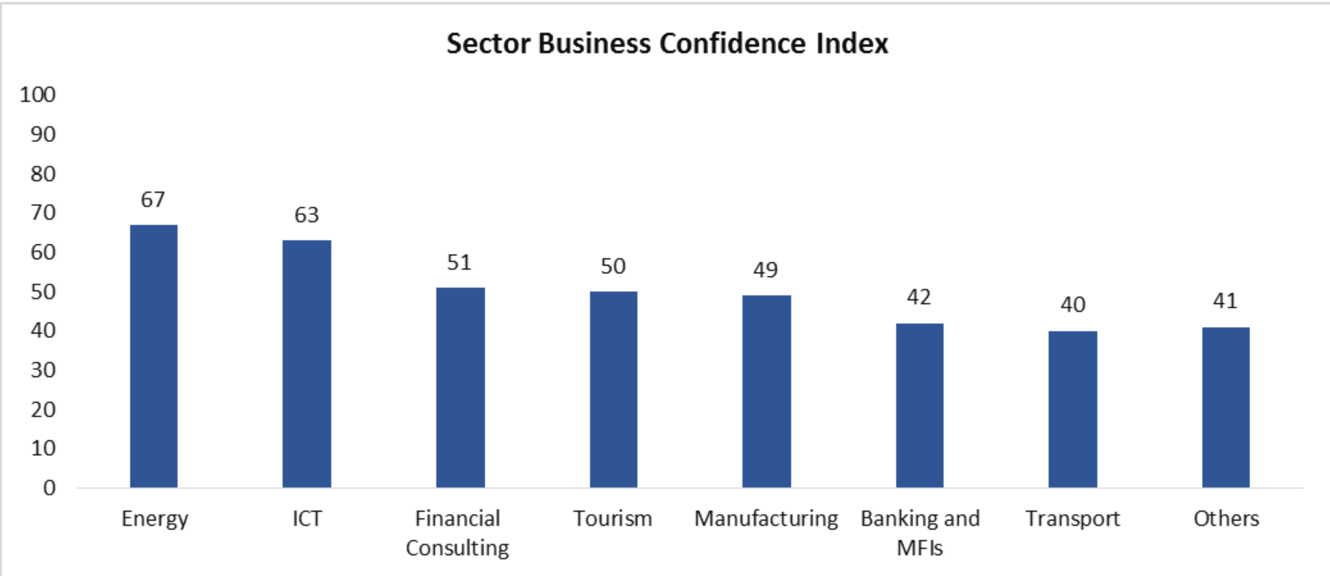
Business Confidence: Energy and ICT Sectors Most Optimistic

Kenya's CEOs Business Confidence survey indicates that the Energy and ICT are the most optimistic sectors of the economy at 67 and 63 index points respectively. The Business Confidence Index was generated to measure the level of confidence that CEOs of various sectors have with the economy.

The sectors with lukewarm confidence are financial consulting services, tourism and manufacturing sector. In addition, the survey findings point out the least optimistic sectors as banking, MFIs and transport sectors.



**Sectors with low sample bases have been classified under others*

** Business confidence varies between 0 and 100, where 0 indicates an extreme lack of confidence, 50 neutrality and 100 extreme confidence.*

The relatively optimistic **Energy Sector** at 67 index points can be attributed to the ongoing activities that are meant to improve the sector such as; plans to increase electricity connectivity to the national grid from 28% to 65% by 2022, introduction of the Scaling-Up Renewable Energy Program (SREP), among others. More factors driving the bullish sentiments could be the zero-rated import duty and VAT exemption equipment and accessories for entities producing electricity via solar energy.

The forecast for Kenya's **ICT Sector** is extremely favourable. With strong support from the government, the ICT industry in Kenya is expected to grow by 20% by 2017. In 2014, this sector grew with an impressive 13.4% and this shows a consistent upward growth trajectory. Growth in the sector has mainly been driven by the mobile segment. M-commerce is expected to grow as it matures from Person to Person (P2P) transactions, to more business transactions. There was also a 25% increase in internet connectivity within the country over the last 3 years, with fiber optics accounting for close to 97% of all ground internet connections.

