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THE CONSTRUCTION INDUSTRY

ANALYSIS OF THE STATE OF COMPETITION

ISO 9001:2008 CERTIFIED

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CONSTRUCTION INDUSTRY IN KENYA

1 INTRODUCTION

1. The Competition Authority of Kenya (CAK) is established under the Competition Act, No. 12 of 2010 (the Act). The Authority's mandate is to enforce the Act with the objective of enhancing the welfare of the people of Kenya by promoting and protecting effective competition in markets and preventing misleading market conduct throughout Kenya.

2. The Authority under the auspices of the Africa Competition Forum (ACF) is carrying out a research in the construction sector. The ACF is an informal network of African national and multinational competition authorities as well as regional competition agencies. The principal objective of ACF is to promote the adoption of competition principles in the implementation of national and regional economic policies of African countries. The research is aimed at assessing the level of competition and trade nexus at a regional level. The research which covers eight (8) countries Kenya, South Africa, Swaziland, Namibia, Mauritius, Malawi, Gambia and Gabon aims to inform government policies to enhance efficiency in the construction sector and also enable the countries involved to be able to collaborate in terms of exchange of information and experiences.

3. Through this study, the Competition Authority of Kenya (CAK) will be in a better position to assess competition issues and any anti-competitive practices that may be present within the construction industry in Kenya.

1.1 Background of the Construction Industry

1. The Kenya Vision 2030 is the national long-term development policy that aims to transform Kenya into a newly industrializing, middle-income country providing a high quality of life to all its citizens by 2030 in a clean and secure environment. The Vision comprises of three key pillars: Economic; Social; and Political[1]. Kenya Vision 2030 overall goal for the construction sector is to increase its contribution to Gross Domestic Product (GDP) by at least 10% per annum and propel Kenya towards becoming Africa's industrial hub.[2] The construction sector has a high potential of employment creation; provides stimulus for growth of the agricultural sector and offers significant opportunities for export expansion. The Kenyan government has planned a complete revamp of road, rail and port transport infrastructure.

2. The construction sector deals with building of new houses, apartments, factories, offices and schools. It also deals with building of roads, bridges, ports, railroads, sewers and tunnels, among many other things. In addition, it deals with maintenance and repair of all of those structures and produces the basic materials such as concrete that are used to make them. The industry's significance is due not only to the fact that it provides the buildings and infrastructure on which virtually every other sector depends, but to the fact that it is such a sizeable sector.[3]

3. Currently, Kenya is going through a construction boom. The government has invested heavily on the construction sector in order to improve on infrastructure such as road networks and at the same time provide new residences for the locals. With increase in population, opportunities exist in the construction of residential, commercial and industrial buildings, including prefabricated low-cost housing. The boom can be attributed to:

[1] http://www.vision2030.go.ke/about-vision-2030/

[2] http://www,knbs.or.ke

[3] Competition in The Construction Industry, DAF/COMP(2008)36

i) Inadequate infrastructure comprising rail, roads and ports presenting opportunities for continued development in the building and construction sector. For instance, in 2014 Kenya signed a Kshs 42 billion deal with a Chinese communication company for construction of the first three berths of Lamu port, part of the ambitious Lamu Port South Sudan Ethiopia Transport (Lapsset) corridor. The Lapsset project is expected to serve land locked countries in the wider Eastern Africa region. These construction projects are meant to make up for decades of under-investment that stagnated economic growth in Kenya and cement its status as East and Central Africa's commercial hub.

ii) Secondly, the rapid growth in population, from 38.6 million in 2009 to 44.2 million in 2015, has led to a rising demand for housing in most parts of the country, grants a major chance for growth as private developers put efforts to meet the demand.[4] Table 1 below shows the value of buildings from 2011 to 2015.[5]

Table 1: Reported Value of New Private and Public Buildings, 2011 – 2015

Year	Private (Nairobi City County – Ksh million)			Public (Nationwide – Kshs million))		
	Residential	**Non-Residential**	**Total**	**Residential**	**Non-Residential**	**Total**
2011	34,046.5	5,803.4	39,849.9	2,614.2	-	2,614.2
2012	37,373.4	6,200.8	43,574.2	4,629.5	70.0	4,699.5
2013	45,236.4	7,039.6	52,276.0	1,725.4	-	1,725.4
2014	50,952.2	8,567.5	59,519.7	502.1	-	502.1
2015	58,428.5	9,645.1	68,073.6	61.5	-	61.5

Source: National Housing Corporation & the State Department for Housing
Note: Public Residential buildings are constructed by the State Department for Housing and NHC

[4] http://www.knbs.or.ke
[5] The Economic Survey 2016, KNBS

4. Subcontracting in the construction industry has greatly increased in recent years. In most construction projects, especially building projects, it is common for 80 to 90% of the work to be performed by subcontractors. Subcontracting is used much more extensively on housing and building construction projects than on engineering and industrial projects.[6]

5. There are various forms of contracts used and choice of contract depends on the prevailing circumstances as well as other determining factors such as time required to complete the project, nature of works and the client. The most popular form of contracting in the Kenyan industry is whereby the consultants carry out the design and a main contractor builds with the help of subcontractors. Subcontractors appointed by the client are termed nominated subcontractors and those appointed by the contractor domestic.[7] Some reasons as to why contractors engage subcontractors is to provide skilled labour, reduce overhead costs and as well as reduce financial pressure on the contractors.

6. Kenyan firms have for a long time complained about their Chinese rivals' competitive advantage both in large public infrastructure contracts and smaller-scale private sector projects. The National Construction Authority requires that for any contract awarded to an international firm, at least 30% of the works must be subcontracted to a local firm.

