Perspetives on current issues and trends in CIPS/Issue 01/December 2012

Spot On

Spot on is a bi-annual magazine focussing on current issues and trends for players in the manufacturing, agriculture, oil & gas, retail, entertainment, tourism and hospitality sectors.

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Introduction

Welcome to our first edition of *Spot On,* a publication focused on developments in Kenya's Consumer and Industrial Products and Services (CIPS) sectors. In this publication we share insights on a variety of issues that are relevant and timely to these sectors. I would also like to share a broader view of these sectors and the growth and risk management strategies among CIPS business leaders to better understand the context in which various specific issues are emerging.

Amid the uncertain economic and business conditions, companies across these sectors are constantly seeking new sources of growth. The solution may lie in new products, market segments or geographies – or in adopting new business models, pricing structures or channels to market. But the common thread through all these strategies is applying innovation and insight to identify and exploit new opportunities. Helping companies to do this successfully and sustainably is what PwC does best.

Clearly, long-term trends are changing the global economy and the competitive landscape for many companies:

- the long-term shift of economic power to emerging countries has accelerated–evidenced at home by the growing presence of hub offices for multinational businesses in Nairobi;
- consumers are changing how and why they buy, becoming increasingly powerful because the internet allows them to buy from all over the world, compare suppliers and tell other people about them;
- cross-border ties are growing stronger with more companies operating in more countries and more governments working together to promote global trade and investment—but there are consequences and risks are becoming more interconnected and complex; and
- demand for labour is shifting to places and industries where supply is short.

These trends necessitate a change in how businesses in the CIPS sectors compete. Moving away from traditional sales models towards creating a value-driven, personalised experience for customers requires a change to their whole approach to innovation. The greatest challenge is whether businesses have the people they need to carry out this strategic shift. Talent management must be a part of any long-term business planning alongside efforts to improve strategic and organisational flexibility while keeping a careful eye on costs.

Business leadership in the CIPS sectors

Business leaders' views and priorities provide a keen lens for evaluating an industry sector. In our CEO Survey, which we conduct every year in Africa's fastest-growing markets, we ask business leaders about their strategies for growth, the risks they face and the talent they need to grow their companies. Most of the CEOs we survey in the CIPS sectors manage multinational organisations or the in-country operations of a multinational operating in Africa. Their responses to our Africa-wide survey are highly relevant in Kenya and they correlate well with the articles in this publication.

Regional growth contributes to high confidence in revenue prospects among business leaders in the CIPS sectors. Overall, 70% of CEOs say that they are very confident of growth over the next 12 months and three years—a consistently stronger response than we've seen among CEOs in any other industry sector. Strategically, a majority are focused on increasing their market share by developing new products and services to meet evolving customer demands.

Shifts in consumer spending trends and behaviours challenge many businesses in these sectors to think differently about distribution channels and marketing—with a new and significant emphasis on social media, as Michael Mwangi discusses in his article, *Engaging customers through social media.* They are also engaging in new promotional strategies to compete more effectively; over 60% of CEOs in these sectors cite competitive threats as driving fundamental strategy change this year.

New strategies like sales promotions can be effective but it's important to manage them carefully, writes Nancy Onyango in *Managing sales campaign and consumer promotion risks.*

Many CEOs in CIPS sectors are investing in relationship management systems or upgrading existing systems to outpace the competition. Within the agriculture sub-sector, in particular, relationship management is gaining traction as an effective tool for managing small-scale farmers, as Thomas Kong'ong'o explains in *Relationship management systems in the agricultural sector.*

Even as business leaders in the CIPS sectors constantly seek new sources of growth, they must also face uncertain economic and business conditions. We know from our survey that risks like exchange rate fluctuations, inflation, bribery and corruption, an increasing tax burden and over- or unclear regulation all influence risk management decisions at the executive level. Business leaders considering expansion must understand and prepare for the risks involved, as Ms Onyango writes in her second article, *Managing risks in new markets.*

At the same time, regional economic integration requires greater clarity on a variety of tax-related issues. Issues like VAT on export services can be a risk to doing business here, according to Joash Rotemo in Does a supply of services to non resident entities qualify as an export? Nairobi is a hub for global investment interest in Africa but it's important to understand the tax implications of operations like liaison offices, argues Agnes Muthee in *Liaison offices: a myth in Kenya?* And the taxation of Kenya's nascent extractive industries sector is still unclear, even as the potential for this industry attracts global investment interest. Read Osborne Wanyoike's article, *A new dawn for Kenya's mining sector,* for more insight on the mining sector's emerging tax issues.

