Transparency International

Integrity risks for international businesses in Kenya

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U4 Helpdesk Answer 2018:18

Integrity risks for international businesses in Kenya

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Date: 20 December 2018

While Kenya is an attractive destination for international businesses active in Africa, integrity risks present a real concern and can be a deterrent to investment. The country's struggles with corruption have a major effect on the business environment. International businesses need to have a sound understanding of this context and the specific integrity risks it will present to their operations.

U4 Anti-Corruption Helpdesk

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Query

Please provide an overview of the most pressing integrity risks affecting international businesses operating in Kenya.

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Main points

- Kenya is a regional economic hub which offers significant opportunities for international businesses.
- Integrity risks for businesses are nonetheless high and stem from a long history of corruption and mismanagement in politics and government institutions.
- Key areas of risk for international businesses across all sectors include public procurement, politically connected partners, engagement with state-owned enterprises, bureaucratic and administration corruption and fraud.
- These forms of integrity risk vary significantly by sector and the extent of engagement by businesses with the government and state-owned enterprises. Different types of international businesses may also experience these problems with varying levels of severity.

Global evidence of the impact of corruption on business and investment

A sizeable and growing body of evidence has provided clear indication that, at the aggregate level, corruption is bad for business.[1] While cross-country panel data have shown that corruption adversely affects economic growth and market demand, firm-level studies have established corruption's detrimental effect on firm growth, innovation, productivity and return on investment.

Corruption in a given country or market is harmful in two mutually reinforcing ways: in highly corrupt

[1] Corruption has been shown to have a detrimental effect on:

- growth (Aidt 2009; Anoruo and Braha 2005; Glaeser and Saks 2006; Knack and Keefer 1995; Méndez and Sepúlveda 2006; Méon and Sekkat 2005; Rock and Bonnett 2004; Ugur and Dasgupta 2011)
- international trade (Ali and Mdhillat 2015; De Jong and Udo 2006; Dutt and Traca 2010; Horsewood and Voicu 2012; Musila and Sigue 2010; Thede and Gustafson 2012; Zelekha and Sharabi 2012)
- market openness (Hakkala et al. 2008)
- return on investment (Lambsdorff 2003)
- foreign investment inflows (Javorcik and Wei 2009; Thede and Gustafson 2012; Mathur and Singh 2013; Zurawicki and Habib 2010)
- business competitiveness and productivity (Fisman and Svenson 2007; Hall and Jones 1999)

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settings, aggregate firm growth and performance is lower, while markets perform poorly when corporate corruption becomes commonplace compared to markets in which firms typically refrain from corrupt behaviour.

Effect on markets

High levels of background corruption have adverse effects on a country's economic performance by reducing institutional quality, undermining competitiveness and entrepreneurship, distorting the allocation of credit and acting as a barrier to trade (Ali and Mdhillat 2015; De Jong and Udo 2006; Horsewood and Voicu 2012; Musila and Sigue 2010; Rodrik, Subramanian and Trebbi 2004; Zelekha and Sharabi 2012).

Corruption has a long-term deleterious impact on the regulatory environment and the efficiency of the state apparatus as it creates incentives for politicians and public officials to create more regulations, restrictions and administrative procedures to have more opportunities to extort payments from citizens and companies. This, in turn, is likely to exacerbate rent-seeking behaviour and breed inefficiencies across the public sector (Argandoña 2004; Dzhumashev 2010).

Unsurprisingly, studies show strong associations between corruption, protectionist regimes and opaque bureaucratic systems (Bjørnskov 2009; Bandyopadhyay and Roy 2007). This is particularly problematic for the business environment, as corruption subverts the fair awarding of contracts, reduces the impartiality and reliability of public services and skews public expenditure (Transparency International 2011).

Corruption also acts as a non-tariff barrier to trade, raising transaction costs and obstructing foreign investment (Zurawicki and Habib 2010; Ali and Mdhillat 2015; Dutt and Traca 2010; De Jong and Udo 2006; Thede and Gustafson 2012; Mathur and Singh 2013). It is no surprise, therefore, that corruption is positively and significantly correlated with lower gross domestic product (GDP) per capita, less foreign investment and slower growth (Ades and Di Tella 1999; Anoruo and Braha 2005; Kaufmann et al. 1999; Knack and Keefer 1995; Hall and Jones 1999; Javorcik and Wei 2009; Méndez and Sepúlveda 2006; Méon and Sekkat 2005; Rock and Bonnett 2004). In fact, some studies have found that in transition economies,[2] corruption is the single most important determinant of investment growth, ahead of firm size, ownership, trade orientation, industry, GDP growth, inflation and the host country's openness to trade (Asiedu and Freeman 2009; Batra, Kaufmann and Stone 2003).

