

**FACTORS THAT INFLUENCE RELOCATION OF
MULTINATIONAL OIL COMPANIES BASED IN KENYA
TO OTHER COUNTRIES**

**BY
BENADETTE WANJIRU MWANGI**

**A RESEARCH PROJECT SUBMITTED IN PARTIAL
FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF
DEGREE OF THE MASTER OF BUSINESS ADMINISTRATION,
SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI**

OCTOBER 2012

DECLARATION

This research project is my original work and has not been presented for examination in any other university

Signed: Date:

BENADETTE WANJIRU MWANGI

D61/70856/2008

This project has been presented for examination with my approval as the university supervisor

Signed: Date:

DR JOHN YABS

LECTURER

SCHOOL OF BUSINESS

UNIVERSITY OF NAIROBI

ACKNOWLEDGEMENTS

First, I thank the Almighty God for giving me the chance to see the fruits of my hard work.

I gratefully acknowledge the insightful guidance, positive criticism, encouragement and valuable advice from my supervisor, Dr. John Yabs, which enabled me to complete this project successfully.

Regards go to all my lecturers and fellow students at the University of Nairobi (MBA programme) for rendering an enriching experience to share and procure knowledge. I also wish to express my profound gratitude to all my friends for their encouragement during the course of the study.

I owe profound intellectual debt to those who enriched this project with much needed information and made it a success. I humbly request that those concerned accept my expression of gratitude for their support. Special thanks to all those who assisted me in any way: May God bless you abundantly.

DEDICATION

I dedicate this project to the members of my family especially my loving husband Martin, son Kent and daughter Michelle.

ABSTRACT

With advent of economic globalization, internationalization has become one of the most important strategies for firms to achieve sustainable growth. Motivations for internationalization of firms have drawn great interests from practitioners and researchers. Well-established multinational companies are suddenly finding themselves closing shop from some regions and countries and relocating to other regions. Multinationals which have closed their operations in Kenya include Colgate Palmolive, Johnson & Johnson, Agip, Unilever, Procter & Gamble, and recently, ExxonMobil, Caltex and Shell just to mention a few. The purpose of the study was to determine the factors that lead to relocation of multinational oil distributors from Kenya. This study had a specific emphasis on the factors that have led Shell Kenya to divest.

A descriptive case study design was employed in this study. The target subjects for this study were senior employees at Kenya Shell. Interview method was applied to collect data from four senior employees at Shell who include General Manager – Kenya, Assistant General Manager – Kenya, Head of Marketing and Fuel Business Development – Kenya and Head of Operations and Projects Development – Kenya. Data collected was qualitative in nature which was analyzed through content analysis.

Study findings indicate that Shell Kenya was divested due to various contributing factors the most compelling being shrinking profit margins due to price ceilings set by the energy regulatory commission. Results also indicated that the country's poor and stagnant petroleum infrastructure was another major contributing factor. Competition from small

and medium upcoming oil companies in Kenya and the multinationals already in the country is another factor contributing to the unattractiveness of the Kenyan market. Government interference in the oil import, distribution and pricing was another factor that made Shell Kenya to close its operations.

The following recommendations are made. First, the pricing formula should be managed by an independent and credible firm which should ensure that all factors are put in the pricing formula not to strangle margins of oil companies too thin. Second, it's important to lessen political and government input in oil import, distribution and pricing. Third, multinationals should ensure that they have sound and competitive marketing and customer service strategies to be able to compete with the upcoming small and medium oil distribution companies. Lastly, oil companies should strengthen their upstream operations not just focusing all their resources and competencies on the downstream operations.

TABLE OF CONTENTS

Declaration.....	ii
Acknowledgements.....	iii
Dedication.....	iv
Abstract.....	v
Abbreviations and Acronyms	ix
 CHAPTER ONE: INTRODUCTION	 1
1.1 Background of the Study.....	1
1.1.1 Internationalization.....	3
1.1.2 Host Country Relations with Multinationals	6
1.2 Research Problem	10
1.3 Research Objectives	12
1.4 Value of the Study.....	13
 CHAPTER TWO: LITERATURE REVIEW.....	 14
2.1 Introduction.....	14
2.2 Theoretical Review	14
2.3 Internationalization	17
2.4 Factors Contributing to exit of oil multinationals.....	19
2.5 Empirical Review.....	20
 CHAPTER THREE: RESEARCH METHODOLOGY	 24
3.1 Introduction.....	24
3.2 Research Design.....	24
3.3 Target Population.....	24
3.4 Sampling Design And Sample Size.....	25
3.5 Data Collection	25

3.6 Data Analysis	25
CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION	26
4.1 Introduction.....	26
4.2 General Information	26
4.3 Factors Influencing Exit Decision	28
4.3.1 Background of the Exit.....	28
4.3.2 Dwindling Margins	28
4.3.3 Inefficient Petroleum Infrastructure	32
4.3.4 Rising Competition	34
4.3.5 Government Regulation	35
CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS ..	38
5.1 Introduction.....	38
5.2 Summary in findings	38
5.3 Conclusion	41
5.4 Recommendations	43
5.5 Suggestions for future research	43
REFERENCES.....	44
APPENDICES.....	48
Appendix I: Letter of Introduction	48
Appendix II: Introduction Letter from the University of Nairobi.....	49
Appendix III: Questionnaire for Kenya Shell managers.....	50
Appendix IV: Companies in the oil Industry in Kenya	51

ABBREVIATIONS AND ACRONYMS

B2B	Business to Business
BP	British Petroleum
CO₂	Carbon Dioxide
DME	Department of Minerals and Energy
FDI	Foreign Direct Investment
IB	International Business
KPRL	Kenya Petroleum Refinery Limited
LNG	Liquefied Natural Gas
MNC	Multinational Corporation
MNE	Multinational Enterprise
NGO	Non-Governmental Organization
NOCK	National Oil Corporation of Kenya
US	United States

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

There are several theoretical perspectives that provide an explanation of the internationalization of firms. The Uppsala models and the innovation theory suggest that firms internationalize gradually as their perceived risk of foreign market decreases. There are two dimensions of the internationalization theory. First, the internationalization theory postulates that firms take the entry mode that requires less resource commitment in the beginning of foreign market entry and then shift to another entry mode that demands more resource commitment as the perceived risks in the foreign market decrease (Johanson and Vahlne, 1977). The other dimension of the internationalization is more related to the order of market entry. That is, the internationalization theory implicitly believes that firms enter markets that are psychically close to home market first and then gradually expand into other markets that have a higher psychic distance from the home market (Johanson and Wiedersheim-Paul, 1975).

The internationalization theory is relevant for international business research since it is a dynamic theory. It offers an explanation of foreign market entries, exit and foreign market expansion. It is also considered dynamic since it assumes that internationalization processes are the result of decisions based on accumulated knowledge over time. The theory states that firms tend to internationalize gradually by developing step-by-step from producing for the domestic market to exporting through agents and sales offices before becoming multinational by establishing production units abroad. When establishing themselves abroad, firms tend to invest and expand in countries with a short psychic

distance to the home country. Psychic distance refers to obstacles in information flows between countries due to differences in business laws, educational levels, business languages, etc. based on Hofstede's (2001) categories for comparing national cultures.

The internationalization process is driven by learning from international operations over time and commitment to international business. The better the knowledge about the market, the more valuable are the other resources, and the stronger is the commitment to the market. Market specific knowledge develops over time by performing international operations in a specific market. Since international operations are risky, firms tend to start their internationalization process in a country close to the home country as defined by psychic or cultural distances. Furthermore, as companies gain experience from such markets, they will gradually invest in more distant countries. Internationalization is also a process increasing commitment to foreign operations and to foreign markets in which they are already operating. They thus become dependent on these markets and may expand further if conditions for expansion exist.

The principal goals of firms in setting up operations abroad includes gaining access to new markets, market extension, responding to local customer's demands, getting closer to customers, satisfying the requirements of local contents on imported products, exploiting favourable policies of the host government, taking advantages of low production costs, skillful workforces, getting close to raw material sources, etc. (Porter, 1990). In the theory of organization, contingency approach considers an organization as an open system influenced by changes in the environmental (economical, political, social,

physical, legal, and technological) factors (Bartlett & Ghoshal, 1989). Any change in the environment demands buffering measures from the organization. Accordingly, Thompson (1967) suggests that in order to buffer changes in the environment, organizations have to appropriately select an organizational structure, develop relationships between departments, plan, schedule, control activities, monitor raw materials and inventories, as well as an evaluation system, and the organizational culture.

