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Investment Climate Policy Refresh: Volume 2 Rwanda, Kenya and Western Cape Case Studies

Kato Kimbugwe, Alfred Kombudo, Brian Stones

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About this Study

This report has been commissioned under the Business Environment Reform Facility (BERF). BERF is funded by the UK Department for International Development (DFID) under the Business Environment for Economic Development (BEED) Programme. BERF is a central facility responding to demand from DFID's priority Country Offices and stakeholders to initiate, improve and scale up business environment reform (BER) programmes. We provide expert advice, analysis of lessons learned, policy research about what works and what does not, and develop innovative new approaches to involving businesses and consumers in investment climate reform.

BERF has a strong emphasis on strengthening the Business Environment for women and girls, as well as for young adults more generally. It is also aiming to improve the relationship between business and the physical environment including, where relevant, linkage to climate change analysis. BERF recognises the need for appropriate political economy analysis in order to underpin BER processes and interventions.

BERF is managed by a consortium led by KPMG LLP. This study presents the research of seven experts conducted over the period August to October 2018, including Carl Aaron (Research Leader, Author of Volume 1), Kato Kimbugwe (Rwanda), Alfred Kombudo (Kenya), and Brian Stones (Western Cape).

Disclaimer

The views contained in this report are those of the authors and do not necessarily represent the views of any BERF consortium member or DFID or any of their professional advisers. This is a working paper shared for discussion purposes only. No reliance should be placed upon this report.

Acronyms and Abbreviations

ANC	African National Congress
BBBEE	Broad Based Black Economic Empowerment
BE	Business Environment
BEE	Business Enabling Environment
BEED	Business Environment for Economic Development
BEEP	Business Enabling Environment Programme
BERF	Business Environment Reform Facility
CDC	Commonwealth Development Corporation
CO	DFID Country Office
CPT	DFID Central Policy Team
DA	Democratic Alliance
DB	Doing Business
DBI	Doing Business Indicators
DEADP	Department of Environmental and Development Planning (Western Cape)
DEDAT	Department of Economic Development and Tourism (Western Cape)
DFI	Development Finance Institution
DFID	Department for International Development
DOTP	Department of the Premier (Western Cape Government)
EAC	East Africa Community
EAIF	Emerging Africa Infrastructure Facility (PIDG)
EPA	Economic Partnership Agreement
EPZ	Export Processing Zone
EU	European Union
EWSA	Energy, Water and Sanitation Authority (Rwanda)
FCAS	Fragile and Conflict-Affected States
FDI	Foreign Direct Investment
FOCAC	Forum on China–Africa Cooperation
GFCF	Gross Fixed Capital Formation
GDP	Gross Domestic Product
GoR	Government of Rwanda
IC	Investment Climate
ICT	Information and Communications Technology
IMSAR	Improving Market Systems for Agriculture in Rwanda
IPA	Investment Promotion Agency
IFC	International Finance Corporation
IPA	Investment Promotion Authority
KCEP	Kenya Competitiveness Enhancement Program
KT	Korea Telecom
M&E	Monitoring and Evaluation
MICE	Meetings, Incentives, Conferences, and Exhbiitions
MSME	Micro Small and Medium Enterprises
MW	Mega Watt
NSTP	National Strategy for Transformation and Prosperity (Rwanda)
OSC	Outgrower Service Company
OSS	One-Stop Shop
PE	Private Equity
PIDG	Private Infrastructure Development Group

PM	Prime Minister
PoE	Party Owned Enterprise
PPA	Power Purchase Agreement
PPP	Public Private Partnership
PSD	Private Sector Development
RAPCO	Rwanda Association for Professional Conference Organizers
RCB	Rwanda Convention Bureau
RDB	Rwandan Development Board
RSA	Republic of South Africa
SACU	Southern African Customs Union
SDG	Sustainable Development Goal
SEZ	Special Economic Zone
SME	Small and Medium Enterprise
SoE	State-owned Enterprise
SA	South Africa
SHF	Small Holder Farmer
SILTPR	Sustainable Inclusive Livelihoods through Tea Production in Rwanda
SSA	Sub-Saharan Africa
TA	Technical Assistance
TMEA	Trade Mark East Africa
UCT	University of Cape Town
UK	United Kingdom
UKEF	UK Export Finance
UNCTAD	United Nations Conference on Trade and Development
USA	United States of America
USAID	United States Agency for International Development
VC	Venture Capital
WB	World Bank
WCG	Western Cape Government
WEF	World Economic Forum
ZAR	South African Rand

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Table 1: Case Study Countries Basic Economic Data

		2012	2013	2014	2015	2016
Population 000s						
Africa		922,877	948,532	974,799	1,001,662	1,029,104
Rwanda		10,789	11,065	11,345	11,630	11,918
Kenya		43,647	44,827	46,024	47,236	48,462
South Africa		52,507	53,312	54,147	55,012	55,909
GDP $M						
Africa		1,530,000	1,593,693	1,702,707	1,459,624	1,441,547
Rwanda		7,221	7,486	7,837	8,060	8,165
Kenya		50,097	45,597	60,577	63,083	69,845
South Africa		385,568	357,013	341,494	309,540	286,651
GDP Per Capita $						
Africa		1,658	1,680	1,747	1,457	1,401
Rwanda		669	677	691	693	685
Kenya		1,148	1,017	1,316	1,335	1,441
South Africa		7,343	6,697	6,307	5,627	5,127
Total FDI and Aid US$ per capita						
Africa	FDI pc	$56	$54	$54	$57	$52
Africa	Aid pc	$42	$41	$27	$34	$33
Rwanda	FDI pc	$24	$23	$40	$33	$29
Rwanda	Aid pc	$81	$98	$91	$93	$96
Kenya	FDI pc	$32	$25	$18	$13	$8
Kenya	Aid pc	$61	$74	$58	$52	$45
South Africa	FDI pc	$87	$156	$107	$31	$40
South Africa	Aid pc	$20	$24	$20	$26	$21
Exports $ Million						
Africa		408,185	400,974	296,117	251,759	298,563
Rwanda		609	657	428	419	661
Kenya		5,568	5,959	5,913	5,695	5,747
South Africa		95,955	91,164	81,488	74,913	89,350
Imports $ Million						
Africa		386,041	385,588	332,293	287,103	311,036
Rwanda		1,990	1,955	1,854	1,795	1,782
Kenya		16,099	18,393	16,096	14,101	16,687
South Africa		109,696	105,887	90,546	79,490	88,031
Ratio FDI to Exports %						
Africa		13%	13%	18%	22%	18%
Rwanda		42%	39%	107%	91%	52%
Kenya		25%	19%	14%	11%	7%
South Africa		5%	9%	7%	2%	3%
Ratio FDI to Imports %						
Africa		13%	13%	16%	20%	17%
Rwanda		13%	13%	25%	21%	19%
Kenya		9%	6%	5%	4%	2%
South Africa		4%	8%	6%	2%	3%
Ratio of Aid: Imports %						
Africa		10%	10%	8%	12%	11%
Rwanda		44%	56%	56%	60%	64%
Kenya		16%	18%	17%	17%	13%
South Africa		1%	1%	1%	2%	1%
Ratio of FDI: GDP %						
Africa		3.4%	3.2%	3.1%	3.9%	3.7%
Rwanda		3.5%	3.4%	5.9%	4.7%	4.2%
Kenya		2.8%	2.5%	1.4%	1.0%	0.6%
South Africa		1.2%	2.3%	1.7%	0.6%	0.8%

Sources: WB, IMF Direction of Trade Statistics, OECD Geographical Distribution of Financial Flows to Developing Countries

1. Rwanda Country Case Study

1.1 Overview

1.1.1 Economy and Population

Rwanda, in East and Central Africa, has a population of a population of 12m (2018).[1] It is member of the East African Community (EAC) one of the fastest growing regional integration blocs[2] on the continent. Following the 1994 Genocide, the country has made a remarkable recovery. Between 2000 and 2014, the economy grew at an average of 8 percent annually, mainly driven by aid inflows and growth in the agriculture and service sectors. In the same period, GDP per capita has increased from $242 to $730 and poverty has reduced from 60.3% of the population to 39.1%.[3] More recently, economic growth has fallen to an average of 5% per annum, mainly due to commodity shocks (mining and agriculture sectors) and the effects of the 2015/16 drought that significantly impacted agricultural productivity and growth. Nevertheless, Government efforts to diversify the economy have yielded results with growth currently being driven by tourism (leisure and business), construction and real-estate, and ICT sectors.

1.1.2 Investment Climate

Rwanda has also been successful reforming and addressing the ease and cost of doing business that are critical to creating a conducive environment for investments and the transition to a private sector driven economy. Rwanda is now ranked as one of the best places to do business in Africa by the World Bank Doing Business survey – ranked 2nd in Africa in the 2019 Doing Business (DB) indicators.[4] For example, it only takes six hours to register a business in Rwanda; most taxes can be paid online; and there are low levels of corruption, a secure and transparent land tenure system, and a one stop shop for investors, and so on. The aggressive reform agenda[5] has contributed to the rapid rise on the WB DB and the WEF rankings.

An investor IFC perception survey[6] found that almost 40% of Rwanda-based companies rate Rwanda as attractive or very attractive. This is similar to Tanzania and Uganda but lower than Kenya. Among potential international investors, the perceived strength of Rwanda is political stability/safety (38%), economic growth (28%), and ease of doing business (24%). The limited market size is the main deterrent for investing. Secondly, 19% of companies saw Rwanda's geographic position as a weakness, since it is a land-locked country. Rwanda-based investors emphasise stability and regulatory environment when deciding locations for their investment. Existing investors have quite similar perceptions about Africa in general, but considerably better perceptions about Rwanda, as 91% find Rwanda "attractive" or "very attractive" which

[1] As projected by the National Institute of Statistics of Rwanda (NISR) - http://www.statistics.gov.rw/
[2] Insert reference on African REA growth rates
[3] NISR EICV4 - 2015
[4] Rwanda's Ease of Doing Business Ranking which has improved significantly from 143 in 2008 to 41 in 2017 and 29 in 2019
[5] Rwanda implemented the highest number of reforms in Sub-Saharan Africa in the past 15 years
[6] IFC (2017) Investor Perceptions and Constraints faced by Exporting Firms in Rwanda's Priority Economic Sectors

is significantly more than for Kenya, Tanzania or Uganda.[7] Nevertheless, 79% of investors with operations in Rwanda mentioned that Rwanda's market poses a big challenge mainly because of its small size, followed by the fact that it is hard to access high quality labour in Rwanda. Some 52% of investors based in Rwanda noted that high production costs resulting from high airfreight, financing and electricity costs, are the next biggest challenge, especially in the manufacturing-oriented sectors.[8]

The private sector policy environment is very clear and predictable. Rwanda has a seven year National Strategy for Transformation and Prosperity (NSTP) that governs and guides all economic and development activities. The NSTP is aimed at driving the country towards attaining upper middle income country status by 2035, and high income status by 2050. Rwanda has also set a target under the NSTP to double private investment by 2025, and triple it by 2035.[9] It has a new seven year PSD and youth employment strategy focusing on firm resilience, growth and productivity. The strategy recognises that certain market failures, such as a lack of access to information and inefficient domestic markets, are becoming more apparent and more challenging as the economy grows in size and complexity.[10] Therefore, the new strategy supports the ecosystem for private sector growth through regulatory reforms to address those market failures, while promoting key value chains and anchor firms with catalytic potential, in a targeted manner. Rwanda's strength is that it follows through on its development plans, and has a very effective performance-based system that guarantees the plans will be delivered, and as a result provides the policy predictability required for private sector growth and investment.

The private sector is primarily informal and dominated by small companies in services such as retail and wholesale. The latest Establishment Census (2014) recorded around 150,000 operating establishments (i.e. including small-to medium companies) – up modestly from 123,000 in 2011.[11] The vast majority are micro and small (employing not more than 3 people).

Transformation is expected to come from a very few large companies, which are formal, and to a large extent located in Kigali. Large companies account for only 0.2 %, some 213 companies, nevertheless more than double the number in 2011. As is typical in low income countries, relatively little employment is in the formal sector. The estimated total number of workers in formal sector enterprises in 2014 was around 175,000 in around 9,000 enterprises.

1.1.3 Foreign Direct Investment

Rwanda has seen a remarkable increase in FDI inflows in recent years, but FDI remains modest. Expansion is a relatively new phenomenon. FDI increased from $103m 2008 to

[7] Ibid
[8] Ibid

[9] GoR (2017) National Strategy for Transformation (2018-2024)

[10] GoR (2017) Private Sector Development and Youth Employment Strategy (2018-2024_

[11] The Establishment Census, NISR, June 2015. The 2017 Survey is currently being analysed and should be available later this year

$342m by 2016. The cost of doing business, together with the size of its internal market, account for the low levels of FDI flows into Rwanda, despite its strong performance in the DB indicators.

