

## AFRICA RISK CONSULTING

### Kenya Monthly Briefing June 2015

---

#### Kenya Summary 10 June 2015

*President Uhuru Kenyatta (2013- present) nominates International Monetary Fund (IMF) adviser Patrick Njoroge as Central Bank of Kenya (CBK) governor. Parliament is expected to approve Njoroge's appointment. United States-based Walmart Stores Inc. enters the Kenyan market but may have misjudged the competition from its domestic counterparts. The National Construction Authority announces new local content regulations for foreign owned construction companies.*

---

#### Kenyatta nominates Patrick Njoroge as Central Bank of Kenya governor

President **Uhuru Kenyatta** (2013- present) nominated **Patrick Njoroge** as **Central Bank of Kenya (CBK)** governor on 3 June.<sup>1</sup> Njoroge's technocratic background is likely to increase investor confidence in the CBK's monetary policy. The absence of a governor at the CBK since **Njuguna Ndung'u** stepped down when his term of office expired on 3 March has contributed to the Kenya shilling's (KSh) slide in recent months.<sup>2</sup> While parliament needs to approve Njoroge's appointment, MPs are unlikely put up significant political resistance due to the **Jubilee Coalition**'s sizeable majority. Kenyatta also nominated **Mohammed Nyaoga** as CBK chairman, and **Haron Sirima** and **Sheila M'Mbijiwe** as deputy governors.<sup>3</sup> Parliament also needs to approve these three appointments. The reason for the delayed appointment is the more transparent open competition process required for senior CBK appointments. Under the new system, the **Public Service Commission** submits a shortlist of three to the president who puts forward one name for parliamentary scrutiny and approval.

Despite the absence of a permanent governor, the CBK has addressed the currency volatility increasingly pro-actively in recent weeks. The shilling is under pressure due to the global strength of the dollar, falling foreign exchange revenues due to decreasing tourist receipts and increasing dollar outflows as multinationals repatriate profits to parent companies, and a widening current account deficit resulting from the increasing import bill.<sup>4</sup> The CBK has notably intervened in the foreign exchange market selling dollars. Additionally, the CBK on 27 May brought forward its bimonthly monetary policy committee meeting from July to 9 June. The CBK increased its benchmark interest rate to 10% at its monetary policy committee meeting on 9 June.<sup>5</sup> Analysts had warned that the failure to increase the interest rate would risk the CBK's credibility and further increase currency instability.<sup>6</sup> The increase will shore up the shilling and contribute to anti-inflationary pressures. This was the first increase since May 2013.<sup>7</sup> Commercial banks followed suit and increased their base rates, which hurt borrowers. In addition to slowing down credit uptake, investors at the **Nairobi Securities Exchange (NSE)** saw the value of their portfolios decrease.<sup>8</sup>

Njoroge is a **Washington DC (United States (US))**-based adviser to a deputy managing director at the **International Monetary Fund (IMF)**, and was briefly at Kenya's finance and planning ministries. Njoroge holds a PhD in economics from **Yale University (US)**.<sup>9</sup> Njoroge's appointment – if confirmed – will increase the number of former IMF officials holding senior positions in Kenya. These include treasury

---

<sup>1</sup> Daily Nation, 3 Jun 2015.

<sup>2</sup> Daily Nation, 3 Mar 2015.

<sup>3</sup> Daily Nation, 3 Jun 2015.

<sup>4</sup> Source, business consultant, Nairobi

<sup>5</sup> Daily Nation, 9 Jun 2015.

<sup>6</sup> Standard, 31 May 2015.

<sup>7</sup> Standard, 31 May 2015.

<sup>8</sup> Source, journalist, Nairobi

<sup>9</sup> Daily Nation, 3 Mar 2015.

secretary **Henry Rotich**, treasury principal secretary **Kamau Thugge** and treasury economic affairs director **Geoffrey Mwau**, and Kenyatta's chief of staff **Joseph Kinyua**. This has facilitated positive relationships with the IMF. In February, Kenya secured a KSh 64 billion (\$663m) IMF stand-by arrangement under the stand-by credit facility (SBA/SCF) amid concerns that increased integration into global markets and high levels of imports for infrastructure projects were increasing the vulnerability of the economy to exogenous shocks. Rotich said on 13 May that the government is deliberating whether to access the precautionary fund in order to shore up the shilling.<sup>10</sup> The IMF completed its first review mission under the SBA/SCF on 2 June.<sup>11</sup> At the end of the mission, the IMF projected growth of 6.5% in 2015 on the back of increased infrastructure investments, decreased energy prices and a conducive environment for private investment.<sup>12</sup> This compared to a previous IMF forecast of 6.9%. The IMF did not explain the reason for the downward revision.