1.1.1 Internationalization

Organizations are both environment serving and environment dependent (Barrett & Baldry, 2003). Environment influences the way organizations work. Organizations that trade internationally therefore are influenced by what is happening either locally or internationally. International business environment is influenced by activities of other organizations internationally, governments and cultures. Internationalization has brought about economic interdependence among countries. The theory of environmental dependency depict that multinational organizations are influenced by activities of other organizations, societies and governments in the global marketplace.

Rugman and Verbeke (2004) define a multinational as an organization with commercial transactions, private and governmental, between two or more countries. Kinkel (2012) similarly define a multinational as consisting of business operations in one country. Ciaramella and Dettwiler (2011) provide a definition in terms of activity: IB activities are those a company engages in when it conducts any business functions beyond its domestic borders. Others define IB in terms of the entity that conducts it, as any firm that engages

in international trade or investment (Bartlett and Ghoshal, 1989). Haynes et al (2003) provide a more detailed definition of IB as consisting of interrelated transactions that are devised and carried out across national borders to satisfy the objectives of individuals, companies, and organizations. From these definitions, it is evident that international business environment is a combination of many local environments into one big arena. These definitions therefore see IB environment as first of all concerned with firm-level business activity that crosses national boundaries or is conducted in a location other than the firm's home country. Second, IB is construed as dealing in some way with the interrelationships between the operations of the business firm and international or foreign environments in which the firm operates (Rugman and Verbeke, 2004).

An organization working or having operations touching other countries is affected by the environmental factors in the global arena. The modern multinational enterprise (MNE) as we know it today has its origins in the second industrial revolution of the late 19th century. British, North American, and continental European firms expanded around the world on the basis of intangible assets such as technology, brands, and managerial expertise. The climax of their worldwide expansion was reached during the 1950s and '60s, as trade and investment barriers gradually fell around the world (Mariotti, 2005). This relatively straightforward state of affairs is changing rapidly. Since the 1990s, the global competitive landscape is becoming increasingly populated by MNEs originating in countries that are not among the most advanced in the world.

The proliferation of the new MNEs has taken observers, policymakers, and scholars by surprise. Many of these firms were marginal competitors just a decade ago; today they are challenging some of the world's most accomplished and established multinationals in a wide variety of industries and markets. Multinational firms exist because certain economic conditions and proprietary advantages make it advisable and possible for them to profitably undertake production of a good or service in a foreign location. The proliferation of the multinational corporation has complicated the global economic perspective. Strategic choice theorists have long suggested that firms actively manage and control their plans such that they can adapt to environmental forces and remain competitive in the market (Bartlett & Ghoshal, 1989). This stream of research places emphasis on a firm's ability to cope with the direct challenges of competitive forces (Porter, 1990). In particular, the literature suggests that market and technological environments are two profound forces influencing MNCs (Rugman & Verbeke, 2004). Market turbulence refers to the rate of change in customer preferences and competitive actions in a host country (Head & Mayer, 2004). Similar to market turbulence, technological turbulence may call for equal attention to MNCs (Voegt, 2008). Technological turbulence refers to the rate of change in new products and processes as a result of proliferating technology in a given host country market (Rugman and Verbeke, 2004). The world has been turned into a global village and some companies are virtually everywhere. This has also made it easier for advantages and crisis to spread fast throughout the world.

1.1.2 Host Country Relations with Multinationals

MNEs investing internationally face various risks which are unique to dealing internationally. Major risk is the governmental and societal actions and policies, originating either within or outside the host country, and negatively affecting either a select group of, or the majority of foreign business operations and investments (Konings & Murphy, 2006) and is prosaically associated with government instability, public corruption, weak property rights protection, and economic imbalances. Political risk deters FDI by jointly increasing both costs of doing business and uncertainty. For instance Mariotti (2005), building upon Pennings and Sleuwaegen (2000), shows that corruption can discourage FDI much more than a tax as in both cases a payment must be made, but with corruption total payment and outcomes are much more arbitrary. Since MNEs will only invest if they are sufficiently compensated for the possibility that the profit potential of their project will not be fulfilled, the uncertainty induced by political risk raises the required return on FDI and diminishes the range of projects deemed attractive to foreign investors.

The objectives of MNCs and host countries' country and organized groups have a number of areas where conflicts may occur (Pennings and Sleuwaegen, 2000). First, is the challenge of whose jurisdiction then MNCs have to accept in the event of conflict between the host country and the home country of the MNCs. There are a number of cases where the MNCs have asserted the home government's rights. This had led to conflict among all the three - the MNC, the host government and the home government.

Host country policies may encourage or discourage MNCs. What policies host country would follow are linked directly with the business objectives and culture of the MNCs.

The developed host countries have broadly similar policies that provide relatively free operation of MNCs in their economies. A large number of developing countries are using their policies, to attract MNCs (Mariotti, 2005). Before analyzing the policy shifts it is useful to identify various elements of developing host countries' policies towards MNCs which were in the centre of the debate in the eighties. It has often been argued that developing countries which have selective foreign direct investment (FDI) and transfer of technology policies create disincentives to MNCs. The selective policies may be manifested in one or more of the following. First is treatment of MNCs under the laws of the country which may deprive them of national or equal treatment. Another is administrative rules and regulations governing MNCs' ventures which may result in a high degree of discretion and lack of transparency in decision making. Another area of conflict is imposition of management and labour policies and equity restrictions. Lack of continuity or uncertainty of FDI and technology collaboration policies and threat of nationalization and expropriation and limitations set on remittances of profits and capital are other areas where conflict and poor relations may emerge between host country and MNCs.

Many countries have enacted a number of policy changes to attract MNCs (Ciaramella & Dettwiler, 2011). Many African states have enacted "Investment Codes" designed to promote both domestic and foreign investment. Such codes usually provide for the grant

of certain general guarantee against expropriation or nationalization without fair compensation and non-discriminatory treatment and repatriation of capital and profits. A number of African countries have established investment coordination agencies with a view to promoting investment by MNCs. In Asia several countries have amended to varying extents their foreign investment policies (Sleuwaegen & Pennings, 2006). South Korea which had a rather restrictive foreign investment policy had liberalized by streamlining and simplifying procedures. Apart from relaxation of foreign direct investment policies, a large number of developing countries have entered into bilateral investment treaties. The developed countries in a bid to secure assurance for the protection of investments originating from their respective home countries have sought to negotiate these agreements which provide security to their MNCs. On the other hand, the developing countries, faced with a number of difficulties on foreign exchange account, have themselves resorted to bilateral investment measures. At the multilateral level, efforts are being made to assure protection to MNCs. There have been endeavours to encourage equity investment and other direct investment flows to developing countries through the mitigation of non-commercial investment barriers especially political risks (Steffen, 2012). This has been developed to enhance relations between MNCs and host countries.

1.1.3 Oil Industry in Kenya

Petroleum is Kenya's major source of commercial energy and has, over the years, accounted for about 80% of the country's commercial energy requirements. Demand for oil in Kenya is quite small due to the country's underdeveloped economy, which is heavily dependent on labour intensive and rain-fed agriculture systems. The domestic demand for various petroleum fuels on average stands at 2.5 million tons per year, all of it imported either as crude oil for processing at the Kenya Petroleum Refineries Limited or as refined petroleum products. Prior to liberalization in October 1994, a significant feature of Kenya's oil industry was a relatively high level of government's direct participation, and a correspondingly low level of private sector involvement. Seven marketing and distribution companies were responsible for procuring and importing their own oil. The National Oil Corporation of Kenya was mandated to supply 30% of the crude oil requirement into the country.