FDI is diversified by sector. In 2016, of the $342m inflows the highest were recorded in the ICT ($113m), financial services ($70m), and manufacturing ($40m) sectors. Tourism saw a significant drop in FDI inflows; however, this was expected given the significant investment that has been made in previous years 2013-2015 in the business tourism sector.[12] In 2017, RDB attracted 137 investment commitments totalling US$1.67bn, which are expected to generate 37,548 jobs.[13] Construction, mining and energy registered the highest investment in 2017, while most jobs were committed in the agriculture, manufacturing and energy sectors (RDB 2017).

Table 2: Rwanda investment statistics

Indicator	2014	2015	2016	2017
GDP $	6.29m	6.87m	7.68m	8.74m
GDP (growth)	7.6%	8.9%	5.9%	6.1%
FDI (stock) $	1.152bn	1.401bn	1.680bn	
FDI (inflows) $	458m	379m	342m	
GFCF ($)	1.523m	1.774m	1.945m	2.003m

Compiled from the 2017 Rwanda Annual Accounts published by NISR

Europe is currently the leading source of FDI, but new actors are emerging. Portugal, United Kingdom, Germany and Spain are among the leading sources. Table 3below provides snapshot of the top six investments as recorded by the RDB (Rwanda's IPA). India's PM Modi and China's President Xi visited in 2018, leading to the signing of deals.

Table 3: Top FDI investments by country, value, and project

Country	Value $	Project
Portugal	400m	Air transport – Bugesera International Airport (phase 1)
UK	203m	10 investments across a number of sectors with the largest being the $55m by Unilever in the tea sector
India	83m	13 investments across a number of sectors with the largest a $27m investment by Luxmi in the tea sector.
UAE	80m	5 projects with the largest investment $35m by DP World Logistics, in a dry port in Kigali.
Germany	64m	A range of investments of which the $20m by VW is the most prominent
China	62m	15 projects across a number of sectors

Compiled from the 2017 RDB Annual report

Rwanda will need to radically open up and encourage more private sector led growth if it is to maintain its growth momentum. Compared to the private sectors in the other EAC countries, Rwanda's private sector is neither as vibrant, and nor is it creating the number of jobs required to meet the growing needs of its bourgeoning youth population. The cost of

[12] Rwanda was ranked as Africa's 3rd leading MICE tourism destination by ICCA
[13] Rwanda Development Board (2017) Annual Report

skilled labour and imported intermediate inputs continue to hamper the domestic industrialisation agenda.

1.2 Government of Rwanda strategy on FDI and IC reform

1.2.1 Institutional Factors

Rwanda shows the importance of a relatively effective investment promotion agency, the Rwanda Development Board (RDB). The RDB was founded in 2008 with the mission to fast-track economic development by enabling private sector growth, in order to transform Rwanda into a dynamic global hub for business, investment, and innovation. The RDB's focus on job creation and improvement of the current account is informed by the NSTP that lays out the need for modern infrastructure and competitive high value jobs and sectors. In 2017 the RDB published its latest strategic plan[14] that focuses on three pillars;

- Accelerating targeted investments - Identify sub-sectors that Rwanda can build a competitive advantage in while creating decent jobs and reducing trade deficit; approach targeted investors with projects beneficial to Rwanda; build target sectors through championing support and cross-cutting government engagement.
- Fostering an attractive investment environment - Continuous improvement of local business environment; driving cross-cutting government reforms; Creating an innovative, proof of concept business environment that is start-up friendly.
- Building an exemplary RDB organisation - Attracting and developing talent, creating engagement and motivation among employees, instilling high performance culture and clarity on roles/responsibilities. Streamlining processes and ensuring stringent and logical project management.

The new RDB strategy demonstrates a shift in focus from IC reform to deal facilitation on selected projects. The IC had been critical in shaping the country's post genocide image by generating attention, credibility and driving investment interest and traffic. The focus on the DB reforms was critical in changing the risk dimension associated with African investment climate, and this needed to happen before any deals were possible. But the RDB had come started to focus on deals. The need to "go beyond DB reforms", and be more targeted on investment strategy and pitch is recognised. The RDB will focus on designing and packaging deals for specific sectors that could drive job creation, exports, and innovation. Critically, there was a need to:

- undertake research and analysis needed to support the packaging and pitching of deals for targeted investment promotion
- do a better job of understanding and responding (aftercare) to existing investors in order to increase and maximise re-investments
- be more proactive than reactive in attracting investments

[14] RDB 2017 Annual report

- focus on four key sectors – business processing operations, nutritious foods value chain, manufacturing of garments and shoes, business conferencing (MICE) and the creation of knowledge industries.

The RDB recognises that more still needs to be done to build the country's investment image; and focus more on investment reforms and facilitation in collaboration with other government departments, given the rapidly changing global investment environment

The bulk of the critical and most innovative FDI flows into Rwanda have been supported by donor funding in some shape or form. Donor funding has been deployed to implement IC reforms, de-risk investment, promote innovative approaches or technology, strengthen government institutions on which FDI is dependent, upgrade skills, and ensure equitable development impact. It is argued that all these areas are important, and as such donor funded IC programmes should be designed to achieve the above mentioned outcomes.

1.2.2 FDI Attraction

Rwanda has attracted investment through a range of IC interventions. **Error! Reference source not found.**Table 4 provides a spectrum of the type of investment climate interventions that have been implemented in Rwanda with an assessment of their effectiveness.

Table 4: Rwanda Investment Climate Support Spectrum

	Description	Examples of FDI attracted	Methodology used in the example provided	Other support provided to facilitate the FDI
Classic investment climate reforms	2018 investment of \$2.15m, to produce 600 tonnes of hybrid maize seed to local farmers by farmers by 2019 by One Acre Fund, Western Seed Company and Agro-Processing Industries	Specific reform of the seeds law that attracted investors opened up the sector for investment	DFID funded RICRP3 programme implemented by IFC funded the update of seed law and regulations	Classic investment climate reforms
Transaction Advice	Transaction advice to initiate, develop and close deals	\$35m by Dubai Ports To build and operate the Kigali Logistic platform	Provision of transaction advice to government to undertake the RFP and contracting	DFID (TMEA) programme provided \$3m to procure transaction advice services
Hybrid	Combination of debt and equity finance	\$50m by Africa Improved Foods (AIF) to establish a factory that help address malnutrition by manufacturing enhanced nutritious foods for vulnerable groups including the rural poor in Rwanda and the East Africa region.	Joint venture with GoR that agreed to be a key off-taker for its child nutrition programme	Facilitated by investments from CDC (UK) and FMO (Dutch)

PPPs	Some government stake in land or investment	$400m by Mota Engil Africa to develop the new international airport in Bugesera Rwanda	GoR issued a PPP tender and then negotiated the BOT contract with the investor	GoR negotiated this deal on their own using the Team in RDB and a local legal firm
Venture Capital / IFC type with specific TA	Thematic funds e.g. green energy, many examples, GroFin	$250m by IFC for the GoR (RSSB) affordable housing scheme to construct 10,000 high density housing units	GoR provided the land and worked with IFC and RSSB to agree joint financing	IFC provided transaction advice
Pure FDI	Attracted by the investment climate and decided to enter the market	$20m by VW to establish Africa's first Integrated Mobility Solution to provide car sharing and ride hailing	Investor attracted by the investments facilitation that Rwanda provided	The German embassy provided political economy analysis

Box 1: Rwanda Sector Transformation Case Study

Meetings, Incentives, Conferences, and Exhibitions (MICE).

Rwanda is emerging as one of East Africa's premier business tourism destinations, following efforts by the government and its partners to help strengthen and grow the private sector in the meetings, incentives, conferences, and exhibitions (MICE) market. Business tourism is one of the most significant contributions of the tourism component was the large growth in the MICE segment of the tourism market. In 2015, contributions from the MICE sector exceeded US$37m, and in 2017, revenues are projected to reach US$55m.[15]

Approaches to the MICE sector

The vision is for Rwanda to establish itself as the hub for hybrid meetings and conventions in East and Central Africa. In 2014, the Rwandan government identified the tourism sector as one of the mainstays of the economy. A key growth constraint of tourism was the lack of product diversity. Rwanda needed to expand its offer beyond Gorilla tourism. It was identified that growth would come from new tourism segments, and products such as MICE tourism. GoR then embarked on the development of a MICE strategy to guide the development of the sub-sector. To pursue its strategy of growing the business tourism sector, Rwanda invested in a new convention center in Kigali. By the end of 2016, 3,400 hotel rooms were available for delegates.

Development finance institutions have supported the development of the MICE sector. The IFC Governance for Competitiveness Project (G4C), helped establish the Rwanda Convention Bureau in 2014. Together, the World Bank Group, which provided US$1.2 million in technical assistance to Rwanda's Tourism and Conservation Department, and the Rwandan government, began using the newly created bureau to promote the country among regional and international clients as a preferred location for business events.

Effective government institutions have been a key driver. Rwanda is the only country in East Africa with a dedicated convention bureau – the MICE Rwanda Convention Bureau (RCB), and has moved from 21st in Africa in 2013 to 7th in 2015 in the MICE segment, with Kigali being 5th among African cities. The RCB also supported the creation of the Rwanda Association for Professional Conference Organizers (RAPCO), which is currently developing accreditation for professional conference organizers, and would enhance the private sector's ability to bid at the tender stage of incoming MICE events, and gradually fully take over that role from the Government. Only South Africa in Africa follows a similar business model of linking the MICE business directly to private sector bidders. The RCB has also created a research desk to create a database and estimate the length of delegate

[15] RDB 2017 Annual report.

stay, amount spent, and pre- and post-initiative impact on the entire value chain, which will help target its future efforts better.

MICE strategy impact

Since the strategy was implemented, there has been substantial growth in this dynamic segment of tourism. Over the last decade, MICE revenue grew by 180% while the number of delegates visiting Rwanda jumped from 15,000 to 28,300 in the same period.[16] In 2016, Rwanda hosted over 40 international conferences, with the Convention Bureau directly engaged in organizing several high-profile events: the World Economic Forum (WEF), The Global African Investment Summit, the African Union Summit and the Africa Hotel Investment Forum. The increase in meetings, conventions and events following the establishment of the Convention Bureau led to revenues exceeding US$37m in 2015 and US$47m 2016. In 2017, revenues from all business tourism in the country are projected to reach US$64m. Business travellers brought in the highest share of overall tourism revenue (33%) followed by Visits (29%) and Holiday travelers (27%)[17]. In terms of origin, visitors from the EAC, Europe and the Rest of Africa generated the highest revenue across all categories (25%, 22%, and 21%).[18]

Opportunities

Enhancing MICE-related tourism and agricultural linkages represents a vital potential mechanism for stimulating local production, retaining tourism earnings in the economy and providing additional rural employment and poverty alleviation, as the cash incomes of rural farmers expand. Tourism (such as the MICE sector for Rwanda) demands goods and services as inputs from other sectors. Tourism is also be a supplier to other sectors (transport services, finance, and insurance). Where tourism linkages remain weak and under-exploited, much of the value added in the tourism sector will be lost or captured by foreign investors and foreign import suppliers (such as Kenyan and Ugandan F&V producers).

1.2.3 Investment Climate Reform

Rwanda has made huge strides in reforming its investment climate. These can be categorised as follows;

- *Attracting FDI* – Here a number of reforms have included (i) the update of the Investment Code/ Law; (ii) setting up the RDB (Rwanda's IPA) as a one-stop centre for investors; (iii) leveraging technology to reduce government bureaucracy;
- *Diversifying the economy* – a number reforms instituted are aimed at diversifying the economy, and these have opened up opportunities for private sector growth in business tourism (MICE), ICT, exports, import substitution and logistics services. These include (i) tax incentives to increase hotel room capacity in order to facilitate the growth of MICE tourism; (ii) the development of export processing zones aimed at encouraging export manufacturing;
- *Privatisation and divestment* - for example, GoR has divested its holdings in the telecoms sector (sold its stake in MTN); banking sector (sold its stake in I&M bank); sought PPP arrangements on a strategic project (Bugesera International Airport); opened up government procurement to domestic, regional, and global competition; and reformed and wound up state-owned and party owned enterprises (SOEs & POEs) that were draining state coffers, and so on.

[16] Ibid.
[17] RDB 2017 annual report.
[18] Ibid.

- *Industrialisation policies* – aimed at addressing Rwanda's growing and unsustainable trade deficit through the introduction of domestic market recapture policies, introduction of the export growth facility to address the export finance challenge; the Made in Rwanda strategy aimed at creating and supporting demand for locally produced products as a way to reduce import dependency.

Regulatory reform may not be the most important approach to investment attraction, (but in certain cases can be catalytic). Regulatory reform was cited as the 5th most important factor by firms attracted to the Rwanda.[19] Only fifteen percent of surveyed firms that had invested in Rwanda indicated that regulatory reform was the key reason for their decision to invest. For example, reform of agri-input policies and regulations led to an increase of private sector companies importing seeds into Rwanda. In 2014, there were three seed companies importing seeds. This figure has increased to six. Only one local company was engaged in seed production in Rwanda in 2014 which increased to six firms in 2018. This reform was funded by a DFID Rwanda investment climate programme implemented by the IFC.

