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Strategy

**Influence of International physical factors (FDI) and
competitiveness (Flower exports)**

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Influence of International physical factors (FDI) and competitiveness (Flower exports)

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Abstract

Purpose: The main purpose of the study was to establish the influence of International physical factors (FDI) on the competitiveness (Flower exports). Therefore, the main research question is how does International physical factors (FDI) influence competitiveness?

Methodology: The study has used value chain analysis and the Dual Double Diamond Models to assess the competitiveness of the sector in Kenya. Data was obtained from sector association reports, research publications and the World Bank Doing Business Reports.

Results: The study found out that International physical factor (FDI) has a positive and significant effect on competitiveness.

Unique contribution to practice and policy: Based on the findings, the study recommends The FDI policy should target attracting investments that provide an upgrade of the current activities performed in the flower value chain. This way, the incoming investors will help develop and enhance the value of the activities carried out by local firms. They will also bring in new technology that will be used in the upgrading activities.

Keywords: *International physical factor, FDI, Competitiveness, value chain analysis*

1.0 INTRODUCTION

1.1 Background and Research Gap

Kenya has been Africa's top producer and exporter of cut flowers commanding a 39% share of the EU market. Others are: Zimbabwe (5%), Uganda (3%), South Africa (2%), Zambia (2%), Ethiopia (1%), and Tanzania (1%) (Comtrade, 2007). More recent data indicate that Kenya's command of the EU cut flower market has dropped to 31% whereas Ethiopia's has risen to 12% indicating that the lead by Kenya is narrowing (DuRoy, 2014). **Figure 1** shows leading African flower exporters to Europe.

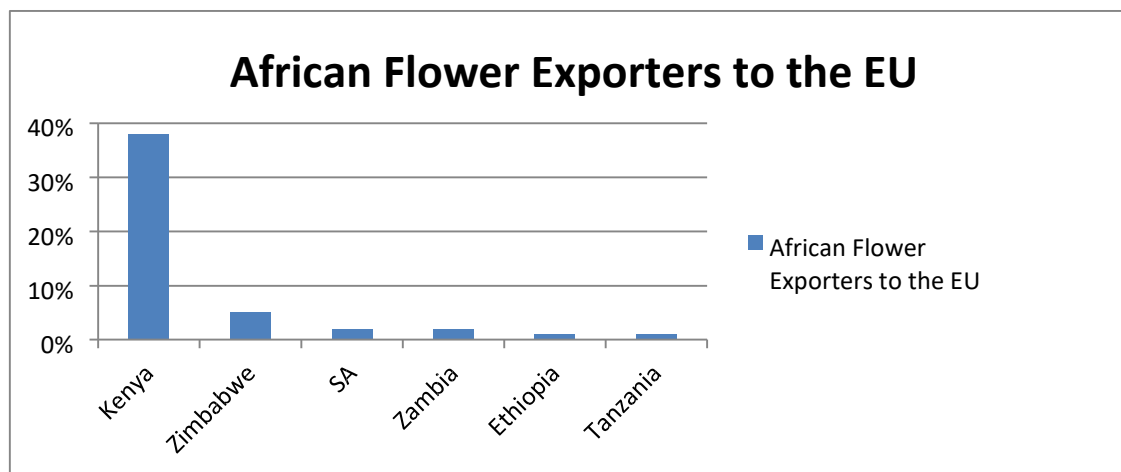


Figure 1: African Flower Exporters to EU (Source: EUROSTAT Database, 2007)

Globally, Kenya has been a top exporter of flowers to Europe as the data for 2001 to 2011 (Comtrade /EC, 2012). The flower industry has been a key contributor to economic growth in Kenya. The industry is the number two foreign exchange earner for the country. In the year 2007, flower export earnings amounted to US\$573m, a growth of 79% over the year 2006 figures (Kenya Flower Council, 2007). In terms of weight, the industry exported a total of 90,000 tons of cut flowers in the year 2007. In year 2008, exports dropped sharply by 16%. In 2009 there was another drop of 3% from the 2008. The decline coincided with the period of the global economic crisis. However, since the year 2010, there is some recovery with an average annual growth of 4.85% to 2015 to reach US\$615 million.