Since liberalization, many new companies have been licensed by the government to engage in petroleum trading, especially import and export, wholesale and retail of petroleum products. With liberalization of the Kenyan oil industry, multinational oil companies like Caltex Oil Kenya, Mobil Oil Kenya, Total Kenya, Shell and BP Kenya and Agip Kenya faced stiff competition from upcoming independent or indigenous oil dealers like Kenol Kobil, Galana, Jovena, Fuelex, Gapco, Millsfield, Jet, Engen, Nock and Skyline among others. The Kenya Petroleum Refineries Limited, Kenya Pipeline Company Limited, National Oil Corporation of Kenya and Kenya Railways Corporation represent the government's presence in the petroleum industry. The Kenya Petroleum

Refineries Limited is owned on a 50:50 equity holding between the government and three shippers, namely, Shell, British Petroleum and Total. The Kenya Pipeline Company Limited, Kenya Railways Corporation and private transporters are involved in transportation of petroleum products from Mombasa to other parts of the country and neighboring countries.

The main players in the petroleum sector are various petroleum companies involved in the distribution of petroleum products. There are about 7 main companies and a growing number of independent oil distribution companies that have sprung up since the liberalization of the sector. The Kenya Petroleum Refinery Limited (KPRL), which operates the only oil refinery in the country, and The Kenya Pipeline Company Limited, which operates the pipeline that runs from Mombasa to Nairobi, Kisumu and Eldoret. The Kenyan petroleum distribution is dominated by multinationals like Total, BP, Shell and Oilibya. These companies face competition from local companies like Kenol Kobil, National Oil Company and other upcoming medium companies.

1.2 Research Problem

With advent of economic globalization, internationalization has become one of the most important strategies for firms to achieve sustainable growth. Motivations for internationalization of firms have drawn great interests from practitioners and researchers. When firms seek internationalization, they have different motivations. The theory of internationalization has been developed and studied regarding temporal and geographical expansion of international activities of firms.

Theory on internationalization has focused on common patterns and explanations of internationalization of firms. As a result internationalization theory has been developed, that explains the gradual internationalization phenomena of firms relatively well across industry types and firm sizes. However, some international firms divest from markets that they had previously entered due to a myriad of factors. Companies that decide to withdraw from an established market usually have good reasons for doing so. Two prevailing reasons for leaving markets seem to be the failure in achieving marketing objectives and corporate refocusing. Other factors include political interference, stiff competition and unfavorable policies.

Locational choices the MNC makes for each individual activity are a function of the combined need to generate firm-specific advantages (through the ways in which activities are configured and coordinated on a global basis), and also to leverage the country specific advantages of the locations in which it operates. Well-established multinational companies are suddenly finding themselves closing shop from some regions and countries and relocating to other regions. Multinationals which have closed their operations in Kenya include Colgate Palmolive, Johnson & Johnson, Agip, Unilever, Procter & Gamble, and recently, ExxonMobil and Caltex just to mention a few. Amidst these rapid-fire buy-outs, shut downs and sale of petroleum retail outlets controlled by multinationals, the mass exodus has been shrouded in subtle downsizing, re-positioning, global strategy, restructuring among other terminologies that have been used to describe the relocation. Multinationals find it difficult to remain at the top of their game for a number of reasons. Most have a slow decision-making process, made in far off offices located in Europe and United States. Others simply fail to carry out a precise analysis of

the local consumers' psyche and behaviour, consumption and spending patterns. Ideally, all markets including across Africa are not homogenous, but to the multinationals, they are, a mistake most multinationals make with regularity.

The field of multinational businesses has been widely studied even locally. Baaij et al (2004) researched on locational decisional variables in a multinational and found that factor prices and political stability were major factors affecting a location decision. Naikuni (2001) studied marketing strategies applied by multinationals in Kenya. Gitau (2002) studied compensation in audit multinationals in Kenya while Kasima (2004) studied change management and resistance to change in oil multinationals in Kenya. The areas of why multinationals close their operations in a host country is unresearched in Kenya despite the fact that many multinationals are closing their Kenyan operations. Kenya through the Invest authority and other government initiatives is working hard to attract FDI. MNCs leaving the country are a cause of concern for policy makers and the economy in general and this area needs more empirical evidence to inform policy and practice. This study sought to fill this empirical gap by answering the following research question: what are the determining factors that influence the relocation of multinational oil distributors outside Kenya?

1.3 Research Objectives

The objective of the study was to determine the factors that lead to relocation of multinational oil distributors outside Kenya

1.4 Value of the Study

This research will get results that will be of importance to the petroleum distribution industry, the government which directs policy and regulations in the sector, and the academic community at large. The petroleum distributors will get a deeper insight on the factors that have made other multinational distributors shun the Kenyan market and may form basis of finding solutions to these challenges.

The findings can also be of importance to government and its petroleum policy and regulatory framework. The government will be in a position to put in place effective policies and regulations to mitigate these factors that lead to multinationals relocating outside Kenya. The Kenyan Investment Authority will get value from the findings in this study and put in place measures in partnership with other authorities to make Kenya an attractive investment destination.

The findings also will prove to be important to academic community. The academic community will have added knowledge which can guide training, policy and further research. This study will fill a gap in knowledge that will give students, faculty and the general academic fraternity added knowledge in the field of international business and investment climate.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

In this chapter, the researcher provides a review of literature that is relevant to international business, multinationals and locational decision making. The theoretical and empirical review is presented. The researcher also discusses the criticism of the theories and the research gaps that exist.

2.2 Theoretical Review

The increasing globalization of the world economy has heightened interest in the process and criteria by which multinational companies (MNCs) select locations for investments outside their home countries (MacCarthy & Atthirawong, 2003). On the other hand, multinational exit from a specific market can be caused by various factors. Multinational operations relocation is a complex phenomenon. Companies can relocate their functions from a region or country because the current location becomes less attractive (push factors). On the other, other countries, regions and cities may be or become magnets in attracting the multinational's functions (pull factors) (Barba & Falzoni, 2004). Determinants that drive relocations can relate to the company-level, industry level or country level. Factors that turn out to be important for the relocation of multinational operations relate to company and industry specific characteristics, external stakeholders, concentration of the multinational operations and institutions.

There is a potential impact of political and socioeconomic influences on multinational operations and withdrawal decisions. The choice to pull out from a market lies fundamentally in a multinational's central values from which its business objectives stem. To determine whether withdrawal is the right decision at the right time, a firm may consider the underlying reasons, potential tradeoffs involved in the decision, and the appropriate timing for the implementation. Ultimately, a multinational must remain loyal to its values and business objectives. When conflicts in a host country pose as severe threats to a multinational's values and fundamental objectives, it may be time for the firm to consider potential exit strategies.

Political and socioeconomic factors generally play a significant role in shaping the business sense of a multinational's withdrawal decision (Mata & Portugal, 2000). Presence in a host country naturally attracts the attention of influential stakeholders such as government entities, environmental groups, customers, NGOs, and the general consumer population among other watchdog groups. Each hopes to exert its influence on a multinational's business decisions depending on the extent of the group's power to influence commercial activities in that particular country. This macro power structure influences the overall regulatory and business environment of the host country.

When withdrawal threats are high due to conflicts with stakeholders in the host country or differing objectives between such stakeholders and the firm, the multinational must re-evaluate the attractiveness of the market and its own business objectives (Pennings and Sleuwaegen, 2000). The level of withdrawal threats, or potential losses to the multinational if it does not withdraw, usually is a product of the powerful groups'

influence on commerce in the host country. In all stages of operations in a host country, a multinational may benefit from periodically reevaluating the fit of its business objectives and values with the objectives and values of the host country and its key stakeholders. Even as early as the initial entry stages into the new market, the multinational must be sure to do its due diligence and examine the attractiveness of the market with relation to its business objectives. This way the firm can see areas where red flags may arise. Conflict is more likely to occur at some point down the road if the preliminary investigations demonstrate misaligned values between the firm and the potential host country. These red flags should be factored into the firm's planning with regards to both its entry and exit strategy into the host country. If it is the case that there are mismatched values on several relevant issues, the firm may want to devise a non-equity entrance strategy. In the case that the company-market match proves not viable, the company can exit more easily and minimize its losses.

When a multinational's core foundation (its objectives and values) does not fit well with the objectives of the host country and its key power players, the firm stands at the crossroads of a tradeoff decision between expected earnings and expected losses depending on whether or not it decides to withdraw from the host country (Delbecque et al, 2008). Usually expected losses will exceed any expected gains from operating in the host country if high withdrawal costs are involved. In other words, if key stakeholders in the host country act in ways that make it difficult and exorbitantly costly to operate in the region, expected losses from operations in that country will erode any attractiveness previously sought in the market.