Table 5: Investment climate reforms and programmes

IC Reform Name	Details: e.g. IC sub-area; ministry; funder/supporter	Key Observations
Liberalisation of Rwanda's global visa regime	RDB and DFID (TMEA programme supported the CAFTA)	The drivers included (i) to secure a regional transport and logistics hub; (ii) ensure Rwandair's survival; (iii) support the growth of the tourism sector; (iv) fulfil an African Union (AU) commitment. As a result, tourism numbers have risen, transit through Kigali has increased and Air passenger numbers have increased since the reform came into place on 1/1/2018.
Comprehensive land tenure reform	RLMUA with DFID and Netherlands support	Rwanda is the most densely populated country in Africa which creates land pressures. The informal land administration system and insecurity of tenure have contributed to frequent land disputes, instability and gender inequality. The GoR requested the UK and a range of donors (EU, Dutch and SIDA) to support this most important reform that was aimed at strengthening land rights, reducing disputes, and kick-starting the rural economy. As a result, by 2017 almost 11.4 million parcels (95% of the country) had been demarcated and more than 8 million land titles issued. The land administration and information system (LAIS) is system allows titles as collateral to access finance.
2014 Investment code	RDB	Launched in 2015, the investment law shifted to a more targeted approach. For the first time, domestic investors enjoy equal opportunities with foreign investors, to boost the level of investment and exports. Minimum investment thresholds in strategic sectors were scrapped to support emerging sectors such as business process outsourcing and financial services.
Rwanda investment climate reform programme (RICRP3)	IFC & DFID	RICRP 3 aims to increase private investments and to create formal employment opportunities by improving Rwanda's investment climate through making the institutions more effective in delivering efficient government services to businesses (G2B), increased competition at national level, and at sector level.

[19] IFC 2017.

IC Reform Name	Details: e.g. IC sub-area; ministry; funder/supporter	Key Observations
Trademark East Africa (Rwanda)	DFID	Reforms to reduce or eliminate NTBs that hinder trade and investments in the EAC.

1.2.4 De-Risking

Donor support has facilitated investment through risk mitigation. For example, DFID funded PIDG through its Emerging Africa Infrastructure Fund (EAIF), which was the co-arranger for the KivuWatt Power Project – a $142m investment by a consortium of Symbion Energy and Highland Group Holdings Ltd towards the extraction of methane gas from Lake Kivu and converting it to electricity using gas turbine generators. EAIF intervention was required to assemble the innovative financing structure. Without it, the KivuWatt project may not have gone ahead.[20] Long-term (commercial) debt for this transaction was otherwise not available. PIDG companies – the EAIF, along with the Technical Assistance Facility (TAF), and DevCo – also helped to finance the project at different stages of its development.

EAIF was also able to arrange long-term finance to support developer Metito, a global provider of water management solutions with 60 years' experience developing and managing water facilities in emerging markets. Kigali Water benefited from a well-coordinated package of blended finance. EAIF led the arrangement of financing for the US$61m plant, providing a US$40m, 18-year-long term loan jointly with the African Development Bank and securing investment from other PIDG companies to galvanize a development, which otherwise may not have succeeded. DevCo—the specialist PPP advisory facility operating through PIDG and implemented by IFC—provided funding to help structure the transaction and its competitive tender. TAF granted US$6.5m in crucial viability gap funding to reduce up-front costs.

In the agro processing consumer goods sector, Unilever and Luxmi have indicated that they would not have committed to investing $55m and $27m respectively in factories and core estates if the supply side risks (smallholder famers in the value chain) had not been de-risked.

Government partnerships have facilitated investment through infrastructure cost sharing. A $140m investment was made by GoR and Korea Telecom (KT) through a Joint venture company to deploy a national high-speed (4G LTE) broadband network. KT brought expertise and made a cash injection of around $140 million, while the Government's equity investment in the JV included assignment of its extensive (over 3,000 km) national fibre optic network assets, spectrum and a wholesale-only operator license. High-speed broadband capability in Rwanda was expected to accelerate development of the ICT sector, create jobs (including more than 100 professional jobs within the JV itself), as well as help facilitate social and economic progress. This investment has facilitated the growth of the Business tourism sector.

[20] World Bank - Utilising natural lake-bed methane to develop 25MW of sustainable power. http://pidg.org/impact/case-studies/kivuwatt.

Given Rwanda's limited resources and current account deficit, PPPs offer an alternative way of attracting vital investment to finance public infrastructure as long as they are properly negotiated and the cost to the public purse is understood. For example, in 2013 GoR signed a PPP deal[21] worth $140m with Korea Telecom to deliver universal broadband access based on world-class 4G LTE technology on top of Rwanda's national fibre optic infrastructure, and manage the fixed-mobile converged infrastructure as the wholesale provider of high-speed mobile broadband, covering 95% of the population within 4 years.

1.2.5 Transactions Advice

Transaction advice is important. Rwanda does not have the wide ranging pool of local technical and industry-specific expertise to take investment opportunities beyond the pitch.[22] For example, the RDB indicated that they would like to seek investment in float glass manufacturing given the silica and methane glass reserves available. RDB does not have the resources and expertise to undertake the important pre-investment analysis to answer critical questions on the viability of float glass manufacture.

1.2.6 Financial Incentives

Financial incentives are generally not a critical factor in attracting investments. Several studies have looked at key factors, including financial incentives, which play a role in attracting FDI in Rwanda. The most recent assessment from an investor perception survey undertaken by the IFC[23] suggests that the incentives offered by the investment law are not the most important factor; however, the importance varies across sectors. The survey found that international investors are primarily driven by market opportunities, with 42% of companies citing size of the national market as a key location driver, and 41% citing access to the African market.[24] Economic stability was the next most important location driver (cited by 39% of companies) followed by low political risk (29%) and the attractive regulatory environment (25% of companies). Low costs (20%) and incentives (15%) were the next most important drivers (IFC 2017). Our consultations with RDB confirmed that the majority of investor negotiations were not focussed on extracting additional financial or fiscal incentives, beyond what was available in the 2015 investment Code. A range of foreign investments, as illustrated in Table 6, were attracted by market opportunity more than financial incentives.

Table 6: Rwanda - Selected Foreign Investments

Investment Name	Details: e.g. Size, Type, Source Country	Key Observations
VW Mobility solutions	$20m FDI, Germany	VW commissioned a study to assess where best to locate their mobility solutions lab for Africa. They chose Rwanda mainly due to how receptive they were to testing the solution in Rwanda and the facilitation they received from RDB. They were also attracted to the record that Rwanda had of being a willing test market for new ideas.

[21] The government has a 49 per cent stake in the firm, while Korea Telecom has 51 per cent shares. Korea Telecom received a 25 year concession.
[22] Currently have a contract with a short-term BCG but this does not include a service to develop opportunities beyond the pitch.
[23] IFC (2017) Investor Perceptions and Constraints faced by Exporting Firms in Rwanda's Priority Economic Sectors.
[24] Ibid.

Azania Milling company	$12m FDI Tanzania	Example of an East Africa firm that expanded its operations from Tanzania to Rwanda. They are located in the SEZ and have installed state of the art factory producing wheat floor for the domestic and export market. Azania was attracted by (i) Rwanda's location with DRC which was a big export market; (ii) the zero tolerance for corruption ; (iii) the KSEZ had all the facilities they needed ; (iv) No red tape - started and finished the investments without interacting with any government ministries; RDB courted and laid out the red carpet for them; working systems with services available online
Singita Lodge	$16m FDI Tanzania	Luxury high end lodge investment capitalising on GoRs's strategy to develop Rwanda as a high-end tourism destination and the Virunga massif is one of the premium destinations for high-end tourists, especially given the presence of rare mountain gorillas
Azam Milling company	$20m FDI Tanzania	One of the first grain milling FDI investments in Rwanda. This is an example of FDI attracted to the Rwanda and by extension the Eastern DRC market.
AIF	$50m FDI United Kingdom	CDC has taken a small stake in this nutritional foods producer that aims to tackle the malnutrition problem in the region. In addition, the Dutch investment bank FMO is one of the other investors in AIF.

1.3 Policy Recommendations

- **Donors should shift away from standalone investment climate programmes. The focus should be on sector level IC programmes that are better targeted and can effectively address IC constraints that affect sectoral FDI flows.** Rwanda has made great strides in improving the ease of doing business. More still needs to be done to unlock FDI flows in line with the improved investment climate. It is increasingly difficult to assess the level of investment generated by IC programmes let alone their development impact.

- **Rwanda recognises that its FDI strategy has to shift to focus on packaging and de-risking investment opportunities.** To date, the bulk of Rwanda's FDI flows have benefited from either transaction advice or some form of de-risking in order to achieve financial and legal closure on the deals. Transaction advice is critical in achieving deal closure. In the Rwandan case, the expertise required to ensure good deals are done, and deliver social and economic impact is not available given the skills challenge. IC programmes should include transaction advice as a key component of their support to IPA's. Facilities and funds (such as PIDG and AgDevCo) play an important role in de-risking investments.

2. Kenya Country Case Study

2.1 Context

2.1.1 Economy and Population

Kenya has traditional strength areas that make it attractive for foreign investment. Kenya is the leading member of the East African Community, with a population of 50 million, where per capita GDP has risen from $404 to $1335 over 2000-14. Its strategic location at the continent's east coast, relatively advanced telecommunications infrastructure,[25] robust financial sector,[26] and extensive aviation connections and Mombasa Port (a major trade gateway) all contribute to stimulating FDI.

2.1.2 Investment Climate

Kenya has been actively reformed the business environment in the last few years**.** In the recent *Doing Business* Kenya was the 7th most improved country in terms of comprehensive ranking in ease of doing business, with a total of 5 reforms implemented among the 11 areas of focus[27]. The reforms highlighted include:

- Registering property: This was through the introduction an online system to clear land rent rates making registering of property easier
- Getting credit: Kenya strengthened access to credit through the creation of a unified secured transactions legal framework, and establishment of a new unified and notice-based collateral registry
- Protecting minority investors: This was achieved by: (i) placing more emphasis on corporate disclosures and increasing directors' liability for better accountability and (ii) increasing regulation on the approval of transactions with interested parties, as well as an increment in the available remedies if said transactions are detrimental, thus increasing shareholders' rights and role in the major corporate decisions
- Resolving insolvency: This was made easier by facilitating the continuation of the debtor's business during insolvency proceedings, as well as the provision of equal treatment to creditors and granting them participation in reorganization proceedings,
- Paying taxes by merging all permits into a single unified business permit and by simplifying the value added tax schedule on its iTax platform.

Kenya now outperforms its regional peers (save Rwanda) in *DB* rankings across several topics. Kenya's overall competitiveness is ranked by the WEF Global Competitiveness Index at 91, ahead of several of Africa's leading FDI performers. Kenya also outscores its peers on

[25] The landing of four fibre-optic international submarine cables drastically reduced the cost of calls and internet access, allowing internet services to be affordable to a far greater proportion of the population. In parallel, the sector's regulator has reduced interconnection tariffs and implemented a range of regulations aimed at developing further competition.

[26] Kenya's financial system comprises numerous commercial banks, non-bank financial institutions, a range of insurance companies and a stock exchange, all which have shown strong growth in recent years. See: http://repository.uneca.org/handle/10855/4926.

[27] https://cytonn.com/uploads/downloads/doing-business-kenya-2019-note.pdf

several sub-topics that matter to investors such as the strength of investor protection, requirements for transparency of transactions, director liability for self-dealing, and the ease of holding officers and directors accountable for misconduct.

2.1.3 Foreign Direct Investment

Kenya's FDI inflows have been relatively small compared with other countries and the size of the economic opportunity. FDI declined from a peak of $1.45bn in 2011, down to less than a third of this sum five years later ($393m). This increased in 2017 with $672m in receipts, attributable to buoyant domestic demand and inflows into ICT industries.[28] Performance in 2017 notwithstanding, Kenya's FDI performance remains underwhelming compared to regional peers.

Even though overall FDI has been on the decline, the private equity segment is growing.

- Kenya is benefiting from a renewed interest by investors into the East African region – funds raised for East Africa private equity investment was estimated at $1.1bn in 2015 and 2016, compared to $1.6bn reported for the whole period 2007-2014, a steep growth (41%) of funds looking at East Africa. PE deals are recording shifting from agribusiness to financial services and manufacturing.
- Europe and North America continue to lead as sources of funds raised for PE investing in East Africa. The volume of reported deals in Kenya has increased significantly to 23[29] in 2016, from just 5 in 2012. The rest of the EAC recorded a combined 11 deals that year. In 2017 there was a substantial increase in the total value of deals, largely due to a Vodacom Group Limited and Safaricom Limited deal reported at US$2.6bn.
- Pension funds are an increasing source of investment. A 2015 amendment to the Retirement Benefit Authority of Kenya's regulation saw an allocation of up to 10% of a fund's assets under management allowed for direct investment by the country's pension funds into private equity as a distinct asset class, raising funds available for private equity in Kenya.

2.2 Government of Kenya Strategies on Foreign Direct Investment and Investment Climate Reform

2.2.1 Institutional Factors

Kenya's Investment Promotion efforts are supported by the government, which has ambitions for substantial scale up of investment. Kenya's investment promotion agency is Kenya Investment Authority (KenInvest), established by the Investment Promotion Act (2004). Its mandate is to promote and facilitate investment in Kenya by both local and foreign investors, although its focus and activities are primarily focused on foreign investment.