Another risk that is gaining traction among business leaders in CIPS sectors is climate change. Two years ago, 40% of CEOs in these sectors cited climate change as a risk impacting growth prospects over the medium term but a smaller percentage (32%) said that this risk was influencing strategy change. Now, our Parliament is engaging in debate on a comprehensive new draft climate change law, The Climate Change Authority Bill, 2012, in the coming months to coordinate activities. It's important that business leaders are engaged in this debate, writes Tim Ash Vie in Living with a changing climate.

I hope you will find these insights useful to you and, as always, we welcome your comments and suggestions.

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Engaging customers through social media

The landing of submarine cables on the East African coast has led to a significant reduction in the cost of internet access, increased bandwidth and a dramatic rise in internet penetration. According to a 2011 Kenya ICT Board report, 25.9% of Kenya's population has access to the internet—a higher percentage than in South Africa.

Of Kenya's ten million internet users, 1.7 million have Facebook accounts. As mobile phone companies improve their data offerings and the price of smart phones continues to drop, internet penetration is bound to keep growing.

The internet and, in particular, social media are changing the way we live and work and providing new marketing channels through which companies can learn about customers, engage with consumers and build loyalty.

But more than this, social media adds a new dimension to the life cycle of products and services by engaging customers in the creative process and shaping the products and services offered.

A number of leading organisations have recognised the importance of engaging their customers through social media. Companies like Safaricom, Nation Media Group, EABL, Nokia and Sony are using YouTube, Facebook, Twitter and other social media mechanisms to grow awareness of their brand and products and to build customer loyalty. However, despite the tremendous opportunity presented by social media, most companies have not yet fully embraced its benefits.

There are five main reasons why organisations should care about social media. First, it's where your customers are gathering. If you knew that members of your target customer segments spent time in a particular place, wouldn't it make sense to set up a store front there—or at least post an advert? It is estimated that half of Facebook subscribers check their page at least once a day. Are you there? If you aren't, do you have a good reason not to be?

Second, conversations about your business are happening—with or without you on social media sites. It's not a question of whether your customers are talking about you, it's a question of whether you're paying attention and participating. What you might think is a potential threat to your brand may actually be an opportunity to build loyalty and advocacy among your customers and employees.

Third, your brand could be circumvented if you're not active on social media. Increasingly, consumers evaluate and compare the things they want to buy based on what their peers are saying on social platforms and less so based on the messages they receive from your business.

Offering mechanisms for your customers to connect with each other to facilitate evaluation and then participating actively in those conversations can put you back in the loop. This will give you more influence on purchasing decisions and help build customer loyalty.

Fourth, social media is the world's largest focus group. It offers the potential of highly personalised, one-on-one interactions with your customers and leads to much better interaction rates than traditional marketing efforts deliver.

If what you're selling is not meeting customer needs or expectations, there is no better way to know it immediately. Social media also expedites customer input straight into the product development cycle. Build the platform, give your customers a reason to participate and then listen to what they say.

Fifth, social media is an effective way to reach your customers. For a surprising breadth of demographic segments, engagement via social media can be the most effective way of moving customers up the value chain from initial awareness to passionate evangelism. According to a report by Chadwick, Martin & Bailey, a market research consultancy, 67% of social media users are more likely to buy a brand that they follow on Twitter while 79% are more likely to recommend a brand they follow on Twitter.

It's important to be aware of the risks involved in managing a social media presence. Effective risk management in this space contributes to an organisation's ability to leverage social media's powerful potential and help it to shape consumer opinion.

In today's digital world, learning from consumers by listening to their needs and expectations on the social web is the absolute minimum. Social media also offers a genuine opportunity to build strong customer loyalty and to engage them in the creative process so that your products and services are attractive and relevant. The marketplace is evolving rapidly and it is clear that social media will be an important component of marketing strategy going forward.