Effect on firms

Corruption imposes a clear burden on companies, and surveys show that business leaders almost unanimously agree that corruption undermines a level playing field to the benefit of less competitive firms (KPMG 2011).[3]

On average, enterprises operating in countries with high levels of background corruption have relatively lower firm performance than those operating in markets with lower risks of corruption (Donadelli and Persha 2014; Doh et al. 2003;

[2] Transition economies as taken to refer to countries in Central and Eastern Europe, as well as the Commonwealth of Independent States (Asiedu and Freeman 2009; Batra, Kaufmann and Stone 2003).
[3] 51% of business people felt corruption makes an economy less attractive to foreign investors, 90% felt it increases stock market volatility and discourages long-term investment, and 99% agree corruption undermines the level playing field to the benefit of corrupt competitors.

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Faruq and Webb 2013; Gray et al., 2004; Mauro 1995; Wieneke and Gries 2011). Recent empirical research has, for instance, found a significant negative correlation between background levels of corruption in US states and the value of firms located in those states (Dass, Nanda and Xiao 2014).[4]

Firm-level data on informal payments from the 2010 World Bank Business Environment and Enterprise Performance Survey found that, in some countries, bribery imposed an additional tax on businesses representing, as much as 10% of their sales (OECD 2016). Worldwide, 14% of firms expect to have to pay a bribe to get an import licence, a figure that rises to 27% in South Asia and 30% in East Asia (World Bank 2018). Corruption in foreign trade can therefore act as a severe deterrent to market entry. This is especially the case for UK firms; a 2015 survey found that 43% of UK compliance and legal professionals indicated they had decided against doing business in a particular country due to high corruption risks (Control Risks 2015).

Even where foreign companies are able to gain a foothold in a corrupt market, studies have shown that greater levels of corruption are associated with higher firm exit rates, suggesting that corrupt environments are highly unstable for businesses (Hallward-Driemeier 2009). Revealingly, 55% of 1,400 CEOs questioned in a recent PwC (2016) survey identified bribery and corruption as a threat to their business's growth prospects.

Nonetheless, when operating in highly corrupt markets, foreign firms unfamiliar with local practices may be inclined to engage in corruption, or succumb to public officials' efforts to solicit bribes in the name of short-term profit maximisation. Doing so is likely to be counterproductive, as corruption commonly affects business growth and productivity, lowering performance, innovation and long-term growth prospects (Fisman and Svenson 2007; Starosta de Waldemar 2012; Rossi and Dal Bo 2006).

Moreover, corruption begets corruption; firms with a propensity to pay bribes not only find themselves spending more time and money dealing with the bureaucracy but also suffering from the indirect costs, such as lower productivity and more expensive access to capital (Nichols 2012: 334; Wrage 2007; Almond and Syfert 1997; Earle and Cava 2009; Krever 2008). Finally, a lax corporate culture can inculcate unethical and unsustainable business practices or lead to internal fraud. If detected, the costs and sanctions, as well as reputational impact, can be extremely costly for companies.

UK exports and overseas investment

Both the nature of the UK's top exports (mechanical appliances, precious metals, motor vehicles, mineral fuels and electronic equipment [HMRC 2018a: 6]) and the kinds of export markets in which UK firms operate entail corruption risks. A number of the UK's top trading partners include countries like Russia, India, China, Vietnam and Saudi Arabia (HMRC 2018b), in which UK companies can be exposed to elevated risks of coercive or collusive corruption (Transparency International 2014).

Alongside the trade in goods, the UK has rising stock of foreign direct investment (FDI) in markets and industries with high associated risks of corruption. Between 2005 and 2014 alone, UK

[4] Dass et al. assessed Tobin's Q as an indicator of firm value against local corruption using a proxy of corruption-related convictions of public officials between 1900 and 2011. Tobin's Q provides a means of estimating firm value by dividing the total market value of the firm by the total asset value of the firm.

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outward FDI to African countries doubled from £20.8 billion to £42.5 billion (ONS 2016). Over half of this investment in Africa was in mining and quarrying (ONS 2016), a sector judged to be the most corrupt in an OECD (2014) study, which found the extractives industry accounted for 19% of all foreign bribery cases.

Encouragingly, a 2015 survey (Control Risks 2015) found that business leaders in economies such as Nigeria, Mexico, Brazil, India and Indonesia largely welcome measures to level the playing field and address the inconsistent enforcement of domestic anti-corruption laws.

Why tackle corruption?

Corruption stacks the deck against competitive, innovative and entrepreneurial companies seeking to expand their overseas operations. This is increasingly recognised by business leaders: a survey of 390 senior executives revealed that 70% believed a better understanding of corruption would make them more competitive, help them make smarter investment decisions and enter new markets (PwC 2008).

