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Policy Brief

Boosting Development in Kenya: Better Participation of Smallholders in Agri-Business

Agriculture has the potential for fueling Kenya's development and pulling the over 15 million rural poor out of poverty. Yet, inconsistent production in recent years has led to food insecurity and increased levels of poverty. While a possible solution could lie in improving smallholders' participation in agri-business, challenges remain for both farmers and private firms towards their fair and viable relationships. This policy brief discusses possible ways of achieving this, and provides recommendations on addressing the challenges towards a truly equitable agricultural development in Kenya.

Key messages

1. The Kenyan private sector in agriculture has adapted fairly well to the changing global economy, often taking over former government prerogatives, and has in some cases increased livelihood opportunities for farmers by supporting their participation in export markets.

2. Despite new opportunities for their livelihoods, farmers are often exploited by middlemen and lack the capacity to bargain fair deals and to fully understand the implications of contracts they enter in. For this reason, belonging to strong producer groups should become the standard among farmers in order for them to enhance their bargaining capacity.

3. Huge investments in rural infrastructure are required for agri-businesses to be able to involve rural areas in value chains and export chains, prevent losses, increase food security and attract the necessary investment. Top priorities should include improving rural roads networks, water supply, and access to affordable electricity and irrigation.

CUTS International Geneva is a leading Southern voice pursuing social justice and economic equity within and across borders.

This Policy Brief is adapted from the Research Study "Facilitating Equitable Agriculture in Sub-Saharan Africa: The Case of Kenya" written by Gloria Otieno for CUTS International Geneva as part of the project entitled "Facilitating Equitable Agricultural Development in Sub-Saharan Afica" (FEAD) with the funding support of the William and Flora Hewlett Foundation.

Background

Kenya is largely an agriculture based economy, with agricultural exports accounting for the bulk of its foreign exchange. The agricultural sector accounts for 23% of the GDP and is characterised by small rural subsistence farming which employs about three quarters of the rural population. In Kenya, small-scale farmers produce close to 70 per cent of agricultural output, mostly for their own consumption.

The sector is dominated by primary production of a few commodities namely cereals (maize, wheat and rice), traditional food crops (pulses, roots and tubers, millet and sorghum), industrial crops (sugar cane, pyrethrum, cotton, tobacco and sisal), exports crops (tea, coffee and horticulture) and livestock (milk, meat and eggs). While most food crops have recorded increased production since 2002, productivity in terms of yields has not increased over the years. Due to climatic conditions, productivity for these products has even declined sharply since 2005.

Declining agricultural productivity in Kenya has led to food shortages, underemployment, low income from cash crops and poor nutritional status, which has further reduced labour productivity. In fact, cultivating more land, using fertilizer, belonging to a producer group, and having access to credit remain important correlates with not being in poverty for small farmers. Sustained agricultural growth requires increases in productivity, not only through improved production efficiencies but also through other factors such as adequate access to productive resources, well functioning markets and infrastructure, and a conducive policy.

In the past decades, the agricultural sector in Kenya has undergone many changes in its organization. As the trend in the global economy was pushing for greater participation in export markets, the private sector emerged as a driving force of Kenya's agriculture while the government dismantled virtually all forms of support to the sector. These changes came with both opportunities and challenges for the over 15 million rural poor in Kenya[1].

The invisible majority

Smallholders at the margins

Small-scale farmers form the bulk of the sector. They produce over 70 per cent of maize, 65 per cent of coffee, 50 per cent of tea, 80 per cent of milk, 85 per cent of fish, and 70 per cent of beef and related products. With over 6 million small-scale farms contributing about 750per cent of the country's total value of agricultural output, developing the agriculture sector and scaling-up agricultural exports will partly mean improving smallholders' productivity and access to international markets. More generally, economic transition and poverty reduction in Kenya will be highly dependent on the performance of small-scale agriculture.