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Liaison offices: A myth for this part of the globe?

Kenya's strategic location and its well-developed business infrastructure make it a natural choice for investors.

Twenty years ago, any talk of investment in African countries was dismissed as idealism. Fast forward to 2012 and any global investor worth its salt is looking to Africa as the new investment frontier and the most emerging of all emerging markets (if there be such a term).

The trend has been great for the African continent and also various African revenue authorities.

Kenya has not been left out, taking its rightful place as an effective entry point for investors with an interest in Africa. Kenya hosts the regional offices of some of the largest multinational corporations worldwide as well as many other global companies, both public and private.

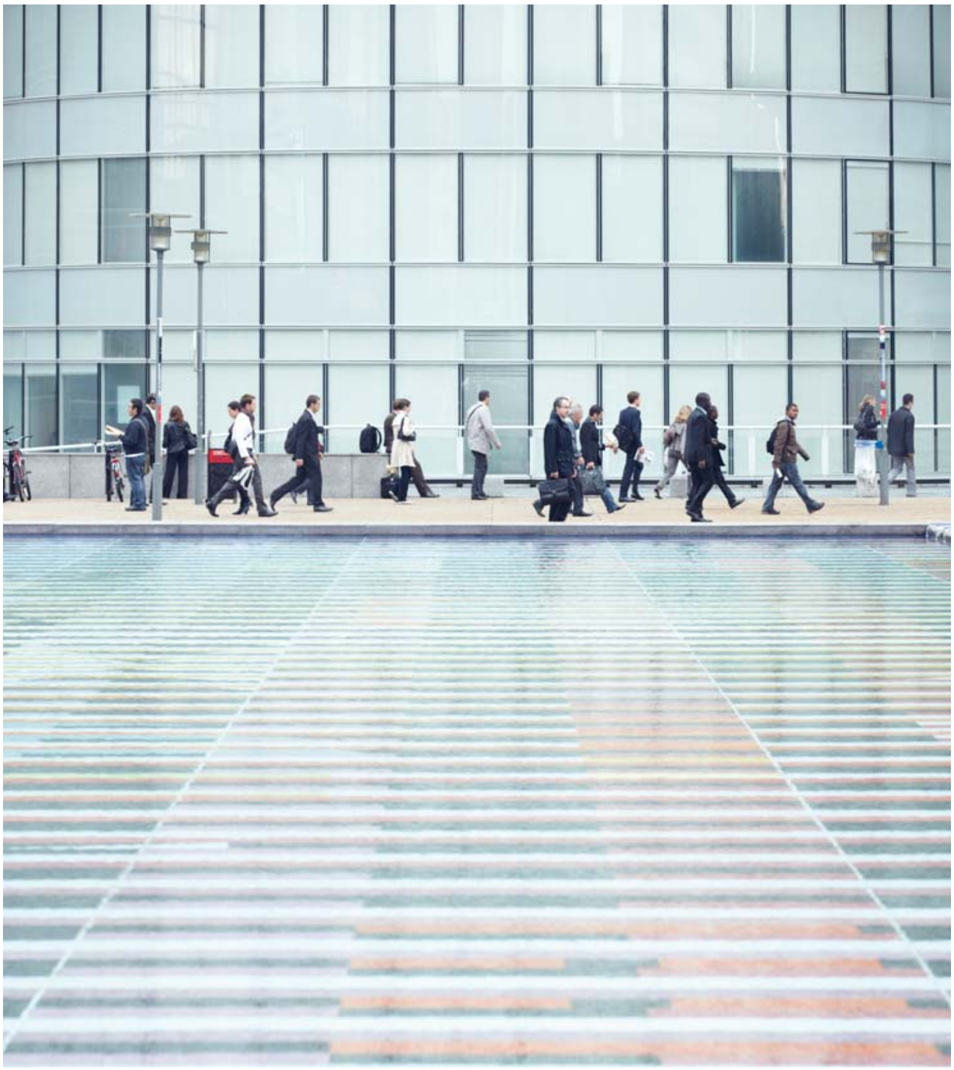
Kenya's strategic location and its well-developed business infrastructure make it a natural choice for investors. Investing in Kenya now also provides access to the larger regional market of the East African Community.