The **Tourism Sector** has an average confidence index of 50 points. In the periods approaching past election years, prospects of the sector tended to dim due to fears of political violence and ethnic conflicts and general unrest, thus keeping away tourists and conferences. The aftermath of the spats of terror attacks on Kenyan soil did affect the sector adversely.

Throughout 2017, Tourism is expected to thrive on domestic and conference tourism. Despite being an election year, a raft of international conferences have been scheduled to be hosted in Kenya. The list includes the African Ports Expansion Conference, the Africa Mobile and Digital Banking Summit, the 2nd East Africa Education Conference, the East Africa Islamic Economy Summit, the Power and Energy Summit Kenya, the Solar Africa Summit, the Oil and Gas Kenya conference, Africa Internet Summit and expos such as the Auto and Mine Expos.

In addition to the rise of Nairobi as a hotbed of international conferences, there has been steady rise in the number of residential units targeting tourists, especially new hotels and serviced residences. There is a likelihood that eight new hotels will open in 2017 in the country. These include Royal City in Kisumu, Pullman Nairobi in Westlands, City Lodge at the Two Rivers, Lazizi Premiere next to Jomo Kenyatta International Airport (JKIA), Hilton Garden Inn also near the JKIA, Park-Inn in Westlands and Best Western Premier. Other include the Alba, Wyndham Amboseli Golf Resort and Spa at the Amboseli.

The confidence index of the **Manufacturing Sector** is at 49 index points. This index is considered relatively optimistic considering the levels of growth of the sector in the past two years and projections ahead. In 2015, the manufacturing sector contributed 10.5% to country's GDP in 2015 and the sector grew by 3.5%. However, the sector during 2016 had a downward trajectory with a 1.9% growth rate recorded for the last quarter of 2016. The sector's performance is way below the targets set in the Medium-Term Plans of 2012-2017 for the sector to grow by 8.7% and remains a damper on the hopes of achieving the expected industrial developments in sync with vision 2030.

Manufacturing in Kenya is largely composed of processed food products (at 43%), beverage and tobacco (8%). These constitute more than half of the sector's output. Other subsectors include textile and apparels, chemicals, fabricated metals, rubber and plastic, furniture, printing and media products etc. Its heavy linkage with the agriculture sector implies a direct negative effect on the manufacturing consistent with the poor performance in the agriculture sector. High production costs due to increased power bills and the high cost of raw materials (especially, agriculture-based) are some of the sources of low optimism in the sector. The maize millers for example have felt the brunt of poor weather conditions where the yields decreased and they have been pushed to acquire the raw materials at very exorbitant prices.

The **least optimistic sectors** are **Transport** and **Banking & MFIs.** Since the enactment of the Banking Amendment Act 2016 that Caps the interest rate, the banking sector has been forced to reduce overheads and staff costs. Banks have been forced to close some of their branches and also lay off staff. This move is expected to result in a reduced Cost-To-Income ratio which should in turn positively impact the bank's profitability.