According to Popovici and Calin, (2015), there is a two-way relationship between competitiveness and FDI inflows. An increase in competitiveness improves FDI inflows. On the other hand, increased FDI inflows will enhance competitiveness in terms of increased investments and transfer of technology. Similarly, in Rovcanin (2007), it is said that FDIs bring in capital, new technology, skills and assist in market access. Foreign firms are more export intensive than local and they are more productive and pay higher wages. Related to this, it has been argued that multinational corporations do help a country enhance its own competitiveness through incoming foreign direct investments (Kim, 2006). However, in Porter (1990), it is felt that inward FDIs are not a source

of competitiveness for the country but outward FDIs by homebased firms supports national competitiveness. Another argument is that the benefits of FDIs are not automatic. They are likely to lead to income inequalities in a society, crowd-out local capabilities, and erode tax base, labor and environmental standards (Rovcanin, 2007). Despite these reservations, it is accepted that foreign direct investments help the country to be more competitive. They bring in additional capital, technology and skills. A country should try to create an environment attractive to multinational corporations (Kim, 2006). The policy framework for FDI needs to focus on attracting inflows and secondly ensuring that the inflows do benefit the economy.

What then are the policies that will attract foreign direct investments to a country? In relation to Singapore, Yew (2000) discusses the role of government in attracting foreign direct investment. The government in Singapore developed infrastructure and also provided well planned industrial estates and in addition allowed for equity participation of locals in industries. Investors were also given fiscal incentives in terms of tax exemptions. They were also supported with export promotions, good labor relations and a sound macroeconomic policy framework. A one-stop center was created to provide information to investors and an aggressive marketing campaign was mounted to inform investors about Singapore and where to find it. Finally, the government embarked on building an international financial center which linked the country to the global financial markets.

As for Ireland, Rovcanin (2007) provides details about what the country did to attract foreign direct investments. Ireland, like Singapore also put effort on aggressive marketing through telephone, visits and presentations. They also provided research data on opportunities available in Ireland for investment. They provided grants covering part of the investors' capital expenditure. Fiscal incentives in terms of tax holidays were offered in addition to building a sound macroeconomic policy framework. Skill and infrastructure upgrading and the provision of land and industrial parks for investors were given priority.

In relation to Kenya, Njoroge and Oketch (2011) discuss some of the factors that affect the country's ability to attract investors into the flower sector. Apart from the natural factors such as a favorable climate, proximity to the European markets and the entrepreneurial spirit of the people, the private sector through the Kenya Flower Council works hard towards improvement of standards and best practices in order to make the country a viable destination for investments in the flower sector. The paper is however, silent about what the Kenya government has done to attract foreign direct investments but details a number of failures like: poor infrastructure (roads and communication), cumbersome regulatory framework (bureaucratic and multiple screening and approval systems), unfavorable labor laws and trade union activity, inadequate policy framework for fair competition, among others.

As a country formulates and implements policies to attract FDI, there is need to ensure that the country and indeed local businesses do benefit from the foreign direct investments and not just the foreign firms that reap the advantages. Melese and Helmsing (2010) in their paper on the contribution of Dutch FDI, Dutch auction market and Dutch aid, have raised a question as to whether these three areas of foreign activity are likely to develop into a Dutch enclave in the sector or they will develop into a process of building local capabilities (indigenization). In relation to

Dutch FDI in Ethiopia, it is felt that whether the Ethiopian local firms will benefit from Dutch FDI depends on their interest and ability to take up the opportunities that arise.

1.2 Statement of the Problem

National competitiveness is a key objective for Kenya as a nation. It is one of the main pillars of the country's vision 2030. The Vision 2030 document of the Government of Kenya spells out the country's intention to become a globally competitive, prosperous and industrialized middle income nation with a high quality of life by 2030. The vision has recognized the importance of a sector focus in the drive towards national competitiveness and growth. Indeed it will be difficult to attain national competitiveness without achieving sector/industry competitiveness (Porter, 1990). A key sector that could play a major role in achieving the vision is floriculture because of its importance to the economy. To-date, floriculture has been a pillar of the country's economy (Ebreyesus & Sonobe, 2009).

However, allegations emerged that cast a doubt as to the continued good performance of the sector. Press statements and pronouncements by respected industry stakeholders intimated that the sector is losing its competitiveness and that investors in it are shipping out to other countries. For example, Erastus Mureithi, who is a past chairman of the Kenya Flower Council, was quoted as saying that Kenya is losing out to Ethiopia in terms of attracting investors to the sector (The East African, 2005). Dick Evans, a former director of Homegrown, a major flower producer in Kenya, was also quoted in the same publication as indicating the company's intention to shift its activities from Kenya to other countries such as Ethiopia, Uganda and Tanzania. Related to this, an item on the BBC news on May 25th, 2006, quoted some European flower farmers in the Naivasha area of Kenya saying that they wished to shift out of the country for various reasons. One of the reasons given for this trend was that the operating environment in Kenya was not favorable. These statements conveyed a message of a possible decline in competitiveness of the flower sector in Kenya. If indeed it is true that investors are leaving the sector and the country, it means that the country is losing its attractiveness as an investment destination for flower investors which will in turn affect the country's foreign currency earnings from flower exports, employment will be lost and the economy will decline (World Bank, 2007)