[28] Leading foreign investments in 2017 included ICT investors Naspers, MTN and Intact Software (South African), tech-oriented investors Boeing, Microsoft and Oracle (U.S.), consumer and retail investors Diageo (United Kingdom), and pharmaceutical investor Johnson and Johnson (U.S.). See https://unctad.org/en/PublicationsLibrary/wir2017_en.pdf?user=46.

[29] Deal volumes represent disclosed transactions whose values were disclosed. See https://estateintel.com/wp-content/uploads/2015/01/2017_KPMG_and_EAVCA_Private_Equity_in_East_Africa_Survey_Final.pdf.

Kenya's Ministry of Finance, its revenue authority and a special economic zones authority also provide key services in the investment process, particularly to foreign investors.

Effective investment promotion may require a stronger institutional mandate than that currently enjoyed by the IPA. Though nominally Kenya's investment promotion agency, KenIvest performs in an environment where several other regulators have a more significant bearing on the investor's decision to invest and comply with regulations during the operational phase of the investment. It is yet however to demonstrate sufficient leverage over these institutions, the establishment of the One Stop Shops notwithstanding. It is however apparent that KenInvest's authority to issue prospective investors with investment certificates maintains its relevance particularly to foreign investors. The award of an investment certificate by KenInvest enables an investor to obtain incentives offered by the Kenya Revenue Authority and the Special Economic Zones Authority. These include incentives related to tax reduction or exemptions, capital gains tax, VAT refunds, customs duty exemption and accelerated depreciation (see Table 9).

Investor facilitation is appropriately targeted on larger investments. KenInvest primarily provides assistance to investors seeking licenses and permits, coordinates stakeholder meetings, issues investment certificates and provides one stop centre services, in part to help meet the objective of raising Kenya's foreign investment receipts from what is currently less than 2% of GDP to 10% by 2030.[30] KenInvest has directly facilitated a total of 1,068 projects in the five ending 2017 where the proposed capital investment was estimated at $7.4bn, according to its officials. KenInvest requires that prospective investors seeking their services demonstrate that they have at least $100,000 to invest. It is not clear whether the decision to invest by domestic or foreign investors is directly attributable to KenInvest's services, or whether KenInvest's services merely eases an investment entry process that would be realized, its services notwithstanding.

Investor tracking and aftercare is an appropriate feature in Kenya's approach, but could be strengthened. KenInvest telephones a selected sample of investors that obtained investment certificates, to identify lingering investment entry and operation hurdles. KenInvest officials thereafter compile a summary of issues which are presented to their Board of Directors on a quarterly basis. It also uses this information as the basis for identifying policy and administrative chokepoints affecting investors and lobbying for an improvement of the investment climate with other government agencies. There is no evidence of how these findings are systematically incorporated into the wider policy and administrative reform priorities of the Kenyan government. That said, this is potentially a critical tool for identifying at a practical level the key issues affecting investors once they commence the investor entry process, and can provide a viable response mechanism to addressing investment climate related chokepoints.

Research and policy advocacy is an area where donor support could usefully be supplied. KenInvest is leading a multi-agency review of Kenya's investment policy, expected

[30] https://www.the-star.co.ke/news/2017/05/22/state-to-open-one-stop-centre-for-all-investors_c1563892

to lead to the publication and adoption of a fresh over-arching investment policy for Kenya. This initiative comes from the realization that Kenya does not have a single, comprehensive and harmonized policy to guide attraction, facilitation, retention, monitoring and evaluation of investments, a factor that has kept its investment stimulation efforts sub-optimal in spite of its *Doing Business* reforms. The policy seeks to anchor the role of private investment in economic development and define the respective roles of various national and county government agencies. On implementation, it is expected to codify roles and responsibilities in investor management to ensure a streamlined and clear investment regime in the context of Kenya's new constitution which creates 47 regional governments with investment management responsibilities particularly in licensing, inspections and issuance of various permits. The current investment policy revision process is an opportunity for DFID to provide technical support to KenInvest and potentially share international best practice in investment climate reform and investor facilitation.

2.2.2 FDI Attraction

Investors consider a broad range of factors in their decision to invest[31]*,* including domestic market size, macroeconomic stability and a favourable exchange rate, labour force talent and skills, and physical infrastructure. Investors are heterogeneous – they may seek natural resources, markets, efficiency or strategic assets, and would prioritize different factors or rank the importance of the same factors differently in their decision to invest. Kenya's performance on global indices and its low return on FDI in recent times emphasizes the point that while *Doing Business* and *Global Competitiveness Index* provide useful information on reforms that are useful to smaller, domestic investors, they do not act as an indicator for a country's success in stimulating and retaining foreign investment. A typology of approaches used to promote investment in Kenya is presented in Table 7.

Table 7: Kenya Investment Climate Support Spectrum

Type of Investment Promotion	Programme	Details
Traditional Investment Climate	*Kenya Investment Climate Reform Programme I&II, World Bank Group*	An investment climate reform program that focussed on reducing regulatory burdens affecting domestic businesses and foreign investors and focussing on regulatory reform, investment generation and improving trade logistics.
Transaction Support/Facilitation	*Private Infrastructure Development Group (PIDG)*	PIDG mobilises private sector investment to assist developing countries in providing infrastructure vital to boosting their economic growth and combating poverty.
	TradeMarkEastAfrica	Its primary focus is to increase trade by unlocking economic potential through increased physical access to markets, enhanced trade environment and improved business competitiveness.
	Msingi East Africa Ltd.	DFID-backed, this program seeks to enable transformational growth in its focus industries by building competitiveness, resilience and inclusiveness. It employs a

[31] World Bank. 2018. *Global Investment Competitiveness Report 2017/2018: Foreign Investor Perspectives and Policy Implications*. Washington, DC: World Bank. The report presents analytical insights and empirical evidence on foreign direct investment drivers and contributions to economic transformation. It is in part informed by the *Global Investor Competitiveness Survey 2015* that interviewed 754 executives of multinational companies.

Type of Investment Promotion	Programme	Details
		pioneer industry approach to crowd in investments, supply capacity and regional value chains.
	Kenya Competitiveness Enhancement Program, World Bank Group	This program works to improve competitiveness by consolidating previous economy wide business enabling reforms, but places stronger emphasis on investment generation through sector specific investment facilitation work and special economic zones development.
	Royal Danish Embassy	This program maintains a suite of interventions including: investing in TradeMarkEastAfrica (TMEA); direct management of a Business Advocacy Fund which supports business member organisations, trades unions and civil society organisations to improve their private public dialogue capabilities; and investor facilitation windows and financing mechanisms which include Danida Business Finance (subsidized access to infrastructure finance) and the Investment Fund Unit (advisory services and risk capital to Danish companies wishing to do business in developing countries).
	The USAID East Africa Trade and Investment Hub	A US-backed project that supports deeper regional integration, enhanced competitiveness of select regional agricultural value chains, promotion of two-way trade with the US and investment facilitation with FDI targets.
PPPs	*Infrastructure Finance/Public Private Partnership Project, World Bank Group*	The objective is to help strengthen the enabling environment for Kenya to increase infrastructure stocks and service levels.
Venture Capital / IFC type with specific TA	*Novastar Ventures*	A +$80m venture catalyst firm that invests in start-up and early phase ventures with demonstrable capacity to scale up through serving lower income segments of the population.
	Fanisi Capital	Founded by Norfund and Amani Capital, it prioritizes industries that have posted revenue or profit in agribusiness, healthcare, energy, retail and education. Funding starts from $1 million (sh.103 million) and they plan to exit in 3 to 6 years.
Pure FDI	CDC	UK's development finance institution focusing on supporting economic development and prosperity primarily in Africa (where it aims to commit up to £3.5 billion investment to African businesses over the next four years) and South Asia.

Investment incentives are impacted by the nature and effectiveness of regional trade taxes.

- The East African Community maintains a *common external tariff* for imports and Kenya adds value added tax of 16% on imports. Although remission of customs duty and VAT refunds are available to manufacturers who export their products outside the bloc, this system is inefficient and holds back significant cash flow for manufacturers.
- EAC *Rules of Origin* define the circumstances where goods manufactured in the bloc or have undergone acceptable value addition may be granted preferential tariffs upon entry into another EAC Partner State. In order to qualify as originating in the region, the goods must in addition be consigned directly from a Partner State and must be supported by a Certificate of Origin. Partner States habitually do not trust and therefore do not recognize

certificates of origin. This affects the ability of investors to take advantage of the 160mn person regional market on a tariff-free basis.

- EAC trade policy requiring investors that take advantage of *fiscal incentives* to export 80% of their products outside the bloc has a negative impact on Kenya's FDI attractiveness. It shrinks the market for their goods. Investors are also worried about the Continental Free Trade Area negotiations, whose objective is to remove tariffs for intra-African trade. They worry that location in EPZs would mean having to export 80% of their manufactures outside the continent, a proposition which is not in line with their competitiveness and the required trade logistics challenges they face.

A suitable regional trade regime may improve regional value chains and retain value addition activities within the bloc. For example, in textiles and apparel, green cotton may be farmed and ginned in Kasese (Uganda) where the soil and climate are favourable. Well integrated trade logistics, adherence to rules of origin, recognition of certificates of origin and compliance to regional sanitary and phyto-sanitary measures would make it easy to export to Kenya, specifically to Naivasha where there is abundant geothermal resources, providing clean and affordable energy for making fabric and apparel, and good rail infrastructure would thereafter transport the finished products for export in the port city of Mombasa.

Box 2: Kenya Sector Transformation Case Study

Kenya Textiles and Apparel Industry

Increased investment in the raw and intermediate stages of the value chain, lower tariffs will unlock more profits for exporters. Kenya's textile and apparel sector heavily relies on imported raw and intermediate inputs, constricting margins for exporters. It imports most of its fabric (from South Korea, China, Indonesia, Singapore and others) and other inputs,[32] relying more on cut, make and trim activities. According to some estimates, 64% of manufacturing cost is attributable to imported fabric. In response, the Ministry of Industry, Trade and Cooperatives has commenced programs to revive the cotton industry to create jobs and cut reliance on imported fabric.[33] This includes provision of high quality, free cotton seeds to farmers, improved credit to small holder farmers and introduction of bale testing systems for cotton. Kenya needs to reduce tariffs on imported inputs and further curb administrative delays and costs.

A skilled yet competitively priced workforce favours Kenya for supply of integrated and higher value services to global buyers. At a range of $125 to $170 per month, Kenya's skilled workers are more expensive than EAC peers, but are competitively priced compared to South Africa or Mauritius, two countries that provide more integrated and higher value services to buyers. This means Kenya has potential – from a wage perspective – to be regionally competitive in higher value services, given availability of skilled workers in garment making and comparatively high worker retention in the sector. Kenya is also competitively priced compared to other major exporting countries. Kenya, in partnership with partners such as USAID East Africa Trade & Investment Hub and McKinsey, is currently expanding training of its workforce through its National Industrial Training Authority.

Kenya's significant investments in cheaper, more reliable power particularly geothermal energy, are expected to reduce energy costs in the medium term, further improving its cost profile for apparel production. At a cost of 16 – 18 UScents/kWh, Kenya's power is one of the most expensive in the region (only lower than Rwanda) and close to triple the cost in Ethiopia, its major competitor. Reliability is also low. Ongoing investments are however expected to improve its cost profile.[34]

Kenya's trade facilitation reforms are bearing fruit, making it easier and cheaper to import textiles and apparel inputs. According to *Doing Business*'s Trading Across Borders indicators, the time and cost of Kenya's documentary compliance

[32] In addition to fabric, Kenya imports dyes, tools and capital equipment.

[33] Kenya National AGOA Strategy and Action Plan 2018 – 2023, Ministry of Industry, Trade and Cooperatives.

[34] https://www.nation.co.ke/news/KenGen-in-ambitious-plan-to-lower-cost-of-power/1056-3367522-rxjqx7/index.html

procedures for imports[35] broadly competitive and better than say Bangladesh, Tanzania, Ethiopia and Uganda. Kenya needs to maintain its current trend of effecting trade facilitation reforms in order to increase its competitive advantage.

Location, investment in transport infrastructure and trade facilitation reforms strengthens Kenya's case as a sourcing destination for apparel. A strong source of competitive advantage for Kenya is a central location in Africa, with close proximity to Europe and comparatively lower costs for air and ocean freight, compared to its regional peers. For example, at an average cost of $2,307 and $3,470 (20' ct and 40' ct respectively) to transport a consignment to the US West Coast, Kenya's sea freight costs are the lowest in Eastern Africa (Mauritius included). Mauritius however enjoys quicker access at 20 days, compared to 34 for Kenya. Kenya also enjoys relatively quick port to park travel times, currently estimated at 1 day, particularly compared to Ethiopia (a major sourcing competitor) where consignments can take more than five times the amount of time to get to a port. Kenya's border compliance procedures for exports are also better than selected regional and global textile and apparel competitors at $143 and 21 hours, [36] and a source of competitive advantage.