The demand for higher value and processed food as well as the rise of supermarkets around the world has implications for the entire food marketing system as it introduces new quality and safety standards and alters procurement systems. For instance, the new procurement systems often expect larger supply volumes, favouring larger farmers. Many smallholders in Kenya risk exclusion from these markets as they face many constraints that prevent them from competing with domestic and international agribusinesses.

Besides the fragmentation of agricultural land into very small pieces that are uneconomical and fail to attract investment, their low productivity is accountable for the marginalisation of rural areas. For instance, poor rural infrastructure (e.g. roads) and lack of access to water and rural electrification greatly alter productivity. and make access to technology and information difficult for them.

The 2008 food crisis in the country gave a stark reality to the problem of infrastructure, as it was virtually impossible to transport food from surplus to deficit zones. While farmers in rift valley had a bumper harvest, people in the North Eastern Arid and Semi-Arid Land (ASALs) areas were faced with starvation. The poor road network leading to Turkana and northern parts of the country is a huge impediment for relief efforts and a hindrance to traders.

Climate change is another source of concern. Over the years, Kenyan farmers have faced major crop failures due to persistent drought brought about by climate change and high variability of weather. In a country where 90% of agriculture depends on rain, farmers lack basic strategies to mitigate effects of drought such as rain water harvesting, the use of drought-resistant varieties of crops and irrigation systems. In fact, the government has failed to invest in irrigation systems to ensure crop production throughout the year. Many are obsolete and operate well below their capacity, like Bura irrigation scheme which operates at about 10 per cent capacity.

Further, lack of market information represents a significant impediment to market access for smallholder farmers. In the past, Kenyan farmers relied on marketing boards to provide market information and to link them with markets. Marketing boards even bought farmers' produce at a predetermined price and hence farmers were assured of good prices for their produce as well as guaranteed market access. However since liberalization and subsequent removal of marketing boards, farmers are now facing markets which are neither competitive nor transparent, and where they are greatly disadvantaged, especially those in remote rural areas. They have no incentive to increase the level of their production and productivity which would alleviate the poverty in which many live.

1 *IFAD, 2009. Rural Poverty Portal, Statistics [online]*

Business on the rise

Evolving role of the private sector

The trends in local and global agri-food business and the proliferation of supermarkets have changed the way producers participate in production chains. With the increasing importance of global food standards, producers are more vertically integrated and agri-business relationships have now evolved to contract relationships between producers, processors and supermarkets to ensure consistent produce in terms of quality and quantity.

Prior to liberalization, farmers relied on marketing boards, cooperatives and the government for their inputs and for their markets. Extension services and information was provided by the government's agricultural extension officers and farmers were trained in farmer schools. They sold their produce through their respective cooperatives, had a guaranteed market and credit was readily available through the Agricultural Finance Corporation (AFC) which was again owned and run by the government. With liberalization, most of these services provided by the government were taken up by the private sector.

Today in Kenya, the private sector is vibrant and growing, especially the small and medium enterprises as more and more people are participating in value addition activities and agro-processing. A wide spectrum of agro-industries exists, ranging from processing staple food and fruits, to beverage and tobacco production for both the domestic and foreign markets. Food processing is thus one of the key activities in Kenya's agro-processing industry.

An improved business environment

Kenya's trade policy was originally based on the need to safeguard local agriculture and domestic manufacturing sector against adverse competition. It tended to unfairly tax agricultural exports thus denying the country of vital foreign exchange with which it could access food imports. Until recently the high tariff regime on intra-regional trade reduced the potential of regional trade in alleviating poverty and food insecurity.

But over the last decade, Kenya has made meaningful strides in implementation of trade policies. For instance Kenya has acceded to the East African Customs (EAC) Union Protocol and is a member of the Common Market for Eastern and Southern Africa (COMESA) Customs Union as well. Under these two regimes, a number of policies and incentives have been harmonized. These include export promotion policies, trade facilitation and logistics, amongst other policies.

