TRANSACTION SERVICES

Kisumu, Kenya

Potential opportunities for investors
May 2008

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Our core fieldwork and research was performed between July 2007 and October 2007. We have noted the significant events since October 2007; however, we have not performed further fieldwork or detailed research.

Appropriate professional advice should be sought to undertake a more specific examination of the particular situation or circumstances applicable to a potential investor. Contact details of KPMG professionals who could assist in this regard are set out on the back cover.

Acknowledgments

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Foreword

As part of KPMG's Global Development Initiative, which focuses KPMG member firms' skills and resources on achieving the United Nations' Millennium Development Goals (MDGs), the UK working with the Kenyan firm was asked by the Millennium Cities Initiative (MCI) to undertake this report on the potential investment opportunities for investors in Kisumu, Kenya.

The MCI is an urban counterpart to the Millennium Villages Project and was set up in association with the UN Millennium Project by The Earth Institute at Columbia University. The initiative is focused on helping a selected number of mid-sized cities across sub-Saharan Africa to achieve the MDGs through economic development, with special attention to urban-rural linkages, including with the Millennium Villages.

This report, which explores the investment potential in and around Kisumu, Kenya, is the first of several that are being produced by KPMG's Transaction Services. It is an excellent example of how KPMG member firms and their people are committed to making a difference to the people in sub-Saharan Africa and is intended to complement the Kisumu Investors' Guide prepared by the MCI.

The fieldwork and research underpinning this report was performed before the December 2007 elections in Kenya. The events that followed the elections highlight the impact of inequality and poverty faced by a large proportion of the urban and rural population in Kenya and bring into perspective the importance of how socio-economic transformation and political reform can support long term stability and prosperity.

Investment in and around Kisumu can help drive the socio-economic transformation, and although investors may take a cautious approach in the short term, the relatively fast restoration of peace supports our belief that there is long term potential in this area.

To this extent, we hope this work will contribute to sustainable economic development and poverty reduction, and will help to secure the future of many thousands of families in the Kisumu region through productive investments and employment creation.

Lord Hastings of Scarisbrick CBE; KPMG International Global Head of Citizenship and Diversity

Professor Jeffrey D. Sachs, Director of The Earth Institute at Columbia University

MILLENNIUM CITIES INITIATIVE (MCI)
THE EARTH INSTITUTE AT COLUMBIA UNIVERSITY

The Millennium Cities Initiative (MCI) is a project of The Earth Institute at Columbia University. Launched by the Institute's Director, Professor Jeffrey D. Sachs, in 2006, MCI seeks to assist, through research and policy analysis, selected mid-sized cities across sub-Saharan Africa to achieve the Millennium Development Goals. Guided by its co-directors, Dr. Susan Blaustein and Dr. Karl P. Sauvant, MCI, more specifically, helps the cities involved to arrive at integrated City Development Strategies. Part of this effort is to demonstrate that more investment, including foreign direct investment, can be attracted to these cities, with the resulting employment and economic growth effects. The staff responsible for working with KPMG LLP (UK) on this report were Karl P. Sauvant, Co-Director of the MCI and Executive Director of the Columbia Program on International Investment, and Jörg Simon, Senior Investment Advisor of the MCI. For further information, please see http://www.earth.columbia.edu/mci/.

Executive summary

Introduction to Kisumu and its addressable markets

Kisumu's key strengths from an investment perspective include its location on Lake Victoria (Kenya) as a gateway to the land-locked countries of East Africa, a good environment for agriculture and a literate and well-educated population.

Approximately half a million people live in Kisumu and 10 million in the Kisumu region (Nyanza and Western provinces), accounting for approximately 27 percent of Kenya's population.

Investment opportunities

There are a number of potential investment opportunities driven by the region's natural strengths. Short to medium term opportunities primarily exist in commercialising farming, agro-processing and associated services.

Although the region has good quality soils, a favourable climate and two rainy seasons per year, current production of most crops and livestock is driven by the subsistence nature of farming.

Longer term opportunities include the broader service sector, e.g., tourism, retail, distribution and business process outsourcing.

Investment challenges

While Kisumu is perceived to generally enjoy better security and lower land costs than other parts of Kenya, investment challenges in relation to business administration, infrastructure and potential skills gaps still exist. We understand that a number of projects and initiatives are in the pipeline to address these challenges, but their timing has not been determined.

Obtaining land and the necessary business permits is one of the most significant hurdles a potential investor could face. The government has recently reduced the number of licenses required to operate a business and the recently opened Investment Promotions Office in Kisumu may also help reduce the burden of starting a business.

Poorly maintained and under-developed transport infrastructure combined with the poor availability and reliability of utilities results in increased operating costs and lower productivity, impacting the potential return on investment. Planned projects, such as the Kisumu Airport upgrade and trunk road improvements, should help the transport situation.

Although the region has a hard-working and educated workforce, there is a lack of essential formal vocational skills which investors will need to bridge, either through training or bringing in expatriate staff.

Competitive threat

Kisumu is likely to face increasing pressure from Ugandan and Tanzanian regions around the Lake Victoria Basin who enjoy much of the same natural strengths. These regions are now starting to enjoy a more conducive investment environment.

Kisumu may be able to capture the opportunities offered by its natural strengths if its issues and challenges are resolved quickly.

Contents

Overview

Kisumu's key strengths are its location as a gateway to land-locked East African countries, its favourable environment for agriculture and its well-educated population.

Key strengths and weaknesses

Kisumu is located in Nyanza province, on the shores of Lake Victoria, a gateway to a number of land-locked regions in east and central Africa.

There is a road and rail network linking Kisumu to Nairobi (Kenya's capital city) and to Mombasa (East Africa's main port). Lake Victoria, the second largest freshwater lake in the world, provides opportunities for fast and cost effective water transport to neighbouring countries, which are key markets for Kisumu. However, the poorly maintained and under-developed transport infrastructure presents some challenges to efficient movement of goods and people.

The Kisumu region, defined as Nyanza and Western provinces for the purposes of this report, accounts for about 4 percent of Kenya's total area.

Approximately 0.5 million people live in Kisumu and 10 million in the Kisumu region, accounting for approximately 27 percent of Kenya's population.

Despite high poverty levels, poor social infrastructure (such as lack of housing and sanitation) and a 'brain drain' of talent to Nairobi, the population is literate, well-educated and English speaking.

The region has fertile soils and a favourable climate suitable for a variety of crops and livestock. However, the smallholding land structure and subsistence nature of rain-fed farming has contributed to low production yields. Additionally, parts of the region are prone to flooding and droughts.