### Walmart challenges domestic retail chains

US-based **Walmart Stores Inc.** entered the Kenyan market in June, with the added competition from international retail companies likely to encourage their domestic counterparts to improve their own management standards. Walmart opened its first **Game** retail outlet in **Garden City** (Nairobi) on 1 June. Walmart offered large discounts which its main competitor **Nakumatt Holdings Ltd** – which also has a presence in Garden City – then matched. Industry insiders say that Walmart erred in thinking that local brands would not protect their turf.

*“People did not find that the high expectations promised were met. Walmart will need to do much more to beat local retailers.”<sup>13</sup>*

Local players say that if Walmart is to be successful, it may have to learn and apply local strategies. One advantage that local brands have is the relationships that they have developed with suppliers.

*“Managers at supplier firms and their counterparts at the retail chains strike a financially and mutually beneficial deal.”<sup>14</sup>*

Towards the last quarter of the year most managers know how much they need to sell in order to hit their year-end targets that ensure that they get their annual (and usually hefty) bonus or retain their jobs. An executive approaches a purchase manager at Nakumatt, **Tuskys**, **Naivas** or another other large retailer and tells them to take on a huge order.<sup>15</sup> This will ensure that the executive hits the annual target. An invoice is sent to the retailer and the executive completes the sale.<sup>16</sup> In exchange retailers get massive discounts and extended credit periods.<sup>17</sup> But in cases where these two alternatives do not work, a deal is arrived at where the retailers can simply return the goods in January the following year and the supplier simply does a reverse entry. A senior accountant at a large retail company says that when auditors ask, the standard answer is that the customers changed their mind or rejected the goods.

While this is a common local practice, foreign firms do not accept it, as witnessed in May when **South Africa-based Tiger Brands** dismissed senior managers at **Haco**, its local and jointly-owned subsidiary. The NSE-listed fast moving consumer goods (FMCG) company said that local managers were engaging in this malpractice to inflate sales and earn their annual bonus.

<sup>10</sup> Daily Nation, 13 May 2015.

<sup>11</sup> Press Release, 5 Jun 2015.

<sup>12</sup> Press Release, 5 Jun 2015.

<sup>13</sup> Source, CEO retail chain, East Africa

<sup>14</sup> Source, journalist, Nairobi

<sup>15</sup> Source, journalist, Nairobi

<sup>16</sup> Source, journalist, Nairobi

<sup>17</sup> Source, journalist, Nairobi

*“Whether a multinational such as Walmart will cut a deal with suppliers in exchange for massive discounts, which are welcome in the retail industry that is characterised by low margins, remains to be seen.”<sup>18</sup>*

Walmart and other international chains will also have to deal with unions, lobby groups and state regulators such as the **Kenya Competition Authority** which has in the past derailed expansion plans of Tuskys, Kenya’s second largest chain. Despite the challenges, Walmart may find it comforting that other international retail chains are showing confidence in the formal retail industry that is estimated to be worth \$2 billion annually.<sup>19</sup> **Choppies**, a **Botswana**-based retail chain, has made a bid to buy 10 stores belonging to **Ukwala**, a Kenyan-based chain whose owners have decided to exit the retail business, while **France**-based **Carrefour** plans to enter the market before the end of the year.

Increased international attention has encouraged traditionally family-owned FMCG companies to explore new sources of financing. In December 2014, Nakumatt said it expected to sell an unspecified stake to a strategic investor in mid-2015 to finance expansion in the **East African Community** and planned listings on the NSE and regional bourses.<sup>20</sup> In May, Tuskys appointed its first CEO from outside the **Kamau** family as it prepares for an NSE listing.<sup>21</sup> The fact that these companies have so far depended on private financing and internal family directorships has deterred investors due to the lack of publicly available information.<sup>22</sup> However, increasingly being family-owned is considered positive.

