KENYA AS A SERVICES HUB: THE ROLE OF SERVICES IN ECONOMIC TRANSFORMATION

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Following introductions from Professor Gituro Wainaina (Vision 2030 Director General), Dr Geoffrey Mwau Economic Secretary at the National Treasury (Budget/Fiscal Planning) outlined the 5 pillars of Kenya's economic transformation agenda:

(1) improving the business and investment environment
(2) improving domestic security
(3) making Kenya a regional transport and logistics hub, including
(4) investment in infrastructure (including reducing energy costs), and
(5) investing in social services, with a focus on health and education.

Dr Mwau outlined that the services sector acts as major input into the production services and is a major element of the Kenyan economy, essential for improvements in infrastructure, health and education. More however needs to be done to position Kenya as a financial services hub through undertaking reforms, including improving the legal framework and increasing advisory capacity.

1. THE ROLE OF SERVICES IN ECONOMIC TRANSFORMATION

Professor Wainaina (Vision 2030 Director General) introduced the session asking how countries can become centres of economic transformation using their comparative advantages. What are the examples of transformation in Kenya and what does Kenya needs to do to become a regional hub? What are the costs and benefits of service-led economic transformation? Kenya's comparative advantages include its geographic positioning, equi-distant to China, India and US, and location in Africa, its favourable weather for tourism and proximity of the national park to Nairobi city, as well as the opportunity for access to capital.

PANELLISTS

Dirk Willem te Velde (SET Programme Director) introduced the SET programme, a DFID funded 3-year programme. Economic transformation (or moving resources to high-productivity activities) is essential for improving the quality of growth to growth that is broad-based, resilient against shocks, and provides increased opportunities. Kenya's export in services has increased at a fast rate moving from $1.9 billion in 2005 to $4.9 billion in 2012. Moving out of services into certain services sectors also provides an opportunity to increase labour productivity. However to date, increases in GDP from services has seen a reduction in employment intensity, whilst increasing the value added of Kenyan exports remains vital. Three key challenges for Kenya will be in nurturing dynamic services sectors; improving the wider contribution of services sectors to the rest of the economy; embracing services heterogeneity, whilst avoiding premature deindustrialisation and agglomeration of low productive services jobs.

Ottavia Pesce (UNECA) outlined that growth in services tends to go hand in hand with GDP growth and value addition in the manufacturing sector, showing strong synergies between these sectors. Growth in the value added of services sectors is very strongly correlated with GDP growth. Over the past two decades services were the fastest growing sectors in Africa, as the main contributor to GDP in 35 out of 54 African countries. Directly and indirectly tourism accounts for a large share of Africa's GDP – accounting for 10% of Africa's GDP (excluding North Africa) or about $170 billion in 2013. Kenya is quickly becoming a regional leader in technology services thanks to a strong private sector and a supportive business environment. Whilst services will be boosted by Africa's underlying megatrends of urbanisation and regional integration – the development of services hubs and regional value chains can help African economies exploit each other's capabilities and boost their competitiveness. This will be dependent on adequate policies at the domestic level.

Julius Gatune Kariuki (ACET) addressed the role of agriculture in economic transformation. Whilst agriculture plays a key role in the Kenyan economy, contributing 52% of GDP (including 27% indirectly through manufacturing), the full potential has yet to be tapped. Kenyan agricultural value chains still face many challenges that need to be overcome, from production and logistics, to processing and marketing/distribution. Innovations in services is however starting to play a key role in farm level production in improving knowledge (such as through ICT services and farmers becoming consultants); inputs (including targeting better subsidies); farm mechanization; and, financing. Traders and middlemen can provide the most dynamic entry point for service based interventions, from input to knowledge services. Markets should drive the development of value chains, whilst governance also needs to be addressed, meanwhile the Kenyan agricultural transformation into industrial agro-processing has yet to unfold.

