



PACT EAC2

Promoting Agriculture, Climate and Trade
Linkages in the East African Community



Kenya

Leveraging the Buy Kenya, Build Kenya Strategy to Promote Sustainable Agro-processing

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Kenya

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Acronyms

ACTIF	Africa Cotton and Textile Industries Federation
BK BK	Buy Kenya Build Kenya
CMP	Common Market Protocol
COMESA	Common Market for Eastern and Southern Africa
EAC	East African Community
GDP	Gross Domestic Product
GDS	Global Development Solutions
GP	Green Procurement
GPA	Agreement on Government Procurement
KEBS	Kenya Bureau of Standards
KENTRADE	Kenya Trade Network Agency
KII	Key Informant Interviews
LPI	Logistics Performance Index
MIED	Ministry of Industrialisation and Enterprise Development
MITC	Ministry of Industry, Trade and Cooperatives
MSE	Micro and Small Enterprises
MSME	Micro Small and Medium Enterprises
NTBs	Non-Tariff barriers
OECD	Organisation for Economic Cooperation and Development
PPADA	Public Procurement and Asset Disposal Act
R&D	Research and Development
SGR	Standard Gauge Railway
SPS	Sanitary and Phytosanitary
TVET	Technical and Vocational Education and Training
UNEP	United Nations Environmental Programme
WTO	World Trade Organisation

Executive Summary

That agro-processing is a catalyst for industrialisation and economic transformation in Kenya cannot be gainsaid. The agro-industrial sector is the main source of manufacturing value added and plays a key role in creation of job opportunities through backward and forward linkages. Yet the sector continues to face several challenges including high competition in the domestic and foreign markets. The Buy Kenya Build Kenya (BKBK) strategy is expected to support agro-processing among other industries through measures geared towards improving the competitiveness and consumption of local products.

The objective of this study was to shed light on the policy measures that should be considered to enhance competitiveness and consumption of local agro-processed products in the context of the BKBK strategy. Taking into account the fact that sustainable agro-processing should be trade driven, food security enhancing, and climate aware, the study focused on five areas. These include: constraints to competitiveness and consumption of local products; reservation of 40 percent of government procurement budget for local goods proposed under the BKBK; promoting climate aware agro-processing under BKBK; consistency of the BKBK strategy with Kenya's trade commitments; and market access challenges in banana and cassava value chains as case studies. These crops were selected due to their potential to address food insecurity and promote creation of job opportunities through value addition.

For the BKBK strategy to work for agro-processors, it is necessary to address infrastructural bottlenecks, climate change, inadequate financing, technological challenges, and limited access to distributional channels. Other constraints to be addressed include: low income among consumers, strong taste and preference for imports, and lack of trust in the quality of local products. Addressing these constraints requires concerted effort aimed at improving the quality, affordability, and consumer confidence in local products. Whereas several policies and legislations have already been enacted, policy coherence and implementation challenges abound.

Reserving 40 percent of government procurement for local goods is a great opportunity to increase consumption of local agro-processed products in the public sector. However, an effective legal and institutional framework has to be created to facilitate successful implementation of this proposal. Of particular concern in promoting sustainable agro-processing is the limited capacity of agro-processors to adapt to climate change owing to financial and technical constraints. Further, a legal and policy framework should be created to implement sustainable consumption measures such as green procurement in the public and private sector.

Cassava and banana value chains have great potential for promoting food security. The micro and small agro-processors in these value chains face market access challenges attributed to difficulties in obtaining product certification, information asymmetry concerning market requirements/ needs, difficulties in meeting requirements set by retailers and limited investment in marketing activities. Deliberate efforts have to be made to address these challenges, as well as to build the capacity of agro-processors to meet market needs.

Chapter 1

Introduction

1.1 Background

A defining characteristic of least developed and most developing economies, especially in Sub-Saharan Africa is the relative importance of agriculture in their economies. Agriculture is the main source of gross domestic product (GDP), employment, foreign exchange earnings, and raw materials for the manufacturing sector in most Sub-Saharan Africa countries. In Kenya, agriculture accounts for about 27 percent¹ of GDP, nearly 58 percent of the value of exports and provides livelihoods to approximately three quarters of the population.² Thus, agriculture holds the key to industrialisation, economic growth, creation of job opportunities and eradication of food insecurity. The potential of agriculture as an engine for growth is best exemplified by the green revolution that led to robust growth in agricultural productivity in Asia and Latin America, thereby reducing rural poverty and food insecurity between 1960 and 1990 (IFPRI, 2009). This success was attributed to consistent investment in crop research, infrastructure, market development, and effective policy framework. In Kenya, agriculture still faces several challenges including low productivity, heavy reliance on rainfall, infrastructural bottlenecks and limited value addition. Thus, Kenya remains food insecure and nearly 36.1 percent³ of its population lives in poverty.

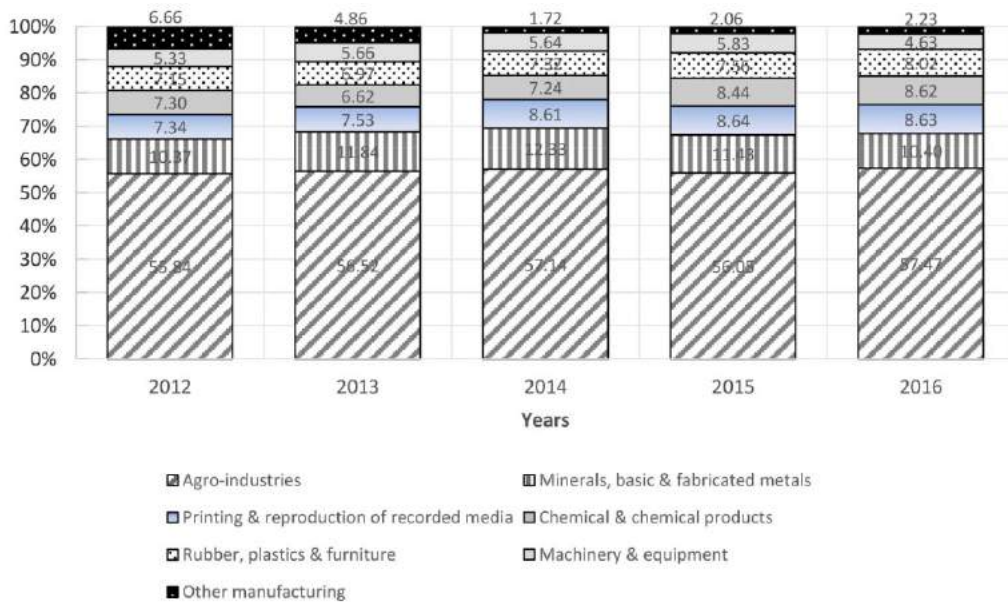
Despite the challenges, the government of Kenya is relying on agriculture as one of the key sectors expected to fuel economic growth in a bid to elevate the country's status to a newly industrialised economy by 2030. Agro-processing development is, thus considered a

cornerstone of industrialisation to the extent that it promotes value addition, as well as forward and backward linkages in the economy. Agro-processing is defined as “the subset of manufacturing sector that processes raw materials and intermediate products derived from agriculture, fisheries and forestry” (Silva, Baker, Shepherd, Jenane, & Miranda-da-Cruz, 2009). Agro-industrial sector encompasses manufactures of food, beverages and tobacco; textiles and clothing; wood products and furniture; paper and paper products; and rubber and rubber products.

Agro-processing is the main manufacturing activity in Kenya. As Figure 1 illustrates, agro-industries accounted for at least 55 percent⁴ of manufacturing value added between 2012 and 2016. They also accounted for about 67 percent of manufacturing jobs over the same period (Figure 2). Overall, agro-industrial sector's value added grew in real terms by 13.1 percent to Ksh 378.2 billion in 2016 from Ksh 334.5 billion in 2012. Employment, on the other hand, increased by 12.5 percent to 204,790 people in 2016 from 182,070 people in 2012.

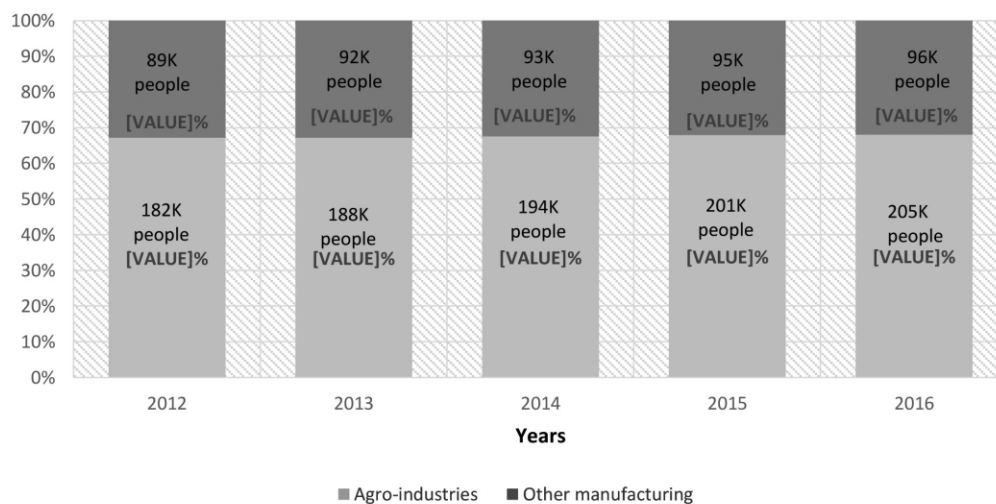
As Figure 3 illustrates, food processing is the largest industry in the agro-industrial sector given that it accounted for at least 43 percent of value added in this sector between 2012 and 2016. Over this period, the highest average annual growth in value added in real terms was realised in textiles (8.9 percent), beverages (7 percent), and wearing apparel (6.6 percent). Paper and paper products experienced an average negative growth of 15.7 percent. Other industries that recorded low or negative growth were food products (1.6

Figure 1: Share of agro-industries in manufacturing value added



Source: KNBS-Statistical Abstract, 2017

Figure 2: Share of agro-industries in total employment in the manufacturing sector

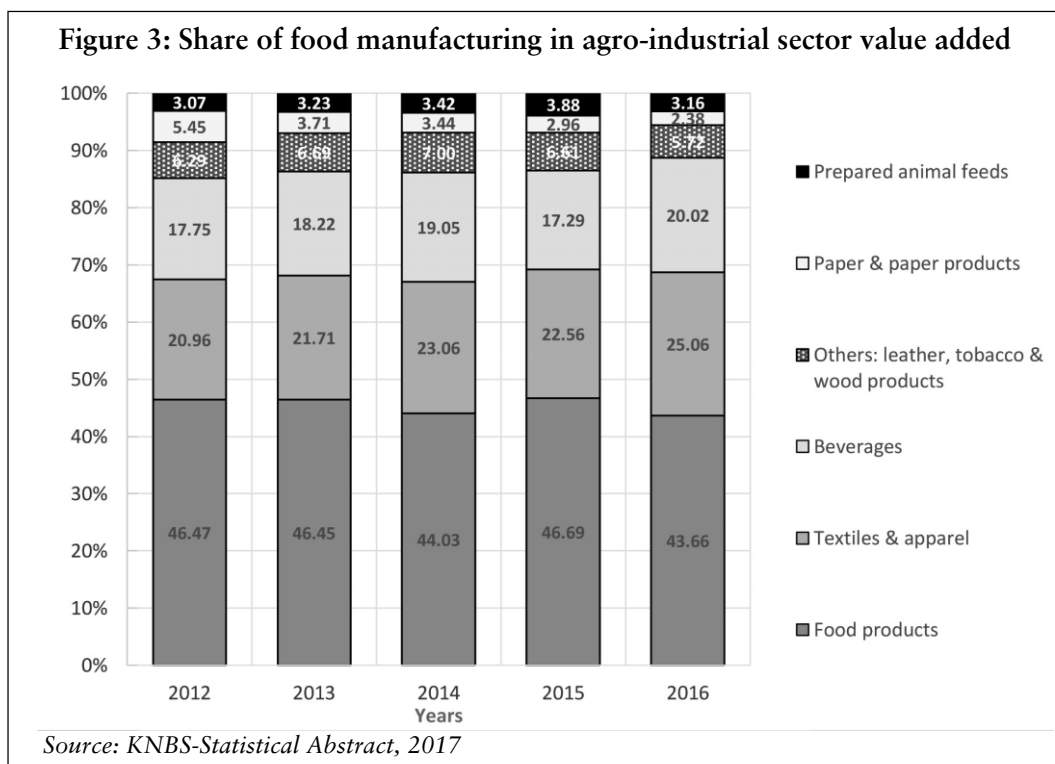


Source: KNBS-Statistical Abstract, 2017

percent) and leather and related products (-3.8 percent). In 2017, there were 3,902 agro-processing enterprises that accounted for 64.8 percent of the total number of enterprises in the manufacturing sector.⁵

For Kenya's agro-processing to be sustainable in the long-term, the sector has to be trade driven. In particular, local agro-processors must be able to compete effectively with their foreign

counterparts by profitably producing and selling products that meet market needs. Further, agro-processing has to be climate aware for it to remain sustainable. This is based on the fact that agro-processing is not only affected by climate change, but also contributes to climate change. Apart from supporting economic transformation, sustainable agro-processing will ensure food security in the country. Thus, efforts geared towards promoting competitiveness and



consumption of local agro-processed products should take into account trade, climate change, and food security linkages.

1.2 The Buy Kenya, Build Kenya Strategy

The Buy Kenya, Build Kenya (BKBK) strategy is one of the key interventions currently being pursued by the government to support local industries in the face of fierce competition in domestic and international markets. Anchored on the National Trade Policy 2017, the overall objective of the BKBK strategy is to enhance the competitiveness and consumption of locally produced goods and services. The rationale for developing the BKBK strategy is the need to promote the growth of local industries to achieve the national industrialisation agenda.

The BKBK strategy is a fundamental shift towards a balanced approach to economic liberalisation, focusing policy interventions on supporting production, purchase, supply and consumption of local goods and services. The implicit assumption of the strategy is that local industries will grow if their competitiveness is improved and if local products are accorded preference by consumers in domestic and

international markets (Buy Kenya, Build Kenya Strategy, 2017). This in turn will accelerate industrialisation and wealth creation.

The Ministry of Industry, Trade and Cooperatives has already developed the draft BKBK strategy which is still under review. In order to achieve its objectives, the strategy includes interventions for improving market access for domestic products. These include reservation of 40 percent of government procurement budget to local goods, as well as creating a business environment that facilitates production of competitive products.

1.3 Statement of the Problem

Despite its potential for promoting industrialisation and food security, the agro-industrial sector in Kenya is grappling with increased competition resulting from liberalisation policies the government pursued in the last three decades (Chege, Ngui, & Kimuyu, 2016). A key challenge has been the limited preference for locally manufactured products in the domestic market as consumers favour cheap imports to meet their consumption needs. In the external markets, Kenya's agro-industries continue to face stiff competition from more

efficient and innovative producers from countries such as China and India, as well as Europe.

High competition is a threat to the long-term sustainability of agro-processing to the extent that it can lead to collapse of local agro-industries. Local agro-processors that are not able to compete effectively with foreign firms face the risk of being driven out of business (Chege, Ngui, & Kimuyu, 2016). This will lead to systematic loss of jobs, decline in foreign exchange earnings, deterioration of terms of trade, worsening of food insecurity and dependence on imports. As a result, achieving the country's industrialisation aspirations will remain a significant challenge. Thus, the urgent need to improve the competitiveness of local agro-industries to secure their sustainability cannot be gainsaid.

As the BKBK strategy takes shape in the policy ambit, state and non-state actors are particularly keen on determining the interventions required for the strategy to work for agro-processors. Thus, the purpose of this study is to provide insights on how the BKBK strategy can be leveraged to promote sustainable - trade driven, food security enhancing and climate aware agro-processing from a policy perspective. The study further considered the market access challenges in two case study value chains- bananas and cassavas. These value chains were selected due to their potential to promote food security and creation of jobs through agro-processing.

An earlier study by Otieno & Washington (2017) showed that development of cassava and banana value chains through value addition can address food insecurity and provide employment to women and youth through backward and forward linkages. The study further highlighted the challenges constraining development of these two value chains through value addition and made recommendations on how they can be addressed. These challenges include inadequate access to credit, pests, diseases, climate change, and technological constraints. This study departs from that of Otieno & Washington (2017) by looking at how market access challenges in these value chains can be addressed.

1.4 Study Objectives

The main objective of this study is to provide practical policy options that should be considered to improve the competitiveness and consumption of local agro-processed products in the context of the Buy Kenya, Build Kenya strategy. The specific objectives are:

1. Determine whether the BKBK strategy is consistent with the East African Community (EAC) integration process and Kenya's multilateral trade commitments
2. Determine how the competitiveness of local agro-processed products can be improved to promote trade-driven and food security enhancing agro-processing
3. Determine how climate aware agro-processing can be promoted under the BKBK strategy
4. Determine and document how agro-processors can benefit from the 40 percent of government procurement budget reserved for local products under the BKBK
5. Case studies: (a) Propose policy options for addressing the market access challenges in cassava and banana value chains; (b) Propose measures to build the capacity of agro-processors to meet market needs.