East Africa has potential to provide Kenya with a ready market for apparel, but trade barriers continue to frustrate Kenyan exports into East Africa. According to Kenyan exporters of apparel products, despite formal adoption of the EAC Revised Rules of Origin (which require 0% tariffs for goods originating from other EAC Partner States) they face non-recognition of their Certificates of Origin when entering Tanzania. Tanzania however avers that Kenya is allowing textiles and apparel manufacturers operating in EPZ to offload their final textile products in the market duty free against EAC rules. Kenyan exporters also face non-recognition of Certificates of Origin for various items when exported into Uganda. Kenya needs to work harder to resolve trade disputes with its EAC neighbours in order to ease Kenyan exports of apparel items.

Overall, Kenya has strong prospects for the textiles and apparel sector, provided the government follows up with its series of donor-supported reforms in the sector, supported mostly by USAID East African Trade & Investment Hub, Msingi East Africa, Africa Development Bank, International Trade Centre, World Bank Group, among other players. Key reforms currently being pursued by government with support of its development partners include:

- technical training for apparel workforce; expanded management & administrative training;
- improved participation of apparel firms in selected export market trade shows;
- more efficient collection and dissemination of information on export markets, technology, operations and finance;
- better organization for engaging buyer inward missions; and
- diversification of products and services that Kenya can provide to export market.

2.2.3 Investment Climate Reform

Regulatory reforms have stimulated foreign investment in Kenya.

- Kenya liberalised its *telecoms sector* from 1998 through the Kenya Communications Act which provided a new regulatory framework for the sector and unbundled Kenya Post and Telecommunications into separate entities.

Investments arising from regulatory reform have gone on to leverage additional investments.

- The Kenyan government decided in 2006 to concession Telkom Kenya to private sector investors, appointing IFC using funding from DevCo to act as transaction adviser. Kenya wanted a comprehensive solution that would restructure the company, benefit the company's employees, strengthen competition in the telecoms sector, and give government coffers a boost. IFC helped TKL arrange US$81 million in financing to fund the cost of downsizing of thousands of its employees by pledging part of TKL's 60% stake in Safaricom. The loan was to be repaid upon the privatization of TKL. This allowed TKL to be privatized as a competitor to Safaricom and thus increase competition in the market. The unbundling of Safaricom also funded the restructuring of TKL's balance sheet so that it could be privatized free of major government liabilities, including government debts and pension deficits. Lastly, IFC engineered the award of a mobile telephony license to TKL, which was critical to its competitiveness and attractiveness to

[35] According to *Doing Business*, the total burden of preparing documentation to enable the completion of an international trade transaction with an assumed trading partner.

[36] According *to Doing Business*, the total burden associated with compliance with customs regulations and with regulations relating to other inspections that are mandatory in order for a shipment to cross the border.

investors during the privatization transaction. DevCo funding was used to procure legal, technical, social/labor consultants as well as telecom specialist for the project.

- The liberalisation of the telecommunications sector created mobile operator Safaricom, now East Africa's most valuable company with a market cap of $6.2bn (Oct. 2018). MPESA, a mobile phone-based money transfer, financing and microfinancing service owned by Safaricom transfers more than $150m daily, more than all the commercial banks in Kenya combined,[37] and dramatically democratised financial services in the country, making it possible for small businesses across the country to access banking and money transfer services.
- Africa Logistics Prosperities, a property developer that benefitted from the WBG's upstream advice to government to establish a Special Economic Zones law and regulations is an integrated company that acquires, develops and manages modern logistics warehousing across Africa.[38] It is developing a portfolio of modern warehousing parks in Nairobi to improve logistics operating efficiencies and costs.

Foreign investors and SMEs have a virtuous relationship. They strengthen each other's position through the web of supply, demonstrational and even rival relationships they develop. An early investment by DFID in *Doing Business* reforms (that improve the business environment for small, domestic businesses rather than larger, foreign businesses) is paying dividends for large foreign firms. These firms use the capacity and skills of local suppliers, while local, smaller firms benefit from larger orders for goods and services from foreign investors who source approximately 43% of their supplies locally.

Table 8: Kenya Recent Investment Climate Reforms

IC Reform Name	Details: e.g. IC sub-area; min stry; funder/supporter	Key Observations
(a) Movable Property Securities Act (2017)	(a) State Law Office, Financial Sector Deepening, World Bank Group	(a) The Act promotes consistency and certainty in secured financing relating to movable assets; and enhances the ability of individuals and corporations to access credit using movable assets.
(b) Kenya Trade Remedies Act (2017)	(b) TradeMarkEastAfrica, Kenya Association of Manufacturers	(b) Key for investment in manufacturing, the Act establishes the Kenya Trade Remedies Agency to investigate and impose anti-dumping, countervailing and trade safeguard measures. It provides the framework for the application of trade remedies in Kenya in compliance with the WTO law which requires a domestic law and institution to receive complaints and, undertake investigations in line with the WTO Agreements. Through this Act, Kenya can impose Anti-dumping and countervailing measures targeted at countries which subsidise their producers or whose exporters dump their products in Kenya.
(c) Companies Amendment Act (2017)	(c) East Africa Trade & Investment Hub, Kenya Private Sector Alliance	(c) The Act removed foreign shareholding restrictions. Prior to the amendment, the Act required at least 30% shareholding in a foreign company be held by Kenyan Citizens where a foreign company wishes to be registered as a foreign Company in Kenya.

2.2.4 De-risking

Kenya should continue to work with DFIs to de-risk private investment – foreign and local, large and small. This means focussing on legal, regulatory and institutional reforms on

[37] https://www.nation.co.ke/news/MPesa-transactions-rise-to-Sh15bn-after-systems-upgrade/1056-3194774-llu8yjz/index.html.
[38] http://www.dobequity.nl/project/africa-logistics-properties/.

the one hand and encouraging capital raising and technical assistance to the private sector on the other. DFIs also need to balance their support for investor facilitation with reforms at a policy and regulatory level. Focusing only on reducing risks at the firm level does not compensate for failing to de-risk regulations and institutions at the sector or macro level. If fundamental elements at a macro level are lacking, investors are unlikely to respond to generous incentives, or such incentives may only attract unviable investments. Kenya's business environment is strengthened by several investment policy, investment facilitation and impact investment projects that are designed to improve the investment climate for both domestic and foreign investors. Examples include:

- *Kenya Competitiveness Enhancement Program* (KCEP), a World Bank Group competitiveness improvement program that seeks to consolidate economy wide business enabling reforms, but places stronger emphasis on investment generation through sector specific investment facilitation work and special economic zones development. KCEP has adopted a "3.0 Strategy" which requires a line of sight to actual investments for upstream policy interventions and accompanying investor facilitation measures. Policy reform programmes are required to be "investor first" in their approach – understanding foreign investor priorities and their de-risking requirements.[39] ;
- *CDC*, which is the UK's development finance institution focusing on supporting economic development and prosperity primarily in Africa (where it aims to commit up to £3.5 billion investment to African businesses over the next four years) and South Asia;
- *PIDG,* which mobilises private sector investment to assist developing countries in providing infrastructure vital to boosting their economic growth and combating poverty;
- *Bi-lateral assistance programmes* such as DANIDA, which maintains a suite of investment climate and investor facilitation programs that include policy intervention support to business membership organisations and community-based organisations, and a number of vehicles that provide subsidized access to finance and financing advisory services.

DFIs are increasingly using a blended approach incorporating elements of investment climate reforms and deals facilitation. Examples include:

- *Square Pharma* invested $75m, attributable to the World Bank Group's investment policy support to promulgate a Special Economic Zones law and regulations. This was followed by investor facilitation support in close collaboration with the Ministry of Trade. Specifically, World Bank staff leveraged:
  - Exemption from imposition of a 20% limit to offload products into the domestic and regional market, a condition imposed on beneficiaries of EPZs.

[39] This thinking is drawn from among other sources a diagnostic, the "Global Investor Survey 2015" and a report emerging from its findings, the "2017/2018 Global Investment Competitiveness Report: Foreign Investor Perspectives and Policy Implications". KCEP used these reports to design their latest competitiveness enhancement programs that have increasingly pitched sector and site-specific interventions and investment generation.

   – Land at the EPZ following direct intervention by bank staff and established public-private dialogue platforms, including a presidential private sector round table. Square Pharma invested in Kenya following this intervention.

Risks accompany the hybrid model, and DFIs should mitigate them. The risks/issues include:

- *Private sector capacity building* which is required by the private sector as much as government: In DFID's earlier support for PPPs the Kenyan government was the sole beneficiary of capacity building efforts. The domestic private sector (that negotiates with government and bids for resulting opportunities) did not receive support, and years later it remains difficult for them to close deals.
- *Investment policy support* is being superseded increasingly by investor facilitation in the search for quick results. Ignoring investment policy support to government may come at a price given that at a minimum the legal, regulatory and policy environment needs to be properly suited for investor facilitation to work.
- *Volatile risk perceptions from the public*, particularly when investments fail. For example, the $140m ARM investment by CDC is being touted as probable evidence that "UK aid strategy is failing"[40] yet it is a single failed investment in a generally successful portfolio by CDC. Such volatility in public opinion is likely to increase as the public judges ODA effectiveness on individual transactions, rather than a broader story of success.

2.2.5 Transaction Support

Investment facilitation programmes should focus on re-investment by existing firms and on dealing with the issues that affect them during the operational phase of the investment. This would include work on investment protection guarantees that are critical for retaining and expanding investments in the long term across all types of FDI.[41] Investor aftercare is a core part of investor facilitation: The *Global Investment Competitiveness Survey 2015* indicates that more than a third of all investors re-invest all of their profits in a country, supporting the view that policies that help investors expand their businesses may yield more than policies to attract new businesses.

After care services are crucial for investor retention. After care services are very poor in Kenya. The authority charged with investment promotion (KenInvest) phones selected investors on a quarterly basis to enquire on their progress. This research is not grounded on a methodology that yields persuasive policy advice to other government departments. Interviews with several DFIs confirm that after care remains a major investor facilitation weakness. The DFI staff suggest that reform of one-stop shops could help. "*De jure*" one stop shops or those that are able to provide investors with "irrevocable legal guarantees of facilitation" would significantly improve the investor entry process, a process which goes

[40] See FT article https://www.ft.com/content/049ccf3a-a5e3-11e8-8ecf-a7ae1beff35b The Financial Times article goes further to say that this investment leads to "renewed questions over British government spending in Africa, and particularly [CDC's] capacity to deliver on Theresa May's ethos of increasingly using the aid budget for private sector projects."

[41] Typical investment protection requirements include ability to transfer currency, legal protections against expropriation, against breach of contract, and against non-transparent or arbitrary government conduct.

beyond formal establishment and lasts several months or even years. The officials further suggest that one stop shops should be hosted in either the Presidency or Ministry of Finance – two government departments with the power to coral other agencies.

2.2.6 Financial Incentives

Kenya does not offer firm-targeted incentives, but has a standard menu of investment incentives available to domestic and foreign investors who obtain an investment certificate from KenInvest, the government's investment promotion agency. Targeted mainly at export processing, the firms that make use of these incentives are mainly apparel firms. Coffee roasters, fruit packagers and processors, logistics firms, plastics and other firms also make use of export processing incentives.

Table 9: Summary of Investment Incentives in Kenya

Investment Incentive	Details
Tax Reduction /Exemption	EPZ: Manufacturers and service exporters obtain 10-year tax holiday (25% rate for next 10 years); 10-year withholding tax holiday on remittances to non-residents; 100% investment allowance on new buildings and machinery invested over 20 years;
Capital Gains Tax	The rate of tax is 5% of the net capital gain
VAT Refunds	EPZ: VAT exempted on both goods and services used by EPZ firms, including machinery, raw materials, building materials, office equipment and certain fuels
Customs Duty exemption	EPZ: exempted from paying import duty on inputs including machinery, raw materials, building materials, office equipment and certain fuels
Accelerated Depreciation	Capital allowance on qualifying investment exceeding KES 200 million (outside main cities): 150%; Allowance on other qualifying investment: 100%; Allowance on farm works : 100% (straight-line); Certain building allowances, ranging from 1%– 50% (straight line)
Others	Exemption from stamp duty on all transactions relating to licensed EPZ firm; No exchange controls.

Incentives should only be offered when investment assets are available for the general public, and when investments generate positive externalities for example encouraging green technology, upgrading skills, or when the investment is an anchor investment. Also, countries that offer incentives must adhere to transparency (measuring costs of incentives and budgeting that cost), reduce discretion, define the criteria for grants, tighten administration of incentives and regularly study its effectiveness in terms of investment outcomes desired.

Regional agreements can provide incentives for a more coherent and disciplined approach to incentives. EAC policy requires export of majority of goods when incentives are offered. EAC trade policy requires that if investors receive customs duty incentives such as duty remission, the investor will be required to export at least 80% of their products outside the EAC bloc. Several investors (including Square Pharma which was exempted from this rule) do not favour this rule, arguing that incentives received are not sufficient to offset the market loss they incur by mandatorily exporting the majority of their goods outside East Africa.

