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THE AGRO-BASED AND OTHER MAJOR INDUSTRIES IN KENYA: KEY CHARACTERISTICS AND REHABILITATION ISSUES

Studies on the rehabilitation of African industry
No. 14

This report has been [illegible] the Secretariat.

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PREFACE

As part of the programme of the Industrial Development Decade for Africa, UNIDO's Regional and Country Studies Branch is issuing a series of studies determining both the major problems of African manufacturing and the potential for regenerating the sector. The aim is to outline policies and measures that may result in overall improvements and to identify individual plants for assistance. The backbone of the series is formed by a number of country-level diagnostic surveys on the rehabilitation requirements of African manufacturing industries. These have been compiled by teams of experts during four-week field missions. As the surveys contain confidential plant-level information, their circulation is restricted. In order to present the salient parts of the full country surveys to a wider readership, a series of 'highlights' is being issued.

This particular report presents the highlights of the Kenyan mission's survey of the industrial rehabilitation needs of Kenya's vegetable processing, cotton-based, and ceramics industries. It provides the reader with a general description of the economic and policy environment for industrial rehabilitation, as well as a description of the industries selected for in-depth examination. Chapters 5 and 6 provide general observations and recommendations regarding government policy and companies which should be very useful in formulating an agenda for rehabilitation efforts. The full survey should be consulted for detailed suggestions for specific plant-level rehabilitation requirements.

The UNIDO field mission visited Kenya from 5 January to 2 February 1990. The team consisted of Mr. George Assaf (team leader) and Mr. Masayoshi Matsushita of the Regional and Country Studies Branch, UNIDO and UNIDO consultants, Mr. Thomas Alberts, Mr. Björn Almquist, Mr. Jan Björk, Mr. Peter Coughlin, Mr. John Litondo, Mr. Graham Smith and Mr. Maurice Thorne.

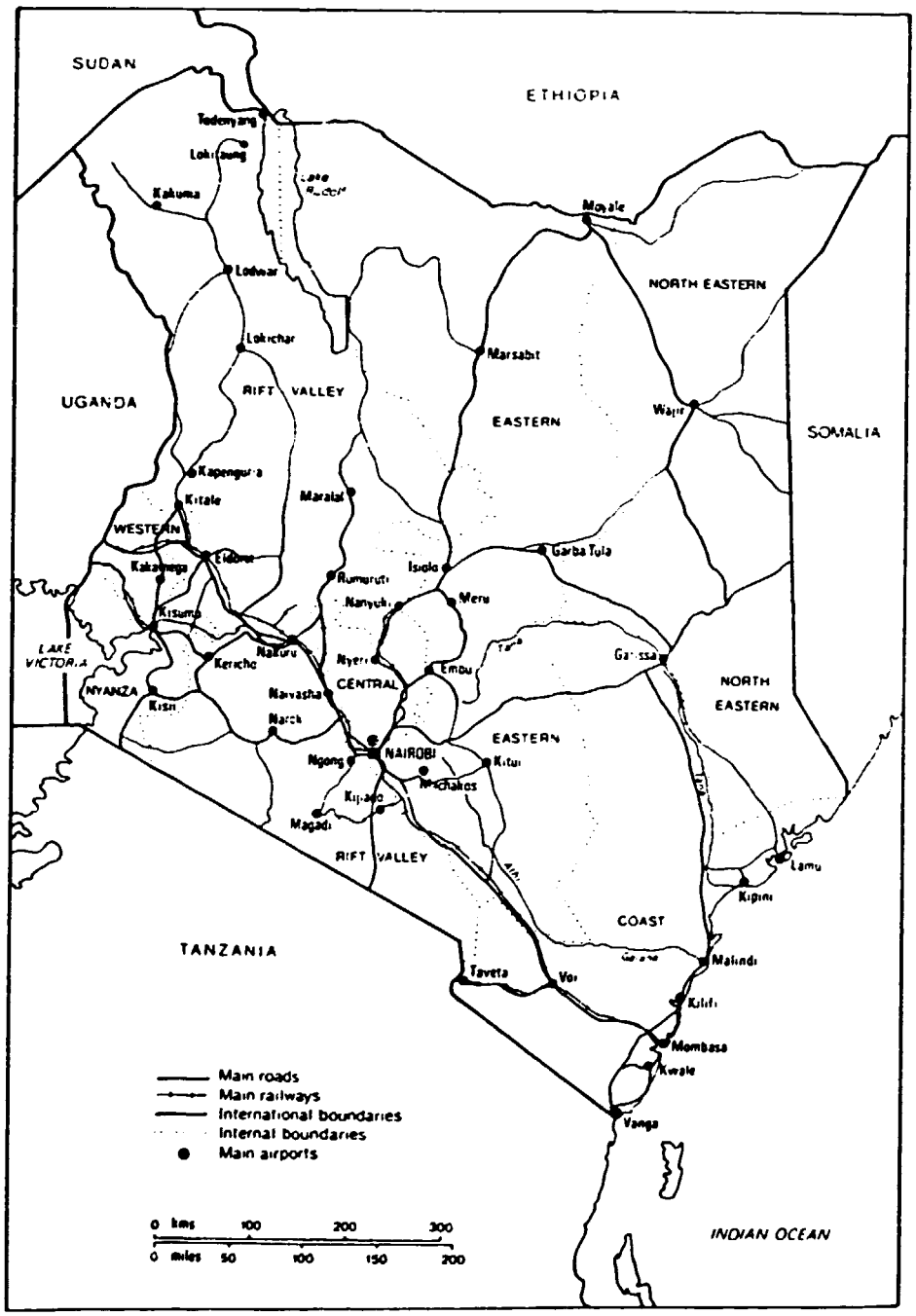
TABLE OF CONTENTS

TABLE OF CONTENTS
(continued)

TABLE OF CONTENTS
(continued)

LIST OF TABLES AND FIGURES

MAP OF KENYA



Source: The Economist Intelligence Unit. Country Profile, 1989-90.

GENERAL COUNTRY INFORMATION

SURFACE AREA:	582,646 sq km (including area of inland water)
POPULATION (total):*	21.8 million (1987), 22.7 million (1988)
(growth rate):	3.7 per cent per year (Government estimate, 1988)
MAIN URBAN AREAS:	Nairobi, Mombasa, Kisumu, Nakuru, Machakos, Meru
GDP (total):	$8.7 mn (1987)
(per capita):	$393 (1987)
(rate of growth):	4.8 per cent (1987), 5.2 per cent (1988)
(sector of origin):	agriculture/forestry/fishing 30.8% industry 19.0% (of which manufacturing 11.5%) services and other 50.1% (1988)
EXPORTS (total):*	$748 mn (1987), $785 mn (1988)
(composition):	coffee 31%, tea 27%, petroleum products 16% (1987)
(destinations):	European Community 42%, Uganda 9%, USA 5% (1987)
IMPORTS (total):*	$1,431 mn (1987), $1,495 mn (1988)
(composition):	industrial machinery 24%, petroleum and products 21%, motor vehicles and chassis 9% (1988)
(origins):	European Community 43%, Japan 11%, USA 9% (1987)
INFANT MORTALITY RATE:	91 per 1000 live births (1988)
LIFE EXPECTANCY:	54 years for males, 56 for females (1985)
LITERACY RATE:	59.2 per cent of persons 15 years of age or older
PRIMARY SCHOOL ENROLMENT:	94 per cent
LANGUAGES:	English is the main language of education, business and government. Kiswahili also serves as a language of trade and government operations.
CURRENCY (denominations):	1 Kenya pound (K£) = 20 Kenya shillings (KSh) 1 Kenya shilling = 100 cents
(exchange rates):	$1 = KSh 17.75 (average for 1988) $1 = KSh 19.28 (as of 3 April 1989)

* Data for 1987 and 1988 are provisional in most cases.

LIST OF ABBREVIATIONS

ACP	Africa, Caribbean and Pacific Convention
ADB	African Development Bank
ADEC	Africa Development and Economic Consultants Ltd.
ART	African Retail Traders
CDC	Commonwealth Development Corporation
CDI	Centre for Industrial Development
CI	Ceramic Industries (E.A.) Ltd.
cif	Cost, insurance and freight
CLSMB	Cotton Lint and Seed Marketing Board
CTB	Central Tender Board
DAC	Development Assistance Committee, OECD
DEG	Deutsche Finanzierungsgesellschaft für Beteiligung in Entwicklungsländern m.b.H.
DFCK	Development and Finance Company of Kenya
DFI	Development Finance Institutions
DIT	Directorate of Industrial Training, MTTAT
EABC	The East African Bag and Cordage Company Ltd.
EAC	East African Community
EAFC	East Africa Finance Consultants Ltd.
EC	European Community
ECA	E.C. Arnold Ltd.
EPZ	Export Processing Zones
FAO	Food and Agriculture Organization
FKE	Federation of Kenya Employers
fob	Free on board
GATT	General Agreement on Trade and Tariffs
GDP	Gross Domestic Product
GNP	Gross National Product
GOK	Government of Kenya
GPS	Generalized System of Preferences
GTI	Government Training Institute
HIT	Harambee Institutes of Technology
IBM	International Business Machines
ICA	International Coffee Agreement
ICDC	Industrial and Commercial Development Corporation
ICDCIC	ICDC Investment Company
IDB	Industrial Development Bank Ltd.
IFC	International Finance Organization
IGADD	Inter-Government Authority on Drought and Development
IMF	International Monetary Fund
ITC	Industrial Training Committee
K£	Kenya pound
KAM	Kenya Association of Manufactures
KANU	Kenya African National Union
KENYAC	Kenya National Capital Corporation, Ltd. (or KNCC)
KGGCU	Kenya Grain Growers Co-operative Union

LIST OF ABBREVIATIONS

(continued)

KIA	Kenya Institute of Administration
KIE	Kenya Industrial Estates
KIM	Kenya Institute of Management
KIRDI	Kenya Industrial Research and Development Institute
KITS	Kenya Integrated Training System
KNCCI	Kenya National Chamber of Commerce and Industry
KPCU	Kenya Planters Co-operative Union
KPLC	Kenya Power and Lighting Company Ltd.
KPTC	Kenya Posts and Telecommunication Corporation
KSh	Kenya shilling(s)
KTA	Kenya Trainers Association
KTDA	Kenya Tea Development Authority
KTTI	Kenya Textile Training Institute, DIT
LDCs	Less Developed Countries
LPG	Liquified Petroleum Gas
Mountex	Mount Kenya Textile
MTTAT	Ministry of Technical Training and Applied Technology
MUB	Manufacturing-under-bond scheme
MVA	Manufacturing value-added
NCPB	National Cereal and Produce Board
NGO	Non-governmental Organization
NITC	National Industrial Training Council
NORAD	Norwegian Agency for International Development
NSSF	National Social Security Fund
NYS	National Youth Service
ODA	Official Development Assistance
OECD	Organization for Economic Co-operation and Development
PROT	Problem Oriented Training
PTA	Preferential Trade Area for Eastern and Southern Africa
PVP	Pan Vegetable Processors Ltd.
RAS	Rehabilitation Advisory Services Ltd.
RONA	Return on net assets
ROS	Return on sales
SADCC	Southern African Development Co-ordination Conference
SDR	Special Drawing Rights
SITC	Standard International Trade Classification (revised)
SMEs	Small- and medium-scale enterprises
UNDP	United Nations Development Programme
UNIDO	United Nations Industrial Development Organization
USAID	United States Agency for International Development
VAT	Value-added tax

INTRODUCTION

The issue

Manufacturing is a leading growth sector in the Kenyan economy. Of late, the sector has accounted for about 12 per cent of GDP, but in recent years it has experienced a period of significant decline. Available data suggest annual gross investment in the manufacturing sector has been declining since 1978.[1] In 1985, gross investment was 40 per cent of its 1978 level in real terms. This severe drop in gross investment suggests that disinvestment has occurred. This explanation is also corroborated by informal observation. The growth of manufacturing has been stymied in recent years by variable economic conditions and uncertainties in the business environment.

The stagnation in manufacturing is also reflected in the fact that there has been very little structural change in the sector. The leading branches have been, and continue to be, food products, tobacco, textiles, electrical machinery, fabricated metal products, chemicals, paper and paper products. The consumer goods branches - largely food, beverage and tobacco products - account for over 50 per cent of manufacturing value added (MVA). The branches producing intermediate products account for an insignificant share of manufacturing MVA in comparison.

Recent surveys[1/] of Kenya's manufacturing sector have concluded that many firms are producing at less than optimal capacity - 50 per cent or less. Thus, although manufacturing industry in Kenya could play a leading role for economic growth, in recent years it has failed to do so. Manufacturing has therefore not generated a dynamic growth process and has not satisfied domestic demand or achieved its significant export potential.

Under-utilization of industrial production facilities is one of the major factors hindering the renewal of economic growth in Kenya. If this trend could be reversed, greater utilization of installed capacity and improved productivity would be the most economical means of restoring dynamism to the manufacturing sector and overall economic growth in Kenya.

Kenya has now reached a stage in its economic development at which manufacturing industry will have to assume a more substantial role. Manufacturing, especially the public sector, needs to be regenerated to be able to increase domestic value added and essential inputs for primary sectors such as agriculture. This enhanced role for manufacturing industry requires revitalization, rehabilitation and restructuring of Kenya's current manufacturing capabilities. Particular attention should be paid to the parastatals sector which accounts for a significant number of Kenya's ailing industries. This regeneration of Kenya's manufacturing capabilities must be supported by an effective institutional infrastructure, human resource development and an appropriate policy framework.

1/ Kenya: Sustaining industrial growth through restructuring and integration, UNIDO, Regional and Country Studies Branch, PPD.85, 22 June 1988; Kenya: Industrial Sector Policies for Investment and Export Growth, Volume I, June 30, 1987, World Bank Report No. 6711-KE, pp. 9-11.

Sessional Paper No. 1 of 1986 and recent budget speeches by the Vice President and Finance Minister, the Hon. Professor George Saitoti,[1/] have stressed the need to re-orientate more of the country's productive capacity towards export production, and the essential need to raise productive capacity to stimulate growth. In this connection, it has also been stressed that there is a large scope for raising efficiency in manufacturing industry, particularly in the parastatal sector.

The Government of Kenya is clearly well aware of the problems of manufacturing industry and its needs for rehabilitation and regeneration. It is for this reason that the Government has decided to launch a process of regeneration of industry by diagnosis and rehabilitation of ailing firms. The aim of the Government's regeneration efforts is to induce much-needed dynamism to industry and thereby to break the vicious circle of increasingly poor performance. UNIDO has, therefore, been requested to assist and support the Government's regeneration efforts by undertaking this diagnostic survey of the rehabilitation needs of Kenya's manufacturing industry with special emphasis on the parastatal sector.

Structure of the diagnostic survey: Top-down/Bottom-up approach

The main objective of this report prepared by UNIDO is to provide a diagnostic survey of plant rehabilitation needs in a few economically strategic firms in key industrial branches of the Kenyan manufacturing sector. The approach used in this survey provides for an analysis of industrial rehabilitation requirements which integrates the policy, economic, technological, managerial, human resources development, financial and marketing dimensions, thereby focussing on plant-level rehabilitation within the context of the overall macro-economic environment.

The methodology employed in this survey consists of a Top-down/Bottom-up approach to rehabilitation.[2/]

From a Top-down perspective, the approach moves the analysis of rehabilitation needs successively from the macroeconomic level down to the plant level. Thus Kenya's recent economic development is first reviewed in its international context. This macro-economic or country level analysis includes an assessment of the evolution of key elements of the country's macro-economic, policy and institutional framework.

At the sectoral level, manufacturing is reviewed in terms of overall characteristics, major problems and constraints, trade, and assessment of policies and institutions relating to the sector. The relationship of manufacturing to agriculture and other primary sectors is given special consideration. This is to fully explore the possibilities of production based on locally available raw materials and the development of rural areas.

1/ See, in particular, Budget Speech for Fiscal Year 1989-1990 presented to the National Assembly on 15 June 1989 by the Hon. Prof. George Saitoti, Vice President and Minister for Finance, Republic of Kenya.

2/ This approach is described in detail in Annex 1.

The same type of analysis of key characteristics, constraints, potentials, policies and institutions is made at the subsector and branch levels.

Finally, at the plant level, a detailed analysis is made of a few especially selected, economically strategic firms. This analysis makes a comprehensive assessment of plant level rehabilitation needs in terms of management and organization, human resources development, financial structure, marketing, technological, economic and policy aspects. The analysis also pays particular attention to issues of maintenance and repair, quality control and raw material supply.

In order to assure that rehabilitation is not impeded by environmental factors, the Top-down analysis is complemented by an assessment of each firm in terms of its working environment, from the Bottom-up. In this Bottom-up perspective, an effort is made to assess what changes in the economic and institutional environment - government tariff and duties, macro-economic policy, company taxation, and so on - constitute preconditions to successful plant level rehabilitation.

An important element of the approach is a concentration on a few important firms in key subsectors with good backwards and forwards linkages to other firms, industries and sectors, especially primary sectors such as agriculture and other natural resource sectors.

Emphasis on a few economically strategic firms with good linkages in key subsectors concentrates resources where they can have most impact. It also maximizes the multiplier effects of any given investment in that, should these firms be successfully rehabilitated, they will exert a significant "pull-effect" on other similarly placed firms. They thus become the motors to start the regeneration process going and provide the dynamism for more widespread economic growth.

In summary, by examining a few economically strategic firms in key subsectors in their total working environment by taking a Top-down/Bottom-up perspective, UNIDO believes it can identify the means for key firms to achieve long-term economic viability and at the same time to galvanize other similarly situated firms into rejuvenation.

UNIDO firmly believes that before a serious effort can be made to carry out detailed rehabilitation of industry in Kenya, it is necessary to diagnose the precise reasons for, and the nature of, the problems/constraints now faced by industry. This is in order to identify the exact measures, investment or market studies, policy and institutional issues, that need to be examined in greater detail as part of the subsequent detailed rehabilitation analysis at the subsector, branch and plant levels. In other words, it is only by broad classification of current problems and their causes can an appropriate approach to rehabilitation technical assistance be designed.

The material in this report also serves as a guidance to potential foreign investors/ partners. It provides useful information on the prospects for Kenya's manufacturing industry in the form of a review of current industrial developments in the context of established national resources and in the light of changes in the macro- and industrial economic framework, and also in the international, institutional and policy environments.

It is important to point out the limitations of this report. The report is based on a detailed examination of only three economically strategic firms in key subsectors. These firms have been chosen to be representative of the branches of industry to which they belong. This means they have to be important firms and typi[illegible] kinds of problems, constraints and potential of firms in the respective branches. In essence, they must serve as models from which lessons can be learned that have applicability to the branch of industry as a whole.

In the particular case of this survey, three firms were selected in three major branches of manufacturing industry in Kenya - ceramics, textiles and vegetable processing. Each of the firms chosen are economically important and are representative of the problems, constraints and potential of firms in the particular branches of industry to which they belong. They are also major firms in the branches they represent especially in terms of volume of sales, market share and number of employees. Thus, an in-depth examination of these three firms will have important implications for the branch of industry of which they are part and probably for manufacturing in general.

However, given the limited nature and scope of this UNIDO diagnostic survey - it was only possible to make an in-depth survey of a small number of firms, it is important not to infer too much from this analysis. Clearly, an examination of the problems and potential of a few economically strategic firms in key branches is only relevant to manufacturing as a whole in as far as the branches of industry chosen are representative of manufacturing industry in general. Though, as is detailed in the text, the ceramics, textile and vegetable processing branches are representative and important to manufacturing, other major branches of industry - for example, paper and paper products and chemicals - need to be examined to give more balance and perspective to the findings and recommendations. This survey, then, should be seen as a first round of analysis. Subsequent more detailed and comprehensive analysis with a broader coverage of important firms and branches of industry will certainly need to be undertaken by the Government and supported by the various bilateral and multilateral agencies. On the other hand, this survey does identify the main areas in which future investigations should be focused.