1.5 Rationale and Scope of the Study

The rationale of this study is the need for evidence-based policy interventions to ensure the BKBK strategy promotes sustainable and competitive agro-processing in Kenya. Currently, there is a dearth of literature/ evidence on how the BKBK strategy can be leveraged to develop a local agro-processing industry that is not only competitive, but also trade driven, climate aware, and food security enhancing. The study sheds light on the key barriers to development of agro-processing in Kenya and provides policy options for tapping into the BKBK strategy to support the local agro-processing industry. The analysis is structured around five key areas:

- I. Analysis of the BKBK strategy in light of EAC integration and Kenya's multilateral trade commitments.

- II. Competitiveness and consumption of local agro-processed products: Supply and demand side constraints to consumption and competitiveness of local agro-processed products; gaps in the institutional, legal, and policy framework for promoting competitiveness and consumption of local products; strategies for incentivising households and private firms to consume local agro-processed products; and incentivising agro-processors to use local raw materials for production.
- III. Reserving 40 percent of public procurement budget for local products under the BKBK: Consumption of agro-processed products by the government (types of goods and their sources); challenges and opportunities for agro-processors under the 40 percent preference scheme; and legal, policy, and institutional constraints to implementation of this preference scheme.
- IV. Promoting climate aware agro-processing under BKBK: Constraints to innovation for climate aware agro-processing; policy options for integrating green procurement practices in public and private sectors; and best practices for promoting sustainable consumption.
- V. Case studies: Market access challenges and opportunities in cassava and banana value chains, as well as policy options for building the capacity of agro-processors to meet market needs.

1.6 Methodology

A mixed research design was adopted to achieve the objectives of this study. This involved using both quantitative and qualitative research techniques. We first did an extensive literature review, focusing on the factors that affect the competitiveness and consumption of local agro-processed products. This covered published research reports, journals, as well as government and industry reports among others.

We also conducted an extensive policy analysis to identify the gaps or weaknesses that should be addressed in the existing legal, policy and

institutional framework for promoting the competitiveness and consumption of local agro-processed products. This covered various Acts of Parliament, sector policies, regulations, and institutions dealing with agriculture, agro-processing, food security, trade, climate change, and industrialisation. We also looked at the multilateral and regional trade agreements that affect Kenya's trade performance.

In the quantitative approach, we collected quantitative data from various official sources, particularly Kenya National Bureau of Statistics (KNBS) and the Central Bank of Kenya (CBK). The World Bank was also a major source of data used in the study. Some of the datasets we used include KNBS' Statistical Abstracts for various years; Micro Small and Medium Size Enterprises Survey (2016), Kenya Integrated Household Budget Survey (KIHBS, (2015/16)); CBK's quarterly Commercial Banks Credit Survey, (2017); and World Bank's Logistics Performance Index (LPI) Survey (2016). Quantitative data was analysed through statistical techniques.

Finally, we collected qualitative data covering various aspects of competitiveness and consumption of local agro-processed products, the BKBK strategy, and market access challenges in the banana and cassava value chains. Qualitative data was collected through key informant interviews (KIIs) conducted at the national and county level. We conducted a total of 55 key informant interviews. The key informants were selected from ministries and state agencies responsible for trade, agriculture, climate change, industrialisation, and public procurement issues at national and county levels. In the private sector, key informants were selected from agro-processing organisations/firms, trade associations and producer groups.

Data for the banana and cassava case studies were collected from four counties namely, Busia and Makeni (cassava), as well as Kisii and Meru (bananas). These counties were selected based on the fact that they are the leading producers of cassava and bananas in Kenya.

Chapter 2

Compliance of the BKBK with WTO Principles and Regional Trade Agreements

The role of seemingly protectionist policies in regional and international trade has been an area of concern to proponents of free trade. The validity of these concerns is embodied in the benefits of free trade such as increased efficiency of local firms due to competition with firms from other countries. Free trade also ensures that consumers have access to a wide variety of affordable and high quality goods and services. Furthermore, regional integration provides greater bargaining power, especially to small economies, in multilateral negotiations such as within the World Trade Organisation (WTO) (Kritzinger-Van, 2005). Lastly, there is potential for economic growth through attracting foreign direct investment (FDI) in the context of a regional economic community due to the formation of larger markets. Therefore, it is incumbent upon policymakers in Kenya to ensure that implementation of the BKBK strategy does not undermine regional integration efforts in the EAC and Common Market for Eastern and Southern Africa (COMESA), as well as Kenya's trade commitments under the WTO. This section, therefore, provides an overview of WTO principles and an analysis of the extent to which key provisions of the BKBK strategy are consistent with these principles, as well as free trade agreements under the EAC and COMESA.

2.1 WTO Principles

WTO rules are based on three vital principles, namely non-discrimination, transparency, and predictability. These principles are enshrined in

the main Articles of the General Agreement on Tariffs and Trade (GATT) and extend to the General Agreement on Trade in Services (GATS) and Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS). Under GATT, the three principles are enshrined in Article I – Most Favoured Nation Treatment (MFN), Article II – Schedules of Concessions, Article III – National Treatment (NT), and Article X – Publication and Administration of Trade Regulations.

Article II on Schedules of Concessions obliges WTO members not to increase border tariffs above the rates agreed in GATT negotiations (bound rates) and included in their schedule of concessions, without an offer of compensation to affected trading partners. Article X on Publication and Administration of Trade Regulations is aimed at promoting transparency of law, regulations, judicial decisions, and administrative rulings relating to aspects of trade such as border tariffs and internal taxes or charges. The Article promotes timely publication of trade regulations so that government and traders can be aware of them.

Article I – MFN treatment and Article II – NT are meant to ensure non-discrimination in the multilateral trade system. And are, therefore the cornerstone of GATT/ WTO agreements. The MFN principle obliges members not to discriminate between trading partners' goods. It specifically provides that, "...any advantage, favour, privilege or immunity granted by any

contracting party to any product originating or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties”. However, Article XXIV provides exceptions to the MFN principle in the context of regional and bilateral free trade agreements provided that such preferential agreements cover substantially all trade between the parties. Departures from MFN is also provided for under the Enabling Clause that permits developed countries to provide tariff preferences to developing countries through schemes such as the Generalised System of Preferences (GSP).

Article III focuses on national treatment with respect to internal taxation and regulations. Article III:1 requires members not to apply to imported or domestic products internal taxes and other charges, as well as laws, regulations, and requirements affecting internal sale, offering for sale, purchase, transportation, distribution or use of products in a manner that protects domestic production. Article III: 2 stipulates that products from a given member state imported into the territory of another member shall not be subjected, directly or indirectly to internal taxes or other internal charges of any type that exceed those applicable to domestic products. Article III: 4 stipulates that goods from a member state imported into the territory of another member state should be treated no less favourably than like goods/ products of national origin with respect to all laws, regulations and requirements relating to internal sale, offering for sale, purchase, transportation, distribution and use. The principle of MFN and NT are also reflected in Articles 56 and 57 of the COMESA Treaty and Articles 17 and 18 of the EAC Common Market Protocol.

2.2 BKBK’s Provisions that have Implications for Regional and International Trade

2.2.1 Preferential treatment of local goods in public procurement

The BKBK strategy proposes that at least 40 percent of government procurement budget

should be reserved for locally produced goods and services. This includes making local content a requirement in all government procurement contracts. The aim of this provision is to support local industries by according their products and services preferential access to public procurement market.

GATT Article III: 8(a) allows governments to purchase domestic products preferentially for consumption, but not for commercial purposes or resale. Thus, government procurement is an exception to the NT principle. This exception is allowed on the grounds that there can be security concerns that necessitate purchase of local products by the government. Moreover, government procurement can promote growth of local industries.

Although government procurement is an exception to NT under GATT, the Agreement on Government Procurement (GPA) under the WTO provides for mutual opening of government procurement markets among parties through elimination of discriminatory measures against foreign firms and goods in public procurement. As a plurilateral agreement, the GPA does not apply to all WTO members. Additionally, members are not obliged to join the GPA. Currently, the agreement covers 19 parties of which Kenya is not included. This means that Kenya is not obliged to open up its public procurement market to foreign firms/ goods under the WTO.

At the regional level, Article 35 of the EAC Common Market Protocol (CMP) provides for free competition in public procurement. This Protocol stipulates that a partner state should not discriminate against suppliers, products or services originating from other partner states. The BKBK is inconsistent with this Article to the extent that the 40 percent of government procurement budget is to be reserved for goods wholly or partially produced in Kenya. Therefore, the definition of local products under the BKBK and the Public Procurement and Asset Disposal Act, 2015 should be broadened to include products produced in the EAC to avoid discriminating against goods from the region in public procurement.

2.2.2 Providing subsidies and incentives to local producers

The BKBK provides an elaborate mix of subsidies and incentives (including taxes) meant to improve the competitiveness and consumption of local goods and services. These include (1) subsidies on agricultural inputs, machinery, and utilities; (2) duty and tax exemptions to local manufacturers and service providers who import machinery or equipment for improving production technology and capacity; (3) tax rebates/ incentives to manufacturers using locally sourced raw materials or meet set percentage of local materials in their production; (4) review proportion of export processing zone products that may be sold in the domestic market; (5) review preferential treatment to manufacturers in Special Economic Zones.

A subsidy is considered to exist in a situation where a financial contribution by a government or any public entity within the territory of a WTO member is made, thereby conferring a benefit. The contributions include forgone tax revenue that is otherwise due, income or price support, and provision of goods and services other than general infrastructure. Thus, three conditions have to be satisfied for the measures proposed by BKBK to qualify as subsidies: (1) a financial contribution has to be made (2) the contribution must be made by the government (national or county) or any public body such as company or parastatal (3) there must be a benefit resulting from the contribution.

The use of subsidies is strictly disciplined by the Agreement on Subsidies and Countervailing Measures (ASCM) due to their trade distorting effects. The ASCM particularly disciplines the use of ‘specific’⁶ subsidies. This means that the measures proposed in the BKBK will be considered specific; thus, subject to ASCM disciplines if they are provided only to a particular enterprise, industry or group of enterprises or region within the country. Subsidies that are widely available within an economy are presumed not to distort allocation of resources and are, thus not subject to ASCM disciplines (Daly, 2016).

The ASCM identifies two categories of subsidies: prohibited and actionable subsidies. Article III of the ASCM prohibits subsidies that are contingent in law or fact on export performance (export subsidies) and subsidies contingent upon the use of domestic rather than imported raw materials/inputs (local content subsidies). Actionable subsidies are permitted, but can be challenged through the multilateral dispute settlement system or countervailing measures if such subsidies cause adverse effects⁷ to another member.

At the regional level, Article 34 of the EAC Common Market Protocol prohibits granting of any subsidy in any form that distorts or threatens to distort effective competition by favouring an undertaking in so far as it affects trade between partner states. However, subsidies can be permitted through Acts or policies of the EAC or decisions of the EAC Council. Article 52 of the COMESA Treaty also prohibits the use of trade distorting subsidies. It stipulates that except as otherwise provided in the Treaty “...any subsidy granted by a member state or through state resources in any form whatsoever which distorts or threatens to distort competition of certain goods shall, in so far as it affects trade between the member states, be incompatible with the Common Market”. Paragraph 2 of the Article allows members to impose countervailing measures equivalent to the provided subsidy if the granted subsidy causes injury to the complainant.

Although subsidies are disciplined, there are exceptions. Subsidies are an exception to the NT principle under GATT Article III: 8(b), as long as the provided subsidies do not violate other provisions of GATT Article III and the ASCM. In addition, tariff exemptions for imported raw materials and intermediate inputs used in production of various goods for export are not considered as subsidies according to Footnote 1 of Article I of the ASCM. This also applies to exemptions from internal indirect taxes such as VAT on inputs that are used in production of exports under conditions such as the requirement that the exemptions or remissions should not

exceed those imposed on the production and distribution of like products when sold for domestic consumption.

Article 27 of the ASCM provides for special and differential treatment of developing country members. It particularly exempts developing member countries referred to in Annex VII (b) from prohibiting export subsidies until they attain a Gross National Product (GNP) per capita of USD 1,000 at constant 1990 dollars for three consecutive years. According to the 2017 report of the Committee on Subsidies and Countervailing Measures, Kenya is still included in Annex VII (b) with a GNP per capita of USD 474 at constant 1990 dollars. However, members that have reached export competitiveness⁸ in one or more products shall eliminate export subsidies on such products within a period of eight years.

GATT Article XVIII on Government Assistance to Economic Development permits developing countries whose economies can only support low standards of living and are in early stages of development to keep a flexible tariff structure. This may include increasing tariff rates by modifying the Schedule of Concessions. However, such measures have to be notified to the WTO in advance and the country applying such measures must initiate negotiations with affected members with the aim of reaching an agreement on compensation.

GATT Article XX also provides general exceptions to GATT obligations, but should not be used in a manner that constitute arbitrary or unjustified discrimination or a disguised barrier to trade. In this case, exceptions from GATT are allowed when it is necessary to:

- Protect public morals
- Protect human, animal, or plant life or health
- Secure compliance with laws or regulations that are compatible with GATT
- Restrict exports of domestic raw materials to ensure essential quantities of such materials are available to a domestic processing industry

2.2.3 Agricultural support and incentives

The BKBK also proposes some level of support targeting the agricultural sector such as subsidies on agricultural inputs, which are covered under WTO's Agreement on Agriculture (AoA). The aim of AoA on domestic support is to discipline rather than to ban production and trade distorting measures. Under AoA members agreed to set limits and reduce the level of domestic support that they can provide. Measures that have minimal or no production or trade distorting effects (Green box measures) are exempted from reduction commitments. These include, for instance government programmes in the area of research, pest and disease control, training services, extension and advisory services, general inspection services, and infrastructure services among others. In addition, developing countries such as Kenya are allowed to implement public stockholding measures for food security purposes.

For developing countries, Article 6.2 of the AoA exempts development measures from domestic support reduction commitments. These measures include the investment and agricultural input subsidies proposed in the BKBK.

The non-exempt policies (Amber box measures) are subject to reduction commitments based on the concept of Total Aggregate Measurement of Support (AMS⁹). Developing countries such as Kenya that did not declare any AMS in the base period (1986-90) can provide production and trade distorting support up to their *de minimis*.¹⁰ In this case, trade-distorting product-specific policies whose value is below 10 percent of the farmgate value of the production of that product are exempted from reduction commitment. The same applies to non-product specific policies whose value is below 10 percent of total value of agricultural production in the country.

2.2.4 Export processing zone (EPZ) and special economic zone (SEZs) incentives

EPZs and SEZs have already been established in Kenya and provide various incentives including

tax incentives, regulatory benefits, and infrastructure services to manufacturers operating in them. The BKBK seeks to review these incentives to ensure they promote competitiveness of local products. Within the WTO, there are no rules dealing specifically with EPZs and SEZs. However, the incentives provided in these zones are subject to WTO disciplines.

SEZ incentives that are WTO compliant include exemptions of duties and indirect taxes on imported inputs used in the production process. Such incentives are already being provided in Kenya's EPZ and SEZs. Measures implemented by private sector organisations are also compliant unless such measures are being implemented on behalf of a government or funded by a government. Non-specific subsidies for which eligibility is automatic and selection of beneficiaries is based on objective criteria are also complainant.

EPZ and SEZ subsidies that are contingent upon export performance and use of local content are not WTO complaint under the ASCM. For instance, the restriction of the proportion of sales that Kenya's EPZ firms can make domestically means that these firms are required to export a certain percentage of their products. This requirement turns the incentives received by EPZ firms into export subsidies. However, there are

exceptions to export subsidies as provided for under Article 27 of ASCM. The Agreement on Trade Related Investment Measures (TRIMS) prohibits measures that are inconsistent with GATT's Article III i.e. national treatment and Article XI on General Elimination of Quantitative Restrictions, subject to applicable exceptions.¹¹ This includes incentives that are pegged on compliance with local content requirements and measures that condition ability of an enterprise to import on its export performance.

Overall, the BKBK has several proposals geared towards improving the competitiveness and consumption of local goods and services. These include preferential treatment of local goods in public procurement, subsidies/tax incentives, and agricultural support, as well as Special Economic Zone and Export Processing Zone specific incentives. Whereas Kenya is not obliged to open its public procurement market under WTO since it is not party to GPA, the EAC Common Market Protocol requires Kenya to avoid measures that restrict participation of other partner states in public procurement. The subsidies and incentives proposed under the BKBK are consistent with WTO principles under circumstances in which they do not cause injury, are not prohibited under various WTO agreements or are allowed under specific exceptions within WTO agreements as discussed in the foregoing section.

Chapter 3

Promoting Competitiveness and Consumption of Local Products

At the firm or micro-economic level, the concept of competitiveness relates to the capacity of companies to compete, grow, and operate profitably. In this context, competitiveness refers to the capacity of companies to consistently and profitably produce goods/ services that satisfy the needs of an open market with respect to price, quality, and quantity (Latruffe, 2010). At the national or macro-economic level, there is no universally accepted definition of competitiveness. In 1992 OECD state that it considers a country competitive if it can produce goods and services that meet foreign competition while at the same time being able to expand and maintain real domestic income.