In this context, and unlike rural infrastructure, major infrastructure such as airports and highways have been greatly improved. The upgraded Kisumu international airport has opened up the entire western region to opportunities for directly exporting, while the Eldoret international airport is also picking up in terms of export volumes. Major roads linking the EAC region are also under construction, including the North-South Corridor.

As a consequence of increased regional trade integration, the African region has become the largest market for Kenyan exports accounting for 52% of all exports in 2009. Exports to the COMESA region accounted for 77.3% of the total exports to Africa in 2009.

The Ministry of Trade's Private Sector Development Strategy (PSDS) (2006-2010) has also improved the environment for private sector participation in agricultural development. The PSDS had five main objectives: (i) to provide adequate infrastructure; (ii) to tackle corruption and bribery which raises transaction costs; (iii) to improve security measures; (iv) to reduce administrative and bureaucratic procedures for licensing and doing business; and (v) to catalyse public-private sector dialogues. Some of these objectives have been achieved by reducing the steps required for licensing of new businesses and permits and creating a "one-stop shop". Infrastructure has also been greatly improved in the last decade in terms of highways and roads.

Besides this, the Vision 2030 recognizes the role of the private sector as an engine for sustained growth. Through it, the National Economic and Social council (NESC) has created a forum in which government, business and labour unions can discuss policy issues and hence improve the input of the private sector in policy making processes.

Smallholders in agri-business: from the margins to the markets

In recent years, many more smallholders are getting involved in agri-business and starting to view farming as a viable business. Farmers are thus becoming more integrated with the wider private sector, which has become a driving force in Kenya's agriculture. The private sector can offer opportunities for small-scale farmers to increase their productivity and participate in agro-processing value and export chains by providing them not only with market linkages but also with inputs, dissemination of market information, training and technical support and even credit and related support.

Progressive integration in agro-processing industries and export markets

Under the second component of the Private Sector Development in Agriculture (PSDA) program, the Ministry of Agriculture assists actors along the value chain (input suppliers, farmers, traders, processors and retailers, and the final consumers) to secure the best possible value at all stages of production, processing, trading and consumption. It highlights weak areas that could benefit from targeted promotion strategies, and integrates service providers, advocacy groups, the government and other institutions in an ongoing dialogue. It also organizes cooperation between public and private agricultural extension services and seeks to expand the services provided by producers and processors' associations.

The PSDA has successfully addressed a number of problems facing the value chains it supports. For instance, potato farmers have increased their yields from 7 to 25 tonnes per hectare. The increased production has created more than 8,500 new farm jobs each season, more than half of which go to women.

Opportunities for market information

In order to fill the market information gap for smallholders, the private sector in Kenya has come up with many ways to provide them with market information by harnessing the potential of information technology. For instance, the Kenya Agricultural Commodity Exchange Limited (KACE) provides farmers and market intermediaries such as traders and consumers with information about market and other services that enhance their bargaining power and competitiveness in the market place.

The KACE Market Information System has country-wide reach thanks to such services like rural market-based Market Information Points, District-level Market Information Centres, an SMS market information service ("SMS Sokoni"), an Interactive Voice Response service, an internet-based database system, and a daily radio broadcasting of price information.

This move by KACE has improved the competitiveness of smallholder farmers in the market place for better prices, and has blocked out various components of transactions between farmers and middlemen in relationships that were often exploitative to smallholders.

PPPs in the provision of financial services

After the disbanding of the government-owned Agricultural Finance Corporation in the 1990's, farmers could only get non-collateral loans from banks at commercial rates leading to a huge gap in the sector. However, some financial organizations like the Equity bank have come up with financial products suited specifically for them, for instance to help them purchase inputs or equipment. In addition, the government recently set up several Public-Private Partnerships (PPP) for microfinance programmes targeted at smallholders.

One such program is the Micro-Enterprises Support Programme Trust (MESPT), which works in partnership with a full range of financial retailers including commercial banks, and provides loans to institutions delivering microfinance services to smallholder farmers in selected ASALs of Kenya. The intermediary institutions then provide loans to business-oriented smallholder farmers and viable agri-based micro and small enterprises through their respective organizations which have to be registered and legally recognized.