This report, therefore, must be seen as only providing the basis for more detailed follow-up work and policy analysis both at the overall economic and industry sector levels and at the branch and plant levels. Thus the various recommendations made in the report regarding the rehabilitation of particular firms should not be regarded as comprehensive project proposals. They must be complemented by more detailed technical and economic analyses in order to provide effective practical guidelines for subsequent implementation.

CHAPTER 1
REGENERATING KENYAN MANUFACTURING: THE ECONOMIC AND POLICY CONTEXT

1.1 The current economic situation - factors and trends

1.1.1 Production

Since independence in 1963, compared to most other Sub-Saharan countries, Kenya's economic performance has been impressive. In 1986, the country's per capita income was US$ 300 which is in the upper end for the low income developing countries. Kenya has also developed better in terms of social indicators than other African countries belonging to the same income level.

Kenya's economic development, however, depends to a large extent on external factors, the most important being its terms-of-trade. Changes in, for example, export prices send ripples through the economy and generate disequilibria which the Government has had difficulties in counteracting. Another salient feature in Kenyan development is its high population growth rate, about 4 per cent per year, which has been a limitation to growth in per capita income.

In 1986 the Government noted that:

> "Kenya has come through a series of economic crises: the oil price rises of the 1970s and the decline in Kenya's terms of trade, domestic inflation of the early 1980s, the world recession of the same period, and the devastating drought of 1984. Kenya has coped successfully with these crises, which can be counted as a major accomplishment. But the cost has been high: economic growth has slowed to the point where average incomes have barely risen in the late 1970s. But because the short-term problems have been brought under control, while progress has been made on re-orienting the economy, 1986 presents a ripe opportunity to look much further ahead, towards the end of the century, to determine what kind of an economy Kenya is going to have then and how it is going to get there."[1]

The regeneration of Kenyan manufacturing must be looked at within the context of changing the country's economic structure and policies as well as the international context.

Overall performance

The rate of economic growth in Kenya, as measured by GDP, shows substantial fluctuations as can be seen from Table 1.1.1. The country's experience can be broken down into six periods.

- the "Kenya miracle" of 1964-1973, with an average growth rate of around 6.5 per cent per year;

1/ Economic Management for Renewed Economic Growth, Preamble, Nairobi, 1986.

- the years 1974-1976, in which the annual GDP growth rate averaged 3.5 per cent (less than the rate of population growth), due to rising oil prices, international recession and widespread drought in Kenya;

- the coffee and tea price boom of 1976-1977, resulting largely from a severe frost which disrupted Brazil's coffee exports. As a result, GDP growth rates were 8.2 and 7.9 per cent per year in the period 1977-1978;

- the period from 1979-1984, with a reduced rate of growth attributable to several distinct causes: the collapse of the East African Community (EAC) in 1977, the oil crisis of 1980-1981, renewed world recession in the early 1980s and another drought in 1984;

- a period of renewed growth since 1985, partly attributable to the return of favourable weather conditions, a general improvement in Kenya's terms-of-trade, and the effects of the restructuring programme in Kenya.

Performance of major economic sectors

Agricultural sector

Agriculture is particularly important to the economy insofar that it employs about 80 per cent of the labour force and accounts for about two thirds of the value of Kenya's exports. However, in terms of value added, its contribution to GDP is only about 30 per cent.

During the period 1974-1988, there have been great variations in the growth of the agricultural sector ranging from -3.9 per cent in 1984 to 11.2 in 1982 (Table 1.1.2). Such large variations in performance have taxed the government's ability to maintain economic equilibria. Overall performance has been quite good as can be seen from Table 1.1.1.

The agricultural sector has top priority in the government's long-term planning, with particular emphasis on high value, labour intensive crops. Food self-sufficiency is emphasized, although the lack of new lands suitable for cultivation means that increased production will have to come from improved yields.

Over half of the cultivated land area is still devoted to subsistence crops, although there has been a steady increase in the area devoted to higher value cash crops. However, the importance of traditional estate crops such as coffee and tea, representing over fifty per cent of total exports, has not diminished. It is the vulnerability of these crops to shifts in international commodity prices, and climatic variations, which accounts for the relatively greater variability in agriculture's share in GDP. Moreover, because of the large share of agricultural exports in total exports, changes in international prices rapidly affect the economy as a whole.

Industrial sector

The manufacturing sector, which will be covered in detail in chapter 3, provided 13.2 per cent of GDP in 1987. This amounts to over 10 per cent of the contribution of the industrial sector to GDP. (See Table 1.1.1 for details). Compared to other Sub-Saharan countries Kenya's industrial sector is large. There are 560 medium- to large-scale, 720 small-scale and 1,600 micro- enterprises. (Some sources claim that the number of microenterprises

are more than 10,000). As can be seen from Table 1.1.2, apart from government services, manufacturing has been the fastest growing sector of the economy.

Kenya's manufacturing sector has been oriented to meeting domestic needs, having been established to cater to the domestic market through a policy of import substitution. High levels of protection were provided for key manufacturing sub-sectors such as metal products, wood products, paper, non-electrical machinery and fertilizers.

Agro-industry is the most important sub-sector. Food, beverage and tobacco products accounted for about 44 per cent of Kenya's manufacturing value added (MVA) in 1987. Other major branches of agro-industry (textiles and garments, leather products, wood and paper products) accounted for, on average, another 12 per cent of MVA. The remaining 44 per cent is accounted for by a relatively wide range of other branches such as petroleum, rubber, plastic, chemical, metal, cement, glass and ceramic products.[1/]

Table 1.1.1: GDP by industrial origin, 1980-1987
(current Kf)

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
Traditional Economy	149.39	155.79	159.59	164.58	170.48	178.40	192.90	191.15	197.34	206.27
Forestry and fishing	20.33	21.05	21.83	22.74	23.80	24.50	25.90	26.33	27.20	28.09
Building and construction	45.37	48.05	48.02	48.96	50.58	54.01	64.11	56.80	58.01	59.60
Water collection	18.41	18.71	19.00	19.29	19.58	20.34	21.14	21.95	22.80	23.69
Ownership of dwellings	65.28	67.98	70.74	73.59	76.52	79.55	82.65	86.07	89.33	92.89
Monetary Economy	2446.64	2542.66	2700.57	2833.66	2896.16	2969.58	3109.84	3293.01	3452.42	3634.18
Agriculture	810.05	817.66	867.33	964.06	979.07	941.05	975.59	1023.39	1062.57	1109.26
Forestry and fishing	26.63	27.55	28.37	30.91	33.52	32.89	33.12	33.63	37.11	41.64
Mining and quarrying	7.95	8.75	5.45	6.61	6.69	7.41	8.11	8.40	9.12	10.15
Manufacturing	333.97	351.47	364.13	372.32	389.07	405.84	424.07	448.67	474.34	502.80
Construction	118.29	126.61	136.73	120.58	109.96	105.72	110.19	114.72	120.26	126.51
Electricity and water	40.10	39.26	45.30	43.71	49.45	26.21	26.16	28.37	31.18	33.88
Trade, rest. & hotels	303.33	318.38	322.52	299.40	307.78	332.60	355.22	389.98	412.53	436.27
Transport, storage & com.	140.87	148.85	151.71	195.87	201.51	202.29	206.54	215.42	224.90	234.02
Finance & business serv.	170.13	169.24	221.34	206.92	223.58	222.50	244.51	261.02	274.52	291.27
Ownership of dwellings	118.16	124.14	135.84	140.69	135.18	187.98	193.20	199.25	205.63	212.20
Domestic services	24.06	28.33	30.69	32.75	34.88	37.16	39.74	43.32	47.82	52.11
Government services	382.39	403.84	425.20	441.35	459.89	473.13	497.26	528.73	554.13	586.16
Other services	51.85	56.99	59.32	62.68	68.46	94.20	99.10	104.05	111.74	119.72
Less: Imputed bank services & charges	-81.14	-78.41	-93.36	-84.19	-102.88	-99.40	-102.97	-105.94	-113.43	-121.81
Total GDP at Factor Cost	2596.03	2698.45	2860.16	2998.24	3066.64	3147.98	3302.74	3484.16	3649.76	3838.45

Source: IBRD and Economic Survey 1989, p. 15.

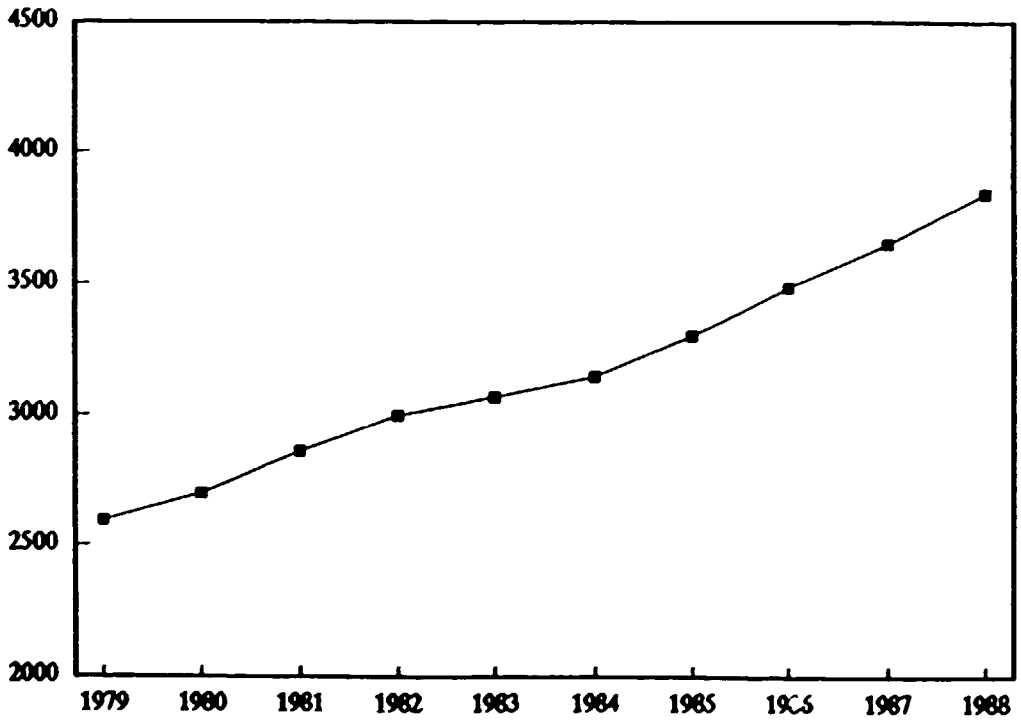
1/ Central Bureau of Statistics, Statistics Abstract 1989, Nairobi, p. 126.

Table 1.1.2: Growth rates of real GDP by industrial origin, 1980-1987
(percentage change in constant 1982 prices)

	1980	1981	1982	1983	1984	1985	1986	1987	1988
Agriculture	0.9	6.1	11.2	1.6	-3.9	3.7	4.9	3.8	4.4
Forestry and fishing	3.5	3.3	6.9	6.8	0.1	1.3	3.2	7.3	8.4
Mining and quarrying	10.1	-37.7	21.3	1.2	10.8	9.4	3.6	8.6	11.3
Manufacturing	5.2	3.6	2.2	4.5	4.3	4.5	5.8	5.7	6.0
Construction	6.7	5.8	-8.2	-5.3	-0.5	9.1	-1.6	3.9	4.4
Electricity and water	-0.9	10.9	-2.0	9.6	-32.6	1.6	6.4	7.3	6.7
Trade, rest. & hotels	5.0	1.3	-7.2	2.8	8.1	6.8	9.8	5.8	5.8
Transport, storage & com.	5.7	1.9	29.1	2.9	0.4	2.1	4.3	4.4	4.1
Finance & business serv.	-0.5	30.8	-6.5	8.1	-0.5	9.9	6.8	5.2	6.1
Ownership of dwellings	4.7	7.5	3.7	-1.2	26.4	3.1	3.4	3.4	3.4
Domestic services	17.7	8.3	6.7	6.5	6.5	6.9	9.0	10.4	9.0
Government services	5.6	5.3	3.8	4.2	2.9	5.1	6.3	4.8	5.8
Other services	9.9	4.1	5.7	9.2	37.6	5.2	5.0	7.4	7.1
Less: Imputed bank services & charges	-3.4	19.1	-9.8	22.2	-3.4	3.6	2.9	7.1	7.4
Total GDP at Factor Cost	3.9	6.0	4.8	2.3	2.7	4.9	5.5	4.8	5.2

Source: Table 1.1.1.

Figure 1.1: GDP at constant 1982 prices, 1979-1988
(Kenya £ million)



Sources: Central Bureau of Statistics, Statistical Abstracts 1989 and Mission estimates.

Electricity consumption increased by 3.6 per cent per year between 1981-1985. The Government has announced ambitious plans to develop Kenya's hydroelectric and geothermal potential, in order to decrease its reliance upon imported oil, increasingly scarce firewood and imported electricity from Uganda.

Kenya remains totally dependent upon oil imports to meet its domestic requirements, although renewed exploration led in March 1988 to the discovery of oil deposits which are as yet of undetermined commercial viability.

Kenya's mining industry is still relatively small, and concentrated in quarrying and in non-metallic or chemical minerals. The main products are soda ash (220,000 tonnes in 1989) and fluorspar (67,000 tonnes). Mining of gold has resumed in recent years. Salt (12,000 tonnes) and limestone products (37,000 tonnes) also yield significant export revenues, although they involve little further processing in Kenya.

The service sector

The service sector accounts for the largest share of GDP, with the most notable growth occurring in subsectors benefitting from Kenya's thriving tourist industry (trade, restaurants and hotels; transport, storage and communication; finance and business services). In recent years tourism has become the largest single foreign exchange earner for Kenya.

Government services have grown at a rate slightly above that of GDP. As a result, their contribution to GDP has slowly risen from 14.7 per cent in 1979, to 15.6 per cent in 1987.

1.1.2 Commodity trade

The main sources of foreign exchange earnings, apart from petroleum products based on processed imported oil, are coffee and tea, which together accounted for about 60 per cent of total exports of goods and services during 1987-88[1/].

The international terms-of-trade have varied significantly for Kenya since Independence. According to information contained in the Economic Survey for various years, in the period 1979-1988, the terms-of-trade have alternated from being unfavourable for the first 5 years to favourable for next five years. Apart from great variability in the terms-of-trade, no definite conclusions can be drawn from this data.

Exports are important to the Kenyan economy. In 1964, exports represented 34 per cent of GNP. Since then the share of exports in GNP has decreased to 26 per cent in 1982 and to 22 per cent in 1987.[2/] This development is common to many other countries pursuing an import substitution policy. It seems exceedingly difficult to maintain a rapid export growth, while protected industries are being established. Another consequence of this trend is balance of payments deficits. This will be discussed later.

1/ Economic Survey 1989, p. 81.
2/ Development Plan 1989-1993, p. 15.

According to the World Bank[1], the share of manufactured goods in total exports has fluctuated around 11 per cent.

As is shown in Table 1.1.3, the main destination for Kenya's exports is the European Community (EC), with the UK alone accounting for 20 per cent of total exports. The next largest regional destination is Africa, headed by PTA members Uganda and Tanzania. As a result of the breaking up of Preferential Trade Area (PTA), there has been a pronounced decline in the share of manufacturing exports going to Uganda and Tanzania which has dropped from 35 to 28 per cent (1975 and 1983 respectively). EC countries also supply the largest proportion of imports, followed by Japan, a major supplier of motor vehicles and electronic equipment, and United Arab Emirates, Kenya's main source of crude petroleum. Imports from PTA member countries are insignificant.

1.1.3 Public finance

Ambitious development plans have in the past necessitated an increasing role for the Government in Kenyan development. As a result government expenditures as a percentage of GDP have increased rapidly and in 1988-1989 were over 39 per cent. In order to finance this expansion, for many years the Government has incurred an overall budget deficit. Different measures of the deficit can be found in Table 1.1.4 below. However, there has been an increasing concern among policy makers about the deficit with the result that the Government is now committed to decrease it substantially in the future. The "Sessional Paper No. 1 from 1986" sets the target to reduce this deficit to 2.5 per cent of the GDP by the year 2000. The Development Plan projected this deficit to be 4.5 per cent in 1988/1989 and as can be seen from the table, the target was almost reached in that year. By 1992-1993, it is planned that this deficit will be reduced further to 3.1 per cent.

Table 1.1.3: Kenya's main trading partners, 1988
(US$ million)

Export destinations			Source of imports		
United Kingdom	186.9	(20)	United Kingdom	333.7	(19)
F.R. of Germany	114.7	(12)	Japan	216.6	(12)
Uganda	83.7	(9)	UAE	201.4	(11)
Netherlands	48.8	(5)	F.R. of Germany	167.3	(10)
USA	46.2	(5)	France	108.9	(6)
Italy	32.8	(4)	USA	88.3	(5)
Tanzania	24.3	(3)	Netherlands	86.2	(5)
France	17.5	(2)	Italy	63.9	(4)
Japan	13.7	(1)	India	28.8	(2)
All others	383.3	(40)	All others	470.1	(26)
Total	951.9	(100)	Total	1,765.2	(100)

Source: Central Bureau of Statistics, Economic Survey 1989, pp. 84-85.

Note: In parentheses, percentage share of total.

1/ Kenya: Industrial Sector Policies for Investment and Export Growth, p. 32.

Table 1.1.4: Analysis of key fiscal indicators 1984/85-1988/89

Overall Deficit as % of	1984/85	1985/86	1986/87	1987/88	1988/89
Total expenditure	-16.7	-13.0	-21.0	-11.4	-11.7
GDP at current market prices	-5.8	-4.3	-7.5	-3.9	-4.6
Total government expenditures as % of GDP at current market prices	34.5	33.0	35.6	33.8	39.4

Source: Central Bureau of Statistics. Economic Survey 1989. p. 63.
Note: 1987/88 and 1988/89 figures are provisional.

As can be seen from Table 1.1.5, to finance total debt the Government has increased its borrowing mainly by a rapid increase in the foreign debt and, to a lesser extent, by borrowing on the domestic market.

Table 1.1.5: Central government public debt, 1964-1988 a/

	1964	1972	1974	1978	1982	1987	1988
Value (Kf Mn) b/							
Debt (D)							
Domestic	18.0	88.5	129.1	283.6	454.2	716.9	706.4
Foreign	68.1	105.8	136.3	242.3	859.3	2280.7	2717.4
Total	86.1	194.3	265.4	525.9	1313.5	2297.6	3423.8
Debt service (DS)							
Domestic	3.2	9.5	9.4	29.4	77.2	206.4	254.3
Foreign	3.0	7.2	8.6	31.2	102.6	257.4	284.3
Total	5.2	16.7	18.0	60.6	179.8	463.8	538.6
GNP	348.9	731.3	1016.0	2049.8	3363.9	6363.2	7324.0
Exports (XGS) c/	119.7	200.1	357.2	593.1	877.6	1400.4	1664.9
Debt ratios							
D/XGS	56.9	52.8	38.2	40.9	97.9	162.9	205.6
DS/XGS	1.7	3.6	2.4	5.3	11.7	18.4	17.1
D/GNP	19.5	14.5	13.4	12.4	25.5	35.8	46.7

Sources: Republic of Kenya, Development Plan 1989-1993, p. 15, and Central Bureau of Statistics, Economic Survey 1989, pp. 21, 22, 70 and 72.

a/ Calendar year totals, derived by averaging two financial years. Exports exclude factor incomes.

b/ The Kenya pound (Kf) is equal to 20 Kenya shillings (KSh). The Kenya pound has been tied since October 1975 to Special Drawing Rights (SDRs), rather than to the US dollar. The U. N. exchange rate as of 14 December 1989 stood at Ksh 21.5 (Kf 1.075) to the dollar. Although the exchange rate is pegged, it is subject to frequent adjustments. Two adjustments amounting to over 20 per cent were made in 1981, and other significant adjustments made in December 1982, when there was a 12 per cent devaluation against the SDR. After December 1982, a "crawling peg" system was adopted, with the exchange rate tied to a basket of Kenya's main trading currencies.

c/ Exports of goods and services.