3.1 Supply-side Factors

3.1.1 Infrastructure bottlenecks and trade facilitation

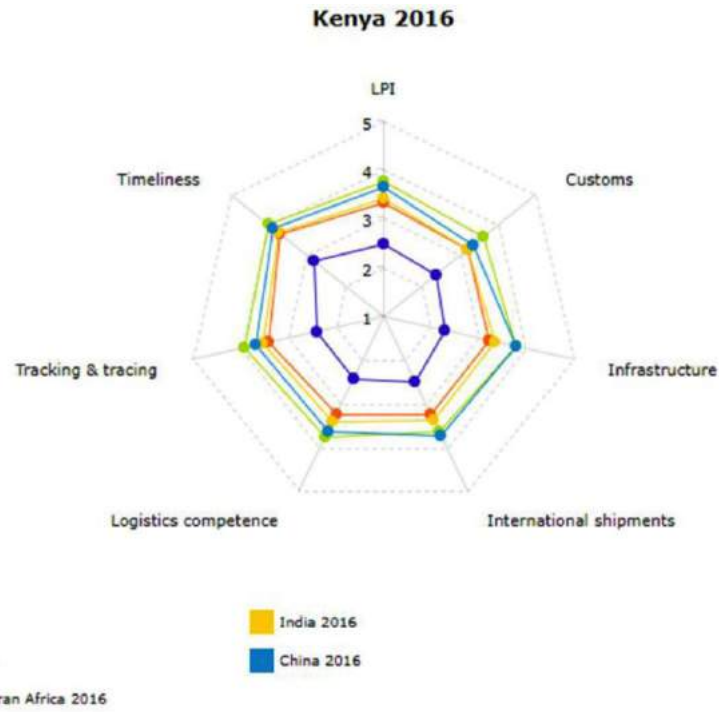
That efficient and reliable infrastructure is a prerequisite for developing a globally competitive agro-industrial sector is well documented. Kenya is ranked at position 42 out of 160 countries in World Bank's 2016 International Logistics Performance Index¹² (LPI) report. Further, road freight charges in the Mombasa-Nairobi route reduced by 38.5 percent to USD 800 in March 2017 from USD 1,300 in June 2010 based on data from the Northern Corridor Transport Observatory. This reflects in part Kenya's improved investment in trade and transport infrastructure such as roads, Standard Gauge

Railway (SGR), airports, seaports, and cargo clearance systems among others. However, in rural areas key informants indicated that most of the roads are impassible during rainy seasons, thereby increasing transportation costs and time to market or limiting access to raw materials for agro-processing.

As Figure 4 illustrates, Kenya lags behind South Africa which is the best performer in the Sub-Saharan Africa region in the 2016 LPI in the six main aspects of logistics: customs, infrastructure, international shipments, logistics competence, tracking and tracing, and timeliness. Kenya also lags behind China and India which are some of its main competitors in the domestic, regional and international markets for agro-processed products.

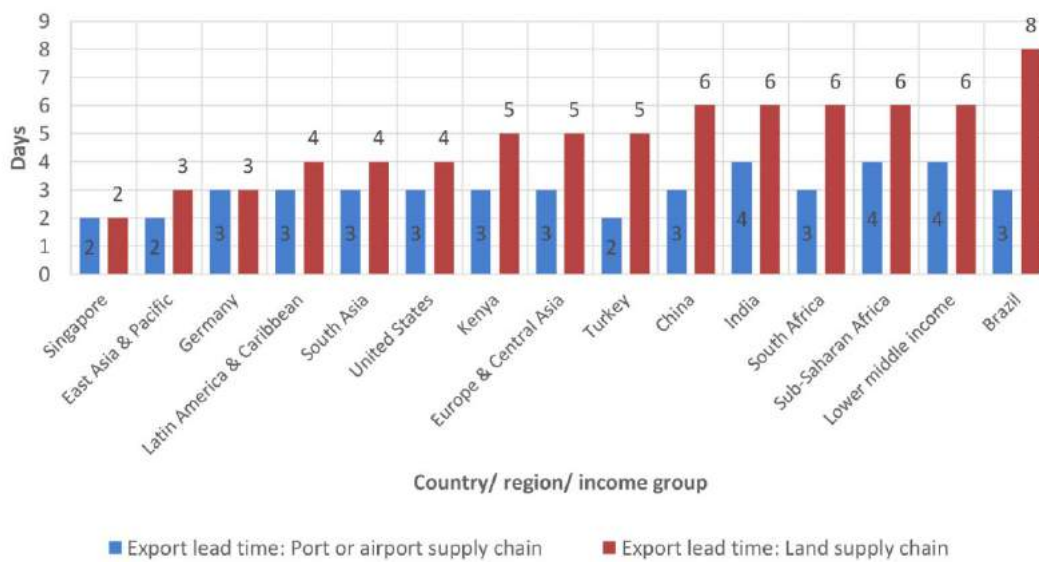
Looking at trade facilitation indicators, the export lead time in Kenya is 5 days for the land supply chain and 3 days for the port or air supply chain (Figure 5). This means that it takes a shorter time to export from Kenya than China, India, and Brazil, but much longer compared to East Asia, Latin America, Germany (best performer in 2016 LPI) and Singapore. As Figure 6 illustrates, the import lead time in Kenya (land supply chain) is shorter than China, Brazil, as well as the average for Sub-Saharan Africa and lower middle income economies. However, there is room for improvement given that it takes a much shorter time to import in key competitors such as South Africa than in Kenya.

Figure 4: Logistics performance index and indicators



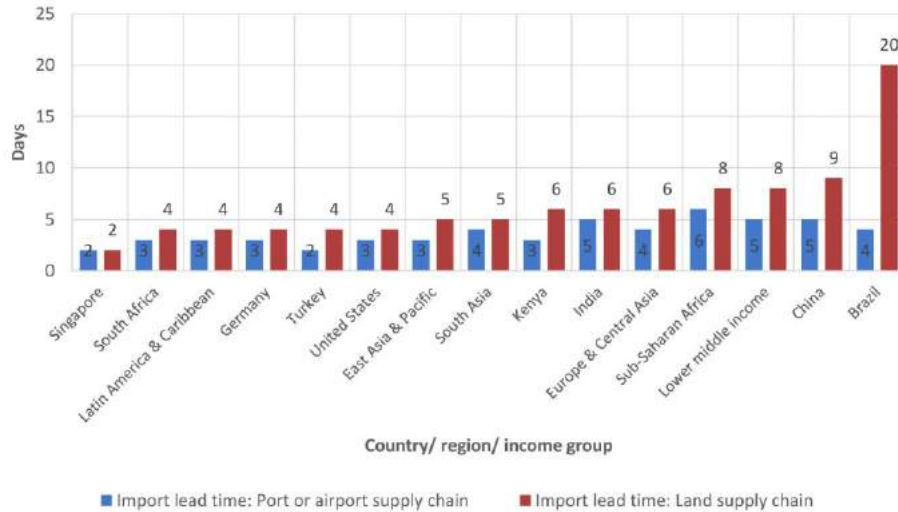
Source: World Bank, 2016

Figure 5: Export lead time



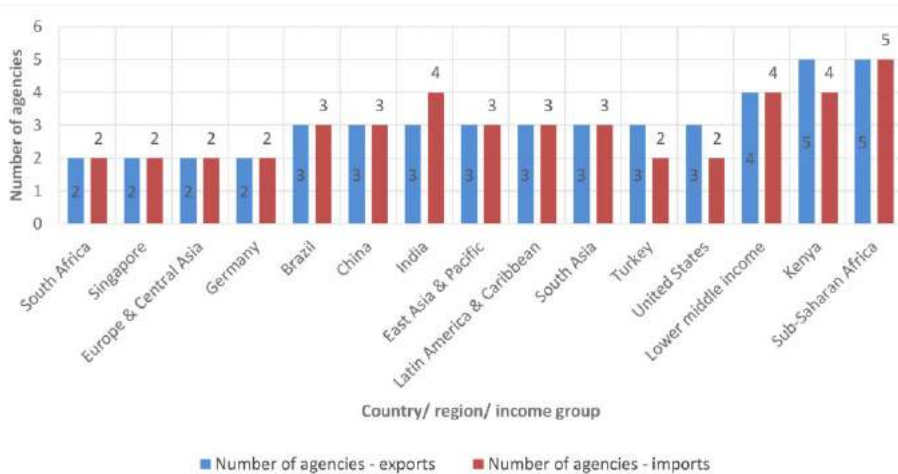
Source: World Bank, 2016

Figure 6: Import lead time



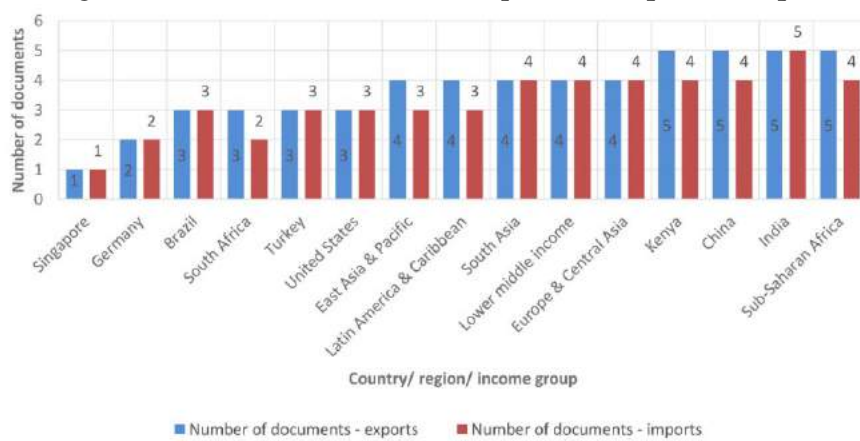
Source: World Bank, 2016

Figure 7: Number of agencies handling exports and imports



Source: World Bank, 2016

Figure 8: Number of documents required to export or import



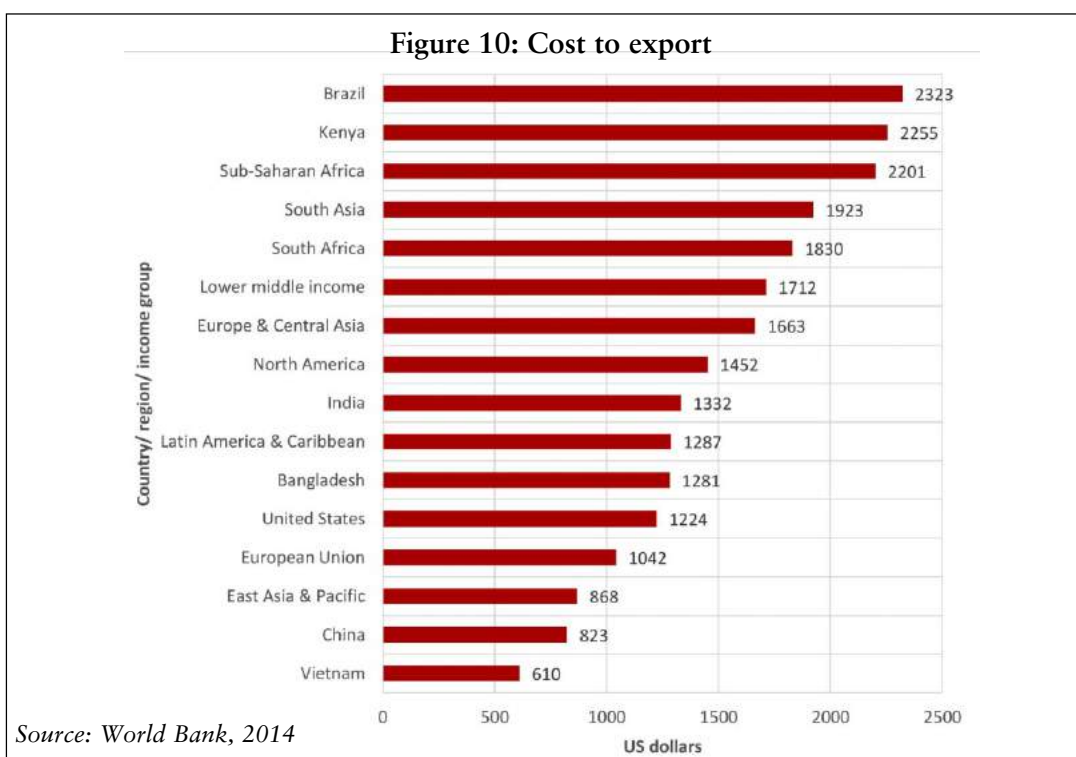
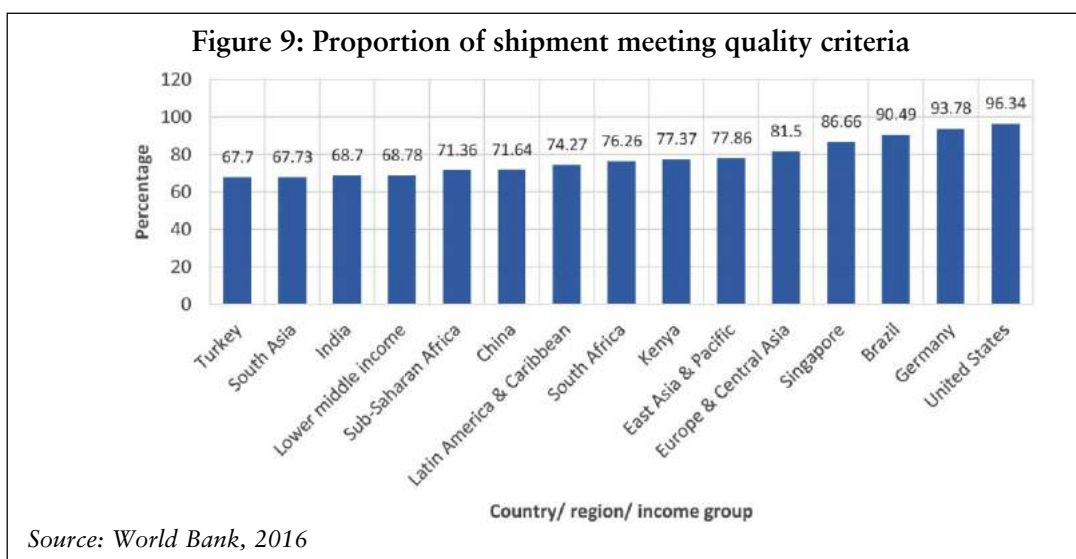
Source: World Bank, 2016

Reducing red tape is also an area that should be prioritised in trade facilitation reforms given that exporters in Kenya have to deal with five agencies and five documents to export (Figures 7 and 8). In South Africa, for instance, exporters deal with only two agencies and three documents.

The proportion of shipment that meets importers/ exports' quality criteria in Kenya (77.37 percent) is better than for various competitor countries such as India and South Africa (Figure 9). However, further improvement could enhance the competitiveness of local producers.

Finally, the cost to export¹³ in Kenya (USD 2255) is much higher compared to nearly all regions including Sub-Saharan Africa (Figure 10). The cost to export in Kenya is 31.7 percent higher than the average for lower middle income countries category where Kenya belongs. Thus, reducing the overall cost of exporting in Kenya should be a top priority to improve the competitiveness of local products.

Access to electricity by businesses has increased in the last decade. However, the cost of electricity for industrial use in Kenya remains very high. For instance, industrial consumers in



Kenya pay USD15 cents per kilowatt hour (Kwh) compared to USD7 cents in China, USD4 cents in Ethiopia, and USD12 cents in Uganda (KAM, 2017). Thus, agro-processors interested in cheap energy have the incentive to manufacture in countries with cheap electricity and export to Kenya. Key informants also cited limited access to electricity in rural areas and frequent power outages as challenges faced by agro-processors. High cost of electricity when passed to consumers make Kenyan products more expensive. As a result, consumers shift expenditure to cheap imports. When producers absorb the high costs, especially in industries such as textile where electricity accounts for up to 25 percent of total costs, profit margins are significantly reduced (World Bank, GDS & MIED, 2016). Micro and small enterprises are particularly vulnerable to high production costs given their lack of the economies of scale needed to achieve cost effectiveness. Thus, energy costs have to be reduced significantly to make Kenya's agro-processing sector competitive. An enabling investment climate should be created to attract private sector investment in generation and distribution of electricity from alternative renewable energy sources such as solar, wind and geothermal to eliminate the losses associated with frequent power outages. Further, the tariff structure should be reviewed with the aim of charging affordable rates to agro-processors to reduce production costs.

Access to water for production purposes is also a challenge to producers, especially micro, small and medium size enterprises (MSMEs). According to the 2016 MSMEs Survey, less than 30 percent of MSMEs owned by family, sole proprietor, partnership, or a cooperative had access to piped water.