Transparency is fundamental to reduce information asymmetries in complex markets; it underpins the ability of companies to fully understand the conditions and constraints for entering and operating in a given market (OECD 2016). Anti-corruption initiatives that reduce the necessity of "insider knowledge" of bribery patterns, middlemen and intermediaries have the potential to lower business costs, reduce uncertainties and reputational risks, lessen vulnerability to extortion and make access to capital easier (Transparency International 2009). Targeted efforts to curb corruption have been shown to yield significant benefits to improve the regulation of the business environment (Breen and Gillander 2012).

As well as helping to make the business environment more conducive to inward investment and market entry by foreign firms, measures to reduce corruption in key markets have the potential to stimulate greater market demand by unleashing greater economic growth and increasing disposable income (Aidt 2009). A 2010 study found that more effective control of corruption in sub-Saharan Africa had the potential to dramatically increase trade volume in general and imports in particular (Musila and Sigue 2010).[5]

Ultimately, efforts to reduce corruption in high-risk markets have the potential to edge out competitors from countries with higher incidences of corruption. As Belgibayeva and Plekhanov (2016) show, there exists kind of a virtuous cycle between investment flows and control of corruption:

- there are greater investment flows between countries with good control of corruption
- as corruption decreases, investment from countries with lower incidences of corruption increases
- as the quality of a county's institutions and control of corruption improves, the country may even attract less investment from countries with widespread corruption
- greater investment volumes from less corrupt countries can further reinforce the strengthening of economic and political institutions that keep corruption in check

[5] The authors estimate that if a country with the same corruption perception index as the African average of 2.8 were to improve its corruption level to Botswana's 5.9, its exports would improve by about 15% and imports by about 27%.

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The Kenyan economy and international investment

Economy overview

Kenya is the second largest economy in the East African region after Ethiopia, accounting for 19% of regional output (African Development Bank 2018) and the fourth largest economy in sub-Saharan Africa (Ernst & Young 2017). The principal sectors driving economic activity in Kenya are agriculture, services (including finance and real estate) and manufacturing. These accounted for 31.5%, 14.9% and 8.4% of gross domestic product (GDP) respectively in 2017 (African Development Bank 2018).

Political disruption in Kenya in the run-up to and following general elections was a major contributory factor to an economic slowdown in 2017, with GDP growth of 4.9% compared to 5.8% in 2016 (African Development Bank 2018). Seeking a second term in office, President Uhuru Kenyatta's Jubilee Party's electoral alliance was declared the winner of national elections in August 2017. A month later, however, the supreme court annulled the results due to technical problems in the processing of votes at the electoral commission. The Jubilee Party won the election re-run in October 2017, although the main opposition group, the National Super Alliance (NASA), headed by Raila Odinga, boycotted the polls. This gave rise to further concerns of disruption which have gradually diminished. Fears of a repeat of the widespread violence following disputed elections in 2007/2008, in which more than 1,500 people were killed, did not materialise.

In office since 2013, President Kenyatta originally branded his government the "digital generation", entering government with plans to ease business regulations, reform the tax code and improve infrastructure, particularly in the energy supply and transport networks. This is in line with the Kenya Vision 2030 programme which, launched in 2008, aims for Kenya to become an industrialising middle-income country by 2030. In the latest election cycle, President Kenyatta has promoted a more socially orientated programme, known as the "Big Four" agenda, which focuses on manufacturing, universal healthcare, affordable housing and food security. The World Bank has recommended the government reprioritises and enhances the efficiency of public spending if it is to make the Big Four agenda a success (World Bank 2018).

Kenya has made improvements on the World Bank's Doing Business Index over the last five years. Ranked 121 of 185 countries in 2013, Kenya has risen over 40 places to rank 80 in 2017 (World Bank 2018). Examples of changes to regulations are reducing the time it takes to pay stamp duty, automation of property transfer processes and improved access to credit information (African Development Bank 2018). GDP growth is projected to rise to 5.7% in 2018 due to the robust performance of the services sector and improved business confidence (World Bank 2018).

Reforms to business regulations and the trend of economic growth have nonetheless not resulted in broad-based development. In 2018, Kenya ranked 142 of 189 countries on the United Nations Development Programme (UNDP) Human Development Index, based on indicators including life expectancy, years of schooling and gross national income per capita (UNDP 2018). When it comes to the private sector, key sectors tend to be dominated by a few large firms, while informal small businesses account for 83% of employment (African Development Bank 2018). The closely-related problems of corruption, insecurity and political mismanagement have all held the economy back from achieving its potential.

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FDI in Kenya

Kenya has a history of openness to foreign investment. Many international businesses and financial institutions active across Africa are based in Nairobi, which is a business hub for the East Africa region. In its 2017 Africa Attractiveness Index, Ernst & Young assessed Kenya as the second most attractive investment destination in Africa after Morocco. The index evaluates countries across the indicators of macroeconomic resilience, market size, business enablement, investment in infrastructure and logistics, economic diversification and governance, and human development (Ernst & Young 2017).

