MICROECONOMICS OF COMPETITIVENESS

Kenya Tourism Cluster

Recommendations to enhance competitiveness

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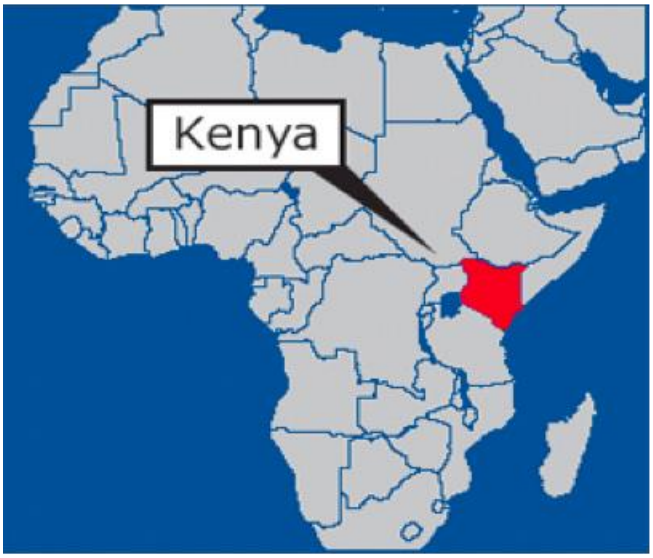


1. OVERVIEW

This paper provides an overview of Kenya's competitiveness, followed by an analysis of the country's tourism cluster. This paper provides tactical recommendations aimed at improving Kenya's tourism cluster, including infrastructure upgrades, the development of specialized factors, addressing security concerns, improving institutions for collaboration, and strengthening related industries.

2. COUNTRY CONTEXT

2.1 KENYA COUNTRY COMPETITIVENESS

2.1.1 Country and Regional Context

Kenya is strategically located on the East Coast of Africa bordering the Indian Ocean to the right, Lake Victoria to the left, and with five neighboring countries. Somalia is a notable neighbor and a source of instability from several terrorist attacks. Kenya occupies an area of 224,081 square kilometers with a population of about 45 million people of 42 different ethnic groups, each with its unique language and culture. The official language is English, but Swahili is the common language of business uniting people of different ethnic languages.

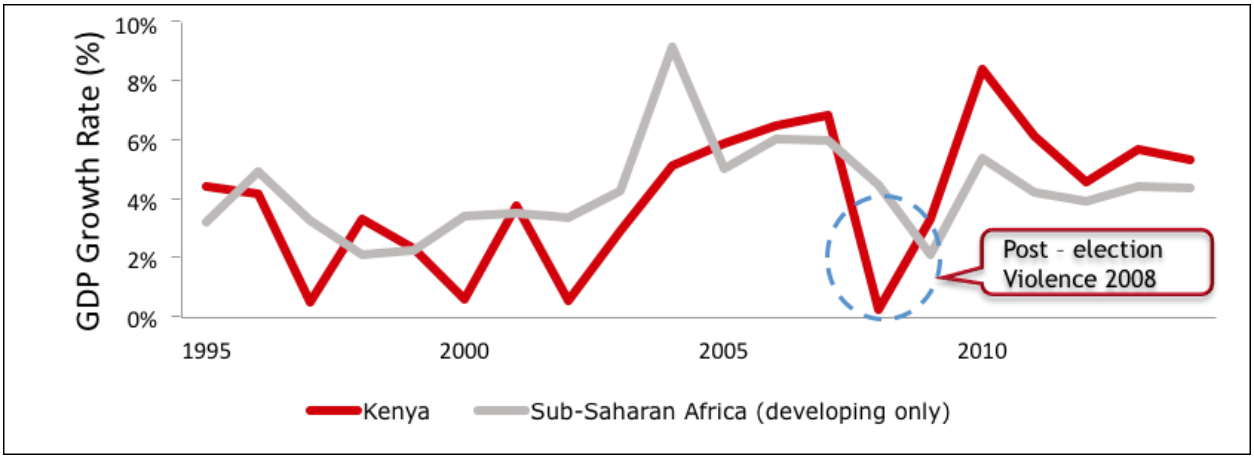
2.1.2 History and Political System

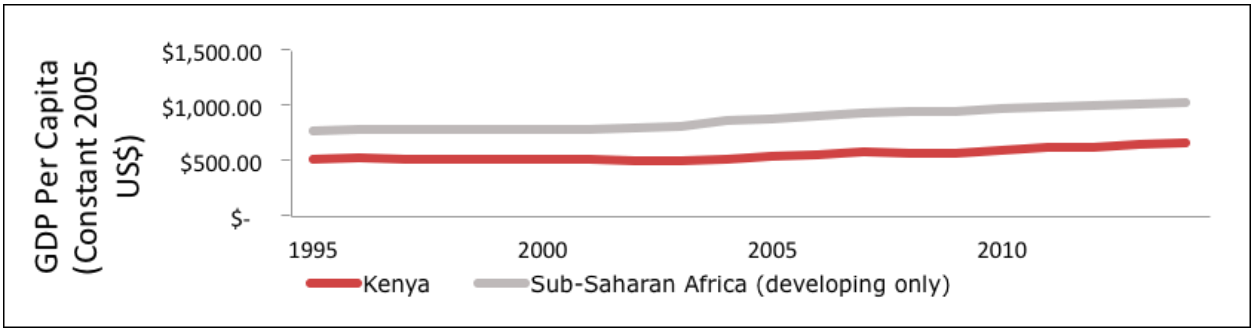
Kenya was colonized by Britain, gaining independence in 1963, and maintained a legacy of political and legal institutions modeled after Britain. It is currently a parliamentary democracy headed by a President. Historically, power and resource allocation has been highly centralized, but after the 2013 elections, the country was divided into 47 different counties. Elections are held every five years and transitions have been mostly peaceful with the exception of the 2008 post-election violence events that tainted the country's safety image internationally.

2.1.3 Economic Performance and Growth

Kenya has a GDP of US$61 billion and GDP per capita of US$ 1,300 as of 2014. It is the fifth largest economy in Sub-Saharan Africa after Nigeria, South Africa, Angola and Sudan. It grew at an average rate of 5% in the last decade, similar to its peers in Africa, but its growth is very erratic. The volatility is caused by internal shocks such as political instability and drought, with exogenous factors such as oil prices and trade having minimal impacts. Election years have been associated with lower growth. GDP per capita growth has also been stagnant and is lagging that of peers.