There is significant potential to commercialise the agricultural and livestock sectors including processing products within the region.

Kisumu was a prosperous regional centre but has experienced industrial and social decline over the last 30 years; however, economic activity has increased recently.

Pre-independence: 1963 and before

Development of Kisumu as a trading hub in East Africa.

- Transport infrastructure established to connect Kisumu to rest of Kenya and other East African countries;
- Railway established in 1901; and
- First airport in East Africa, established in the late 1930s.

Post independence growth: 1960s–1970

Period of strong economic growth, mirroring the growth phase of the Kenyan economy.

- Development of sugar, fishing, cotton and brewing industries;
- Population highly literate; and
- Health and poverty levels in line with Kenya as a whole.

Addressable markets

The region's prime location provides good access to large domestic and regional markets such as Uganda, Rwanda, Burundi and parts of Tanzania and the Democratic Republic of the Congo (DRC).

The addressable market can be segmented as follows, ordered by ease of access:

1 **The Kisumu region and part of the Rift Valley province:** Population of approximately 12 million. Source of primary product inputs for Kisumu-based industry.

2 **Lake Victoria Basin:** Population of approximately 26 million live around the lake shore in Kenya, Uganda and Tanzania. Potential water transport using Lake Victoria should provide good access to this market.

3 **Kenya:** Population of approximately 36 million. Goods transported primarily by road and rail network. Air freight should be possible after planned Kisumu Airport expansion.

4 **East African Community and part of DRC:** Population of approximately 148 million in Kenya, Tanzania, the land-locked countries of Uganda, Rwanda, Burundi, and the eastern part of DRC. Goods primarily transported by road. Lake transport should make these markets more accessible.

5 **Global:** Export goods from Kisumu to global markets in Europe, Asia and the Americas. Market accessed from the port of Mombasa or potentially directly from Kisumu Airport (needs international upgrade). Currently high transportation costs due to poor road and rail infrastructure, impacting the competitiveness of goods from the Kisumu region.

Post-independence decline: 1980s onwards

Exposure to international competition combined with under-investment in infrastructure causes decline in industrial activity.

- Trade liberalisation led to influx of cheap imports, exposing inefficiency of parastatal enterprises;
- Cotton collapsed and brewing industry left Kisumu;
- Uncompetitive sugar industry sustained through import tariffs; and
- Literacy levels fell due to increasing poverty with urbanisation becoming a significant problem.

Recent upturn

Privatisation of main sugar mill, alongside established large businesses such as United Millers, demonstrates that industry can succeed in the Kisumu region.

- Mumias Sugar producing sugar profitably;
- Re-investment from local business people and increased construction indicates that the local economy is picking up; and
- Kisumu hosts the headquarters of the Lake Victoria Basin Commission.

Future

Economic growth in the Kisumu region essential for Kenya to achieve the 'Vision 2030' plan.

- Plan calls for annual economic growth of 10 percent — focus on value addition in agricultural industries; and
- With the expected trade liberalisation through the East African Community, Kisumu is well placed to regain its status as a regional trading hub.

Kisumu's economy currently revolves around agriculture and retail; opportunities primarily exist in bringing agro-processing and associated services to the region.

Economic snapshot

The Kisumu region's economic value chain is largely driven by the primary products available locally. The region accounts for approximately 25 percent of Kenya's agricultural output from 4 percent of its area, although most processing is performed outside the region.

Current production of most crops and livestock is driven by the subsistence nature of farming; there is significant potential to increase and/or change the mix of produce.

The main industrial opportunities, bringing agro-processing and associated support services to the region, are dependent on improvements in the primary products sector. There are some opportunities, such as tourism, that depend on wider economic or environmental development in the region.

The state of the supporting infrastructure, while being a challenge to doing business, also presents some opportunities for investors with a longer term outlook.

The following sections present the opportunities by value chain sector and detail the state of the supporting infrastructure.

Primary products

The Kisumu region's economy is dominated by cultivation of primary products:
- Agriculture
- Livestock and fishing

Processing/industrial

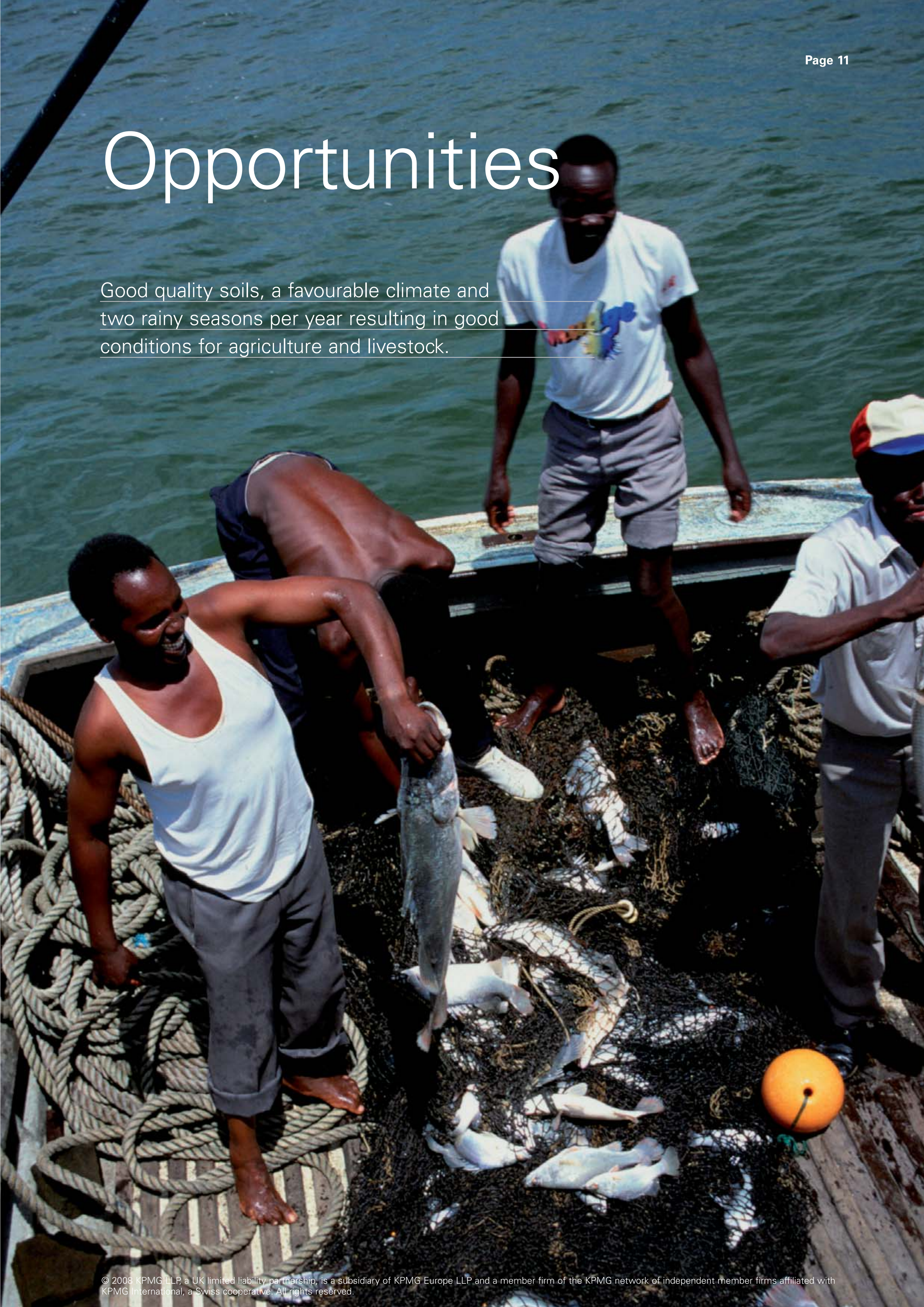
There is some processing of agricultural products, e.g.:
- Sugar
- Flour