Lucy Muchoki (Kenya Agribusiness and Agroindustry Alliance, and Kenya Private Sector AllianceAgricultural Sector board) outlined Kenya's medium-term investment plan to promote agribusiness, including through public-private sector dialogue. Kenya has the potential to be transformed through agribusiness, in addressing food security and job creation. So how can we transform available services? Kenya is the biggest exporter of French beans, a major part of the world's export. However value addition to exports remains low. Only 3% value addition is achieved for tea crops, compared with 50% in China. Kenya's potential for potato production is 1.5 billion, which could capture a significant share of the global market, however despite availability of land and seed this is currently at zero. Improving production efficiencies could double mango yields. There is the potential for exports to the East given geographical positioning. The key for Kenya will be research and knowledge dissemination through platforms to action the potential yet to be tapped.

Waturi Matu (TMEA) TradeMark East Africa provide direct investments or grants to partners, focused on increasing competitiveness and reducing costs, as well as services in IT, engineering and skills. Reforms need to be directed towards the Kenyan educational system and transport infrastructure (roads, rail and air) in ensuring transportation costs are low and competitive, especially for air travel. Development of transport infrastructure could develop Tanzanian lakes into tourism centres. Opportunities in Kenya lie in digital and internet services, with current e-commerce services internally focused leaving the scope for expansion into regional services. Services will increase available markets and distribution channels, and reduce trade costs. Supporting partners through lobbying for financial market services, gaining political goodwill to tackle tariff and non-tariff barriers, as well as providing access to financial instruments to develop the services sector will be vital. Strategy needs to aim to become a regional/global exporter, with a current ratio of 4 inbound freight containers compared with 1 outbound.

DISCUSSION

Gituro Wainaina (Vision 2030 Director General) summarised the speakers' discussion on value addition in services and skills development, as well as the potential avenues for Kenya to become a services hub.

Strahan Spencer (DFID Kenya) focused on how to prioritise services sectors in Kenya, based on the event concept note criteria of the share of services in (i) value added, (ii) employment, (iii) exports, (iv) contribution to value added in exports, and (v) services productivity. He agreed that services such as finance, ICT and transport could play a very important role in supporting agriculture and manufacturing. However, in terms of their direct impact in creating jobs, only tourism would seem to justify strong government support.

Sunita Kapila (EU delegation to Kenya) outlined that the problems of value addition and services for agriculture have been known for a while, what are the political economy obstacles that need to be overcome to catalyse change? Hon. John Mruttu (Taita Taveta Governor) identified Kenya's history of revolving funds for women, youth and disabled peoples, asking on whether they have made a contribution to economic transformation or should be redirected towards the services sector? David Kitur (MicroLAN Africa Ltd) outlined that regulatory bodies tasked with increasing exports are in fact inhibiting small-scale operations through the promotion of oligopolies, recommending reductions in agricultural production controls instead.

Gituro Wainaina (Vision 2030 Director General) responded that the architecture of revolving funds for women, the youth and disabled have not been efficiently directed and should be reviewed. Dirk Willem te Velde (SET) stated that diversification (as part of economic transformation) is necessary to boost resilience to shocks, and the need to diversify beyond a focus on the tourism industry; appropriate regulatory frameworks will be required for boosting exports in Kenya. Julius Gatune Kariuki (ACET) outlined that 70% of value addition in chocolate exports is captured through branding, highlighting the importance of marketing and advertising. He also noted the importance of addressing governance reforms towards addressing the political economy. Lucy Muchoki (Kenya Agribusiness and Agroindustry Alliance, and KEPSA Agricultural Sector board) highlighted platforms that include the business sector in negotiations for market access opportunities are needed, as well as to help resolve political economy obstacles. Ottavia Pesce (UNECA) recommended the use of different criteria to prioritise services sectors, disagreeing that all services are exportable; prioritisation based on rankings would require cross-country analysis, as well as acknowledgment that certain services sectors support others, such as financial services. Waturi Matu (TMEA) outlined the need for inter-ministerial collaborations to create an enabling environment for the private sector, as well as investment in support services including infrastructure and transport.

Gituro Wainaina (Vision 2030 Director General) closed the session noting the need for a collaborative and efficient environment for the private sector, as well as the importance of county level action for services.

