct participation in the construction of the indices; suggested the use of available indicators in a benchmarking capacity. He also suggested that indices need to take crime and corruption into account.

(d) Will be prepared to provide information for the construction of the ICI;
(e) Will pay for indices only if there is significant value for his company;
(f) Feels strongly that the ICI should be privately hosted and maintained;
(g) Prefers quarterly ICI frequency. Feels that it would difficult to maintain a monthly index roll-out.

2.4 Meeting with Dr. Aloys Ayako (Director: Research Dept; Central Bank of Kenya)

(a) Feels Kenya needs ICI; Dr. Ayako indicated that the bank is likely to be a “consumer” of the indices.
(b) Suggested the inclusion of the following: Tourism, Agriculture, IT & Telecommunication (mobile) Transportation, Financial Services and Horticulture;
(c) Prefers survey-based indices but want to see comparison between indices and the bank’s own leading indicators; Suggested electricity consumption, Tourist arrival times and telephone usage as proxies;
(d) Will be prepared to provide information for the construction of the ICI;
(e) Will not pay to receive ICI;
(f) Feels strongly that the ICI should be privately hosted and maintained; Suggested that there be regular consultation with other non-government organisations in the maintenance of the indices;
(g) Prefers quarterly ICI frequency.

2.5 Meeting with Mr William Lay (Chairman &Managing Director: General Motors)

(a) Feels Kenya needs ICI;
(b) Suggested the inclusion of the following: Tourism & Agriculture; Strongly recommended that the impact of crime and corruption should be re ected in the methodologies adapted;
(c) Prefers survey-based indices;
(d) Will be prepared to provide information for the construction of the ICI;
(e) Will not pay to receive ICI but would consider paying for sector-related in-house products;
(f) Feels strongly that the ICI should be privately hosted and maintained; Objected to government’s involvement in any form;
(g) Prefers annual frequency.

3. 21st July 2004

3.1 Meeting with Mr. Arun Devani MD: London Paints and President of Manufacturing Association of Kenya

(a) Feels very strongly that Kenya urgently needs ICI to help address information gap in the various sectors;
(b) Suggested the inclusion of the following: Transport, Manufacturing and energy sectors. Wanted an index specifically for the Manufacturing sector.
(c) Prefers survey-based indices and does not trust economic data from government;
(d) Will be prepared to provide information for the construction of the ICI; Even prepared to mobilize members of the Manufacturing Association to support the index program;
(e) Will not pay to receive ICI but is willing to help raise funds to support the index program;
(f) Feels strongly that the ICI should be privately hosted and maintained; Objected to government’s involvement in any form;
(g) Prefers biannual frequency.

Meeting with Mr.Bharat Thakker, MD of Advertising Agency

(a) Feels very strongly that Kenya urgently needs ICI to help address information gap in the various sectors;
(b) Suggested the inclusion of the following: Transport, Manufacturing and energy sectors. Wanted an index specifically for the Manufacturing sector.
(c) Prefers survey-based indices and does not trust economic data from government;
(d) Will be prepared to provide information for the construction of the ICI; Even prepared to mobilise members of the Manufacturing Association to support the index program;
(e) Will not pay to receive ICI but is will make use of sector-related information;
(f) Feels strongly that the ICI should be privately hosted and maintained;
(g) Prefers quarterly frequency.

4. 22nd July 2004

4.1 Meeting with Mr. Peter Muthoka: MD of Sasini

(a) Feels very strongly that Kenya urgently needs ICI to help address the issue of government governance.
(b) Suggested the inclusion of the following:
Agriculture, Tourism. Manufacturing and Financial Services. Wanted an index specifically for the tea and coffee “sector”.
(c) Prefers survey-based indices supplemented by key economic data;
(d) Will be prepared to provide information for the construction of the ICI; even prepared to mobilise members of his sector to support the index program;
(e) Will not pay for sector-related projects linked to the indices;
(f) Feels strongly that the ICI should be privately hosted and maintained;
(g) Prefers quarterly frequency.

4.2 Meeting with Mr. Bayo Ligali: Chief Executive, Unilever

(a) Says an ICI for Kenya is an excellent idea.
(b) Suggested the inclusion of the following:
Manufacturing, Governance issues, Infrastructure and employment.
(c) Prefers survey-based indices supplemented by key economic data;
(d) Will be prepared to provide information for the construction of the ICI.
(h) Willing to pay for sector-related projects linked to the indices;
(i) Prefers an ICI owned by credible private sector;
(j) Prefers quarterly frequency.