Services

The service sector is under-developed with activities primarily in:
- Wholesale, distribution and retail
- Retail banking

SUPPORT INFRASTRUCTURE

Business support	Complex business, investment and regulatory environment
Transport and utilities	Under-developed and poorly maintained
People	Large pool of literate English speakers; however, skills gap and poor living conditions Largely informal sector workforce



Opportunities

Good quality soils, a favourable climate and two rainy seasons per year resulting in good conditions for agriculture and livestock.

Opportunities: primary products

A wide range of primary products are currently available in the region; opportunities exist to commercialise farming practices.

Kisumu has good quality soils, a favourable climate and two rainy seasons per year resulting in good conditions for agriculture and livestock, as highlighted below by the range of primary products available in the region.

Agricultural crops

Food crops: arrow roots, bambara nuts, beans, cassava, cow peas, finger millet, green grams, groundnuts, Irish potatoes, maize, rice, sorghum, soya beans, sweet potatoes, wheat.

Cash crops: coffee, cotton, oil palm, pyrethrum, simsim, sugarcane, sunflower, tea, tobacco.

Horticultural crops: cabbages, carrots, chillies, kale, onions, tomatoes.

Fruit: avocados, bananas, citrus (oranges and lemons), jack fruit, mangoes, papaya, passion fruits, pineapples.

Livestock and fish

Bees, cattle, chickens, donkeys, goats, guinea fowls, Nile perch, omena, ostriches, pigeons, quails, rabbits, sheep, tilapia.

Other resources

Copper, gold, limestone, materials for ceramics (e.g. kisii stone), rare earth minerals and niobium, rocks for construction (e.g., granite, tertiary lavas of phonolites and nephelinites), sustainable forests, water hyacinth.

Notes: Ordered alphabetically. See Appendix 1 for further detail on agricultural production

Agricultural crop production could be increased or the mix changed through farmer support, market creation and better land utilisation.

Land availability, usage and yields

The Kisumu region has approximately 1.6 million hectares of agricultural land. However, it is estimated that only 58 percent of the land is currently utilised.

The majority of farming in the lake basin region is subsistence driven leading to relatively low production volumes. Current crop yields are considered to be significantly lower than the potential afforded by soil and climate conditions.

Current low land utilisation and yields are driven by the lack of guaranteed markets and associated support services. An investor could stimulate farmers into increasing production by:

- **Providing a market for produce:** guaranteed outlet for farmers' products at fixed prices, thereby guaranteeing income and livelihood;
- **Increasing farm size:** aggregation of smallholding farms to gain scale and enable mechanisation; although tea and milk industries demonstrate farming can be efficient at smallholding scale;
- **Improving access to farm inputs:** provision of seeds, seedlings, fertiliser, agro-chemicals and credit;
- **Improving access to extension services:** land preparation support, delivery and collection services for smallholders, training and education with best practice farming techniques, research on improved crop varieties; and
- **Implementing man-made irrigation systems:** investment in irrigation to boost yields, although there are restrictions on use of lake basin water under the Nile Treaty.

Mix of products

A wide variety of produce is available locally, ranging from large quantities of sugarcane to small quantities of honey.

Highly fertile land and variations in temperature and rainfall across the region provides a suitable environment for a broad range of agricultural crops. There is further potential for new crop varieties or changing the mix of current produce, as demonstrated by the Millennium Villages Project.

Smallholder farmers are reported to be willing to switch crops if they are supported by the investor through:

- Provision of seeds and other extension services to initiate the new crops; and
- Guaranteed purchase of the new crop after harvesting.

Greater output and use of livestock and aquaculture provides further opportunities for investors.

Improve livestock farming

Like agriculture, livestock farming is currently performed primarily on a subsistence basis. Cattle are predominantly indigenous breeds with lower milk output than grade cattle.

Increased output of livestock and related products could be driven by improving the quality of and access to support services such as:

- Artificial insemination;
- Disease control;
- Commercial feed to enable zero-grazing; and
- Training and extension services.

Greater aquaculture activities

The Kenyan part of Lake Victoria covers approximately 0.4 million hectares (4,100 square kilometres), with 550 km of lake shoreline; most of this shoreline is under-utilised.

The long term sustainability of current fishing output in Lake Victoria is not clear. Increased aquaculture activities could result in greater output and variety of fish from the region while further supporting the farming and fishing communities.

In order to support aquaculture, investors would need to provide high quality fish feed, extension services and also establish guaranteed markets, which is critical in persuading farmers to invest in aquaculture.

Opportunities: processing/ industrial

The main industrial investment opportunities are based on processing local primary products for regional and international markets, driven by Kisumu's key competitive advantage of its large source of primary products and proximity to large end-markets.

Key opportunities for industrial investment utilising local produce are grouped in the following areas and examples are detailed on the following pages.

Utilising agricultural products

Currently, the main industries in the region are sugar production and grain milling, but historically the region also had a textile industry.