2. IT ENABLED SERVICES AND ECONOMIC TRANSFORMATION (WITH APPLICATION TO KENYA)

Professor Bitange Ndemo (University of Nairobi) introduced the panellists for the session.

PANELLISTS

Anupam Khanna (ex-NASSCOM) outlined India's export revolution, with three-quarters of Indian exports in IT and business services with the remainder often IT-enabled; the success has largely been in the sustainability of the strategy and sophistication of services exports, promoting quality as well as quantity of exports. The IT industry is currently worth 140 billion dollars, of which 100 billion is exported. Contributions to the economy account to 4% of value added of GDP, 23-25% of exports and 7% of the FDI share. Contributions are also made in terms of private sector employment, contributing 3 million direct jobs and 9.5 million indirect (30% are women). The transformation has also marketed India as a leader in global sourcing landscape, with 55% share of the global sourcing market, also enabling India to become an innovation hub for IT. The industry has also evolved from discrete processing in the 1980s (such as data entry, customer support and software development) to developing end-to-end development (including consulting, analytics and engineering), with strategy moving forward on product innovation and business transformation. What are the critical factors that determine success? Factors supporting competiveness and access to markets will be important policy factors for Kenya, including facilitating infrastructure for a knowledge economy, effective talent management environment, conducive business environment and international connectivity, a vibrant innovation system as well as easy movement of people.

Eunice Kariuki (Kenya ICT Authority). The ICT Authority established in 2013 (beforehand the ICT Board) has a mandate to provide standards and guidelines for ICT services, as well as develop human capital, infrastructure, both hard and soft. In following on from the Indian example, it is important that Kenya does not compete with India but rather adopts a different strategy towards an ICT services-led transformation. The ICT Masterplan launched in 2003-4 has evolved over time and helps to shape the Government's policy approach. The critical success factor will be in increasing value addition through innovation; maximising on the high proportion of youth in the Kenyan population. ICT can act as a driver of industry and the focus has been on achieving open data to encourage innovation to transform other sectors. The key determinants will be in access to infrastructure, connectivity between counties in Kenya and applying the appropriate technologies in different industries/areas to promote access and innovation.

Lawrence Arul (Zensar Technologies) highlighted the role of skills development as an essential foundation for IT-enabled services. Strategies for Kenya need to focus on what sectors and areas can be developed for a service-led transformation, for example services-led transformation in the manufacturing sector. A key indicator for developing the strategy should be on export-related services. For the development of skills, many multinational corporations are getting into domestic skills development in host countries. However private sector contributions to skills development are often in silos; the Kenyan Government needs to move towards bringing these together through conducive government policy.

Prasad Kotikela (Tech Mahindra) noted the prevalence of Indian companies in Kenya to access the sub-Saharan African market. When they arrived the Kenyan market was not well-adapted to the IT sector, however today a large proportion of investment is being attracted into Kenya, largely due to improvements in infrastructure (including the prevalence of office space in Nairobi). In order to ensure sustainability of IT services, localisation is required including partnerships with local firms, local skills development. For example, offering universities and student partnerships, such as developing specialised programmes for IT, or training schemes in India. Skills training also needs to be geared towards rural populations. Whilst incentives should be developed to attract skilled Africans working overseas back to Kenya. A conducive market exists, for which the Government needs to catalyse policies towards IT sector development. Investment in infrastructure will also be necessary to facilitate travel in Kenya (roads and rail).

Monica Kerretts-Makau (Strathmore Business School) asked to what extent technology is really driving services? Further how accessible is ICT to Kenyans? On the latter access is largely limited to mobile phones. Kenya's youth population will be the drivers of innovation towards economic transformation in the country. Skills development must also be applied practically through entrepreneurships and jobs. A key question will be in how to ensure pro-poor innovation and competitiveness in the Kenya economy. Further how to address questions of privacy and cyber-security in the global IT sector. She also highlighted the importance of infrastructure and power, ensuring uninterrupted internet use, as well as the role of ICT in understanding the entire value chain and promoting knowledge transfer in agriculture and manufacturing.