1.1.4 External debt and the balance of payments

The burden on the Kenyan economy caused by its debt service charges has grown enormously in the 1980s. Government statistics presented in Table 1.1.5 show that while the ratio of external debt to GNP increased 2.4 times, the ratio of debt service to exports increased 10.1 times. The Government thus considers that reducing the level of debt servicing is of critical importance.

In addition to the external public debt there is also a significant external private debt, the servicing of which probably represented about an additional 5 per cent of export earnings in 1987 (mission estimate).

Like many other developing countries, Kenya needs to import most capital goods, certain intermediate goods and many raw materials, especially oil. But exports have not grown enough to finance these imports. While in the period 1965-1969 exports financed 73 per cent of imports this ratio had dropped to 57 per cent in the 1980-1984 period.[1/]

Although the data in Table 1.1.6 are not directly comparable, they suggest that there has been a significant contraction in exports in the 1980s as well as for imports, although the latter to a lesser extent.

The budget deficit as well as the stagnant growth in exports explain the growing foreign debt. Its repayment will further aggravate Kenya's economic difficulties.

1.2 Recent policy changes and their impact

Radical changes in economic policies are rare in Kenya. Fundamental changes in economic policies are implemented over several years. Kenya is in the process of introducing such fundamental changes in the economy. The process was initiated many years ago. Since the beginning of the 1980s there has been a growing concern over the negative effects of import substitution policies and of the stifling influence of the state in the economy. Among these negative effects can be mentioned:

- the slowing down of overall growth
- the sluggish performance of exports
- the rapidly growing foreign public debt and service payments strangling needed imports and hence threatening future growth
- the persistent budget deficit and the squeezing of the private sector of needed capital

The Government has received support from the World Bank since the early 1980s to support structural changes with a view to facilitate more efficient use of resources in both the public and private sectors.

Sessional Paper No. 1 of 1986 established the basis for a reorientation of policies towards a more market oriented economy. The Development Plan 1989-1993 states: "First, the Plan pioneers the incorporation of the structural adjustment process."[2/] The Plan outlines the following objectives:

1/ Republic of Kenya, Sessional Paper No. 1 of 1986 on Economic Management for Renewed Growth, Nairobi, Kenya, 1986, p. 21.

2/ Republic of Kenya, Development Plan, 1989-1993, Nairobi, 1989, p. 33.

Table 1.1.6: Summary balance of payments
(US$ million)

	1980	1981	1982	1983	1984	1985	1986	1987	1988
CURRENT ACCOUNT									
Trade									
Exports(fob)	1261	1081	936	937	1034	943	1170	909	790
Imports(fob)	2378	1834	1468	1198	1348	1273	1457	1623	1399
Net trade	-1117	-753	-532	-271	-314	-330	-287	-714	-609
Exports as per cent of imports	53.0	58.9	63.8	77.4	76.7	74.1	80.3	56.0	56.5
Services									
Receipts	823	718	708	608	635	652	736	831	673
Payments	740	741	601	554	618	611	701	828	685
Net services	83	-23	107	54	17	41	35	3	-12
Transfers									
Receipts	167	248	164	215	214	220	242	257	300
Payments	19	32	31	35	37	29	35	43	31
Net transfers	148	216	133	180	177	191	207	214	269
Current account balance	-886	-560	-292	-37	-120	-98	-45	-497	-352
CAPITAL ACCOUNT									
Private long-term	149	3	11	-5	9	5	29	12	-15
Government long-term	395	258	66	101	138	-25	5	197	224
Government corporations	4	51	7	23	-15	-31	69	75	34
Short-term	134	17	29	-14	41	46	32	109	42
Capital account net	682	329	113	105	173	-5	135	393	285
Errors and omissions	10	31	-19	20	-10	-12	-1	11	8
OVERALL BALANCE	-194	-200	-198	88	43	-115	89	-93	-59
MONETARY MOVEMENTS									
Changes in reserves	47	120	-30	-200	-60	50	14	198	-46
Transactions with IMF	148	71	198	116	-2	56	-106	-109	96
Changes in other liabilities	0	8	30	-2	17	9	2	3	10
Total, monetary movements	195	199	198	-86	-45	115	-90	92	60

Sources: World Bank, Kenya: Recent Economic Developments and Selected Policy Issues, 26 September 1988, p. 82; and Central Bureau o. Statistics, Economic Survey 1989.

- A growth rate target of 5.4 per cent
- An orientation of industry towards the export market
- An enhancement of the investment climate for both local and foreign entrepreneurs

The budget speeches presented each year by the Finance Minister further elaborate on the reorientation of policies.

A series of measures have been taken to implement Government policies during the last few years:

- The tax system has been streamlined, including a reduction in corporate taxes from 45 to 40 per cent. As of 1990 a value added tax (VAT) was introduced which replaced the previous sales tax. A VAT is more conducive to an efficient use of resources.

- The import licensing system has been modified and the number of goods which can be imported more or less automatically has been increased. There will be further liberalizations of imports in the future.

- The Government is streamlining and simplifying the tariff system. Protection of domestic industry will depend less on import licensing and more on the tariff system.

One area of conflict among policy makers, has been the role of parastatals and the private sector. A review of policy statements and documents reveal that there has been a gradual shift towards government divestiture and privatization of parastatals. While Sessional Paper No. 1 of 1986 reiterates the continuity of past policies and one element of which has been "... concentration of Government on the provision of economic infrastructure and social services ..."[1/], the Development Plan elaborates further on this issue. According to the Plan, in the past the policy " ... emphasized the Government's role and involvement in commercial activities even where the private sector would be more efficient and failed to effectively grapple with the unemployment problem".[2/] In the last budget speech (1989-1990) by the Finance Minister and Vice-President of Kenya, there was an explicit reference to government divestiture and privatization of parastatals.

Some senior government officials also expressed their opinion to the UNIDO mission that unprofitable parastatals should be closed down and that the Government would consider privatizing them.

A series of actions have been taken to improve the investment climate. The procedures for investment approvals have been simplified by the establishment of the "one-stop office" in the Investment Promotion Centre to simplify procedures for foreign investors to establish themselves in Kenya. The restrictions on foreign companies to borrow in the domestic capital market have been somewhat relaxed.

The Government is studying the roles of Development Finance Institutions (DFIs) and the results of the studies should pave the way for decisions on the restructuring of these institutions. The scope of price controls has been reduced and further liberalizations are expected in the future.

1/ Sessional Paper No. 1 of 1986, p. 3.
2/ Ibid. p. 33.

The successive liberalization of markets could well result in growing income- and wealth-inequalities to such an extent that the present strategy may become non-viable. The objective of the Government of Kenya (GOK) to channel resources to the informal sectors, for economic growth and employment creation, may be difficult to attain without concerted efforts by the Government.

In summary, the enabling environment for industrial rehabilitation has improved significantly in the last few years. Further improvements in the environment can be expected within the next few years. In the past there has been a reduction in foreign private investment in Kenya. Whether these policy changes will be enough to attract a significant inflow of foreign private capital remains an open question. Still, the need to strengthen the role of Kenyan investors and entrepreneurs will remain for many years to come.

1.3 The international and regional contexts

1.3.1 Development assistance

Accelerated economic growth in Kenya will necessitate an increasing flow of capital to the country. In the past, externally funded development assistance has grown slowly (1981-1986) as can be seen from Table 1.3 below. These flows have been of approximately the same magnitude as GOK's development budgets.

Table 1.3: Externally funded development assistance[a/]
(US$ million)

	1981	1982	1983	1984	1985	1986	1987
United States	78.0	54.0	78.0	43.0	76.0	31.0	44.0
United Kingdom	71.9	56.2	46.0	47.2	40.5	46.3	43.2
F.R. of Germany	42.3	31.3	44.2	39.0	36.4	46.2	57.2
Japan	27.1	21.3	54.8	32.2	33.4	54.9	69.6
Other bilateral	161.0	192.8	137.3	161.4	186.4	238.5	257.6
Total bilateral	380.3	355.6	360.3	342.2	372.7	416.9	471.6
IDA	14.8	83.6	19.8	35.6	34.9	30.0	72.1
European Community	46.0	28.7	16.6	16.6	15.8	11.2	29.3
World Food Progr.	3.9	5.9	2.2	14.9	15.1	3.7	1.6
UNDP	8.1	8.4	5.9	5.2	5.6	6.3	5.9
Other multilateral	12.5	20.6	15.2	7.8	18.2	19.2	18.4
Total multilateral	85.3	147.2	59.7	88.1	89.6	70.4	127.3
Total ODA[a/]	465.5	502.7	420.3	430.3	462.4	487.3	598.9
Bilateral as per cent of total assistance	81.7	70.7	85.8	79.5	80.6	85.6	78.7

Source: OECD Development Assistance Committee, Geographical Distribution of Financial Flows to Developing Countries, Paris, 1989, pp. 166-167.

Note: a/ Gross official development assistance (ODA).

In 1987, there was a significant increase in assistance to Kenya. This may well be a reflection of a growing confidence in Kenya's restructuring programme and in the new liberalization policies.

Bilateral aid accounts for the largest share, about 80 per cent, while multilateral aid for only some 20 per cent. During the same period the USA, UK, Germany and Japan were the main co-operation partners.

Kenya's serious balance of payments situation has led to a series of foreign exchange crises. The country has resorted to IMF stand-by arrangements on seven occasions since 1978, to the World Bank for two structural adjustment loans, and to the high-interest euro-dollar market for loans of several hundred million dollars. The most recent IMF package (February 1988) features a stand-by agreement worth US$ 85 million and a credit of US$ 90 million under its low-interest structural adjustment facility.

1.3.2 Regional economic co-operation

The breaking up of the East African Community in 1977, caused strains in the Kenyan economy, because Kenyan manufacturing had invested with a view to exporting to the Community.

Since then, Kenya has been an active promotor of the Preferential Trade Area Treaty (PTA). The PTA became operational in 1983 and has 16 members.[1/] The treaty is to encourage trade by reducing, and eventually eliminating, tariff and nontariff barriers on selected commodities. These are included in a Common List.

Since most members suffer from shortages of foreign exchange, a Clearing House was established to permit the use of national currencies. The balance due for members is paid in convertible currencies.

However, the share of intra-PTA trade in total PTA trade was only 8 per cent in 1980 and fell to 6.2 in 1987. Still, the share of intra-PTA trade going through the Clearing House has increased from 9 per cent in 1987 to 13 per cent during the first 10 months in 1989. Almost 60 per cent of the trade was settled in local currencies. Hence, member states saved needed foreign exchange.

Important discussions are underway to make PTA more effective. Proposals include the making of PTA members' currencies convertible, and to create a monetary union as first step towards creating a common market. The need for intensified regional co-operation is considered a priority area of action by the Kenyan Government.

1/ The PTA members are: Burundi, Comoros, Djibouti, Ethiopia, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Rwanda, Somalia, Swaziland, Uganda, Zambia and Zimbabwe.

CHAPTER 2
THE ENVIRONMENT FOR REHABILITATION RESOURCES, POLICIES AND INSTITUTIONS

2.1 The natural resource base and its renewal as they relate to the current diagnostic survey

The following discussion is focused on conditions that have a direct influence on the industries examined in this survey - namely, the ceramics industry and the textiles and vegetable processing industries.

Kenya has a total land area of 571,416 km^2, a comparatively long coast and a number of lakes covering a total area of some 10,700 km^2.

Kenya is also endowed with a range of natural resources, particularly rich farm land, favourable climatic conditions in large areas, and natural forests which unfortunately are facing serious problems as a result of excessive cutting and encroachment by agriculture. Industrial forest plantations cover 165,000 hectares producing raw material mainly for sawmills and the pulp and paper industry.

The country's mineral resources are limited to non-metallic minerals including feldspar, kaolin, wollastonite, flourspar, gypsum and vermiculite, all of which are essential for manufacture of crockery, tiles and sanitary ware. Mining of these minerals was very erratic and with substantial variations in quantity during the period 1977-1986. Detailed knowledge of locations and extent of deposits appear to be limited.

Kenya has rivers and geo-thermal energy sources which are used for generating electrical power. In 1987, these energy sources had a combined capacity of about 400 megawatts. Further development of these resources is continuing.

Out of its total agricultural land of 52.05 million hectares, about 6.8 million hectares are classified as high potential farm land and 3.1 million hectares as medium potential land. The mission did not have access to detailed land-use plans but concludes that the availability of land per se is not a restricting factor for increased production of cotton and/or vegetables.

Cotton is the major raw material in the textile industry and is, according to available figures[1/] currently grown on about 140,000 hectares. Thus cotton is grown on only 7 per cent of the total area of 1.8 million hectares which are classified as suitable for cotton production in 18 districts of Kenya.

During the late 1970s there was a substantial increase in overall cotton output leading to a record output of 62,179 bales, or 11,500 tonnes in 1979. Due to various reasons, there has been a constant decline in the output of cotton during the 1980s and by 1987-1988, total cotton lint production in Kenya was only 36,632 bales or about 5,700 tonnes.[2/]

1/ Ministry of Agriculture, Kenya Agriculture Research Institute, World Bank/CAMP Assisted Research Project, report of October 1988.

2/ Statistics obtained from the Cotton Lint and Seed Marketing Board.

Major constraints for increased cotton production include severe delays of payment to the producers, sometimes more than one year. As a result, many farmers have abandoned cotton production and turned to other competing cash crops such as sugar cane and horticultural crops. A new legislation, the Cotton Act, 1988, which introduces a modified marketing system for cotton seed is intended to improve the situation and increase farmers interest in growing cotton. However, the average yield of cotton lint is low in Kenya, about 100 kg/hectare.

But results from various trials in different parts of the country show that the yield per hectare can be increased to between 450 kg and 900 kg of lint per hectare if improved varieties and production technology are adopted. Considering the price of cotton, which also reflects the world market situation, it is doubtful whether cotton production can in fact gain any greater popularity if the crop yields and hence the income per hectare are not improved.

Increased cotton production in Kenya is dependent largely on the resources to improve the varieties of cotton, develop better production techniques, and substantially improve the extension services to the farmers.

In addition to deterioration of the crop yields the turn-out from the ginneries have degraded with an impact also on the quality of the lint. This, in association with sometimes inadequate storage facilities at the farm and co-operative society level, results in cotton lint of low quality which the cotton mills have no alternative but to accept.

Although the potential for increased cotton production in Kenya appears to be quite considerable there is a long way to go to satisfy the demands of the ginning material cotton industry for cotton fibre.

Vegetables are grown on about 70,000 hectares with a concentration in the Central and Rift Provinces. Table 2.1.1 shows the hectarage of vegetables grown in all provinces.

Table 2.1.1: Area used for vegetables, 1988

Province	Hectares
Rift	11,932
Central	32,597
Western	7,348
Nyanza	6,299
Eastern	8,055
North Eastern	127
Coast	2,914
Total	69,272

Source: Horticultural Crops Development Authority

Tomatoes and onions are grown in every province and, as with most of other types of vegetables are more or less concentrated to areas where they grow best. For instance, carrots are mostly grown in the Central Province, beans are grown in the Central Province but also in the Western and Rift Valley Provinces, and different types of Asian vegetables in the Eastern Province.

Table 2.1.2: Production of vegetables 1963-1988, selected crops

Crop	Hectare Year 1963	Hectare Year 1988	1,000 tonnes Year 1963	1,000 tonnes Year 1988	Tonnes/Hectare Year 1963	Tonnes/Hectare Year 1988
Cabbage	945	33.200	4.77	591.6	5.1	17.0
Carrot	600	3.040	1.85	27.4	3.2	9.0
Cauliflower	102[a/]	490	1.04[a/]	9.8	10.2[a/]	20.1
Chili	3.069	2.300	2.80	7.1	0.9	3.1
French bean	354	6.530	0.39	16.3	1.1	2.5
Garlic	131[b/]	150	0.20[b/]	0.9	1.5[b/]	5.9
Kale	566	18.550	0.79	157.7	1.4	8.5
Onion	330	7.300	1.53	80.3	4.6	11.0
Sweet pepper	60	780	0.23	6.3	3.9	8.1
Tomato	531	15.500	4.79	314.0	8.9	20.1

Source: Annual reports for 1963 and 1988, Ministry of Agriculture.

a/ 1970 figure
b/ 1976 figure

Table 2.1.2 shows that vegetable production has developed significantly since independence. The creation of the Horticultural Crops Development Authority in the 1960s has contributed to this development through the launching of several projects important to the vegetable industry.

The future availability of raw material for the textiles and vegetable processing industries is largely dependent on agricultural policies and the prices paid to producers.

Efficiency and an adequate technological structure of Kenyan manufacturing industry is essential, and a prerequisite for industry to be able to offer attractive prices for raw materials. If farmers are paid sufficiently attractive prices for high quality raw material, the future raw material base is not expected to be a constraint for further expansion of either the textiles or the vegetable processing industry.

In the 1960s and 1970s there was an "Export Marketing Development Project" assisted by FAO/ITC. A "Horticultural Nursery roject" and a "Horticultural Extension and Training Project" took off in the 1970s followed by a scheme for establishing "Horticultural Production Centres" in the 1980s. This project is designed to organize farmers and train them in growing horticultural crops, advance credits, supervi.e the production and market the products on behalf of the farmers and pay them after the recovery of advanced credits.

Although the project still continues, only a few centres have been fully developed due to lack of finance. The developed centres have reportedly been very successful.

The mission concludes that policies and socio-economic conditions affecting the farmer's choice of crops is the dominating factor influencing the future availability of raw material for both the textiles and vegetable processing industries.

Very limited statistical information is available to show the amount of mineral resources locally available for processing, especially for ceramic manufacturing. The minerals of economic significance, not necessarily for ceramic manufacturing, include soda ash, flourspar and salt.[1] Other minerals, such as diatomite, carbon dioxide, gypsum, kaolin and others used as industrial and construction materials are currently being exploited for domestic use. In general, as shown in Table 2.1.3, mineral production has risen in recent years.

Table 2.1.3: Quantity and value of mineral production, 1984 1988

Mineral	1984	1985	1986	1987	1988[a]
Quantity (tonnes):					
Mineral					
Soda ash	226.000	227.760	230.000	228.000	220.000
Flourspar	50 883	57.949	50.851	46.568	67.351
Salt	58.352	67.213	61.980	72.269	94.682
Limestone products[b]	20.855	30.479	35.000	37.460	28.601[d]
Other	35.818	37.202	39.276	37.705	38.459[d]
Total	391.908	420.603	417.107	422.002	449.093
Value (Kt'000):					
Soda ash[c]	11.836	13.180	16.514	17.442	17.477
Fluorspar[c]	2.951	3.761	3.129	2.802	3.399
Salt	2.744	2.662	2.763	2.317	3.043
Limestone products	662	1.126	1.150	1.173	924[d]
Other	1.500	1.538	1.663	1.779	1.783[d]
Total	19.693	22.287	25.219	25.513	26.626

Source: Central Bureau of Statistics, Economic Survey 1989, Nairobi, May 1989, p. 108.

Notes: a/ Provisional.
b/ Excluding limestone used as input into cement product.
c/ Export value only.
d/ Rough estimates only.

As Table 2.1.3 shows, except for flourspar, there is not much detailed information on the production of minerals used for ceramic manufacturing. Although some raw materials for ceramic manufacturing are available locally such as feldspar and wollastonite, the mission found that a significant amount of inputs were imported (for example, plaster-of-Paris and glaze inputs). However, in recent years, ceramic manufacturing firms have had to make use of substitutes for these imported inputs because of financial difficulties. For example, imported kaolin has been substituted with soapstone from Kiisi and imported clay balls with Ngumba clay. The substitution of imported raw materials has created problems with product quality, and necessitated the use of a mixture of local and imported materials to maintain reasonable quality standards.