3.1.2 Climate change

Kenya is one of the countries with high levels of vulnerability to climate change. This is attributed to the high dependence on agriculture, the fact that nearly 80 percent of land area is arid and semi-arid, and environmental degradation (Parry, Echeverria, Dekens, & Maitima, 2012). The most common climate change related disasters in Kenya are frequent draughts and excessive

sporadic rains. Extreme climatic conditions have adverse effects on quantity and quality of agricultural raw materials through postharvest losses and crop failure. Further, excessive rains often damage infrastructure such as roads, whereas draughts limit hydroelectricity generation.

Although climate change is a global challenge, Kenyan agro-processors are disproportionately affected due to their limited ability to adapt to its impacts. Interviews with key informants showed that micro and small agro-processors lack adequate technical and financial capacity to source raw materials from diverse sources in response to local shortages caused by adverse climatic conditions. As a result, some agro-processors have to scale down production or close their businesses due to shortage of raw materials.

Other adaptation challenges include limited access to agricultural insurance and alternative sources of energy such as solar for production, as well as inadequate awareness of available adaptation and mitigation strategies (Sibiko, Veetil, & Qaim, 2016). Therefore, improved investment in climate change adaptation should be considered as a strategy for enhancing competitiveness and consumption of local products. Efforts in this regard should focus on enhancing access to the technologies, skills, capital, and equipment required by agro-processors to adapt to climate change.

Apart from climate change, adequate access to quality raw materials is limited by other factors that affect agricultural production. These include high cost of land due to increasing demand; expensive agricultural inputs; farmers' reluctance to shift from subsistence to commercial farming; and poor prices that discourage production (KAM, 2017). Other challenges include the prevalence of crop pests and diseases, as well as environmental degradation. Access to raw materials has to be improved by addressing the constraints that affect their supply. Particularly, land and physical planning related policies have to be reviewed to address the high cost of acquiring land for agricultural production and

processing. Further, the National Agri-business Strategy should be implemented to facilitate commercialisation of agriculture to ensure adequate production of quality raw materials.

3.1.3 Human capital: cost and quality

Access to adequate and appropriate skill set is crucial for improving the competitiveness of local agro-industries. Appropriate skills facilitate product and process innovation that translates into products that meet demand conditions in terms of quality and price. Labour costs in Kenya measured by average real¹⁴ minimum hourly rate, increased by 49.3 percent to Ksh 209.33 in 2016 from Ksh 140.26 in 2013.¹⁵ Monthly minimum real wage increased by 47.4 percent to Ksh 23,264 from Ksh 15,780.71 in 2013. Although the rise in wage rate benefits workers, it leads to an increase in the cost of production.

Regarding the quality of labour, most small and micro agro-processors do not perform training needs audits to identify critical skill gaps. This holds true even among medium size enterprises in sectors such as textile and apparel (World Bank, GDS & MIED, 2016). Further, there is limited interaction between agro-processing firms and training institutions to identify current and future skill requirements. Although most public universities and tertiary colleges are now offering courses targeting agro-industries such as food processing, textile and apparel, the institutions have limited training capacity due to underfunding and use of obsolete equipment for training (Kaane, 2014). As a result, a significant skill gap exists; thus, constraining production of competitive goods. The skill gap also translates into high operating costs in industries where agro-processors have to incur additional expenses to retrain their workers.

3.1.4 Equipment and technology

Access to and utilisation of state of the art equipment, machinery, and technology is an integral aspect of enhancing productivity in agro-processing sector. Yet in Kenya, use of modern equipment and technology is skewed towards a few large and medium size agro-processors with factory based production systems. Micro and

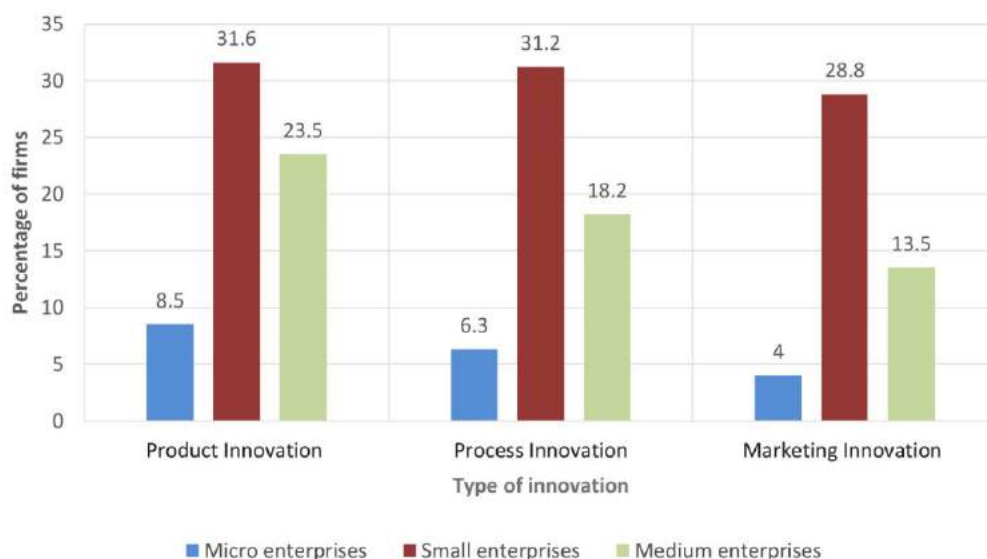
small agro-processors, on the other hand, still rely on rudimentary technologies and improvised equipment that are inefficient and not fit for purpose. The main constraint to access to modern equipment and technologies is the high cost of acquiring them (World Bank, GDS & MIED, 2016). This challenge is compounded by reliance on expensive imported equipment coupled with limited availability of appropriate financing facilities.

Reliance on imported equipment and machinery is occasioned by inadequate research and development (R&D) to facilitate local production of the same, as well as the failure of the local equipment manufacturing sector to attract adequate investment. Obsolete equipment and technologies lead to inefficiencies in production, thereby raising production costs. Moreover, agro-processors relying on rudimentary technologies have limited capacity to respond to market needs in terms of product quality, packaging, and pricing. These challenges are compounded by low levels of investment in innovation, especially by MSMEs. For instance, the 2016 MSMEs survey showed that the proportion of micro enterprises in the manufacturing sector that engaged in product, process and marketing innovation was less than 10 percent (Figure 11). Technological challenges should be addressed through incentives that facilitate acquisition of appropriate technologies and equipment; increased investment in R&D and commercialisation of research findings; promoting technological transfer through integration of local agro-processors in global value chains; and creating a business environment conducive to manufacturing equipment locally.

3.1.5 Financing

Access to appropriate credit facilities remains a significant challenge in Kenya's agro-processing sector to the extent that it prevents access to the much-needed financial resources for expanding production activities to satisfy demand. The government, in a bid to enhance access to credit from the formal banking sector, introduced interest capping in 2016 to reduce the cost of borrowing. This strategy however, has had the

Figure 11: Proportion of MSMEs in manufacturing sector engaging in innovation



Source: KNBS-MSMEs Survey, 2016

unintended effect of reducing access to loans as banks have embarked on rationing credit especially to sectors such as agriculture that are considered high risk.

According to the Central Bank of Kenya’s Commercial Banks Credit Survey for the third quarter of 2017, 35 percent of the surveyed banks indicated that interest rate capping led to increased demand for credit. Despite the increased demand, 45 percent of the banks indicated that interest rate capping had only little positive effect on actual credit granted, while another 45 percent indicated that the capping led to a decrease in actual credit granted. Further, 54 percent of the banks indicated that interest rate capping negatively affected their lending to SMEs. This was attributed to increased risk mitigation measures by banks that locked out potential customers who failed to meet certain risk thresholds on existing product standards.

MSMEs are disproportionately affected by credit rationing since they lack collateral to secure loans from formal banking institutions. As a result, MSMEs have to rely on capital invested by their owners or limited internal resources to finance their operations. In early 2018, the government acknowledged the failure of the interest rate capping. In mid-June 2018, the National Treasury

made a proposal to Parliament to repeal the interest rate capping law to enhance the supply of credit. However, there is the risk of interest rates becoming very high after repealing the law. So banking sector reforms should focus on addressing the underlying causes of high interest rates that include credit risks, as well as structure and competition in the banking sector (Were & Wambua, 2014).

3.1.6 Access to distribution channels

A well-developed wholesale and retail sector provides one of the best channels for reaching consumers of agro-processed products in any country. Kenya has one of the most developed wholesale and retail sector in Africa with nearly 30 percent of retail transactions taking place in the formal retail industry (Deloitte, 2015). Our key informant interviews showed that most micro and small agro-processors face significant difficulties in accessing the formal retail channel to serve the local market. This is attributed to a lack of awareness of the opportunities in selling through formal retail channels such as supermarkets.

Another major challenge cited by key informants is the lack of technical and financial capacity to meet the requirements of supermarkets such as

obtaining product certification from the Kenya Bureau of Standards; acquiring barcodes; appropriate product packaging; meeting supply quotas; and supplying products on a credit basis. As a result, small and micro agro-processors depend on the informal retail and wholesale traders to reach consumers. Whereas the informal retailers have no stringent requirements, their market reach is often limited to specific locations and they hardly get into legally binding supply agreements with agro-processors to ensure long-term market access. A large group of small and micro agro-processors are also selling directly to consumers. This channel has the advantage of ensuring better profit margins by eliminating intermediaries. However, the market reach is limited as most agro-processors can only serve a limited number of customers. This challenge is compounded by cumbersome business licensing procedures and the multiple taxes or levies imposed by county governments that not only discourage inter-county free movement of goods but also increase operating costs.

Although large and medium size agro-processors have relatively better access to the formal retail channel, challenges abound (MITC, 2017). The key challenges include:

- I. Late payment to suppliers which forces some agro-processors out of business by tying up working capital for as long as one year
- II. Unjustified unilateral termination or threat of termination of supply relationships that lead to significant losses among agro-processors
- III. Unjustified return of unsold goods at suppliers' expense
- IV. Transferring commercial risks or costs to suppliers through, for instance, requiring suppliers to fund the cost of sales promotions. In some cases, suppliers have to make additional payments such as product listing fees, shelf space fees, and joint marketing contributions to access the formal retail system
- V. Refusal by retailers to receive all or part of goods delivered due to reasons not

attributable to suppliers. This leads to significant losses as agro-processors find it difficult to access alternative markets for the rejected goods in the short-term.

- VI. Requiring suppliers to provide huge margins to retailers that in turn lead to losses among suppliers.

3.1.7 Access to regional and international market

Africa is Kenya's main export destination accounting for 40.6 percent of its exports in 2016. This is followed by the European Union at 21 percent, Far East at 15.6 percent and America at 9.2 percent.¹⁶ Within Africa, COMESA and the EAC are the main markets. However, Kenya's trade surplus in the EAC has been declining since 2011 due to increased imports of agricultural products and strengthening of manufacturing sector in other partner states (KIPPRA, 2017). Access to COMESA and EAC is facilitated by trade liberalisation under the Common Market Protocol in these regional economic communities (RECs). Additionally, a simplified trade regime (STR) is being implemented to facilitate MSMEs' participation in cross border trade in the EAC and COMESA. The STR allows traders to use a simplified customs document and certificate of rules of origin on a selection of commonly traded goods with a value of up to USD 2,000. In the EAC, Trade Committees have been established in border points such as Busia, Malaba and Namanga to monitor and report illicit trade (counterfeits and smuggled goods) and non-tariff barriers (NTBs) to trade. Additionally, Cross Border Trade Associations (CBTAs) and Trade Information Desks (TIDs) have been established to facilitate participation of SMEs in trading across the borders. The CBTAs that have been formed include the East Africa Cross Border Traders Association (EACBTA), the Kenya-Tanzania Cross-Border Traders Association (KTCBTA), and the Busia Women Cross-Border Traders Association.

Despite the efforts to facilitate cross border trade, agro-processors continue to face new and old NTBs that hinder their access to regional markets, particularly the EAC. According to

Winters et al (2017) the EAC had resolved a total of 100 NTBs by 2016. However, some NTBs remain unresolved or resurface after having been addressed. The key NTBs that continue to stifle free flow of goods in the EAC include quality and safety standards related measures, import bans, and customs and trade facilitation measures that are inconsistent with the EAC-CMP. In 2017, the trade standoff between Kenya and Tanzania resulted into import bans and escalation of tariffs on specific products. This led to restriction of entry of Kenya’s products such as cigarettes and milk into Tanzania. On the other hand, banning wheat imports from Tanzania denied local food processors such as bakeries access to cheap wheat.

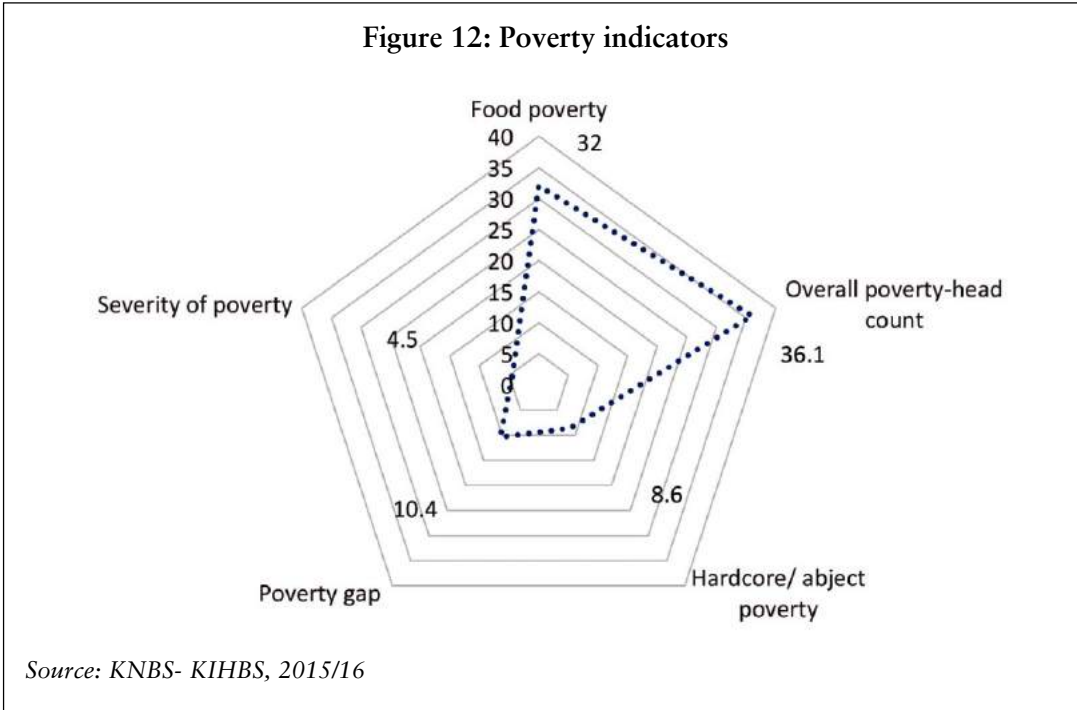
Access to regional and international markets is also affected by information asymmetry regarding existing business opportunities, price levels, and demand and supply conditions. There is also limited awareness on Sanitary and Phytosanitary (SPS) requirements, customs procedures, and product standards. The recently launched Kenya Trade Portal,¹⁷ as well as initiatives by non-state actors such as Sauti Africa¹⁸ that provide both web-based and mobile phone based trade information are expected to alleviate information asymmetry. Technical barriers such as product standards that are difficult to achieve

also prevent market access, especially in international markets.

3.2 Demand-side Factors

Several demand side factors affect consumption of local agro-processed products in Kenya. Income is one of the factors affecting demand in nearly all agro-industries. Although Kenya is considered a lower middle-income country, 36.1 percent of its population (16.4 million people) still lives in poverty (Figure 12). Further, 32 percent of the population is food poor – unable to consume the minimum daily calorific requirement of 2,250 Kcal due to financial constraints. The incidence of hardcore or abject poverty at the national level is 8.6 percent (3.9 million people). This comprises individuals living on less than Ksh 1,954 a month in rural areas and Ksh 2,551 in core-urban areas. This level of income is inadequate to support the minimum food consumption even if the entire income is spent on food only.¹⁹

Given the high level of poverty, the mean and median per capita consumption remains low – Ksh 7,811 and Ksh 5,830 respectively. Thus, price is a major determinant of consumer choices. The majority of consumers go for the cheapest products irrespective of their source and quality.



This challenge is exacerbated by product dumping and illicit trade in the form of smuggled goods and counterfeits that ensures increased access to cheap imports. For instance, consumers often purchase imported second hand clothes and shoes since they are nearly five times cheaper than locally made clothes (Magezi, 2017).

A strong taste and preference for imports is another key challenge facing agro-processors, especially in the textile and apparel industry (ACTIF, 2011). Imports are normally associated with high quality that guarantees them acceptability in the local market at the expense of domestic products. In some instances, purchasing an imported product from western countries is associated with a higher social status compared to a local product. In the textile industry, imports usually reflect the latest fashion trends that give them a competitive edge over local products. This means that agro-processors must go beyond meeting the minimum quality standards set by KEBS by developing products that have all the attributes that are important to consumers.