DISCUSSION

Bitange Ndemo (University of Nairobi) highlighted that industry have not been included in discussions on what is needed to promote ICT sector-led services. An innate challenge for democracy is in aligning various policy priorities and various incentives. He also noted certain Government resistance towards ICT; for example, in resisting the outsourcing of telephone services by Kenyan police, until a trial period revealed the significant advantages of such an approach. Another challenge will be in creating ambition and hard-work in the mindsets in the young population will be a key challenge for Kenya.

Tony Mbugua (Fintech Kenya Ltd) outlined the need for improved IT sector data, including adequate definitions on what constitutes IT services; for example, how do we effectively monitor development of soft infrastructure? Fredrick Wambua (Social Media Association of Kenya) recommended the engagement of youth in IT discussions and forums. He also asked whether the Kenyan private sector is doing enough to engage with the digital sector? Diana Gitiba (SoftAge Adept International) noted some disappointment in the Government's progress in ICT, given Kenya's comparative advantage (including language, educated youth, etc.) there is needs to be a concerted effort to digitise private sector firms and public sector entities.

David Kitur (MicroLAN Africa Limited) highlighted that many universities offering ICT courses are not regulated, creating disparities in the skills of graduates. Raymond Mutura (Fintech Group) stated that IT services have been exported from Kenya for the last 21 years, however a strategy for IT exports needs to be developed (e.g. should the focus be on mobile financial services?) John Ngigi (Copycat Ltd) outlined the importance of PPPs and the need to address salaries in the ICT sector to attract the appropriate skills.

Prasad Kotikela (Tech Mahindra) noted that discipline in India's youth has largely stemmed from competition in order to reach certain milestones (academic or professional). Lawrence Arul (Zensar Technologies) outlined that there needs to be synergy between the different bodies trying to deliver different objectives for the IT sector, as well as improved monitoring systems. Eunice Kariuki (ICT Authority) identified reliability of data as an important consideration (including promoting digitisation); however the key challenge will be in shortage of skills and budget for delivering on ICT priorities, as well as the polarisation of opportunities for urban and rural areas. She noted Enterprise Kenya's work in providing funding and access to markets to entrepreneurs. Anupam Khanna (ex-NASSCOM) highlighted that India had also experienced discipline problems in their youth, however encouraging aspiration and confidence have been vital in creating change. Further highlighting that it is important to develop a broad range of skills for ICT, beyond "techies", whilst also facilitating SMEs development. Monica Kerretts-Makau (Strathmore Business School) on the problem of data promoted a role for counties and promotion of 'open data', also noting the challenge in leadership for ICT in translating knowledge into day-to-day decision making in the Government and other sectors.

Bitange Ndemo (University of Nairobi) closed the session with a brief discussion on PPPs, which would allow the Government to deliver an IT transformation through leveraging private sector financing.

3. FINANCIAL SERVICES AND ECONOMIC TRANSFORMATION (WITH APPLICATION TO KENYA)

Julius Muia (National Economic and Social Council) launched the session and introduced the panellists. The Kenyan Government should provide better intermediation between savings and investment. Leveraging the financial sector will be important to help mobilise funds towards the Vision 2030 strategy, how can the private sector be engaged? How also can Kenya become a regional financial services hub?

PANELLISTS

Judith Tyson (ODI) outlined Kenya's strong success in its financial services sector, accounting for 7.4% GDP in 2013 (over 1% greater than many over countries), whilst also accelerating financial deepening has accelerated, demonstrating growth in regional banks and cross-border banking, and innovations in mobile banking. Meanwhile its regulation is keeping pace with new demands. Globally financial services represent 3.2 trillion or 5% of global GDP and 10% of service exports. Developing countries are beginning to integrate into global system and generate important lessons for Kenya. Three types of hubs developing countries have been successful in cultivating are regional hubs (e.g. Lagos, Johannesburg, Hong Kong and Singapore), processing financial hub (e.g. India and Philippines), and specialist financial hub (e.g. Dubai and Bermuda). Regional hubs often provide better advantages, including high potential contribution to GDP, high potential for high-skilled high-wage employment, and strong linkages to other sectors. Regional hubs require skilled youth, which Kenya has, as well as tailored training (e.g. from foreign firms). Challenges however include the need for a better regulatory framework and political security.