Improved agricultural output could enable industries such as edible oil manufacturing, juice extraction, fruit and vegetable canning and re-establishing the cotton ginneries.

Utilising livestock and fish

The region currently has some milk processing facilities, fish fillet processing and livestock slaughter houses.

A number of industries are possible, for example: re-establishing hide tanneries, fish processing beyond the current filleting, ice production for the fishing industry, increasing milk processing and feedstock production.

Utilising other resources

There are other industries in the region, for example, manufacturing household plastic goods, soft drink bottling, quarrying and some engineering, but most of these are small scale.

Investment opportunities appear to be more limited, mainly focused around utilising natural resources (e.g., cement from limestone, crafts or biodegradable plates from water hyacinth and boat building)

Sugar, electricity, ethanol (from sugarcane)

Investors are likely to find opportunities in the privatisation and refurbishment of the remaining parastatal sugar mills or construction of new mills with potential to:

- Improve sugar production by approximately 20 percent to 600,000 tonnes per year;
- Generate between 400–600 GWh of electricity per year (approximately 7–11 percent of total Kenyan demand) using bagasse (by-product from current sugarcane production) with the potential to utilise the Clean Development Mechanism (CDM) and trade CO_2 emissions; and
- Produce between 20–200 million litres of ethanol (depending on how much sugarcane is diverted from sugar production to ethanol production); which can be blended with petrol or used in other power/industrial applications.

This sector is critical to improving the state of the Kisumu region.

However, to fully utilise the potential from sugarcane, there are a number of issues that would need to be resolved:

- The Government would need to cancel debt to enable privatisation of the existing parastatal sugar mills;
- New entrants looking to build a sugar mill would require nucleus estates and agreements with smallholders to supply cane;
- Investors seeking to establish non-integrated processing of sugarcane by-products would need agreements with existing sugar mills to supply bagasse/molasses;
- Efficient electricity generation is likely to need a sugar mill with 200–300 tonnes cane crushed per hour capacity;
- Electricity generation would require a connection to the national grid and a purchase agreement to enable the sale of excess electricity; and
- If ethanol production is intended for use in transport, the Government would need to mandate blending of ethanol with petrol.

Fruit and vegetable juice or canning

There is potential to process locally grown fruit into juice e.g. passion fruits, tomatoes, pineapples and mangoes.

For example, approximately 5,000 tonnes of passion fruit is grown in the region, but there is potential to increase this to over 50,000 tonnes resulting in approximately 12,000 tonnes of passion fruit juice. Although there is a small processing facility in the region, it may not have sufficient scale or support for fruit juice export.

Investors have the option of refurbishing/reviving existing processing facilities or building new facilities. Additionally, investors would need to provide support to farmers, such as input and extension services, to encourage them to use land to grow fruit trees.

Edible oil and related products

Kenya imports approximately Ksh 12 billion of edible oil (sunflower, groundnut, maize, oil palm and cotton seed) annually.

Some oil crop trials have been conducted in the region, but there is potential to significantly increase production of oil crops and process them locally. However, the available capacity of the Bidco processing facility in Nakuru may make a local facility uncompetitive until there is sufficient production of input crops.

Investors would need to construct a modern processing facility, potentially with a nucleus estate, and provide support to farmers, such as input and extension services, to encourage them to use land to grow appropriate crops.

Aquaculture and fish processing

Existing processing facilities are dependent on lake fishing. The onus is to reduce the burden on Lake Victoria through the establishment of fish farms, as the sustainability of fishing levels is uncertain. Additionally, there is potential to utilise waste from fish fillet production to produce fish meal, fish oil and fish skins.

The requirements for successful aquaculture and fish processing are:

- Establishing fish ponds, both as part of a nucleus estate and in conjunction with local farmers;
- Providing collection services from farmers and existing fish processing plants; and
- Constructing modern cold storage and processing facilities.

Tanning and leather (cow hides)

Currently, hides and skins produced locally are transported to Nairobi for processing.

Approximately 6,000 tonnes of raw hides and skins are available in the Kisumu region annually which could be processed locally. Additionally, it may be possible to source hides and skins from the wider Lake Victoria Basin.

Investors would need to construct a new tannery and establish sourcing agreements, primarily with slaughter houses in the region, but also with individual farmers.

Cement (from limestone)

Cement can be produced locally, resulting in cost savings in transporting cement from other parts of Kenya into the region.

There is a limestone deposit, estimated to be 65 million tonnes, in the region which has yet to be exploited. Additionally, there are carbonatite deposits which could also be used for cement; however, they could first be developed for rare earth and niobium minerals. This could supply a small-scale cement plant with a production capacity of approximately 150,000 tonnes per year.

Investors would need to perform extraction feasibility and mineral composition studies and secure gypsum supply as it is not available locally.

Paper, pulp and building materials

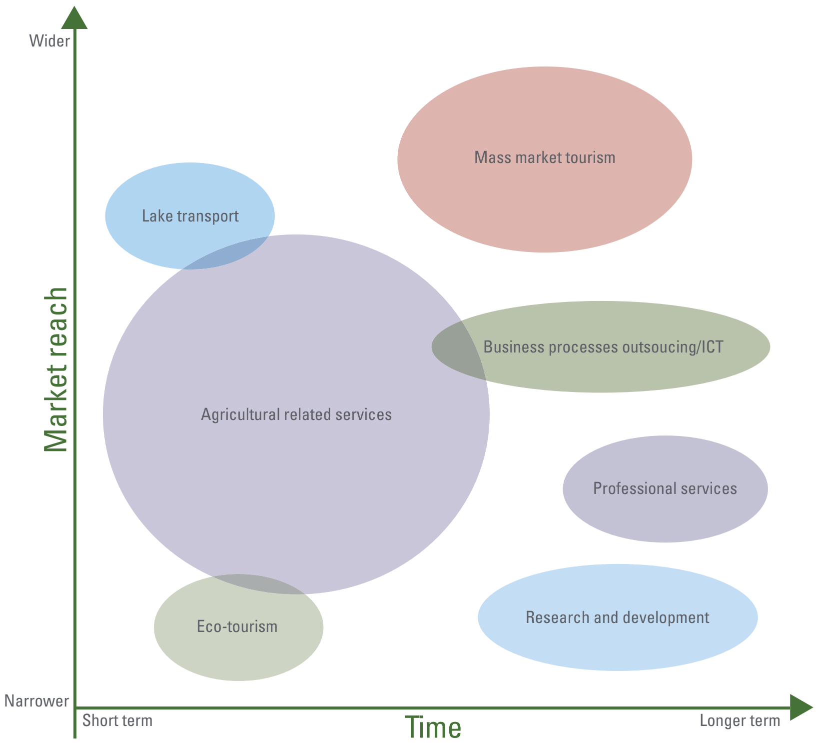
A shortage of building materials in the area means that these have to be brought in by road.