According to figures from the United Nations Conference on Trade and Development (UNCTAD) World Investment Report, in 2017 FDI inflows into Kenya were US$672m. This was driven principally by investments into the information, communications and technology (ICT) sector (UNCTAD 2018). The latest figures released by the Kenya National Bureau of Statistics (KNBS) cover 2015 and show that the top five sources of inward direct investment to Kenya were the UK, France, US, China and Mauritius (KNBS 2017). The Netherlands and South Africa have also historically been important sources of foreign investment in the country (Santander 2018). KNBS figures for 2015 show that the sectors receiving the most investment were finance and insurance, information and communication, manufacturing and retail (KNBS 2017). The infrastructure, horticulture, oil and gas, and tourism sectors have also all attracted significant investment from foreign companies.

The Kenyan government has taken various measures to attract foreign investment. Recent examples include a 2013 act regulating public-private partnerships and the 2015 Business Registration Services Act, which seeks to improve the ease of business registration. A 2017 investment policy will also provide a basis for a review of the legislative framework for foreign investment (Santander 2018).

In spite of these measures, as well as the overall attractiveness of the country, the level of foreign investment is relatively low in proportion to the size of the Kenyan economy (Santander 2018). The 2017 figures show that Kenya received the fourth highest level of investment in East Africa despite having the second largest economy (UNCTAD 2018). This may partially be attributable to uncertainty generated by the recent electoral cycle. A key part of the explanation though is the significant integrity risks which face businesses operating in the country, which can be a deterrent to investment.

The political context to integrity issues

Kenya’s long struggle with corruption

Corruption is an issue which has long been recognised as a major societal problem in Kenya. Foreign investors should have an understanding of this context and the risks it might entail for their operations in Kenya.

Recent political administrations have each been marked by corruption scandals. Daniel Arap Moi’s (1978 to 2002) administration saw the Goldenberg export subsidy scandal. This involved collusion in the 1990s between government officials and directors at a company called Goldenberg International, who falsely claimed funds from a compensation scheme designed to boost Kenya’s foreign exchange earnings. The Goldenberg Affair is estimated to have cost the country US$600m (BBC 2006) and was the most prominent of a number of scandals under Moi, which it has been

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estimated may have culminated in the theft of over US$1bn of public funds (The Guardian 2007).

Although he initially entered office pledging to clean up government, the government of Mwai Kibaki (2002 to 2008) was similarly tarnished by corruption. The Anglo-Leasing scandal was the most notorious of the scandals under Kibaki. The scheme revolved around the award of government contracts, such as a new passport printing system, to phantom shell companies including Anglo Leasing and Financing Limited. Senior members of the Kibaki government were widely believed to hold financial interests in the companies receiving contracts. The case was investigated by the then head of Kenya's anti-corruption agency, John Githongo who, after receiving death threats, was obliged to leave Kenya. Githongo's story was covered in a well-known book on Kenyan corruption by the journalist Michela Wrong called *It's our Turn to Eat* (2009).

The title of Wrong's book captures well one of the principal drivers of corruption in Kenya: competition between ethnic groups. There are 42 ethnic groups in Kenya with the five largest – Kikuyu, Luhya, Kalenjin, Luo and Kamba – constituting around 66% of the population (The Conversation 2017). Politics has historically involved around the formation of alliances between Kenya's main ethnic groups. This leads to a zero-sum game in which groups compete for the resources of the state and heightens the tension around election cycles. External investors can and have become implicated in these dynamics.

Corruption and anti-corruption under the Kenyatta government

Kenya's long-term challenges in managing corruption issues are reflected in the present day in its poor ranking on global corruption indexes. Kenya is ranked 143 of 180 countries globally on Transparency International's 2017 Corruption Perceptions Index (CPI). Its score of 28/100, where the scale ranges from 0 (highly corrupt) to 100 (very clean), puts it below the sub-Saharan Africa regional average of 32/100 (Transparency International 2017). Similarly, the World Bank's Worldwide Governance indicators, where 0 corresponds to the lowest rank and 100 to the highest, show that for control of corruption Kenya had a percentile rank of 15 compared to the sub-Saharan Africa average of 31 in 2017 (World Bank 2017). There has been little movement on either index since President Kenyatta assumed office in 2013. At this time, Kenya's score on the CPI was 27, and it held the same percentile ranking of 15 on the World Bank's control of corruption indicator.

Like past political administrations, the reputation of the Kenyatta government has been damaged by corruption scandals. In a recent example, it has been alleged that officials have stolen up to US$98m from the National Youth Service (NYS), a paramilitary agency providing training and skills, through procurement and fictitious invoices (Financial Times 2018). As an illustration of the extent of the problem across government, in March 2018 the auditor-general reported that US$400m of public funds could not be accounted for (The Guardian 2018).