Professor Lemma Senbet (African Economic Research Consortium) defined the role of finance as raising capital and mobilising finance, with banks mobilising finance and lending, and dysfunctional bank lending to Governments. There is also a need for improved governance of the financial system. Through an analysis of financial development indicators, Kenya is still achieving low numbers leaving a 'financial development gap'. Banks are improving access to finance, with Kenya having the second highest rate of financial inclusion in Africa (after South Africa), but now what do we do? There is a need to think beyond developing a regional financial services hub to a global financial services hub. Equity Bank has started to bring in long-term vision in developing ‘systemically critical institutions’, whilst issues of stability, transparency governance need to be developed in order to prevent financial systems from collapsing. The example of Kenyan airways, privatised through the stock exchange, demonstrated the role of the private sector in improving governance and efficiency, in helping to deepen market integration and diversify ownership. How do we move up? Through improvements in governance and skills.

Sam Makome (KCB) the 1990s saw an increase in financial inclusion through improvements in market penetration. Where multinational banks did not bank in rural areas due to fears on profitability, KCB as a national bank had no choice but to establish banks in rural areas. During the past 15 years there has been rapid growth with an increase to 125 KCB-owned banks, as well as a few hundred banking representative. However a sufficient level of penetration was only achieved through mobile banking, achieving 2 million KCB accounts, from less than 100,000 2 years ago, also demonstrating the importance of leapfrogging through technology. Inclusion is reached by developing daily relevance to people in managing money, borrowing, etc., and is vital to economic growth. As financial intermediation requires obtaining resources, pooling them, and distributing them to those in need, if you decide 50% cannot reach the table this reduces the pool of assets. The next level challenge for KCB is in SME banking and increasing the penetration of mortgage services in Kenya (with 80% mortgages currently focused around 3 states).

Jareh Osoro (Kenya Bankers Association) stated that 45% of national income (or $25 billion dollars) is captured within the formal banking system. Financial infrastructure is key in raising finance, including to support the Vision 2030 strategy. The Kenyan financial system is bank-led, with the banking sector holding a significant share of the financial system, compared with a market driven financial sector. Both result in the financing of growth, however a bank-led financial system does not provide market access. The banking system relies significantly on the development of capital markets, and expansion of technology to improve reach and allow leapfrogging of capital markets. The closing of boundaries for banks needs to be through outreach in capital markets arena (such as for KCB and similar banks) and the creation of synergies between banks and mobile operators. There are two options in expanding boundaries, developing economies of scale through (1) regional banking, or (2) increasing penetration. If Kenya is thinking about becoming a financial services hub, certain questions need to be determined: what type of hub? What level of accessibility for financial services? What is the role for enhancing efficiency, including through technology? More broadly, what is the cost of doing business? For the latter Kenya’s performance has been erratic.

Gitau Mburu (FSD Kenya) outlined that FSD Kenya has been carrying out data collection on financial inclusion, finding that two-thirds of Kenya’s adult population are financially included (using prudential/financial regulated services) and approximately 8 out of 10 Kenyans live within 5km of a financial delivery channel (bank or banking agent). The challenge is that this can be improved. Financial services usually follow from a dense and heavy infrastructure. Approximately one-third of Kenyans use informal financial services, but that number is shrinking showing harmonisation. Tracking expenditure over a 12 month period in Kenya households found that poorer populations do save, but not necessarily through formal services. The Kenyan landscape is developing in such a way as to enable economic transformation, however many things still need to happen. How can financial inclusion lead to economic transformation? What needs to be done? (1) Banks need to extend reach to less densely populated areas and include younger segments of the population. (2) Need to extend business lending portfolios, particularly to SMEs that are more likely to employ the younger generation (currently 22% of lending portfolios). (3) Increasing understanding of client preferences to develop product portfolios. (4) Digitisation of financial services, particularly given potential to reduce end-to-end costs. (5) Improving regulation, including of the informal sector where abuses are most likely to occur. Policy action needs to be directed towards these key areas in order to promote the quality of financial services towards inclusion.