There is potential for investing in forestry, although this would be a long term investment due to the maturity period of trees and the need to secure large tracts of land. However, there is also potential to use forestry as a carbon sink.

Water hyacinth grows rapidly on the lake and is a major problem. It could be used for particle board manufacture, biodegradable plates and other products. Removal of this fast growing lake weed would have the added benefit of easing lake transportation problems and improving access for subsistence fishermen. Investors would need to secure agreement to harvest water hyacinth with local authorities and develop/supply harvesting equipment.

Opportunities: services

Development of the service sector in Kisumu could evolve from being focused on supporting the agricultural sector to wider offerings. These are likely to become more attractive in the longer term as the economy and environment improves.



Note: Indicative graphic

Source: KPMG LLP (UK), 2007

Service sector investment opportunities appear to be more limited than other sectors in the short to medium term due to the dependence on the region's economy and environment improving.

Short to medium term opportunities are likely to be focused around the region's core sectors (agriculture and livestock) e.g.:

- Tractor hire/land preparation;
- Machinery service and maintenance;
- Storage/silo facilities;
- Logistics and transportation/collection;
- High quality seed distribution and retailing;
- Feedstock distribution and retailing;
- Supply of irrigation systems; and
- Pest/disease control.

Other sectors such as eco-tourism and lake transport (people and/or freight) should be possible in the short to medium term. However, they will require improvements in the supporting infrastructure, such as dredging the lake and the construction of appropriate facilities.

Further development of Kisumu's industrial and export sector should lead to a greater requirement for broader support services in the longer term, such as:

- Professional services;
- Information, communication and technology (ICT) support;
- Business process outsourcing (BPO); and
- Research and development (primarily agricultural).

Tourism and conferences

The tourism industry, e.g., hotels/resorts and related activities and support services, is relatively underdeveloped.

Natural tourist attractions in the Kisumu region include:

- **Lake:** cruises, water sports, beaches, islands;
- **Kakamega:** Kenya's only rainforest with a diverse bird and butterfly population;
- **Mount Elgon:** Kenya's second highest mountain; and
- **Maasai Mara:** closer to Kisumu than Nairobi.

Over the past few years, there has been a shortage of hotel beds in Kisumu. This could come under further pressure as meetings and conferences of the East African Community begin to be held in Kisumu.

Developing the tourism potential in the region requires:

- Marketing of the Kisumu region by the Kenya Tourist Board;
- Cleaning up Kisumu's bay of pollutants, water hyacinth and the snail parasite to enable tourist use;
- Introducing regional/international flights into Kisumu Airport; and
- Improving roads in the region to enable fast transport to Mara and other attractions.

Wholesale/distribution

The development of Kisumu as a regional hub could result in increased freight volumes. There is potential for:

- Expansion and modernisation of the inland container port; and
- Wholesale, distribution and logistics services.

However, to encourage traffic through Kisumu, the transport infrastructure will need to be upgraded.

Retail

The local market is growing in size, although the poverty level limits scope for consumer facing opportunities in the short to medium term.

Retail opportunities should increase as economic growth drives consumer spending. However, development of lake transport is needed to tap into the wider catchment area.

BPO/ICT

There is potential for call centres and outsourcing services staffed by an educated, literate, English speaking population, on cheaper wages than Nairobi.

Realising this potential is dependent on:

- An upgraded telecommunications backbone;
- A reliable and high quality electricity supply;
- Training on specific processes and technology; and
- Initial demand from African businesses for outsourced services to demonstrate the capability to the global market.

Opportunities: investment entry options

There are a number of investors who have successfully set up in the Kisumu region, either through new ventures, joint ventures or acquisition.

The most suitable entry option is dependent on the opportunity area: for example, the most effective option for entering sugar milling could be through acquisition, whereas developing a specific food crop related opportunity may be realised most effectively through a new venture.

Potential investors should liaise with the Kenya Investment Authority and the MCI to progress specific opportunities.

Realising opportunities and overcoming challenges: Dominion Farms case study

Dominion Farms was set up in 2004 as a new venture in the Yala Swamp area to primarily produce rice for the local Kenyan market. The area shares many of the difficulties and potential of the Kisumu region and Kenya as a whole. Despite the tropical climate and abundant freshwater from Lake Victoria, 70 percent of the population lives on less than 50 cents a day.

Dominion Farms saw an opportunity to use the natural resources of the area to address a market need and improve the lives of the local population while making a good financial return. The company purchased a 45 year lease on a 6,900 hectare (17,050 acre) plot within the flood plain. The land is being converted primarily to rice paddies, although other products are planned, such as organic crops and fish farming. Initial crop testing suggested that 2.2 rice harvests per year are possible, more than twice the productivity of a comparable farm in the US.

The lease area had previously been run by an array of government and charitable bodies; however, it fell into disrepair and was disused. To rectify this, Dominion Farms has constructed a network of dams, dykes and roads, and due to the remoteness and isolation of the area, has also constructed water supplies, back-up power generation, a mill, drying and storage facilities and an airstrip.

The farm is predicted to break-even in 2008 and become profitable shortly thereafter producing 100,000 tons of rice annually for the Kenyan market (40 percent of Kenya's import demand) and 20,000 tons of farmed fish for the export market, as well as bio diesel and feedstock by-products. Alongside the commercial opportunities, Dominion is also constructing a youth centre, classrooms, public roads and medical clinics and its US$1.6 million annual payroll is estimated to have moved 50,000 people above the poverty line.

Investment entry options

New venture

Most industrial or agricultural opportunities could be addressed through new ventures. An example of an investor setting up a new agro-based business in the Kisumu region is Dominion Farms.

Joint venture/partnership

Some opportunities, where there is an existing business in the region, may be best addressed through a joint venture or partnership with a local company.

An example of this is the Kisumu Ethanol plant, owned by Energem Resources Inc of Canada and Spectre International, a local Kenyan business:

- The plant was refurbished and has the capacity to produce approximately 60,000 litres of potable ethanol per day; and
- Ethanol is sold into the Kenyan market and exported to neighbouring countries.