The mission suggests that the exploration of minerals be continued to ensure that there is adequate raw materials for the mineral processing industries and to reduce the dependence of the industries on imported inputs.

1/ Republic of Kenya, Development Plan, 1989-1993, p. 173.

2.2 Transport, communications and energy
2.2.1 Transportation

Air transportation

Kenya has a very good international and domestic air transport infrastructure with a main international airport in Nairobi (Jomo Kenyatta) served by more than 25 scheduled international airlines. This makes Nairobi the major hub in the region and one of the most important air transport centres in Africa. Commercial traffic at Nairobi in 1987 amounted to 1.9 million passengers and 49,700 tonnes of freight. Domestic flights from Nairobi are all centered on Wilson airport.

A medium-sized airport is located at Mombasa, which also handles some international flights. The airport handled 520,000 passengers in 1987 and 10,500 tonnes of freight. In addition the country is serviced by more than 150 airstrips located throughout the country.

Sea transportation

Mombasa is the principal seaport of Kenya and is one of the most modern in Africa. It serves all of Kenya and also provides vital sea transport services for Uganda, Tanzania, eastern Zaire, Sudan, Rwanda and Burundi. The port is dredged to a depth of 11 meters and has 16 deepwater berths, 2 bulk oil jetties, 2 bulk dry wharves, 1 cased oil jetty, 2 lighterage quays and an explosives handling jetty. The port is equipped with 17, 40-tonne gantry cranes and 53 portable cranes capable of handling 20 tonne loads. In addition the port has cold storage facilities and warehousing. Its container facility is the largest and most well equipped in the region. Container shipments have been further facilitated by the installation of a new inland depot near Nairobi, thereby allowing easy movement of containers to and from Mombasa by rail.

Road transportation

Kenya has an extensive road network connecting most parts of the country and linking up with the road networks of neighbouring countries. The national road network comprised of 54,200 km in 1986, of which 6,700 km was paved. Of all roads, approximately 12 per cent are classified as international and trunk roads, 14 per cent as primary roads and 67 per cent as minor roads. The secondary and minor roads are generally passable all year, except in abnormally heavy rains. Rates for road transport are negotiable and vary from one transporter to another. The cost of a 12 tonne lorry from Nairobi to Mombasa would be Ksh 3,000-5,000.

Rail transportation

Kenya is served by a single-track railway system connecting Mombasa, Nairobi and Kampala in Uganda. There are branches to Kisumu, Nanyuki and Tanzania. The system operated by Kenya Railways carried 3 million tonnes of freight and 3.8 million passengers in 1987. Approximate freight costs from Mombasa to Nairobi are Ksh 190/tonne, Mombasa to Nakuru Ksh 240/tonne and Mombasa to Kisumu Ksh 300/tonne.

2.2.2 Communications

Post and telecommunication services are provided by Kenya Posts and Telecommunications Corporation (KPTC). The services are operated efficiently and communication with the major cities of the world are excellent. KPTC recently installed an international subscriber dialling system, allowing direct dialling worldwide.

Overseas calls to Europe and the United States cost approximately Ksh 58 minute and to the Far East Ksh 78 minute. Local calls cost Ksh 1.15 unit and the telephone rental costs Ksh 840 per line per year. A communication tax of 15 per cent is also charged. In 1987 there were a total of 145,000 telephone exchange connections in the country.

International telex services are available and telex rental services are provided by major hotels. There are approximately 2,400 telex subscribers in Kenya. Costs range from Ksh 30 per minute to the U.K. to Ksh 43 per minute to the USA plus a 15 per cent tax. Other services such as telegraph and facsimile service are also available from the KPTC.

2.2.3 Energy

Electrical energy

Expansion of electrical capacity has kept pace with growth in demand. In 1987 the hydroelectric capacity in the country was 353.5 megawatts; thermal (oil-fired) capacity of 176.2 megawatts and geothermal capacity of 45 megawatts, a total of 574.7 megawatts. Further development in hydro and geothermal power continues. Most electricity is supplied by Kenya Power and Lighting Company Ltd. (KPLC) and its associated companies, the Kenya Power Company and Athi River Development Authority.

Kenya Power and Lighting monthly charges[1/] are:

- For users of less than 7,000 units (KWH), the fixed charge is KSh 30 and additional unit charges are Ksh 0.37 for the first 50 units; KSh 0.87 for the next 50 units; KSh 1.07 for the next 50 units and KSh 1.33 per unit up to 7,000.

- For users of between 7,000 and 100,000 units (at 240 volts single phase or at 415 volts three phase) the fixed charge is KSh 120, the unit charge is KSh 0.97 and a KVA demand charge is KSh 50 per KVA of demand per month.

- For users of more than 100,000 units the charges are the same as for the previous group except that the unit charge is KSh 0.51.

1/ Investment Promotion Centre, Investor's Guide to Kenya, May 1989.

Industrial Fuel

Supplies of industrial diesel fuel, liquified petroleum gas (LPG) and kerosene are all available from the refinery in Mombasa. However, the refinery is old and breakdowns are quite frequent with the result that supplies of oil are sometimes in short supply. Supplies of LPG from the refinery are not sufficient for the domestic demand, so that industries relying on this fuel for their operations suffer disruptions to their production.

Current prices of fuels are approximately:

Industrial diesel: KSh 3,250/tonne[3/]

Kerosene: KSh 5,210/tonne (KSh 4,273/1,000 litres wholesale[2/])

LPG: KSh 8,341.5/tonne (KSh 4,817/1,000 litres[2/])

2.3 Management training and human resource development

2.3.1 Management training

At present, Kenya has a large number of institutions which cater for managerial training needs at all levels. In the capital itself there are no less than 45 institutions listed with the Kenya Trainers Association.

The most important organizations for this purpose are, apart from the universities, the Kenya Institute of Management (KIM), the Kenya Association of Manufacturers (KAM), the Kenya Institute of Administration (KIA), the Federation of Kenya Employers (FKE), and the Government Training Institute (GTI). All these training facilities are organized under one umbrella organization called the Kenya Trainers Association.

Big companies usually have their own training programme for management training. Training is also offered by major suppliers of equipment such as International Business Machines (IBM) for computer systems or suppliers of services like Price Waterhouse and others.

KIM is the biggest of these training institutes. It is a private organization started in 1954 by a number of private companies to improve the standard of managers in the country's business enterprises. Special emphasis is put on training people at middle manager levels, a category of managers which needs urgent improvement in Kenya.

Courses are held for all levels of managers and supervisors in a company. A new point of departure is training for entrepreneurs for the small-scale business sector; this training is intended to give assistance to people who have started a small business or who are about to start up a business. KIM can also provide financing for training as well as loans for starting up a

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1/ Investment Promotion Centre, Investors Guide to Kenya, May 1989.

2/ Caltex 12 January 1990.

3/ Ceramic Industries (E.A) Limited, 12 January 1990.

small business. KIM has a particularly interesting training programme for small business. The programme is called PROT which stands for Problem Oriented Training. This facility can be used for small companies that have wound up in trouble. This is a sort of advisory service. KIM has access to approximately 2,000 managers within different fields and specialities who can act as teachers and advisers.

The management training usually consists of evening courses where three levels of examinations can be obtained. This particular section of the institute is intended to be the core of a future business school.

KIM is also collaborating with foreign training organizations such as GOPA-Consultants in the Federal Republic of Germany. GOPA-Consultants has one representative, Dr. Ralph Engelmann, working on a full time basis with the small business training programme at KIM. From the UK, Kim has obtained an aid package intended for training purposes.

Training in the use of computers within the various sections of a business such as Management Information Systems, will soon be available in the institute when the necessary computer systems have been acquired.

The training offered at the institute is mainly for KIM's own members while for instance, public or governmental companies have their own training facilities for their managerial staff (see below).

Kenya Association of Manufacturers collaborates with the Kenya National Chamber of Commerce for training that is mainly geared towards problems concerning export, shipping, customs tariffs and so on. That training is mainly intended for members of KAM and the Kenya National Chamber of Commerce.

Kenya Institute of Administration is giving courses mainly to senior government officers and employees of parastatal companies. The Government Training Institute in Mombasa is providing the same type of training as KIA but for lower level managers. Both of these organizations are co-ordinated under the Directorate of the Personnel Management Department of the Office of the President.

The Federation of Kenya Employees is an organization offering management training in collaboration with ILO, from which they obtain funds.

All mentioned training organizations co-operate when necessary and when their training programmes complement each other.

The training offered by the various institutions mentioned above appears, in the mission's opinion, to be of a high standard and performed by professional staff. However, there are certain deficiencies with regard to training in Management Information System. This is now given highest priority within KIM and computers and associated software are being purchased.

2.3.2 Human resource development[1/]

Kenya's formal industrial training system has steadily developed since its inception in the early 1970s. The Industrial Training Act was enacted by the Kenyan government in 1970 "to make provisions for the regulation of the training of persons engaged in industries". The Act was to establish training schemes under the Directorate of Industrial Training (DIT) which was established in 1971. In the same year the National Industrial Training Council (NITC) was created under the Act and an Industrial Training Levy was established.

DIT and NITC are the two basic establishments under the Industrial Training Act. NITC is the body which implements policy and makes final decisions and approvals. It has authority to approve new Training Schemes and Levy Orders. DIT is responsible for: 1) the provision of training programmes and facilities for industry in both the private and public sectors, 2) the administration of the Levy Fund, and 3) the Curriculum Development, National Co-ordination and Technical Support System.

The objective of government training policy is to improve the quantity as well as the quality of industrial training, and also to ensure that firms share training costs equally and to promote training in the private sector. There are two main bodies within the training system responsible for implementing government policy towards industrial training: the NITC and the Industrial Training Levy Fund.

NITC, which is a legislative body, has divided the country's training needs into 11 industrial sectors,[2/] and with an Industrial Training Committee (ITC) for each sector. Each ITC has a technical sub-committee which is supposed to identify the training needs of industry. In addition, another ITC is established specially to develop management training. Each of these three bodies in the hierarchy has tripartite representation from DIT, Trade Unions and Federation of Kenya Employers.

1/ This section draws heavily on information provided in Irmgard Nubler, "The Formal Industrial Training System and Policy in Kenya", Working paper No. 444, Institute for Development Studies, University of Nairobi, September 1986.

2/ Eleven industrial sectors identified by the Industrial Training Act are as follows: Motor Engineering, Transport and Allied Industrial; Banks and other Financial Institutions; Textile and other Allied Industries; Saw Milling, Timber, Furniture and Allied Industries; Food Processing and Allied Industries; Printing, Publishing, Paper Manufacturing and Allied Industries; Engineering and Allied Industries; Chemical Manufacturing, General Processing and Allied Industries; Commercial, Distributive and Allied Trades and Industries; Plantation, Agriculture and Allied Industries, Building, Construction, Civil Engineering and Allied Industries.

An important instrument of the government's training policy is the Training Levy Fund. This Fund was set up for each of the 11 industrial sectors and ITCs. Each firm registered in the Fund is obliged to pay a levy according to a formula specific to the industry of which it is a part. Reimbursement for some of the training costs is given for approved in-plant and in-centre training programmes. The Industrial Training Levy covers systematic and formal training within the modern formal sector. The levy system intends to promote the training in firms and to give firms more responsibility for the development of skilled manpower. Therefore, all trainees in the approved training programmes have to be sponsored by employers.

In 1979 with the assistance of UNDP/ILO, the Kenya Integrated Training System (KITS) was developed. KITS embraces all industrial training, the principal components of which are:

- the Indentured learner system (operatives)
- the Craft Apprentice system (skilled workers)
- the Technician Apprentice system (technicians and supervisor)
- the system of National Trade Tests
- institutional training (national training centres, technical schools, Polytechnics, Kenya Textile Training Institute (KTTI))
- KITS training materials
- other learning materials

An important recent study has examined the quantity and quality of training by the number of companies and of trainees in seven selected industrial sectors.[1/] Of 2,889 companies registered at DIT in the seven sectors, a mere 474 companies have been involved in formal industrial training in the period of 1979-1985. This implies that the training levy fund is not giving most of the companies an incentive to train their employees. Many companies consider the levy simply as a tax. Small-scale companies which sent their employees for training were disturbed by the delay of refund due to the shortage of funds. As many large-scale firms have their own training system, they do not have to use the government facilities.

In the period of 1979-1985, the number of trainees in the seven sectors was 12,158, out of which only 3,432 (28 per cent) received technical training at the craft and technician levels, the original target group for the training system. During the period 1983-1985, most of the training given was for management training. Since management costs are very high, companies took advantage of the levy fund.

The distribution of the levy fund also has a problem in that only a handful of large-scale companies have received significant refunds, while small-scale companies with less than 50 employees received, an average, only 5.4 per cent of the refund.

In sum, the nature and scope of industrial training in Kenya needs to be examined to streamline operations, speed-up reimbursement of training costs, and to give additional incentives for firms to offer appropriate industrial training.

1/ Irmgard Nuber, op. cit. 1986.

2.4 Industrial policy

The sluggish rate of growth in the exports of manufactured products has been of major concern to the Government. In recent years investments in the industrial sector appear to have been negative. Kenya's industrial policy seeks to increase foreign and domestic investments in industry. During the last decade, there has been a successive shift in emphasis towards relying more on private as opposed to public investments in industrial development. The strengthened role of the private sector in Kenyan development is further discussed in section 2.5.

Policy changes have been introduced to provide incentives to increase exports of manufactured products. In this regard, a package of policy measures have been implemented and new measures will be introduced within the next few years (see section 2.7). A review of some of the major policy changes would suggest that a significant improvement in the enabling environment is taking place.

A cumbersome import licensing system is still in effect in Kenya. Depending on the availability of foreign exchange, import licenses have been granted according to a pre-determined list of priorities. The declared policy is to rely less on quantitative restrictions and more on the exchange rate and tariffs. As a first step, the list of goods which can be imported with few restrictions has been increased (from 803 to 1,121 items between 1984 and 1987).

Often, the Government has, however, relied on quantitative import restrictions when foreign exchange reserves have dwindled. Policy alternatives such as using the exchange rate, reducing domestic demand and absorbing liquidity in the economy have not yet been fully explored. One of the key tests for the credibility of the new policies will be the successful liberalization of imports.

There are uneven and high levels of protection. Inefficient producers are shielded from competition and efficient producers can charge undue high prices to consumers. Measures have been taken to rationalize tariffs so that similar goods bear similar tariffs. The number of tariffs has been reduced from 25 to 12. A further step will be to reduce the rate of protection. The latter policy change is subject to discussion among policy makers. Although the official policy is to reduce protection to foster competition, others claim that potentially efficient companies will be liquidated.

There has been little, if any growth, in exports in manufactured products. The high protection provided through the import licensing system, and through the tariff structure has made production for the domestic market more profitable than exporting. Moreover, high tariffs on imported inputs and an over-valued exchange rate made many Kenyan products uncompetitive in world markets. In 1974, the Government established the Export Compensation Scheme by which eligible exporters receive a compensation. In 1984, this compensation was raised from 10 to 20 per cent of the export value. At present, the Government of Kenya is introducing a system by which import duties will be reimbursed for exports. Plans are well advanced to establish Export Processing Zones (EPZ). A manufacture under bond scheme for the export market allows duty free imports as well as exemption from the sales tax.

Prices for a wide range of manufactured products are controlled by the Government. In 1987, the prices of 11 basic foods and beverages and of 40 manufactured goods were subject to price control. Since then, the range of price controls has been reduced and further liberalizations have been announced.

Taken together, these policy changes should greatly improve the enabling environment for future industrial growth. However, there is still a certain ambiguity in industrial development policy. Too often the implementation of policies bear little resemblance with stated intentions. This ambiguity has to be removed, since potential private investors carefully assess the investment climate. Liberalization of capital flows in the world market also has repercussions in Kenya. Today, international capital moves freely in the world market, and stated policy intentions must be substantiated. The development problems of Kenya have been eloquently stated in government plans and documents. The Government has recognized the need for a significant increase in the flow of capital to Kenya. Important steps have been taken towards implementing this objective and should pave the way for a continuation along this reorientation of development strategy.

2.5 Strengthening the role of the private sector

Since Independence, policy planners have sought to keep Kenya a mixed economy, wherein Government and the private sector play specific and complementary roles.[1/] Although the private sector has played an important role in the Kenyan economy, the government predominates, through direct participation, as well as indirectly, in productive enterprises and marketing channels.

Through the International and Commercial Development Corporation (ICDC), Development Finance Company of Kenya (DFCK), The Kenya National Chamber of Commerce and Industry (KNCC), Industrial Development Bank, Ltd. (IDB) and other Development Finance Institutions (DFIs), the Government holds controlling or dominant ownership shares in a large number of enterprises. The Government's portfolio includes more than a hundred industrial companies - 38 parastatals and minority holdings in 66 industrial enterprises. Most of the majority holdings are in textiles, sugar refineries, and cement production.[2/]

The Government exerts strong influences on many enterprises, especially food manufacturing and textile industries, directly through numerous marketing boards, which buy commodities from primary producers and distribute to manufacturers, and on terms of purchase and sale that are set by the boards. The many complaints by managers of enterprises about supplies and prices demonstrate that the terms are not efficiently determined. The marketing boards include: the Coffee Board, Tea Board, Sisal Board, Pyrethrum Board, National Cereals and Produce Board, National Irrigation Board, and the Cotton

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1/ Sessional Paper No. 10 of 1965 on African Socialism and Its Application to Planning in Kenya.

2/ UNIDO, Regional and Country Studies Branch, Kenya: Sustaining industrial growth through restructuring and integration, Industrial Development Review Series, Vienna: United Nations Industrial Development Organization, June 1988, pp. 22-23.

Board. Besides control from these marketing channels, the structure and performance of the manufacturing sector is shaped by the Government's administration of the Kenya Railways, Kenya Post and Telecommunications Corporation, and the Harbours Authority.

Although the financial rate of return of 7 surveyed parastatal enterprises was good (at 15 per cent) in a 1986 World Bank survey, private sector enterprises showed rates of return that were significantly better (at 20 per cent). It should be pointed out that the rate of return on parastatal enterprises is more easily attainable because they are operated behind a higher protective barrier - an effective rate of protection of 184 per cent versus 60 per cent for the private sector firms. Moreover, negative rates of return have been recorded for the parastatals, which dominate the sugar and textiles industries.1/

A number of firms in the public sector are in a poor financial state. They are operating at low levels, due to insufficient working capital, and they have contracted heavy debts, which are beyond their means to service out of operating profits. Some are allowed to default for long periods on their debts because closure of the firms would create difficult problems of unemployment. Several enterprises have been kept in operation under receivership for a long period in order to avoid the consequences of closure.

Because of poor performance of the parastatal investments in manufacturing, the portfolios of the DFIs are under review for evaluation of the strategic importance and classification of each parastatal. The enterprises are classified according to need for rehabilitation or restructuring, the need for divestiture, as well as the need for retention. Clearly, though not yet explicitly, the decision-makers are moving toward a lower degree of government involvement in manufacturing primarily through privatization and through promotion of private sector investment by African-Kenyans and foreign investors.

The recommendations and assistance given by the World Bank in Kenya's structural adjustment programme support privatization of industry. In the same direction, the government will limit its initiatives to those activities that cannot be fulfilled by the private sector.

The direction of these changes to reduce the role of government and to leave more of the market economy to the private sector is not new. Past development plans, especially the fourth plan, emphasize the government's intention to strengthen the private sector. The steps taken to liberalize imports by rationalizing custom duties and import classifications within three schedules are evidence of the Government's commitment to strengthen the private sector. For similar reasons the Government has introduced the Foreign Investment Protection Act, the Investment Promotion Centre, the Kenya External Trade Authority, and recently the Restrictive Trade Practices, Monopolies and Price Control Act.

1/ Ibid.