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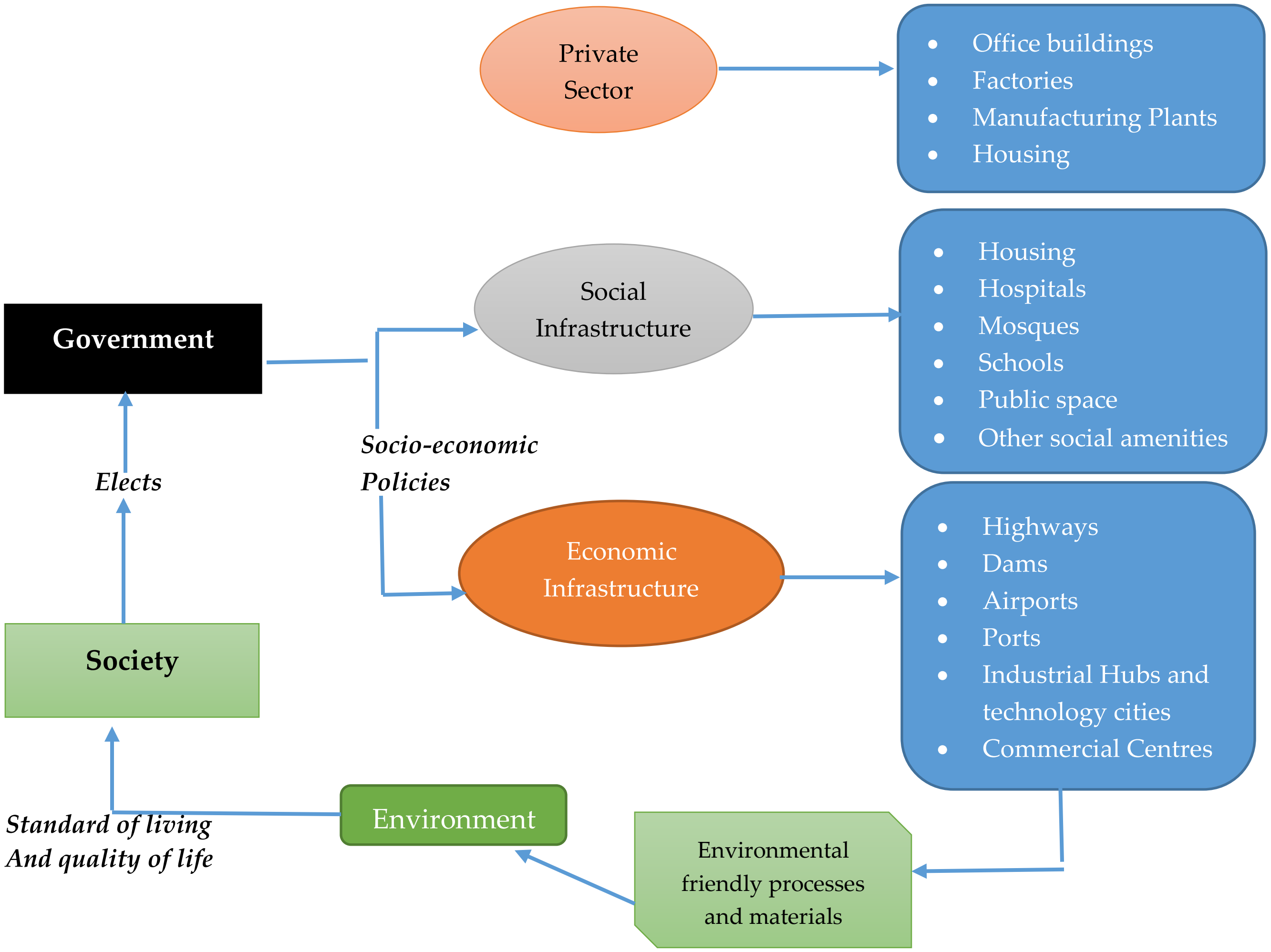
[6] Construction Contracting by Clough, Richard & Sears 1994

[7] Construction process in Kenya by Eng. Peter Kimari http://www.hdm.lth.se/fileadmin/hdm/alumni/papers/icm2000/ICM2000-10.pdf


Private Sector
Office buildings
Factories
Manufacturing Plants
Housing
Government
Social Infrastructure
Housing
Hospitals
Mosques
Schools
Public space
Other social amenities
Socio-economic Policies
Elects
Economic Infrastructure
Highways
Dams
Airports
Ports
Industrial Hubs and technology cities
Commercial Centres
Society
Standard of living And quality of life
Environment
Environmental friendly processes and materials

1.2 Overview of the Construction Industry

1. Kenya has a well-established construction industry that comprises businesses mainly involved in the construction of commercial and residential buildings, engineering structures and affiliated trade services. The construction industry is a major contributor to Gross Domestic Product (GDP) in the Kenyan economy and plays a leading role in determining economic growth. According to the Kenya National Bureau of Statistics (KNBS), the real estate and construction sectors have been some of the main drivers of economic growth in Kenya for the last five years. The Kenyan construction industry contributed 7 percent of the Gross Domestic Product (GDP) in 2015, which makes it clear that Kenya has a well-developed construction industry.

2. The Vision 2030 aims to strengthen the framework for infrastructure development and accelerating the speed of project completion, raise efficiency and quality of infrastructure projects and increase their timely implementation. It also aims to develop and maintain an integrated safe and efficient transport network, benchmark infrastructure facilities and services and provision with globally acceptable performance standards targeting to enhance customer satisfaction as well as enhance private sector participation in the provision of infrastructure facilities and services strategically complemented by government interventions.

3. According to the Economic Survey 2016 report released by the Kenya National Bureau of Statistics, the country witnessed a thriving building and construction sector in 2015 registering a growth of 13.6 per cent in value added. Formal employment in the sector grew by 11.4 per cent to stand at 148.0 thousand in 2015 up from 132.9 thousand in 2014. Total proposed development expenditure on roads increased by 79.2 per cent. Consequently, the

index of Government expenditure on roads increased from 263.4 in 2014 to 386.7 in 2015 to support projects being undertaken during the year.

4. The construction sector is estimated to have expanded by 9.2 per cent in 2016 compared to a relatively higher growth rate of 13.9 per cent recorded in 2015. The slower growth was principally due to a considerable reduction in the activity of the construction of the Standard Gauge Railway (SGR) as it neared completion. The significant reduction in the import of key construction materials such as iron and steel (14.5 per cent) and non-ferrous metals (2.2 per cent) were also an indication of scaling down of construction activities related to the SGR. Further, the slowed growth was also evidenced by a slow uptake of loans in the building and construction sector from KSh 106.3 billion in 2015 to KSh 104.8 billion in 2016. The estimated value of building works completed in Nairobi City County rose from KSh 70.9 billion in 2015 to 76.2 billion in 2016. Similarly, the number of new private buildings in Nairobi City County (Kenya's Capital) grew from 9,054 in 2015 to 10,002 in 2016. The construction of new public residential buildings rose from 45 in 2015 to 1,062 in 2016. During the period under review, cement consumption increased by 10.4 per cent from 5.7 million tonnes in 2015 to 6.3 million tonnes in 2016, an indication of a robust growth despite the slowdown.[8]

5. The country's 2015 Economic Outlook, shows that the construction industry is one of the major sectors drawing investors into the country. Investment prospects exist particularly in transport, slum upgrading and informal settlements, urban renewal, construction of middle and low income housing and the manufacture and supply of building materials and components.

[8] The Economic Survey 2017, KNBS

6. Cement consumption went up by 9.9 per cent in 2015 in tandem with the growth in the building and construction sector. Total construction cost index increased by 4.9 per cent compared to an increase of 10.1 per cent in 2014, mainly attributable to the fall in fuel prices, a key input component of the index. The index of reported private building works completed in major towns rose from 341.4 in 2014 to 367.1 in 2015. In addition, the index of reported public building works completed in main towns registered an increase from 106.1 in 2014 to 116.2 in 2015. Loans and advances to the sector increased by 32.3 per cent from KSh 80.4 billion to KSh 106.4 billion in 2015.