Acquisition/privatisation

A number of business, particularly in the sugar industry, are run as parastatals. Privatisation of these generally loss-making businesses could make them profitable.

An example of this is Mumias Sugar Company, which owns and runs the Mumias Sugar Mill. The mill was loss making as a parastatal but was turned around into profitability after privatisation.

Challenges

The cost and difficulty of starting a business in the Kisumu region, and more generally in Kenya, potentially impacts the commercial viability of opportunities.

Challenges: overview

Potential investors are likely to face challenges due to business support, infrastructure and people issues.

The cost and difficulty of starting a business in the Kisumu region, and more generally in Kenya, potentially impacts the commercial viability of opportunities. The current supporting infrastructure and business processes are not conducive to a flourishing investment environment.

However, despite a challenging environment, the region has a number of successful businesses such as United Millers, Dominion Farms and Mumias Sugar.

Challenges to starting and running a business in the Kisumu region

Starting a business
Key issues include:

- Acquiring suitable land;
- Obtaining business and work permits quickly;
- Building/plant construction;
- Sourcing/importing equipment;
- Finding appropriately skilled staff;
- Securing input materials, either locally sourced or imported; and
- Obtaining cost effective commercial finance.

Kisumu's advantages over other parts of Kenya include:

- Lower land and people costs; and
- Better security and lower crime historically.

Running a business
Key issues include:

- Transport costs;
- Availability and reliability of key utilities and services; and
- Workforce management and staff turnover due to poor health.

Kisumu's advantages over other parts of Kenya is its proximity and accessibility to key East African countries.

Challenges: business support

Starting a business efficiently is the most significant challenge facing potential investors, especially obtaining land and the necessary business permits. The Kenya Investment Authority opened an Investment Promotions Office in Kisumu during 2007, which should help reduce the burden of starting a business.

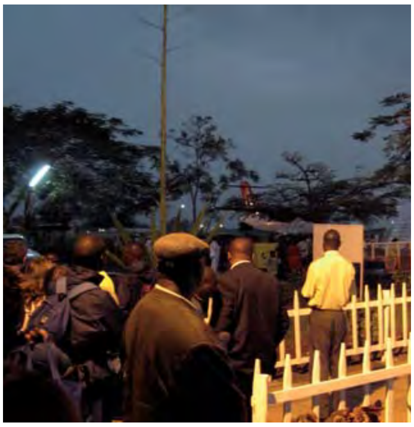
Land

There appears to be plenty of idle land (agricultural and industrial) available in and around Kisumu at cheaper rates than Nairobi. However, investors have to negotiate directly with private landowners which can be a time consuming and uncertain process. Ensuring legitimate title to land is particularly difficult as the land registry is not computerised.

Foreigners are not permitted to own agricultural land in Kenya; however, this is subject to presidential exception.

Potential investors should prioritise land acquisition/leasing early in their investment process.

The Kenya Investment Authority should consider acquiring unused land in and around key industrial areas of Kisumu for leasing to potential investors (as exemplified by the investment authority in Uganda).



Bureaucracy

A single business licence is required to start a company but approximately 30–50 other permits are typically needed in addition to the single licence.

In total, there are over 1,300 licences in existence with varying processes for obtaining them, adding to the uncertainty in business start-up timings; approximately half of these are administered by local authorities.

Another example of the difficulty in starting a business in the Kisumu region is that key actions, such as registering a business name, have to be completed in Nairobi.

Investors should seek professional assistance in understanding and commencing the licensing requirements early in their investment process.

The Government of Kenya should continue with its commitment to eliminate or simplify 800 business licences (approximately 350 completed to date).

Work permits

Expatriate employees are often necessary to plug the skills gap and provide management expertise. However, an unclear and inconsistent process to obtain permits combined with limited availability poses a serious problem for potential investors.

An estimated 6,500 expatriate work permits are in operation annually, of which 2,500 are new or renewed annually. This is a key limiting factor as many permits are already assigned to existing businesses.

The official cost per permit is Ksh 200,000 for two years, although in practice there are additional costs, understood to be facilitation costs.

Investors should carefully plan staffing requirements to ensure the appropriate number of work permits are obtained.

The Government of Kenya should reform its work permits policy in line with best practice countries.

Hurdles and opposition

Investors may find opposition, interference and hurdles, for example due to environmental concerns, from a variety of local people, groups and organisations.

Marketing the benefits of the investment and getting support from government and community leaders is likely to be an important driver of success.

Challenges: infrastructure

Poorly maintained and under-developed transport infrastructure presents a financial and logistical challenge to businesses. Transportation costs are estimated to be two to three times more than in developed countries.

Roads

Roads are currently the main method of transporting goods in, out of and around the Kisumu region. However, main and feeder roads are poorly maintained, leading to higher business costs through longer journey times and increased vehicle maintenance.

Additionally, the poor road infrastructure results in difficulties for farmers to get goods to market in time.

It is understood that the government has plans to improve the road infrastructure in Kenya generally; however, there is uncertainty over timing and scale of the programme.

There is potential to invest in road construction, maintenance and toll operation.

Rail

The railway in Kenya is operated under concession by South African Rift Valley Railways (RVR), which is responsible for investing in infrastructure and services.

The Kisumu-Nakuru branch line provides links to Nairobi and Mombasa. However, light axle load line limits freight capacity between Kisumu and Nakuru, thereby increasing freight costs.

Upgrade costs are substantial as over 20 bridges are too weak to support larger trains and approximately 160km of the line needs upgrading.

Upgrading bridges and the line on the Kisumu to Nakuru route is needed to provide increased capacity into the Kisumu region. However, public/donor funding may be necessary as RVR is focusing investment on more profitable routes.

There is potential for long term investment in the railway infrastructure. Interested investors should liaise with the Kenya Investment Authority and Kenya Railways to gain a more detailed understanding of the opportunities.

Air

Kisumu Airport has eight daily passenger flights between Kisumu and Nairobi. The domestic-only airport, however, has very limited cargo capacity due to a short runway and small terminal building.

It is understood that the Government has plans to upgrade the airport. The Ksh 2.6 billion World Bank-financed expansion of Kisumu airport is scheduled to start in the second half of 2008 to provide a longer runway and reconstruction of the terminal building.

There are no plans to make Kisumu Airport international. Investors requiring direct international air transport from the airport should liaise with the Ministry of Transport to understand the future possibility of providing international services.

Lake

Kisumu Port is managed by Kenya Railways with one railway wagon ferry operated by RVR between Kisumu and Mwanza (Tanzania).