Global investment in Kenya also brings with it a diverse range of business operating models. One of the most interesting models is the liaison office, which is a representative office set up primarily to explore and understand the business and investment climate in a market.

Generally, a liaison office is limited to carrying out non-profit generating activities or functions (such as providing information to clients and prospects and maintaining contacts with clients, prospects and the head office) and is sustained by remittances received from its parent company.

In line with this definition, it would follow that a liaison office would never be expected to make profits and consequently would never be in a tax paying position.

For many companies, setting up a liaison office makes a lot of sense because it allows them to investigate whether investing in Kenya is worthwhile. The trouble is that the concept of a liaison office is foreign to Kenya's tax regime.



The Kenyan Income Tax Act only makes reference to two types of entities: a company incorporated under the laws of Kenya (like a subsidiary) or a non-resident company having a permanent establishment in Kenya (like a branch).

Applying the legislation, a liaison office set up in Kenya would qualify as the second type of entity but the Income Tax Act also says that transfer pricing provisions are applicable to transactions between a branch and its related non-resident entities.

This implies that a liaison office cannot just operate as a cost centre. In the context of a group, the relationship between a branch office and other revenue generating non-resident related parties must meet the arm's length principle.

This principle reflects the commercial arrangement that would have been put in place where the cost centre was supporting an independent enterprise. It therefore follows that a cost centre must earn some form of consideration from the related parties that it supports.

Once the level of consideration is established, it would be chargeable to tax at the non-resident corporate tax rate which is currently 37½%.

The message to all global investors with an interest in Kenya is that there is no such thing as a liaison office that is simply a cost centre. A value must be placed on any such entity and the Kenya Revenue Authority must receive its share of that value.

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Living with a changing climate

Climate change affects all sectors of the society and economy, from transport and energy to education and public health and it must be dealt with comprehensively across them all.

The last 12 months have demonstrated how vulnerable we are in Kenya to the extremes of weather. During the long rains we received terrible news of many deaths caused by flooding across the country. Our infrastructure struggled to cope. Roads were badly damaged, energy supplies disrupted, and massive economic losses and social costs were incurred.

In 2011 drought was arguably the single largest weather related challenge in Kenya. Agriculture recorded growth of just 1.5% compared to 6.4% in 2010. This was primarily due to erratic weather conditions.

People starved in the arid north of the country and thousands of livestock perished. Famine was declared over the border in Somalia by the UN and through the latter part of the year many displaced people came into Kenya as half of the population of Somalia required food assistance.

In January the Rift Valley experienced a frost that has caused losses of 500 million shillings to the tea industry, Kenya's largest source of foreign currency earnings. And work released by the International Centre for Tropical Agriculture in February this year demonstrated that the space for tea to grow in Kenya will shrink by something like 50% by 2050 under current climate projections.

Kenya is not standing by in the face of the climate threat; it has been developing a comprehensive climate change action plan that is spearheaded by the Government of Kenya in a process that will culminate by the end of the year.

Additionally, Parliament will be debating a new draft climate change law, The Climate Change Authority Bill, 2012, in the coming months. That bill proposes to integrate issues of climate change into the national schooling curriculum and the formation of the Climate Change

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Authority to coordinate activities aimed at ensuring Kenya remains one of the least carbon emitting countries in the world.

If this response is to make a difference it will need to achieve three things. First, it has to align with ongoing government processes for the development of the country, most notably the planning processes for Vision 2030, and be mainstreamed into the budget cycle.

Second, it has to address the challenge of how to raise finance and mobilise technologies to help us adapt to climate change and to keep growing the economy without increasing our dependence on fossil fuels.

Third, it needs to be relevant to the private sector. Addressing climate change is not just an issue for governments. The private sector must contribute to addressing the climate challenge (from information needs to services and products), as well as preparing its own assets and operations for anticipated climate change.

Climate change will require new thinking to improve food, water and energy supplies. Businesses that rely on access to water, energy and natural resources need to start building their resilience. In agriculture, strategies could include developing climate resilient agricultural systems, new seed varieties, more efficient use of water via improved irrigation systems, tree planting with drought resilient trees or innovative post-harvest storage facilities.