2.3 Policy Recommendations

- **There should in the Kenya context be a stronger focus on crowding in private finance for development objectives,** an approach currently being explored by GuarantCo, a PIDG firm. ODA should increasingly find ways to leverage conditions for

private finance to contribute to development outcomes.[42] DFID can explore supporting this approach by working with the private and public sectors in ways that support investment climate by leveraging the private sector and optimizing the use of scarce public resources.

- Improving the quality of competition policy and practice becomes important when DFIs trend towards providing investor-specific facilitation. This is important as a safe-guard to ensure that firm rivalry, an important aspect of country competitiveness,[43] is maintained or takes root. This is particularly important in investor facilitation projects where a new, pioneer operator is being facilitated to enter and operate in the market
- **Investor aftercare should be a core part of investor facilitation**. Investment facilitation programmes should focus on re-investment by existing firms, and on dealing with the issues that affect them during the operational phase of the investment.

[42] Page 2, "Maximizing Finance for Development: Leveraging the Private Sector for Growth and Sustainable Development", World Bank Group. Known in this report as the "Hamburg Principles", this approach provides a common framework for multi-lateral development banks (MDBs) to increase levels of private investment in support of development. Based on their experience to date in working with the private sector, the MDBs agreed to focus their efforts on three main areas: strengthening investment capacity and policy frameworks at national and sub-national levels; enhancing private sector involvement and prioritizing commercial sources of financing; and enhancing the catalytic role of MDBs themselves. In support of these principles, when a project is presented, one should ask if there is a sustainable private sector solution that limits public debt and contingent liabilities. If "yes", prioritize the private sector solution. If "no", ask whether it is because of policy or regulatory gaps or weaknesses. If so, provide support for policy and regulatory reforms.

[43] When firm rivalry is intense, country competitiveness can improve. This is because rival firms tend to be co-suppliers for large international orders, thereby improving the reliability of the country as a buying destination. Also, firm rivalry incentivizes firms to specialize, thereby increasing their efficiency and profitability.

3. Western Cape (South Africa) Sub-National Case Study

3.1 Overview

3.1.1 Economy and Population

South Africa's economy can be characterised in the African context as richer, sophisticated, highly unequal, and unable to maintain rapid growth to absorb the very large numbers of unemployed. South Africa's upper-middle income economy is one of the largest in Africa, with a population of 57.7 million. Historically, South Africa's economy was built on primary and secondary industries (agriculture, mining and manufacturing), but in recent decades, and in line with global developments, growth has shifted to services. South Africa's economic performance has fluctuated widely over the decade to 2017 with GDP growth consistently below 2% since 2014 and a low of 0.6% in 2016. Sub-Saharan Africa and to a lesser extent Rwanda have mirrored the negative trend over this period. The South African economy has since moved into recession, contracting at an annualised rate of 2.6% in the first quarter and 0.7% in the second quarter of 2018.[44] The IMF, which projects modest growth recovery to 1.5% in 2018 and 1.8% in later years[45], prescribes strengthening the fight against corruption, implementing reforms in product and labour markets, improving competitiveness, enhancing education quality and leveraging opportunities provided by digitalisation to boost efficiency and support growth.[46] Major obstacles to growth include a regulatory environment not conducive to private investment, inefficiencies in state-owned enterprises (SoEs), increased cost of inputs as a result of the depreciating currency, labour market rigidities, and lack of effective competition in product markets, corruption and policy uncertainty. With a malfunctioning economy unable to create enough jobs, inclusive growth has been unachievable.

The Western Cape Province, which has particular strengths in terms of attracting investment, is the third largest province with a population of 6.6m (11.4%).[47] The Province recorded a regional GDP of R424.38 billion (equivalent to US$29.3 billion) in 2016,[48] accounting for 14% of South Africa's GDP in 2016. In comparison to the rest of South Africa, the Western Cape has lower unemployment, a lower Gini coefficient and a higher Human Development Index.[49] The single largest contributor to the region's economy is the financial and business services sector, followed by manufacturing. Close to 30% of the gross regional product comes from foreign trade with agricultural products dominating exports. The Western Cape experienced annual average export growth from 2012 to 2016 of 17.8% and import

[44] Statistics South Africa. http://www.statssa.gov.za/?p=11507.
[45] IMF Regional Economic Outlook. Sub-Saharan Africa. May 2018.
[46] Moody's Investors Service cut its estimate for South Africa's 2018 GDP growth to between 0.7% and 1% following two quarters of negative growth. https://www.fin24.com/Economy/moodys-cuts-sas-gdp-forecast-as-recession-bites-20180906.
[47] Mid-year population estimates 2018. Statistics South Africa. Annual population growth is estimated at 1.2%. http://worldpopulationreview.com/countries/south-africa-population/ http://www.statssa.gov.za/?page_id=1854&PPN=P0302&SCH=7362.
[48] Economic Performance Indicators for Cape Town. Cape Town: City of Cape Town. 2016.
[49] Regional Development Profile City of Cape Town. Western Cape Government. 2011.

growth of 7.7%.[50] The top three export destinations for the Western Cape were Namibia (R12.27bn), the United Kingdom (R9.17bn) and the United States (R8.98bn), accounting for almost a quarter of total exports.

3.1.2 Investment Climate

South Africa's performance on investment climate indicators is good, but not as good as it should be given the level of development in the country. Measured against Sub-Saharan African (SSA) economies competing for FDI, South Africa demonstrates a mixed record on the Doing Business rankings**Error! Reference source not found.**. Overall South Africa (82) is behind Kenya and Rwanda but is well above the SSA average.

There is evidence that the business environment is deteriorating. The Rand Merchant Bank/Bureau for Economic Research Business Confidence Index declined from a high of 51 in the fourth quarter of 2014 to a low of 29 in the second quarter of 2017, while the percentage of manufacturers rating the general political climate as a constraint increased to 89% in the fourth quarter of 2017. Confidence was lower in the goods-producing sectors (manufacturing and building) than in the trade sector.[51] In the first quarter of 2018, business confidence saw an increase in the Index to 45, while the share of manufacturers rating the general political climate as a constraint fell to 72%. Business confidence fell back slightly in the second quarter of 2018.[52]

The Western Cape investment climate is better than average for South Africa. Cape Town is one of the world's leading cities to do business, ranking strongly on ease of doing business, cost, transportation, infrastructure, sustainability and the natural environment.

However any province will be impacted by national factors. South Africa has a number of problems which could discourage investors. There has been an increase in labour strikes and greater social unrest in recent years, which rating agencies have warned could further lower South Africa's credit rating.[53] Violent crime and corruption continue to be widespread. Access to electricity is also increasingly problematic. Additionally, although unemployment is high, skilled labour is in short supply and immigration laws make it difficult to hire foreign workers. Investors are also concerned about the general direction of policy making, in particular economic policy and structural reforms. The policy and practice of Broad Based Black Economic Empowerment (BBBEE) potentially impose restrictive regulations on doing business in South Africa. Investment potential is hampered by legal uncertainties which discourage foreign investors, despite the promulgation of the Protection of Investment Act in December 2015, which reinforces legal guaranties for foreign investors. The new ANC

[50] Western Cape – Africa's Trade and Investment Springboard. Wesgro. 2017.

[51] Rand Merchant Bank/Bureau for Economic Research Business Confidence Index. The Index takes the percentage of respondents that rate prevailing conditions as satisfactory as an indicator of business confidence. The Index is a composite of the unweighted mean of five sectoral indices (manufacturers, building contractors, retailers, wholesalers and new vehicle dealers). Business confidence can vary between 0 and 100, where 0 indicates an extreme lack of confidence, 50 neutrality and 100 extreme confidence. https://www.ber.ac.za/Home/

[52] South African Reserve Bank. Quarter 2 2018 Economic Review.

[53] Moody's is the sole major global ratings agency to rate South Africa's sovereign debt at above investment grade.

administration led from February 2018 by President Ramaphosa is expected to focus policy direction on foreign investment.

3.1.3 Foreign Direct Investment

South Africa's FDI has declined, with growing net outflows of investment in the period 2014-2017, with a net FDI outflow of $12.5bn (Table 10**Error! Reference source not found.**). The decline in private direct investment contributed substantially to the decline in fixed capital formation. In the 2018 Report UNCTAD further noted that "FDI to South Africa declined by 41 per cent to $1.3 billion, as the country was beset by an underperforming commodity sector and political uncertainty.[54]

Table 10: South Africa and SSA: Foreign Direct Investment (FDI) Flows ($m)

Foreign Direct Investment	2013	2014	2015	2016	2017	Net Inflow /Outflow
South Africa: FDI Inflows ($m)	8,300	5,771	1,729	2,235	1,325	19,360
South Africa: FDI Outflows ($m)	6,649	7,669	5,744	4,474	7,360	31,896
South Africa: Net FDI Inflows ($m)	1,651	(1,898)	(4,015)	(2,239)	(6,035)	(12,536)

Source: World Investment Report 2018. UNCTAD.

FDI in South Africa is dominated by OECD countries, although China is now the fifth largest investor. The UK is the biggest foreign investor (R712.4bn) followed closely by The Netherlands (R395.8bn) and the USA (R126.6bn), Germany (R92.3bn) and China (R87.4bn).[55] The largest share of foreign investment is in financial and business services (R780.7bn), followed by manufacturing (R386.0bn), mining (R379.9bn), transport and communications (R192.4bn) and wholesale and retail trade, catering and accommodation (R82.6bn).[56]

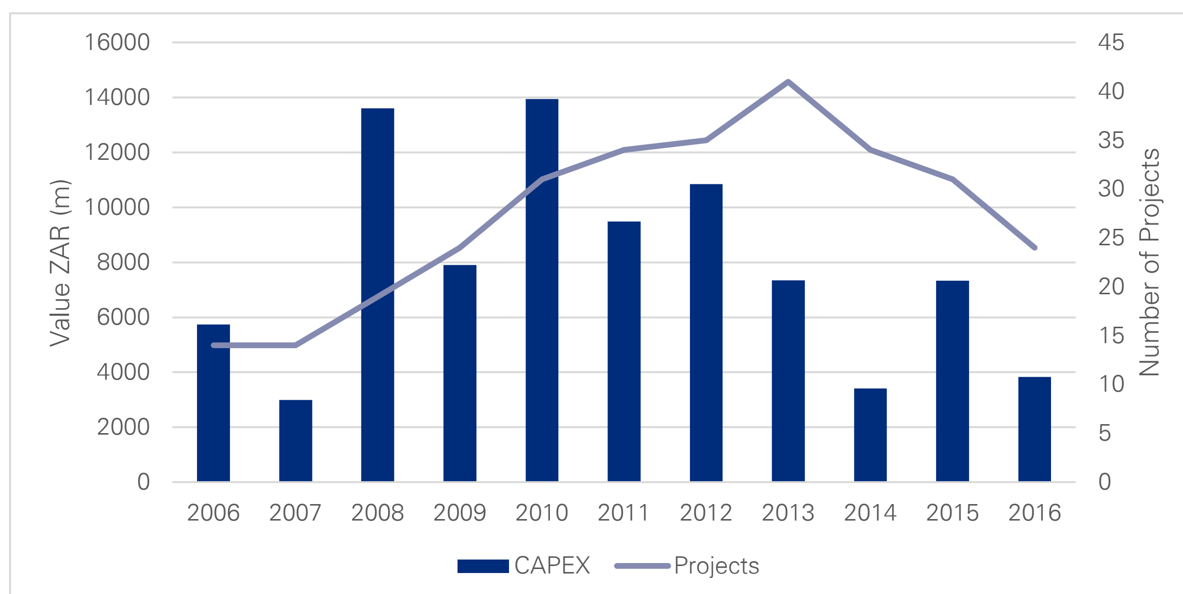
The Western Cape, although declining in recent years, is the second largest provincial destination for FDI in South Africa (after Gauteng Province) accounting for 19% of projects from 2006 to 2016 – 301 FDI projects were recorded in this period, representing a total capital investment of R87bn.

[54] http://unctad.org/en/PublicationsLibrary/wir2018_en.pdf.

[55] There has been wide publicity of China's announcement of a $60bn loan package to Africa.

[56] South African Reserve Bank. Quarterly Bulletin June 2018.

Figure 1: Western Cape: FDI 2006-2016



Source: Western Cape – Africa's Trade and Investment Springboard. Wesgro. 2017

Figure 1 shows the changes in inward FDI into the Western Cape since 2006, demonstrating consistent growth in numbers of FDI projects from 2006 to 2013 with a downward trend in capex value since 2010, and a decline in number of projects from 2014 to 2016.

3.2 Strategy for FDI and Investment Climate

3.2.1 Institutional Factors

Western Cape, as a sub-national government, has a relatively well developed institutional structure to promote investment. Wesgro is the Tourism, Trade and Investment Promotion Agency for Cape Town and the Western Cape Province of South Africa with a mission to attract and retain direct investment in the Western Cape, grow exports and market the province as a global tourism destination. There is a strong bias towards international business through FDI, multi-nationals, exporting (Wesgro undertakes 15-20 overseas missions p.a. to high growth markets), air access (focus is on direct flights into Cape Town) and international tourism; and a focus on business expansion – 60% of deal flow is growth of existing businesses.