Despite the Kenyatta government's economic growth agenda, recent press coverage illustrates there is widespread dissatisfaction regarding the administration's willingness to address corruption. The government has appointed new individuals to the posts of director of public prosecutions, inspector-general of police and director of criminal investigation in the police (Bloomberg 2018). While the government has launched periodic crackdowns in which large numbers of civil servants have been arrested or charged – for example, around 20 officials were arrested in relation to the NYS

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scandal (Financial Times 2018) – this has resulted in few convictions.

Bloomberg reported around the same time that "politicians look set for an easy ride in Kenya's corruption crackdown", highlighting a previous anti-graft campaign in March 2015 when the president passed a list to parliament of 175 officials implicated in wrongdoing, but as yet none have been jailed. The news agency quoted the respected anti-corruption campaigner John Githongo who said, "corruption is essential to Kenya's political economy … dealing with it is political suicide for key elements of our ruling elite" (Bloomberg 2018). Githongo has elsewhere commented that "the level of cynicism" about the president's commitment to fighting graft is so great that he needed "to pay some sort of political price", such as removing senior politicians from office (Financial Times 2018). The record of the current government has led to concern that anti-corruption measures operate only at a superficial level.

Cross-sectoral integrity risks

Potential exposure to corruption presents the foremost integrity risk for businesses operating in Kenya. In the following sections we discuss the forms of the problem which are most relevant to foreign businesses before providing additional commentary by sector.

Public procurement

As the previous sections showed, public procurement has historically been one of the primary vehicles for corruption by public officials and political elites in Kenya. Based on a survey of 116 business people, PwC found in its 2018 Global Economic Crime and Fraud Survey that 34% had experienced procurement fraud, the highest rate in East Africa.

Foreign companies participating in procurement managed by government bodies can be exposed to a range of integrity risks at all stages of the process. This can, at its most direct, include requests for bribes to participate in or win tenders. Alternative forms of abuse include manipulation of documentation and procedures to favour certain bidders; breaches of bidder confidentiality to the advantage of a preferred company; collusion between bidding companies; kickbacks to officials for contract awards; subcontracting of contracts to companies affiliated with decision-making officials or politicians; and illicit payments to ensure inadequate monitoring of projects once awarded (for a step-by-step overview of integrity risks in public procurement see the United Nations Office on Drugs and Crime 2013).

There are several cases of foreign investors having been implicated in corruption in public procurement in Kenya. Two examples are:

- In January 2016, the UK Serious Fraud Office (SFO) fined Smith and Ouzman, a printing company, £2.2m for making corrupt payments of around £500,000 to win a contract to print election material. Two of the company's British directors were also sentenced to prison and confiscation orders (SFO 2018). Trials of the officials involved in the case appeared to be on-going in Kenya at the time this Helpdesk answer was compiled (The Star 2018 a.). The case is popularly known as Chickengate, because chicken was used as a code name for cash payments.
- An investigation by the SFO led to a £1.89m fine in 2012 for the academic publishing company, Oxford University Press, after managers in its Kenyan and Tanzanian subsidiaries bribed government officials to win a contract to supply school textbooks. The conduct, which occurred between 2007 and

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2010, also resulted in the two subsidiaries being excluded from World Bank contracts for three years (The Guardian 2012).

Politically connected partners

It is common for politicians and public officials to have extensive private business interests, which can give rise to conflicts of interest. International investors can be drawn into these conflicts through poor assessment and decision-making around partners. Association with a politically connected partner can expose an investor to accusations of influence peddling or illicit activity.

The Kenyan government has promoted local content requirements for foreign investors and in some sectors there are specific provisions. For example, foreign companies in the construction sector are also required to enter into subcontracts or joint ventures to ensure that at least 30% of the work is undertaken by locally owned firms. The 2015 Companies Act had initially contained language requiring all foreign companies to have at least 30% shareholding by Kenyans, but the clause was eventually repealed (US Department of State 2018). As the pool of partners is potentially small in some sectors, this can push foreign companies into partnerships which may pose legal and reputational risks. Small- and mid-sized companies may be more exposed to this risk where they have less influence over their choice of partner.

Engagement with state-owned enterprises (SOEs)

While the Kenyan state has reduced the number of direct participations it holds in companies through privatisations in the 1990s and 2000s, there are a significant number of SOEs which occupy strategic positions across the Kenyan economy. Privatisation processes have themselves been the subject of controversy in the past. The Africa Centre for Open Government (AfriCOG), a Kenyan civil society organisation, released a report in 2011 entitled "Deliberate Loopholes", which detailed concerns around the level of information disclosed and speed of the approval process for the privatisations of the telecommunications firms Telkom Kenya (Telkom) and Safaricom (AfriCOG 2011). The Kenya privatisation commission has plans to sell participations in a further 26 SOEs, including the National Bank of Kenya, the Kenya Ports Authority, the Kenya Pipeline Corporation and five sugar millers (The East African 2018). Investors involved in privatisations must therefore have an understanding of the proper process to be followed and be alert to potential integrity issues when there are deviations from this.