1.3 Objectives of the Study

This is a comparative analysis study that aims to map out the major players across the countries, the main changes over time and the market structures. The market dynamics to be assessed include barriers to entry, regulatory arrangements, as well as identifying strategies that can enhance efficiency in the sector. The specific objectives of the study are as follows:

i) Assess the market structure of the construction industry;

ii) Identify how the conduct of key players in the construction industry affect competition;

iii) Identify barriers to entry existing in the construction industry in Kenya;

iv) Assess the effects of existing regulations on competition in the construction industry.

v) Make recommendations for enhancing competition in the construction industry

1.4 Methodology

1. Information used in this study was obtained from a number of sources, including requests for written submissions from relevant stakeholders as well as interviews with selected stakeholders in the industry. The stakeholders that were requested to provide information include the construction industry regulator (the National Construction Authority - NCA), Government departments, and construction services procuring entities (both public and private).

2. It should be noted, however, that very few stakeholders responded to the requests for information that the Authority made. Among others, the Authority received responses from: the NCA, Department of Infrastructure and the Public Procurement and Oversight Authority. In addition to the requests for information, the Authority also used secondary data from various sources including relevant studies and the internet search.

1.5 Limitations of the Study

1. The construction industry consists of diverse related activities which include construction of physical infrastructure, electrical services, architecture and construction related consultancy services. As there are more than one product market in the construction industry, it is not easy to define product markets appropriately. Due to time and resource limitations, this study focuses on construction of physical infrastructure and mainly civil engineering works. These include heavy constructions such as roads, bridges, tunnels, railways, airports, harbours (e.g. the lapsset project) and other water projects.

2. The main focus will be on government and government funded projects, with reference to the National Government, County Governments and other State Agencies/ Corporations. Therefore, the findings of the study may not be applicable to the whole construction

industry. The other limitation is in terms of inadequacy in data used in the analysis. The information used in this initial analysis is based on a few interactions with stakeholders and desk research.

3. The study is structured as follows: Section 2 presents the regulatory framework and Statutory Boards; Section 3 looks at the general state of competition in the construction industry; Section 4 looks at the price determination and section 5 gives an analysis of the procurement policies and procedures; Section 6 provides concluding remarks.

2 REGULATORY FRAMEWORK AND INDUSTRY ASSOCIATIONS

1. The government regulates various sectors of the economy to ensure that the consumers reap maximum benefits as opposed to letting market forces determine how things are run. Regulation is also a means of accomplishing objectives that go beyond pure competition goals such as implementation of universal policies to ensure access to basic services and subsequently contributing to economic growth that may otherwise not be achieved.[9] Consequently, every country regulates some sectors of its economy at any given time.

2. In Kenya, the construction industry is regulated by the National Construction Authority (NCA). The NCA is established under Act No. 41 of 2011 Laws of Kenya. NCA's mandate is to regulate, streamline and build capacity in the construction industry. The NCA also registers and regulates the performance of local and foreign contractors and accredits skilled construction workers and site supervisors. It has segregated construction firms into categories based on the contract value they are allowed to undertake as well as the academic requirements for the owners of the companies.

2.1 The National Construction Authority Act No. 41 of 2011

1. This is an Act of Parliament to provide for the establishment, powers and functions of the National Construction Authority and for connected purposes.[10] The Act establishes the National Construction Authority which has been given wide ranging powers as far as the industry is concerned. The definition of construction is also very wide and covers anything from buildings, roads, dams and telecommunication apparatus amongst others.[11]

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[9] The Role of Competition Agencies In Regulated Sectors https://www.justice.gov/atr/file/519376/download

[10] http://kenyalaw.org/kl/fileadmin/pdfdownloads/Acts/NationalConstructionAuthorityAct_No41of2011.pdf

[11] http://www.erubiengineering.com/?p=43

2. The National Construction Authority Act (NCA) was gazetted in December 2011 and the NCA Board inaugurated in July 2012. It was formed with the main aim of consolidating and creating a well-regulated construction industry that will promote sustainable socio-economic development[12].

2.2 The National Construction Authority Regulations of 2014 (The Construction Regulations)

1. The Construction Regulations give the NCA the mandate to regulate, promote quality assurance and undertake research in the industry. Registration under each category of the Works is on a point basis pegged on criteria such as financial capacity, experience, available equipment and technical expertise. Certain Works are now exclusively reserved for local contractors as opposed to open bidding which attracts all interested bidders. Foreign contractors are only eligible to register for a NCA-1 contract (i.e. a building contract above Kenya Shillings five hundred million) whereas local contractors will be eligible to register for all categories of contracts.

2. In a nutshell, the regulations outline how the following should be done:-
   i) Registration of contractors
   ii) Joint ventures
   iii) Identification and reporting of construction works, contractors or projects by owner
   iv) Certification and accreditation of skilled construction workers and construction site supervisors
   v) Enforcement of the following:-
      - Fees

[12] http://building.co.ke/introduction-to-the-national-construction-authority/

- Investigation of complaint or suspicion.
- Removal of contractors from Register
- Liability of principals and employers.

Sub-Contracting and Joint Ventures

1. The scope of the Regulations is far reaching in that under a joint venture contract, it is mandatory to recruit employees from the local labour market and where one requires technical or skilled foreign employees, the prior approval of the NCA is sought, provided that such skills are not available locally. It is notable that while the NCA is empowered to give an exemption from the Regulations, this power seems to be discretionary as the criteria for exemption has not been provided under the Regulations[13].

2. The NCA may register such joint ventures that a foreign contractor enters into with a local firm or person. The Construction Regulations further require that the employees of such a joint venture be competitively recruited from the local labour market. Recruitment or employment of foreign technical or skilled workers on such contract shall only be done with the approval of the NCA where such skills are not available locally. It is important to note though that contractors may be exempted from this provision by the NCA.[14]

Registration of foreign contractors

1. The Construction Regulations define a "foreign contractor" as:
    - a firm incorporated outside Kenya; or
    - a firm incorporated in Kenya in which 51% of the shares are held by a non-Kenyan.

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[13] http://www.africalegalnetwork.com/blog/2015/04/legal-alert-kenya-the-national-construction-authority-nca-stiffens-regulations-on-foreign-contractors-in-kenya/

[14] http://www.oraro.co.ke/alert/building-a-strong-national-foundation-local-content-in-kenyas-construction-industry/

2. The Regulations require that a contractor, whether foreign or local, must be registered under the category of construction works (Works) they propose to undertake. The Works are classified under eight categories; NCA-1 to NCA-7, ranging in monetary value from unlimited value contracts (NCA-1 contract) to contracts valued for Kenya Shillings five million and below (NCA-7).