Heavy investments in advertising and aggressive marketing strategies by multinationals exporting to Kenya also reinforce the loyalty of consumers to imported brands. As a result, consumers continue purchasing imported products that they have developed trust in rather than take the risk of purchasing local ones that they have little or no experience in using. Local micro and small agro-processors lack the financial capacity to invest in advertising or aggressive marketing to increase the visibility and hence consumption of their products.

Product quality also influence consumers' choices in the market. According to a key informant from the retail sector, consumers are particularly concerned about the quality of local products. Generally, consumers tend to buy local products manufactured by medium or large agro-processors who are believed to have the capacity to meet quality and safety standards. Moreover, consumers have a strong preference for well branded and packaged products. Yet most micro and small agro-processors still face packaging and

branding challenges such as lack of packing materials and equipment, as well as expertise in branding.

Product availability across different retail channels also determines consumption. Consumers tend to purchase products that they can access conveniently. Thus, agro-processors with limited capacity to consistently supply their products across various retail channels end up losing their market share.

3.3 Review of Existing Policy and Legal Framework

In the agricultural sector, several policies have already been developed to support agro-processing. The Agricultural Sector Development Strategy (ASDS) 2009-2020 provides an overarching policy framework for creating an innovative, commercially-oriented, and modern agriculture sector. It seeks to increase productivity, commercialisation, and competitiveness of agricultural products and enterprises, as well as to develop and manage key factors of production. The National Agribusiness Strategy, 2012 has the objective of improving the competitiveness of Kenya's agribusiness sector including agro-processing. It recognises climate-related risks as threats to competitiveness of local agri-businesses. However, the strategy does not integrate key adaptation mechanisms such as cultivation of drought resistant crops; climate smart agriculture; and developing alternative sources of raw materials. Regarding market access, the strategy has no provisions for improving MSMEs' access to local formal retail channels to enhance distribution of agro-processed products.

The National Horticulture Policy, 2012 incorporates measures to improve competitiveness of horticultural products (fresh and processed). This includes strategies geared towards resolving infrastructural bottlenecks, improving value addition, enhancing access to markets, provision of financial services, climate change adaptation, and research and development. The National Livestock Policy 2008 integrates policy measures meant to

address the challenges facing the livestock sector with regards to breeding, feeding, disease control, value addition, marketing, and research. Implementation of the policy, however, is still constrained by the lack of a legal framework to create key institutions such as Kenya Livestock Research Institute, Livestock Breeding Board, and Kenya Livestock Marketing Board.

The National Agricultural Research Systems Policy, 2012 has adopted a collaborative approach to promote comprehensive research and development at all stages in agricultural value chains. Further, it provides for linkages between research institutions and industry to ensure improved uptake of research outputs. However, the policy lacks provisions for supporting R&D entities to protect the intellectual property rights embodied in their research outputs. Although the Industrial Property Act and Copyright Act provide a legal framework for protecting intellectual property, a policy framework is still needed to facilitate the provision of technical and financial support to individuals, firms, or R&D entities to protect their inventions. Regarding food security, the National Food and Nutrition Security Policy 2011 incorporates measures to enhance competitiveness of agro-processing, food trade, and adaptation to climate change to ensure food security.

On industrialisation and investments, the Sessional Paper No. 9 of 2012 on the National Industrialisation Policy Framework for Kenya 2012-2030 seeks to promote development of “...globally competitive and diversified industrial sector for generation of wealth and employment through creation of an enabling environment”. The Sessional Paper incorporates a ban of exports of unprocessed/ semi-processed cotton, skins, and hides to ensure improved access to these raw materials for local agro-processing. Currently, raw skins and hides are subject to export tax (80 percent) to encourage their use in local industries. Although raw material export bans and export taxes are well intentioned, they can discourage rather than increase the production of raw materials. Specifically, farmers have no incentive to continue producing these raw

materials if they cannot obtain fair prices in the domestic market or export them. This challenge can be addressed in part by supporting local agro-processors through incentives that promote high value addition such as building leather industrial parks²⁰ and cottage industries. Value addition is expected to improve the earnings of local agro-processors, thereby allowing them to offer prices that can spur production and supply of locally produced hides and skins, for instance, to the domestic market. This should be accompanied by farm level cost reduction measures to encourage farmers to continue producing raw materials for local industries.

The draft Kenya Investment Policy, 2017 is aimed at promoting foreign direct investment (FDI) and domestic direct investment (DDI) to ensure sustainable economic growth. Therefore, the policy has provisions for creating a business environment that supports investment; ensure investment transparency and clarity; and protect investor rights. The Investment Promotion Act 2004 (revised 2009) provides a legal framework for promoting and facilitating investment by assisting local and foreign investors to obtain licenses and permits required to invest, as well as facilitate access to investment-related incentives. The Act also established the Kenya Investment Authority to promote and facilitate investment in Kenya. The Competition Act 2010 (revised 2016) is aimed at promoting and safeguarding fair competition in the domestic market and protects consumers from unfair and misleading market conduct.

The Special Economic Zones (SEZ) Act 2015 provides generous tax incentives, regulatory benefits and promotes the development of excellent infrastructure to boost the competitiveness of enterprises operating in SEZs. Additionally, the Act provides for establishment of Agricultural Zones to enhance growth of the agricultural sector including agro-processing. The Act allows SEZ enterprises to sell their goods in the local market subject to the conditions applicable to imported commodities. This may improve the consumption of local agro-processed products in the domestic market.

Finally, the Micro and Small Enterprises Act, 2012 provides the legal and institutional framework for promotion, development, and regulation of micro and small enterprises (MSEs). This includes creating an enabling business environment; facilitating access to business development services; formalising and upgrading informal micro and small enterprises; inculcating a culture of entrepreneurship; and developing representation associations. The Act established the Micro and Small Enterprises Authority to promote development of competitive and sustainable MSEs. Further, the Micro and Small Enterprises Development Fund is created under the Act to finance development of MSEs, provide affordable credit to MSEs, finance capacity building of MSEs, as well as finance R&D, innovation and technological transfer. It is important that the scope of the Act be extended to medium size enterprises, which also face the same challenges as MSEs.

Regarding international and domestic trade, The National Trade Policy (NTP) 2017 seeks to transform Kenya into an efficient domestic market and export-led globally competitive economy. This will be achieved through implementation of open, competitive, and export-oriented policy measures. As the government implements the policy, it should fast track and finalise the on-going review of the legal (Sales of Goods Act, Competition Act, and Companies Act) and institutional framework to establish an effective regulatory framework for the wholesale and retail industry. The key issues that should be addressed in the review include late payment to suppliers, non-compliance with sales contracts, establishment of an alternative dispute resolution mechanism other than courts, and establishment of or designation of an institution to oversee the implementation of regulations in the wholesale and retail industry. This will address the challenges facing the wholesale and retail sector, thereby providing an effective channel for agro-processors to distribute their products.

The draft BKBK strategy, 2017 provides for measures to enhance the competitiveness and consumption of local products. Whereas the strategy supports the increased purchase of local

goods by government agencies, it fails to provide for measures to entrench green procurement in the public sector to ensure sustainability. Further, the Public Procurement Regulatory Authority, which has experience in regulating public procurement, is not part of the National Steering Committee (NSC), which is the highest decision making organ with respect to BKBK implementation. There is also no provision for co-opting other relevant ministries and agencies in the NSC to enhance implementation.

The Anti-Counterfeit Act, 2008 prohibits production and trade in counterfeit goods to protect local industries from unhealthy competition. The Anti-Counterfeit Regulations, 2010 provide guidelines for operationalising the Act. The Act also established the Anti-Counterfeit Agency to combat counterfeiting and trade in counterfeit goods. Nonetheless, trade in counterfeit goods remains a significant challenge to competitiveness of local industries. This underscores the need to strengthen the Anti-Counterfeit Agency to fight trade in counterfeit goods in the country.

In response to dumping, the government enacted the Kenya Trade Remedies Act 2017. The Act forms the legal basis for investigation and imposition of anti-dumping, countervailing, and trade safeguard measures in Kenya. It is important that the government fast-tracks the establishment of Kenya Trade Remedies Agency (KTRA) to combat dumping and trade in subsidised imports through implementation of appropriate or WTO compliant trade remedies. Another challenge that needs to be addressed to operationalise the Act is the lack of technical capacity to investigate cases of unfair trade practices to provide the evidence needed to implement countervailing measures.

Looking briefly at climate change, the Kenya National Adaptation Plan 2015-2030 supports the agro-industrial sector to the extent that it provides measures to enable actors in agro-value chains to cope and adapt to climate change. However, the success of the plan heavily relies on the government's ability to raise the USD38.3 billion required to implement it until 2030. In

the face of dwindling external financial support and constrained internal revenue generation, a clear strategy is needed to leverage innovative financing mechanisms to fund the plan.

The Climate Change Act 2016 provides a legal framework for development, management, implementation, and regulation mechanisms to enhance climate change resilience and low carbon development. The Act establishes the National Climate Change Council (NCCC) to provide an overarching national climate change coordination mechanism. A missing link in the Act is the lack of provisions for establishment of user-friendly and publicly accessible databases to provide accurate and timely data and information on aspects of climate change such as climate finance, vulnerability, impact, and effectiveness of adaptation and mitigation strategies among others to aid planning and implementation of climate response strategies.

Overall, the analysis in the foregoing shows that several policies and legislations meant to address various challenges affecting competitiveness of local agro-industrial sector have been developed. The persistence of the challenges is an indication that the policies and legislations have yet to achieve the desired results. This is attributed in part to implementation challenges and lack of policy coherence across various sectors. Some of these challenges include government interventions that affect prices of raw materials such as maize and sugarcane. Although regulating sugarcane prices through the Sugarcane Pricing Committee is well intentioned, it creates more problems for the sugar industry. Fixing sugarcane prices has distortionary effects to the extent that it eliminates the role of the market in the efficient determination of prices. In the maize milling sector, the government often purchases maize at above market price, forcing millers to offer higher prices than the government to access maize. Ultimately, the high prices are passed to consumers.

In the dairy sector, poor enforcement of safety and quality regulations has led to growth of a large number of informal traders in dairy products. The informal traders not only ignore

safety and quality standards, thereby denting consumer confidence in local products, but also cause unfair competition to the formal dairy sector.

The government's strategy to liberalise the agro-industrial sector through privatisation of agricultural state corporations and opening the domestic market to foreign competition was meant to ensure efficiency and development of market-based production in the sector. However, the recent reinvestment by the government in firms such as Kenya Cooperatives Creameries, Pan Paper, and various sugar companies seem to be contrary to the privatisation objective. Regulation becomes difficult when the government that is expected to enforce regulations is also a major producer.

Although the government seems to be committed to reducing the cost of agricultural production and agro-processing, much more needs to be done. For instance, uncontrolled fragmentation and commoditisation of land has made it difficult and expensive to acquire adequate land for farming and constructing agro-processing facilities, especially in urban centres.

Several ministries and state agencies are involved in the implementation of agro-processing related policies and legislations, thereby creating coordination challenges. Attempts to improve coordination led to the formation of the Agricultural Sector Coordination Unit (ASCU) in 2005. The unit brings together various ministries involved in agriculture-related issues to coordinate policy development. However, with the formation of county governments in 2013 and devolvement of some aspects of agriculture, coordination remains a significant challenge. Policy implementation is also constrained by underfunding of the ministries in the agricultural sector (Kerosi, 2017).

To this end, the government should firstly embark on reviewing the policies and legislations to address the identified gaps or weaknesses. The review should focus on improving policy coherence and synergies to promote competitive and sustainable agro-processing. Most

importantly, implementation of the policies and legislations should be prioritised. Effective implementation calls for a collaborative approach that brings together state and non-state actors to design and implement appropriate programmes to achieve the desired policy objectives. This should be supported with adequate funding through collective resource mobilisation towards policy implementation. Furthermore, monitoring and evaluation of progress towards achievement of policy objectives should be conducted regularly as provided for in most policy documents. The outcome of monitoring and evaluation should form the basis for taking remedial action in response to emerging challenges and issues.

3.4 Review of Institutional Framework

A robust institutional framework is critical to development of a sustainable agro-processing sector. In Kenya, over twenty institutions are directly involved in promoting competitiveness and consumption of agro-processed products as annexure 1 illustrates. The key institutions include the Ministry of Agriculture, Livestock, and Fisheries, which formulates and implements agricultural policies. The Ministry of Industry, Trade, and Cooperatives is responsible for the development and implementation of industrial, trade, and cooperatives related policies. The Ministry of Environment and Natural Resources develops and implements environment and climate change policies.

Kenya Bureau of Standards (KEBS) develops and promotes adoption of standards relating to products, materials, and processes among others. It also certifies industrial products to ensure consumption of quality goods. Kenya Industrial Research and Development (KIRDI) conducts multi-disciplinary research and development in industrial and related technologies. Its research mandate covers agro-industries such as textile, leather, and food. Kenya Agricultural and Livestock Research Organisation (KLRO) promotes and regulates research in the agriculture and livestock sector. The Agriculture and Food Authority (AFA) regulates the

production, processing, marketing, grading, storage, and transportation of agricultural products.

The Export Processing Zone Authority (EPZA) and Special Economic Zones Authority (SEZA) are mandated to oversee implementation of various incentive schemes meant to improve the competitiveness of Kenya in production and trade in various goods. The Export Promotion Council promotes export trade by addressing the bottlenecks facing exporters. Brand Kenya Board is mandated to create and maintain the Kenya brand to ensure identification and distinction of Kenyan products in various markets.

In the private sector, there are several industry apex organisations such as Kenya Private Sector Alliance (KEPSA), Kenya Association of Manufacturers (KAM), and Africa Cotton and Textile Industries Federation (ACTIF) among others. These organisations play a key role in policy lobbying and advocacy, as well as providing specific services to their members such as research, training, or provision of industry information. Several agricultural cooperatives have also been formed to provide specific services to their members. These include provision of credit facilities, farm inputs, marketing, processing, and transportation services.

The challenges facing the institutional framework include weak coordination of the activities implemented by various organisations to facilitate improvement of the competitiveness and consumption of local products. Given the large number of institutions involved in development of the agro-industrial sector, a policy or legal framework has to be created to guide coordination of their activities. This will facilitate successful implementation of policy provisions and programmes meant to improve competitiveness and consumption of local goods.

Duplication of roles among institutions in the agro-industrial sector also undermines efforts to ensure efficiency and synergies in policy and programme implementation. This calls for a review and redefinition of the roles of each

institution to avoid duplication (FAO-MAFAP, 2013). Further, collaborations among institutions responsible for shared roles such as research is critical to policy and programme implementation.

Underfunding is another major challenge facing the institutional framework. In some ministries and agencies, low absorption of budgetary allocations due to factors such as delays in disbursement of funds to implementing units and donor contributions negatively affect project implementation. Funding constraints prevent various institutions from implementing their programmes or policy provisions effectively. Thus, the government should consider increasing funding to the institutions responsible for promoting consumption and improving competitiveness of local products.

Finally, political interference in the management and operations of the institutions is a hurdle that has to be addressed (EACC, 2010). Political interference undermines the independence of sector regulators, thereby creating loopholes for breaching regulations that are meant to ensure consumer confidence in local products. Thus, the legal frameworks establishing key institutions such as regulators should be strengthened to eliminate political interference. In the private sector, agricultural cooperatives continue to face challenges that prevent them from functioning effectively. These include poor financial management, leadership disputes, and political interference. Agricultural cooperatives should be strengthened through better enforcement of regulations to enable farmers and agro-processors access services from them.

3.5 Incentivising Private Sector Firms and Households to Consume Local Agro-processed Products

Globally, a wide variety of incentives is being used, albeit with varying success, to motivate private firms and households to consume domestic rather than imported goods. The incentives can broadly be categorised as: Price incentives, product quality incentives, measures that promote the use of local raw materials, and awareness creation measures.

3.5.1 Price incentives

Price incentives are often implemented through market-based instruments meant to influence consumption through the price channel. They include reduction of the taxes applicable to domestic goods or provision of subsidies meant to reduce the price of the final product.

Reducing or eliminating consumption taxes such as value added tax (VAT) can make domestic products cheaper than imports, thereby increasing their consumption. An example in this regard is India's goods and services tax (GST) introduced in 2017. Under this new tax regime, several Central and State level taxes such as excise duty, service tax, state VAT, sales tax, and purchase tax among others were replaced by a single tax – GST (KPMG, 2017). Consumers pay only the GST charged by the last dealer in the supply chain. A zero percent rate applies to essential food products, whereas mass consumption items such as tea are subject to a GST of only five percent. Thus, consumers are expected to benefit from a lower tax burden.