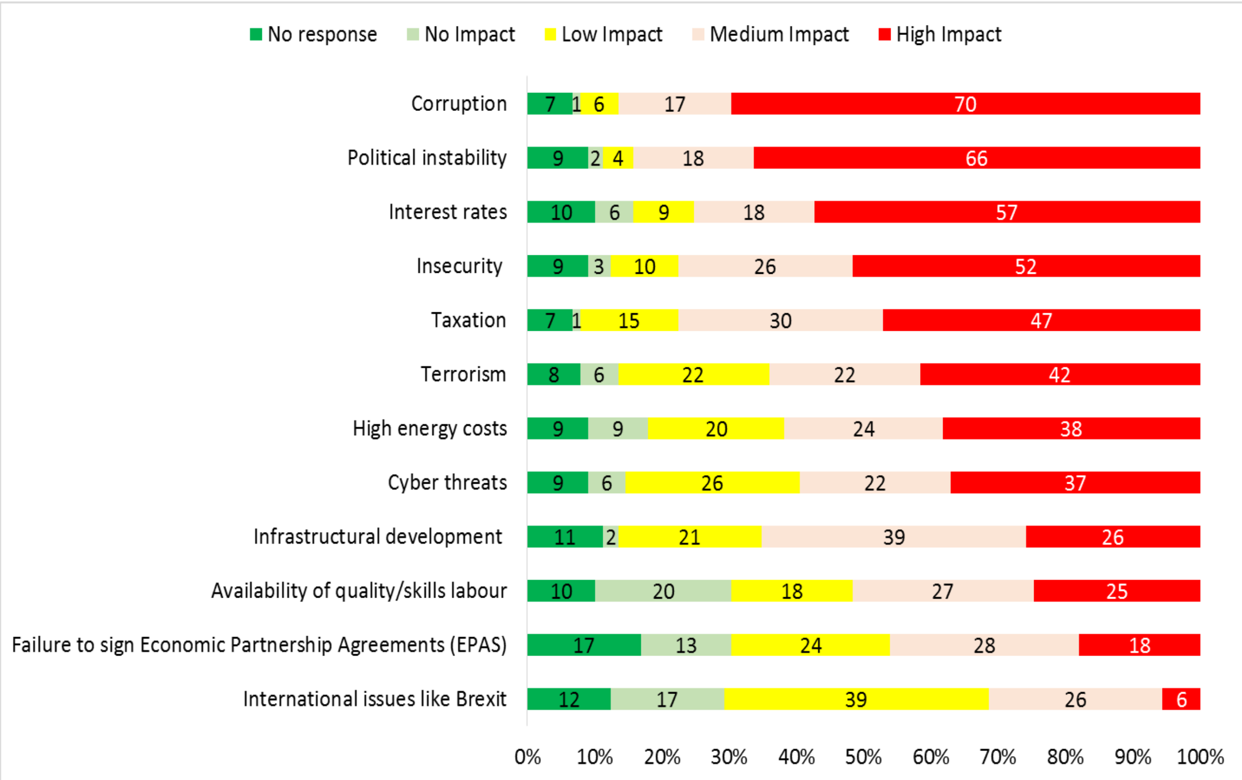
The **Transport Sector's** less optimism combines the perception of a composite of four sub-sectors: land transport, seaport transport, air transport and other transport including postal and courier activities. The poor prospects for air transport appears to be the factor weighing down the scales of optimism in the whole industry while the postal and courier activities have the buoyant effect on the sector.

A review of industry data indicates that the sector is the 3rd largest contributor to GDP. In 2015, it contributed 8.4% after manufacturing's 10.3% and agriculture's 30%. It is also one of the fastest growing sectors in the country having improved from a real GDP value of Ksh.240 billion in 2013 and growth of 4.6% to reach Ksh270billion in 2015 and 7% growth. In the first 3 quarters of 2016, the sector recorded accelerated growth of 8.4%, 8.8% and 10.3% respectively compared to 6.7%, 6.8% and 9.4% growth recorded in the corresponding periods in 2015. With the ongoing expansion of Mombasa port, Port throughput grew by 7.3% in the 3rd quarter of 2016 with imports through the port of Mombasa growing by 10.2%. However, performance of the air transport sub sector declined marginally (0.8 per cent) during the 3rd quarter mainly due to operational challenges experienced by the national carrier.

Over the next few years, the sector is expected to continue improving as the upgrade in infrastructure takes shape and new features e.g. the SGR are launched and operationalized in June 2017. It could be concluded; therefore, that the less optimism reflected in this survey is more of a transitory event rather than a defining factor in the medium-term. This is perhaps because of the expected reduction in movement of people and goods from one place to the other during the coming six months as businesses in other sectors requiring transport adopt a cautious strategy.