These actions and policies are driven by the urgent need to reduce the increasing numbers of unemployed in the labour force and to reduce the deficit in the merchandise trade balance. These problems have been nurtured in the environment of parastatals and government controls. Employment and export earnings are not growing fast enough. Consequently, the Government is moving to improve the enabling environment for the private sector to grow, creating more jobs and exporting more.

The current development plan, for 1989-1993, departs from previous plans that have been oriented towards sectors and projects. This plan presents a strategy to return to a stable growth path along which real income per head increases, employment grows, production diversifies, and everyone participates in the development.

The first priority is to create productive employment for nearly two million new entrants to the labour force between now and the year 2000. This growth will be generated by agriculture and industry, including small-scale enterprises. The next priority is greater foreign exchange earnings, followed by increased expenditure from the private sector on basic needs services. In these efforts, the government will provide policy and operational support to the private sector, while looking after the natural environment. The private sector will be given a greater role in the economy, as well as being given access to the necessary technical and financial resources.

The major pattern of development objectives for the economy from the present to the end of the century, shows modest contraction of public sector participation in production and great expansion of the private sector, measured in terms of capital investment, employment, output, and exports.

For this pattern of objectives to be achieved, the government must not crowd out the private sector from access to financial resources for investment. Domestic financing of the government budget must be reduced. Private sector savings are about 20 per cent of GDP, while private sector investment is about 12 per cent of GDP. The private sector is contributing to financing public investment and part of government consumption. The government deficit, and possibly investment, must be reduced, releasing funds for investment by the private sector, in order for the private sector to fulfilled its new mandate to create jobs and exports.

2.5.1 Support to small- and medium-scale enterprises (SMEs)

The current Development Plan recognizes that small-scale enterprises and the very small economic activities (jua kali enterprises) have been insufficiently exploited in the past. The neglect is to be redressed so that they can make a crucial contribution to meeting the national targets for employment and income generation, as established in Sessional Paper No. 1 of 1986.

The Government intends to support smaller enterprises by establishing an appropriate enabling environment. The environment will be "firmly rooted in policy restructuring and liberalization covering the pricing structure, trade regime liberalization, foreign exchange management, wages and investment policies and financial restructuring."[1/]

1/ Republic of Kenya, Development Plan 1989-1993, Nairobi, p. 165.

The Plan states that the Government intends to encourage the sector by amending rules and regulations in order to reduce constraints that are presently proportionally heavier on smaller firms. These constraints include administrative procedures for obtaining various business, trade, and import licenses, and other constraining requirements, such as compliance to building codes.

The Government intends to support and promote the dissemination of information, upon which rational business decisions must be made. The Ministries of Foreign Affairs, Technology and Research, Labour, Manpower Planning and Development, and Information and Broadcasting will be channels for bringing new knowledge to this sector of entrepreneurs. The information will be related to markets for materials, products, and technology.

Besides review and amendments to rules and regulations, as already mentioned, the Government intends to set up Small-Scale and Jua Kali Business Allocation Boards at the level of districts for the allocation of land. Financing will be a focus in review of the network of NGOs that assist the jua kali or micro- enterprise sector. ICDC and Kenya Industrial Estates (KIE) will continue to support medium size businesses in their financial needs. The Co-operative Bank will be expected to take a greater interest and provide more help.

The Plan also calls for the Capital Markets Development Authority to formulate and implement means to assist the smaller enterprises to expand their capital bases. Complementary to this effort will be new initiatives by the government to bring together Kenyan and non-Kenyan entrepreneurs in partnerships. Efforts will be made to see that skills are transferred in such partnerships in the normal procedures of business. In-service training, workshops, and seminars will be encouraged.

While most of the details for government support to the small- and medium-scale sector are yet to be devised, the current development plan shows the Government's concern for the sector and intentions for renewed efforts to support it. For the present, the various financial institutions, training institutes, and NGOs will be the dominant support.

2.6 Strengthening the role of the institutions involved in industrial development and regeneration

A great number of public institutions as well as private organizations are involved in the promotion and regeneration of industrial development in Kenya.

From the point of view of industrial development, government institutions involved in promoting industrial development suffer from a number of shortcomings.

There is insufficient co-ordination, and sometimes outright competition between Ministries and agencies that are partners in a project or in the execution of a policy.

Both foreign and private investors have complained about the time delays in obtaining necessary official approvals and also about the arbitrariness of decisions. The Government is conscious of these deficiencies and important steps have been taken to change this state of affairs. For example, the liberalization of imports is one such important step.

Besides establishing policies and regulating the industrial sector, the Government through its agencies is directly allocating investment funds and credits for the sector's development. A number of DFIs exist and the public sector has ownership in a large number of enterprises. These institutions affect Kenyan development in various ways. Scarce resources are channelled through them to promote development and it is in the country's interest that the companies are operated efficiently. The DFI's have been criticized for having low returns on their investments due to the poor portfolios. Because of lack of clear objectives, the roles of these institutions need to be better defined.

Parastatals have been criticized because of weak management. The ultimate responsibility falls on the Board of Directors which designates the managing director. A board of directors of a company should reflect the interests of the owners. In case of public enterprises, the owner is the State of Kenya and the Directors have to make sure that the companies are operated in a commercially efficient way. Moreover, at times, social, as different to commercial considerations have to be taken into account as well when making decisions. For example, in setting prices a state monopoly should not use its market position to reduce output to increase profits, or social reasons may be so compelling that a low rate of return can be accepted.

However, too often, company objectives are not clear, with the result that company management cannot define the business strategy of the company or even present yearly business plans. Appointments of Boards of Directors, and subsequently General Managers, have not always been guided by the principle of finding competent personnel to secure efficient and profitable production in the companies.

The role of the public sector in industrial development needs further clarification. As was mentioned in Chapter 1, the present trend is that the Government will let the private sector perform most productive functions. However, in the case of industrial development, the Government needs to provide needed infrastructure, such as telecommunications, supply of water and electricity. Although there is ample evidence of poor performance of parastatals in both developing and industrialized countries, there are also examples of efficiently operated companies. To the extent that the Government of Kenya wishes to retain ownership in strategic enterprises, their economic performance must be strengthened.

A major part of the industrial sector is related to agro-industries. Such industries are strategic to Kenyan development. Such industries involve not only the Ministry of Industry, Finance, Development but also the Ministry of Agriculture. Adequate infrastructure facilities are essential for agricultural development. Increases in Kenyan exports will largely be in the form of processed agricultural goods. A comprehensive approach to agro-industrial development is needed and complementary public institutions to support this development are also required.

2.7 Improving the macro-economic environment

2.7.1 Control of public finances

Three major issues emerge concerning the control of public finances: the size of the budget deficit; the increase in government employment while non-wage recurrent expenditures decrease; and how and whether deficits crowd out private investment in Kenya.

The Government's fiscal status deteriorated between fiscal years 1984 to 1987 and thereafter improved slightly (see section 1.1.3). "The overall cash deficit (including grants) increased from 3.9 per cent of GDP in FY84 ..... to 5.4 per cent in FY86" and 4.6 per cent in FY89.[1/] Total government expenditures as a per cent of GDP also rose from 34.5 per cent in 1984-85 to 39.4 in 1988-89.[2/] Though difficult, the Government has tried to increase its revenue by improving tax collections and imposing some cost-sharing upon beneficiaries of public health and education services.

Expenditures, especially for labour costs, have been hard to restrain. The share of labour costs including transfers to the Teachers' Service Commission increased steadily from 60.5 per cent of recurrent expenditures in 1980-81 to 70.6 per cent in 1986-87 and then fell to 66.3 per cent in 1987-88.[3/] As a result, real non-wage recurrent expenditures per civil servant declined by nearly one-third (32.5 percent). This trend has quite worried the Government:

Unless a better balance between personnel costs and complementary outlays is achieved, the productivity of many branches of government will fall below acceptable levels. Eventually, many services may cease to be offered at all, while officers continue to draw salaries.[4/]

Each Ministry now has an employment ceiling to help restrain personnel expenditures. Employment in the central government declined 1.4 per cent in 1988, though overall public-sector employment, including teachers, has been increasing by 5.0 per cent per annum between 1986 and 1988.

The pressures to expand educational opportunities have been especially insistent. Introduction of the 8-4-4 educational system and several yearly double in-takes of students into an increased number of universities "caused the share of education in the recurrent budget to rise to 38 percent."[5/]

1/ Republic of Kenya (1989) Economic Survey 1989, Nairobi: Government Printer; World Bank, Country Operations Division, Eastern Africa Department, Africa Region Kenya: Recent Economic Developments and Selected Policy Issues, Washington, D.C.: World Bank, 1988.

2/ Republic of Kenya, op. cit., 1989, p. 63.

3/ World Bank, op. cit., 1988, p. 47.

4/ Republic of Kenya, Economic Management for Renewed Growth. Sessional Paper No. 1 of 1986. Nairobi: Government Printer, p. 32.

5/ Republic of Kenya, Development Plan 1989-1993, Nairobi: Government Printer, 1989, p. 61.

The Government and the World Bank have both been concerned lest the large loans to Government crowd out private investment.

Although the proposition about crowding out is still being hotly debated, there is some rather mixed evidence to support this conclusion. For example, the change in credit extended to the government soared from Kt 42.5 million in 1984 to Kt 265.9 million in 1985 - the worst year - while the change in credit to the private sector rose from Kt 123.5 million to Kt 165.5 million. Two years later, when lending to the government decreased by Kt 86.4 million, credit to the private sector soared, growing by Kt 251.3 million in 1988 as against Kt 150.2 million in 1987. Though lending to the private sector and to the government may be correlated, the relationship is not unequivocable. For example, the World Bank's recent report on the manufacturing sector in Kenya states that "In addition to forced bank lending to the Government through the liquid assets ratio, there is evidence of a very small government crowding out effect on the supply of credit to the private enterprise sector (emphasis added)."[1/] Moreover, though fixed investment shrank to its nadir in 1985 - 17.4 per cent of GDP - it climbed back to 22.8 per cent in 1988 while gross investment equalled 29.8 percent.[2/] These are not bad levels, although investment is funded increasingly by foreign savings (13.7 per cent in 1985, 31.2 per cent in 1988). To know the urgency and appropriateness of governmental policy reforms, clearer evidence is required to verify and measure crowding out. This evidence is not yet available but may be forthcoming.

A far less debatable proposition is that the Government should use its resources more efficiently, strategically focused to boost productivity throughout the economy, for example, through expenditures for research and development, needed training, export-market research, and communication and transport networks.

2.7.2 The currency and foreign-exchange-rate regime

The Kenyan Central Bank authorities maintain a managed peg of the Kenya shilling to the currencies behind the IMF's Special Drawing Rights by using weights reflecting Kenya's pattern of trade with those countries. In addition to the exchange rate, the Government also imposes import licensing procedures to ration foreign exchange according to priorities embedded in three schedules, ranging from nearly automatic to severely restrained imports. Though overpricing of imported inputs and underpricing of exports is a major conduit for illegal transfers of funds abroad, the Government merely relies on General Superintendence Corporation and Veritas to check the value and newness of most imports, but not exports. The Government has not tried to train and institute local capacity to check even high-value, fairly homogeneous imports.[3/]

1/ See World Bank, op. cit., 1987, p. 143.

2/ World Bank, op. cit., 1987, p. 101.

3/ Coughlin, P. and Ikiara, G.K., Industrialization in Kenya: In Search of a Strategy, Nairobi: Heinemann; London: 1988 pp. 133, 142, 244, 246, 274, 280, 300.

Kenya's terms-of-trade and foreign-exchange earnings fluctuate widely, mostly due to big variations in international prices for coffee and tea. Instead of using strongly counter-cyclical monetary and fiscal policies, the Government allows most of the changes in international prices, minus distribution costs, to be passed on to the farmers. Consumption, investment, and imports surge and later drop. When export earnings fall, the authorities tighten non-tariff import controls and only marginally increase the exchange rate.

These big swings in trade policy make long-term investment planning difficult and risky and may discourage export diversification. Especially since the Central Bank's premiums for forward foreign-exchange contracts is prohibitively expensive (about 2 per cent per month), investors cannot rely on the availability and price of foreign exchange and imported inputs and, hence, the relative profitability of different economic sectors.[1] Even the existence of the export-compensation scheme is not assured. For example, early in 1983, the Government suddenly suspended the scheme for three months. Many Kenyan exporters lost big sums on contracts concluded long before. Stung, many were very reticent to resume importing. Years passed before they tried again. Having learned from this experience, the Government resisted pressure from the World Bank to change radically the export compensation scheme to a three-tier system in 1989. But in other ways, the large expansions and contractions due to export booms still whipsaw the domestic economy.

Though the Foreign Investment Act guarantees foreign investors the right to repatriate all their profits, they have often encountered long delays. Previously, investors had to deposit their profits in low interest frozen accounts while awaiting foreign exchange, sometimes for years: now, they are permitted to invest in deposit accounts at market interest rates. The Government is now trying to speed up the allocation of foreign exchange for this purpose.

Since 1982, the Government has gradually, but increasingly devalued the shilling's real exchange rate. Despite a reversal in 1984, the real exchange rate had devalued nearly 22 per cent by 1987.[2] The Government seems committed to continue this trend, making Kenya more attractive to tourists and promoting import substitution and exports.

1/ World Bank, Industrial Development and Finance Division, Eastern and Southern Africa Region Kenya: Industrial Sector Policies for Investment and Export Growth. Report No. 6711-KE. Washington, D.C., World Bank 1987, p. 125.

2/ World Bank, op. cit., 1988, (Table 3.7), p. 87.

2.7.3 Pricing policy

Government policy affects prices in many ways through direct price controls, value-added taxes (formerly, sales taxes), tariffs, non-tariff barriers, export compensation, inflation, and direct and indirect controls on real wages.

Price Controls

The Government has steadily decreased the number of price-controlled items. Even meat is no longer price controlled. Due to political exigencies, the Government does regulate the prices of a few popular necessities, for example, rice, maize meal, sugar, sodas, galvanized steel roofing sheets, and beer (except in high-class bars, restaurants and clubs).

The new Monopolies and Price Commission within the Ministry of Finance oversees prices and, as mandated, should curtail business practices that restrain trade and competition. However, the Monopolies and Price Commission is experiencing opposition from business circles. This opposition may reduce its future effectiveness.

Sales Taxes

In the past, many firms, especially small ones, wholly or partly evaded paying the 17 per cent sales tax. This gave them a big competitive edge if the large firms in their industry could not so easily escape paying taxes. Though, starting February 1990, the sales tax will be changed into a 17 per cent value-added tax, the implicit subsidy for certain dishonest or small firms continues.

Tariffs and non-tariff barriers

For various Structural Adjustment Programmes, the Government has promised to switch non-tariff barriers into their tariff equivalents, lower the level of protection, and make tariffs more uniform. Though this has occurred for many products, overall the pattern is less clear. Between 1978 and 1984, the average nominal tariff rate increased from 29.5 per cent to 41.0 per cent.[1/] But a World Bank study during the third quarter of 1986 found that the average nominal rate of protection was 34 per cent; and the effective rate of protection averaged 89 per cent, though with wide variations between industries.[2/]

1/ Sharpley, J. and Lewis, S.R. Jr., "Kenya's industrialization, 1964-84." Discussion Paper No. 242, (Table 9), IDS (Sussex), 1988.

2/ World Bank, op. cit., 1987, p. 52.

Although the rate of effective protection in Kenya's industrial sector is not excessive by the standards of many developing countries that have followed an import-substitution development strategy, it is nonetheless high and the most serious distortion in the economy's incentive structure.[1]

The Government is presently implementing a manufacturing-under-bond (MUB) scheme for investors willing exclusively to export their output. Such firms will get imported inputs tax free; and the import licensing will be quick. Using clout derived from an inter-ministerial cabinet-level subcommittee formed specifically to overcome the obstacles to foreign investment, the newly single-stop Industrial Promotion Centre expedites approvals for foreign investments, now within a month. By late January, the Centre had received 50 projects; of those nine, including four manufacturing-under-bond, were operating. Thirteen MUB projects had been approved. Appointed in mid 1989, the Centre's Director - formerly the executive director of the Kenya Association of Manufacturers - moved with alacrity to employ dedicated personnel and set up a system to help investors. The Centre apparently has strong, serious support from very high within the Government. This bodes very well for Kenyan manufacturing.

The notorious, widespread smuggling of consumer goods may spur discrimination against local production if, as suspected, material inputs used to locally manufacture those goods cannot escape paying tariffs so easily. Since consumer goods - textiles, shoes, tiles, and so on - come in bulk, sent by multitarious traders, whereas manufacturers' material inputs often come in small lots from major overseas exporters, tax evasion may be easier for finished consumer goods. Thus the differential permeability of the import cordon can impede the second stage of import substitution. However, corruption by the custom's authorities can turn protection into an illusion, or worse, its opposite. The problems of corruption among the ports and customs authorities is an area that must be urgently addressed by the Government.

Export compensation

The Government pays compensation - 20 per cent of the f.o.b. value - to exporters of approved items with at least 30 per cent local content. Nevertheless, due to the high import content of most manufactured exports, the net extra incentive to export is little for many products after subtracting tariffs paid directly and indirectly on inputs used to make the exported item. Moreover, most payments go to just two large multinational companies exporting pineapples and cement. Red tape and delays of four to five months in receiving the payments have for long reduced the programme's effectiveness. The list of eligible items was slashed to about 700 items in 1988 to help government speed up the payments. Some manufacturers do report an improvement, but no systematic survey exists.

In early 1988, the World Bank tried to get the Government to switch to a multi-tiered export-compensation scheme with each tier set to offset approximately the value of the export's imbedded tariffs. Fearing the revised scheme would cause a bureaucratic nightmare - many appeals about detailed financial calculations - the Government and, eventually, the World Bank backed away from the proposal.

1/ World Bank, op. cit., 1988, p. 28.

Inflation and real wages

After historically high rates of inflation during the early 1980s, the Government held inflation to less than 12 per cent (Table 2.6). Real wages fell about 13 per cent between 1980 and 1988. This increased the competitiveness of Kenyan manufacturers in the world market and against imports.

Table 2.7: Changes in annual rates of inflation and changes and in real average earnings, 1980-1988

(percentages)

	1980	1981	1982	1983	1984	1985	1986	1987	1988
Change in consumer prices	11.3	24.8	18.3	10.1	11.0	11.5	5.8	10.0	10.7
Change in real average earnings	0.9	1.2	-12.5	-6.9	0.7	-1.5	3.0	0.1	1.9

Source: Republic of Kenya, Economic Survey (various years), Nairobi: Government Printer.

2.7.4 Credit and interest rate policies

For manufacturing, the important aspects of the credit system are: the tendency of Commercial Banks to extend mostly short- and medium-term finance; the lack of sectoral priorities by the development finance institutions (DFIs); the failure of DFIs to roll their loans over to fund new investments; the inability of many DFIs to offer funds free of significant foreign-exchange risks; the prohibitive expense of the Central Bank's futures contracts for foreign exchange; and the absence of long-term export credit financing.

Lending policies by financial institutions are very conservative and biased against all but the largest manufacturing enterprises.

> In general, Kenyan commercial banks will not extend term loans for more than three years. Moreover, such loans have to be backed by collateral whose marketable value exceeds the face value of a loan by a considerable margin (often 150 percent) ..... Banks have become increasingly reluctant to accept land deeds as collateral because of the long-time lags involved in actually gaining possession. Because of these strict collateral requirements small and medium sized firms [which] usually have little equity backing are rationed out of the loan market, with the vast majority of loans going to large prime domestic borrowers.[1/]

The non-bank financial institutions' demands for collateral are also stiff; and most of their loans are for only two or three years.[2/]

1/ World Bank, op. cit., 1987, p. 141.

2/ Ibid., p 148.