The challenge with tax incentives is that tax reductions can only shift consumption to local products if they result in substantial price reductions (OECD, 2008). Yet private firms who have the final say on retail prices may not pass the cost savings resulting from tax reductions to consumers. Moreover, tax reductions can result in revenue loss that resource-constrained countries such as Kenya may not be able to afford. Further, application of internal tax measures should be consistent with GATT/WTO's principle of most favoured nation and national treatment.²¹

Subsidies aimed at making domestic products cheaper than imports have also been used to encourage consumption of local goods. However, like most developing countries, Kenya has limited capacity to provide subsidies due to financial constraints. Moreover, subsidies can have trade distorting effects. Therefore, the application of subsidies should be compliant with various WTO, EAC and COMESA free trade agreements.²²

3.5.2 Product quality measures

Product quality measures are meant to build the confidence and trust of consumers in local products. Globally, a variety of measures are being implemented to ensure product quality. A good example is European Union's Policy for Quality Agricultural Products and Foods. The policy provides for measures to promote production of high quality products, help consumers understand product attributes, and legal protection of product names or brands that are associated with high quality (European Union, 2007). Most governments have industry specific regulations that govern product quality. Implementation of such regulations can help in winning consumers' trust in local products. In competitive markets, agro-processors have the incentive to adopt and exceed set quality standards to ensure market access. Although product standards set by government and private firms can promote consumption of local products, they can also serve as technical barriers to trade. Moreover, monitoring compliance can be expensive (OECD, 2008). Thus, it is important to provide technical and financial support to agro-processors to meet product quality standards for them to remain competitive.

3.5.3 Promoting the use of local raw materials in production

Encouraging the use of locally produced raw materials has great potential for promoting consumption of domestic products. The success of this strategy, however, depends on availability, cost, and quality of local raw materials. Agro-processors are likely to use local raw materials if they are affordable, high quality, and readily available in adequate quantities. These conditions can be achieved through incentives such as WTO compliant subsidies, tax incentives or agricultural support measures that promote production of agricultural raw materials and intermediate goods.²³ Improving investment climate and ease of doing business can further support the production and utilisation of local raw materials in production and consumption of domestic products (Adeniji, 2013).

3.5.4 Awareness creation measures

Awareness creation measures are founded on the idea that individuals make poor choices due to lack of information. Thus, awareness creation is meant to provide the information necessary to promote consumption of local products. Awareness can be created through a variety of communication channels and strategies including advertising, product exhibitions, social media campaigns and trade missions. These can be implemented by both government and private firms. The information being communicated normally centers on key product attributes that consumers identify with. Communication plays a key role in reinforcing the behaviours and cultural practices that promote consumption of local products such as the African attire in West Africa. It also facilitates branding and positioning a product as the right solution to consumers' needs.

Awareness creation can promote consumption of local products in Kenya given the information asymmetry and negative attitudes and perceptions that consumers have towards domestic goods with respect to price and quality. The challenges in creating awareness include a lack of expertise in identifying what to communicate, how to communicate it, and where to communicate the required information (BIO Intelligence Services, 2012). Creating expertise in these areas through capacity building programmes is important and should be prioritised.

3.6 Incentivising Agro-processors to use Local Raw Materials for Production

Using local raw materials is expected to create and strengthen forward and backward linkages among agro-processors, producers, and service providers, thereby creating more job opportunities. By sourcing raw materials locally, agro-processors can reduce their transportation costs and eco-logical footprint.

For agro-processors to use local raw materials in their production processes, such materials have to be of high quality, affordable, and available in adequate quantities. To this end, a collaborative approach should be employed to first address the supply-side constraints that prevent production of quality raw materials. These include increased investment in climate change adaptation, pest and disease control, shifting agricultural production from subsistence to commercial, improving the quality and availability of infrastructure such as roads and electricity and reducing the cost of farm inputs (KAM, 2017). Essentially, an enabling business environment has to be created to facilitate

production of high quality raw and intermediate goods that feed into agro-processing processes.

Further, incentives such as tax rebates provided to agro-processors can significantly encourage the use of local raw materials. Agro-processors also need to be sensitised on availability and use of alternative raw materials that are available locally. This can be achieved through agro-processing demonstration centres, TV or radio programmes, seminars, workshops, and direct messaging. The sensitisation efforts should also highlight the benefits of using local raw materials to encourage uptake.

Chapter 4

Reserving 40 percent of Public Procurement Budget for Local Products

Government procurement refers to the purchase, lease, or rental of goods and services by public or government entities (UNCTAD, 2003). Globally, governments often favour the purchase of products produced in their economies to achieve national objectives such as promotion of domestic industries and ensuring national security. Governments discriminate against foreign firms in public procurement by: prohibiting foreign companies from bidding for local public tenders; imposing rules requiring foreign firms to use substantial amounts of domestic goods in their execution of public procurement contracts; and restricting participation of foreign firms in public procurement by using preference schemes that favour local firms.

Public procurement laws or policies that discriminate against foreign goods or firms have distortionary trade effects to the extent that they curtail international flow of goods (UNCTAD, 2003). In the short run, restrictive procurement laws may facilitate achievement of industrialisation objectives by enhancing local goods' access to domestic public procurement market. This can facilitate creation of decent job opportunities through forward and backward linkages; rapid industrialisation; and poverty reduction, especially in small developing economies such as Kenya.

However, the restricting participation of foreign firms in domestic public procurement can have unintended outcomes. Specifically, excessive

protection under procurement laws can serve as a disincentive for local firms to improve their competitiveness through product and process innovation. As a result, domestic firms will be left behind in terms of competitiveness. Limiting the participation of foreign firms in public procurement also prevents the government from purchasing the best products at the lowest price. Consequently, government budget may not achieve maximum utility.

One of the key provisions of the BKBK strategy is the proposal to reserve 40 percent of government procurement budget for locally produced goods and services. This provision is expected to enhance domestic market access for local products, thereby supporting the growth of local agro-industries, as well as improving job opportunities and reducing poverty.

4.1 Consumption of Agro-processed Products in the Public Sector

Currently there is no publicly accessible data on the value and quantities of various agro-processed products consumed by the national and county governments, as well as public institutions. However, key informant interviews with procurement officers in public institutions showed that the government purchases a variety of agro-processed products. The key products include paper and paper products, as well as furniture for office use. Food and beverages such as processed milk, sugar, coffee, tea, and vegetable oils are purchased by public

organisations such as hospitals, prisons, and learning institutions. Textile and leather products are purchased by public institutions such as prisons and the police service.

The local market is the main source of food and beverages purchased by the government. Paper and paper products, as well as textile and leather products are imported due to limited local production. However, the government has adopted a new policy requiring all uniforms for the disciplined forces to be sourced from the local market. The government has traditionally imported furniture from Asian countries. However, in 2010 the government adopted a new policy requiring all ministries and state agencies to purchase only local furniture to support the industry.

4.2 Opportunities and Challenges in Implementing the 40 percent Preference Scheme

4.2.1 Opportunities

The 40 percent preference scheme presents immense opportunities for local agro-processors to sell to the government. To begin with, public school feeding programmes are a good opportunity for agro-processors to produce and sell high quality food products given the rapid increase in enrollment rates in primary and secondary schools. The government implements a regular school feeding programme that benefits pre-primary and primary school children in Arid and Semi-Arid Lands areas. Boarding secondary schools also provide meals to students. The State Department for Basic Education allocated Ksh 2.68 billion to School Health, Nutrition, and Meals programme in 2016/17 financial year. This programme is expected to benefit from a funding of at least Ksh one billion annually up to 2019/20 based on the 2017/18 Programme Based Budget estimates data.

The government being one of the major consumers of paper and paper products presents a great opportunity for local agro-processors to supply these products to public institutions under the 40 percent preference scheme. This calls for

reviving and expanding the local paper and paper products industry to reduce reliance on imports occasioned by limited local production. Resuscitating the local industry requires concerted efforts to enhance access to raw materials and reduce the cost of production in the paper and paper products industry. Supplying uniforms for the disciplined forces is also a major opportunity for textile and apparel producers, given that these products are to be sourced from the local market only.

Producing high-end furniture for the public sector is also an opportunity that is yet to be fully exploited by local agro-processors. Transforming the local furniture industry from a largely informal sub-sector with heavy reliance on rudimentary technology and semi-skilled artisans to a formal and competitive sub-sector that is capable of producing quality products is crucial. Apart from enhancing access to technology and equipment, the government should provide incentives geared towards reducing the cost of training artisans and developing a positive attitude towards such training. This is based on the fact that existing training institutions such as polytechnics that provide relevant courses such as carpentry are operating at low capacity due to underfunding and students' negative attitude towards such courses (Kaane, 2014).

4.2.2 Challenges

Several hurdles are likely to affect implementation of the 40 percent preference scheme, including expansion of the agro-products that can benefit from it. To begin with, supply-side constraints (discussed in section three) limit expansion of the range of products that can benefit from this preference scheme. Inadequate awareness of available procurement opportunities and procedures for applying for the same is also a major concern, especially to MSMEs. The experience with existing preference schemes indicate that advertising government tenders through newspapers does not create adequate awareness on available opportunities. This calls for the use of diverse communication channels including local radio stations to create awareness.

Participation of agro-processors in the preference scheme is also likely to be hampered by a lack of appropriate business skills coupled with difficulties in meeting prequalification requirements such as business registration and obtaining tax compliance certificates (Obiri, 2016). To this end, the Public Procurement Regulatory Authority (PPRA), Kenya Institute of Supplies Management, National Treasury, and Ministry of Industry, Trade and Cooperatives in collaboration with other state and non-state actors should focus on building the capacity of agro-processors to meet pre-qualification requirements, as well as acquire and apply appropriate business skills in order to benefit from public procurement.

Financial constraints not only prevent production of products that can benefit from the 40 percent preference scheme, but also limit the ability of MSMEs to apply for high value tenders to enhance their earnings. It will be helpful for the government to collaborate with private sector financial institutions to create appropriate trade financing schemes to enhance access to credit.

Lack of transparency and corruption in awarding tenders also discourage participation of local agro-processors in public procurement. The opportunities provided by the 40 percent preference scheme may not be fully exploited if transparency and fairness is not guaranteed in public procurement. Thus, the PPRA should collaborate with relevant authorities and institutions including the Ethics and Anti-Corruption Commission (EACC), judiciary, police and procuring entities to eliminate corruption in public procurement. Further, PPRA and Ministry of Industry, Trade and Cooperatives must ensure transparency through improved reporting and publishing information on the level of compliance with the preference scheme.

Late payment by the government is another major obstacle to implementation of the preference scheme. Late payment ties up capital, thereby limiting the amount of funds available for expanding production (MITC, 2017). For micro and small agro-processors with limited financial

resources, late payment can lead to closure of business or unsustainable dependence on expensive credit. This calls for enactment of appropriate regulations to ensure that suppliers are paid on time.

4.3 Legal, Policy and Institutional Constraints to Implementation of 40 percent Preference Scheme

4.3.1 Legal and policy constraints

Preference schemes in public procurement are anchored on the Constitution of Kenya, 2010 and the Public Procurement and Asset Disposal Act (PPADA) 2015. Article 227(2) of the Constitution provides for enactment of an Act of parliament (PPADA) to guide implementation of public procurement policies and procedures including establishment of preference schemes for disadvantaged groups. These groups include youth, people living with disability, women, as well as micro, small, and medium enterprises. Thus, the PPADA provides for reservation of 30 percent of government procurement budget for the disadvantaged groups. Moreover, county governments are required to reserve at least 20 percent of their procurement budget to their residents. These preference schemes apply to goods wholly or partially manufactured in Kenya or firms where Kenyans have above 51 percent shareholding.

For international tenders, foreign suppliers are required to source at least 40 percent of their supplies from local contractors before submitting their tenders for consideration. This makes the foreign firm that wins a tender an intermediary between the government and local suppliers. This leads to several challenges. First, it exposes small and medium enterprises to high competition from large firms that have better financial and technical capacity to enter into supply contracts with foreign tenderers. Second, foreign firms may demand very low prices due to their high bargaining power, thereby exposing local suppliers from whom they have to obtain 40 percent of their supplies to the risk of making losses. Third, foreign firms use technical barriers such as product standards to avoid purchasing

their supplies from local firms as indicated by a key informant from the public sector.

In national tenders, there is no provision in the PPADA that requires government organisations to allocate at least 40 percent of their procurement budget to local goods. Thus, it is important to review the PPADA to provide a clear legal basis for reserving 40 percent of government procurement budget to local goods. The PPADA should further provide clarifications on the criteria for identifying the goods and firms that will benefit from this preference scheme. Moreover, there should be provisions or regulations for harmonising all the preference schemes to ensure seamless implementation.

4.3.2 Institutional constraints

Several institutions are involved in management of public procurement in Kenya. The National Treasury is responsible for formulation of public procurement and asset disposal policy and standards. At the county level, County Treasuries implement public procurement and asset disposal policies and regulations. The Public Procurement Regulatory Authority is responsible for enforcing the PPADA. Its roles include monitoring, assessing, and reviewing public procurement and asset disposal system to ensure compliance with relevant policies and regulations. The Public Procurement Administrative Review Board (PPARB) facilitates resolution of public procurement related disputes. The Kenya Institute of Supplies Management (KISM) is responsible for implementation of the Supplies Practitioners Management Act 2007. Its functions include promoting learning, training, development of procurement best practices, and regulating the conduct of procurement practitioners in Kenya.

Despite the great progress in establishment of relevant institutions to ensure seamless operation of public procurement, challenges abound. To

begin with, there is significant overlap and duplication of roles among the institutions, which hinder effective implementation of procurement policies and regulations. Currently, public procurement issues fall under the National Treasury. Yet the BKBK is to be implemented by a unit to be established in the Ministry of Industry, Trade, and Cooperatives. Therefore, effective and efficient coordination between these two ministries will be necessary to ensure successful implementation. Further, there should be clear roles for each institution to avoid overlaps and duplications.

The Public Procurement Administrative Review Board consists of only six members and mainly operates from Nairobi. Further, there is little awareness about it particularly among the small and medium enterprises. Thus, it is difficult to access the services of the board to ensure quick resolution of procurement disputes. Resolving public procurement disputes through the court system, on the other hand, is expensive and can take over 100 days to be concluded. It will be helpful for the government to establish an alternative dispute resolution mechanism that can easily be accessed by MSMEs.

Monitoring compliance with preference and reservation schemes is also a challenge. For instance, some county governments and state organisations fail to submit data and reports to PPRA indicating their levels of compliance. At the county level, some procurement units are under staffed whereas some officers are not aware of their roles in management or implementation of preference and reservation schemes (Obiri, 2016). Therefore, it is important to build the capacity of procurement staff through relevant training to equip them with the right skills and knowledge. Moreover, county governments should allocate adequate budgets to address the human resource constraints in their procurement units.

Chapter 5

Promoting Climate Aware Agro-processing under the Buy Kenya, Build Kenya Strategy

5.1 Constraints to Innovation for Climate Aware Agro-processing

Climate change, if not taken into account, can undermine development of the agro-processing sector. Agro-processors need to embark on process and product innovation to effectively adapt to climate change, whilst reducing their ecological footprint (mitigation). Process innovation in this context, refers to the implementation of new or significantly enhanced production or trading methods or techniques to adapt an agro-processing entity to climate change. Product innovation in a broad sense involves developing new products, or redesigning existing products, or using new/ alternative raw materials to manufacture existing products in response to climate change.

Interviews and discussions with key stakeholders in the agro-industrial sector revealed that the capacity of local agro-processors to adopt innovative ways to adapt to climate change is limited by several factors. First, there is limited awareness among stakeholders on the linkages between climate change and the sustainability of the agro-processing sector. Most agro-processors obtain their raw materials from small-scale farmers who have limited knowledge on climate smart agriculture. Farmers also have inadequate knowledge, expertise and skills in using modern technologies to address postharvest losses, as well as pest and disease outbreaks associated with climate change. Small and micro agro-processors, on the other hand, have

inadequate expertise in managing the logistics of obtaining raw materials from alternative sources in response to climate change induced shortages and applying climate aware technologies such as solar in production. Micro and small agro-processors also lack the technical skills required to improve efficiency to reduce production costs in a bid to free up capital to respond to climate change related risks. Moreover, designing and manufacturing innovative merchandise such as food products that rely on drought resistant crops as their main raw materials remains a challenge to agro-processors due to their limited technical capacity.

Second, insufficient availability of capital among agro-processors is a significant barrier to adaptation to climate change. Adaptation involves costs that often arise as agro-processors reorganise their production processes and product offerings in response to climate change. This includes the cost of acquiring new technologies, training staff, conducting research and development and purchasing new equipment to adapt to climate change. These costs are a burden, especially to MSMEs that face financial constraints occasioned by insufficient credit supply and meager internal resources.

Third, inadequate access to appropriate technologies also hinder adaptation. This is explained by several factors including inadequate investment in R&D to develop affordable technologies locally and the high cost of the initial investment needed to acquire adaptation

technologies such as solar-powered refrigeration systems. Further, loose integration of local agro-processors into regional and global value chains constrains access to appropriate technologies through technological transfers.

Finally, policy implementation challenges undermine efforts to adapt agro-processing to climate change. The National Adaptation Plan and the Green Economy Strategy and Implementation Plan (GESIP) 2016-2030 provide elaborate measures to improve the resilience of various sectors of the economy including agro-industries to climate change. For instance, GESIP provides for measures aimed at ensuring macroeconomic stability, improving ease of doing business, climate proofing infrastructure, capacity building and promoting efficiency in resource use to facilitate mitigation and adaptation to climate change. However, implementation of these interventions has been inadequate leaving agro-processors with little or no support to adapt to climate change.