Ultimately, a multinational must not lose sight of its roots and should not compromise its values or basic foundational principles of existence (Birkinshaw et al, 2006). While the political and socioeconomic climate of the host country and the world may change, the core, boilerplate reasons for the firm's existence must remain constant. Otherwise, the firm will risk losing trust not only from its employees but also from customers, present and potential, as well as consumers in its home country. The multinational may bear reputational costs for compromising its integrity. A firm's greatest assets are trust and integrity. When a host country's commercial setting or requirements threaten to infringe on the multinational's values and basic foundation for existence, it may be time for the firm to consider the potential losses of continuing operations in accordance with its values or possible exit strategies.

2.3 Internationalization

Internationalization involves having operations in another country apart from home country. A multinational corporation (MNC) is a firm that engages in foreign direct investment and owns or controls value-adding activities in more than one country (Griffin and Pustay, 2002). The MNCs influence international trade. International companies control about 25 percent of the global output, one-third of which is produced in host countries. However, managing international operations presents a complex and challenging set of tasks. Unfortunately, the research on the operational modeling of MNCs is sparse. Hence, it is very difficult to ascertain the effects of changes taking place in one geographical location on the functioning of the other facilities, and on the overall performance of the MNCs.

Different terms abound for the MNC. They are: global, world, transnational, international, supernational, and supranational corporations (Czinkota *et al.*, 1994). Likewise, there are various definitions for an MNC. The United Nations defines MNCs as enterprises which own or control production or service facilities outside the country in which they are based. Another definition is MNC being a firm that engages in foreign direct investment and owns or controls value-adding activities in more than one country (Griffin and Pustay, 2002).

Foreign direct investment (FDI) represents one component of the international business flow and includes start-ups of new operations, as well as purchases of existing companies. Initially, a firm has to decide whether it should expand internationally. If it decides to become an MNC, then decisions related to international location(s), production strategy (mode)/strategic role, and operations have to be made. Several studies have shown that transferring production to foreign locations is a viable alternative for lowering production costs, entry into foreign markets, and avoiding import (export) restrictions to gain competitive advantage in domestic and global markets.

McDonald (1986) claims that many manufacturing companies are willing to locate their facilities in any part of the world where they can obtain cheap labor, more reliable materials, parts, subassemblies, vendors, and governments that provide financial incentives. However, Hoch (1982) points out that many firms fail to recognize the potential of these investments – leading to faulty facility location. The location decision is complex and involves many factors (List and Catherine, 2000). Tong and Walter

(1980) identified 32 possible location variables, and then using factor analysis narrowed them down to five factors including availability of transport services, labor attitudes, proximity of markets, space for future expansion and suitable plant sites. The attempt was to try and come up with a handful of factors that could be considered when foreign firms consider locations to setup facilities. In another study Schemmer (1982) talks about ten basic variables that firms looked at before deciding on locations. They include labor, climate, access to suppliers and transportation to name a few.

2.4 Factors Contributing to exit of oil multinationals

Companies that decide to withdraw from an established market usually have good reasons for doing so. Two prevailing reasons for leaving desirable markets seem to be the failure in achieving marketing objectives and corporate refocusing. The latter is defined as the disposal of peripheral activities (divestiture) and the renewed concentration on core businesses in order to raise performance (Johnson, 1996). In addition, some companies may get discouraged from remaining by cultural barriers (Ricks, 1993), legal barriers, political problems, economic downturns in the industry or specific market, and consolidation.

According to Mugo (2009), international oil companies owned at least 55% of sub-Saharan African oil market in 2002. today, that hold has shrunk to about 22%. This market shift is attributed to shifts to growing competition in the region as more non-majors join in. the oil majors that have withdrawn form sub Saharan Africa are the oil giants of the world.

Factors which have been fronted as the major contributors of exit of oil giants from sub Saharan Africa are competition, excessive government interference in oil, efforts to concentrate downstream resources and capital on strategic global assets and failure to environmental and ethical standards of parents (Mugo, 2009).

2.5 Empirical Review

The analysis of a sample of business relocations in the US, Latin America and Europe reveal that cost savings and business expansions are the main reasons for relocation regardless of whether it is a subsidiary or headquarters (Chan et al, 1995). In the European context restructuring and flexible reactions to new market conditions for new innovative products were found to be the most important reasons for relocations (Mucchielli and Saucier, 1997). Relocations can also be a response to discriminatory trade measures (Belderbos, 1997).

Based on Belgian data, it was found that labour intensity, access to global networks, company size and the rate of innovation have a positive effect on the probability of relocation. Uncertainty has a negative effect on the probability of relocation. This is an important finding in the context of the current economic environment. The positive effect of company size and profitability on the relocation decision is clearly distinct from its effect on the exit decision of a company. Companies' produce where it is less costly and the multinational investment literature underline the importance of transferable technological advantages and operational multinational flexibility in the presence of high uncertainty.

Wages and market potential of host countries are important determinants for location choice. Large companies have a higher probability to relocate to remote countries. In addition empirical studies have found that public aid only plays a decisive role for relocations to neighbouring countries. As such they potentially distort competition (Sleuwaegen and Pennings, 2006). In line with the behavioural theory, Brouwer et al. (2004) find that relocation propensities decline with the company size and maybe with the company age. Relocation factors that can be explained by the neoclassical theory, like market size and region, also play a role in the decision to relocate. Many recent studies have looked at the impact of market potential on the location of producers. It is found that market potential does matter for location choice but that traditional non-structural variables retain an important role in the location decision. This suggests that downstream linkages are not the only cause of relocation decisions (Head and Mayer, 2004). Although earlier contributions from the U.S. found cost savings not to play a significant role in relocations (Chan et al. 1995), more recent evidence shows that in the U.S. high wages can increase the probability of multinationals relocating their operations in a low wage cost country (Strauss-Kahn and Vives, 2009).

Studies have also indicated that relocation decisions are increasingly affected by international mergers and acquisitions. The change of ownership is often seen as an opportunity to restructure and an effective way to reduce administrative and managerial employment (Nilsson et al. 2008). Therefore, the rationalization of organizational services leads to a relocation of management and other overhead functions to the regions which are seen by the combined firm as better.

Both the unbundling of organizational structures and the rise in mergers and acquisitions, have underlined that the distribution of global companies must be redefined (Desai, 2009). It is important for countries to understand that shift as a prerequisite to be able to keep and attract multinationals. There is empirical evidence that external stakeholders prove to be important drivers for the overseas relocation of multinational corporation's operations. Results based on Swedish MNEs show that business units are relocated to get closer to important external influencers, primary shareholders and financial markets (Birkinshaw et al. 2006). External growth factors turn out to be particularly important to explain the relocation behaviour of large companies. Strauss-Kahn & Vives (2009) analyzed the determinants of the relocation of multinationals and found that companies that are the outcome of a merger tend to relocate more. Brouwer et al (2004) offered more detailed empirical evidence that companies which have been involved in a merger, an acquisition or take over are much more likely to relocate than others.

Taxation is another factor often mentioned as an important determinant for the location of capital, companies and profit. High taxes can make companies leave whereas low taxes may attract companies. According to Mooij and Ederveen (2001), the mean value of the tax rate elasticity in the literature is around -3.3, meaning that a 1% point reduction in host-country tax rate raises FDI in that country by 3.3% and vice versa. However, evidence on the importance of taxes for relocation substantially varies as studies covering the issue use different tax measures and different data. However, an overall conclusion may be that effective average tax rates tend to play an important role in discrete location choices, and hence in the overall location of capital (Devereux and Maffini 2006).

Empirical evidence shows that labour market institutions matter for FDI decisions. As such this finding does not relate directly on the relocation of multinational operations but may illustrate that institutional labour market factors may also play a role in choosing a new destination for multinational functions. Delbecque et al. (2008) analyzed the empirical effect of labour market institutions on French companies' expansion strategies abroad. They focussed on French companies from the manufacturing sectors and their creation of foreign affiliates. They explained the probability of a French company investing in a given country by a set of country and sector specific variables, including detailed information on labour market institutions using measures of employment protection, trade unions' bargaining power, the centralization degree of wage bargaining, the minimum wage legislation and the generosity of the unemployment benefits. Two main findings emerged from their analysis. First is that labour market does matter for FDI decisions of French companies. Labour market rigidity puts a brake on the host country's attractiveness and may force relocation. Second, in addition French companies were found to be more sensitive to the design of labour market institutions. If institutions were not properly designed, relocation was possible.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the methodology that was used to carry out the study. The chapter considers in detail the methods that were used to collect any primary or secondary data required in the study. In this chapter, the researcher discusses the research design, population, sample design and sample size and the data collection and analysis techniques and tools.