However, infrequent lake transport and the lack of container port facilities limit the ability for businesses to use the lake. Additionally, the low water level by the port restricts the size of boat able to access the port.

KPMG is not aware of any plans to improve the condition of the lake for transport. However, to fully utilise the lake's potential, improvements such as dredging, water hyacinth removal and lake surveying will be needed. This would improve the potential in container port construction/ maintenance/ operation and lake cargo services.

Electricity

The cost and reliability of electricity significantly impacts business operation. Businesses are effectively forced to install expensive back-up diesel or fuel oil generators to ensure continuity of operations. Additionally, obtaining an electricity connection, especially in more rural locations, can be a difficult and lengthy process.

The Sondu/Miriu hydro-power station should improve the situation by providing approximately 330 GWh annually.

By using bagasse (waste from sugarcane processing) cogeneration, the region's current additional power requirements could be met. Additionally, bagasse generated electricity would complement hydro-power as the two are counter cyclical.

Potential investors, especially those with high expected power usage, should investigate the availability and reliability of electricity in the proposed location to understand cost and operational implications.

Water/sewage

Although improvements in the availability of water and sewerage services are underway by KIWASCO (Kisumu Water and Sewerage Company), the current situation is contributing to the poor state of the region's human capital.

Investors may need to investigate obtaining water from boreholes if an adequate supply is not available in the proposed location.

Telecoms

The fixed line telecoms infrastructure is basic, although internet connectivity is available.

However, mobile phone network coverage, including GPRS, is relatively good throughout the region, although call quality and data rates are of variable quality.

KPMG understands that there are plans to lay an internet backbone cable from Nairobi to Kisumu. However, KPMG is not aware of the technical details or progress of the project.

Potential investors with heavy telecoms requirements should further investigate the availability, suitability and cost of telecoms connectivity in the region. Given the current structure of the telecoms industry in Kenya, the investment opportunities appear to be limited.

Poor availability and reliability of utilities results in increased operating costs and lower productivity.

Challenges: people

The region has a hard-working and highly educated workforce. However, there is a lack of essential formal vocational skills.

Education and capability

There are large numbers of well-educated, literate, English speaking unemployed people in the area. However, local business reports a lack of technical and professional skills such as carpentry, engineering, architecture and accountancy.

A restrictive work permit scheme (see earlier) makes it hard to employ expatriates to fill the skills gap in the short term.

The people in the region may not be as entrepreneurial, commercial or driven as other parts of Kenya and this appears to have contributed towards the subsistence nature of farming. Additionally, a lack of technical farming know-how has resulted in reduced levels of agricultural productivity

Investors will need to either provide appropriate training to local people or obtain work permits for expatriate staff for certain key management or functional positions.

Investors in the agricultural sector will need to provide education/training services to ensure farmers have sufficient support to increase land utilisation and yields. This creates investment opportunities in technical education and training.

Health

High poverty rates and the resulting disease burden depletes human capital and damages labour productivity.

Investors should aim to provide health services and support for staff to ensure health issues do not impact staff productivity and turnover.

Housing

There is a lack of available low-cost housing adding to social and health problems in the region.

Investors may need to provide appropriate housing for staff, especially if the business location is outside Kisumu. This could help reduce health problems, resulting in better productivity and staff morale.

Constructing and providing low cost housing, either as a managed service to businesses or for sale to the general public, is an opportunity for investors.

Competitive threat

Kisumu's opportunity to become a leading trading hub in East Africa is under threat from some of Kenya's neighbours.

There is a risk that trade and industry bypasses western Kenya, as there is currently a more conducive investment environment in Uganda and a rapidly improving investment environment in Tanzania. Additionally, local industrial opportunities are currently being captured by Nairobi or Nakuru. Kisumu may be able to capture these opportunities.

Kisumu's development is key to achieving Kenya's Vision 2030 …

The Kisumu region is a high potential area, strategically located on Lake Victoria, with a sizable natural resource endowment and the ability to become a regional industrial and trading hub.

Development of the Kisumu region is considered to be crucial if the country is to reach the growth targets of Vision 2030: sustained economic growth of 10 percent per annum.

Additionally, if greater investment does not start flowing into the region, there is significant risk that the social and environmental impact will continue to worsen.

… but advantages of the region could be lost to neighbouring countries

Other regions around Lake Victoria in Tanzania and Uganda have the potential to surpass Kisumu due to their improving investment environment.

Uganda

Ugandan authorities encourage new business through a one-stop investment authority which:

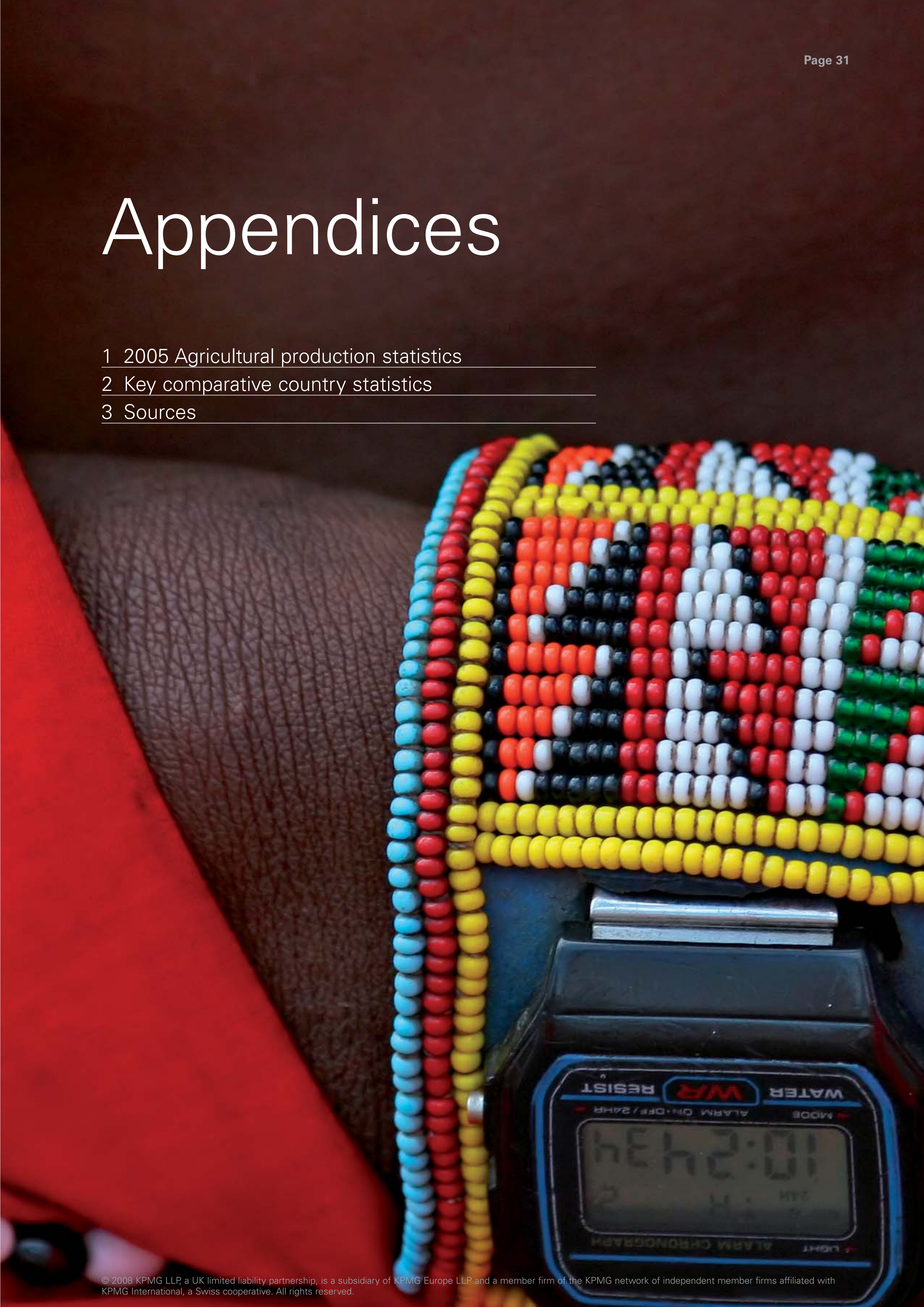
- Grants land and work permits to investors; and
- Offers tax incentives and subsidies.