Figure 1: Kenya's economic performance (1995-2010)





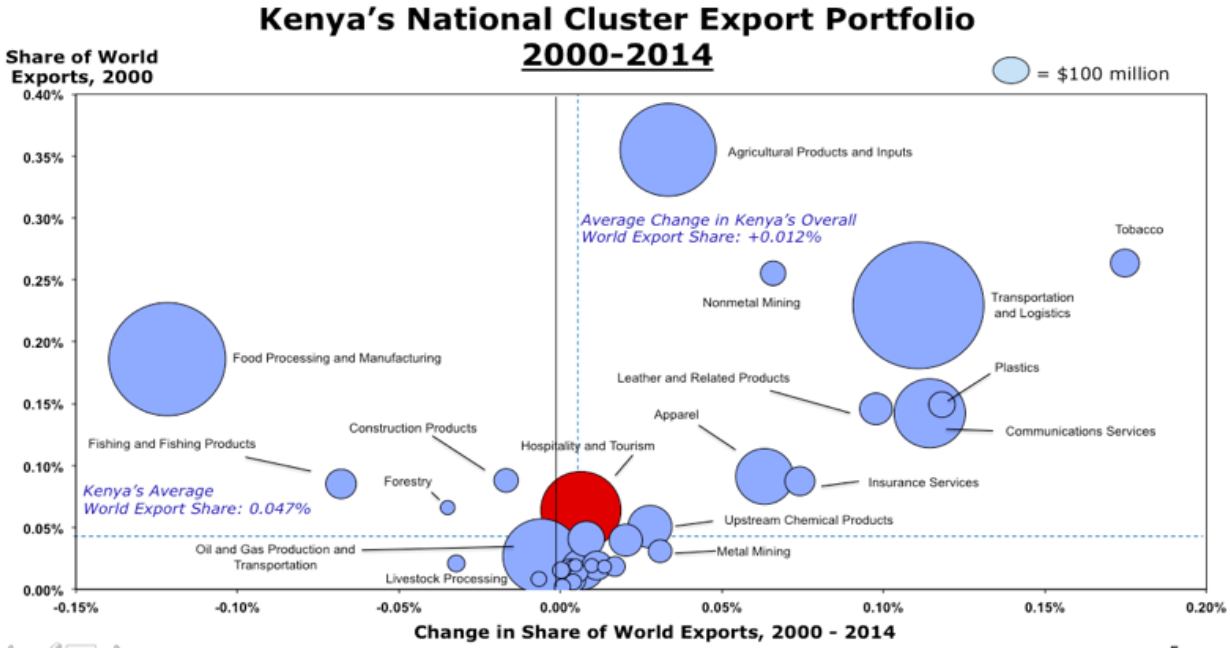
Source: CIA Factbook

In terms of productivity, Kenya performs poorly compared to its peers. It has a very high minimum relative to its productivity, although productivity varies greatly by sector. Productivity differences are highest among textile manufacturing and mining /quarrying firms and lower for those in chemicals, rubber and plastics.

2.1.4 Composition of the economy by cluster

The Kenyan economy is dominated by services that comprise 50% of GDP in terms of value add, followed by agriculture at 30%, and industry at 20%. Transport and communications are the largest service sectors and the main sources of growth. Food processing and manufacturing is a key sector in the economy, but it is in decline. Most of the agricultural sector consists of subsistence farming for personal consumption, with limited exports.[1] Tourism is a significant source of foreign exchange for the country with 2015 earnings totalling approximately $2.3 billion.

Figure 2: Kenya's Cluster portfolio



[1] Cut flowers are the main agricultural exports.

2.1.5 *Endowments*

Kenya is endowed with rich natural resources including wildlife, aquatic and marine life, hydropower and some minerals. Kenya's diverse terrain rises from a low coastal plain on the Indian Ocean in the east to highlands in the center of the country before descending into a humid lake basin on Lake Victoria in the west. There is also ample productive land for agriculture, and it is strategically located in East Africa with coastline (536 km) on the Indian Ocean.

2.1.6 *Social Infrastructure and Political Institutions (SIPI)*

Kenya performs poorly on human development factors, ranking 145 with a Human Development Index of 0.45. It has a low expectancy rate of 61 year, and more than 45% of the population lives below the poverty line. In addition, large differences in prosperity among different ethnic groups lead to ethnic based politics and violence.

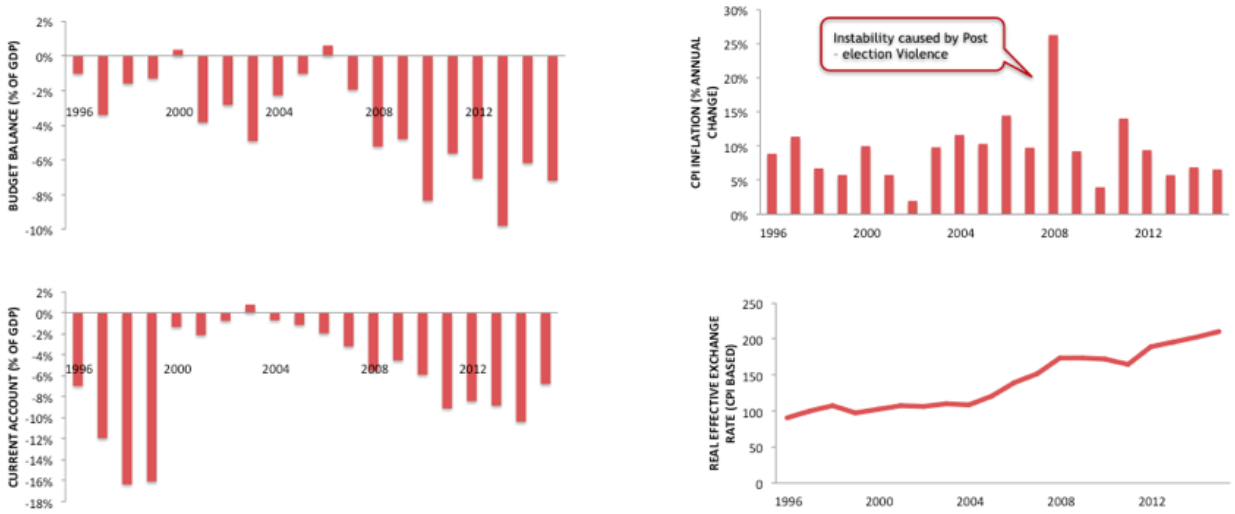
The political system is relatively stable, but weak institutions undermine the business environment. Corruption was cited as the most critical impediment to doing business in Kenya. Security concerns and terrorism attacks are linked to weak institutions, corruption and enforcement of the rule of law. Other factors that create a less favorable business include government bureaucracy and complexity of tax regulations.

2.1.7 *Performance on macroeconomic competitiveness*

While Kenya's macroeconomic fundamentals remain stable, there are vulnerabilities that exist which a pose a threat to the economy. The twin current account and fiscal deficits are growing rapidly and are a symptom of underlying problems of low savings and procyclical fiscal policy, respectively. Increased government borrowing from local banks is crowding private sector by driving up lending interest rates and limiting access to credit.

Although Kenya has experienced episodes of high inflation, effective monetary policy has played an important role in maintaining price stability within target levels. High Inflation is a result of both exogenous factors like global food prices and internal shocks like the post election violence when it rose up to 26%. In parallel to the inflation-targeting monetary policy, the real exchange rate has experienced low volatility but is in a depreciating trend. This increases the competitiveness of exports puts pressure on imports required for production, and foreign currency denominated debt.

Figure 3: Selected Macroeconomic indicators for Kenya



Source: CIA Factbook

2.2 QUALITY OF THE NATIONAL BUSINESS ENVIRONMENT

A competitive analysis of Kenya's business environment highlights strengths and opportunities for improvement (**Figure 4**). Applying Michael Porter's diamond framework, four broad attributes of Kenya's national advantage are analyzed below. Overall, the local business environment is characterized by relatively strong factor inputs and robust demand from a

growing middle class. However, there is low competition in many industries, under-developed related and supporting industries, and poor infrastructure.