The allocation of credit shows little evidence of being guided by a development strategy stressing the need to fill gaps in the nation's industrial structure. Aside from a weakly enforced, poorly defined Central Bank requirement that at least 17 per cent of each bank's loans must help agriculture, there has been no effort to steer investment into priority sectors. The DFIs passively wait for project proposals to be brought to them for evaluation and finance. In the years since independence, the DFIs have not gradually tunneled more funds into industries producing intermediate inputs or capital goods.[1] The DFIs have a nearly frozen portfolio with a few very profitable firms subsidizing massive losses by others. The DFIs have failed to roll over their assets by starting a firm and then selling it after a few years in order to fund new projects. This has limited the DFIs' developmental impact.

The DFIs, especially the Industrial Development Bank, have too much foreign exchange to lend, but with no ability to cushion a borrower's foreign-exchange risk. Many borrowers have been hit very hard by the recurrent devaluations of the shilling and have become very reticent to borrow foreign currencies. Presently there is no reasonable solution for manufacturers since the Central Bank's forward contracts for foreign exchange sell at a prohibitively expensive premium. The government is now discussing ways it can partly absorb this risk. The absence of long-term export-credit financing is a related problem that stymies exports, especially since foreign suppliers often get a competitive advantage by being able to offer long-term financing to prospective importers.

2.8 Potential for economic co-operation and development

Kenya participates in three major trade agreements: the Preferential Trade Area Agreement (PTA), the Lome Convention, and the General Agreement on Tariffs and Trade (GATT).

Preferential Trade Area Agreement

The PTA with 16 members is a major initiative to divert to and create trade among southern and eastern African countries.[2] It aims to gradually eliminate tariff and non-tariff barriers within the region. Despite having signed the agreement, many countries are hesitant to implement its provisions. The persistently large trade surpluses by Kenya and Zimbabwe cause the weaker economies to question whether, overall, their manufacturing sector will benefit by getting supplies from within the PTA (Table 2.7). These doubts have inspired some to delay publication of their Common Lists detailing the reduced tariffs applicable to eligible imports from within the PTA. Others do not pay their own exporters export compensation if the PTA Clearing House is used since the net payments between countries are cleared only every two months.[3]

1/ This conclusion is derived from an unpublished statistical analysis by Barbara Goetz made available to the mission of the allocation of equity and loan finance by the Industrial Development Bank, Industrial and Commercial Development Corporation, and Development Finance Corporation of Kenya between 1965 and 1983.

2/ See section 1.3.2 for listing of members.

3/ Hall, S. 1987. "The Preferential Trade Area (PTA) for eastern and southern African states: Strategy, progress, and problems" IDS (Nairobi), Working Paper No. 453.

Although doubts about the benefits of intra-PTA trade hinder regional co-operation, the Kenyan Government has not yet officially recognized that it should adjust its policies and institutional procedures to be more receptive to imports from other PTA countries. A long-term vision of the region's potential and how to achieve it is required. Petty mercantilism emphasizing selling but not buying will only brew discontent and frustrate the region's, including Kenya's, potential. As manufacturing slowly develops within the region, forces will build opposing bureaucratic and chauvinist impediments to realizing economies of scale achievable with specialization.

Spontaneously, some trading houses have been trying to facilitate trade through countertrade and triangular deals. But this has been hard. The Central Banks generally do not have standard, easy procedures to approve two-way trade deals requiring minimal foreign exchange. The custom authorities are not set up to permit duty-free imports for processing and onward export even when the input-output relations would allow little measurement-error. Even dies, moulds and patterns cannot move easily between countries so as to use excess capacity better.

A significant problem is the inadequacy of the region's transport infrastructure. Eastern Africa does not have a regional organization like the Southern Africa Development Coordination Conference (SADCC) that focuses on building up the region's infrastructure. Moreover, a special problem for Kenya has been the steady deterioration of the services in Mombasa port. This has led some freighters to divert trade to the port at Dar es Salaam.

Another immediate problem with the PTA was the requirement that only majority locally-owned firms could be eligible for the reduced PTA tariffs. This stricture was slackened temporarily for five years, but many foreign-owned firms in Kenya will be disadvantaged if the clause ever comes into full force. Still, the pressures to increasingly localize the ownership of manufacturing in Kenya may be attractive to Kenya's long term development.

Table 2.8: Kenyan trade within the Preferential Trade Area, selected years, 1979-1987

(K£'000)

	1979	1981	1983	1985	1987
Exports					
Domestic	65.5	108.5	124.7	135.7	140.3
Re-exports	10.6	9.7	8.5	9.5	16.8
Total	76.1	118.2	133.1	145.3	157.1
Imports	10.2	13.9	14.3	24.6	35.2
Ratio: Exports/imports	7.5	8.5	9.3	5.9	4.5

Source: Republic of Kenya. Statistical Abstract 1988. Nairobi, Government Printer, 1988, p. 52.

Lome Convention

Along with other countries from Africa, the Caribbean, and the Pacific, Kenya is a member of the Lome Convention for aid, co-operation, and trade with the European Economic Community (EEC). They get preferential access to the EEC market and nearly all industrial products are exempt from duty. Though their exports are not supposed to suffer quantitative restrictions, some restrictions, especially through the Multifibre Agreement, do apply. Firms from countries which have exhausted their textile quotas are beginning to set up stitching operations manufacturing under bond in Kenya so as to sell more cloth into the EEC. As yet, no quota has been imposed on Kenya; and Kenya enjoys preferential access to the EEC market.

General Agreement on tariffs and trade

Along with other less developed countries (LDCs), Kenya benefits from the generalized system of preferences (GSPs) programmes of different countries and economic zones. The GSPs allow LDCs, including Kenya, lower tariffs and preferential access to markets for most manufactured products. GSPs reduce the margin of special preference that some developed countries grant subsets of LDCs so as to maintain special historical and economic links. But often a GSP is restricted to exclude certain products, for example, textiles or shoes. These restrictions and the very underdevelopment of most LDCs means that, in practice, the more advanced LDCs benefit most. For example, the EEC's "GSP scheme had eroded the tariff advantages which would be enjoyed by the ACP over other developing countries."[1/] When discussing GSPs, Kenya usually has little influence except, perhaps, as one among many LDCs taking a united position.

2.9 Assessment of the environment for rehabilitation

Kenya's manufacturing sector has been growing steadily, though more slowly now. Gradually, the linkages between industries are becoming more robust and complementary, thus reducing the diseconomies imposed on firms due to working in an environment where many inputs and services are of poor or unreliable quality or just not available locally. Despite bureaucratic obstacles and resulting expenses, supplies can normally be obtained either from local wholesalers or as imports. Firms rarely shut for lack of raw materials. And, when firms, except parastatals, go into receivership, the market usually works within a year or so to put the assets to productive use again in different hands.

The government is increasingly aware that unnecessary bureaucratic obstacles stifle initiative and curtail productivity. During the latter half of the 1980s, the government began to liberalize the business environment by:

- simplifying the tariff and import-licensing systems to liberalize imports;

1/ Moss, J. and Ravenhill, J., "Trade between the ACP and EEC during Lomé I." In: Stevens, C., ed., EEC and the Third World: A Survey 3, The Atlantic Rift, London, Hodder and Stoughton in association with the Overseas Development Institute and IDS (Sussex), p. 150.

- devaluing the shilling to avert the tremendous inefficiencies and misallocation of resources arising when businessmen must recur to the black market for foreign exchange;

- reducing and centralizing the procedures to establish new business ventures;

- reducing the number of products subject to price control;

- easing the repatriation of funds by foreign investors;

- assisting potential exporters to travel to promote their products; and,

- lessening the harassment of the informal sector.

The Government understands that, by regulating industry, it has sometimes engendered stagnation or even decline, for example, in the productive chain from cotton to ginneries and cotton-textile factories. Though some parastatal manufacturing firms are very successful, others are nightmares of mismanagement and financial losses. Recognizing this, the Government is committed to privatize many of its parastatals, though concern about their future ownership and productivity causes delays. Still, it appears certain, the government has chosen its path. The Government, with a welcomed realism, is creating an attractive enabling environment for business initiative, and, hence, rehabilitation.

CHAPTER 3
THE MANUFACTURING SECTOR AND ITS REHABILITATION

3.1 General overview

Soon after Kenya achieved independence in 1963, the objectives for the country's national development plans were propounded in African Socialism and its Application to Planning in Kenya, the title of Sessional Paper No. 10 of 1965. The paper clarified that the Government was dedicated to large scale development of infrastructure. The Government also planned to be involved in productive enterprises. Nevertheless, the paper clearly made the point that market forces of a private sector economy would be predominant.

The Government has since produced five Development Plans based on the objectives that were expressed in Sessional Paper No 10. Those Plans centered on various aspects of progress, alleviation of poverty, and equitable distribution. The sixth Development Plan (1989-1993) has "Participation for Progress" as its theme, calling for the commitment of everybody to development activities for structural adjustment. It is the first of three plans to be based on the objectives for 1988-2000, which are set out in Sessional Paper No. 1 of 1986 on Economic Management for Renewed Growth.

In the first plan, the Government was confident about the capacity of the agricultural sector of the economy to be the basis for economic growth and foreign exchange earnings. Foreign exchange was vital for purchases of fertilizers and other essential agricultural inputs that were needed to increase the productivity of agriculture. Foreign exchange was also needed for purchases of capital equipment and material inputs for the development of industry.

While agriculture was mainly, though not exclusively, oriented to the production of cash crops for exports, manufacturing was largely oriented to production for domestic needs, particularly import substitution. The objectives were to develop the nation's industrial productive capacity, to increase employment, and in the long term to reduce expenditures of foreign exchange.

The Government took the initiative to provide the basis for expanding production in both agriculture and manufacturing through public investment in physical infrastructure (roads, railway lines and equipment, telecommunications, ports, energy generation and distribution, and so on). Marketing boards were established to encourage production and to expand the monetary economy. Most of these steps were taken in the interest of developing the African entrepreneur in agriculture and industry. At the same time the government maintained an effort to expand large scale, modern manufacturing investments by assuring foreign investors of a secure and profitable investment environment with guarantees of property ownership, repatriation of capital and remittance of profits. This policy was enunciated in Kenya's Foreign Investment Protection Act and incorporated in the Constitution of Kenya.

The manufacturing sector grew significantly from independence to the early 1970s. During the period, 1963-1973, value added in manufacturing grew, on average, by 9.1 per cent per annum. This rate of growth exceeded the average annual rate of growth of GDP, 6.2 per cent. Towards the end of the 1970s and beginning of 1980s, the rate of growth of manufacturing value added (MVA) fell to 4.6 per cent. The changes in the rate of growth are shown in Table 1.2.

The rapid growth in manufacturing during the first decade is attributed to a strategy of industrial development through import substitution. The strategy required a number of policies, which at first had the desired effects but eventually created conflicting forces that now are causes of inefficiency and slower industrial growth. For example, import substitution policies require a high degree of protection of manufacturers, resulting in the market being supplied by relatively high cost manufacturers. The foreign exchange cost is sometimes high for machinery, parts, and production inputs that are required to keep an import substitution enterprise in operation and the employees engaged.

Most subsectors of manufacturing recorded increases in MVA between 1984 and 1988. Real output in the manufacturing sector grew by 5.7 per cent in 1987 and by 6.0 per cent in 1988. The branches in food products that had the largest increase were meat and dairy products and grain mill products. Significant increases were made in metal products, petroleum and other chemicals, and paper and paper products. A few branches show a small degree of negative growth. The only significant decline was in the rubber products branch. Miscellaneous food products and miscellaneous manufactures grew by 18.5 and 20.6 per cent, respectively. Textiles grew by 2.4 per cent; clay and glass products grew by 5.1 per cent.

There has been little structural change in manufacturing. The leading branches continue to be food products, tobacco, textiles, electrical machinery, fabricated metal products, chemicals, paper and paper products. Consumer goods branches continue to account for over 50 per cent of MVA, and the branches that produce intermediate products constitute a relative minor segment of manufacturing in Kenya.

Food, beverage and tobacco products have accounted for over 40 per cent of Kenya's manufacturing value added in recent years. Other major branches of agro-industry, namely, textiles and garments, leather products, wood and paper products, account for another 15 per cent of MVA. The remaining 45 per cent of MVA is derived from many other branches, including petroleum, rubber, plastic and chemical products, glass and ceramic products, cement, and metal products. The values of the output from various branches are shown in

Manufacturing accounts for 13.1 per cent of total GDP and three-quarters of total industrial GDP. Manufacturing's share of GDP has increased by only a small amount from 12.9 per cent of GDP in 1984. The share of total industry in GDP has increased by the same number of percentage points. Wage employment in the manufacturing sector is 13 per cent of total employment. Manufacturing as a whole employs 14.8 per cent of the men in the labour force and 6.4 per cent of the women.

Table 3.1: Value of manufacturing output by sub-sector, 1980-1987
(in current Kf thousands)

	1983	1984	1985	1986	1987
Subsector/branch					
Meat and dairy products	97.2	123.8	154.2	189.7	233.3
Canned vegetables, fish, oils and fats	79.5	87.9	129.3	147.3	158.6
Grain mill products	148.7	193.4	218.9	280.0	311.7
Bakery products	43.6	53.1	60.4	83.4	85.0
Sugar and confectionery	80.5	93.7	94.2	105.7	125.6
Miscellaneous foods	413.6	556.2	653.9	813.5	1,028.7
Beverages and tobacco	128.4	144.1	216.0	277.4	298.7
Food processing (including animal feeds)	991.5	1,252.2	1,526.9	1,897.7	2,241.6
Textiles	99.5	112.5	145.0	182.1	186.6
Clothing	63.0	59.8	68.8	87.9	103.9
Textiles and clothing	162.5	172.3	213.8	270.0	290.5
Leather products and footwear	22.1	28.9	39.6	42.0	54.8
Wood and cork products	37.2	43.4	43.5	44.8	57.6
Furniture and fixtures	18.6	18.8	21.5	21.2	15.7
Paper and paper products	74.6	92.7	93.6	97.4	109.6
Printing and publishing	51.1	57.6	54.7	56.4	60.7
Wood and paper products	181.5	212.3	213.3	219.8	243.6
Industrial chemicals	81.9	86.6	91.9	97.9	134.8
Petroleum and other chemicals	392.0	506.0	617.6	797.2	912.5
Petroleum & chemical products	473.9	692.6	709.5	895.1	1,047.3
Rubber products	50.9	64.7	64.2	71.2	98.7
Plastic products	32.8	38.5	42.6	45.1	68.6
Pottery and glass products	8.1	8.4	8.6	8.7	7.6
Non-metallic mineral products	74.9	88.3	96.4	102.1	140.3
Building materials & ceramics	166.7	199.9	211.8	222.1	315.2
Metal products	167.7	198.2	242.0	298.9	337.4
Electrical machinery	13.7	16.2	20.0	21.7	20.3
Non-electrical machinery	87.1	97.5	119.6	143.9	179.0
Transport equipment	142.9	166.1	208.4	243.4	315.1
Metals and metal products	411.4	478.0	590.0	707.9	851.8
Miscellaneous manufactures	13.7	21.6	30.6	37.5	44.8
Total, all manufactures:	2,425.6	2,956.7	3,535.6	4,296.7	5,089.7

Source: Central Bureau of Statistics, Statistical Abstract 1989, p. 126.

Human resources: employment in the manufacturing sector

Employment data recorded by the Government covers wage and salary employment in the modern sector, and urban and rural small-scale enterprises. In these sectors the total number of employment was 1.6 million in 1987 which was less than 20 per cent of the total labour force in Kenya. In the period, 1983-87, employment grew at 3.7 per cent in the modern sector and 9.0 per cent in small-scale enterprise sector.

Manufacturing employment in private and public sectors and in total in the modern sector accounted for 20.5 per cent, 5.9 per cent and 13.3 per cent respectively in 1987. During the period 1983-87, manufacturing employment has increased at an annual rate of 3.4 per cent. In 1988, employment in the manufacturing sector made a marginal increase of 0.3 per cent. This was the lowest growth in employment recorded for the sector since 1982. This poor performance in employment creation was partly due to the fact that two sugar factories and two textile mills were non-operational during 1988. In addition, some textile mills were operating with fewer employees because of an lack of adequate market for their products.

Food and beverages and textile and wearing apparel sub-sectors have the largest shares of employment and together account for 50 per cent of the total manufacturing labour force. The basic metals and capital goods sub-sectors also have a large share (20 per cent in 1987) of total manufacturing employment. In particular in 1987, the manufacture of rail road equipment, which is wholly public owned, accounted for 7.7 per cent of the total manufacturing employment.

However, manufacturing employment is small in comparison to the total labour force which includes unrecorded self-employed and unpaid family workers. This implies that there is a significant potential labour force for manufacturing in urban and rural areas.

3.2 Major problems and constraints

Manufacturers are confronted with relatively few natural constraints and problems in Kenya compared to many countries in Africa and elsewhere. The country has a significant coast line. Good port facilities have been built in the excellent harbour in Mombasa. Nairobi has proven to be a convenient location for stopovers on the routes of international airlines for refueling and passenger destinations. The climate is favourable.

The economic environment is also favourable. Government expenditures on education and the moderately large population provide manufacturers with a good source of human resources. Besides the port facilities, the nation has a considerable amount of physical infrastructure. For example, the road network is good, although not always in good repair on the important Mombasa-Nairobi connection. Electric power is generated in sufficient quantities at the hydroelectric plant on the Tana River and supplemented by the thermoelectric facilities in the Rift Valley. Amenities in cities, major towns, and most urbanized areas are modern and more or less adequate for the population. There are few problems with roads, street lighting, electric power and water supply, medical facilities, cultural facilities, and so on.

Nevertheless, manufacturers still confront a number of problems and constraints. There are many controls on enterprises. Among the chief ones are import licenses and taxes. Price controls are no longer the constraint that they have been until very recently. Import licenses have always presented severe constraints. For example, manufacturers can only guess as to what proportion of their requested amount would be allowed, when the license would be issued, and how the exchange rate would change, if at all. The procedure results in considerable waste. Manufacturers are thought to over-estimate their import needs. Stocks are costly if the entrepreneur wrongly guesses the action that will be taken on an import license that is either granted early or granted for an amount that is larger than necessary. Insufficient or slow approval may result in underutilization of capacity, reduced production, and other inefficiencies.

In addition to constraints due to the process of application and obtaining import licenses, Kenyan manufacturers face further constraints because of their distance from suppliers. Those constraints include long delivery periods, unfavourable prices on small orders, and unfavourable terms on Kenyan manufacturers that are not known by the supplier.

Economy-wide constraints are insufficient foreign exchange, import policies of existing and potential trading partner nations, and deteriorating terms of trade.

Foreign ownership is a constraint on the volume of exports to PTA countries if the firm is not eligible for PTA preferences that are available only to firms under African management.

3.3 Linkages

Interindustry trade is weak in the Kenyan economy, but expanding. Linkages are developed in the large food processing industry with agricultural producers, transporters, and packaging suppliers. The motor vehicle assemblers and coach builders have established some linkages with smaller workshops for a few components. Linkages are weaker in most other industries.

Focusing on the sectors of this study, namely, cotton-based textiles, vegetable processing, and the ceramics industries, many actual linkages can be traced, but potential linkages are probably more numerous.

The cotton-based textile industry is linked backwards to primary cotton production via cotton ginning enterprises, to suppliers of dyes, printing, and finishing chemicals, and to producers of synthetic fibres for blended textiles. The main forward linkages are to tailors and to final consumers through retail outlets. Significant potential exists for other linkages to engineering workshops for machine parts, to specialized tailors for curtain, upholstery, and such textiles, and to the hotel and service industries, and the foreign market.

Vegetable processing is obviously linked to farmers and to the upstream producers of food products. The sector is linked to producers of tins and packaging materials, to producers of pallets, and transporters. Potential linkages could be possible to machine manufacturers and existing forward linkages could be expanded in wider markets.