Corruption, Political Instability & Interest Rates to Exert Pressure on Economy

Q. What impact are the following factors likely to have on the economy in the next 6 months?



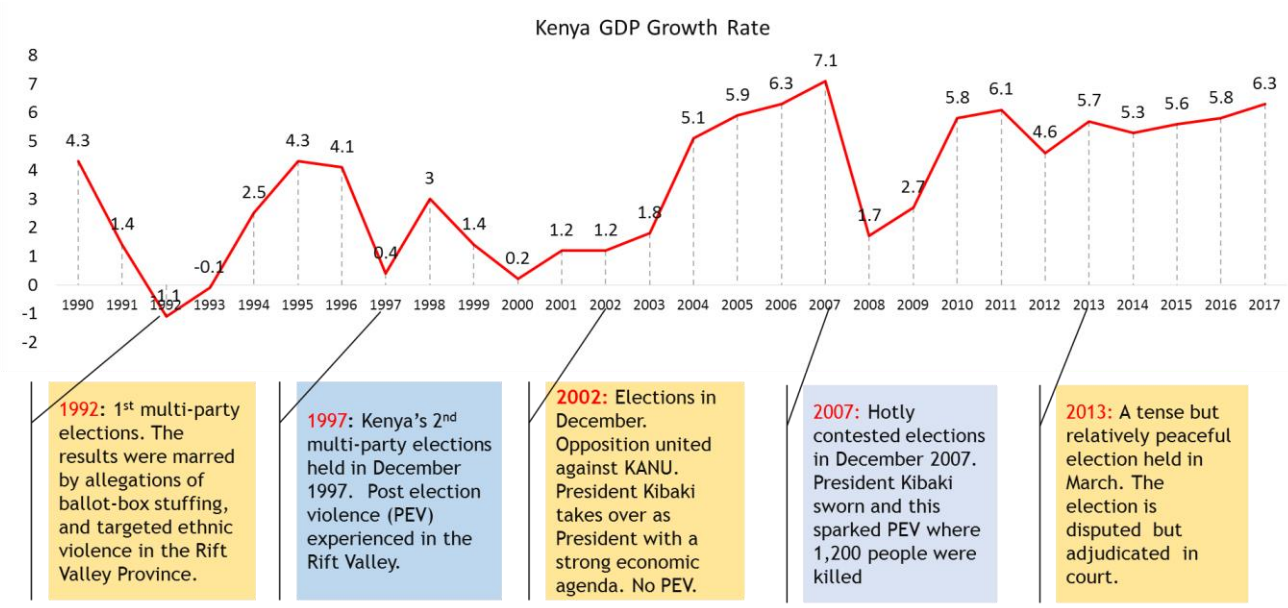
The top factors that expected to have a high impact on the economy over the next six months are corruption and political instability with a high impact score of 69.7% and 66.3% respectively. The findings of this study indicate that CEO's feel that corruption will have a high impact on the business environment. This sentiment comes against the backdrop of several of corruption allegations on public funds as well the rise of economic crimes such embezzlement bribery and procurement fraud. The upcoming election slated for August 2017 is making business leaders anxious.

Other factors with above 50% high impact ratings include high interest rates and insecurity. The interest rate cap made good politics but bad economics for business as the impact is likely lead to a drying-up effect of credit as banks look for more stable customer such as GoK. Banks have also raised requirements for loans for individuals and SMES; thereby affecting their ability to access lines of credit. The cap will have an effect on the wider economy through its impact on consumer and business activities.

Kenya is insecurity is also linked to terrorism as over the last 4 years, the country has suffered attacks from Al Shabaab militants, which have discouraged tourist and investors.

The Context of Kenya's Economic and Political Climate

In December 1991 the Kenyan Constitution changed allowing for multi-party democracy. Since then, Kenya has had four general elections: 1992, 1997, 2002, 2007 and 2013. Apart from the 2013 one, all of them have had a common factor of post-election violence (PEV). This violence has an impact on the economy either on the actual year or the one following the election. The most adverse PEV was experience early 2008 and the GDP growth rate declined from 7.1% to 1.7%.



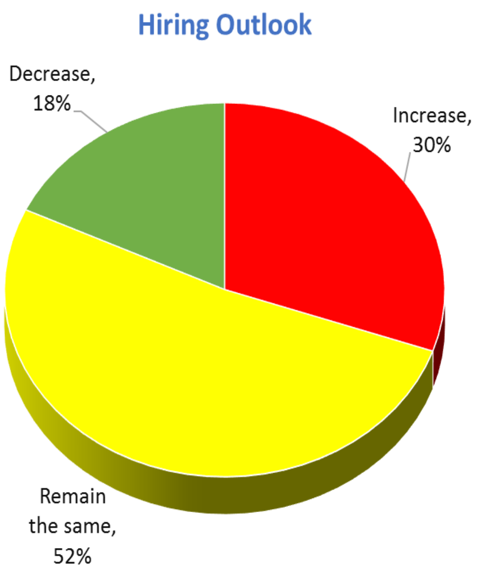
The economic projections indicate that Kenya has enjoyed a stable macro-economic environment with the GDP growth rate slowly rising from 5.3% in 2014 to 6.0% in 2016. The World Bank has upheld Kenya's growth projection for this year at 6%, largely unchanged from an estimated 5.9% in 2016.