2.2.1 Factor conditions

Kenya is moderately rich in natural resources, e.g. agricultural land, wildlife, and beaches, but it has limited mineral wealth. Moreover, while Kenya has strong human capital relative to its neighbors, the labor pool is not competitively specialized due to the lack of specialized educational institutions. Similarly, while domestic sources of capital are available for firms, this capital is often not specialized and can easily be replaced by foreign sources of capital.

2.2.2 Demand conditions

Demand in the home market help companies create a competitive advantage, e.g. when sophisticated consumers pressure firms to innovate or create more advanced products. Relative to its peers, Kenya has favorable home demand conditions. Kenya has a rapidly growing middle-class, which has increased demand for local products and services. There is also increasing penetration of mobile and internet, which continues to increase the tech savviness and sophistication of the Kenyan consumer base. Despite these favorable characteristics, however, there is still room for improvement in Kenya's demand conditions. Most significantly, there is high inequality in Kenya with a large segment (~43%) of the population living in poverty (CIA, 2015). This segment has low purchasing power and constitutes "less sophisticated" demand.

2.2.3 Related and supporting industries

Internationally competitive home-based suppliers create advantages in important ways – they deliver cost-effective inputs and support innovation and upgrading. Kenya, however, lacks internationally competitive home-based suppliers. Many Kenyan suppliers are inefficient and unreliable, and thus, there are high levels of vertical integration among local firms. Furthermore, many Kenyan suppliers have high customer concentrations, with some suppliers being owned by its largest customer, leading to conflicts of interest and ineffective management. On the whole, related and supporting industries in Kenya have only weakly participated in the upgrading and innovation process of local industries.

2.2.4 Context for firm strategy, structure and rivalry

In Kenya, there is fierce competition in select industries, e.g. financial services and telecoms, but weak rivalry in others due to conglomerate firm structures that limit competition. In general, there is high accountability of firms through capital markets. However, there are high degree of shareholder concentration and family ownership that limit the competitiveness of some industries. Moreover, government ownership and protection limit rivalry in some industries.

Figure 4: Determinants of National Competitive Advantage in Kenya

FACTOR (INPUT) CONDITIONS

✓ Moderately rich in **natural resources**, e.g. agricultural land, wildlife and beaches, but limited mineral wealth
✓ Strong **human capital**, relative to neighbors but the labor pool is not competitively specialized due to the lack of specialized educational institutions
✓ **Domestic sources of capital** are available and strong relative to neighbors, but this capital is not specialized and can be replaced with foreign capital
✗ **Infrastructure** generally weak and not specialized

CONTEXT FOR FIRM STRATEGY AND RIVALRY

✓ **Fierce competition** in select industries, e.g. financial services and telecoms
✓ Accountability through **capital markets** and aligned management incentives in some industries
✗ Inefficient **conglomerate firm structures** in many industries
✗ High degree of **shareholder concentration** and family ownership limits some industries
✗ **Lack of scale in firms** across many industries
✗ **Government ownership** and/or protection in some industries
✗ **Anti-trust concerns** in some industries

RELATED AND SUPPORTING INDUSTRIES

✓ **Presence of MNCs** strengthen distribution networks and raise standards
✗ Many **home based suppliers** are not efficient causing the cost of inputs to increase
✗ High levels of **vertical integration** due to unreliable suppliers
✗ High **dependence on imports** for supplies in some industries
✗ Many suppliers have **high customer concentration**
✗ **Conflicts of interest** with management of customers owning shares in suppliers
✗ Weak links between **R&D** and industry

DEMAND CONDITIONS IN KENYA

✓ **Growing middle-class** increases home demand for products and services
✓ High and growing **mobile and internet penetration** increases tech savviness
✓ Higher classes of society are generally **sophisticated**, exposed to world trends, and will demand high standards
✓ Kenyan consumer base is regionally respected and admired and can **export trends** to neighboring countries
✗ Higher classes **import** when domestic goods do not meet their standards
✗ High **inequality** with a large segment of society constituting "less sophisticated" demand
✗ Low domestic **purchasing power** and poor neighbors

2.3 ANALYSIS OF KEY COUNTRY COMPETITIVENESS ISSUES

The three most significant impediments to national competitiveness are analyzed below, along with a discussion of ways to overcome these challenges.

2.3.1 Prevalent conglomerate firm structures and government involvement undermine competitiveness in many industries

Many private businesses are organized as subsidiaries of a single holding company, e.g. the Comcraft Group. Furthermore, many suppliers are also subsidiaries of the same holding companies, e.g. Pwani Hauliers and Export Trading Group. Such conglomerate structures cause individual subsidiaries to be dependent on other subsidiaries for business, undermining competitiveness. On a standalone basis, these subsidiaries are often small and inefficient. The

management of individual subsidiaries are typically not compensated with stock in the holding company or in the subsidiaries, creating potential misaligned incentives. Moreover, the conglomerate firm structure makes it difficult for individual subsidiaries to raise capital independently due to the sharing of corporate services and lack of individual financial statements. Many conglomerates are also family-owned (e.g. ETG Group, Da Gama Rose Group, Chandaria Group), which keeps these businesses away from the scrutiny and rigor of public markets.

In addition to the conglomerate structure, government intervention impedes competitiveness in several industries. The Kenyan government plays a role in several sectors through: (i) owning parastatals, or (ii) maintaining minority ownership with the power to veto for "public interest." The government is often a large customer of these businesses and sometimes provides capital and other support, causing businesses to be dependent. Management selection can be problematic, as appointment can be political, e.g. election losers are typically appointed board chairmen. Furthermore, government ownership may crowd out or scare away investment capital from the individual businesses or from the sector as a whole.

While conglomerate firm structures and government intervention are pervasive in Kenya, some industries exhibit much better governance, lower ownership concentration, and very little government ownership. The two most notable industries with these characteristics are financial services and telecom. In fact, the government passed a law that no single shareholder can own >15% of a bank or an insurance company. There is much more rivalry in these industries with 48 banks, 47 insurance companies and 4 telecom operators. The largest of these companies are also publically traded and subjected to the scrutiny and pressures of public markets. Management is also competitively appointed and appropriately incentivized to perform. The