Careful due diligence is also required, as many SOEs are affected by poor corporate governance and high levels of corruption, including nepotism in appointments of personnel to the firms. There are many cases of corruption scandals centred on Kenya's SOEs. To give one recent example, the former chief executive of Kenya Power is on trial along with several other senior managers at the firm after an audit uncovered suspected corruption in procurement contracts (Reuters 2018a).

Foreign companies will routinely have to deal with SOEs, whether to win business or obtain basic services, such as licence approvals or utility connections. This can expose companies to requests for illicit payments and lead to wider patterns of misconduct. The US$16m settlement paid by Goodyear Tire & Rubber Company (Goodyear) to the US Securities & Exchange Commission (SEC) for books and records violations illustrates the legal risks this can pose to companies. Goodyear subsidiaries in Africa had routinely paid cash bribes to employees of state-owned entities, which in Kenya included payments

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to employees of the Kenya Ports Authority, East African Portland Cement Co. and Telkom.

Bureaucratic and administrative corruption

Bureaucratic and administrative corruption is a widely prevalent risk for all companies operating in Kenya. Companies frequently report coming under pressure to make small bribes, or facilitation payments, to complete basic transactions, such as to obtain visa and work permits, pass inspections by officials and obtain project approvals from national or local government authorities (US Department of State 2018).

The East African Bribery Index illustrates the extent of the problem across Kenyan society as a whole. The index ranked the police (83.3/100), judiciary (44/100) and land services (41.7/100) as the most bribery prone institutions in Kenya, with a score of 100 indicating the worst score across five measures of bribery (Transparency International 2017).[6] The latest World Bank Enterprise Survey (2013), based on a survey of 781 firms covering the period January 2013 to September 2014, confirms this risk; 28.2% of firms reported that they are expected to give gifts to public officials to “get things done”, which is slightly above the average for sub-Saharan Africa at 27.4%. Particular bureaucratic processes highlighted from the survey as most problematic are getting a construction permit, where 34.6% of firms reported that gifts are expected, getting a water connection (30.9%) and meetings with tax officials (17.4%).

The World Bank Enterprise Survey (2013) also shows that petty corruption is evident with import licences (17%). This reflects a broader problem of pervasive corruption within the customs administration in Kenya, which presents a risk for all investors bringing goods and materials into Kenya through the ports and across the country’s borders. Respondents to the World Economic Forum Executive Opinion Survey in Kenya (2016) ranked corruption at the border as the second most problematic factor for importing, behind tariff and non-tariff barriers.

This is again a problem which may vary in severity according to the size of a business. Large multinational companies that can point to a clear global compliance framework may find it easier to deflect demands for small bribes than small- and medium-sized companies.

Fraud

Businesses operating in Kenya can suffer losses from fraud within their operations in addition to the problems which occur in the interaction between the private and public sectors. PwC’s 2018 Global Economic Crime and Fraud Survey maps out the main forms of fraud reported by businesses in Kenya: 48% of respondent businesses had experienced asset misappropriation, the most common form of economic crime, in 2017. The second most common crime reported was consumer fraud. Other forms of fraud captured by the survey include accounting fraud, cybercrime and intellectual property theft.

Additional commentary by key sector

The following sections provide further discussion of integrity risk in four key sectors for foreign investors in Kenya.

[6] The score is an aggregate of five indicators: the likelihood of encountering bribery; the prevalence of bribery; the average size of a bribe; the share of the national bribe; and the perceived impact of bribery.

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The financial sector

Kenya aspires to be a financial services hub for East Africa, and expanding the sector is an objective of the Kenya 2030 economic development programme. Alongside 42 commercial banks (15 of which are foreign-owned), there are 13 microfinance banks in Kenya as well as a large market for mobile money and remittance services (Central Bank of Kenya 2017).

The major integrity risks affecting financial institutions are money laundering and terrorist financing. Predicate offences for money laundering can include corruption, but also significantly in Kenya include funds generated from organised crime, namely drug trafficking and poaching (see UNODC 2013a for an overview of organised crime in Kenya). The risk of handling funds for terrorist organisations stems chiefly from Kenya's border with Somalia, where the Islamic militant Al-Shabaab controls extensive territory, as well as affiliated domestic groups, such as Al-Hijra, which, in July 2018, was designated by the US Department of State (2018a) as a terrorist group.