The ceramics industry is also obviously linked to the domestic non-metallic mineral sector for the supply of clay, feldspar, kaolin, and other composites. It is linked forward to the hotel industry and to construction, for tableware, tiles, and sanitaryware. As in the other industries, there is scope for expansion of linkages to engineering works for dies, machinery, and parts. Further linkages could be developed to the power supply industry for insulators, to chemical laboratories that use porcelain items, for example.

3.4 Ownership patterns

African entrepreneurs own very few medium- and large-scale firms. Unga Limited, the largest grain miller in the country, is one of the few. The medium- and large-scale manufacturing enterprises are almost entirely owned by multinational companies, Kenyan Asians, or the Government, largely in the form of parastatals.

The ownership structure is to some extent a constraint on expansion of investment. Political pressures for Africanization of ownership and employment are additional constraints on management and at times a threat to the long-term existence of the enterprise.

Because property ownership in the fast developing urban areas of Kenya, especially in Nairobi, has always enjoyed long-term capital gains, has few of the bureaucratic problems of import licenses, training levy taxes, and so on, many investors prefer to own property in the Nairobi area. Property ownership is perhaps easier for somebody who has no industrial experience or technical background. The pattern of ownership mainly shows that buildings are owned by Africans and manufacturing concerns are owned by non-Africans.

3.5 Spatial distribution

Government planners designated eight larger towns as centres of growth, in one of the first Development Plans, in order to relieve the pressures of rapid urbanization on Nairobi and Mombasa. In 1986, the Government announced an industrial decentralization policy to create a suitable environment for industrial employment in the rural areas.

Incentives have been provided for the development of the small-scale sector. These include reductions and exemptions from income and sales taxes. The 1989 budget provided for a reduction from 45 to 42.5 per cent tax on local firms, a foreign company rate cut from 52.2 to 50 per cent, for investment, a deduction for capital expenditure of 35 per cent for Nairobi and Mombasa, and 85 per cent for other areas. These incentives are only marginal inducements to establish production facilities outside the two largest cities, Nairobi and Mombasa. Industry is likely to remain concentrated in Nairobi, Mombasa, and Kisumu. There is no indication that other centres will grow, although Thika, near Nairobi, and Nakuru have become more attractive as the road connections have improved considerably.

3.6 Trade in manufactured products

Kenya exports are predominantly agricultural commodities, notably coffee and tea. Petroleum products out of its refinery in Mombasa also figure large in the export accounts. Exports of industrial supplies have grown in recent years, especially since 1986. Significant increases in industrial supplies have been in hides and skins, textile fibres, sisal, and minerals such as sodium chloride and flourspar.

Table 3.6.1: Total exports[a/] by broad economic category, 1984-1988
(Kf million)

	1984	1985	1986	1987	1988 b/
1. Food and Beverages	467·06	492·71	646·77	451·85	546·36
Primary	420·70	446·17	598·61	402·81	492·57
For Industry	208·58	233·25	391·88	196·97	248·00
For Household Consumption	212·12	212·92	206·73	205·84	244·58
Processed	46·37	46·54	48·16	49·04	53·78
For Industry	3·79	1·66	2·11	3·03	5·49
For Household Consumption	42·58	44·88	46·05	46·01	48·30
2. Industrial Supplies (Non-Food)	113·21	128·14	146·71	147·20	194·38
Primary	58·68	64·05	78·01	85·04	113·71
Processed	54·53	64·08	68·70	62·16	80·66
3. Fuel and Lubricants	142·19	126·51	106·85	101·20	118·34
Primary	0·01	0·01	0·02	0·03	—
Processed	142·18	126·50	106·82	101·18	118·34
Motor Spirit	31·91	27·05	24·39	24·56	25·45
Other	110·26	99·45	82·43	76·62	92·89
4. Machinery and other Capital Equipment	2·16	2·63	4·17	4·06	5·61
Machinery and Other Capital Equipment	1·85	2·16	3·16	3·36	4·55
Parts and Accessories	0·30	0·48	1·01	0·70	1·06
5. Transport Equipment	1·24	1·57	3·23	4·14	5·34
Passenger Motor Vehicles	—	—	0·27	0·38	0·09
Other	0·14	0·37	0·72	0·89	1·63
Industrial	0·14	0·34	0·68	0·78	1·61
Non-Industrial	—	0·03	0·04	0·11	0·02
Parts and Accessories	1·10	1·19	2·24	2·87	3·65
6. Consumer Goods not elsewhere specified	28·42	33·37	49·95	44·72	47·52
Durable	0·53	0·64	5·13	1·30	1·36
Semi-Durable	7·11	10·37	12·40	9·13	12·71
Non-Durable	20·78	22·36	32·42	34·29	33·45
7. Goods not elsewhere Specified	0·54	0·17	0·29	0·24	0·18
TOTAL	754·81	785·10	957·97	753·41	917·72
PERCENTAGE SHARES:					
1. Food and Beverages	61·9	62·8	67·5	60·0	59·5
2. Industrial Supplies (Non-Food)	15·0	16·3	15·3	19·5	21·2
3. Fuel and Lubricants	18·8	16·1	11·2	13·4	12·9
4. Machinery and other Capital Equipment	0·3	0·3	0·5	0·6	0·6
5. Transport Equipment	0·1	0·2	0·3	0·6	0·6
6. Consumer Goods not elsewhere specified	3·8	4·3	5·2	5·9	5·2
7. Goods not elsewhere specified	0·1	—	—	—	—
TOTAL	100·0	100·0	100·0	100·0	100·0

Source: Republic of Kenya, Economic Survey 1989, Central Bureau of Statistics, Ministry of Planning and National Development, Nairobi, May 1989

Note: a/ Exchange re-exports.
b/ Provisional.

The value of manufactured exports is not large. The value and relative proportions of exports are shown in Table 3.6.1. The value of food and beverages, industrial supplies (non-food), and fuel and lubricants was 93.6 per cent of the total of merchandise exports. The remaining 6.4 per cent consisted of: commodities that are classified under machinery and other capital equipment (0.6 per cent), transport equipment (0.6 per cent), consumer goods not elsewhere specified (5.2 per cent), and a negligible amount of other items.

Table 3.6.2: Total imports by broad economic category, 1984-1988
(Kf million)

	1984	1985	1986	1987	1988 a/
1. Food and Beverages	127·58	109·00	116·21	98·10	100·97
Primary	83·41	50·74	37·01	35·34	28·82
For Industry	77·06	34·49	21·50	21·63	13·95
For Household Consumption	6·35	16·25	15·51	13·71	14·87
Processed	44·18	58·26	79·20	62·76	72·14
For Industry	37·89	45·13	42·02	40·68	60·21
For Household Consumption	6·29	13·13	37·18	22·07	11·93
2. Industrial Supplies (Non-Food)	289·14	353·33	407·97	468·97	641·60
Primary	15·30	13·59	14·70	16.51	21·86
Processed	273·84	339·73	393·27	452·46	619·74
3. Fuel and Lubricants	332·43	376·19	238·55	282·42	245·91
Primary	295·78	347·96	210·48	248·27	215·75
Processed	36·65	28·23	28·07	34·15	30·17
Motor Spirit	4·05	4·69	5·81	3·15	5·93
Other	32·59	23·55	22·27	31·00	24·24
4. Machinery and other Capital Equipment	184·89	180·19	254·46	319·67	414·27
Machinery and Other Capital Equipment	129·14	124·44	181·00	214·76	259·57
Parts and Accessories	55·75	55·76	73·46	104·91	154·70
5. Transport Equipment	113·46	122·16	259·61	190·72	267·19
Passenger Motor Vehicles	13·21	19·35	28·94	34·61	43·24
Other	59·52	56·60	164·84	90·84	137·98
Industrial	58·40	55·39	162·50	87·98	132·44
Non-Industrial	1·13	1·21	2·35	2·86	5·54
Parts and Accessories	40·73	46·20	65·83	65·27	85·98
6. Consumer Goods not elsewhere specified	47·40	53·96	59·79	70·60	93·91
Durable	9·90	10·60	10·03	12·22	20·96
Semi-Durable	8·77	10·61	9·44	11·76	16·66
Non-Durable	28·74	32·76	40·32	46·63	56·29
7. Goods not elsewhere Specified	2·30	1·18	1·30	0·41	1·30
TOTAL	1,097·21	1,196·00	1,337·89	1,430·88	1,765·14
PERCENTAGE SHARES:					
1. Food and Beverages	11·6	9·1	8·7	6·9	5·7
2. Industrial Supplies (Non-Food)	26·4	29·5	30·5	32·8	36·4
3. Fuel and Lubricants	30·3	31·5	17·8	19·7	13·9
4. Machinery and other Capital Equipment	16·9	15·1	19·0	22·4	23·5
5. Transport Equipment	10·3	10·2	19·4	13·3	15·1
6. Consumer Goods not elsewhere specified	4·3	4·5	4·5	4·9	5·3
7. Goods not elsewhere specified	0·2	0·1	0·1	—	0·1
TOTAL	100·0	100·0	100·0	100·0	100·0

Source: Republic of Kenya, Economic Survey 1989, Central Bureau of Statistics, Ministry of Planning and National Development, Nairobi, May 1989.

Note: a/ Provisional.

Imports (shown in Table 3.6.) are dominated by industrial supplies (non-food). The declining trend in food imports is evidence of increasing food production in Kenya. The value of imported petroleum products fluctuates with the changing price of petroleum. The changing importance of imports of machinery and other capital equipment, as well as industrial supplies, reflects the growth of gross fixed capital formation in the economy since 1985.

One of the major objectives of the current development plan is to expand the "capacity of the industrial sector to diversify into export orientation in support of traditional exports of agriculture and tourism".1/ The Government intends to encourage exports, particularly non-traditional exports. Kenya's policies have been increasingly oriented in toward this end, since the earlier policies of import substitution have been shown to be no longer suitable. Various trade liberalization measures concerning import licenses, the exchange rate, and schedules of customs duty, are aimed to make Kenyan products more competitive on the international market.

An Export Compensation Scheme, has been developed since 1974 to permit duty drawbacks on imported inputs and to refund indirect tax revenues to export-oriented firms. In 1986, as many as 700 products were eligible for the Export Compensation Scheme. Manufacturers frequently complain about the scheme, saying that the paper work for the application for drawbacks and refunds consumes a considerable amount of time and, moreover, the refunds are uncertain to be paid even after a very long time. The scheme is structured such that it disproportionately benefits exporters of manufactures to developed countries, especially canned pineapples. Larger firms are thus the main beneficiaries.

3.7 Policies and institutions for the manufacturing sector

Governmental institutions, both centralized and decentralized, focus upon the manufacturing sector for planning, regulating, training, researching, and purchasing. For these functions, the standard institutions exist. A recent review of the role of government institutions in Kenya's industrialization, has concluded that:

> Kenya has an impressive number of institutions to facilitate industrial development. There are institutions established to provide finance for small, medium and large enterprises and others charged with control and research responsibilities. Though most of these institutions have the right national objectives, implementation is often poor. The objectives tend to be ignored in the actual operations of the institutions .....
>
> A serious lack of co-ordination among various government institutions exists even when they are handling related industrial issues. This failure together with a lack of resources has reduced the overall impact of these institutions. Policy makers in various government organs also lack intimate knowledge of the structure of Kenyan industry, its resources and constraints. This has reduced the catalytic role of government in the manufacturing sector and has contributed to a failure to clearly identify and encourage those industries with the highest potential.

1/ Development Plan 1989-1993, p xx.

> The overall picture emerging ..... is that although various institutions have been established, they have not been effectively used to achieve faster industrial growth.[1/]

Thus, although the required institutions are mostly there, their motivation, focus and performance should improve.

To illustrate the problems of performance and focus, the rest of this section discusses four governmental institutions that are especially critical for industrialization: the Ministry of Planning and National Development, the big parastatal development finance corporations, the Industrial Promotion Centre, and the Central Tender Board. Though others, for example, the Customs and Excise Authorities, Price Controller, Kenya Industrial Research and Development Institute, and Kenya Bureau of Standards are also important, a full discussion is beyond the scope of this report.

The Ministry of Planning and National Development together with the Ministry of Industry plan the development of manufacturing by vetting feasibility studies, especially for economic infrastructure, and determining the policies and incentives required to guide industrialists. For example, the Government offers strong tax incentives for manufacturers to locate their enterprises outside of Nairobi and Mombasa. It also offers 20 per cent export compensation and has instituted a new manufacturing-in-bond scheme for exporters.

Though, during the 1960s and 1970s, the Government directly promoted industrialization through many joint ventures with multinational corporations, it virtually ceased doing this during the 1980s except for its prolonged support for seriously ailing parastatal manufacturing firms. In 1985, the government abolished the ad hoc inter-Ministerial New Projects Committee which was supposed to vet industrial projects. Although the committee had many problems - political interference - rapidly changing membership, inadequate professional support, it was the only central forum for approving and disapproving projects. By abolishing it instead of restricting its scope and enhancing its status and staff support, the Government abandoned a powerful tool of economic development planning: the ability to steer funds away from low-priority projects and into much needed activities. Instead, Government has increasingly relied upon macroeconomic and sectoral policies to guide manufacturing.

The large parastatal development finance institutions - IDB, DFCK, ICDC, and less so KIE - were once dynamic forces for industrialization in Kenya, especially during the 1960s and 1970s. During the 1980s, they became increasingly passive, too busy nursing the sick companies in their portfolios rather than aggressively promoting new industrial activities and divesting in

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1/ Ikiara, G.K, "The role of government institutions in Kenya's industrialization", 1987. In: Coughlin, P. and Ikiara, G.K., eds. Industrialization in Kenya: In Search of a Strategy. Nairobi: Heinemann; London, p. 247.

order to gain funds for new ventures to help fill the gaps in Kenya's industrial structure. That dynamism, vision, and ability to set priorities has been missing. Recognizing some of these problems, the Government has commissioned a currently ongoing study of the development banks to evaluate whether restructuring them would help.

With the appointment of a new Director in mid-1989, the Industrial Promotion Centre finally began to get the high-level support plus external aid required to streamline the procedures to approve a new project in Kenya. Previously, up to 30 approvals - but usually about 12 - were needed before an investor could begin a project. Now, an inter-Ministerial Cabinet-level Committee meets monthly to authorize approval there and then for any project that has encountered bureaucratic obstacles in getting some approval. This Committee has sufficient clout to cut across the normal lines of bureaucratic power. As a result, the Centre is truly becoming a one-stop office where entrepreneurs go to get all the required approvals, currently, within one month. The centre processes simple cases without referral to the inter-ministerial committee. The newly dynamic Centre holds promise of reversing the worrying trend of low or negative capital inflows.

The Government continues to miss many opportunities to use its Central Tender Board (CTB) to promote industrialization. The Board mainly considers the price and quality of a product and the reliability of the supplier.

> Foreign-exchange content, linkage effects, employment creation, etc. are hardly ever considered in the awarding of tenders. Most CTB officials were not aware of the role that the tendering system could play in the economy ..... The decentralization of the tender system leaves the CTB with only 40 per cent of the tenders. This weakens the CTB further.[1/]

The decentralization has increased the travel and marketing costs as well as the opportunities for corruption - costs that many small producers cannot afford. This often gives importers and large manufacturers an unnecessary advantage. With tender boards in 40 districts plus Nairobi, many opportunities to achieve bulk-purchase discounts or to encourage local production are lost, though a much-reduced list of items eligible for decentralized tendering may have helped promote rural production.

3.7.1 Human resource development institutions in manufacturing[2/]

In this section, institutions of formal technical training are reviewed with a focus on industrial training in Kenya.

A considerable variety of formal training institutions exist in Kenya: youth training centres, youth polytechnics, secondary technical schools, national youth service, Harambee Institutes of Technology, national polytechnics and universities. The curriculum technical training in these institutions includes not only industry related training, but service training and general education as well.

1/ Ikiara, G.K. 1988. op. cit., p. 239.

2/ This section is based on information contained in Dr. Mauri Yambo, Technical Training and Work-Experience in Kenya: A National Tracer Study of the Leavers of Harambee Institutes of Technology and Youth Polytechnics, December 1986.

Youth polytechnics are the single largest of all the types of training institutions. These institutions comprise about one-third of technical training institutions and train about one-third of all trainees. The original purpose of youth polytechnic training was to prepare primary school leavers for self-employment in rural areas. The current goal, however, is to provide primary school leavers and higher school leavers with practical skills to facilitate self- or wage-employment in local areas.

In 1984, a motion was passed in the Kenyan parliament which urged the Government to establish a Youth Polytechnic in every location in the country, which amounted to 876 locations in 1984. By 1985 the number of government-aided Youth Polytecnics had increased to 321 with an enrollment of about 21,500 trainees.

Secondary Technical Schools had 9,200 enrollments in 18 schools in 1985. The courses offered by the schools were mechanical engineering, electrical engineering, motor vehicle mechanics, agricultural mechanics, welding, masonry, plumbing, surveying, carpentry and industrial tailoring.

The National Youth Service (NYS), originally intended as a post-primary training programme, has recently increased its intake to admit secondary school leavers. In 1985, NYS had a total enrollment of 7,000. The courses offered by the NYS includes motor vehicle mechanics, panel beating, welding, general fitting, carpentry/joinery, masonry, plumbing, painting/signwriting, tailoring/dressmaking, upholstery making, and other service training such as typing and shorthand.

Harambee Institutes of Technology (HIT) were initiated by local self-help groups with considerable involvement of politicians and civil servants. The purpose of the HIT programme has been to train secondary school leavers in various skills, generally at the craft level intended to facilitate self or wage- employment. In 1984, there were 15 operational HIT with 3,900 trainees. The courses offered in the HIT largely overlap with other institutions.

National Polytechnics, among all the industrial training institutions, play a leading role in training a technically proficient workforce, especially in the private sector. Three National Polytechnics have been established in the urban centres in Kenya - Nairobi, Mombasa and Eldoret. Kenya Polytechnic (Nairobi) and Mombasa Polytechnic had a combined enrollment of 5,036 in 1987-88. The Polytechnic in Eldoret was only recently opened, as such it is not clear what is the exact size of its enrollment.

Kenya Polytechnic offers courses in manufacturing industry related technical skills. These courses are given in the engineering department (mechanical, electrical, automobile, general, aeronautical and telecommunications). In 1987-88, enrollment for these courses in Kenya Polytechnic was 976 or 28 per cent of the total enrollment. If other industry related courses such as building and civil engineering, and laboratory and other technicians are included, industrial training accounts for 54 per cent of total enrollment.

Mombasa Polytechnic has a greater emphasis on manufacturing industry technical training than Kenya Polytechnic though the total number of trainees was only 1,547 in 1987-88. The engineering department had 724 trainees, or 47 per cent of the total enrollment and by including other industry related courses, industry related trainees account for 62 per cent of total enrollment.

Although the total enrollment of trainees has been unchanged, around 5,000, in the two national polytechnics since 1984-85 - the National Polytechnics including the new one in Eldoret are likely to retain a significant share of the total technical training capacity in Kenya.

University education lies on the top of all training institutions. The University of Nairobi has by far the largest student capacity in Kenya. In 1987-1988 the total number of students exceeded 10,000 and the number of first degree course students was 8,500, of which 817 students were enrolled in engineering course. In other universities - Moi and Kenyatta universities - no course is offered in the field of engineering. In 1987-1988, the total number of students enrolled in Kenyan universities was 17,000, of which 15,000 were undergraduates. Among undergraduates, the ratio of engineering students was only slightly higher than 5 per cent. It should be noted, however, that many Kenyans go abroad to pursue university education, particularly in North America, Western Europe and India, and those graduates who obtained a degree overseas have established important positions in Kenyan industry.

Finally, although Kenya appears to be steadily increasing its training institutions, especially those imparting technical skills at all levels, it appears that the country is still not producing the right number and quality of trained people for manufacturing employment.