3.2 Research Design

This study employed a descriptive case study design. Descriptive research is used to obtain information concerning the current status of the phenomena to describe what exists with respect to variables or conditions in a situation (Cooper & Schindler, 2006). This enabled an analysis of the factors that have contributed to oil multinationals exiting the Kenyan market. This design was appropriate for this study since it described systematically the facts and contributing factors to relocation of oil multinationals from Kenya. This study was in the form of case study. This involved getting data from employees at Kenya Shell which at the time was finalizing their exit from Kenya.

3.3 Target Population

The target population of this study was all the oil companies in Kenyan market. Subjects for the purpose of this study were senior employees in the oil companies.

3.4 Sampling Design And Sample Size

To have the subjects from the population who participated in the survey, convenience sampling was applied. This sampling design was applied because the population of interest had a specific segment of companies which could give hard facts which could attain the objective of establishing why oil multinationals were leaving the Kenyan market. Kenya Shell was selected due to the fact that it was at the time in its final stages of exit process.

3.5 Data Collection

Interview method was applied to collect data from four senior employees at Shell who include General Manager – Kenya, Assistant General Manager – Kenya, Head of Marketing and Fuel Business Development – Kenya and Head of Operations and Projects Development – Kenya. Data collected was qualitative in nature and described challenges that Kenya Shell has faced, factors leading to its withdrawal and recommendations on policy and general business environment in Kenya. Interviews were pre-arranged with the senior employees and were scheduled to take 30 minutes for each. Data was collected as the interviews progressed in note form.

3.6 Data Analysis

The data and information obtained through the interviews was qualitative in nature and in note form. Analysis of data was through content analysis and presented through narratives which were discussed and relate to theories and earlier studies.

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

The objective of this study was to establish the reasons behind exit of oil companies from the Kenyan market. This section provides analysis of data from four interviews which were carried out on four senior executives of Shell Kenya. The interviewees were General Manager – Kenya, Assistant General Manager – Kenya, Head of Marketing and Fuel Business Development – Kenya and Head of Operations and Projects Development – Kenya. Data collected was qualitative in nature and was analyzed through content analysis.

4.2 General Information

The respondents indicated that Shell is a global group of energy and petrochemical companies with around 90,000 employees in more than 80 countries and territories. Their approach ensures that they are ready to help tackle the challenges of the new energy future. The study found from the respondents that the group's headquarters are in The Hague, the Netherlands. The parent company of the Shell group is Royal Dutch Shell plc, which is incorporated in England and Wales.

The respondents revealed that the company's strategy is to generate profitable growth and drive forward with their investment programme, to deliver sustainable growth and provide competitive returns to shareholders, while helping to meet global energy demand in a responsible way. In Upstream, the company was indicated to focus on exploring for new oil and gas reserves and developing major projects where their technology and

know-how adds value to the resource holders. Their upstream businesses, the study revealed, are grouped into two organisational units: Upstream Americas, covering the Americas, and Upstream International, covering the rest of the world with major interests in Europe, Asia, Middle East, Russia, Australia, Oceania and Africa.

In Downstream, the respondents revealed that the company's emphasis remains on sustained cash generation from their existing assets and selective investments in growth markets. The study revealed that the company's downstream organisation is made up of a number of businesses. Collectively these turn crude oil into a range of refined products, which are moved and marketed around the world for domestic, industrial and transport use. These include fuels, lubricants and bitumen. The study further revealed that Shell's manufacturing business includes refining, supply and distribution. Marketing includes their retail, business to business (B2B), lubricants and alternative energies and carbon dioxide (CO₂).

Further, the study established that the global network of Shell trading companies encompasses Shell's trading activities in every major energy market around the world. They were also revealed to manage one of the world's largest fleets of liquefied natural gas (LNG) carriers and oil tankers. The study therefore determined that Shell follows a global strategy. According to Bartlett and Ghoshal (1989) global strategy involves competing everywhere, appreciating that success demands a presence in almost every part of the world in order to compete effectively, making the product the same for each market, centralized control and taking advantage of customer needs and wants across

international borders. The global strategy according to Bartlett and Ghoshal (1989) involves locating their value adding activities where they can achieve the greatest competitive advantage and integrating and co-coordinating activities across borders. Shell was reported to follow this strategy to have advantages such as economies of scale, lower costs, co-ordination of activities and faster product development. The decision to divest from the Kenyan market was reported to come from headquarters.

4.3 Factors Influencing Exit Decision

4.3.1 Background of the Exit

The respondents revealed that Shell early in 2012 concluded over \$1 billion divestiture deal from its 21 markets in Africa. Kenya was one of the 21 markets in Africa where Shell chose to exit. This was mentioned by the respondents to be the most recent in a string of departures by global oil brands from the African petroleum market in recent years. The respondents mentioned them as Caltex (Chevron), Beyond Petroleum plc (BP), Mobil, Agip and Esso. The respondents further revealed that Shell is exiting from all African operating markets — except Egypt and South Africa, as well as ceasing some exploration activities.

4.3.2 Dwindling Margins

The respondents concurred that new price ceilings set by the energy regulatory commission in an effort to protect consumers have shaved the profits of oil dealers significantly. The respondents indicated that this move has also been taken by various African governments which have capped oil prices. Respondents indicated that Shell was

concerned that the formula for setting price caps does not cover all operating costs, infrastructure costs and the negative effects of system inefficiencies.

Some of the respondents detailed that the refining cost provided for in Kenya of 20 per cent is not sufficient. The respondents further revealed that routine refinery production inefficiencies and imports handling demurrage costs pile pressure on the price of fuel, with subsequent effects on the economy. Kenya Shell top management thought that the price controls which have been adopted by many African governments will make the oil business unviable and unprofitable. One respondent indicated that, ‘The formula does not reflect the operational conditions as they currently are. It costs the company Sh15 to transport one litre per kilometre using the big haulage companies. It is not clear how that was arrived at. Transport and delivery has been pegged at Sh7.50 per litre’.

Respondents also indicated that this was a major factor in reaching at the exit decision by Shell. The respondents indicated that with margins in the industry shrinking faster than in other industries due to high competition among marketers, the government’s tightening control of oil import, storage and distribution processes with the price caps introduced and inefficiencies in the supply chain, the company felt that the situation can only deteriorate making it difficult to make profit and give a fair return to owners of capital and other relevant stakeholders. These findings agree to findings MacCarthy and Atthirawong (2003) who indicated that there is some criteria by which multinational companies (MNCs) select locations for investments outside their home countries. This criterion includes taxation, level of government regulation and interference, competition

and profitability outlook. Another study by Barba and Falzoni (2004) had similar findings and had indicated that companies can relocate their functions from a region or country because the current location becomes less attractive.

The study established that Shell as a company felt that the formula does not recognise nor provide for investment in storage depots. The study also revealed that Shell did not seem to understand the basis of how the price caps are calculated. Shell was reported to cite the regulations to negatively assess the business climate in the country.

One respondent indicated that consumer clamour, fuelled by a belief that oil marketers were exhibiting cartel-like behaviour in pricing, forced the government to reintroduce price caps nearly 16 years after liberalising the economy. The Energy (Petroleum Pricing) Regulations 2010 capped the margin for oil wholesalers at Sh6 per litre of petrol and Sh3 for retailers. The respondent indicated that Shell felt that the price caps, which are announced every month, do not recognise investment in depots.

The respondent further observed that the Kenyan pricing model differs significantly from that in South Africa, on which it is modelled. The respondent revealed that in South Africa, the prices change on the first Wednesday of every month as advised by the Central Energy Fund, to which the Department of Minerals and Energy (DME) and the marketers contribute a levy to offset temporary changes in international fuel costs. This is why, the respondent intimated, Shell was understandably remaining in South Africa among other factors considered.