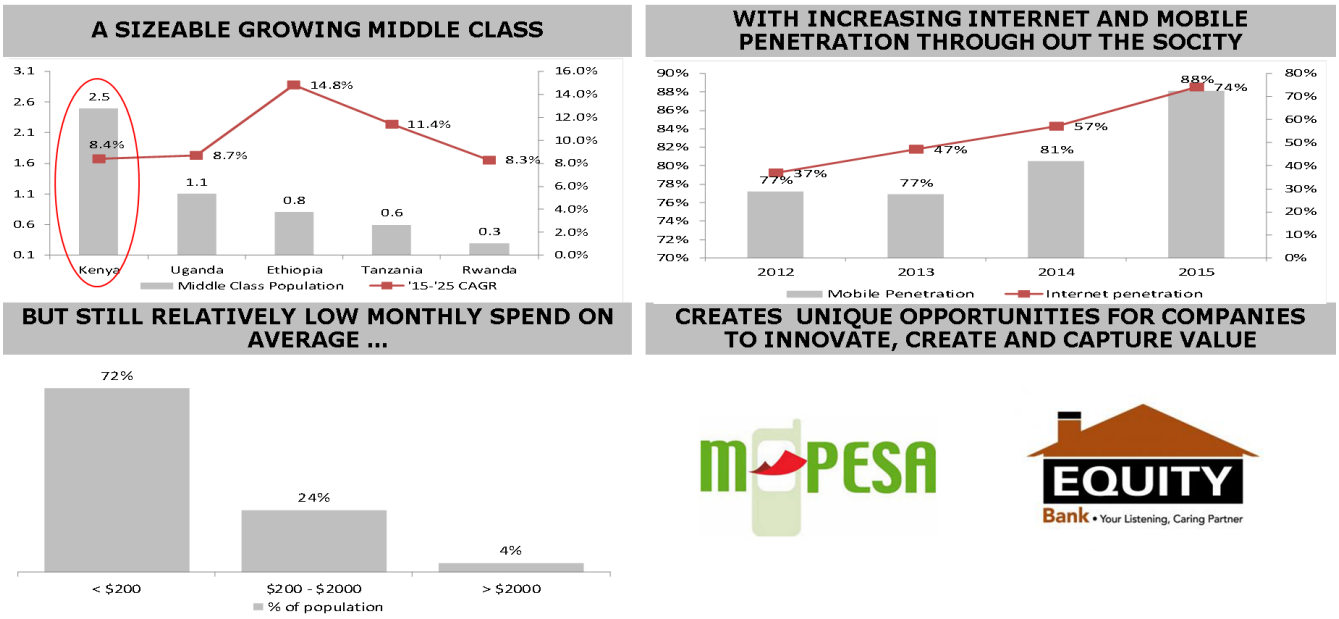
companies in these segments are regionally competitive and generally highly profitable, e.g. Kenya Commercial Bank, Equity Bank, Safaricom ETC. The financial services and telecom industries serve as counterfactuals to the pervasive conglomerate and government ownership structures that are prevalent in Kenya.

2.3.2 Given high inequality and poverty in Kenya, innovation is required to unlock the full potential of home demand

Kenya has challenging home demand conditions due to the large percentage of the population that continues to live in poverty (~72% of the population has a monthly spend of <$200). Innovation is thus required to unlock the potential of home demand. We have seen successful examples of businesses that have created unique opportunities to capture value from local consumers, most notably, M-Pesa and Equity Bank in Kenya.

- **M-Pesa** is a mobile platform for money transfer that has opened the door to formal financial services for Kenya's low-income population (World Bank, 2015). M-Pesa has been wildly successful – in 2013, ~43% of Kenya's GDP flowed through M-Pesa, with over 237M person-to-person transactions (Runde, 2015).
- **Equity Bank** extends financial services to the low income segment and the un-banked population. In 2013, Equity was voted Best Bank in Kenya and the Bank with Lowest Charges (Equity Bank, 2015).

Figure 5: Characteristics of home demand create opportunities for innovative business models



Source: Economist, Communications Authority of Kenya, East African Standard

2.3.3 Underdeveloped related and supporting industries (RSIs) undermine the competitiveness of Kenyan firms

The absence of internationally competitive suppliers and supporting industries undermine national competitiveness in Kenya. There are numerous examples across sectors of how underdeveloped RSIs led to compromised performance of local firms, including:

- **Kenya Airways**: Kenya's national carrier, Kenya Airways, has been losing market share to Middle Eastern airlines such as Emirates. In 2015, the company posted the largest loss in its history ($252M). Kenya airways played a critical part in marketing the tourism sector through its inflight magazine "Msafiri." With the airline cutting routes and scaling down operations due to financial distress, the tourism sector is losing reach in marketing.
- **ETG**: In-sourcing transport and logistics in the Agri-business space often leads to misallocated capital. For instance, Kenya's largest Agri-business supply chain manager,

Export Trading Group (ETG), in-sources transport of its produce to its own fleet of trucks (that number 1000+) due to unreliable third party providers. The company is very capital consumptive in its trading business and could have used the capital tied up in trucks to secure additional lines of credit to grow its core trading business.

These examples underpin the importance of developing Kenya's RSI to increase national competitiveness.

3. TOURISM CLUSTER ANALYSIS

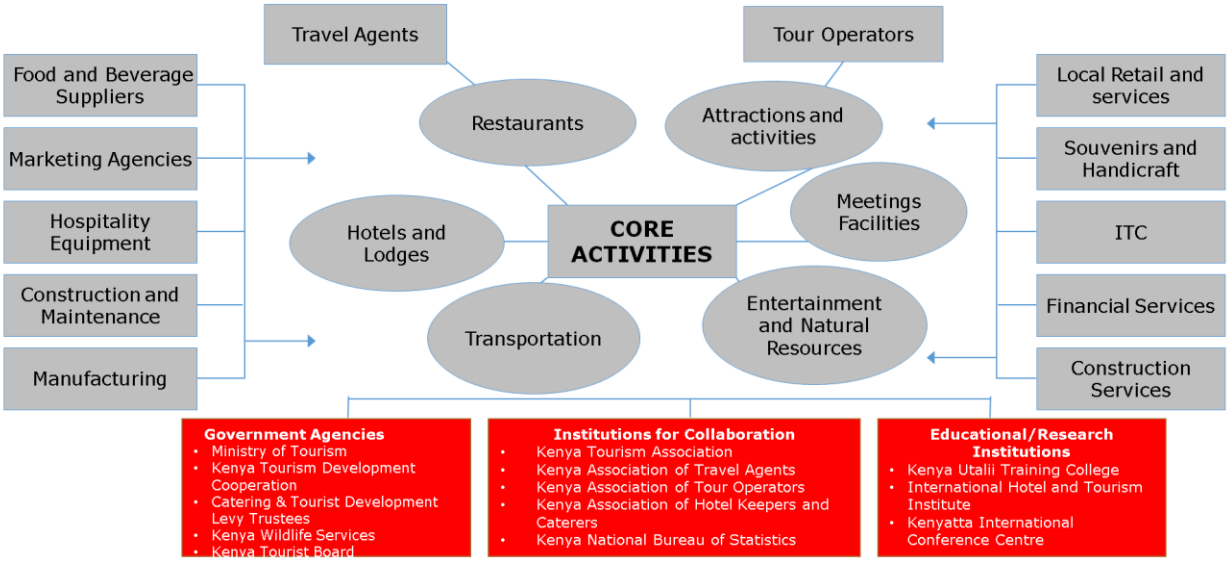
3.1 Products and Services

Kenya uses its unique natural endowments to give it a comparative advantage. It has 32 national parks and reserves that cover approximately 8% of the total area. Kenya offers several tourism products based mainly on its diverse natural endowments from the wildlife in the plains, beaches and marine life along the coast, and inland natural lakes. The tourism products and services offered by Kenya exhibit varying degrees of productivity and success. In accordance with the Kenya Tourism Cluster Map (**Figure 6**), at the core, are two traditional and well developed products, i.e. the wildlife safari and beach and marine activities tourism. Much less developed, under-resourced, and under-marketed, yet with great potential are the Cultural and Heritage Tourism. In this regard Kenya has 3 UNESCO World Heritage Sites, 42 cultures and countless other heritage tourism products. This category of products has significant potential for further growth, yet it is heavily under-marketed.