These new developments have improved access to finance and credit for farmers by over 300 per cent in the past 3 years, and this has led to improvements in productivity especially in ASALs.

Opportunities for productivity and participation in export chains

In order to ensure consistent supply of produce adapted to their overseas markets, many exporters now provide production support to farmers' organizations through contract farming. Under these forward agreements, the farmers 'agree' to produce a particular product of a particular quality and quantity at an agreed price, which guarantees them a market for their produce, while the purchaser provides them with a range of support services.

Under these contracts, support services to farmers include the supply of inputs on credit (seeds, fertilizers and pesticides) and technical advice. The purchaser also supports initial investments for the required standards, which are then deducted from farmers' income after the harvest. Through its presence on the ground, it also provides extension services and training to groups of farmers on various aspects of production and related standards.

Contract farming in the horticultural sector has been identified as a great success in Kenya. Structural and macroeconomic reforms, preferential duty-free access to EU markets under the Economic Partnership Agreements as well as the introduction of more liberal trading environment have boosted Kenya's emergence as one of the major producers and exporters of horticultural products in the world. In this sector, several large integrated exporting companies often have contracts with smallholders through their respective producer organizations, thereby reaching thousands of farmers.

Similar contracts exist in other sectors, such as out-grower schemes in sugar cane production and marketing through which farmers are provided with inputs, harvesting and transport services. However, many sugar cane farmers are very dissatisfied with this system because of high input costs and high transport costs charged by the companies leaving some of them with a negative payment slip at the end of harvesting.

This points to the fact that despite opportunities to improve farmers' livelihoods through better integration with the private sector in agriculture, some challenges and constraints remain to be addressed if the sector is to lead Kenya's economic transition and poverty reduction.

Remaining challenges for private sector-led equitable agricultural development

Macro-economic environment

Rising inflation and the Central Bank's failure to stabilize the currency has negatively impacted Kenyan agri-businesses who cannot effectively compete in the export markets because it has invariably led to rising costs of raw materials, production and finished products. This means not only that demand in the domestic market is lower, but also that their inability to compete with cheap imports discourages farmers from producing. For instance, the rice subsector whose potential could easily fulfill domestic demand, with surplus for export, is largely untapped.

High cost of energy and labour

Interviews from several private sector representatives and agro-processing industries revealed that high energy costs are the most pressing problem. The cost of electricity has increased by more than 300 per cent in a span of 3 years and this has put a considerable amount of pressure on many agro-processing industries. In addition, unreliable supply of electricity in the last two years has led to huge losses for many industries. For instance on average manufacturing firms lost about 12 per cent of output due to unreliable supply of electricity and their costs were pushed up by the need to install power generators, dig their own boreholes and repair their own roads. In addition, rising costs of fuels have further exacerbated the problem and this negatively impacts on the ability of Kenyan firms to compete both in the domestic markets and in the export markets.

Another issue identified by the private sector in agro-processing as a major impediment for their growth is the increasing cost of labour. The minimum wage being one of the highest in the EAC region most firms are forced to downsize production and reduce the number of workers in order to bring down costs.

Poor rural infrastructure

Poor road infrastructure especially in the rural areas is one of the biggest impediments to private sector participation in agriculture. Even though major highways have recently been improved by the government, infrastructure bottlenecks still exist in the rural areas that impede effective collection of raw materials and access to producers and other smallholders. This impedes their participation in agro-processing and/or value addition activities which would otherwise raise their incomes. Furthermore, other infrastructure such as water and electricity is still a major impediment which invariably leads to increased transaction costs and in some cases abandonment of agricultural activities altogether.

Investment gap

Most of the agricultural production is done by smallholders who are characterized by an over-reliance on rain-fed agriculture, which is unreliable and unsustainable in the face of climate change. Poor investments in irrigation, post-harvest facilities and drought mitigation technologies are impediments for investing in the sector and many agro-processing companies have thus resorted to importing raw materials from neighbouring Uganda and Tanzania, at the expense of Kenyan farmers. In order to secure their livelihoods through more reliable production, huge investments are needed in these areas.