The respondents indicated that for the price formula to be credible it should be managed by an independent audit firm as is the case in South Africa which Shell had recommended but no action was taken. The respondents observed that it's important to remove political and government input and become transparent and independent to let the industry be competitive and efficient.

Respondents indicated that in mid 2000s, Shell Group had to face the fact that its giant African downstream operations — refining and fuel marketing — were making unacceptable returns. Respondents indicated that the corporation's leaders decided on a large-scale reorganization to reshape Shell Africa's 28 national operating companies by creating a pan-African structure. The goal, as the respondents indicated, was to raise business returns significantly by gaining scale and critical mass at the African level while retaining strong local customer relations. However, respondents indicated that this was a tall order which did not succeed and the decision to exit the market was reached.

Respondents indicated that Shell Africa was a business that had been underperforming for a while. The respondents gave details that the unsatisfactory situation had not been terribly transparent, because under the previous organizational structure the results of what currently is the Oil Products group were hidden in the national-operating-company accounts. As the company's management looked more closely, respondents indicated that it became evident that the downstream operations were far from meeting Shell's objective of a 15 percent return on average capital employed for a mature business and that a radical reorganization was called for.

Further, respondents indicated that what was less obvious, initially, was that the company was failing to satisfy customers — something the company spent a lot of time rectifying. As for the retail business, respondents indicated that Shell first had to figure out exactly what it was. The group had no clear understanding of the retail-customer experience or offer. Once the Group defined what it meant by retailing, it soon understood that the level of return was unacceptable. Whether they used Shell shareholder expectations or they benchmarked against gas-and-convenience retailers around the world, the company clearly needed to make improvements fast.

4.3.3 Inefficient Petroleum Infrastructure

Another factor that was mentioned as the reason for Shell exiting the Kenyan market was the country's poor and stagnant petroleum infrastructure. Respondents indicated that although the Kenyan economy has consistently expanded in the past eight years, with a corresponding demand for petroleum, little has been done to increase storage and distribution capacity. The respondents indicated that Shell, has continually and consistently blamed the inefficient petroleum infrastructure in the country for hampering their profitability and growth. A study by McDonald (1986) had similar findings to this study. This study found that multinationals are willing to locate their facilities in any part of the world where they can obtain cheap labor, infrastructure, more reliable materials, parts, subassemblies, vendors, and governments that provide financial incentives. Another study which concurs to this study is by Hoch (1982) who established in his study that there were many location decision variables which include availability of warehousing and transport services.

Respondents indicated that the pipeline and refining systems have repeatedly failed to deliver products to the market efficiently and at a fair cost. Further respondents intimated that inefficiencies in the refinery, which has been slated for an overhaul and an upgrade, cause oil firms to receive lower grade products necessitating private imports which are more expensive. The respondents further indicated that the pipeline flow is yet to deliver its full potential despite an upgrade in November 2008.

Respondents further took note of the limited berthing space of tankers at the Kipevu and Shimanzi oil terminals in Mombasa. The study established from one of the respondents that ships wait for as long as a month to discharge their products, thus introducing demurrage charges into the cost of fuel when it reaches the consumer.

Respondents further indicated that although there is an official recognition that the petroleum infrastructure is not adequate, investments have been insufficient, late and haphazard. Even after the Kenya Pipeline Company completed a major upgrading project to improve product flow between Mombasa and Nairobi, this did not ease problems as petroleum is still hauled by truck. This, the respondents observed had not eased the transport costs and inefficiencies adding on to the challenge.

4.3.4 Rising Competition

Another factor determined in the study to influence the exit decision was rising competition causing reduction in turnover and profits. The net profitability of Shell has been changing very little over the years due to reduced volumes and rising competition. The respondents revealed that their last financial year before exit decision had their net profit standing at KSh 206.7 million in the three months to March, compared to Sh206.3 million for the same period in 2010. Revenues grew by five per cent to Sh21.9 billion in the period which were lifted by high petrol prices as volumes dropped 19 per cent to 220 tonnes due to reduced diesel consumption by electricity power generators and motorists. The findings from this study agree with those from a study by Delbecque et al (2008). The study by Delbecque et al (2008) established that when a multinational expect losses to exceed any expected gains from operating in the host country due to competition, unfavourable conditions of political action, then the multinational considers exit as an option. This option according to Delbecque et al (2008) is taken if key stakeholders in the host country act in ways that make it difficult and exorbitantly costly to operate in the region and hence expected losses from operations in that country will erode any attractiveness previously sought in the market.

Respondents indicated that all competitors of Shell focus on customers. And all their competitors strive to serve the customer better in order to make more money. The African operations could not focus well on customers when their returns were so low and hence the only logical thing to do was to close the African operations. With the low margins, Shell could not compete in the long term and this made the group to make the sad but

crucial decision. After all, one respondent indicated that, ‘meeting customer needs profitably is the reason we are in business.’ The findings from this study support the findings of a study by Mugo (2009), which indicated that international oil companies owned at least 55% of sub-Saharan African oil market in 2002 but by 2009 that hold had shrunk to about 22%. Mugo’s (2009) study attributed this shift to growing competition in the region as more non-major oil companies join in. Further, a study by Strauss-Kahn and Vives (2009) indicated that the major contributors of exit of oil giants from sub Saharan Africa are competition, excessive government interference in oil, efforts to concentrate downstream resources and capital on strategic global assets and failure to environmental and ethical standards of parents. This study findings agree with the study by Strauss-Kahn and Vives (2009) on the competition issue as a factor in divestiture by multinationals.

4.3.5 Government Regulation

Respondents indicated that regulation and price ceilings by government were another major reason which has contributed to Shell exiting the Kenyan market. Respondents indicated that new price ceilings set in an effort to protect consumers have shaved the profits of oil dealers significantly. Shell, respondents observed, was concerned that the formula for setting price caps does not cover all operating costs, infrastructure costs and the negative effects of system inefficiencies.

Further, respondents revealed that the refining cost provided for (20 per cent) is not sufficient. Routine refinery production inefficiencies and imports handling demurrage costs pile pressure on the price of fuel, with subsequent effects on the economy. Further, complaints by oil companies including Shell are not acted upon which leads to more frustration for the oil firms. Shell, as the respondents indicated believe that the price controls will make the oil business unviable and unprofitable. One respondent further explained that the formula for arriving at the price ceiling does not reflect the operational conditions as they are. The respondent indicated that it costs Shell KSh15 to transport one litre per kilometre using the big haulage companies. The respondent further indicated that Shell did not have information about how those figures were arrived at by the regulator. It further, the respondent intimated that transport and delivery has been pegged at Sh7.50 per litre and it is not clear how the wholesale margin and retail margin were calculated. This makes it very hard for an oil company to make profit while serving its customers well. A study by Pennings and Sleuwaegen (2000) had similar findings. The study indicated that withdrawal threats are high due to conflicts with stakeholders in the host country or differing objectives between such stakeholders and the firm which forces a multinational to re-evaluate the attractiveness of the market and its own business objectives. This study's findings indicated that Shell evaluated their business in the country and decided to exit.

The respondents indicated that the ramifications of the price caps will have an adverse effect on the industry and some players like Shell are finding exit as the only option. Respondents indicated that it is not only Shell that has a plan of exit but indicated that companies like OiLibya, Kenya Shell, KenolKobil and Total, with a more than 75 per

cent stranglehold on the Kenyan fuel market, have all issued warnings that controlling fuel prices could see the exit of multinational firms, with investors likely citing the regulations to negatively assess the business climate in the country.

The respondents further indicated that the Kenyan oil market is becoming very unattractive and it's not able to compete with other markets in Africa and beyond. Respondents indicated that with margins in the industry shrinking faster than in other industries due to high competition among marketers, the government's tightening control of oil import, storage and distribution processes with the price caps introduced and inefficiencies in the supply chain strangles oil firms.