Most recently, the Kenyan government has undertaken moves to diversify its tourism product offerings and in this regard, introduced Eco- Tourism, Sports Tourism and the Meetings,

Incentives, Conferences and Events (MICE) products. These products fall within the category of under-resourced products that are not well marketed.

Figure 6: Kenya Tourism Cluster



3.2 Tourism Source Markets

In 2012, there were 1.9 million international tourist visitors to Kenya. According to the Embassy of Kenya in Berlin Germany, Europe is at the top as Kenya's leading tourist market, constituting approximately 60% of Kenya's tourist arrivals. Africans, who comprise approximately 23% of tourists to Kenya, takes the second position whilst Americans constitute 9% and Asians another 9% of visitors. These figures indicate that Kenya has struggled to gain a significant portion of the tourism market from the emerging source markets, e.g. China, Japan and India. Domestic tourism is also not well developed despite that fact that Kenya has an emerging middle class. This leads to a significant reliance on aging customers from Europe and thereby leaving Kenya susceptible to economic volatility in the developed markets.

3.3 Institutions for Collaboration

Further to the core elements of the cluster map, the tourism industry in Kenya is supported by diverse institutions for collaboration, which are intended to play a crucial part in the marketing of the sector, as well as the provision of key services and capacity building necessary for the expansion of the sector. In this regard, the government of Kenya plays a major role in the Tourism Cluster through its National Ministry of Tourism and Wildlife. The Ministry bears the political responsibility to regulate the sector, formulation and implementation of policies. In addition, there are various institutions of collaboration which the Ministry has the responsibility to oversee. These are the: Kenya Tourism Development Cooperation, Catering & Tourist Development Levy Trustees, Kenya Wildlife Services and the Kenya Tourist Board.

The private sector also has its own institutions for collaboration. Kenya Tourism Association is a Trade Association representing over 200 professional tour operators. The Kenya Association of Hotel Keepers and Caterers is a civil society organization to promote eco-tourism and sustainable tourism practices. The Kenya Association of Travel Agents represents businesses that own and operate hotels, lodges, restaurants, membership clubs & airline caterers. The Kenya Association of Tour Operators represents over 84 professional travel agencies whilst the International Hotel and Tourism Institute is responsible for hospitality training and tourism education & training. The Kenya Utalii College (KUC) is a public institution formed to offer training and establish hospitality standards in Kenya. Besides the Utalii College and the Institute, there are no other tourism training focused institutions in Kenya.

Notwithstanding the existence and broad coverage of the Institutions for Collaboration, they also present some key weaknesses which limit their ability to effectively support the

industry's competitiveness and growth. Poor government support in term of allocation of funds for public agencies also affects their effectiveness. However, by far the biggest challenge is the lack of effective coordination between the private and public agencies and therefore no unified vision and strategy for Kenya tourism development.

3.4 Cluster Early Origins

The Kenyan Tourism cluster started in the 1920s with mostly wealthy individuals visiting the country for its wildlife viewing and big game hunting. The industry remained largely wildlife focused and elite until independence in 1963; at independence only 65,000 tourists visited Kenya annually. Mass tourism took off in 1967 with tourists tripling between 1966 and 1968. The government gazetted an additional 6 game parks between 1964 and 1969 adding to the existing 5 parks at independence. It also financed the construction of hotels in the game parks through the Kenya Tourism Development Corporation (KTDC). In the 1970s, Kenya began supplementing its wildlife safaris with beach tourism; between 1970 and 1980, Kenya added 10,000 hotel beds in 500 hotels. Again, the KTDC funded most hotel construction during this period. Through the KTDC, we see the foundations of government involvement and support that continue to this day. The KTDC also effectively functioned as a mechanism of transferring wealth from the government to private individuals which is the foundation of family ownership and fragmentation in the industry today (Hornsby, 2005).

3.4.1 The role of politics and ethnicity

The KTDC's activities also created a political dynamic that came to later affect the development of the industry in the 1980s and 1990s. The primary beneficiaries of loans from the

KTDC to develop hotels mainly belonged to the then President's ethnic group (the Kikuyu). Following the death of the first president Mzee Jomo Kenyatta in 1978, the Kikuyu elite developed an antagonistic relationship with the second president Daniel Arap Moi. During the early Moi era (1978 -1992), there was systematic state sanctioned transfer of wealth from the Kikuyu to other ethnic groups (Hornsby, 2005).

3.4.2 Reform of the financial sector and stabilizing the macroeconomic environment

Addressing the weaknesses in the financial sector during the 1990s led to greater availability of capital that greatly enabled the take off in the tourism sector in the early 2000s. In the late 1980s into the early 1990s, the view of many was that critical difficulties and deficiencies in the macroeconomic environment and financial system were undermining the development prospects for the country across several sectors including tourism. The macroeconomic environment was characterized by the following weaknesses: 1.) a central bank unable to carry out monetary policy with no control of the money supply leading to monetization and very high inflation; 2.) central bank unable to supervise bank and non-banks leading to non-compliance; 3.) lack of central bank independence leading to accommodation of loose fiscal policies of the government 4.) chronic fiscal deficits and excessive domestic government borrowing leading to crowding out of the private sector (UNESP, 1997).

The context for firm strategy and rivalry in the financial sector was also characterized by the following problems: 1.) excessive government control over deposit and lending interest rates 2.) dominance of four banks resulting in oligopolistic market structure with Net interest margins as high as 12% in 1992 3.) use of parastatal deposits and central bank advances to protect banks from the rigors of marker discipline 4.) unequal incentives between commercial banks and non-

bank financial institutions . The result of these difficulties was an increased state of financial distress of banks and non-bank financial institutions. In early 1992, 13 commercial banks and 31 non-bank financial institutions were in a serious state of financial distress. This severely undermined the confidence of depositors; real growth in deposits with banks during the period 1987- 1992 was only 3.5%. This was clear evidence of the financial sector not playing its role of mobilizing and transferring capital from savers to companies (UNESP, 1997).

3.4.3 The reforms

The government committed to reducing the budget deficit to a level that can be financed without inflationary domestic sources (printing money) and crowding out the private sector. The central bank also committed to control monetary expansion and keep inflation in line with Kenya's trading partners. As part of this initiative, the central bank moved away from "direct instruments" such as credit ceilings and fixed interest rates to indirect instruments such as reserve ratios. The central bank also began to gradually move away from its role as underwriter of government bond issuances. This was expected to increase its independence while giving it more control over and flexibility in implementing monetary policy by creating a third party market for government bonds. The supervisory role of the central bank was enhanced and means for sanctioning institutions not complying with rules and regulations put in place (Hornsby, 2005).