4.3 Meeting with Mr. Tom Mshindi: Group MD of Standard Media Group

(a) Feels very strongly that Kenya urgently needs ICI to affirm trends rather than the current reliance on hearsay.
(b) Suggested the inclusion of the following:
Agriculture, Energy, Communication infrastructure, Manufacturing, Security and Tourism.
(c) Prefers survey-based indices of leading indicator supplemented by key economic data;
(d) Willing to provide information for the construction of the ICI;
(e) Will be interested in the details, probing the findings especially by sector;
(f) Feels that the ICI should be privately owned but should include key stake holders;
(g) Prefers semi-annual frequency.

4.4 Meeting with Mr. Albert Mwenda, CEO, Institute of Economic Affair

(a) Feels very strongly that Kenya urgently needs ICI with corruption and employment as possible proxies.
(b) Suggested the inclusion of the following:
Agriculture, Tourism. Manufacturing, Financial Services and ICT.
(c) Prefers survey-based indices and key economic data;
(d) Will be prepared to provide information for the construction of the ICI;
(e) Feels strongly that the ICI should be privately hosted and maintained;
(f) Prefers quarterly or biannually frequency.

4.5 Meeting with Mr. David S.O. Nalo; Permanent Secretary, Ministry of Planning and National Development.

On arrival at his office something urgent came up and as a result we only sat down with him for a very brief period. He was however in favour of the establishment of a Business Confidence Index for Kenya and suggested survey-based information to be used.

5. 7th August 2004

5.1 Meeting with Mr. Mathur Malde: General Manager, Pwani Oil Product.

(a) Feels very strongly that Kenya urgently needs ICI.
(b) Suggested the inclusion of the following:
Agriculture, Manufacturing, Banking.
(c) Prefers survey-based indices supplemented by key economic data;
(d) Will be prepared to provide information for the construction of the ICI;
(n) Willing to pay for sector-related projects linked to the indices;
(o) Feels strongly that the ICI should be owned by both private sector and government;
(p) Prefers quarterly frequency.
(q) Feels political stability and currency stability are most critical factors affecting business in Kenya.

13.3 EXAMPLES OF SECTOR-SPECIFIC INVESTOR CONCERNS

Banking Sector (Citibank): The feeling was that there are few leading indicators in Kenya to guide investors in the banking and financial services sector. The Executive was not satisfied with the current "lagging" indicators of economic and business activities and have had to develop their own in-house, "leading" indicators. Citibank was very supportive of a business confidence index for Kenya.

Technology/ ICT sector: The key sector concerns were the following:

- Margins and profitability in the sector
- Very volatile sector risks
- Current unemployment in the sector and
- Unavailability of a pool of skilled workers. UUNet for instance cannot get local sales people with the IT skills that it needs in a country with high unemployment.

The technology sector is relatively easy to enter or exit as information is more readily available than other sectors. Large corporations are also big users and consumers of its products. The weaknesses of its regulators, especially the Communications Commission of Kenya (CCK), are key investor concerns as they play a leading role in opening up the market. UUNet expressed support for KBCI.

Manufacturing sector (Kenya Association of Manufacturers -KAM): Manufacturers' "feel good factor" is currently very low. Investors in the manufacturing sector feel marginalized. Manufacturers are particularly affected by poor quality and high power costs. The chairman's own industrial area factory logged 11,030 power uctuations in 2002 against a standard level of 6 annually in the USA. It was surprising that the bulk of manufacturers' concerns originated from the poor performance and very low standards of service delivery of local authorities and the city council. With an estimated 80% of all manufacturing industries based in Nairobi and about 90% considered as SMEs, the KAM Chairman considered it critical to get the city administration and local authorities working more closely and efficiently together to help improve the sector.

"The poor business environment adds 15% – 25% to our costs" - Chairman, KAM

The Manufacturers' Association attributed high rail freight and shipping costs, to the presence of anti-competitive practices by conference-lines and shipping agents. These combine cartel-like groupings to maintain high rail transport costs that contribute towards the high costs of doing business in Kenya They pointed out the need to invoke "anti-trust" rules to enforce greater competition in transportation.

Pwani Oil Products of Mombasa highlighted the issue of high transport costs and the shortage of containers at the port as a major handicap for manufacturers. According to its General Manager this "creates a conducive environment for corruption to thrive"

Unilever cited poor governance with inconsistency and unpredictability of government policy as major impediments to doing business in Kenya.

KAM expressed strong support for a quick survey of confidence in the manufacturing sector to help press its case for efficient delivery of services from government. In overall terms manufacturers were the keenest supporter of the proposed business confidence index. Their request for a separate survey of investor confidence restricted to manufacturing firms and SMEs further reinforces their concerns.

In summary, the two most important issues identified by the current chairman of the Kenya Association of Manufacturers that adversely impact key investors in manufacturing were:

- Poor governance and inconsistent government policies
- The deteriorating business environment

Tea & coffee export sector

The Kenyan Tea and Coffee sector wanted to see the development of Kenyan brands and blends for export, the setting up joint ventures with foreign partners and government action to increase investor confidence and spur investments.