Table 2: Categories of contractors in Kenya

CLASS	CONSTRUCTION WORKS
NCA 1	Unlimited contract value
NCA 2	Contract value up to 500,000,000 (contractors –buildings), up to 250,000,000 contact value (specialist contractors), up to 750,000,000 (roads and other civil works).
NCA 3	Contract value limited to 300,000,000 (contractors –buildings), up to 500,000,000 (roads and other civil works)
NCA 4	Contract value limited to 200,000,000 (contractors –buildings), up to 100,000,000 (specialist contractors) up to 300,000,000 (roads and other civil works)
NCA 5	Contract value limited to 100,000,000 (contractors- buildings), up to 50,000,000 (special contractors) up to 200,000,000 (roads and other civil works)
NCA 6	Contract value limited to 50,000,000 (contractors – buildings) up to 20,000,000 (special –contracts) up to 100,000,000 (roads and other civil works)
NCA 7	Contract value limited to 20,000,000 (contractors – buildings), up to 50,000,000 (roads and other civil works).

3. From the table above, large construction firms range from classes one (1) to three (3) while the smaller construction firms range from classes four (4) to eight (8). Each class has an upper bound on the size and value of projects it is eligible to undertake, where smaller contractors work on small scale projects while the large contractors operate on large scale development projects. NCA 1 contractors are in the unlimited category that is illegible to undertake projects of any size. The classification criteria is largely premised on three factors:

- Financial Capability;
- Technical Qualifications;
- Skills and Experience;
- Statutory Requirements (PIN certificate, VAT certificate, audited accounts, Tax clearance, etc) ;
- Equipment/machinery the contractor possesses.

4. According to NCA rules and regulations, a contractor may be registered for more than one class of construction works but may hold only one category of registration in relation to particular class of construction works at any given time.[15]

2.3 Statutory Bodies and Industry Associations

1. In Kenya, the construction industry is regulated by various other parastatals in addition to the NCA. These institutions are mandated to manage, develop, rehabilitate and maintain public roads, develop and maintain public buildings as well as residential houses. These institutions include National Housing Corporation (NHC), Kenya Urban Roads Authority (KURA), Kenya Rural Roads Authority (KERRA), and Kenya National Highways Authority (KENHA).

2. In addition to government parastatals, there are governing boards and industry associations that are mandated to regulate the market and monitor the conduct of players in the industry. These include Board of Registration for Architects and Quantity Surveyors, Engineers Board of Kenya (EBK), Architectural Association of Kenya (AAK) and the Institute of Quantity Surveyors of Kenya (IQSK). These boards are established in order to execute the scheme and curriculum for professional education and other activities of matters of continuous training for the registered persons and examinations for those wishing to be registered. All applicants

[15] http://www.nca.go.ke

interested to venture into the construction industry are also vetted by these Boards, before seeking registration with the NCA.

2.4 Overview of the other Relevant Government Acts

		Limit the number or range of contractors, e.g. establishes a license process as an operation requirement	Limit the ability of contractors to compete, e.g. significantly raises production costs of new entrants relative to incumbents	Reduce the incentive of contractors to compete vigorously; reduce mobility of consumers between suppliers
1.	Physical Planning Act Chapter 286	• Provide for the preparation and implementation of physical development plans and for connected purposes		Provides for the appointment of the Director of Physical Planning, requires regional and local authorities to adopt Physical Development Plans in accordance with this Act and provides for control of development and subdivision of land.
2.	Environment Management and Coordination Act (Amendment) of 2015	• Establishes the National Environment Management Authority (NEMA) • Requires an environmental impact assessment (EIA) preliminary report to be undertaken on a project prior to its construction. • Only consultants registered by NEMA are allowed to provide environmental impact assessment submissions, whether as an EIA project report or a full EIA	• Payment of 0.1% of the estimated project cost or a minimum of ten thousand Kenyan Shillings must be made with the submission of the EIA reports	The Act provides for environmental protection through; • Environmental impact assessment • Environmental audit and monitoring • Environmental restoration orders, conservation orders, and easements

		Limit the number or range of contractors, e.g. establishes a license process as an operation requirement	Limit the ability of contractors to compete, e.g. significantly raises production costs of new entrants relative to incumbents	Reduce the incentive of contractors to compete vigorously; reduce mobility of consumers between suppliers
		study. The lead environmental expert must be registered with NEMA.		
3.	Engineering Technology Act No 23 of 2016	• Establishes the Kenya Engineering Technology Registration Board. Establishes requirements for one to work as a • professional engineering technologist, • consulting engineering technologist, • certified engineering technician A person must apply for a practicing license	For one to be a consultant Engineer, he must be • Registered with EBK as a Professional Engineer; • Must have at least 9 years continuous professional experience of which 5 years will be post registration as a professional engineer	• The Applicant shall pay 2,000/= as processing fee and Kshs. 20,000/= as registration fee for local firms. • Foreign firms to pay 150 USD as processing fee and 600 USD as registration fee.
4.	Kenya Roads Act 2017	• provided for the creation of three new agencies to be responsible for the development and maintenance of the road network namely: • Kenya National Highways Authority (KeNHA) • Kenya Rural Roads Authority (KeRRA) • Kenya Urban Roads Authority (KURA).	Not applicable	Not applicable

2.5 Devolution and County Governments

1. The devolved government, proposed during the making of the new constitution, is primarily geared towards achieving two main objectives.

i) Involve the people in governance

ii) Allow better supervision and implementation of policies at the grass root level

2. Established under chapter 11 of the constitution of Kenya, county governments are in charge of land survey and mapping as well as county public works and drainage in urban centers. Of major concern is that the National Government and county governments constantly pass laws and issue regulations touching on health, safety, environmental concerns and other issues, which more often than not, raise construction costs while at the same time curtailing the level of competition in the sector.

2.6 Impact of the Regulatory Framework on Competition and Market Outcomes

2.6.1 Registration and membership fees

1. The National Construction Authority Act No. 41 of 2011 obligates all contractors to register with the NCA, as well as their professional bodies and renew their membership annually. This process involves the contractors paying registration fees and membership fees. Analysis of the respective registration fees shows a huge discrepancy between the fees paid by local contractors as compared to those paid by foreign contractors. For instance, for the NCA 1 category, local contractors pay fees of approximately KES 100,000 while foreign contractors pay approximately KES 300,000, for firms of similar category.

2. This gives a competitive advantage to local contractors over foreign firms. The higher registration fees paid by the foreign firms will translate to higher operation costs. Consequently, most foreign firms tend to quote higher in order to factor in the high fees paid. That notwithstanding, the Kenyan construction sector is dominated by foreign firms as per appendix I attached. Foreign firms are only eligible to register under the NCA 1 category which encapsulates major construction projects.