The national policy framework is important for any sub-national investment promotion agency. Wesgro operates within a broad FDI strategy operated by the South African Government which offers a range of incentives to manufacturing investors. The Western Cape Government's (WCG) strategic plan calls (i.a.) for economic growth and jobs, and improved education and training particularly for youth. A Research and Development function within the Department for Economic Development, Agriculture and Tourism (DEDAT) monitors economic performance, maintains an economic data repository and disseminates data through a Quarterly Economic Bulletin; whereas DEDAT's M&E function monitors and assesses internal Departmental performance.

Western Cape is potentially disadvantaged by political divergence from the ruling national government. Africa does not have a federal system of government, and the provincial governments have limited revenue raising capabilities. The Western Cape is the only province of the nine which has elected a government run by the Democratic Alliance (DA), the official opposition party in South Africa. The other eight provinces have ANC governments. This has led to difficulties in implementing desired local agendas, with delays in national decision making, budgetary anomalies and some dysfunctional levels of cooperation – the 2017/18 drought in the Western Cape is a striking example of this. The One-Stop-Shop (OSS) is helping to ease these tensions at a practical level and the Western Cape leadership is frequently approached by other provinces to share best practices. These examples of cooperation are encouraging trends.

Wesgro provides a role model for provinces in South Africa in terms of creating jobs and undertaking targeted initiatives. In the 12 months to the first quarter of 2018, the Western Cape created 123,000 jobs (75%) out of 165,000 jobs created in the whole South African economy – a statistic that speaks for the success of the WCG's integrated and carefully planned economic development initiatives and systematic focus on BERs. The following measures are of relevance to the business environment for FDI:[57]

- The WCG's sector strategy (Project Khulisa) prioritises agro-processing, oil and gas and tourism as the three sectors to "change the trajectory of economic growth and job creation in the Province." Agribusiness focuses on Halal products and wine and brandy exports; oil and gas focuses on supply of new build and maintenance services to the industry; and tourism focuses on connectedness with other sectors such as transport, accommodation, hospitality, construction and retailing.
- Green economy measures, following the water crisis in 2017-2018, have become an important component of WCG initiatives, including attracting domestic and foreign investment into the green economy, increasing the uptake of solar PV installation and establishing a green economy technical hub in the Special Economic Zone (SEZ) at Atlantis outside Cape Town.
- The SME value chains initiatives focus on improving value chains – supplier workshops are aimed at enhancing the ability of local SMEs to transact with government; and a procurement portal has been developed to provide suppliers with a single point of access to government contracts. Other initiatives include township revitalisation through improvements in the retail environment; and workshops to match entrepreneurs from poor communities with sources of technical support and finance. Agribusiness sector initiatives focus on value chain development and on improving business skills and competitiveness.
- Skills development is recognised as a critical area justifying WCG intervention, particularly in the light of national and regional skills shortages in engineering, manufacturing and construction. Digital economy initiatives and a mobile digital literacy

[57] Department of Economic Development and Tourism. Annual Report 2017/18. WCG. The following points are raised briefly in the body of the report, but it has not been possible to assess the effectiveness of the initiatives.

programme have been launched to respond to the growing demand for ICT skills by local and foreign businesses. The Apprenticeship Game Changer programme focuses on supporting first-time job seekers looking for a career in strategic, rapid growth sectors with training, experiential learning and work placements. Apart from Game Changer, the WCG funds a wide range of skills development programmes in key sectors, usually in partnership with the private sector and TVET institutions, which incoming investors could readily access.

3.2.2 FDI Attraction

The FDI strategy for Western Cape leverages the geographical and economic advantages of the Province. The Western Cape is an attractive investment destination for the following reasons:

- *Strategic position* as a springboard into Africa – an estimated 51% of companies investing into the Western Cape indicated regional and sub-regional motives for investing, typically setting up headquarters in the Western Cape;
- *Highly sophisticated infrastructure*, with 2nd busiest airport (Cape Town International) in South Africa and 3rd busiest in Africa, three ports catering for different sectors (Cape Town, Saldanha Bay, Mossel Bay), a newly designated Industrial Development Zones; and a growing ICT and manufacturing hub.
- *Strong and efficient governance* at provincial and city levels, producing a stable public platform. It has a relatively positive reputation for service delivery that is not mired in the corruption problems besetting other provinces in South Africa.
- *Attractive natural environment quality* as the primary tourist hub in the country – climate and natural beauty have fuelled migration to the Western Cape boosting employment in skills industries such as ICT and financial services. Cape Town also has a leadership position in hosting international and domestic conventions, trade shows and conferences.
- *Tertiary education institutions* with an international reputation, which has augmented the number of graduates who have remained in the Province post-graduation, contribution to the availability of a skilled workforce.
- *Competitive wages.* Wesgro has been able to attract global players looking to operate at lower cost e.g. Burger King has set up a manufacturing operation to produce Halal products; Amazon has established a technical centre; and Barclays Bank invested in an ICT incubator.

Key criteria for support to investors are contribution to growth of the regional economy (gross investment value in terms of capex and opex over five years) and number of new jobs created. Wesgro's top five investments are (Table 11):

Table 11: Top Five Investments in Western Cape

Company	Country of Origin	Investment Value[58]	Activity	Rationale for Western Cape Location
Pegas	Czech Republic	R1.4bn	Manufacture of non-woven textiles (nappies) for Kimberly-Clark	Global value chain contributor
Axiona	Spain	R1.1bn	Manufacture of wind turbines	Diversified energy feeding the national grid
Da-Realty	UAE	R900m	Property development	International tourism investment
Hisense	China	R800m	Manufacture of consumer white goods and TVs	Rapid growth potential of national consumer market
Kimberly-Clark	USA	R600m	Manufacture of nappies and other consumer products	National and regional consumer market

Source: Wesgro Interview. 3rd October 2018.

Table 12: Wesgro: Investment in Sectors and Job Creation 2017/18

Sector	Projects	Investment 2017/18	Jobs Created
Manufacturing	5	R1,104.4m	395
Agribusiness*	6	R756.0m	1,412
Green Economy	3	R600.8m	234
Real Estate	1	R500.0m	150
ICT	3	R90.7m	235
Total	**18**	**R3,051.9m**	**2,426**

Note: * Includes food and beverages, marine, food processing. Source countries represented include South Africa (11), France, Zimbabwe, UAE, Ghana, Czech Republic, USA and Norway (all one project each).

Wesgro secured 18 investment projects in 2017/18 to the value of R3.1bn, creating 2,426 jobs (Table 12). Manufacturing was the largest sector for FDI (R1.1bn) followed by agribusiness (R756m) and the green economy (R600m). Agribusiness created the largest number of jobs (1,412) followed by manufacturing (395).

Box 3: Western Cape Transformation Case Study

Agriculture and Agro Processing in the Western Cape

Agricultural, forestry and fisheries sectors have remained relatively untransformed throughout most of South Africa.[59] Redistributive land reform and smallholder support programmes achieved little in addressing dualism of the sector, in spite of government commitments to review interventions. Agricultural employment in South Africa declined from 1.9 million during the 1960s to 843,000 in 2018.[60]

The sector is important for jobs and even more so for exports. Agricultural employment in the Western Cape was 181,000 in June 2018 (7.3% of total employment), against manufacturing employment of 339,000.[61]

[58] Capex + opex over 5 years.

[59] Minister of Agriculture, Forestry and Fisheries, Senzeni Zokwana, presenting the Departmental budget to Parliament. Farmers Weekly. May 2018.

[60] Stats SA. Quarterly Labour Force Survey. Q2/2018. July 2018.

[61] As above.

Agriculture and agro-processing added R21bn and R33bn respectively to Western Cape 2016 value added, contributing 14.2% to regional GDP. Output growth was driven mainly by labour intensive horticulture (mainly fruits, including wine) for export. Western Cape exports were R121bn in 2016, with 52% coming from agriculture and agro-processing.[62] The Western Cape Government (WCG) estimates that a 70% increase in food production will be needed by 2050 to feed the Province's population. To achieve this, WCG's agriculture strategy has been closely aligned to the National Development Plan in terms of creating opportunities for growth and decent inclusive jobs, maintaining agricultural exports, increasing agriculture and other rural economic opportunities, and developing a skilled and capable workforce to support an inclusive growth path.

Sector Transformation

There are significant sector challenges, including climate change and an uncertain policy environment. Recent Parliamentary actions on land expropriation without compensation have created serious uncertainty on policy. Although this would normally logically dampen foreign investment, the current trend is that the bigger land investors continue to invest in land, which remains at a premium in the Western Cape. The main threat to a successful and sustainable outcome over the next five years is restrictions on the water supply for irrigation of high-value agricultural exports. The possible continuation of severe droughts in the region places investments at risk in the sector.

The Western Cape's agricultural sector is already globally competitive and has a reputation for production stability and high quality products, supported by well-developed infrastructure both for input supply and output processing. It has been for many decades an efficient adopter of global technologies, adapted to the local market.[63] Automation, now replacing certain types of agricultural labour, has the potential to limit the sector's contribution to labour absorption and inclusive growth. Producers are accelerating the adoption of these technologies which result in higher yields, cost reduction and improvement in nutritional value. Nevertheless the support of the sector could be strengthened:

- **Labour legislation, government levies, trade promotion activities and investment incentives should be revised** to support agricultural exports and imports including by smallholders. The widespread belief that 'bigger is better' and that small-scale operations are unviable and impractical has limited the enthusiasm for the promotion of smallholder agriculture. But this is changing with advances in technology which are expected to disrupt current agribusiness models.
- **Support is needed to build capacity to adopt and finance new technology in the agricultural sector, whether in the form of shared platforms, financing schemes, servicing solutions, and internet services**. The digital revolution[64] creates an opportunity to reverse economic decline and combat widespread poverty by transforming agricultural value chains and expanding agricultural exports.[65] Agriculture is positioned poorly in terms of digital transformation – there is a lack of leadership, awareness, skills, and support through sector policies, as well as a myopic view of cyber risks and cyber security tools.

3.2.3 Investment Climate Reform

The investment climate of a sub national region is constrained by the national policy context and other factors beyond the control of the Provincial government. The Western

[62] Stats SA, 2014.

[63] The Future of the Western Cape Agricultural Sector in the Context of the Fourth Industrial Revolution. The Western Cape Department of Agriculture and the University of Stellenbosch Business School (USB), 2018.

[64] (including interconnectedness of the physical with cyber-led production and distribution)

[65] The Future of the Western Cape Agricultural Sector in the Context of the Fourth Industrial Revolution. The Western Cape Department of Agriculture and the University of Stellenbosch Business School (USB), 2018.

Cape Government places emphasis on creating a conducive environment for businesses to operate freely, create jobs and grow the economy. DEDAT rather than Wesgro manages the "doing business" portfolio of business environment improvements at municipal and provincial levels. Wesgro has identified the following regulatory and business environment weaknesses – these are regarded as external threats because they are largely outside the control of the provincial and city governments:

- Deteriorating South African investment climate as measured by key Doing Business and other relevant indicators.
- Insecure and unreliable energy supply (the country was subject to repeated outages in the 2016-2017 period).
- Unpredictable exchange rate fluctuations of the order of up to 25%.
- An uncertain and at times threatening political environment.
- Increasing security risks in the tourism sector.
- Severe drought in the Western Cape.

If Wesgro or an investor reports a bottleneck or constraint, Wesgro can approach central government directly through the OSS which is located in an adjacent building – in practice, there is a direct link to the Department of Trade and Industry (DTI) and ultimately to an Inter-Ministerial Committee. At the sector level e.g. beneficiation of primary products, if a firm approaches the regulator for the necessary permissions, it can take up to 120 days to achieve compliance, but through the OSS it takes around 30 days.

Nevertheless, Provincial Governments do see the need to focus on IC Reforms. The Western Cape ease of doing business initiative focuses on red tape reduction through business process audits of local municipalities e.g. reducing approval times for building plans and for tour operator licences; while other initiatives aimed at improving service delivery by national government include digitisation of visa applications and renewals. A red tape reduction assessment tool tracks and calculates the collective benefit of doing business reform initiatives.

3.2.4 De-Risking

From the point of view of decision-making by the investment authorities that helps to overcome investment uncertainty, support for investors by Wesgro and the WCG seeks to facilitate and expedite investments e.g. by accessing national government support through the One-Stop Shop or municipal authority assistance through planning permissions and construction licences, thus leading to some cost reduction, but this cannot be regarded as a full de-risking approach.

3.2.5 Transaction Support

The Western Cape Government (in particular DEDAT) and its promotion agency, Wesgro, have an acknowledged track record of being pro-private sector business investment. WCG has been the primary interface with the Department of Trade and Industry (DTI) in accelerating problem solving, clearing roadblocks and securing decisions. The One-Stop Shop has had a

positive impact on improved cooperation with national government and its agencies and in red tape reduction. Investment facilitation support in the province includes support for access to incentives and grants, site location, professional referral services, immigration guidance, and policy advocacy.