Kenya has previously appeared on the Financial Action Task Force (FATF) list of countries with deficiencies in their anti-money laundering and countering of financing of terrorism (AML/CFT) controls. In 2010, FATF identified problems with Kenya's legal framework for AML/CFT; the functioning of the financial intelligence unit; and level of awareness among law enforcement of AML/CFT issues. Progress in these areas allowed Kenya to be removed from FATF's monitoring process in 2014 (FATF 2014).

However, standards of AML/CFT compliance controls are variable among local financial institutions. In September 2018, the Central Bank of Kenya fined five commercial banks for failing to report suspicious transactions in connection with stolen funds from the NYS scandal (see earlier). The banks included the local subsidiary of Standard Chartered as well as Equity Bank, Diamond Trust, Co-operative Bank and KCB Group (Reuters 2018b). Foreign banks are therefore exposed to risk if they maintain operations locally or through their correspondent relationships with Kenyan banks.

International lenders need to conduct fiduciary risk assessments in providing funds to government and state-owned entities, which are increasingly looking to raise funds on international capital markets. As an illustration of this risk, a report released by the Kenyan auditor-general in 2016 raised concerns that some of the funds raised from the Kenyan government's debut US$2bn Eurobond had gone missing (The Standard 2016). Lenders should have a clear understanding of how funds are to be used with built-in accountability mechanisms.

Telecommunications

The telecommunications sector, and particularly the mobile money segment, is a prime example of economic innovation in Kenya. As of March 2018, Safaricom's M-Pesa scheme, in which users can transfer cash between mobile phones, was used by over 22m Kenyans (The Star 2018) with Kenya recognised as a global leader in the sector (The Economist 2015). According to African Development Bank (2018) statistics, the ICT sector in Kenya was valued at US$1bn in 2017.

In spite of the success of the sector over the past two decades, it has not escaped corruption scandals under different political administrations. The Anglo-Leasing scandal under the Kibaki government included contracts in the sector, such as access to a satellite-based network at post offices and a network for the police and prison service, both of which were allegedly delivered at grossly inflated prices (Sutherland 2015). As noted

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previously, the privatisation processes of Safaricom and Telkom Kenya in the 2000s also came under suspicion due to a lack of transparency, with concerns there may have been hidden political owners in the transaction structures (Sutherland 2015; AfriCOG 2011).

For network operators in the sector today, integrity risks may arise in bidding for mobile network and spectrum licences, which tend to be highly competitive processes. Risks can also stem from the choice of local partner. The sector regulator, the Kenya Communications Authority, requires foreign companies to have at least 20% Kenyan shareholding within three years of obtaining a licence (US Department of State 2018). With wide geographic coverage, telecommunications companies' day-to-day operations are also likely to entail exposure to bureaucratic corruption and requests for small bribes. Where contractors carry out activities on a firm's behalf, it is important to ensure they abide by the same integrity standards.

Infrastructure

The Kenyan government has committed to increased investment in infrastructure in areas such as transport and energy. Energy sector infrastructure has a financing need of around US$19.8bn from 2015 to 2035. The transport sector financing need is US$25.6bn for the same period (African Development Bank 2018). Foreign companies have an important role in filling this gap by bringing finance and technical expertise.

Typically high-value, complex in scope and overseen by government, infrastructure projects are vulnerable to corruption. The integrity issues associated with public tendering processes (see earlier) present the principal form of risk in infrastructure projects. However, the execution of works, which typically requires approvals from government ministries and agencies, the need for importation and transportation of equipment and materials and subcontracting of work to local firms also can entail integrity risks. These risks clearly vary according to a company's role in the project.

The controversy which has surrounded the Kenyan government's flagship infrastructure project, the US$3bn Mombasa-Nairobi standard gauge railway, illustrates these issues well. The contract was awarded without an open tender to the China Road and Bridge Corporation (CRBC) in 2012. This was despite the fact that CRBC had been barred from World Bank financed projects in 2009 following allegations of corruption in its involvement in road projects in the Philippines. There have been persistent concerns around the pricing of the project, which is based on a cost per km far in excess of international norms (The Economist Intelligence Unit 2014). More recently, the government arrested 18 people, including the managing director of the Kenya Railways Corporation, due to allegations they had made false compensation claims for land used in the project (Reuters 2018).

Oil and gas

Oil and gas is a nascent yet potentially important sector in Kenya which has attracted a number of foreign companies. The first oil discoveries were made in 2012 by the British company, Tullow Oil, in the remote northern Turkana province. To date, no company has progressed to production and export of oil due to a combination of a low global price and major gaps in infrastructure (The Africa Report 2018)

Oil and gas is a sector which is widely known to be prone to corruption. The principal risks confronting companies active in the sector include corruption in licensing processes, permit applications and the subcontracting of parts of a company's operations. Kenya is not a member of

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the Extractives Industry Transparency Initiative (EITI). There is a low level of information on payments to government and contract disclosure in comparison to some other oil-producing countries in sub-Saharan Africa.