The gaps in policy implementation have forced agro-processors to devise their own means of supporting themselves and vulnerable members of their value chains to adapt. For instance, a few medium size and large agro-processors are providing capacity building and technical support to their suppliers (farmers) to cope with climate change in a bid to ensure a steady supply of raw materials. This includes promoting increased uptake of innovations such as the use of solar powered water pumps for irrigation, using bio-pesticides and organic fertilisers, and cultivating draught resistant crops. However, the scope of these interventions is limited since they involve additional costs to agro-processors.

5.2 Integrating Green Procurement Practices in Public and Private Sector

Green procurement refers to a process whereby public and private entities meet their needs for goods and services by choosing products that have minimum impact to the environment throughout their lifecycle as compared to alternative products (Environment Protection

Agency-Ireland, 2014). Green procurement is increasingly becoming a mainstream concept in the developed world due to its potential to support sustainable or climate-aware production and consumption. However, implementing GP often faces challenges including high initial cost of transitioning to GP practices, resistance from suppliers and difficulties in monitoring compliance.

In Kenya, implementation of GP practices in the public and private sector is still at a nascent stage. In the public sector, there is no legal or policy framework for integrating GP practices in government procurement. In the private sector, adoption of GP practices is slow and remains a voluntary process due to lack of appropriate incentives and regulations. The BKBK provides a great opportunity to promote sustainable consumption in the public and private sector through adoption of GP practices.

Implementing green procurement requires policy coherence and involvement of all relevant stakeholders. One of the guiding principles of the Public Procurement and Asset Disposal Act, 2015 is protection of the environment through procurement of environment-friendly goods. Nonetheless, the Act does not have specific provisions to entrench GP practices in the public sector to protect the environment. Therefore, it is important to review the Act to provide for clearly defined measures and guidelines for promoting GP in the public sector. In the private sector, regulations and guidelines should be provided to facilitate adoption of GP practices. This includes policy provisions for eliminating obstacles to green procurement.

The definition of environmental standards in procurement policy is also important. According to the OECD (2015), without credible standards outlining what is “green”, it is difficult to implement green procurement practices. One way to go about this is to establish standards for determining green products and embedding eco-labeling in procurement policy to enable suppliers to demonstrate their compliance with GP requirements.

There are concerns about lack of knowledge and skills or expertise among procurement practitioners on how to make a shift to green procurement. Thus, policy on green procurement ought to support building the capacities of procurement staff at national and county levels to allow for seamless implementation of GP. Capacity building initiatives should also be targeted at equipping suppliers with the skills and knowledge required to meet GP requirements.

Awareness creation is key to the success of green procurement implementation. For GP to be adopted successfully, stakeholders need to know its benefits, risks, and strategies to implement it in Kenya. This calls for policy actions that encourage dissemination of information about GP to the public and government officials. To this end, it is important to adopt multiple communication platforms such as stakeholder dialogues, dedicated web pages, direct messaging, conferences, and public forums to create awareness on GP.

In order to wade off potential resistance to GP, it is important to provide appropriate incentives to suppliers including agro-processors to comply. This includes providing technical support, particularly to vulnerable groups such as micro and small agro-processors to comply. Further, financial incentives such as tax rebates and credit facilities should be provided to suppliers to address the concern that GP could have dire financial implications to their businesses.

Finally, Kenya lacks reliable mechanisms to gauge progress in adopting green procurement in the public and private sector. This underscores the need to put in place measures to monitor compliance, as well as evaluate progress and impact of GP periodically to ensure success through timely identification of challenges and taking appropriate remedial measures.

5.3 Best Practices for Promoting Sustainable Consumption

The negative effects of consumption on health and the environment are well documented. Consumption is associated with production

processes that may cause harm to the environment. Moreover, manufactured products may cause environmental damages throughout their lifecycle if they are not eco-friendly. These concerns necessitate a shift to sustainable consumption, generally defined by UNEP (2011) as “a holistic approach to minimising the negative environmental impacts from consumption and production systems while promoting quality of life for all”. To this end, various countries are already implementing different innovative programmes and strategies to promote sustainable consumption.

To begin with, awareness creation has successfully been used to promote sustainable consumption, especially in developed countries. Eco-labeling is one of the awareness creation strategies that have been used with considerable success to ensure sustainable consumption. The objective of eco-labels is to communicate verifiable and accurate information about the environmental aspects of a product to stimulate demand and supply for such products. Germany provides a good example for successful eco-labeling. In Germany, the Federal Environment Agency supported a consumer organisation to develop an online platform²⁴ containing information on various labeling initiatives in Germany and Europe. The platform provides consumers with information on existing eco-labels and their certification systems, thereby facilitating sustainable consumption. For eco-labels to be implemented successfully in Kenya, technical support should be provided to the private and public sector to develop and operate product certification and eco-labeling systems.

Incentives such as reduction of taxes applicable to a product with the aim of encouraging resource-smart and climate friendly consumption and production are also being used. These initiatives are used to influence choices made by households and individuals by making sustainable consumption less costly. A case in point is the Netherlands’ *Nu Spaarpas* Scheme (NU card scheme) that was launched in 2002 by the Rotterdam Municipal Authority. The card allowed consumers to earn points when they purchased green products. The points were

redeemed for sustainable goods (OECD, 2008). Within one year, 10,000 households and 100 retail outlets were participating in the scheme. Moreover, over 1.5 million points had been issued, thereby encouraging sustainable consumption. Implementing a similar scheme in developing countries such as Kenya calls for public private partnerships (PPPs) to access the technical and financial resources needed to build the required infrastructure and create awareness to ensure participation of citizens.

Sustainable consumption has also been promoted through development and implementation of cohesive policies and programmes. Sweden provides best practices in this regard. In particular, Sweden has developed a strategy that

aims at promoting sustainable consumption by strengthening cooperation between state and non-state actors; streamlining resource use, creating awareness on sustainable consumption, and phasing out harmful chemicals (Ministry of Finance-Sweden, 2016). Food and transport are among the key areas in which the strategy promotes sustainable consumption. For Kenya, developing an effective policy, legal, and institutional framework will be a good starting point in the quest for sustainable consumption. Through benchmarking, Kenya can identify best practices in sustainable consumption by learning from countries that have successfully implemented sustainable consumption practices such as Sweden.

Chapter 6

Case Studies: Cassava in Busia and Makueni and Bananas in Meru and Kisii²⁵

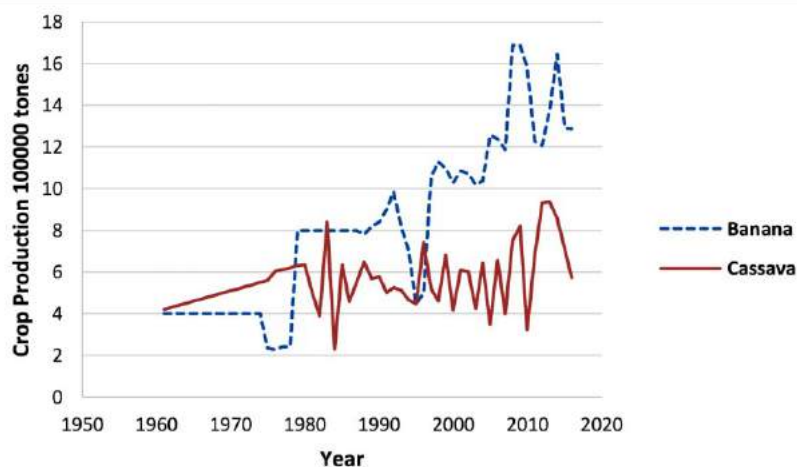
6.1 Overview of the Two Sub-sectors

Banana is one of Kenya's most important fruits, produced mainly by smallholders and supports the livelihoods of multiple actors including farmers, input suppliers, traders, and other service providers along its value chain (USAID, 2013). According to the Kenya National Banana Development Strategy (2013-2016), bananas make for 30-40 percent of all fruit revenue generated in the country. Bananas are associated with high gross margins among those who cultivate it and have high nutritional value. There are about 165 banana cultivars grown in Kenya, mainly in Kisii, Meru, Kiambu, Murang'a, Tharaka-Nithi, Kirinyaga, Embu, Nyamira and Taita Taveta.

Cassava is one of Kenya's most important root crops, providing a source of income to over 2.5 million people in the country (USAID, 2013). The crop is mainly grown for subsistence but is increasingly being grown as a raw material for manufacturing a variety of commodities including ethanol, starch, gum or adhesive and animal feed. Cassava provides approximately 300 calories a day to about 200 million people in Africa. And its production stood at 570,000 tonnes in 2016 (Figure 13). Some of the counties in which cassava is produced are Makueni and Busia.

Banana and cassava yields have yet to reach their full potential. This has been attributed to farm level constraints such as limited access to credit, inadequate extension services, pests and diseases, and limited capacity building to farmers on good

Figure 13: Banana and Cassava Production 1961-2016 in Kenya



Source: FAOSTAT

agricultural practices. Banana yields are sensitive to climate change given that an increase in temperatures by 2⁰C can reduce banana productivity by 10 percent. The problem is compounded by the fact that farmers lack both the technical and financial capacity to adapt to climate change.

6.2 Domestic Market Access Challenges and Opportunities

6.2.1 Banana value chain

6.2.1.1 Marketing: products, distribution channels, market opportunities

Processing of bananas is currently conducted on a small-scale, with actors in both counties specialising in the processing of a variety of products such as banana biscuits, crisps, cakes, porridge flour, wine, jam and juice. These products are distributed mainly through wholesalers and kiosks. Direct sales to consumers was also identified as a major distribution channel. A small number of respondents indicated that they sold their products to supermarkets and major retailers within their respective regions.

According to the interviewed respondents, a major challenge associated with the use of the wholesale channel was low sales turnover. Selling through this channel required agro-processors to depend on intermediaries (brokers) who set prices that fell far below standard prices, forcing agro-processors to sell their products at a loss. Agro-processors are particularly susceptible to exploitation by brokers due to the lack of guidelines on pricing. Selling to local kiosks was seen as a last resort, brought about by the inability of agro-processors to reach large groups of consumers directly. Producers in both Meru and Kisii felt that the most effective distribution channel would be supermarkets and big retail chains, as it would enable them to access larger consumer groups to improve their sales turnover.

New trade opportunities for agro-processors lie in markets outside their localities. For example, in Kisii, agro-processors felt that there are significant market opportunities in neighboring

counties that do not grow or process banana commercially such as Kericho, Bomet, Kisumu, Migori and Homa-Bay. National, regional, and international distribution was also identified as an opportunity for local agro-processors to increase their sales. Lastly, there are unexploited opportunities for earning additional income through generation of electricity from banana waste, soap production using waste emanating from processing banana crisps and production of animal fodder.

6.2.1.2 Market access challenges

Product certification was identified as a major market access challenge, especially in the case of accessing supermarkets and other major retailers. Products from most small-scale agro-processors are not certified by the Kenya Bureau of Standards (KEBS), limiting the nature of markets that such products can access. Some of the interviewed agro-processors were aware of what was required to apply for KEBS certification but reported being constrained in terms of the equipment and technical capacities needed to facilitate the certification. Further, there are significant costs and time involved in acquiring business and food handler permits that are necessary for production and market access.

Limited investment in marketing activities such as advertising was identified as another major barrier to accessing the market. Marketing initiatives by micro and small agro-processors, where they exist, are modest and cost-constrained. This limits the ability of micro and small agro-processors to compete with their large counterparts that make significant investments in marketing. Agro-processors that actively engaged in marketing in Kisii used farmer field days, the Kisii Agricultural Show and school sports days as platforms to build networks and sell their products. However, the agro-processors often had to pay to participate in these fora. In Meru, the interviewed agro-processors did not invest much in marketing activities such as advertising and sales promotions. This was attributed mainly to lack of funds that forced agro-processors to rely on word of mouth to attract customers. It is worth noting that for

some micro and small agro-processors, investing in activities such as advertising through mainstream media such as radio may not be viable due to the limited scope of their targeted markets. This underscores the need for leveraging alternative communication channels such as social media to attract customers.

The cost associated with supplying markets outside agro-processors' immediate localities was also identified as a constraint. Micro and small agro-processors located in rural areas found it very expensive to transport their products by themselves to major towns and cities. In addition, there was very little information available to rural agro-processors regarding the markets outside their immediate localities. This was compounded by lack of financial resources for conducting market research.

Low productivity at the farm level, coupled with the inability to scale production was also cited as a challenge. In Kisii, an agro-processor reported that they had approached a major supermarket to distribute their products. However, they were not able to supply all outlets of the supermarket with their products due to their low production capacity.

6.2.2 Cassava value chain

6.2.2.1 Marketing: products, distribution channels, market opportunities

Cassava processing is an important income stream to agro-processors in Busia and Makueni. The key cassava products processed in these counties include cassava crisps, baking flour, chips, cakes, biscuits, and crackies (chevda). In Makueni, agro-processors indicated that they mainly distributed their products through wholesalers. However, they sometimes sold their products directly to consumers. Distribution channels in Busia were more diverse, with respondents indicating that they sold products directly to consumers or through wholesalers and retail centres in Busia such as kiosks.

In Makueni, wholesalers were preferred since they had ready markets for products and were consistent in buying from agro-processors. Even

so, there were concerns that prices offered by wholesalers were low. In Busia, agro-processors felt that direct sale to consumers was an effective channel as it enabled them to realise higher profit margins compared to other channels such as local kiosks and wholesalers. However, both direct sales and kiosks were limiting in terms of the number of consumers that could be reached.

Investment in marketing activities such as sales promotion or advertising was limited by financial constraints. Some agro-processors felt that there was enough knowledge about their products in the local market, eliminating the need to advertise. Agro-processors that invested in marketing used agricultural field days, trade shows, sales promotions and materials such as flyers and banners to create awareness about their products.

Unexploited market opportunities in the cassava value chain, according to respondents, include the use of cassava to manufacture alcohol and paints. The limited supply of agro-processed cassava products at the national and regional levels was also identified as an opportunity to increase sales and earnings among cassava processors.

6.2.2.2 Market access challenges

One of the major market access challenge reported was multiple taxation in the local markets. This discouraged agro-processors from accessing spaces in local marketplaces where there is potential to sell large volumes of various products. Access to formal distribution channels such as supermarkets was hampered by various requirements including KEBS certification. Some agro-processors also lacked information about prospective buyers of their products. For example, in Busia, some agro-processors were not aware of how to reach wholesalers with their products. Although agro-processors were aware that direct sale to consumers would fetch the best returns, they had limited access to platforms for networking with consumers to attract more buyers.

Limited access to credit was also identified as a significant market access challenge in the cassava

value chain. This constrained access to the funding required to invest in packaging facilities. Additionally, high cost of logistical services denied agro-processors the opportunity to sell their products countrywide.

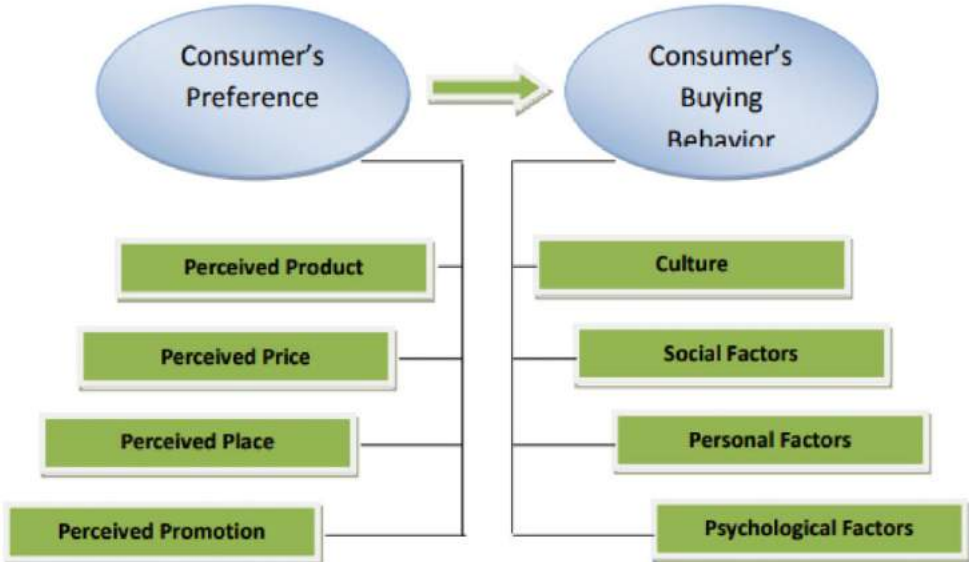
6.3 Consumer Behaviour and Preferences in Cassava and Banana Value Chains

Apart from the market access challenges highlighted in the preceding section, consumption of processed cassava and banana products is influenced by consumers’ preferences and buying behaviour. According to Anojan and Subaskaran (2015), the elements of consumer preference that determine consumption of a product include product attributes, price, place, and promotion. Product and price relate to the quality of the commodity being sold and the cost of acquiring it respectively. Place relates to the way the product is delivered to the customer (distribution channel) whereas promotion refers to the marketing communication strategies used to motivate customers to purchase a product. Consumers’ buying behaviour, on the other hand, is determined by cultural, social, personal, and psychological factors as depicted in Figure 14.