2.6.2 Foreign-Domestic Firm Partnership Requirement

3. A foreign firm is required to make an application to the National Construction Authority before undertaking work under category NCA-1. The application must be accompanied by an undertaking in writing that the foreign contractor shall:

a. subcontract or enter into a joint venture with a local person or firm for not less than 30% of the value of the contract work for which temporary registration is sought; and

b. transfer technical skills not available locally to a local person or firm in such manner as the NCA may determine from time to time;

4. Foreign contractors have been increasingly dominating the Kenyan construction scene over the last couple of years. Most of the contracts issued by the Kenyan government and the big private sector players in the country have been undertaken by foreign companies who are favoured by clients because of their relatively significant expertise and financial muscle. For this reason, local contractors felt that they were being edged out unfairly and consistently pushed for affirmative action which led to the enactment of the National Construction Authority Regulations, 2014 (the Regulations).

5. The requirement to partner with local firms gives a loophole for local contractors to quote exorbitantly high prices in partnering with foreign contractors. The challenge with this regulations is that

a) They are not binding on the part of the foreign firms. The foreign firms may win tenders individually and it is up to them to then seek a local partnering firm afterwards

b) The local firms may not get their fair share of the agreement. Most local firms are assigned just segments of the project and hence may not really benefit from the skills transfer initiative.

c) Majority of the local firms lack the technical capacity and know how to handle such projects. Subsequently, the quality of work done is normally very shoddy as the labourers hired are mostly ill equipped and inexperienced.

2.6.3 Conflict of Interest on the Composition of the NCA Board

6. In addition to representatives from the Ministry of Public works and devolution, the NCA Board consists of members from various industry associations such as the Architectural Association of Kenya, The Institute of Engineers in Kenya, The Institute of Quantity Surveyors of Kenya, The Law Society of Kenya and two other members appointed by the Cabinet Secretary to represent groups with special interests in the construction industry. The Board composition may result in conflict of interest as some of the members may pass regulations to ensure they protect their interests within the industry.

7. In summary, determining the proper relationship between competition enforcement Agencies and sectoral regulators is a complex issue that depends on not only the legal and regulatory systems of a country, but also the appropriate balance between conflicting regulatory and market-oriented objectives. It also depends on the confidence that the Kenyan government has in the effectiveness of the market so as to determine outcomes that are best for consumers and the economy as a whole[16].

[16] Role of Competition in Regulated Sectors by Stuart M. Chemtob

3 GENERAL STATE OF COMPETITION IN THE CONSTRUCTION INDUSTRY

3.1 Industry Structure

The various players in the construction sector include:-

Contractors

1. Contractors for construction projects are readily available in Kenya. One may find contractors of all categories ranging from labour based contractors for simple jobs to those with the most advanced equipment in the market today and a capital base of millions of US dollars. There are also foreign-based contracting companies who have invested in Kenya such as John Gleeson and Mowlem from UK. The National Construction Authority Act No. 41 of 2011 defines a contractor as follows:-

> ***16. Meaning of "Contractor"***
>
> 1) For the purposes of this Act, a person carries on business as a contractor where such person, for reward or other valuable consideration, undertakes the construction, installation or erection, for any other person, of any structure situated below, on or above the ground, or other work connected therewith, or the execution, for any other person, of any alteration or otherwise to any structure or other work connected therewith, and undertakes to supply
>   a) the materials necessary for the work, or is authorized to exercise control over the type, quality or use of the materials supplied by any other person;
>   b) the labour necessary for the work, or is authorized on behalf of the person for whom the work is undertaken or any other person, to employ or select workmen for employment for the purposes of the execution of the work, whether under a contract of service or otherwise: Provided that a person shall not be deemed to be a contractor if the work undertaken -
>   i) does not incur a cost exceeding such sum or sums as the Board may from time to time determine; or
>   ii) Consists of a residential house for private use, not requiring a structural design.
> 2) The Board shall register eligible contractors to undertake any of the classes of contracted works set out in the Third Schedule depending on their knowledge and experience.
>
> ***National Construction Authority Act, No. 41 of 2011 [Rev. 2012]***

2. The government sometimes carry out construction works for its own projects by using the Ministry of Public Works and Housing which is also the custodian of all government owned properties[17].

Architects

3. The architect designs the form of the building providing space to meet the client's needs and also incorporating aesthetics based on cultural and regional trends and environmental aspects. Regulation of entry is very strict, with regulation requiring one year of practice and successful completion of a professional exam to become a full member of the profession. Furthermore, becoming an architect in Kenya requires having at least one year of domestic experience or demonstrating sufficient knowledge of the country's building contract procedures. In addition, a relatively high number of services (four) are provided by the profession under an exclusive or shared right. Cooperation is only allowed between comparable licensed professionals.[18]

4. According to the OECD competition assessment toolkit, license or permit requirements are often stricter than is necessary for consumer protection and can unnecessarily reduce consumer choice and create artificial scarcity that raises prices. While licensing schemes often have well-founded consumer protection objectives, such barriers frequently have the effect of protecting incumbent producers from competition. Care needs to be taken that license and permit requirements do not become more onerous than is necessary to achieve the sought regulatory objectives.[19]

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[17] http://www.lth.se/fileadmin/hdm/alumni/papers/icm2000/ICM2000-10.pdf

[18] UNLOCKING GROWTH POTENTIAL IN KENYA; Competition Authority of Kenya (CAK), and the IFC, a member of the World Bank Group (WBG).

[19] http://www.oecd.org/daf/competition/46193173.pdf

Engineers

5. Engineers have the unique role of solving social problems through the use of machines, devices, systems, materials and processes. Entry into the profession involves basic requirements such as a mandatory exam to practice the profession, in addition to compulsory university education (five years on average), and licensing. Engineers also enjoy exclusivity rights, in some cases together with architects, for some activities such as the preparation of feasibility studies, planning, designing, drawing, construction, commissioning, operation, maintenance, supply of specialized engineering equipment, and management of engineering works or projects. Conduct is not strictly regulated, with the only constraint being that cooperation is allowed only between comparable licensed professionals.[20]

Quantity Surveyors/Building Economists

6. It is common practice in Kenya to incorporate bills of quantities in the tender documents. The advantage of this is that all the tenderers have the same project parameters and therefore make it quite easy to analyze the bids and also ensures responsiveness of the tenders. As a result building economists provide an invaluable role in the construction process. Ideally the building economist is not part of the design team but provides staff input for the architect or project manager. Building economists are readily available in Kenya although they have traditionally been termed quantity surveyors.

Environment Experts

7. In the earlier days projects were constructed without much regard to the sustainability of the construction industry or care for the environment. Construction projects require huge amounts of the Earth's natural resources and it is, therefore, necessary to protect the environment form the vagaries of the industry. Environmental experts assess

[20] UNLOCKING GROWTH POTENTIAL IN KENYA; Competition Authority of Kenya (CAK), and the IFC, a member of the World Bank Group (WBG), 2015

projects and draw environmental impact assessment with a view to minimizing the negative effects while enhancing the positive ones.