For the government to take action and stem this alleged trend of loss of competitiveness, it requires information. There is need for detailed research to establish the truth about the decline in competitiveness and provide accurate information on the same. Therefore this study set out to establish the real situation on the ground in terms of whether the sector was actually declining in competitiveness. The study also set out to establish the influence of International physical factors (FDI) on competitiveness (Flower exports) Kenya.

1.3 Objective of the Study

The objective of this study was to examine the influence of International physical factors (FDI) on competitiveness (Flower exports) Kenya.

2.0 METHODOLOGY OF THE STUDY

This is an explanatory study which sought to understand the level of competitiveness of the flower sector in Kenya and recommend how it could be improved. Using a deductive approach, it applied the DDD and Value Chain Analysis models in reaching the desired conclusions. The techniques

used in the analysis were both qualitative and quantitative. The qualitative and quantitative data were collected from primary sources using questionnaires. Secondary sources of data were also tapped to form the basis for the theoretical analyses as well as supplementing primary data analyses and discussions for triangulation. The qualitative features of this study focused on surveys including face-to-face interviews to collect data as well as the study of peer reviewed journals and books. The quantitative aspects involved use of statistical tools to analyze measures in terms of financial costs, time requirements and scaling. The research culminated into conclusions regarding the competitiveness of Kenya's flower sector and generated various policy recommendations to enhance performance of the sector.

The study population consisted of actors in the flower sector value chain in Kenya and abroad such as sector associations, transporters, flower farms, seed producers, retailers in Europe, the government agencies, non-governmental organizations (NGO), banks, insurance companies and post-harvest support organizations. A list of forty nine flower farmers, who are members of the Kenya Flower Council and another of the two hundred and ten registered with the Horticultural Crops Development Authority (HCDA), were used. The total sample size selected was 97 respondents grouped according to the roles they play in the flower sector. This included 47 growers, 3 regulators and researchers, 1 transporter, 1 ministry, 2 NGOs, the two sector associations, three banks, three insurance companies and two post-harvest support organizations. In selecting the size of the sample, the study was guided by Roscoe's Rule of Thumb as quoted by (Sekaran, 2003) which states that a sample size of 30 or more and less than 500 is appropriate for most studies.

Both hard and soft data from primary and secondary sources was duly collected. Hard data was obtained through the analysis of records, databases, reports and publications from the Ministry of Agriculture, Kenya Flower Council, the Horticultural Crops Development Authority of Kenya (HCDA), the Central Bank of Kenya, Kenya National Bureau of Statistics and other authors. Soft data was collected through surveys by use of questionnaires and face to face interviews with the guide of structured interview protocols.

2.1 Domestic Physical Factors

Flower farming is mainly for the export market and therefore the availability of international physical factors is necessary. In this section the study selected two factors to proxy for the international physical factors. These were; the inflow of foreign direct investments (FDI) into the flower sector; and the international network linkages.

FDI inflow is assessed in terms of actual money inflows into the country to support the flower sector. In addition, FDI inflows help to develop local capability through infusion of management skills and introduction of new technology for flower production. With more investment in the sector comes more growth and competitiveness.

The international network linkages flower farmers have to outside buyers and suppliers are very crucial in flower business as it guarantees access to the markets and technical support to improve skills and quality. They are linked to flower buyers as well as the owners of seed franchises. Given the foregoing discussions, we now develop hypotheses using Foreign Direct Investments (FDI) as a proxy for International Physical Factors:

Ho: There is no relationship between International Physical factors (FDI) and Competitiveness (Flower Exports)

Ha: There is a relationship between International Physical factors (FDI) and Competitiveness (Flower Exports)