Kenya removed central bank ceilings and other restrictions in the determination of interest rates. Competitors are now free to set their own interest rates based on supply and demand in the market. All non-bank financial institutions were instructed to convert to banks and come under great scrutiny of monetary authorities to level the regulatory playing field

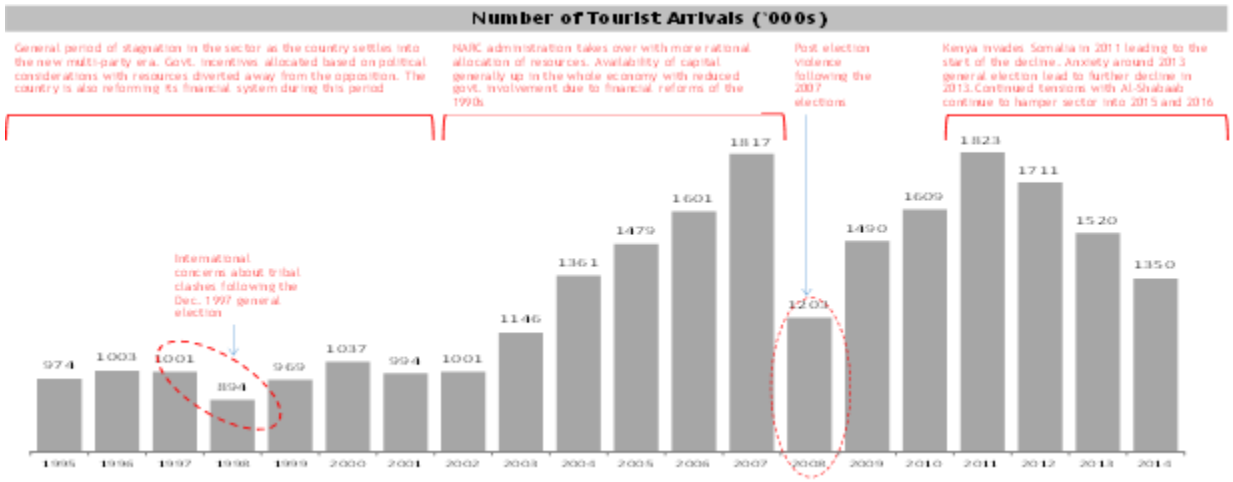
between banks and non-bank financial institutions. The country also eliminated most restrictions on FDI to encourage foreign capital to enter the market and increase competition. Capital requirements for starting a bank were raised to increase stability and individual ownership of a bank was limited to 25% to encourage banks to list of the stock market and undergo the rigors of capital market scrutiny. The government also sold it share of Kenyan banks on the stock exchange and reduced various investment taxes to make stock market investing attractive. Kenya also removed exchange controls on most current account transactions as well as the capital account and moved to market determined exchange rates (Hornsby, 2005).

3.5 Cluster Recent Timeline

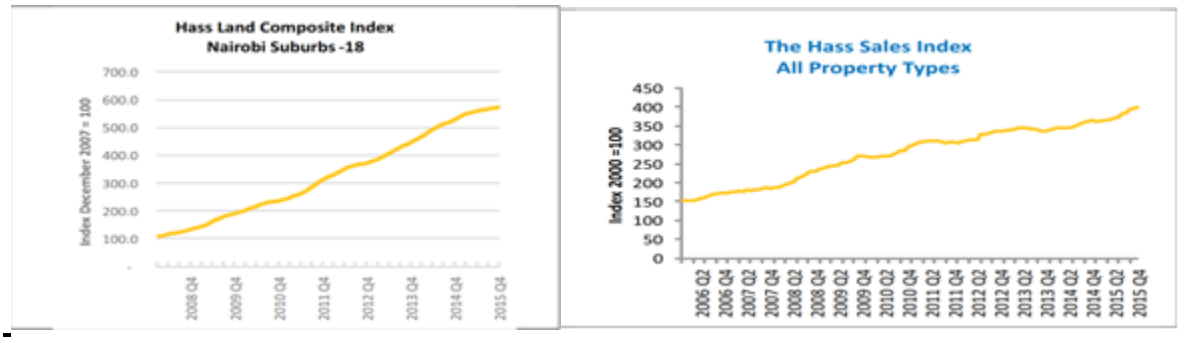
Following a decade of stagnation in the 1990s, the cluster grew strongly through most of the 2000s buoyed by better availability of capital following the reforms of the financial sector and general domestic and international optimism about Kenya following the victory of the opposition after 40 years of rule by one-party (KANU). The availability of capital coupled with increasing urbanization led to strongly increasing real estate prices in Kenya during the 2000s that created wealth and capital that further supported investment and growth in the tourism cluster. The growth in the 2000s was punctuated by post-election violence following the December 2007 presidential elections but rebounded soon afterwards. In 2011, following episodes of Somali pirates kidnapping tourists, Kenya entered Somalia to assist the Somali government eliminate Al-Shabaab (the terrorist group responsible for the kidnappings). Kenya's activities in Somalia have led to a series of retaliatory attacks from Al-Shabaab that led several governments to issue cautionary travel advisories to their citizens. These advisories and general

concerns about safety, led to the start of the decline of the cluster beginning in 2011 and continue to be a major overhang even today.

<u>Figure 7:</u> Kenya Tourism Cluster Timeline



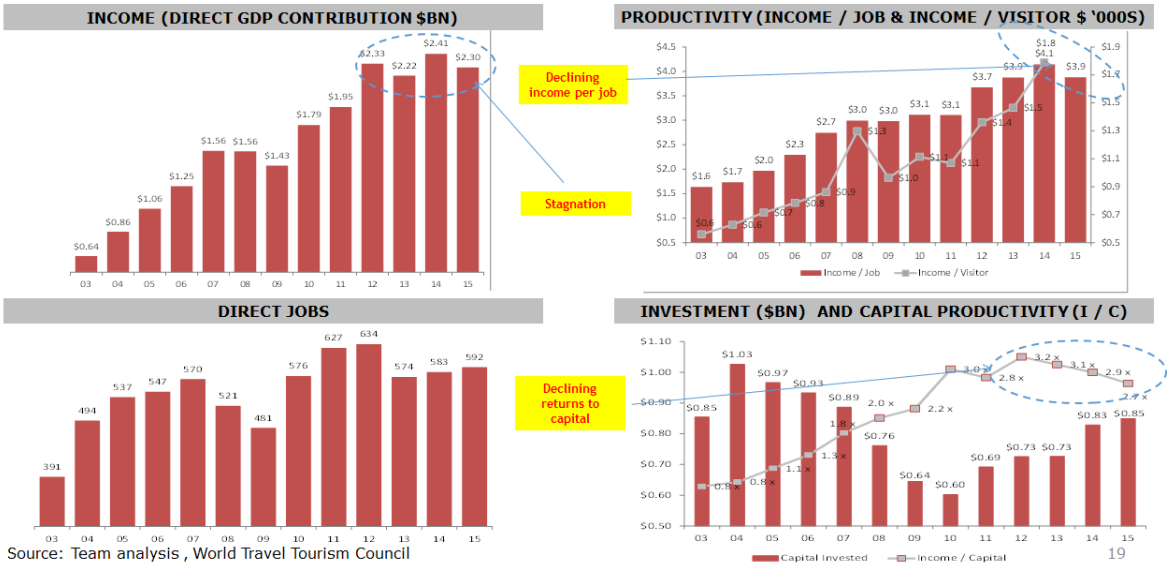
<u>Figure 8:</u> Property and land prices have been increasing enabling the growth of the cluster



3.6 Cluster Recent Performance (2003 – 2015)

The cluster exhibited increasing contribution and productivity until 2012 when the impact of concerns about security started being felt (please see the exhibits below)

Figure 9: Kenya statistics



3.6 Cluster Competitiveness – A comparison versus South Africa and Tanzania

A side by side comparison of the Kenyan Tourism cluster with the South African and Tanzanian tourism clusters reveals some areas of concern. First, the amount of capital invested in the Kenya tourism cluster in 2015 ($0.85 BN) is much less than the capital invested in South Africa ($5.0 BN) and in Tanzania ($1.2BN). More concerning is the fact that the growth of capital invested in Kenya tourism is negative (-1.3%) as compared to Tanzania which is growing robustly (12.6%). Given the relatively similar endowments of Tanzania and Kenya, this means investors greatly prefer the current business environment for tourism in Tanzania than in Kenya.