Clients

8. The clients include government parastatals, county governments, and individuals, private companies such as a banks, industrial organizations or institutions such as schools or hospitals. Pension funds and insurance companies are also involved in the construction industry as clients. The client normally initiates the project and provides the design team with a project brief based on his needs and budgetary constraints and therefrom the design team undertakes to propose solutions to the client's needs.

Project Managers

9. The concept of independent project managers is fairly new in Kenya and is the process of taking root. Previously one of the design consultants used to act also as a project administrator and would provide the necessary liaison between the client and the design team. The disadvantage of such a set-up is that a person may lack objectivity as a project administrator and favour his team leading to unnecessary conflicts between the various consultants and the contractor in a project and affect the implementation of the project. Indeed this has been the case in Kenya up to a point where the market has lost confidence in the industry.

Social Scientists

10. Social scientists analyze projects and come up with recommendations appertaining to gender and other social issues thus incorporating a social dimension to projects. This helps in maximizing the benefits accruing from a project. For example building of a factory in a certain location may appear to be a good idea considering the number of jobs that will be available to the local populace but on the other hand if not carefully implemented this may lead to growth of slum areas in a bid to provide shelter and social

amenities for the labourers in the factory. Therefore, demographic effects of the project need to be assessed and results incorporated in the design.

Material Suppliers

11. There are enough construction material suppliers in the country at the moment to satisfy the demand. Materials such as paints, glass, cement, steel, plastic and ceramic wares are all manufactured locally. However there is a dire need for increased prefabrication to minimize wastage and improve on the quality of the finished product and delivery time. This is an area where the suppliers can capitalize on as the players are very few. Maybe when the number of prefabricators increase the cost of prefabricated products will reduce making such goods more attractive to contractors as opposed to site fabrication and thus making construction cheaper to the clients.

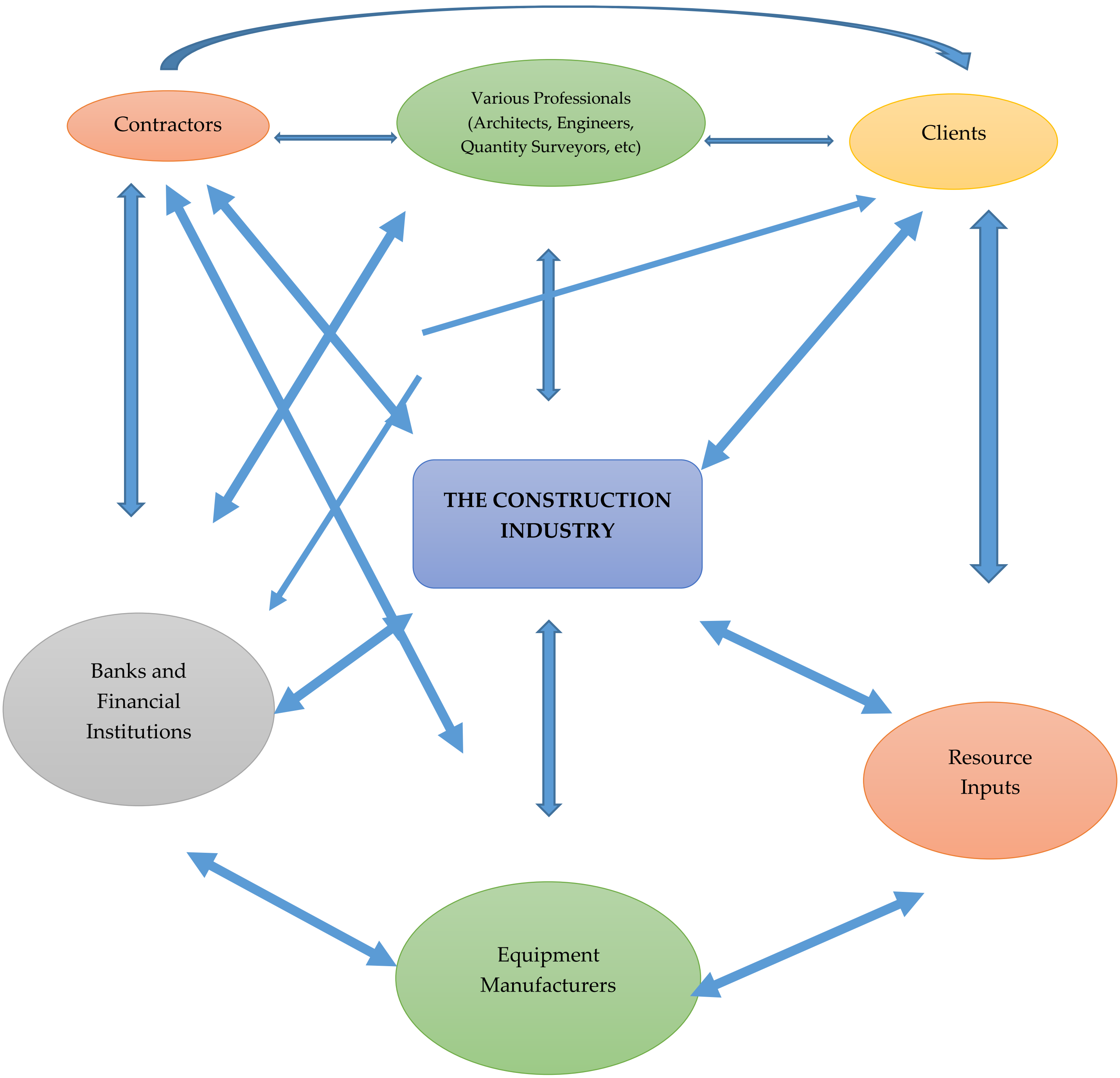
Financial Institutions

12. There are various finance institutions from which investors may get financial assistance such as banks, mortgage companies, non-governmental organizations, public and private pension funds, financial and insurance companies. All these are organizations that need to invest for long terms. Of particular interest to the building industry are mortgage companies which are created purposely for the building industry. World Bank, African Development Bank and bilateral aid agencies also finance projects through loans and grants to the government and non-governmental Organizations.

Property Managers

13. Once the facility is complete and has been occupied property managers take over to ensure that the value of the facility is maintained by putting in place proper maintenance and operation procedures for maximization of the utility and profits accruing from the facility.