3.0 RESULTS OF THE STUDY

3.1 Flower Sales to the Market

This section examined the market options available to the Kenyan flower farmers in the value chain in terms of which particular market a farmer sells their product or service. The focus of the question is more on how important that market is perceived to be to the farmer. Various options were generated in terms of flower destinations and the respondents were asked to rank these destinations in terms of importance. The ranking is based on a 7 point Likert scale whereby 1 is for least important and 7 most important. The results in terms of means have been portrayed on the pie chart, **Figure 2**. These results as indicated in the bar chart show that the Dutch auction market has the highest share with a mean of 6.27 followed by EU supermarkets with 5.22 and UK supermarkets 5, while the least significant market outlet is China with a mean of 3.00. Europe has been a major destination of Kenya's flowers and according to the Kenya Flower Council, the country commands upwards of 25% of the market share of the region. However, given recent economic events in Europe and with the emergence of China and the Middle East, the industry must redirect its marketing strategies elsewhere for growth. Japan and USA are also untapped markets and with the expected initiation of direct flights from Nairobi to these destinations, an opportunity is now available to tap them.

It is clear that inspite of the effort by the Kenya flower exporters to seek markets elsewhere, Europe is going to be a major destination for a long time to come. According to Rikken (2011), the top three destinations for Kenyan flowers are The Netherlands, United Kingdom and Germany which together, account for 88% of the country's flower exports. However, to sustain presence in this market, Kenyan flower exporters have had to join various accreditation bodies in order to raise their social and environmental standards (Leipold & Morgante, 2013).

In terms of actual flower export percentages to the various markets, the ITC Trade Map (2010) has given the following figures indicated in **Table 1**:

Table 1: Destination for various Kenya flower products

Destination	Cut Rose Exports	Other Flower exports
Netherlands	77%	61%
UK Supermarkets	8%	24%
Germany	4%	5%
Russia	2%	2%
Other	9%	8%

Source: ITC Trade Map 2010(www.intracem.org)

There are definitely some differences between the information obtained through research and what is reported by the ITC Trade Map in **Table 1**. First of all the farmers were asked about the markets they consider important both for now and the future. According to farmers, they see Europe, China and Dubai taking more of Kenyan flowers compared to the UK supermarkets.

Secondly, farmers were asked if they produce for others to export (sub-contracting). To the farmers, this was a potential market that was not fully exploited. Thirdly, there was some bias in the study sampling as the field work focused on the farms that were willing to give information. Many of the foreign partners for the local farms are difficult to access for data. For this research, Russia is part of the EU.

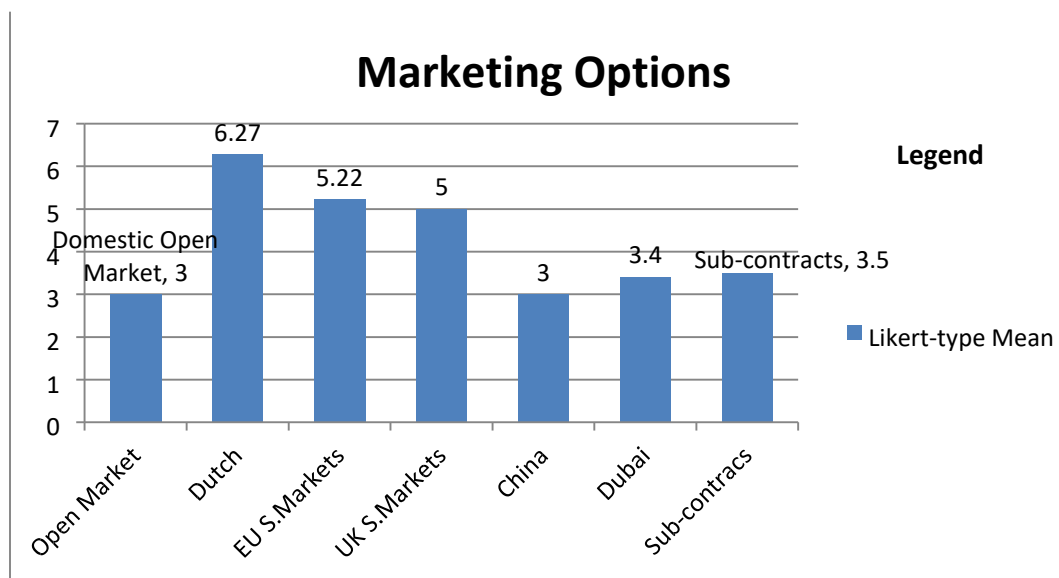


Figure 2: Destination Markets for Kenya Flower Sales

3.2 Emerging Markets

The question directed to the respondents is about the emerging flower markets. This question was designed to establish the respondents' perceptions as to which markets were seen as emerging and with potential for Kenya's flower industry's future growth. Options were generated and presented to the respondents using a 7-point Likert scale with 1 representing low potential and 7 representing a high potential. **Figure 3** shows the findings and Japan emerged as the highest ranked emerging market with a mean of 4.67 and standard deviation of 0.723. The next highly ranked emerging market was the Middle East and Russia with similar means of 3.67 and standard deviations of 0.875 and 0.103 respectively. Prospects for the Middle East emerging as a top flower market for Kenya are high due to its proximity and economic growth potential. Russia as well has potential but it is far and flight connections to Moscow are complicated. The lowest ranked emerging market was Australia with a mean of 2.50 perhaps due to the very long distance involved in reaching the country. In addition, there are no direct flights from Nairobi to Australia.