The main issues that impact business investors in the agro-processing sector were:

- Political governance, with corruption as the primary problem, but also weak corporate governance and weak enforcement of procedures, rules and regulations;
- An enabling environment with better physical and social infrastructure;
- Government's interference in business
- Lack of enforceable investment code

Advertising and media sector

Kenya's leading investor in the advertising industry estimated that, on a scale of 1 to 10, investor confidence now is as low as 3 and decreasing. This has fallen from levels he rated at 6 a decade earlier. Advertising is a key service industry that in many countries closely tracks the health of the economy. "If my clients do well, there is more advertising. If my clients are doing well I would know it from their advertising spend" he said. He indicated that commercial clients of the advertising industry are not currently doing well and are largely engaged in "maintenance" advertising. The key finding from the advertising industry executive was that investor confidence has not been increased by the new government. He strongly supports a KBCI.

A leading media investor decries the tax regime, which he viewed as unfavorable to importers as well as discriminatory in favor of manufacturers. This is illustrated by the punitive taxation on imported paper, a key input in the media and services sectors while raw materials and capital equipment in manufacturing attract low duty. The other key factor he says are the low purchasing power of the consumer and the level of education. "The intellectual ability to enjoy and appreciate the media still curtails quality."

OTHER SECTOR-RELATED CONCERNS FROM THE STUDY

Key concerns of IEA (a public policy think tank)

- Liberalization of economy
- Regulation and licensing (e.g. 30 different licenses needed in building a road)
- Inconsistency in government policies

Key Concerns of the automotive sector

- Security
- Rising transport and fuels costs
- Devaluation of the shilling that impacts on their imports
- Regional governance, especially a third term for a regional leader (Uganda)

Key Macro Economic Concerns

These centered on the main functions of the Central Bank of Kenya (CBK) and included:

- Unfavorable monetary policies:
- Lack of price stability;
- Poor performance and poorly structured policy direction of CBK;
- Need for proper, sound macro economic stability;
- Sustainable capital account liberalization policies
- Need to establish sound banking and financial systems;
- Need for efficient payment systems aimed at reducing transaction costs:
- Need for the government as a key investor to encourage long term FDI investors while limiting potential damage that may arise from short term portfolio and speculative investments.

The CBK was enthusiastic about the KBCI and expects the index to encourage FDI ow into the country.

According to the CBK many weaknesses in Kenya that impact on investors' confidence are not in the micro-economy but lie in macro, structural issues: the main ones outlined by the Bank were

- The judiciary [poor, slow dispute settlement mechanisms];
- Non- performing loans in the banking and financial system (NPLs)

- Security of investments;
- Law and order [insecurity);
- Corruption;
- Heavy transaction costs and high costs of doing business;
- Poor infrastructure.

SECTORS THAT INVESTORS CONSIDER MOST IMPORTANT

Key sectors for a Technology Firm (UUNET)

- Mining,
- Agriculture,
- Tourism,
- Infrastructure, building and construction.

Key sectors to the banking and financial system regulator (CBK)

- SMEs
- Agriculture
- Tourism
- Services,

Key Sectors for Automotive Investor

Agriculture, especially export crops

Key sectors for the Kenya Association Of Manufacturers

- Manufacturing
- Transportation
- Energy

Key sectors for the services executive (advertising)

- ICT -Communications
- Finance and banking
- Manufacturing
- Tourism

Key Sectors for Agro-processing investors

- Agricultural (especially value added or export sectors tea, coffee, pyrethrum, dairy)
- Tourism (including developing facilities)
- Manufacturing
- Horticulture
- Services (mainly banking, insurance, financial services and transportation)

Key sectors for the NSE

- Tourism
- Manufacturing
- Construction and building
- Transport
- Agriculture
- Services, including banking and financial services.

Key sectors for the public policy think tanks

- Building and construction
- Manufacturing
- Tourism
- ICT
- Agriculture

6.6 Top sectors according to Media group executive

- Agriculture
- Energy
- Infrastructure and ICT
- Manufacturing
- Security
- Tourism

SCOPING SURVEY FOR KENYAN INVESTOR CONFIDENCE INDEX

Name (Optional) .... **Company:** ....

1. Does Kenya need an Investor Confidence Index (ICI)? **Yes** ☐ **No** ☐

2. In order of preference, name key economic sectors you think should be included in the index calculation:

2.1 .... **2.4** ....

2.2 .... **2.5** ....

2.3 .... **2.6** ....