We should be cautious of saying the extreme weather that has affected the country over these last twelve months is a result of climate change. But what we can say is that the scientific community is telling us that more of these sorts of extreme weather events – torrential rain and drought – are precisely what we have to prepare ourselves for across Africa. In Kenya, it seems likely that the weather we have witnessed over the last year is a harbinger these changes and challenges to come.

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Managing risks in new markets

In the last decade, more and more companies have expanded beyond national borders and looked at the greater East African Community as one market. Debates on where to locate production facilities and reap the benefits of economies of scale are raging especially now that governments across the patch are settling cross-border tariffs and treaties and investing in regional infrastructure.

Regional or bilateral trade/investment agreements are becoming commonplace and they influence investor confidence among local, regional and global companies and investors.

We know that emerging markets in Africa offer significant opportunities for growth. Nearly 60% of the CEOs who took part in our annual Global CEO Survey said that emerging markets are now more important to their companies' future than developed markets, and 75% said that Africa is a region where they anticipate growing their operations. CEOs in East Africa are even more optimistic; 77% say that emerging markets are critical to growth strategies and almost all of them—96%—say that Africa is a growth region.

Investing regionally often makes good business sense and in some cases, may be the only option to ensure long term survival. However, it is important to perform a thorough risk assessment at both the strategic and tactical levels.

Understanding the risk environment is a vital part of any entry strategy. In general, the following questions can help to assess risks although they are not a substitute for seeking professional advice.

Are you assessing the emerging market's risk holistically?

Invariably, the risks identified come down to two main types: reputational risks and viability issues. Reputational risks can be more acute in emerging

markets due to weaker governance, legislative and ethical frameworks. Operating in markets with governments that are authoritative, corrupt or involved in human rights abuses could present a significant risk to the values of many organisations.

Viability could be impacted by a great many operational risks influencing profitability. For example, numerous regulatory requirements increase costs.

Political instability and weak policy, legal and regulatory frameworks, graft and corruption, poor educational standards, inadequate infrastructure, low-quality working practices, poor enforcement of judicial and legislative policies, porous borders, a history of parties dishonouring agreements and physical risks to staff and assets as a result of rampant insecurity/crime, terrorism, negligence, conflict or post-conflict risks can all influence viability.

These and other factors like access to medical, educational, travel, accommodation and legal services should form the basis of a holistic assessment. Various sources of information can help to assess an emerging market's risks and it is important to go beyond the obvious.

Do you understand the political context?

The relationship between politics and business is often more intertwined in emerging markets. In many cases, political power is synonymous with control of resources.

When power is concentrated in the hands of a few well-connected individuals or families, it can create an environment where nepotism, tribalism and corruption flourish. Organisations can undertake a thorough initial assessment and conduct regular monitoring to address this risk.

Additionally, immigration laws may also make it harder to source staff with technical expertise. Our CEO Survey shows that government immigration policies influence site decisions for 45% of CEOs in Africa overall and 49% of CEOs in East Africa. Seeking local input can help but bear in mind that all views may not be objective.

Are you well prepared?

Failure to prepare is preparing to fail. Practical considerations should include office locations, security measures, cultural sensitivity and deciding with whom to associate and do business. Preparation should include identifying your risk appetite and limits, weighing the opportunity against the cost of the risk mitigation, sourcing the necessary expertise to look at each risk aspect and carrying out due diligence on business partners.

Many companies have tried and failed to enter new markets, thus damaging their reputations. To get it right the first time, companies need to prepare carefully, monitor risks thoroughly and respond effectively.

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Managing sales campaign and consumer promotion risks

Sales promotions are a popular way to attract customers and build brand awareness. In the process of designing a promotional strategy, however, many organisations fail to adequately assess the potential risks involved.

Increasingly, companies are rolling out promotions that make it easier for consumers to participate. A short text message, for example, is a lot easier than filling out a form and submitting it at a designated point.

Form-filling might make sense for entities that are in the business of selling paper-based products like magazines and newspapers but for the most part, promotions are becoming more sophisticated.

More and more prizes are being awarded in the form of mobile money or airtime and embracing technological advancement. This is a smart move because it increases consumer participation and facilitates targeted outreach. These awards also result in a higher payout ratio and hence a higher adoption rate.