In Kenya, specific risks also arise from the remote location of oil blocks, with companies frequently having to engage with local officials and communities in these areas. The development of infrastructure to serve the sector, including a key pipeline for export, has partially been delayed by security concerns, and will also present integrity risks, as outlined in the previous section. The Kenya Pipeline Company, a parastatal with which foreign companies may be required to interact, is another SOE where there have been serious allegations of corruption (The Standard 2018a).

Business anti-corruption initiatives in Kenya

While this Helpdesk answer has shown that the integrity risks across key sectors in Kenya are high, we also briefly highlight below anti-corruption activities which are of relevance to foreign investors.

First, there are initiatives led from within the private sector. Of particular note in this regard is the UN Global Compact Network, whose efforts have resulted in over 500 companies signing up to Code of Ethics for Business in Kenya. The code, which was developed with the Kenya Private Sector Alliance and Kenya Association of Manufacturers (KAM), commits companies to responsible business conduct and implementing an anti-corruption management programme. Signatories of the code include local subsidiaries of multinational businesses (Hapa Kenya 2016). In 2014, the UN Global Compact and KAM also released a report outlining four case studies of Kenyan businesses which had adopted compliance programmes. The businesses were AAR (a healthcare company), East African Breweries, Kapa Oil Refineries and Safaricom (UN Global Compact/KAM 2014).

Alongside these initiatives, the Kenyan government has made changes to the legal framework for corruption in the private sector, principally through the Kenya Bribery Act (2016), which came into force in January 2017. Influenced by the UK Bribery Act (2010), the act extended the bribery offence to apply to private entities in addition to individuals and public bodies. An important aspect of the act is that all public and private entities are required to have procedures in place for the prevention of bribery and corruption. It can also be an offence for a private entity to fail to prevent bribery. Individuals holding a position of authority in a private entity further have a duty to report knowledge or suspicion of bribery to the Kenya anti-corruption agency, the Ethics and Anti-Corruption Commission (EACC) within 24 hours (LexAfrica 2017). Although on paper the act includes strong measures, there are major doubts about the capacity and willingness of government to enforce the new law, as discussed earlier.

It is important to note that most foreign investors and businesses will be obligated to comply with anti-corruption laws in their home country while active in Kenya. Some laws, such as the US Foreign Corrupt Practice Act and UK Bribery Act, have broad extraterritorial application regardless of whether a company is headquartered in the UK or US. In practice, and as examples in the previous sections have shown, foreign businesses found to have committed offences in Kenya have generally been penalised under international rather than Kenyan law.

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Anti-corruption measures for businesses

Companies looking for guidance on how to manage integrity risks in their operations can draw on ample existing reference material. The following section briefly points to some of the most useful tools and documents for companies implementing anti-corruption measures.

GAN Integrity's Business Anti-Corruption Portal (2018) provides a good starting point for companies wishing to develop an internal compliance programme. The portal sets out eight elements to a successful compliance programme:

- the development of proportionate written policies and procedures, such as a code of conduct, and the implementation of internal controls
- top-level commitment from the company's senior management to show visible support for a company's compliance activities
- periodic and comprehensive risk assessment to identify the corruption risks affecting a company's operations
- oversight autonomy and resources, namely by investing an individual with responsibility for compliance and establishing a compliance oversight team
- due diligence on third parties, such as joint venture partners, agents, consultants and contractors
- communication and training on policies and procedures
- monitoring and review of the effectiveness of the compliance programme through reports to senior management
- establishing a whistleblowing channel to allow employees to report issues without fear of retaliation.

Alternative reference documents providing an overview of the core components of a compliance programme are Transparency International's Business Principles for Countering Bribery (2013) and the United Nations Global Compact Framework for Action for Businesses Against Corruption (2011).

More detailed guidance on specific anti-corruption mechanisms can be found in other documents. For example, on risk assessment, valuable publications include Transparency International's 2013a. Diagnosing Bribery Risk and the United Nations Global Compact's (2013) Guide for Anti-Corruption Risk Assessment. Free e-learning training courses are available on GAN Integrity's Business Anti-Corruption Portal (2018 a.) and the Transparency International (2018) website Doing Business Without Bribery. The World Economic Forum has also released Good Practice Guidelines on Conducting Third-Party Due Diligence (2013).

Many of these publications speak primarily to managing integrity risks in larger multinational companies. There is nonetheless additional guidance available for SMEs on developing compliance procedures proportionate to their operations. The Centre for International Private Enterprise's (2014) Anti-Corruption Compliance Guidance for Mid-Sized Companies in Emerging Markets is one such example. The International Chamber of Commerce (2015) has also released a guide for SMEs on conducting third-party due diligence.

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