Figure 1: Main Players in the Construction Industry and their Inter - Relationships



3.2 Number of Construction Firms in Kenya

1. The National Construction Authority (NCA) whose mission is to regulate, streamline and build capacity in the construction industry in Kenya is the regulator of local and foreign contractors operating in Kenya.[21] According to NCA 18,000 contractors registered with NCA in 2015 with local contractors forming about 50%. As at 2015, 111 NCA 1 contractors applied for registration with NCA. More than 50% of NCA 1 contractors were from local Kenyan companies. 80 percent of Kenyan contractors fall below NCA 4 and as such lack requisite financial capacity, equipment and manpower to undertake massive projects.[22]

2. The table below shows some of the major construction projects currently being undertaken in the country:-

	PROJECT	DESCRIPTION	MAIN CONTRACTOR (S)	COST
1.	**LAPSSET**	The LAPSSET Corridor Program is a regional flagship project intended to provide transport and logistics infrastructure aimed at creating seamless connectivity between the Eastern African Countries of Kenya, Ethiopia and South Sudan	• China Roads and Bridge Corporation the international arm of China Communications Construction Company	Estimate of US$24.5 billion, equivalent to Kshs. 2.4 Trillion
2.	**Standard Gauge Railway**	The project comprises the construction of the USD 200 million Nairobi Commuter Rail Network and the USD 3.2 billion Mombasa Nairobi-Malaba Corridor	• China Road and Bridge Corporation	Estimated cost of shs. 484 billion
3.	**Dongo Kundu**	The Dongo Kundu bypass, which is part of a three-phase plan to decongest Mombasa. To develop the	• China Civil Engineering Construction	Estimate of kshs. 25 billion

[21] http://www.nca.go.ke

[22] http://www.constructionkenya.com/3000/nca-registered-contractor

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	PROJECT	DESCRIPTION	MAIN CONTRACTOR (S)	COST
		traffic route to Mombasa South Coast towards Tanzania, alleviate congestion in this area and facilitate the logistics from the new container terminal through development of the Kipevu Link Road and Mombasa Southern Bypass (Dongo Kundu Bypass).	Cooperation (CCECC)	
4.	**Nairobi Public Transport System**	The rail and road system-hyped as the long-sought solution to Nairobi's public transport mayhem, aims to ease urban mobility and make commuting a less stressful experience for the over 2.6 million people currently entering or leaving the city daily	• Gauff Ingenieure-JBG and PB-Consult GmbH (GER) (Gauff Consultants)	Estimate of kshs. 100 million

3. Many construction projects could not be efficiently completed without some degree of sub-contracting. Even large contractors have to rely on smaller, more specialized firms for some aspects of their projects. However, at times, a winning bidder will sub-contract part of a project to a firm that would ordinarily be its rival. In fact, firms in the construction sector often consider talking to and partnering with each other to be a normal way of doing business.

4. Whereas in one project companies might truly behave like independent competitors, in another project they might form a joint venture or have a contractor/subcontractor Agreement. That kind of complex relationship causes headaches for competition authorities because it may not be clear whether or not meetings and communications between the companies served a legitimate business purpose. Some of the largest construction firms in Kenya are:-

- China Road and Bridge Corporation
- China Wu Yi
- Southern Engineering Company Limited
- H Young Company EA Ltd
- Civicon Ltd
- Zakhem Construction Limited
- Cementers Limited
- SS Mehta & Sons Limited
- Vaghjiyani Enterprises Limited[23]

3.3 Barriers to Entry in the Construction Industry.

1. The entry of new players restrains the exercise of abuse of dominance and excessive market power of incumbent players. One indication of a competitive market therefore is that it must be possible for a new firm to enter and for existing firms to expand or exit. The exercise of market power is unlikely when entry is likely, timely and sufficient

2. For small construction firms, the start-up costs for entering their local market tend to be low. That may be due to the fact that relatively few pieces of equipment have to be bought. Small firms commonly lease equipment on an as-needed, project-by-project basis. There are other financial hurdles, though. Customers with substantial projects often require construction firms to post a bond, which acts as a financial guarantee for the customer in the event that the firm is unable or unwilling to fulfil its obligations. The standard amount of the bond varies substantially from country to country, being as little as zero to as much as the entire value of the contract. These bond requirements may present formidable obstacles to new firms, especially if they are small.

[23] National Construction Authority

3. There exists a lot of business rivalry in the construction sector. This is mainly seen through rivalry between foreign owned firms and local contractors who perceive the foreigners as a threat of substitutes within the industry. Competition focuses heavily on price because companies typically cannot fund major innovations.[24] Kenyan construction industry is not insusceptible to challenges and impediments just like in other developing countries in Africa and the entire world, there are several setbacks in the construction industry. Examples of such setbacks include lack of transparency in bid procedures, inelastic demand, highly cyclical business, large number of buyers and sub-contracting, to name but a few.

3.3.1 Strategic Barriers

Government Regulations

4. The NCA has segregated construction firms into categories basing on the contract value they are allowed to undertake as well as the academic requirements for the owners of the companies. Owing to this fact those companies that do not meet the minimum requirement are unable to access projects that are beyond their scope in terms of financial and academic parameters.

5. Barriers to entry in this industry are not only restricted to construction firms but also to professionals bodies. The professional regulatory framework has procedures and criteria that have seen qualified professional registered with the bodies but at rates that have seen a number of court cases involving the registration of individuals to these bodies for example registration to Engineers Regulatory Board and Board of Registration of Architects and Quantity Surveyors (BORAQS).

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[24] Factors Affecting Performance Of Local Road Construction Companies In Kenya; Sirkoi 2015

3.3.2 Natural and Intrinsic Barriers

Technology

6. In construction sector technology is crucial since it affects performance, hence those construction companies that do not possess the required technology are unable to compete with the ones that are well equipped. Construction companies that fall short in regards to technology are not in a position to undertake certain technologies this especially applies to small construction companies who cannot afford to purchase certain equipment to facilitate in completing the project.

3.3.3 Entry and Exit Dynamics

Capital

7. Quite a number of construction companies are below the NCA 4 category thus are unable to undertake massive projects. Such companies are unable to fully take advantage of economies of scale when compared to big companies who possess financial power. Among other challenges experienced in this industry, capital has been outlined as one of the major challenges faced by entrepreneurs in the construction sector, coupled with complacence among the contractors as they tend to settle for what they have attained. However, the sector is expected to grow faster towards the end of the year as commercial banks continue to lower lending rates (CBK, 2015).

8. In addition, some of the machines acquired by contractors cannot be used after the assignments are completed resulting in various sunk costs. Furthermore, various administrative constraints (such as: building permissions, special qualifications) or costs of complying with quality regulations may constitute barriers to entry.[25]

[25] OECD COMPETITION IN THE CONSTRUCTION INDUSTRY , DAF/COMP(2008)36

County Levies

9. The imposition of higher levies, charges and taxes by many of Kenya's 47 new counties is causing increased concern to traders, consumers and investors because of the impact on business costs and the threat of higher inflation. The wide disparity between tax levels in different counties poses an additional complication. Counties cite the need for revenue, but new local-level taxes will reinforce the impression that Kenya is a high-cost economy and will potentially have a negative impact on investment.[26]

Registration Procedures and Costs

10. Firms that intend to carry out construction work in Kenya are required to be registered by the NCA. This applies to both local and foreign firms, although registration requirements and fees paid vary. The firms also need to be vetted by statutory bodies for the respective professions.