Companies offering promotions have always faced challenges with regard to distributing prizes. Kenya's Betting Control & Licensing Board (BCLB) provides stringent requirements for those seeking to obtain a license to offer a promotion.

These licenses are compulsory, and the BCLB requires that any monies not awarded to consumers must be paid to the BCLB. Companies therefore prefer to award prizes to consumers directly, so promotional strategies that improve outreach to consumers are very attractive.

The proliferation of promotions in recent years means that consumers now have more choices and companies have had to up the ante to attract an increasingly savvy population. Brand loyalty, ease of play and pricing as well as the size or appeal of the reward all influence consumer decisions.

In my view, these factors don't much matter if a consumer believes that the winners are pre-selected and that their participation earns them little chance of winning. In promotions, trust has become an issue.

Consumers need to know that the rules and process give them a fair chance to win.

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To avoid damaging your company's reputation through a mismanaged promotion, companies should make sure that they fully comply with BCLB requirements. Audit trails and reconciliations may need to be modified to accommodate electronic records. Checks and balances and controls are more likely to be automated, which requires different skills and tools.

Depending upon technology owned by a third party like a mobile operator increases risk; many promotions have stumbled following an operator's failure to remit data or meet contractual obligations.

In one case, an entity was required to pay ten times the budgeted prize money because of a transposition error in an SMS message. In technology-based promotions, the authenticity of the source of the code is not checked by the system if a valid code is sent.

Promotions may increase the risk of fraud. Promotional materials may be stolen in advance, during the printing or storage phase and authentic codes released or submitted before legitimate consumers get a chance to play.

Many promotions are now being modelled with limited direct customer interface, which provides an opportunity to validate the winners as they present themselves but also means that the volumes of winners processed is limited. It's a balancing act between numbers of participants and control.

In several cases, we have seen innovative fraudsters send messages/rules very similar to authentic promotions soon after the legitimate one is launched with the intention of confusing and scamming consumers. Fraudsters have even developed counterfeit goods and marketing materials, infiltrating the promotion among both players and employees.

Companies can evaluate these risks and seek professional advice to help manage them. But one of the most significant risks to organisations using promotions is the failure to measure return on investment.

The impact is difficult to measure, perhaps because accounting processes do not isolate or report the impact of a single product. Impact should be evaluated during and after the launch. It's also important to measure the data collected and establish ownership of the risks and controls early.

Promotions are becoming more and more intricate, as innovations and technology improve the consumer experience and value. So if you think things are complicated now, watch this space.

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A new dawn for Kenya's mining sector

Mining in Kenya has been in the news lately, especially the potential for coal and titanium deposits. Highly publicised transactions involving mining companies have generated significant interest especially among local communities who demand their share of the spoils—or at least a fair hearing, as stipulated in the new Constitution.

Around East Africa, Tanzania is best known for its rich mineral resources including gold, uranium and diamonds. Major multinational corporations conduct exploration and mining activities but whether the Government receives an equitable share of the benefits from mining remains unresolved in many minds.

In terms of taxation, countries are now focusing more on indirect taxes like Value Added Tax, Custom duties and Employee taxes. Direct tax (which is based on the profits of the company) is considered complex in terms of interpretation since it is based on the audited financial statements of the company which are prepared using historical costs.

In the extractive industry, taxing the value of minerals extracted or the volume of minerals extracted is gaining currency among tax authorities. It is harder to evade taxes based on turnover (volume or value) than it is when you rely on taxing profits.

Kenya is said to be an 'exploration country' in terms of mining. In other words, Kenya is yet to discover significant deposits of base minerals.

However, due to an upsurge in the demand for minerals by countries like China, investors are seriously considering Kenya as a place to explore and mine minerals. At the same time, a multi-million dollar mining project in Eastern Kenya has a partner from China.

It's clear that China's demand for metals continues to have a significant impact on the mining sector. According to the International Monetary Fund, in 2010 China accounted for approximately 40% of the world's base metals' consumption.

Even a moderate percentage increase in consumption has a huge impact on global demand and while China's consumption is significant, it is part of a larger trend among rapidly emerging countries with vast populations like India, Indonesia, Brazil and Nigeria.