For example, Hisense, a large Chinese-owned white and brown goods manufacturer, did not involve Wesgro in their original decision to locate in the Western Cape, but subsequently Wesgro and DEDAT have had an important role in supporting the establishment of their operations, with assistance in securing cash grants from the DTI of 15 to 30 percent of payroll for employing local people. Furthermore, Wesgro secured DEDAT support in covering locally hired staff wages for six months for workers who had never previously been employed, conditional on retention of at least 70 percent at period end. Wesgro was instrumental in negotiating a doubling of electrical power infrastructure for Hisense, a critical success factor; the Agency also played a major role in overcoming difficulties with the local fire department, which required the direct involvement of political leadership in the province to achieve a satisfactory outcome.

3.2.6 Financial Incentives

There is only constrained scope for a provincial government to offer financial incentives. The City of Cape Town offers investment support in areas of property acquisition and servicing, utilities, infrastructure e.g. telecoms. Wesgro's capacity to offer wider inducements is subject to the limited revenue raising powers of local and regional government. At the national level, certain sectors are eligible for financial support[66] but central government tries not to offer financial incentives and makes applications for financial support deliberately very bureaucratic. At provincial and local levels, financial inducements are available: Hisense received 50 percent payroll support for six months from DEDAT (WCG); and some local authorities have waived local property taxes for inward investors.

3.3 Policy Recommendations.

- **A contextual 'hybrid' investment policy – combining deals facilitation with BER is appropriate when the business environment is severely constrained** and risk mitigation is a major component of the investment decision. The scale of the socio-political problem in South Africa is enormous: a reform of rules would attract little serious attention, whereas there is an appetite for a deals focus and in such cases where a rules intervention is appropriate, a hybrid approach is the only practicable option acceptable to government stakeholders. Focus on the "speed to benefit" – that is, how quickly the investment gets secured – shortens the decision cycle and generates a speedier return on the investment, and therefore deals facilitation has to be the main focus of IPA activity. But uncertainties created by risks are not resolved adequately in deals facilitation.
- **A successful approach to investment promotion does not necessarily involve transformational sectors,** but is likely to engage with specific sectors which offer

[66] See http://www.investmentincentives.co.za/expenditure-capital/large-industry.

particular advantages. Wesgro has identified growth sectors but there is little evidence of cross-sector fertilisation and no explicit recognition of the relevance of and the Agency's role in transformation. The Western Cape relies heavily on *agriculture* and *agribusiness/agro-processing* for jobs and exports, both high yielding sectors which have embraced innovative technologies and adopted world-class practices that drive improvement in quality and yields. *Tourism*, the Western Cape's flagship industry, embraces transport, telecoms, wildlife conservation, accommodation, food and beverages and business services – the interplay of sectors and global value chains make this an important sector for change. *Green energy* has been identified as a sector with potential for rapid growth, but there is a question about green energy as a distinct sector rather than as a composite sector with a wide supply chain emanating from other sectors e.g. electronics, light engineering, cabling, solar panels manufacture, etc. The differential speed of change in sectors and sub-sectors has implications for the coherence of interventions, as some are faster than others – the key should be to engage sector leaders in the change dialogue so they are aware of what facilitation might be required. HMG could facilitate inter-institutional and industry collaboration and cooperation with intellectual inputs, fertilisation of new ideas and examples from other countries of how problems could be addressed and solutions shared. Successful and sustainable growth in transformative sectors requires the integration of manufacturing in global and regional value chains to provide access to leading edge technology and working practices that are not available through local operations yet are needed for important cross-fertilisation of approaches, ideas and operational experiences. There are important lessons to be learnt from the relative demise of South Africa's garment industry (which used to employ over 150,000 people), which was (and still is) not integrated in global markets or value chains.

- **HMG could play a role in arguing the case for engaging with full-scale monitoring and evaluation in order to create a development impact balanced scorecard with critical metrics across the inward investment landscape.** The need for jobs is so great that Wesgro does not assess potential investors on any other formal criteria than economic growth and gross new job creation – it essentially accepts all-comers. There is a recognition by Wesgro and the Western Cape Government that impact measures such as female and youth employment and skills development are important political factors but detailed intervention data is not currently being monitored and reported in a systematic way. There is recognition by the Western Cape Government of the need to *"address the supply of…critical skills needed in the Western Cape economy…the apprenticeship 'game changer' has been a focused approach aimed at selected economic sectors, particularly those with the potential for a higher uptake in employment and economic growth prospects; and within specific occupations and trades within these*

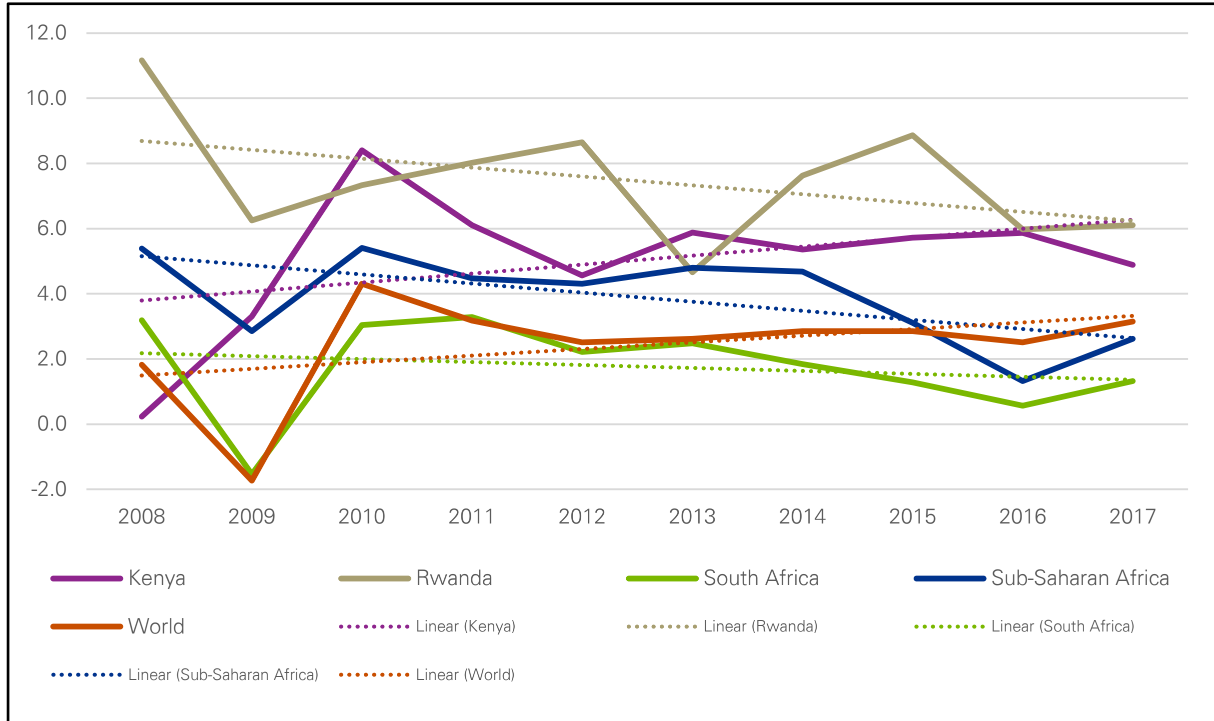
sectors.'[67] Gender equality, however, has not yet received the attention required to move development in the general direction established by the SDGs.[68]

[67] Annual Report 2017/18. Economic Development and Tourism. Western Cape Government.

[68] UNCTAD's research finds that only a third of analysed industrial development strategies refer to gender issues, although gender references are more common in general economic development strategies. However, countries that do not include gender issues in their industrial policy have programmes to address gender issues.

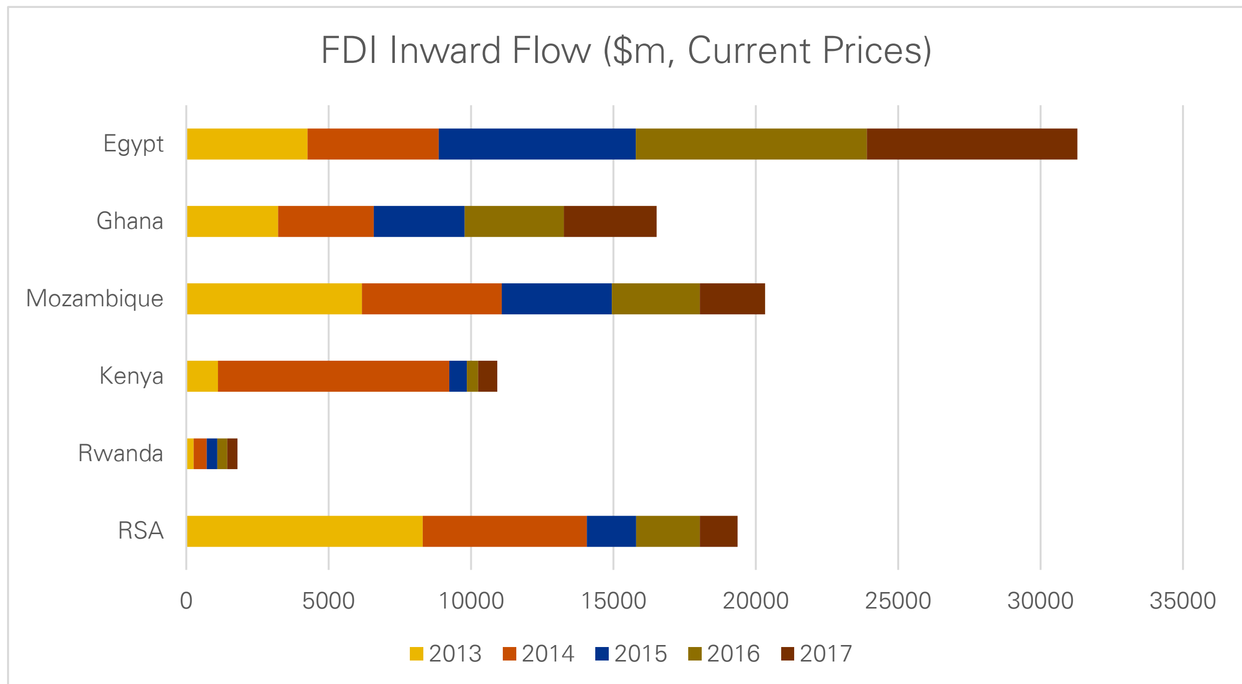
Annex 1: Statistical Comparisons, Selected Countries

Figure 2: GDP Growth % p.a.



Source: World Bank and OECD National Accounts Data 2018.

Figure 3: FDI Inward Investment



Source: World Investment Report 2018

Table 13: Selected Doing Business Indicators 2019

	South Africa	Rwanda	Kenya	Sub-Saharan Africa
Starting a business				
Ease of doing business ranking (190 countries)	82nd	29th	61st	142nd
Starting a business (190 countries)	134th	51st	126th	125th
Number of procedures	7	5	7	7.4
Time (days)	40	4	23	23.3
Cost (% of income per capita)	0.2%	14.8%	24.9k%	44.4%
Min. capital (% of income per capita)	0%	0%	0%	10.0%
Construction				
Construction permits – number of procedures	20	15	16	14.7
Construction permits – days	155	113	159	145.7
Getting Electricity				
Getting electricity – number of procedures	5	4	3	5.2
Getting electricity – days	109	30	97	112

Source: Doing Business – Sub-Saharan Africa. World Bank. 2019.

Table 14: Selected Doing Business Indicators 2019: Ranking in Africa

	South Africa	Rwanda	Kenya
Ease of doing business ranking	4	2	3
Starting a business	25	6	24
Construction permits	13	15	23
Getting electricity	10	2	4
Registering Property	10	1	18
Getting Credit	9	1	3
Protecting Minority Investors	4	2	1
Paying Taxes	5	4	14
Trading Across Borders	14	5	10
Enforcing Contracts	4	2	3
Resolving Insolvency	4	3	2

Source: Doing Business – Sub-Saharan Africa. World Bank. 2019.

Table 15: Aid and Foreign Investment Relative Volumes ($ m)

		2012	2013	2014	2015	2016
Africa	Aid	39,034	39,247	26,697	34,436	34,275
	FDI	51,985	50,790	52,440	56,633	53,190
	Ratio	75%	77%	51%	61%	64%
Kenya	Aid	2,654	3,307	2,661	2,464	2,190
	FDI	1,380	1,119	821	620	393
	Ratio	192%	296%	324%	397%	557%
Rwanda	Aid	876	1,086	1,035	1,085	1,148
	FDI	255	258	459	380	342
	Ratio	344%	421%	226%	286%	336%
S Africa	Aid	1,057	1,295	1,077	1,420	1,181
	FDI	4,559	8,300	5,771	1,729	2,235
	Ratio	23%	16%	19%	82%	53%

Source Aid OECD Geographical Distribution of Financial Flows to Developing Countries 2018

Source FDI UNCTAD World Investment Report 2018

Contact us

John Burton
BERF Engagement Manager
john.burton2@kpmg.co.uk
+44 20 7694 5538

www.kpmg.com

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