Considering Kenya's past and rising political uncertainty regarding presidential elections, the business community is apprehensive about the economy. As a result of this, the business community is likely to take a wait and see attitude and delay investment decisions. Overall, political stability is important for the business environment and the business community are keen on peaceful elections.

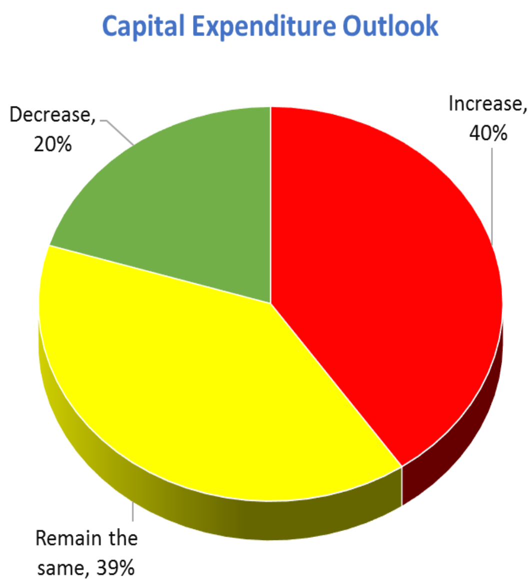
Moderate Hiring and Capital Expenditure Outlook

On the jobs front, 30% of the CEO's surveyed expect to see hiring increase in the next six months, while 52% indicate that hiring will remain unchanged and 18% expect hiring will decrease.

Q. Do you expect your company's total number of employees will increase, remain about the same, or decrease during the next 6 months?

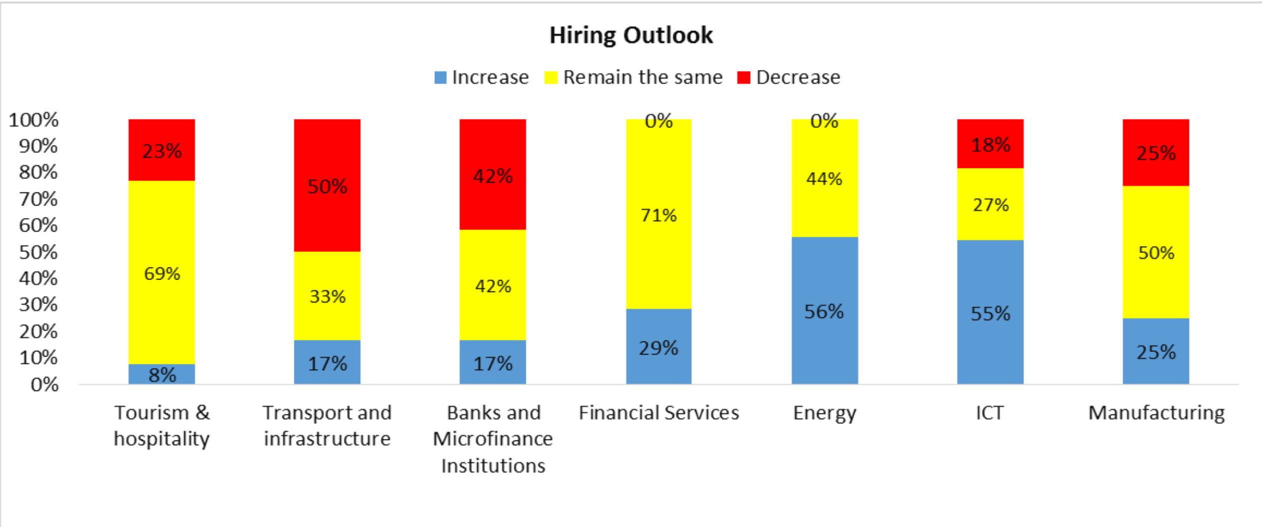


Q. Is your firm's total capital expenditure (on land, buildings, and equipment, etc.) likely to increase, remain about the same, or decrease in the next 6 months?