China is today's story but other emerging market nations will help to sustain a demand-led boom over the longer term.

The risks and uncertainties associated with mineral exploration continue to be significant, however. In a survey we published this year, 'Mine: The growing disconnect', PwC found that the mining industry's headline story over the last five years was about demand.

Now, the focus is shifting and the story over the next five years will be about supply. There are several reasons for this: structural changes to cost bases caused by decreasing grades and increasing input costs, changing fiscal regimes and resource nationalism, ongoing disruptions to production, remoteness of certain locations and increasing capital expenditure requirements to bring supply to market. All of these factors influence supply.

Our survey shows that ownership of resources and mining industry fiscal regimes remain high on the agenda for many governments around the world.

Nations are looking at taking a greater share of profits and resources through a range of measures. Ongoing discussions and debates, formal reviews of fiscal regimes or recently enacted changes have been seen in countries like Australia, Chile, Ghana, Peru and South Africa.

In Kenya the draft Mining Policy seeks to put in place a simple, stable, predictable, efficient and unified regulatory framework.

The Policy also aims to stimulate investment in the minerals and mining sector while ensuring that small scale mining companies use well-integrated, efficient and modern technology. Many of these enterprises will need to be brought into the formal economy so that they contribute fairly to the tax base—and Kenya's future as a mining economy.

Due to an upsurge in the demand for minerals by countries like China, investors are seriously considering Kenya as a place to explore and mine minerals

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Relationship management systems in the agricultural sector

Over the last several months, a number of sugar companies have been embroiled in bitter fights over cane deliveries from farmers. At the heart of this rivalry is a fundamental shift of power in favour of cane farmers caused by an increase in the number of sugar millers providing alternative buying centres for cane.

For a long time, the balance of power was in favour of sugar millers. This changed when out-grower institutions and cooperatives that were meant to promote, represent and protect the interests of small-scale farmers proved ineffective.

At the same time, millers saw little or no need to analyse or fully understand the issues driving farmer behaviour and loyalty and so failed to develop a structured approach to managing their relationships with them.

Suspicious farmers quickly began to question their obligations to specific millers despite their contractual obligations.Productive and committed farmers are the lifeblood of many agriculture-based organisations in Kenya. The sugar, tea, cereal, dairy and coffee sectors rely heavily on small-scale farmers but these relationships must be nurtured to ensure sustained loyalty.

In the sugar sector, the Kenya Sugar Board estimates that farmers supply over 92% of cane milled in Kenya. The remaining 8% comes from the millers' nucleus estates. This dependency on farmers underscores the importance of miller and farmer relationships.

The Kenya Sugar Board has identified the 'effective farmer' as the starting point for building an efficient and competitive sugarcane industry.

Issues like excessive land subdivision, delayed payments to farmers and food insecurity threaten the industry and, by extension, the relationship between millers and farmers.

Millers invest heavily in the development and maintenance of infrastructure and community-based projects but these are not generally seen as representative of their overall relationship with farmers and their communities.

As the balance of power shifts and the demand on farmers for more cane continues to increase, the options available to farmers for getting the most value for their cane will also increase. Sugar millers have few options other than to adopt a structured approach to how they manage their relationships with farmers. Relying on contractual obligations is not enough; enforcing contracts is difficult and expensive and leads to unintended consequences.

An effective, structured approach to relationship management must begin with the development and adoption of a clear strategy. That strategy would allow the millers to do three things.

First, the strategy should help millers to understand farmers and their interests. Beyond the immediate signatory to the cane supply contract and next of kin, millers need to understand the dynamics of succession, relationship profiles and family structures because these issues tend to drive farmers' actions.

Second, the strategy should help millers to understand how both parties derive value from the relationship. For millers, this means understanding what exactly farmers need from them. For farmers, this means understanding what exactly millers are able to provide.

So long as there is misalignment between the expectations of the two parties, both the miller and the farmer will remain dissatisfied.

Third, the strategy should help millers to build processes and systems to remove blockages. An effective farmer relationship management system should provide insight through data consolidation and analytical support to the relationship management process.