3. Who should develop and update the index?

3.1 Private ☐ **3.2** Government ☐ **3.3** Other; Specify ☐ ____________________

4. Who should own the index?

4.1 Private ☐ **4.2** Government ☐ **4.3** Other; Specify ☐ ____________________

5. Please indicate your preference for the basis of the index

5.1 Survey-based (qualitative & forward-looking)

5.2 Based on key economic data (quantitative & backward-looking)

5.3 A composite Index based on 5.1 & 5.2 above

5.4 Other; Specify

6. Name the two most important factors that affect business or investor confidence in Kenya

6.1

6.2

7. Is your company willing to pay or subscribe to a Kenyan Investor Confidence Index that is comparable to those of, for instance Standard & Poors (SP 500)?

Yes ☐ **No** ☐

8. Are you willing to provide information towards the construction of a Kenyan Investor Confidence Index?

Yes ☐ **No** ☐

9 Which frequency of index roll-out will benefit your company?

9.1 Monthly ☐ **9.2** Quarterly ☐ **9.3** Semi-Annually ☐ **9.4** Annually ☐

10. Which index would you prefer

10.1 Composite contry wide indicator ☐

10.2 Sector-specific indicator ☐

10.3 Composite and sector-specific ☐

11. Please indicate the scale of firms you expect the index to cover

11.1 Only big business? ☐

11.2 Only medium-sized and big business? ☐

11.3 All businesses? (Small, Medium-sized and Big) ☐

12. Any other comments: ____

____

____

Please return this questionnaire dully filled to:

Economic Intelligence Ltd. 5th Floor, Consolidated Bank House, Koinange Street Tel: (254 02) 311 425, 316 259 Fax: (254 02) 315 034 Email: mail@mi.co.ke

5.5 LIST OF INTERVIEWEES

	NAME	INSTITUTION	POSITION
1	Henry Njoroge	UUNET	Regional Managing Director
2	Ashok Shah	APA Insurance	Managing Director
3	Sridhar Srinivasan	Citibank	Country Officer & General Manager
4	Robert Mathu	Francis Drummond	Managing Director
5	Arun Devani	Kenya Association of Manufacturers	Chairman
6	Tom Mshindi	The Standard Newspaper Group	Group Managing Director/ CEO
7	Julius Kipng'etich	Investment Promotion Centre	Managing Director
8	William Lay	General Motors EA.	Managing Director
9	Peter Muthoka	Sasini Tea & Coffee	Managing Director
10	Andrew P. Hamilton	Sasini Tea & Coffee	Chairman
11	Bayo Ligali	Unilever Kenya	Chief Executive Officer
12	Albert Mwenda	Institute of Economic Affairs	Acting Chief Executive
13	David Nalo	Ministry of Planning	Permanent Secretary
14	Dr. Alloys Ayako	Central Bank of Kenya	Director of Research
15	Donald Ouma	Nairobi Stock Exchange	Manager, Research
16	Barrat Thakker	ScanAd	Managing Director

5.6 LIST OF WORKSHOP PARTICIPANTS

	NAME	INSTITUTION	POSITION
1	Evans Osano	AIG Global	Investment Manager
2	Sammie Mulanga	Capital Market Authority	Research & Market Development Manager
3	Sridhar Srinivasan	Citibank	Country Officer & General Manager
4	Susan Kikwai	Investment Promotion Centre	Senior Manager
5	James Njuguna	Investment Promotion Centre	Policy Manager
6	Collins Apuoyo	DFID	Senior Programmes Officer
7	Catherine Masinde	DFID	Private Sector Adviser
8	Jane Delorie	Research Solutions	Managing Director
9	Wanjiku Mugane	First Capital	Managing Director
10	Diana Patel	Avenue Health	Managing Director
11	Brian Odwori	Z.K. Advertising	Managing Director
12	Joshua K. Mulinga	Export Promotion Council	Business Counselor
13	Fred Michuki	Standard Chartered Bank	Head of Fixed Income
14	Laurncia K. Njagi	KPLC	Company Secretary
15	Florence K. Obura	KPLC	Corporate Communications Manager
16	Joseph Ogutu	Telkom	
17	George Waititu	Steadman Research	Managing Director
18	Albert Mwenda	Institute of Economic Affairs	Chief Executive
19	Festus Kiragu	Hewlett Packard	Finance & Admin. Manager
20	Antony Muriu	Ministry of Trade & Industry	Principal Economist
21	Esther Pambah	Kenya Revenue Authority	Senior Assistant Commissioner

Economic Intelligence Limited
5th oor, Consolidated Bank House
Koinange Street
PO Box 12800-00100, GPO
Nairobi, Kenya

Tel: (254 20) 311 425, 316 259
Fax: (254 20) 315 034
Email: oloo@mi.co.ke

Contact: Ochieng Oloo

Africa Centre for Investment Analysis (ACIA)
University of Stellenbosch
Business School
PO Box 610
Bellville 7535, South Africa

Tel: +27 (0) 21 918 4261
Fax: +27 (0) 21 918 4261
Email: nbiekpe@acia.sun.ac.za

Contact: Prof. Nicholas Biekpe