Low investments in the agricultural sector are also caused by the cartelization of entire sub-sectors where cartels import cheap products to dump into the country at very low prices. Agri-businesses in these sectors cannot compete with cheap imports and some have had to close shop.

Unbalanced market powers

Because of lack of proper and organized marketing channels through cooperatives or producer groups, smallholders have no bargaining power and are more often price takers. They are paid very little for their produce at farm gate, most of the time making losses or very little profits. This problem of unequal power relationships with wholesalers, middle men, exporters and agro-processors persists in virtually all the sectors, including those where contract farming is prevalent as the purchasers have the prerogative for reducing agreed prices if the world market prices go down.

However through collective action through their respective cooperatives and producer groups smallholders are able to bargain for better services and/or fair prices. These farmer organizations can also prove useful when it comes to taking loans for expanding their production and for support services such as extension, training and capacity building and provision of inputs.

Conclusion and recommendations

Agriculture in Kenya has a huge potential for fueling Kenya's development while pulling millions of rural poor out of poverty. The Kenyan private sector in agriculture has adapted fairly well to the changing global economy, and its participation in the sector has evolved to include not only agri-business and agro-processing but also various forms of support services such as information, financial services, input provision and capacity building. Through contractual arrangements, it has also enabled small-scale farmers to better participate in export markets and thereby increased livelihood opportunities for thousands of them.

However, truly inclusive and equitable agricultural development is hindered by existing constraints which range from poor rural infrastructure, low levels of technology adoption, low investments, low budgetary allocation in the sector and corruption and cartelization of certain sub-sectors. The private sector and agri-businesses also face high transaction costs occasioned by high energy and labor costs, high inflation, and lack of harmonization of trade and agriculture policies both at the regional and national levels. Importantly, farmers need to increase their bargaining power in order to benefit from participation in export markets.

If these constraints are addressed then growth of the sector is inevitable, and the potential of agriculture for securing livelihoods for the majority of the Kenyan population will finally be harnessed. Towards this end, the following priority measures should be undertaken by various stakeholders both in the long and medium term:

- Inflation and currency stabilization must be an immediate priority in order to lower production costs and improve competitivity with food imports.

- Huge investments in rural infrastructure are required for agri-businesses to be able to involve rural areas in value chains and export chains, prevent losses, increase food security and attract the necessary investment. Top priorities should be improving rural roads networks, access to affordable electricity, and irrigation.

- Belonging to a producer group should become standard among farmers in order to increase their bargaining power and access to finance, training and other services. These groups and cooperatives need to be provided with legal support for contractual arrangements which they have with private sector exporters, and should also build institutional capacity through partnerships at the local and national level that will ensure smallholder participation in an equal and fair manner.

- In order to curb the cartelization of various sub-sectors, strict regulations must be put in place to curb unnecessary imports and hoarding of commodities such as sugar and maize by cartels.

- Harmonization of the country's trade policies with those of EAC and COMESA should also be a priority.

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This Policy Brief is produced as part of the project entitled "Facilitating Equitable Agriculture Development in sub-Saharan Africa (FEAD).

For agricultural development in Africa to substantially contribute to its overall growth, development and poverty reduction, three conditions need to be met: there should be increase in productivity and production to generate "marketable surplus"; the infrastructure should be in place, including trade facilitation measures, to transform the "marketable surplus" into "marketed surplus"; and there should be a healthy interaction between farmers, the private sector investors and traders. While the first two are getting the attention of both national governments and their development partners, the third is still neglected. Productivity-enhancing initiatives are certainly important but in order to make use of them, both **"better infrastructure for better marketing"** and **"positive terms of trade between the farmers, and investors and traders"** need to be provided. This project aims to address this third critical aspect for the development of African agriculture, focusing on countries in the East African Community (EAC).