Additionally, the productivity (as measured by income/job) in Kenya of $3,878 / job lags both South Africa at 13,289 / job and Tanzania at 4,932 per job. An analysis of income / visitor supports our understanding of Kenya being a predominantly high end / luxury tourism

destination. Conversely, Kenya lacks an offering in the Mass tourism market. Kenya's income / visitor was $1,701 in 2015 as compared to $643 in South Africa.

Analysis of data from the Tourism and Travel Competitive Index shows that safety and security, price competitiveness and lack of created cultural resources are the biggest impediment to competitiveness for the Kenya tourism cluster.

Figure 10: Comparison with South Africa and Tanzania

	South Africa	**Tanzania**
Strengths versus Kenya	• Safety and security • Cultural / non-natural resources – e.g. education, shopping and wine tasting • More sophisticated products and local demand • Generally better infrastructure and higher density of reputable doctors and hospitals • Price competitiveness • High level of capital investment	• Safety and security – • Natural resources - Tanzania's natural resources more highly regarded than Kenya's • International openness / reputation – Tanzania is better regarded than Kenya internationally while Tanzania has not • High level of capital investment compared to Kenya
Weaknesses versus Kenya	• International openness – South Africa is increasing visa restrictions. • Natural resources – Kenya's national endowments are more highly rated • Macroeconomic stability – the South African rand is very volatile • Slowing national economic growth • Human resources are weaker than Kenya	• More sophisticated products and local demand in Kenya • Generally better infrastructure and better density of reputable doctors and hospitals than Tanzania • Human resources are stronger in Kenya

<u>Figure 11:</u> Comparative cluster size and performance – Kenya, South Africa, Tanzania

COMPARATIVE CLUSTER SIZE AND PERFORMANCE

	Kenya	South Africa	Tanzania
2015 cluster income ($BN)	$2.30	$9.34	$1.91
2015 cluster jobs ('000s)	592	703	386
2014 tourist arrivals ('000s)	1,350	14,530	1,140
2015 capital investment ($BN)	$0.85	$5.01	$1.21
2015 Income / Capital	2.7 x	1.9 x	1.6 x
2015 Income / Job	$3,878	$13,289	$4,932
2015 Income / visitor	$1,701	$643	$1,672
10 YR CAGR Capital	-1.28%	4.04%	12.56%
10YR CAGR Income / Job	7.02%	0.10%	4.12%
10 YR CAGR Income / visitor	11.03%	-4%	-1%

Lower job productivity

Lack of mass market product

Relatively lower capital investment

Low growth rate of capital

COMPARATIVE COMPETITIVENESS

Kenya is considered unsafe

	Kenya	South Africa	Tanzania
TTCI Global Index Ranking	78	48	93
TTCI Overall value	3.58	4.08	3.35
Enabling environment			
Business environment	4.33	5.35	3.97
Safety and security	3.78	4.30	4.85
Health and hygiene	3.29	3.85	2.68
Human resources	4.44	4.09	4.03
ICT readiness	3.13	4.29	2.48
Enabling policy environment			
Govt. prioritization	5.36	4.88	4.83
International openness	3.01	2.38	3.25
Price competitveness	4.50	4.99	4.87
Environmental sustainability	4.42	4.29	3.78
Infrastructure			
Air transportation	2.56	3.28	1.94
Ground and port transportation	3.36	3.59	2.56
Tourist service infrastructure	3.30	5.02	2.70
Endowments			
Natural resources	4.63	4.28	4.91
Cultural resources	1.67	3.39	1.54

Kenya is relatively expensive

Kenya has weak cultural resources

Source: Team analysis, World Economic Forum

3.7 Kenya Tourism analysis

3.7.1 Factor Conditions

Despite a number of high quality endowments and a sizeable labor pool, the tourism industry in Kenya struggles with poor transportation infrastructure and the inadequacy of basic services such as power, water and sanitation. Urban centers such as Nairobi are mired in traffic and road conditions outside the capital are poor, while the colonial-era rail networks have suffered years of damage and neglect. The poor quality of surface infrastructure makes it difficult and expensive for tourists to visit popular attractions such as wildlife safaris, many of which can only be accessed by costly charter flights or hours of driving on unpaved roads. Planned upgrades to aviation infrastructure have long been delayed, with a direct Air Kenya flight from the United States, Kenya's second largest tourist source market, on hold for the last six years due to aviation authorities' failure to upgrade security arrangements at the Jomo-Kenyatta International Airport. The electrification rate is less than 25%, while nearly 40% of

Kenyans lack access to clean water. In addition, there is a lack of specialized factors to support growth and diversification.

3.7.2 Context for Firm Rivalry

While there is healthy competition among hotels in the high-traffic tourist destinations, government intervention creates market distortions that enable the existence of many sub-scale operators and family-owned hotels in conglomerate structures. In addition, competition is clustered in high-end hotels, with very few establishments at the lower end of the spectrum. However, the limited presence of international branded hotel operators means even the high-end hotels are not readily attractive to tourists. Kenya has lagged peers in attracting such operators, with only 8 international branded hotels committed in 2015, vs. 13 in South Africa and 51 in Nigeria.