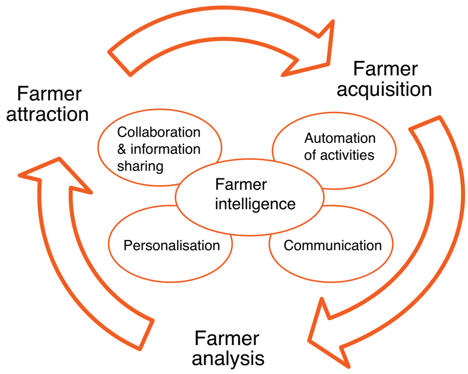
To date, agricultural organisations in Kenya are not known for their level of automation and use of systems. Although many millers invest in enterprise systems to support management information needs, they lag behind in deploying relationship management systems that could help them to acquire, analyse and generate relevant information.

Farmer relationship management systems help support a deliberate relationship management strategy. These systems help millers to understand their

farmers better, improve retention and loyalty, attract new farmers, build a sense of community and collaboration and reduce farmer management costs.

The sugar sector in Kenya is changing and millers' long term success will depend upon how they manage these changes. As long as they obtain a significant portion of their cane from small-scale farmers, they need to ensure a good working relationship with these suppliers. Farmer relationship strategies and systems can help—and not just in the sugar sector. Agribusinesses in the tea, coffee, dairy, grain and horticulture sectors could also benefit.

The diagram below summarises a typical farmer management cycle, supported by a relationship management system.



Farmer relationship management systems help support a deliberate relationship management strategy.

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Does a supply of services to non resident entities qualify as an export?

Imagine a market research firm in Nairobi that provides services to a non-resident client in Zambia. Are these services taxable in Kenya? This question is perplexing in Kenya because the definition of 'export of a service' contained in our tax legislation is not clear.

Entities in Kenya providing taxable services to non-residents are facing uncertainty as to whether such services are considered to be an export and therefore zero rated. Our current VAT legislation provides that a service exported out of Kenya is a service provided for use or consumption out of Kenya regardless of the place of performance of the service. Yet other rules within the legislation deem a service to be supplied in Kenya where the service is physically performed in Kenya. Thus the uncertainty.

There are two schools of thought on how the above should be interpreted. The first is that the Kenya Revenue Authority (KRA) has not provided a clear interpretation of the term 'use or consumption'. There are instances where KRA has interpreted the rules in their favour and implied that if taxable services are performed in Kenya then such services are used or consumed in Kenya and therefore subject to VAT at the standard rate (currently 16%).

The second is that the place of ultimate consumption is the determining factor for VAT status. This means that a service performed in Kenya (like market research) purely for the benefit of a non-resident entity (in Zambia, for example) should constitute an export and therefore attract VAT at the zero rate.

The main problem, whichever school of thought we look at, is the fact that current legislation and regulations do not attempt to define the term 'use or consumption' and do not deal with situations where more than one person in different jurisdictions use a service or consume a service.

Because this definition is unclear, most taxpayers revert to literal interpretations of the two terms—using a dictionary. The dictionary does not provide proper guidance in this case. For example, some of the definitions advanced in defining the term 'use or consumption' indicate economic utilisation of a resource to satisfy a need, but it is still not clear about who exactly utilises the resource.

There are also instances where KRA officials have taken the view that if the services relate to maintenance, installation, repair or servicing of a machine or an asset in Kenya, then the services are consumed in Kenya if performed after the sale has been concluded. However, it is still unclear whether demand-creation services such as marketing and advertising conducted on behalf of a non resident person would be considered to be consumed or used in Kenya or not.

For example, if a non resident supplied machines in Kenya and a local entity assisted with servicing the machine in Kenya before the machine was sold to local consumers then the question is whether the services that the local entity provided were consumed or used in Kenya or out of Kenya.

We should also consider that KRA's position on this issue could be tantamount to double taxation of foreign consumers of the service provided by Kenyan entities since these services may be treated as imported services in the foreign country and subject to reverse VAT (if applicable in that foreign country).

Overall, the current legislation is inadequate to determine what the term 'use or consumption' is in the context of the export of services. The ongoing review of the VAT Bill should give due consideration to the definition of the term to make it more clear.

To do so, Kenya could borrow best practises from countries like India and the United Kingdom which have successfully introduced and implemented effective 'place of supply' rules.

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