*“When the family name is everything, they don’t want to let it or [other family members] down; it’s actually a good guarantor that everything is run above board.”<sup>23</sup>*

### New local content regulations come into force in construction sector

The **National Construction Authority (NCA)** in May announced new local content regulations for foreign-owned construction companies. The NCA regulation is indicative of popular and political concern about the dominance of **China**-based companies in the real estate and infrastructure construction sectors. The NCA said that under new regulations, foreign-owned construction companies will require either 30% local ownership or to ensure 30% of their work goes to domestic employees.<sup>24</sup> CEO **Daniel Manduku** said that all foreign companies must register with the NCA before 28 May and submit an affidavit setting out their commitment to the local content requirements for the government to consider them for future contracts.<sup>25</sup> Foreign construction companies will also need to pay an additional 0.5% levy on new construction projects.<sup>26</sup> There are a large number of Chinese financed and led infrastructure projects in Kenya. Chinese construction firms are leading the expansion of **Jomo Kenyatta International Airport** and the development of the **Lamu Port-South Sudan-Ethiopia Transport corridor (LAPSSET)** programme.

### Implications

The appointment of the technocratic Njoroge will encourage investor and business confidence in the CBK at a time of increased uncertainty on the back of the timing and scale of US interest rate increases. The higher benchmark interest rate will also reassure investors about the credibility of the CBK’s monetary policy. While it is positive for restraining inflation and bolstering the exchange rate, it may also undermine bank lending rates and demand for credit.

<sup>18</sup> Source, journalist, Nairobi

<sup>19</sup> Source, journalist, Nairobi

<sup>20</sup> Bloomberg, 4 Dec 2014.

<sup>21</sup> Business Daily, 4 May 2015.

<sup>22</sup> Source, lawyer specialising in mergers and acquisitions, Nairobi

<sup>23</sup> Source, lawyer specialising in mergers and acquisitions, Nairobi

<sup>24</sup> Daily Nation, 7 May 2015.

<sup>25</sup> Daily Nation, 7 May 2015.

<sup>26</sup> Daily Nation, 7 May 2015.

FMCG companies will continue to look to take advantage of Kenya's middle class, which is increasing in size and prosperity. Listings and securing international financing will improve management and governance standards at domestic FMCG companies.

The NCA recommendation is indicative of an increasingly protectionist streak in Kenya which will contribute to its foreign direct investment continuing to lag behind that of its neighbours. The new regulations may create a popular impression that the government is seeking to share the benefits of infrastructure investment more widely among local companies and workers, but will also create an opportunity for rent-seeking by politicians linked to Kenya's construction sector.

---

### About Africa Risk Consulting:

**Africa Risk Consulting (ARC)** is a pan-African consulting company that provides timely, relevant information and advice that enables its clients to take informed investment decisions and to safeguard their reputations.

**ARC's** core consulting services include integrity due diligence and corporate investigations, political advisory and country assessments, opportunity monitoring and reputation risk management. Most relevant to private equity firms is ARC's integrity due diligence and corporate investigations capability. Specifically, ARC offers pre-deal integrity checks to highlight red flags before negotiations start; full detailed multi-jurisdictional reputation due diligence; and supplier and senior hire vetting and repeat due diligence for compliance programmes. ARC is unique in that it offers a 10-day delivery for a routine integrity due diligence. ARC also offers a suite of corporate investigations services from immediate investigation, evidence gathering, e-discovery, forensic accounting and whistleblower support on one end to crisis media management and regular monitoring on the other.

[www.africariskconsulting.com](http://www.africariskconsulting.com)

### About ARC Briefing:

**ARC Briefing** is ARC's essential online business information service.

Companies at any stage in their Africa expansion, whether building or communicating an Africa strategy, investing directly, expanding current operations, financing other investors, doing the legal leg-work or researching the Africa growth trend, need ARC Briefing.

**ARC Briefing** is an online information service keeping you:

- Up to date with Country Chronologies of business-critical events
- In the know via Country Briefings on political, economic, business and operating trends. Written in-country, ARC experts analyse and comment
- Ahead with Country Planner which details future elections, budgets, regulatory changes etc.

[www.briefing.africariskconsulting.com](http://www.briefing.africariskconsulting.com)

### Getting in touch

Please contact us by email [info@africariskconsulting.com](mailto:info@africariskconsulting.com) or call + 44 (0) 20 7078 4080

Follow us on Twitter: [@ARCBriefing](https://twitter.com/ARCBriefing)