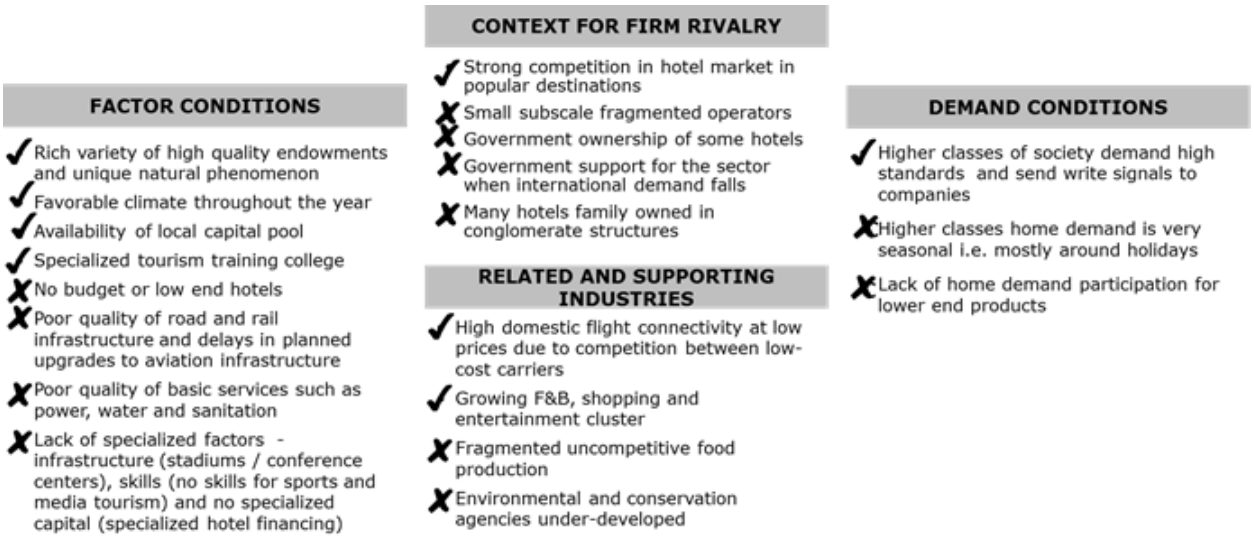
3.7.3 Related and Supporting Industries

While Kenya's international airline, Kenya Airways is bleeding losses, the entry of multiple low-cost carriers in recent years has improved domestic flight connectivity at low prices. The food and beverage cluster is growing despite fragmented food production, and there are increasing nightlife options in Nairobi and Mombasa. However, the retail sector remains relatively underdeveloped, with an emphasis on sales of lower-end souvenirs, handicrafts and a small number of local brands such as Rift Valley Leather, but very few international brands that tourists recognize or high-end shopping malls delivering quality shopping experiences. Furthermore, environmental and conservation agencies lack sophistication, and are not a priority.

3.7.4 Demand Conditions

There is strong higher income demand for tourism, putting pressure on local operators to maintain high standards. However, domestic demand remains seasonal and de-focused on lower end products and services. Together with the lack of strong local marketing, this results in Kenyans often seeking cheaper travel options in neighboring countries like South Africa instead of vacationing within Kenya.

Figure 12: Kenya Tourism cluster analysis



Source: Team Analysis

3.8 Analysis of key competitiveness issues facing the cluster

These cluster conditions result in low price competitiveness and a persistent over-emphasis on natural tourism that need to be addressed. The absence of specialized factors is a common barrier across both issues:

- **Labor:** Kenya has high wages and low productivity compared to peers. In addition, there is only one hospitality-focused college, limiting the amount of specialized labor available to support sports, media and MICE tourism.
- **Capital**: Lending interest rates range in the high-teens, and there are few specialized vehicles and instruments to spur investment.
- **Infrastructure**: As a result of the above, there is little high quality, specialized infrastructure such as stadiums and convention centers to attract non-natural tourism in areas such as sports and MICE. Poor surface infrastructure and unreliable electricity supply drive higher costs of doing business, for example, companies have to rely on generators for backup power.

Additional challenges to price competitiveness include a lack of scale economies due to fragmentation among both operators and suppliers, lack of affordable hotels, lackluster innovation due to government incentives, reliance on imports due to the lack of reliable and quality supply of local inputs such as hotel fittings or food ingredients. The introduction of VAT tax on tourism products since 2014 has also driven up the prices, with no counter-acting demand pressure as affordable tourism is not properly marketed to domestic tourists.

Targeted marketing and promotion is also a key lever to boost non-natural tourism, with a small and declining fraction of tourists today visiting Kenya's cultural attractions compared to the consistently >30% of tourism activity spend directed to natural tourism like safari parks. At the same time as Kenya tries to incentivize more budget hotels, it needs to court international branded hotel chains to open in Kenya to attract MICE and business tourists. Inter-sectoral coordination could also be helpful in this regard, for example, if hotels and airlines collaborated with local companies to host more conferences.

<u>Figure 13:</u> Cluster Value Proposition

Current Cluster	Vision Cluster
• Predominantly natural resources (wildlife and beach tourism) based • Foreign market focus with limited home market demand participation • High end / luxury price point • European older age groups are the primary target customer group • Moderate collaboration	• Natural resources tourism strongly complemented with cultural and created resource tourism. Examples include Meetings Incentives, Conferences and Events (MICE) Tourism, Sports and Entertainment Tourism, Education Tourism and Health Tourism • Both foreign and home market demand focused • Diversification across price points both high end and mass market • Increased focus on Asia and emerging markets • Increased focus on younger demographics • Stronger collaboration

4. Recommendations and Conclusion

The analysis above highlights critical issues and challenges affecting Kenya's competitiveness as a tourist destination. This section provides tactical recommendations to address these issues.

4.1 Complete ongoing basic infrastructure upgrade and then focus on developing "Specialized Factors"

	Recommendations	Execution parties and considerations
Build Specialized Infrastructure	• Build sports (athletics) infrastructure and training facilities in the highlands to expand nascent sports tourist demand • Build hotels and hostels that cater to the mass segment • Build specialized meeting places and convention centers • Build new or significantly expand existing stadiums to attract event tourism	• Private sector to build specialized facilities. Construction cluster in Kenya is developed and can finance and execute on the development • Government to provide incentives to encourage development of specialized infrastructure e.g. tax break for developing a stadium
Develop Specialized Capital Sources	• Develop specialized instruments and vehicles for investing in Tourism infrastructure such as real estate backed bonds. **Funding infrastructure cannot be left to Kenya's overstretched govt**. • Put in place the regulatory and legal framework for these securities • Educate local and international investors on the merits of these securities	• Financial Intermediaries and banks to create securities • Govt. and private sector to collaborate in establishing regulatory and legal framework • Govt. to put in place appropriate tax and other incentives for these securities

Develop Specialized Labor and training institutes	• Work with international partner to expand and upgrade Utalii college to world class standards • Develop local talent for meeting and convention tourism, media tourism and sports tourism e.g. movie scene shooting experts and commercial athletics coaches • Capitalize on the United Nations Environmental Program headquarters in Kenya to make Kenya an Environmental policy thought leader	• Private sector • Academic institutions partnering with world thought leaders such as Nike for athletic shoe development

4.2 Address security concerns, improve collaboration, and strengthen related industries

	Recommendations	**Execution parties and considerations**
Address Security Concerns	• Establish direct flights to the USA to validate the country's security position • Work with foreign governments to get all travel advisories to the country lifted • Publicize reasons for the issuance of travel advisories and clarify to which regions the advisories apply so that the whole country is not penalized. Heavily publicize progress and success • Increase public relations assault on terrorism • Find lasting solution to instability in Somalia	• Govt. • Media community • Academic community to champion thought leadership on terrorism and Somalia and publish articles in the New York times
Improve collaboration	• Expand Kenya Tourism Board mandate beyond marketing to include coordination • Strengthen collaboration between the cluster and academic institutions • Establish inter-sectoral initiatives with other key adjacent clusters such as sports, media and entertainment, retail, education and healthcare • Establish links with world thought leaders such Nike in athletic shoe development	• Kenya Tourism Board with expanded mandated or brand new institution for collaboration

Strengthen related industries	• Increase efficiency and scale of food production and supply to reduce unit cost of food • Continue to develop world class shopping experience – bring more shops that are familiar to international travellers in addition to existing Kenyan brands • Strengthen Kenya Airways position in the Rest of Africa and in the far East. Also establish direct flight from the USA to Kenya • Increase number of other Africans coming to Kenya by developing key adjacent clusters of private education and private healthcare	• Private sector

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