The enabling environment is also a function of international policies and agreements, most important being the international trade agreements. The efforts on the ground may not bear fruit if the provisions in international trade agreements (e.g. under the WTO and the Economic Partnership Agreements (EPAs) with the EU) are not in harmony with these efforts and vice versa. Hence, this project also aims to **link the national and international actions** through research and analysis, advocacy and dissemination and networking. It will also strengthen the pro-trade and pro-equity credible Southern NGO voice in Geneva.

PUBLICATIONS

» *Boosting Development in Kenya: better participation of smallholders in agri-business.* Policy Brief N°1, November 2011

» *Towards Equitable Agriculture Development in Uganda: A look at the Terms of Trade amongst Stakeholders.* Policy Brief N°2, November 2011

» *Equitable Development through Agriculture: Policy Options for Tanzania.* Policy Brief N°3, November 2011

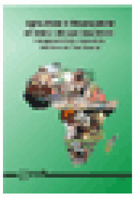
» *Sowing Multilaterally, Reaping Locally: Can the WTO promote Equitable Agriculture Development in the East African Community?* Policy Brief N°4, November 2011

» *EAC-EU Trade Negotiations: Bringing Equitable Agriculture Development to the Forefront.* Policy Brief N°5, November 2011

www.cuts-grc.org/ FEAD-Project.htm

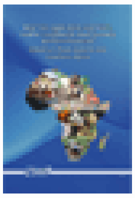
ABOUT CUTS INTERNATIONAL, GENEVA

CUTS International, Geneva is a non-governmental organization pursuing social justice and economic equity within and across borders by persuading governments and empowering people. It promotes a pro-trade pro-equity credible Southern NGO voice in the policy making circles working on trade and development and other related issues in Geneva. Over the past years, it has established itself and contributed effectively in the international and national policy making process, particularly in Eastern and Southern Africa. The strength of the organisation lies in its capacity to bridge existing gaps between all actors, from the grassroots to global leaders, through a work methodology that links research, advocacy, networking.



Agriculture in Development of Select African Countries

After 15 months investigating the importance of agricultural trade for food security and poverty reduction in five countries of Eastern and Southern Africa, this research underscores limitations faced in boosting agricultural productivity and ensuring food security, due to physical, legal, economic, social and cultural factors, and outlines how the promotion of regional trade and effective trade facilitation policies can provide effective solutions.

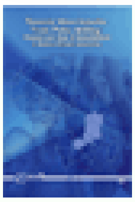


How Can Agriculture and Trade Lead to Livelihoods, Food Security and Development?

This monograph summarises analysis around ten themes of importance to development in Eastern and Souther Africa. The themes range from the role of agriculture to that of governments, donors and CSOs, and also include international and regional trade, education and capacity building needs, and multi-stakeholder consultations and coordination. It offers comprehensive and yet concrete suggestions for action.

Taking East African Regional Integration Forward: A Civil Society Perspective

Through this research, the East African civil society offers to join hands as equal partners of policy makers, researchers and businesses in the process of regional integration and takes on some of the difficult issues of making markets work in the region. For example, it makes a case for facilitating easy movement of people, and suggests ways to attract, retain and spread skills across the region.



Towards More Inclusive Trade Policy Making

This research looks into trade policy making processes in five Eastern and Southern African countries. A number of governmental initiatives have opened up these processes to a larger group of stakeholders who are now eager to play an active role in trade policy making. This publication discusses the remaining constraints to their effective participation and ways to improve consultative mechanisms.

Improving Ownership through Inclusive Trade Policy Making Processes: Lessons from Africa

This advocacy monograph looks into trade policy making processes and role of main stakeholders in five countries of Eastern and Southern Africa. Although stakeholders are eager to play an active role in trade policy making, and despite efforts of governments to open up these processes, their effective participation requires strengthened capacity, improved and more consistently used consultative mechanisms, and promotion of a culture of dialogue.

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