Perceptions of agro-processors with respect to consumer preferences for cassava and banana products in Meru, Kisii, Busia, and Makueni were captured. The most important product attributes considered by consumers were price and quality. Generally, consumers preferred fair priced and high quality products. Price was especially important as agro-processors targeted both high and low income consumers. The quality aspects that were considered by consumers included the taste of the products and nutritional value. The size of the package or the quantity sold at a given price also influenced consumers’ choices with respect to consumption of processed banana and cassava products. Product packaging and the caliber of customer service were also important considerations for consumers.

For agro-processors targeting export markets, product traceability was identified as a key determinant of consumption. In export markets, consumers prefer products that can be traced to their sources to enable them to consume products that meet certain social, safety, quality and environmental standards. This includes the quality of cassava or banana used in production in terms of its maturity, type and exposure to diseases.

Figure 14: Elements of Consumer Preferences and Behaviour



Source: Anojan and Subaskaran (2015)

Apart from product attributes, consumption of processed banana and cassava products was influenced by consumers' income. Products such as banana crisps and cakes were considered luxury products among low-income customers. By contrast, high-income consumers considered such products a necessity due to their high nutritional value.

Ease of accessing the products was another important consideration. Consumers preferred and often consumed alternative or substitute products that are easier to access such as wheat, maize, sorghum, and millet flour, rather than cassava and banana flour. This was compounded by lack of information among consumers about existing cassava and banana products.

In light of these findings, it is important to improve investment in market intelligence to provide information relating to demand and supply conditions, prices and potential buyers in the local market to agro-processors through easy to access and affordable communication channels including radio, TV, social media, mobile phone and web-based portals. National and county governments have to invest in appropriate market infrastructure in various urban centres and reduce the cost of using them. This will provide an opportunity for agro-processors that are not able to access retail channels to sell their products directly to consumers. Finally, national and county governments should provide technical and financial support to agro-processors to empower them to take advantage of unexploited opportunities such as developing new products and serving underserved markets.

6.4 Building the Capacity of Agro-processors to Meet Market Needs

Given the market access challenges and drivers of consumption highlighted in the preceding section, it is important to build the capacity of agro-processors to meet market needs. There are currently efforts by institutions such as the Kenya Industrial Development Institute (KIRDI) to train farmers and provide incubation for their agro-processing businesses as a gateway to certification by KEBS. These initiatives should

be expanded to cover more farmers and key aspects of agro-processing including the following:

First, agro-processors require capacity building on production to enable them to develop products that meet market needs in terms of quality standards relating to safety or health, packaging, taste, and nutritional value. This can be achieved by training agro-processors in areas such as product design, implementing quality assurance mechanisms and processing techniques that enhance efficiency while allowing for consistent improvement of product quality.

Second, building the capacity of agro-processors on marketing can enhance their ability to reach a wider market to increase their sales turnover. The key aspects of marketing that should be considered in capacity building initiatives include pricing, using appropriate marketing communication channels, branding and customer care. Furthermore, it will be helpful to equip agro-processors with adequate skills to conduct marketing research on their own to gain the market intelligence required to align production to market needs. To this end, it is important to embed marketing in policy, taking into account issues of advertising, marketing research and branding to improve the visibility of local products.

Third, distribution is an area where capacity building is required to improve sales and hence consumption of local products. Of particular concern is the heavy reliance of micro and small agro-processors on a narrow range of distribution channels, mainly direct sales and kiosks or wholesalers to reach their target customers. It is important to build the capacity of agro-processors to use a variety of distribution channels to reach the market. This includes training agro-processors on how to meet the requirements of local supermarkets such as obtaining barcodes, as well as management of commercial relationships. Training and creating awareness on e-commerce can enable agro-processors to reach more customers through online retail platforms such as OLX. This should

be supported by appropriate regulations to guide use of e-commerce for distribution.

Finally, the expansion of markets through venturing in cross border trade has been identified as a potentially viable opportunity for local agro-processors. Yet limited knowledge on issues such as customs formalities continue to constrain the participation of local agro-processors in regional and international trade. This presents an opportunity for building the capacity of agro-processors to engage in cross-border trade, which should include training and awareness creation on customs procedures, meeting product standards set in various foreign markets, and SPS measures among others.

Capacity building programmes can be implemented through Technical and Vocational Education and Training (TVET) centres such as universities, polytechnics, and tertiary collages. Apart from this, agro-processors can benefit

from periodic workshops and seminars organised by the government, industry associations, or other relevant stakeholders. This can provide opportunities for agro-processors to access trainings tailored to their needs, as well as share knowledge and ideas with their peers and other industry stakeholders. Capacity building can also be conducted through online platforms, as well as TV and radio programmes.

To improve the outcomes of capacity building initiatives, an appropriate training syllabus should be developed and reviewed regularly to take into account emerging capacity building needs. The syllabus should be developed through wide consultation and involvement of all relevant stakeholders to ensure it is fit for its purpose. Along with this, TVETs should be equipped with modern training equipment. The cost of providing training through TVETs should also be addressed through improved funding to these institutions and scholarships to students.

Chapter 7

Conclusions and Recommendations

7.1 Conclusions

The Buy Kenya Build Kenya strategy provides an important opportunity for developing a robust agro-processing sector in Kenya to the extent that it seeks to improve competitiveness and consumption of local products in the domestic and export markets. For the strategy to work for agro-processors, it will be necessary to implement measures geared towards addressing the supply-side and demand-side factors that continue to constrain production and consumption of local products. The key supply-side constraints include infrastructural bottlenecks, climate change, inadequate financing, technological challenges and limited access to distributional channels. On the demand side, the key constraints include low income among consumers, strong taste and preference for imports and lack of trust in the quality of local products. Addressing these constraints requires concerted effort aimed at improving the quality, affordability and consumer confidence in local products. Whereas several policies and legislations have already been enacted, policy coherence and implementation challenges abound. This is compounded by gaps in the institutional framework for improving the competitiveness and consumption of local products.

The proposal to reserve 40 percent of government procurement to local goods is a great opportunity to increase consumption of local agro-processed products in the public sector. The success of this proposal is contingent on the extent to which the government will create an

effective legal and institutional framework to implement it. Moreover, regional integration agenda should not be lost as the country implements the BKBK strategy.

The long-term sustainability of the agro-processing sector depends in part on the capacity of agro-processors to adapt to climate change. Of particular concern is the persistence of barriers to adaptation, including inadequate financial and technical capacity for adaptation among agro-processors, as well as lack of a policy framework to implement sustainable consumption measures such as green procurement in the public and private sector.

Cassava and banana value chains have great potential for promoting food security and creation of decent jobs through production and trade in a wide variety of processed products. For us to realise the full potential of these value chains with respect to food security and job creation, deliberate efforts have to be made to address the market access challenges facing agro-processors.

7.2 Recommendations

For the Buy Kenya Build Kenya strategy to support trade driven, food security enhancing and climate aware agro-processing, the following measures should be considered.

- Broaden the definition of local goods and services to include products from the EAC to avoid discriminating against products or firms from partner states in public procurement.

- Build the capacity of state officers to conduct investigations on the impacts of unfair trade practices such as dumping or injury caused by subsidised imports. Furthermore, adequate resources should be allocated to Kenya Trade Remedies Agency to facilitate investigations into illicit trade practices. This will enable the government to provide the proof or evidence required as the basis for taking countervailing measures to protect local products from unfair competition.
- Apart from the Public Procurement Administrative Review Board and Judiciary, alternative dispute resolution mechanisms that are affordable and time efficient should be explored to enable resource-constrained micro and small agro-processors to access justice in public procurement.
- On-going review of the legal (Sales of Goods Act, Competition Act, and Companies Act) and institutional framework for the wholesale and retail industry should: create regulations to address late payment to suppliers, establish an alternative dispute resolution mechanism other than courts, and establish or designate an institution to oversee implementation of regulations in the wholesale and retail industry. This will address the challenges facing industry, thereby providing an effective channel for agro-processors to distribute their products.
- The subsidies and tax incentives to be provided under BKBK should be limited to those that are permissible²⁶ under the WTO, EAC and COMESA.
- Integrate green procurement practices in public and private sectors to ensure sustainable consumption under BKBK. As the government reviews the Public Asset and Disposal Act to facilitate implementation of the BKBK, provisions for green procurement should be considered. This should be accompanied by a policy framework that address potential barriers to implementation and compliance with green procurement practices in the public and private sector.
- It is important to implement training and capacity building programmes targeting farmers and agro-processors to equip them with the knowledge and skills needed to adapt to climate change. This should be accompanied by financial and technical support to farmers, including expansion of the Kenya National Agriculture Insurance Programme (KNAIP) and Small-scale Irrigation and Value Addition Project (SIVAP) to enhance the resilience of agro-processing to climate change.
- Finally, the BKBK has to be supported by an ecosystem of effective policies and legislations that address various aspects of improving competitiveness and consumption of local products. The government should review the existing policy, legal and institutional framework to make it fit for its purpose by addressing the existing gaps or weaknesses.²⁷ Implementation of the policies should be improved through better involvement of stakeholders, as well as funding and coordination of the activities of the implementing institutions.

Annexures

Annexure 1: Institutions involved in promoting competitiveness and consumption of agro-processed products

Institution	Role
Ministry of Industry, Trade and Cooperatives	Formulates and implements industrial, trade and cooperatives policies
Ministry of Agriculture, Livestock and Fisheries	Formulates and implements agricultural, livestock and fisheries policies
Ministry of Environment and Natural Resources	Formulates and implements environment and climate policies
Kenya Investment Authority	Promoting investment in Kenya
Export Promotion Council	Attract and expand the market share of Kenya's products in export markets through product identification, development and marketing
Special Economic Zones Authority	Implement the policies and programmes of the government with regard to special economic zones
Export Processing Zones Authority	To attract and retain export oriented investment and trade through various incentive schemes
Kenya Agricultural and Livestock Research Organisation (KALRO)	Promote, streamline, coordinate and regulate research in agriculture and livestock development. Also promotes the application of research findings.
Kenya Industrial Research and Development Institute (KIRDI)	Conducts research and development with the aim of promoting development and transfer of appropriate industrial technologies
Agriculture and Food Authority (AFA)	Promotes best practices and regulate production, processing, marketing and transportation of agricultural products
Kenya Plant Health Inspectorate Services (KEPHIS)	Ensures the quality of agricultural inputs and produce to prevent adverse impact on consumers' health, economy and environment
Kenya Bureau of Standards (KEBS)	Development of standards relating to products, materials, process, as well as certification of industrial products and assistance in development of quality goods
Brand Kenya Board	Coordinate initiatives for marketing Kenya, as well as creating and maintaining the Kenya brand
Kenya Institute for Public Policy Research and Analysis (KIPPRA)	Conducts public policy research and analysis in various sectors including agriculture, private sector (manufacturing, finance etc), trade, infrastructure
Tegemeo Institute	Conducts agricultural policy research
Anti-counterfeit Agency	To combat manufacturing and trade in counterfeit goods
Micro and Small Enterprises Authority	Formulates and coordinates implementation of policies for promotion and development of micro and small enterprises
Industrial and Commercial Development Corporation (ICDC)	Provision of financial capital to various sectors including agro-processing
Agricultural Finance Corporation	Provision of credit to the agricultural sector
Kenya Industrial Estates Limited	Provision of industrial infrastructure, financial products and business development services
Kenya Industrial Property Institute (KIPI)	Administers industrial property rights, provides technological information and training on industrial property
Kenya Dairy Board (KDB)	Regulates the dairy sector

Annexure 2: County socio-economic profiles

County	Socio-economic Profile
Busia	Busia County, located in the western part of Kenya, covers an estimated 1,695 square kilometers and has an estimated population of 840,000 people. Poverty rate in the county stand at 69.3 percent of the total population in the county. More than half the population, 59.5% is food poor. The climate in the region is generally humid, attributed to proximity to Lake Victoria. Temperatures range from 17°C to 30°C while rainfall is between 900mm and 1,500mm annually. These climatic conditions are conducive for farming. The county is reliant on farming and fishing as its predominant economic activities. Major crops grown in the county on a small scale basis include maize, beans, sweet potatoes, millet, cassava, cotton and sugarcane. Farm produce is either sold to neighboring counties or within the county through major supermarkets in towns and in open air markets found in trading centres.
Makueni	The land area of Makueni County is an estimated 8,034 square kilometers. Makueni has a population of 959,000 people, with approximately 34.8 percent living below the national poverty line. The food poverty in the county stands at 30.7 percent. Makueni is located in the eastern region of Kenya and experiences temperatures ranging from a low of 12°C to a maximum of 28°C. Rainfall patterns in the county are typical of Arid and Semi-Arid Lands in Kenya, ranging between 150mm and 650mm. The main economic activities in the county is agriculture and major products of this include fruits like pawpaw and water melons, beans, lentils, cassava, cow peas, and pigeon peas. Beekeeping is also widely practiced in the county.
Kisii	Kisii County covers a land area of 1,333 square kilometers and is located in the western part of the country. The county has a population of approximately 1,347,000 persons of which 41.7 percent is living below the national poverty line. And food poverty stands at 44.5 percent of the population. The climate in the region is highland equatorial, with biannual rains and moderate temperatures. This climate permits the growing of cash crops such as tea and coffee, as well as food crops such as maize, beans, finger millet, potatoes, bananas and groundnuts along with dairy farming activities.
Meru	Located in the eastern region of Kenya, Meru County covers approximately 6,936 square kilometers. The population of the county is 1,471,000 people, with 19.4 percent living in poverty. Additionally, food poverty in the county stands at 15.5 percent. Pertaining to climate, temperature in the county ranges between a low of 16°C experienced in the cold season and 23°C during the hot season. The county receives rainfall of 500-2600mm per annum. The primary economic activity in the county is agriculture, with the most cultivated crops being maize, beans, sorghum, millet, cabbages, bananas and a variety of fruits. Meru is also prominent for large-scale cultivation of khat.

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Endnotes

- 1 Average contribution of agriculture, forestry and fishing to GDP from 2010 to 2015
- 2 Average share of agriculture, fish, and forestry in exports from 2012-2016. See KNBS Statistical Abstract, 2017
- 3 Kenya Integrated Household Budget Survey (KIHBS) 2015/16, <https://www.knbs.or.ke/publications/>
- 4 See KNBS Statistical Abstract, 2017
- 5 Based on 2017 Census of Establishments <https://www.knbs.or.ke/download/report-2017-kenya-census-establishments-coe/>
- 6 A subsidy is specific if it is accorded to a certain enterprise or group of enterprises or industry
- 7 Injury, serious prejudice or nullification or impairment of benefits accruing under GATT 1994
- 8 If the share of exports of that product accounts for at least 3.25% in world trade of that product for two consecutive years
- 9 AMS refers to the annual level of support in monetary terms provided for an agricultural product in favour of the producers of the basic agricultural product or non-product specific support provided in favour of agricultural producers in general
- 10 Refers to the minimal amounts of trade distorting support that is allowed
- 11 As discussed in section 2.2
- 12 See World Bank's <https://ipi.worldbank.org/international/global/2016>
- 13 Includes the fees charged on a 20-foot container i.e. fees associated with completing procedures to export such as costs for documents, administrative fees for customs clearance and technical control, customs broker fees, terminal handling charges and inland transport, excluding taxes.
- 14 At constant 2016 prices
- 15 Statistical Abstract, 2017
- 16 See KNBS Economic Survey, 2018. Data for America includes the United States of America, Canada, other American countries
- 17 <http://kenyatradeportal.go.ke/>
- 18 Learn about the platform at <http://sautiafrica.org/>
- 19 KIHBS 2015/16
- 20 The government has initiated construction of a leather park in Machakos County. Completing this park should be prioritised
- 21 See section 2.2 for exceptions applicable to tax measures
- 22 See section 2.2 for allowable subsidies
- 23 See section 3.6 for more strategies for promoting use of local content
- 24 See <https://label-online.de/>
- 25 See annexure 2 for the socio-economic profiles of these counties
- 26 See section 2.2 for permissible subsidies and WTO exceptions that apply to subsidy and tax incentives
- 27 See section 3.3 for the gaps or weaknesses to be addressed

About the Book

Agro-processing is one of the sectors expected to promote industrialisation, food security and creation of job opportunities in Kenya. However, agro-processing is facing high competition in both the domestic and international markets and its sustainability is threatened by rapid climate change. The Buy Kenya, Build Kenya (BKBK) strategy is one of the major policy measures being pursued by the government to improve the competitiveness and consumption of locally-produced goods and services. This study provides insights on how the BKBK strategy can be leveraged to promote climate aware, food security enhancing and trade driven agro-processing in Kenya. It sheds light on the key barriers to development of agro-processing and provides policy options for tapping into the BKBK strategy to support the sector.

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