These findings agree with findings from a study by Mata and Portugal (2000) which established that political and socioeconomic factors generally play a significant role in shaping the business sense of a multinational's withdrawal decision. The study had established that presence in a host country naturally attracts the attention of influential stakeholders such as government entities, environmental groups, customers, NGOs, and the general consumer population among other watchdog groups. These groups exert their influence on a multinational's business decisions depending on the extent of the group's power to influence commercial activities in that particular country. This macro power structure influences the overall regulatory and business environment of the host country. This was the case in this study where the regulation of imports, distribution and pricing is regulated by government authorities which in turn influenced Shell's decision to exit the market.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The objective of this study was to establish the reasons behind oil multinationals exiting the Kenyan market. This section provides summary of the results, conclusions and recommendations. Section 5.2 gives summary of the findings, section 5.3 presents the conclusions while section 5.4 presents recommendations.

5.2 Summary in findings

The study findings indicated that Shell is exiting from all African operating markets, except Egypt and South Africa, as well as ceasing some exploration activities. The results from the respondents indicated that reduced profit margins, increased competition, poor oil infrastructure and official price caps are the major reasons behind Shell Group's exit from the Kenyan market. Anglo-Dutch giant Shell early in 2012 concluded a \$1 billion divestiture deal from its 21 markets in Africa, becoming the latest oil marketer to exit Kenya. This was after five international major oil companies left the country in the past decade over various reasons the biggest being dwindling margins. It is the latest in a string of departures by global oil brands from the African petroleum market in recent years.

Findings indicated that Shell, a global group of energy and petrochemical companies with around 90,000 employees in more than 80 countries and territories made a decision to pull out of Kenya and other African countries due to a combination of many factors.

Findings showed that the company's strategy is to generate profitable growth and drive forward with their investment programme, to deliver sustainable growth and provide competitive returns to shareholders, while helping to meet global energy demand in a responsible way. In Upstream, findings indicated that the company focused on exploring for new oil and gas reserves and developing major projects where their technology and know-how adds value to the resource holders. Findings revealed that Shell early in 2012 concluded over \$1 billion divestiture deal from its 21 markets in Africa. Kenya was one of the 21 markets in Africa where Shell chose to exit.

One of the major reasons that led to the exit was shrinking profit margins. The new price ceilings set by the energy regulatory commission in an effort to protect consumers have shaved the profits of oil dealers significantly. This move has also been taken by various African governments which have capped oil prices. Results from the study indicated that Shell was concerned that the formula for setting price caps does not cover all operating costs, infrastructure costs and the negative effects of system inefficiencies. This has left the companies to operate on very low margins making it difficult for companies to make profit under very competitive environment. Results indicated that the refining cost provided for in Kenya of 20 per cent is not sufficient. Further findings revealed that routine refinery production inefficiencies and imports handling demurrage costs pile pressure on the price of fuel, with subsequent effects on the profitability of Shell thus giving unacceptable return on investment. Results indicated that these price controls made Kenya Shell top management to decide that oil business in Kenya is unviable and unprofitable.

The respondents indicated that with margins in the industry shrinking faster than in other industries due to high competition among marketers, the government's tightening control of oil import, storage and distribution processes with the price caps introduced and inefficiencies in the supply chain, the company felt that the situation can only deteriorate making it difficult to make profit and give a fair return to owners of capital and other relevant stakeholders.

The study established that Shell as a company felt that the formula does not recognise nor provide for investment in storage depots. The study also revealed that Shell did not seem to understand the basis of how the price caps are calculated. Shell was reported to cite the regulations to negatively assess the business climate in the country. Results further indicated as the reason for Shell exiting the Kenyan market was the country's poor and stagnant petroleum infrastructure. Findings indicated that though the Kenyan economy has consistently expanded in the past eight years, with a corresponding demand for petroleum, little has been done to increase storage and distribution capacity. The inefficient petroleum infrastructure in the country has hampered profitability and growth and hence making the long run viability of Kenyan business unviable. Results also indicated that the pipeline and refining systems have repeatedly failed to deliver products to the market efficiently and at a fair cost. These inefficiencies cause oil firms to receive lower grade products necessitating private imports which are more expensive.

Limited berthing space of tankers at the Kipevu and Shimanzi oil terminals in Mombasa was another factor that was found to limit operations of oil companies and Shell found that very limiting. Ships wait for as long as a month to discharge their products, thus introducing demurrage charges into the cost of fuel when it reaches the consumer and thus making the operations very uncompetitive. Results also indicated that investments in infrastructure is insufficient, late and haphazard and hence doing very little now and in the future to contain the poor situation.

Results also indicated that competition from small and medium upcoming oil companies in Kenya and the multinationals already in the country is another factor contributing to the unattractiveness of the Kenyan market. This competition was reported to cause reduction in turnover and profits. The net profitability of Shell has been stagnant and sometimes declining over the years. With the low margins, Shell decided that it could not serve its customers effectively and profitably thus leading to divestiture. Results from the study indicated that with margins in the industry shrinking faster than in other industries due to high competition among marketers, the government's tightening control of oil import, storage and distribution processes and price ceilings, the Kenya market becomes very unattractive to outside firms seeking growth markets.

5.3 Conclusion

From the study findings, the study makes the following conclusions. First, the major reason why Shell Kenya was divested was the shrinking profit margins due to price ceilings set by the energy regulatory commission. Shell determined that the formula for

setting price caps does not cover all operating costs, infrastructure costs and the negative effects of system inefficiencies thus making it very difficult to have an acceptable return on investment from the Kenyan operations.

The country's poor and stagnant petroleum infrastructure was another major contributing factor. Though Kenya has developed and grown over the years, little has been done to increase oil storage and distribution capacity. These inefficiencies cause oil firms to receive lower grade products necessitating private imports which are more expensive. The inefficient petroleum infrastructure in the country has hampered profitability and growth and hence making the long run growth and sustainability of Kenyan business unviable.

Competition from small and medium upcoming oil companies in Kenya and the multinationals already in the country is another factor contributing to the unattractiveness of the Kenyan market. This competition was reported to cause reduction in turnover and profits. The net profitability of Shell has been stagnant and sometimes declining over the years. With the low margins, Shell decided that it could not serve its customers effectively and profitably thus leading to divestiture.

Government interference in the oil import, distribution and pricing was another factor that made Shell Kenya to close its operations. Lack of openness in price capping and lack of consultation from all stakeholders made the process to be questionable and haphazard. This affected operations and profitability of oil companies making Shell to make the exit decision.

5.4 Recommendations

From the study findings, the following recommendations are made. First, the pricing formula should be managed by an independent and credible firm. The firm would ensure that all factors are put in the pricing formula not to strangle margins of oil companies too thin.

Second, it's important to remove political and government input in oil import, distribution and control and even though a reasonable control should be left, the control and regulation should be transparent and independent to let the industry be competitive and efficient.

Third, to oil companies, multinationals should ensure that they have sound and competitive marketing and customer service strategies to be able to compete with the upcoming small and medium oil distribution companies.

Lastly, oil companies should strengthen their upstream operations not just focussing all their resources and competencies on the downstream operations. Upstream operations are the backbone for the long run competitive advantage and sustainability of any oil company.

5.5 Suggestions for future research

Future research can be carried out on similar study for other companies in the same industry and different industry players as well.

REFERENCES

- Baaij, M., F. Van Den Bosch, et al. (2004). The International Relocation of Corporate Centres: Are Corporate Centres Sticky?. *European Management Journal* Vol 22(2): pp. 141-149.
- Barba N.G. and Falzoni, A.M. (2004). Home country effects of foreign direct investment. In Barba Navaretti, G., Venables, A.J., *Multinational Firms in the World Economy*, Princeton University Press, Princeton, NJ, pp.217-39.
- Barrett, P. and Baldry, D. (2003). *Facilities Management, Towards Best Practice*, 2nd ed. Blackwell, Oxford.
- Barrios, S., H., Huizinga, et al. (2008). International Taxation and multinational firm location decisions. *CEPR Discussion Papers Issue* 7047 pp. 1-45.
- Bartlett C, Ghoshal S. (1989). *Managing across Borders*. Harvard Business School Press: Boston, MA.
- Belderbos, R. (1997). Antidumping and Tariff Jumping: Japanese Firms' DFI in the European Union and the United States. *Weltwirtschaftliches Archiv* Vol 133 pp. 419-457.
- Birkinshaw J., P. et al. (2006). Why do some multinational corporations relocate their headquarters overseas? *Strategic Management Journal* Vol 27 pp. 681-700.
- Brouwer, A. E. and I. Mariotti, et al. (2004). The firm relocation decision: an empirical investigation. *The Annals of Regional Science* Vol 38 pp.335-347.
- Chan, S. H. et al, (1995). Stock Market Reaction to Capital Investment Decisions: Evidence from Business Relocations. *Journal of Financial and Quantitative Analysis* Vol 30 pp 81-100.
- Ciaramella, A. and Dettwiler, P. (2011). A relocation model of European manufacturing firms: cases from Italy and Sweden. *Journal of Corporate Real Estate*, Vol. 13 Iss: 4, pp.233 – 246.
- Cooper, D., & Schindler, P. (2006). *Business Research Methods*. 9th Ed., New Delhi: McGraw-Hill.
- Czinkota, M.R., Ronkainen, I.A., Moffet, M.H. (1994). *International Business*. The Dryden Press, New York.