Recent investments in Uganda show that the environment appears to be more investment-friendly then Kenya.

For example, Bidco (a manufacturer of edible oils, fats and hygiene products) tried to set up a palm oil plantation in the Kisumu region but was forced to look elsewhere after facing hurdles and opposition; it ended up realising the opportunity in Uganda.

Tanzania

There is potential for Mwanza in Tanzania to challenge Kisumu if transport infrastructure linking it with Dar es Salaam is improved. Dar es Salaam is the second largest port in East Africa and Mwanza is the second largest city in Tanzania.



Appendices

Appendix 1: 2005 agricultural production statistics

	Production (000 tonnes)	Area under cultivation (000 hectares)	Yield (tonnes/hectare)
Food crops			
Maize	927	459	2
Cassava	518	44	12
Sweet potatoes	456	43	11
Beans	174	296	1
Sorghum	74	59	1
Irish potatoes	41	3	16
Finger millet	20	27	1
Rice	13	5	3
Cow peas	12	9	1
Groundnuts	11	19	1
Arrow roots	7	1	13
Soya beans	2	3	1
Greengrams	2	4	1
Wheat	1	1	1
Bambara nuts	<1	<1	<1
Industrial crops			
Sugarcane	5,627	98	57
Tea	151	20	8
Tobacco	18	13	1
Coffee	11	6	2
Cotton	5	8	1
Sunflower	5	4	1
Oil palm	<1	<1	5
Pyrethrum	<1	<1	<1
Simsim	<1	<1	<1
Horticultural crops			
Kale	179	14	13
Tomatoes	149	8	18
Cabbages	52	3	19
Onions	35	3	12
Local vegetables	23	11	2
Chillis	2	<1	5
Carrots	<1	<1	5
Fruit			
Bananas	644	35	18
Pineapples	78	5	16
Avocado	28	2	14
Mangoes	23	3	7
Pawpaws	20	2	10
Citrus (oranges and lemons)	5	1	5
Passion fruits	5	1	4
Jack Fruit	<1	<1	11

Note: Reliable and consistent data on 2006 and 2007 statistics was unavailable during our fieldwork. Production volumes vary by year and potential investors should seek the most recent information before developing a specific investment opportunity.
Sources: Nyanza Provincial Commissioner's Office, Western Provincial Commissioner's Office, Ministry of Agriculture, KPMG analysis 2007

Appendix 2: Kenya — key comparative statistics

Kenya compared with the broader East African market(a)

	GDP 2006 estimate (US$ billion) [b]	Population July 2007 estimate (millions)	Literacy [c] (percentage of 15+)
Sudan	25.5	39.4	61%
Kenya	17.4	36.9	85%
Ethiopia	13.3	76.5	43%
Tanzania	13.1	39.4	69%
Uganda	8.5	30.3	67%
DRC	8.0	65.8	66%
Somalia	2.5	9.1	38%
Rwanda	2.0	9.9	70%
Burundi	0.8	8.4	59%

Notes

(a) All information from the same source for comparative purposes.
(b) GDP does not include informal sector output.
(c) Various dates, all post 2000.

Source: CIA, *The World Factbook*, 16 August 2007

Kenya is part of the East African Community (EAC), and has preferential access to the Common Market for Eastern and Southern Africa (COMESA), the EU market and also to the US market for a number of products through the African Growth and Opportunity Act (AGOA).

The official languages of Kenya are Kiswahili and English.

Appendix 3: Sources

The primary sources of information have been the interviews conducted in Kenya (see Acknowledgments). The interviewees cover a wide range of organisations from international through to local businesses and across a number of sectors including financial, industrial, infrastructure and government.

Actis, Agro-Chemical & Food Company, Barclays Bank, British High Commission, Cameco (Caneland Ltd), Cedar Investment Group International, CFC Bank, Channan Agricultural Company, Commercial Bank of Africa, Department for International Development, Dominion Farms, Homa Lime, Imperial Hotel, Kenya Investment Authority, Kenya Railways, Ministry of Agriculture, Ministry of Trade and Industry, Ministry of Transport, Nyanza Provincial Commissioner's Office, Oraro & Company, Rift Valley Railways, Rotary Club of Kisumu, Sojpar, Strategic Consultants, The MDG Centre, The Millennium Villages Project, United Millers Limited and Western Provincial Commissioner's Office.

In addition, the following publicly available sources were consulted:

- Ministry of Agriculture, various publications
- Ministry of Trade and Industry, various publications
- Nyanza Provincial Commissioners Office, various publications
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