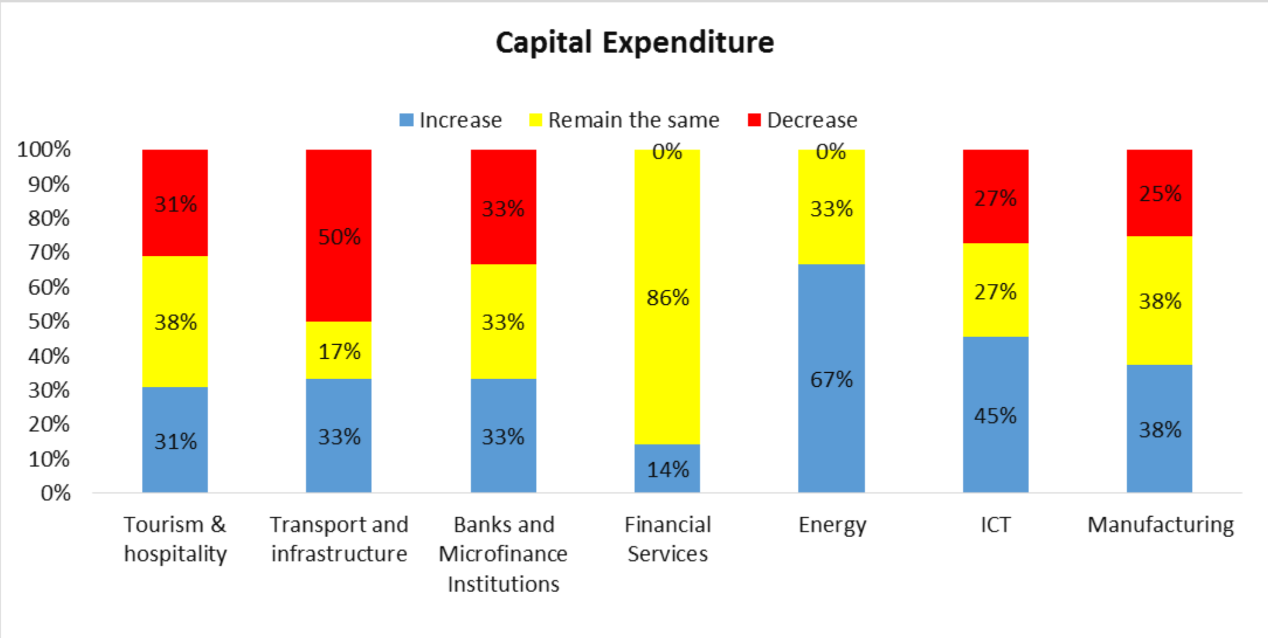


In regard to capital expenditure, 40% of the CEO's expect to see increase in expenditure, whilst, while 39% say it will remain the same and 20% expect it to decrease.

More than half of the firms in the ICT and energy sectors are more likely to increase staff as compared to the others sectors. On the contrary, the highest job cuts are expected to be in the banking & MFIs, and transport & infrastructure sectors.



Similar to the hiring outlook, more firms in the energy and ICT sectors are likely to increase their capital expenditure over the next 6 months.



Challenges Facing Businesses

Regardless of the industry, the largest challenge facing businesses is the anxiety over the general election. Due to this concern, businesses are holding back as they adopt a "wait and see" attitude.

"Reduced business pipeline as companies adopt a 'wait & see' policy"