- Delbecque, V., I. Méjean, et al. (2008). Social Competition and Firms' Location Choices. *Centre D'études prospectives et d'informations internationales (CEPII) Working Paper* 12.
- Desai, M. A. (2009). The Decentering of the Global Firm. *The World Economy* Vol 32(9) pp. 1271-1290.
- Devereux, M. P. and G. Maffini (2006). The Impact of Taxation on the Location of Capital, Firms and Profit. *Oxford University Centre for Business Taxation Working Paper* 07(02).
- Griffin, R.W., Pustay, M.W. (2002), *International Business: A Managerial Perspective*, 3rd ed., Prentice-Hall, Englewood Cliffs, NJ.
- Haynes, M., Thompson, S., Wright, M. (2003). The determinants of corporate divestment: evidence from a panel of UK firms. *Journal of Economics Behavior & Organization*, Vol. 52 pp.147-66.
- Head, K. and T. Mayer (2004). Market Potential and the Location of Japanese Investment in the European Union. *The Review of Economics and Statistics* Vol 86 pp. 959-972.
- Hoch, L.C. (1982). Site selection for foreign operations. *Industrial Development*, Vol. 151 pp.7-9.
- Johanson, J., Vahlne, J. (1977). The internationalization process of the firm: a model of knowledge development and increasing foreign commitments. *Journal of International Business Studies*, pp.23-32.
- Johanson, J., Wiedersheim-Paul, F. (1975). The internationalization of the firm: four Swedish case studies. *Journal of Management Studies*, pp.305-22.
- Johnson, R.A. (1996). Antecedents and outcomes of corporate refocusing. *Journal of Management*, Vol. 22 No.3, pp.439-94.
- Konings, J. and Murphy, A.P. (2006). Do multinational enterprises relocate employment to low-wage regions? Evidence from European multinationals. *Review of World Economics*, Vol. 142 No.2, pp.267-86.
- List, J.A., Catherine, Y. (2000). The effects of environmental regulations on foreign direct investment. *Journal of Environmental Economics and Management*, Vol. 40 No.1, pp.1-20.

- MacCarthy, B.L., Atthirawong, W. (2003). Factors affecting location decisions in international operations – a Delphi study. *International Journal of Operations & Production Management*, Vol. 23 No.7, pp.794-818.
- Mariotti, I. (2005). Firm relocation and regional policy: a focus on Italy, The Netherlands and the United Kingdom. Royal Dutch Geographic Society/Department of Spatial Sciences, University of Groningen, Groningen.
- Mata, J., Portugal, P. (2000). Closure and divestiture by foreign entrants: the impact of entry and post-entry strategy. *Strategic Management Journal*, Vol. 21 No.5, pp.323-43.
- McDonald, A.L. (1986). Of floating factories and mating dinosaurs. *Harvard Business Review*, Vol. 64 No.6, pp.82-6.
- Mooij, R. A. and S. Ederveen (2001). Taxation and foreign direct investment: a synthesis of empirical research. *International Tax and Public Finance* Vol 10 pp. 673-693.
- Mucchielli, J. L. and Saucier P. (1997). European Industrial relocations in low-wage countries: policy and theory debates. In P. J. Buckley and J. L. Mucchielli, *Multinational Firms and International Relocation*. London, Edwar Elgar.
- Mugo, K. (2009). African refiners meet in Kampala. *Petroleum Insight*, 4th quarter, October-December, 2009.
- Nilsson Hakkala, K., F. Heyman, et al. (2008). Multinational Firms and Job Tasks. *IFN Working Paper* 781.
- Pennings, E. and L. Sleuwaegen (2000). International relocation: firm and industry determinants. *Economics Letters* Vol 67(2) pp. 179-186.
- Pennings, E., Sleuwaegen, L. (2000). International relocation: firm and industry determinants. *Economics Letters*, Vol. 67 pp.179-86.
- Petroleum Insight (2012). Overall market share. January – March 2012.
- Porter M.E. (1990). *The Competitive Advantage of Nations*. Free Press: New York.
- Ricks, D.A. (1993). *Blunders in International Business*. Blackwell, Cambridge.
- Rugman A, and Verbeke A. (2004). A perspective on regional and global strategies of multinational enterprises. *Journal of International Business Studies* Vol 35(1) pp. 3–18.

- Schemmer, R.W. (1982). *Making Business Location Decisions*. Prentice-Hall, Englewood Cliffs, NJ.
- Sleuwaegen, L. and E. Pennings (2006). International Relocation of Production: Where do firms go? *Scottish Journal of Political Economy* Vol 53(4) pp. 430-446.
- Steffen K. (2012). Trends in production relocation and backshoring activities: Changing patterns in the course of the global economic crisis. *International Journal of Operations & Production Management*, Vol. 32 Iss: 6, pp.696 – 720.
- Strauss-Kahn, V. and X. Vives (2009). Why and where do headquarters move? *Regional Science and Urban Economics* Vol 39(2) pp. 168-186.
- Thompson J.D. (1967). *Organizations in Action*. McGraw-Hill: New York.
- Tong, H., Walter, C.K. (1980). An empirical study of plant location decisions of foreign manufacturing investors in the United States. *Columbia Journal of World Business*, Vol. 15 No.1, pp.66-73.
- Voget, J. (2008). *Headquarter Relocation and International Relocation*. Centre for Business Taxation, Oxford University.

APPENDICES

Appendix I: Letter of Introduction

Benadette W. Mwangi
P.O. 5871-00100
NAIROBI

Dear Sir/Madam

MBA RESEARCH PROJECT

I am a post graduate student at University of Nairobi pursuing Master of Business Administration in fulfillment of the course requirements; I am undertaking a research on Factors that influence relocation of multinational oil companies based in Kenya to other countries.

I kindly request you to grant me an opportunity for an interview to gather information regarding the research topic to enable me complete the project. The information to be gathered is needed purely for academic research and therefore will be treated with utmost confidentiality.

Your assistance will be highly appreciated.

Yours faithfully,

Benadette W. Mwangi

Appendix II: Introduction Letter from the University of Nairobi

Appendix III: Questionnaire for Kenya Shell managers

1. Number of years you have worked in Shell?
2. What is your title in the company?
3. What challenges has Kenya Shell faced in the Kenyan market
4. What are the factors contributing to the company leaving the Kenyan market?
 - ❖ Poor performance
 - ❖ Failure in achieving marketing objectives
 - ❖ Corporate refocusing
 - ❖ Cultural barriers
 - ❖ Legal barriers,
 - ❖ Political problems,
 - ❖ Economic downturns
 - ❖ Competition
 - ❖ Excessive government interference in oil,
 - ❖ Efforts to concentrate downstream resources and capital on strategic global assets
 - ❖ Failure to adhere to environmental and ethical standards of parents
5. What specific responses do you think Kenya as a trading destination can adopt to specifically deal with the issue of multinationals leaving the country?

Appendix IV: Companies in the oil Industry in Kenya

1. Kenolkobil
2. Total
3. Shell
4. Libya oil
5. National oil
6. Bakri
7. Hashi energy
8. Gulf oil
9. Hass petroleum
10. Gapco
11. Galana
12. MGS
13. Engen
14. Banoda
15. Petro
16. East African Gasoil
17. Addax
18. Fossil
19. Royal
20. Alba
21. Ainushamsi
22. Banoda
23. Olympic
24. Tosha
25. Ranway
26. Jade
27. Oilcity
28. Regnol
29. Rivapet

Source: Petroleum Insight April-June, 2012.