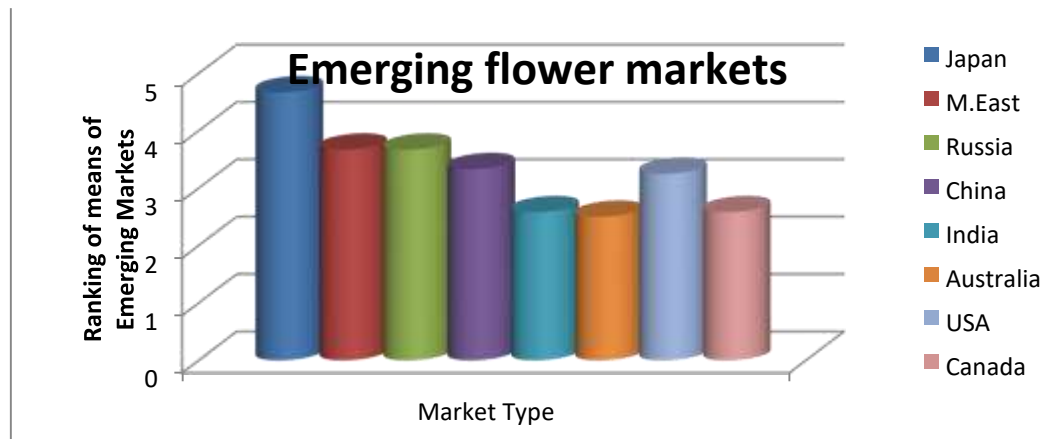


Figure 3: Ranking of Emerging Markets

3.3 Market Competition

To assess the market competition a 7-point Likert scale with 1 representing very low and 7 representing very high. Here the respondents were asked to indicate who they consider to be their main competitors in the flower market. The question required each respondent to indicate where they felt the most competition to their business as flower exporters is coming from. From the results of **Figure 4**, the highest level of competition was deemed to come from Ethiopia with a mean of 5.17 and standard deviation of 0.749 while fellow Kenyan farmers provided stiff competition with a mean of 5.00. The least competition emerged from Uganda and Tanzania with means of 2.08 and 2.09 respectively. Therefore for the average Kenyan flower farmer and exporter, the highest threat to their market share is expected from the farmers in Ethiopia. The challenge is to know why and what should be done to stem this competition.