DISCUSSION

Julius Muia (National Economic and Social Council) summarised the session. In the context of becoming a regional financial services hub, Kenya is competing with Lagos and Johannesburg. Strong regulation of the financial sector will allow the sector to improve.

Radha Upadhyaya (IDS Nairobi) outlined the need for bigger discussion on the macroeconomic dimensions of becoming a financial services hub; what are the wider impacts (e.g. exchange rate effects on the competitiveness of the wider economy) from increased house prices, proportion of exports (and its poverty implications)? What are the innovative safeguards that need to be put in place? An academic representative asked on the relationship between the regulation of price controls and financial services. Participants also asked on the role of disruptive technologies in the distribution of financial services and the potential in improving cloud facilities; also, the outpacing of policy by technology affecting performance, how can banking rules be harmonised across the region to improve business opportunities? Other questions were addressed to what the financial sector is doing to address upcoming needs for the youth, as well as the potential for training to improve the uptake of financial services by communities.

Judith Tyson (ODI) outlined the history of examples on financial sector expansion gone wrong, which can also trigger financial crises, but some policy solutions can be employed including managing interest rates, currencies, or more supportive capital controls. There is however some trade off with certain policies and attracting international investors. Jareh Osoro (Kenya Bankers Association) outlined that price controls would be a negative thing for inclusiveness. Sam Makome (KCB) highlighted that in interacting with investors and firms you need to track financial sector markets (e.g. stocks) and ensure you don't shock the market. Banking charges for different products are often published, with the Kenya Bank reference computed in a scientific manner, which increases transparency. Gitau Mburu (FSD Kenya) stated that increased awareness amongst clients has led to increased disclosure from banks and uniform base rates to price credit. Evidence from microbanking shows increased savings in these products, whilst at the macro-level there has been a clear role for technology in enhancing banking processes. Lemma Senbet (African Economic Research Consortium) outlined that macroeconomic instability arises due to distorted information and incentives, Kenya therefore needs the skills and understanding for macroeconomic management and to deal with private sector institutions.

Julius Muia (National Economic and Social Council, NESC) summarised the discussion on policies to support the youth, highlighting NESC's Youth Enterprise Development Fund and NESC's agenda on guarantees to support the youth and SMEs in accessing banking sector lending.

4. CONCLUSIONS

Dirk Willem te Velde (SET Programme Director). In addressing value addition for economic transformation, what is the ICT and financial services niche Kenya can develop to become a services hub? Strategic Government thinking (including through the Vision 2030 strategy) is required to develop networks and connectivity, including connections between sectors (e.g. ICT and financial services), as well as skills. So what next? The SET programme provides policy and data analysis, and convenes meetings towards economic transformation. The DEGRP programme funds research on inclusive economic growth (particularly in low-income countries). He also thanked Vision 2030 staff and others for the event.

Gituro Wainaina (Vision 2030 Deliver Secretariat) thanked ODI, participants and panellists. He highlighted the importance of action at both the Government and county levels towards economic transformation. Technology is outpacing policy development, however the Government can move very quickly on important issues. The importance of services in economic transformation has been well highlighted, we need to focus on IT as an enabler, the role of counties, and improving access to data and information.

Dennis Kwena (DFID Kenya) Economic development and growth are central to DFID's strategy moving forward, aligning also with the Sustainable Development Goals. In Kenya the focus has been on development of the business environment rather than traditional social grants; for the financial sector the focus has been on access, particularly cost and quality (including consumer protection, ethical issues and market conduct). There is a need to unlock constraints to doing business, including Dr Mwau's comment on reducing energy costs by 30% through geothermal. DFID are currently working on an inclusive growth diagnostic to identify the constraints to truly transformative growth, in line with the Vision 2030 strategy. Manufacturing and agribusiness came out with the greatest potential to deliver transformative growth; but services will still play a role. Should we then focus on linkages between services and other sectors, or do we focus on the services sector in its own right, to deliver transformative growth? The manufacturing and services pathways do not compete, but need to think about their transformational, sustainable and equitable. Finally he thanked organisers to the event.

PICTURES