Partnership

11. Kenyan Nationals can gain entry into the sector freely. However, foreign companies are limited to only one project at any one time. 30% of the contract business should be handled in Kenya. Foreign staff must also acquire immigration permits.

4 PRICE DETERMINATION IN THE CONSTRUCTION INDUSTRY

1. Unlike most of the sectors of the economy, the construction industry does not have structured units of measurement which can be quantified to determine the price. It is not possible to calculate straight forward standard costs as the determinant factors vary from project to project.

2. The table below shows the annual percentage changes in construction input price indices for the period 2014 to 2016. Overall, the total cost index grew by 4.1 per cent in 2016

[26] http://country.eiu.com/article.aspx?articleid=1871570571&Country=Kenya&topic=Economy

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compared to a 4.9 per cent increase in 2015. This may be attributed to a slowed rate of increase in compensation of employees in 2016. Stability of prices of inputs in construction occasioned by the relative stability of the Kenya Shilling against other currencies also contributed to a lower increase in the construction cost index. However, other material inputs such as timber, hydrated lime and structural steel recorded increases in prices in 2016. The rate of change of the total cost index of residential buildings and other construction was 3.4 per cent and 5.0 per cent, respectively, in 2016. Wages in the Building and Construction sector increased by 7.9 per cent in 2016 compared to 10.0 per cent increase in 2015.[27]

	Materials			Labour			Total		
	2014	2015	2016*	2014	2015	2016*	2014	2015	2016*
Residential Buildings	8.7	2.0	1.5	7.9	10.0	7.9	11.2	4.3	3.4
Non-Residential Buildings	7.6	1.9	1.4	7.9	10.0	7.9	9.4	4.7	3.6
All Buildings	8.2	1.9	1.5	7.9	10.0	7.9	10.4	4.5	3.5
Other Construction (roads, bridges and dams)	6.7	0.7	1.2	7.9	10.0	7.9	9.6	5.6	5.0
Overall Cost Index	**7.7**	**1.5**	**1.4**	**7.9**	**10.0**	**7.9**	**10.1**	**4.9**	**4.1**

Source: KNBS and Ministry of EAC, Labour and Social Protection[28]
***Provisional**

4.1 Major Cost Items for Construction Works

Information to be compiled

[27] KNBS Economic Survey 2017
[28] KNBS Economic Survey 2017

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5 PROCUREMENT POLICIES AND PROCEDURES

5.1 The Public Procurement and Asset Disposal Act No. 33 Of 2015

1. An Act of Parliament to give effect to Article 227 of The Constitution; to provide procedures for efficient public procurement and for assets disposal by public entities; and for connected purposes enacted by Parliament of Kenya. Information to bidders and contractors is made available the standard procurement and asset disposal documents pursuant to: Section 58 (1) & (2) and Section 70 (2), (3) & (6) of Public Procurement and Assets Disposal Act, 2015(the Act herein after referred to as PPADA, 2015).

2. Section 67 of PPADA, 2015 restricts disclosure of information relating to a procurement whose disclosure would:
   a) Impede law enforcement or not be in the public interest;
   b) Prejudice legitimate commercial interests, intellectual property rights or inhibit fair competition.

   NB: The restrictions do not apply where:

   a) the disclosure is to an authorized employee or agent of the entity involved in the procurement proceedings
   b) the disclosure is for the purpose of law enforcement
   c) the disclosure is pursuant to a court order
   d) the disclosure is to PPRA or Public Procurement Administrative Review Board

3. Regulations arising from the Public Procurement and Asset Disposal Act are currently in the process of being developed

5.2 Debriefing of award results

4. Notification letters are sent to both the successful and unsuccessful bidders.

NB: Section 87 (3) of PPADA, 2015 requires notification letters to unsuccessful bidders disclose the successful tenderer and also inform the unsuccessful tenderers on why their bids were unsuccessful.

5. Entities required to: publish and publicise all contract awards on their notice boards and website if available; and to report all contract awards to PPRA; The E-Tendering/procurement is used/carried out through the Integrated Financial Management Information System (IFMIS) under National Treasury.

6. The procurement law has made provision for the application of preference and reservation scheme under part XII of the Act (sections 155, 156, 157 & 158 of the Act) with the main objective of ensuring sustainable promotion of local industry and for purpose of protecting and ensuring the advancement of persons or groups previously disadvantaged by unfair competition or discrimination, reservations, preferences.

7. To ensure a level playing field, the National Treasury and PPRA are mandated to monitor and evaluate the implementation of the preference and reservations. The Kenya Anti-Corruption Commission jointly with the Public Procurement Oversight Authority developed Corruption Prevention Guidelines in Public Procurement in 2009. The guideline outlines corruptions risks in public procurement system.

8. Part XV of the Act provides for the administrative review of procurement and disposal proceedings. A candidate or a tenderer, who claims to have suffered or to risk suffering, loss or damage due to the breach of a duty imposed on a procuring entity by the Act or the Regulations, may seek administrative review by the Public Procurement Administrative Review Board. In addition, Section 175 (1) of the Act states that a person aggrieved by a decision made by the Review Board may seek judicial review by the High Court

5.3 Impact of Procurement Policies on Competition and Market Outcomes

9. The procurement policies and procedures highlighted above have various positive attributes. These ensure that the procurement process is fairly competitive and follows due process. It also ensures participation of local contractors in construction projects, while at the same time boosting the local capacity in the construction industry

Foreign-local contractor partnership

10. The requirement for foreign contractors to ensure that 40% of the contract business is handled in Kenya or by local contractors has its benefits. However, this arrangement also has adverse effects on competition and outcomes on the market as well as the quality of work produced. The National Construction Authority also reviews incorporation certificates issued by foreign counterparts in other countries in its evaluation of foreign contractors.

Use of standard procedures for bidding

11. Under Section 9(1) (k) of the Act the Authority is mandated to develop and manage the State portal on procurement and asset disposal and ensure that it is available and easily accessible. Similarly, Section 9(1) (m) of the Act requires the Authority to create a central repository or database that includes:-

    a. Complaints made on procuring entities;
    b. a record of those prohibited from participating in tenders or those debarred;
    c. market prices of goods, services and works;
    d. benchmarked prices;
    e. State organs and public entities that are non-compliant with procurement laws;
    f. statistics related to public procurement and asset disposal;
    g. Price comparisons for goods, services and works; and (any information related to procurement that may be necessary for the public.

12. The Public Procurement and Asset Disposal Authority in the process of developing the state portal as part of the monitoring and evaluation framework

6 CONCLUSION

6.1 Summary of Findings

To be compiled

6.2 Recommendations

To be compiled