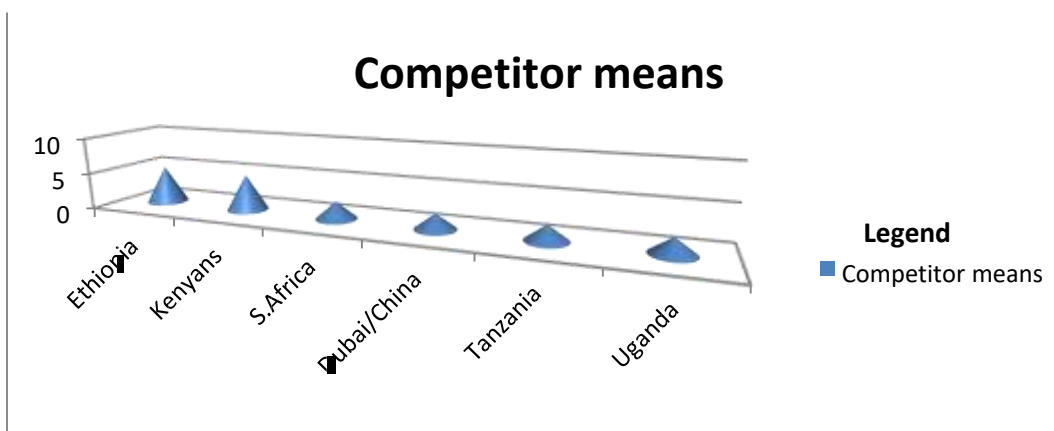


Figure 4: Competition on the Flower Market

3.4 Regulatory Environment

This section addresses the regulatory environment based on opinion ranking on a 7-point Likert scale whereby 1 represents weak and 7 represents strong regulations. The respondents were required to state the rules and regulations they are subjected to in the market. The results are depicted on **Table 2**. The strongest regulations concerned quality and standards with a mean of 5.50 and standard deviation of 0.023. On the other hand, gender equity rules and regulations had the lowest ranking with a mean of 3.83. The flower sector is mainly self-regulated and private sector dominated and with strong value chains linking farms to the market. In addition, the flowers are mainly sold to sophisticated and mainly rich customers in the developed countries. These customers are usually sensitive to issues of product quality. That is why business oriented quality and standards dominate the regulations while socially inclined rules and regulations, such as gender equity, that should be administered by the government remain low. **Table 2: Regulatory Environment in Flower Sector**

Regulations in flower market	Mean	Std. Deviation
Quality and standards	5.50	0.023
Employment rules	5.17	0.850
Environmental regulations	4.92	0.193
Child labour regulations	4.83	0.480
Trade rules	4.67	0.923
Human rights regulations	4.25	0.137
Gender equity rules N = 18	3.83	0.406

3.5 International Standards

These are standards that have been developed by various bodies representing different stakeholder interests around the world. Adherence to international standards is crucial for any flower producer who wants to produce and export flowers to the markets. The standards requirements took centre stage in this section ranked using a 7-point Likert scale in which 1 indicated weak treatment while 7 represented strong observation or treatment. The respondents were asked if they were required to observe any specific international standards in the conduct of their flower business. From **Table 3** the strongest observed international standards requirements were global gaps standards with a mean of 4.55 and standard deviation of 0.162. Other strong requirements are Kenya Gaps standards and Environmental standards with means of 4.08 and 3.50 respectively. Labour standards were the lowest applied regulations with a mean of 3.00. Flowers are a luxury product sold to sophisticated and knowledgeable customers. Survival and success in this business greatly depends on the ability of a farmer to observe and maintain high international standards of quality. This requires strong links to the market to facilitate a clear understanding of their requirements. The supermarkets in Europe play a key role in obtaining useful customer intelligence and communicating it to the produce through the value chain. The Kenya Flower Council (KFC) plays

a leading role in collecting information on standards and adopting them to the Kenya situation and then ensuring that their members observe them.

Table 3: International Standards Requirements in Flower Sector

International Standards requirement	Mean	Std. Deviation
Global gaps standards	4.55	.162
Kenya Gaps standards	4.08	.539
Environmental standards	3.50	.877
Fair trade standards	3.42	.712
Kenya Flower Council silver standards	3.36	.908
ISO standards	3.18	.714
Labour standards N=18	3.00	.625

3.6 Hypotheses testing for relationship between International physical factors (FDI) and competitiveness (Flower exports)

H₀: There is no significant relationship between international physical factors and competitiveness

Table 4: Regression results

Coefficients ^a					
Model	Unstandardized	Standardized	T	Sig.	
		Coefficients		Coefficients	
		B	Std. Error	Beta	
1	(Constant)	398.117	32.147	12.384	.000 international
	(FDI)		physical factors	.345 .083 .881 4.172 .009	

a. Dependent Variable: Flower export (USD)

Results in **Table 4** above show that the p-value was 0.009 which was less than the critical p value, 0.05. This indicates that the null hypothesis was rejected hence there is a significant relationship between international physical factors and competitiveness.

4.0 CONCLUSIONS AND RECOMMENDATIONS

4.1 Conclusion

Based on the findings, the study concluded that international physical factors has a positive and significant effect on competitiveness. Success of the process of indigenization will depend on government policy framework towards foreign direct investments that encourages partnership and transfer of skill and knowledge in order to empower the locals. It also depends on the literacy levels as well as the entrepreneurial skills of the local people. In addition, for foreign investors to agree to form partnerships with local citizens they need assurance about long-term political and economic stability and it is only the government that can guarantee this.

4.2 Recommendations

To maximize the benefits, the government should establish frameworks for partnerships between local firms and foreign investors. It should also focus on the development of the relevant skills in order to enhance absorptive capacity of the benefits from foreign direct investments. The FDI policy should target attracting investments that provide an upgrade of the current activities performed in the flower value chain. This way, the incoming investors will help develop and enhance the value of the activities carried out by local firms. They will also bring in new technology that will be used in the upgrading activities.

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