"Impending elections - anxiety due to possible political instability or violence

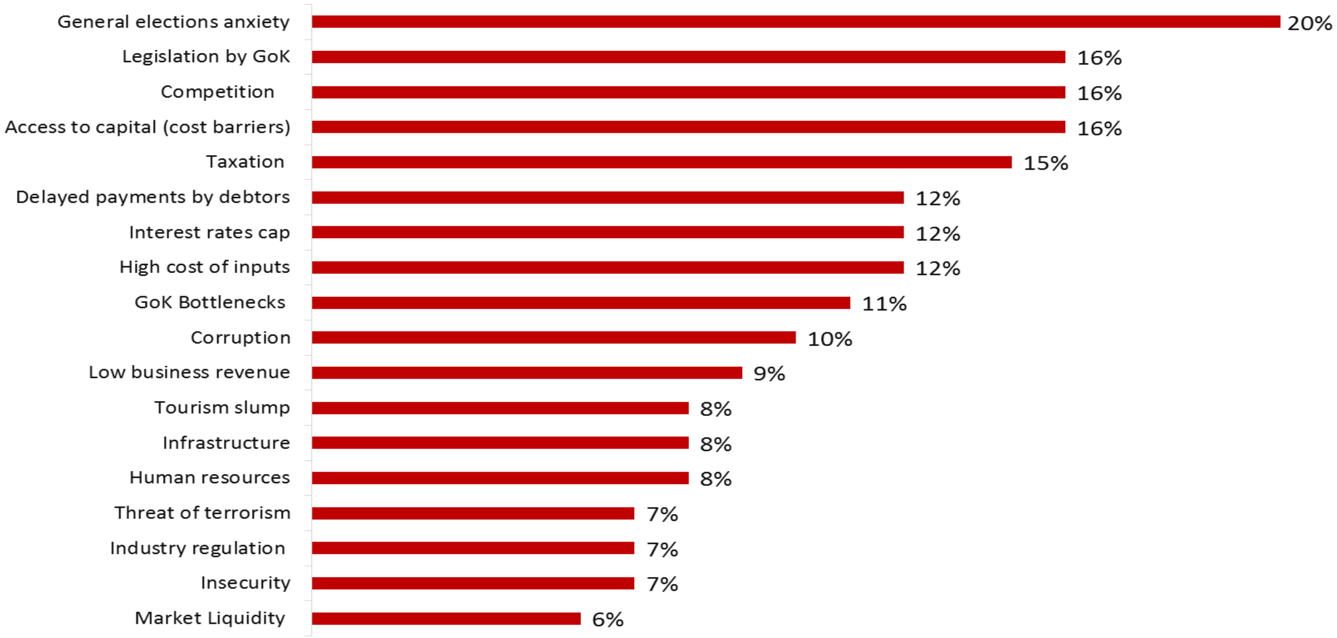
Legislation by Government of Kenya (GoK) continues to be barrier to business – key areas of concern include; uncertain regulatory and legal environment, customs, minimum wage, the proposed NSSF Act, Private Security Act, etc.

"Competitors from hell! Competitors who openly do not pay taxes and operate illegally. Competitors who do not pay the legislated minimum wage"

"Youth, women and disabled companies competing directly and set up through corrupt means to deny legitimate businesses"

Some of the companies participating in this study exist in a competitive market landscape. However, unfair business practices such as price wars, corruption, not paying minimum wages, competitors who do not pay taxes greatly affect their businesses.

Q. What are the key challenges that companies in your industry are currently facing?



Capital is a major ingredient to the operations of a business however, the reduced lending by banks pose a challenge to companies. The consequence of capping interest rates is dire, especially to Small and Medium Enterprises because banks might not extend loan facilities to them.

About the Study

The CEO Confidence Survey seeks to gauge the economic outlook of CEOs, determining their concerns for their businesses, and their view on where the economy is headed. CEOs are considered to have a helicopter view of the economy and their assessment of their industry and the overall economy would be a good indicator of the near future economic performance. CEOs are regarded as having the power to make large investment decisions that can impact the economy as a whole. CEO Confidence Surveys can provide investors and entrepreneurs with valuable insight into current and future economic conditions.

The target population for this study was the business community operating from the central business district. A total of 90 business leaders participated in this study including. The data was collected between November 2016 to January 2017.

Computing CEO Business Confidence Index

There are the reply options for each question. i.e i) current economic conditions vis a vis 6 months ago, ii) expectations of the economy, six months ahead iii) expectations of own industry, six months ahead.

A score for each question is determined by assigning the following values to the responses and calculating the average. Substantially Better – 100; Moderately Better – 75; Moderately Worse – 25; Substantially Worse – 0. The measure of CEO Confidence is an average of the first 3 indicators. Measure of CEO Business Confidence ranges from 0 to 100.

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