Chapter 4
Selected Industries and their Rehabilitation

4.1 Cotton-based textiles

4.1.1 Overall characteristics

The textile industry - spinning, weaving, knitting, and finishing fabrics - is Kenya's second largest manufacturing employer: in 1987, it had 20,123 employees, or 12.0 per cent of employment in manufacturing. Of the total labour force in the textile industry in 1987, 5,665 were in knitting mills. Since 1983, employment in the industry has been growing faster (8.7 per cent) than the average for all manufacturing (3.3 per cent); and so has its quantity index of production (7.0 per cent as against 5.1 per cent).

The textile industry has strong backward and forward linkages to other manufacturing industries, such as ginneries, filament extruders, mechanical engineering, and garment and furniture manufacturers. In 1987, the ginneries had 1,180 employees; and the garment manufacturers, 8,253. As yet, dyes and most chemicals used in the industry are not made locally.

Though the textile industry in Kenya was traditionally based on cotton, a long-term profound shift towards using more synthetic fibres - polyester, viscose, nylon - has occurred since the early 1970s. Most mills, even those that had exclusively woven cotton fabrics, now increasingly produce cotton/synthetic blended fabrics. This switch has been stimulated partly because the production of locally grown cotton has been decreasing and the government, through the Cotton Lint and Seed Marketing Board (CLSMB), has allowed insufficient imports of cotton, and even that reticently.

The textile industry operates at a high rate of capacity utilization - 81 per cent in 1986 and is diverse, robust, and fairly mature.[1/] In 1986, 14 large factories were fully integrated from fibre blowing through fabric finishing. Five plants import polyester pellets to produce and spin continuous-filament yarn; one of those plants also produces continuous-filament nylon yarn. In the 1980s, the industry began to decrease raw wool and export wool tops, and, more recently, to spin wool yarn for local consumption. A factory in Nakuru is installing machinery to spin wool-carpet yarn, mainly for export. And, Kenya Threads, a large African-owned enterprise, exports the bulk of its output of cotton yarn whenever the local price of cotton is equal to or less than the international price.

1/ Coughlin, P. (1986) "The gradual maturation of an import-substitution industry: The textile industry in Kenya," Discussion Paper, Industrial Research Project, Economics Department, University of Nairobi, Mimeo; World Bank, Industrial Development and Finance Division, Eastern and Southern Africa Region (1987) Kenya: Industrial Sector Policies for Investment and Export Growth, Washington, D.C., World Bank, pp. 275-87.

In both spinning and weaving, "Kenyan firms display superior technological mastery in [both spinning and weaving], with levels creditably near world best-practice levels."[1] The industry is also highly protected: in 1986, its effective rate of protection for polyester yarn and diverse fabrics ranged between 72 per cent and 93 per cent.[2]

Though from 1980 to 1987 the textile industry reduced imports of fabrics from US$ 40.7 million to US$ 14.0, its exports fell from US$ 6.1 million to US$ 3.3 million.[3]

> Kenya has not yet succeeded to export much yarn, fabric and garments. For some products, the Kenyan producers are not efficient, e.g., shirts, towels, and linen. For others, they are only efficient enough to penetrate the limited regional market and to keep out most imports, e.g., most blankets and sweaters. For yet others, some firms have begun to sell into the European markets, e.g., T-shirts, men's briefs, dress pants, some ready-made suits, and wool tops[4].

Kenya may, however, begin soon to export much more. In response to the Government's whole-hearted, high-level support for the new single-stop Industrial Promotion Centre for encouraging foreign investors, four foreign investors manufacturing garments under bond for export only, have started production. Thirteen other projects manufacturing under bond - mostly garment manufacturers - had been fully approved by January 1990 and await for the entrepreneurs to start investing. The centre also reports many inquiries by potential investors.

Since Kenya still has easy access for its garments in the European Economic Community's market, investors from Asian countries stymied by import quotas under the Multifibre Agreement are considering sewing garments in Kenya using fabrics from their countries. Gradually, the local textile factories should be able to sell fabrics and yarns to these new factories. If continued, these new investments would much change the focus and competitiveness of Kenya's textile industry.

4.1.2 Major problems and constraints

Though other, lesser problems exist, three major constraints bridle Kenya's textile industry: lack of sufficient cotton at a good price and quality, lack of specialization and economies of scale in the textile mills, and often weak managerial skills.

1/ World Bank, op. cit., 1987, p. 283.

2/ Coughlin, P., op. cit., 1986, p. 39.

3/ These statistics comprise all of SITC 65 except for garments, SITC 658.

4/ Coughlin, P., op cit., 1986, p. 40.

Cotton shortages and inadequate quality

Local cotton production has shrunk despite strong growth of the textile industry (Table 4.1). In addition to climatic variations, the main reasons were:

- the sharply declining real prices to farmers (Table 4.1);
- the very low yields and, hence, profitability of the crop for farmers;[1/]
- the more than one-year delays in paying farmers.

These reasons have caused many farmers to stop growing cotton. For example, in Busia district, the longer farmers had to wait to get paid, the more reticent they were to grow cotton for the next season.[2/] The delays resulted both from the dire financial situation of the CLSMB and the cotton co-operative societies' delays in forwarding payments to the farmers.[3/]

To obviate part of the delays, the CLSMB began during 1988 to pay farmers directly, instead of through their co-operative societies. CLSMB's officers report that, as of January 1990, the farmers have been fully paid for the 1988-89 crop. With the reduced delays and higher payment per kilo, the CLSMB hopes that the 1990-91 cotton harvest will be much better.

Despite shortages, CLSMB has only reticently imported cotton, and then, in very insufficient quantities (Table 4.1). In response to complaints from textile manufacturers, the government began in early 1989 to require manufacturers to submit a joint request for imports through the Textile Manufacturers' Association. Still, the requests are delayed both by the association, the CLSMB which must give a letter of no-objection, and the import-licensing and foreign-exchange authorities. The result: factories still do not get enough cotton.

Nor is the quality good enough. Kenya produces medium-staple, medium-strength cotton that lowers the quality and strength of the yarn and decreases the efficiency in weaving. The lower quality is also difficult to sell in export markets. Partly for this reason, factories manufacturing under

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1/ "The farmers' cotton yields are fairly low, averaging about 100 kilos of lint per hectare. Results of research experiments in various parts of the country, however, show that with improved varieties and production technologies, yields of between 450 and 900 kilos of lint per hectare can be realized." National Fibre Research Centre (Mwea Tebere) (1988) "National cotton research project." Report for the Kenya Ministry of Agriculture, p. 2.

2/ Etyang, M. (1979) "Price elasticity of cotton supply in Busia District." M.A. research paper, Economics Department, University of Nairobi, pp. 60-101.

3/ Routsi, J. (1989) "Cotton ginning industry in Kenya: The case of the co-operative ownership and management mode." IDS (Nairobi) Working Paper No. 479, p. 4; Dijkstra, T. (1988) "Cotton lint and cotton seed for the domestic market in Kenya." Report for the Kenya Ministry of Planning and National Development, Nairobi, Mimeo, p. 12.

bond resist using local fabrics. The CLSMB has not encouraged factories to import stronger, longer-staple cotton for blending with local fibre to upgrade the end product. This reticence has hampered the industry's effort to secure the domestic market against the many imported - often smuggled - fabrics.

Table 4.1: Farm-gate prices and sales of cotton to CLSMB, 1980-1988

	Farm-gate price (KSh/kg)	Price index	Price gate price[a] (KSh/kg)	Real farm- Production ('000 tonnes)	Net imports ('000 tonnes)
1980	3.41	1.00	3.41	38.1	n.a.
1981	3.41	1.18	2.89	25.5	n.a.
1982	3.52	1.44	2.44	14.3	n.a.
1983	3.69	1.64	2.25	15.8	n.a.
1984	4.48	1.82	2.46	22.8	1.1
1985	4.80	2.02	2.38	38.0	-1.7
1986	4.70	2.16	2.17	25.4	-.4
1987	4.82	2.34	2.06	23.8	-.9
1988	5.86	2.62	2.24	10.9[b]	1.9
1989	6.00	n.a.	n.a.	n.a.	n.a.
1990	10.00	-	-	-	-

Sources: Kenya Government (1986 and 1989) Economic Survey for 1986 and 1989. Nairobi: Government Printer; Kenya Government (1984) Statistical Abstract, 1984. Nairobi: Government. Printer; and for prices for 1989 and 1990, interview with F. Kebenev, production officer, CLSMB, 30 January 1990. Statistics for net imports come from Kenya Government (1986 and 1988) Annual Trade Reports for 1985 and 1987. Nairobi: Government Printer.

a/ This index was constructed from official indexes for middle-income Nairobi prices and recalculated for the base year, 1980.

b/ Provisional estimate.

Specialization and economies of scale

Loss of economies of specialization is the major cause of loss of productivity by Kenyan textile firms relative to technologically similar best-practice firms in the UK.[1/] The Kenyan plants are sub-optimal in size and

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1/ Pack, H. (1987) "Productivity, technology choice, and project design, with an application to the cotton textile sector." In: World Bank, Appropriate Industrial Technology, Phase II. World Bank Report No. 671-77, Washington, D.C.

produce too many types of products to achieve economies of scale.[1/] Since the plants are usually closely linked to but a few wholesalers, they feel pressured to satisfy all the diverse demands of these wholesalers.[2/]

Weak managerial skills

Apart from a few with multinational links, most textile firms in Kenya are weak in marketing and product design, partly due to the industry's inward orientation and the limited competition in certain products.[3/] For example, Mountex is the only local producer of 48" bed linen; and Kenya Taitex Mills, of nylon fabric. Many firms, especially parastatals, have very weak upper management and miss easy, immediate opportunities to reduce costs or increase production and sales. Most managers - public or private - do not understand and use the concept of marginal costs, and, hence, forego the chance to use compartmentalized pricing to capture new domestic or export markets.[4/]

Other problems

The industry faces other, lesser problems. Much of the equipment is old, and many factories have significant imbalances between sections. Engineering maintenance is often deficient, and few firms have systematic preventive maintenance programmes. The engineering difficulties are compounded because Kenya's mechanical engineering capabilities seldom surpass medium precision, and their reliability is quite mixed.[5/] This, of course, drives up the costs of operating a factory.

Despite existence of the Kenya Textile Training Institute and the textile training schools at many factories, "all firms complained of a general shortage of skills. There is, therefore, a long-term need to provide appropriate training programmes in the country."[6/]

On-site amenities for workers are often lacking or sorely deficient. Moreover, the health conditions in many, especially cotton factories are often bad and sometimes atrocious, with thick cotton lint in the air, while workers - lint caught on their eyebrows, caps, and overalls - toil unprotected even by a mask.[7/] Respiratory ailments are common and, in some factories, are a major cause of absenteeism.

1/ World Bank, op. cit., 1987 p. 283.

2/ Coughlin P., op. cit., 1986 pp. 33-37.

3/ World Bank, op. cit., 1987 p. 285.

4/ Coughlin, P., op. cit., 1986 p. 23.

5/ Coughlin, P., "Converting crisis to boom for Kenyan foundries and metal engineering industries: Technical possibilities versus political and bureaucratic obstacles." Africa Development, Vol. 10, No. 4, 1985.

6/ World Bank, op. cit., 1987 p. 285.

7/ Coughlin, P., op. cit., 1986 pp. 32-33.

Many factories discriminate against female production workers absolutely: except for maids and secretaries, they hire no women. Other factories have mainly women in certain sections and only men in others. No systematic study exists of differential productivity by sex, and the experiences and views of managers in diverse textile factories in Kenya.

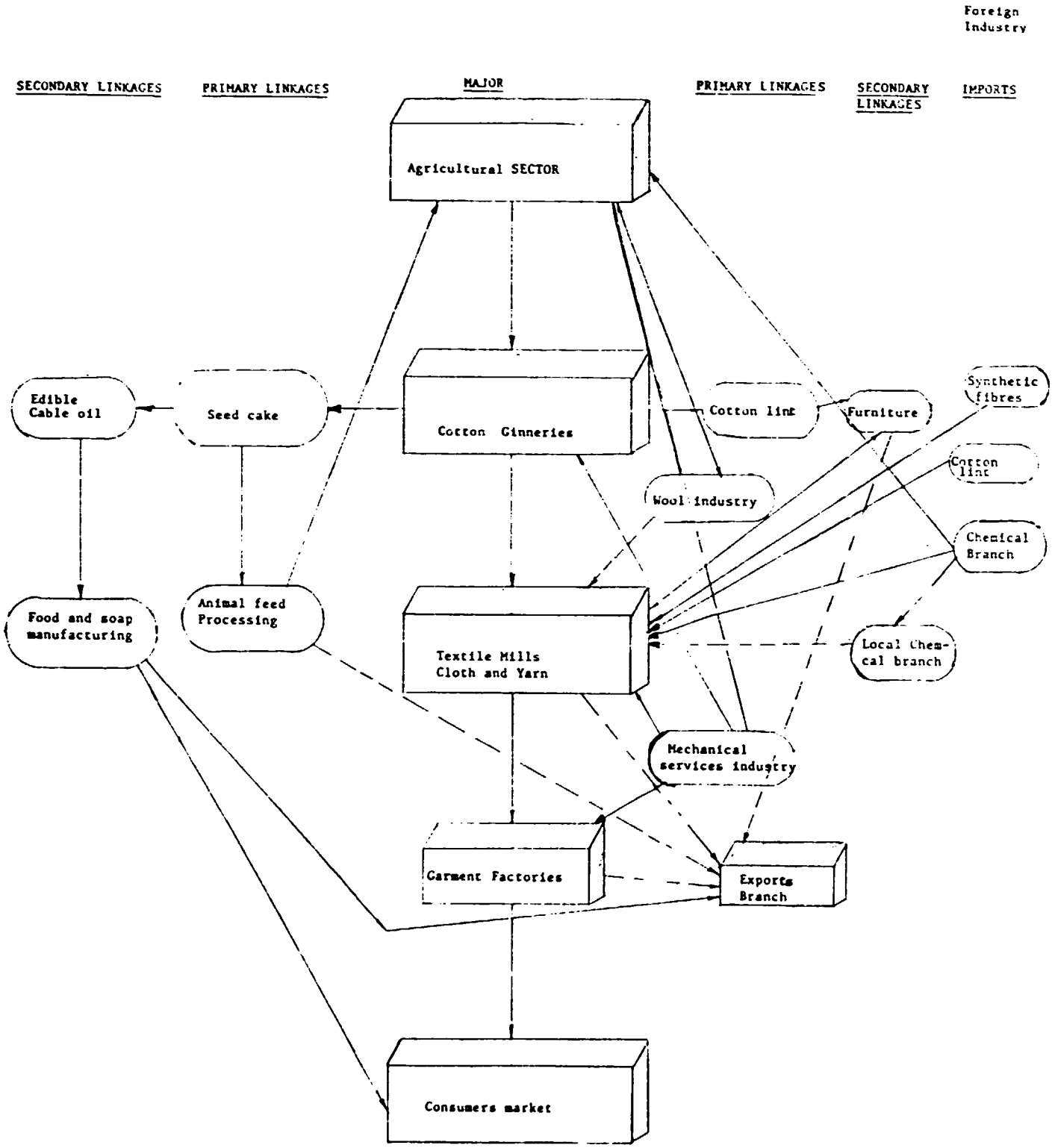
4.1.3 Linkages

Kenya's cotton-based textile industry has many forward and backward linkages (Figure 4.1). For example, ginneries provide cotton; mechanical engineering supplies spares; and the local chemical industry supplies some chemicals, though most are imported. The cotton-based textile industry supplies the major input for garment and furniture manufacturers: cloth. It also supplies cloth to wholesalers who supply retailers and small garment manufacturers.

Due to declining real prices for cotton and long delays in payments, local farmers have been growing less and less cotton. In reaction, the cotton-based textile factories have gradually shifted towards using imported synthetics and cotton, thus weakening the domestic linkages.

Growth of the local cotton-based textile industry would stimulate many agriculture-based industries, for example, edible oil processing, animal feeds, and cotton lint for hospital gauze and sanitary towels.

Figure 4.1: Present potential linkages for the cotton based textile industry



4.1.4 Ownership pattern

Most textile firms and filament extruders in Kenya are owned either by the big development finance institutions, such as IDB and ICDC, or by private Kenyan citizens.

The non-Government sector of the textile industry is overwhelmingly owned by Asian-Kenyans (though there are several instances of equity shares by overseas Asians). There is only one medium-sized firm with majority African shares, but this is also managed by Asians. The parastatal textile firms have Africans in top management positions, but rely partly on some expatriate (Indian and/or European) technical managers.

The private firms have usually concentrated managerial control in local Asian hands, and have drawn extensively on textile technicians from India for know- how and engineering expertise. However, there has been a clear tendency to Africanize technical positions as people with the appropriate training have become available.

The Government through its investment houses owns six companies that employ 3,755 workers. The relative distribution between Government-owned and privately-owned companies was not available to the mission.

4.1.5 Spatial distribution

There are 53 known companies[1/] involved in the textile industry branch, which are carrying out weaving, knitting or filament extrusion. Their distribution is as follows:

Nairobi	17
Mombasa	16
Thika	5
Nakuru	5
Eldoret	3
Nanyuki	2
Athi River	1
Ruiru	1[2/]
Total	51

The above companies do not include garment manufacturers unless they also possess the ability to make their own fabrics. Of the above companies, nine are involved, to some extent, in garment manufacture. Fourteen of the companies integrate spinning with either knitting or weaving.

1/ Coughlin, P., The Gradual Maturation of an Import Substitution Industry: The Textile Industry in Kenya, 1986.

2/ Even though there are 53 known firms, the location of 2 of the firms is unknown.

The distribution is naturally heavily concentrated in Nairobi and Mombasa, the two major population centres of the country, which are the main markets for much of the production from the mills. Synthetic textile producers, which rely on imported inputs have a preference for the two main centres.

4.1.6 Human resources

In 1987, the cotton-based textile industry including wearing apparel, had a 20 per cent share of total manufacturing wage employment. In the period of 1983-1987, employment in the textile industry grew at an annual rate of 5.0 per cent. In the same period, employment in the spinning, weaving, and finishing textiles branch at an annual rate of 9.7 per cent. Though the textile industry grew rapidly until the middle of the 1980s, the numbers employed reached a peak in 1986 and since then have declined. The decrease in the numbers employed in the textile industry may be a reflection of the fact that two textile mills have recently closed and many textile mills are now operating with fewer employees.

The Government has established a training school for the textile industry, "Kenya Textile Training Institute" (KTTI) in Nairobi in order to increase the number of skilled textile specialists. It is currently managed by the Ministry of Technical Training and Applied Technology. KTTI is the only specialized textile training school in Kenya where textile firms can send their employees to upgrade their technical skills. Although there have been certain criticisms with respect to its training schemes and obsolete equipment and facilities, there is no doubt that KTTI is the major technological and training center of the textile industry in Kenya.

Particular training weaknesses in the industry at present are in industrial design, weaving and quality control. Usually in the development of the textile industry, women's labour force is a major contributor. However, women are not utilized to an optimal level in some factories in Kenya. In particular factories, there appears to be a strong prejudice against using female labour.

4.1.7 Policies and institutions relating to cotton-based textiles

The main policies and institutions affecting the cotton-based textile industry in Kenya are general policies which concern exports, the supply of domestic and imported inputs, management of parastatal textile firms, and training.

Besides the new manufacturing-under-bond programme for plants producing for export only, the Government grants other manufacturers a 20 per cent export-promotion payment on the f.o.b. value of exports. After subtracting the value of tariffs imbedded in their inputs, this payment still renders a 9 per cent to 12 per cent incentive for exporters working outside the manufacturing-under-bond scheme.[1/]

1/ Coughlin, P., op. cit., 1986 p. 39.

Imported uncarded cotton attracts a 30 per cent tariff and no sales tax; imported uncarded polyester fibres have a 25 per cent tariff and no sales tax. These tariffs have imposed a significant disadvantage on the textile industry because the bans and tariffs against imported fabrics and clothing have been so permeable, and, hence, partly illusory. As a result, unofficial imports are large and restrict the industry's growth.

The selection of top managers for most of the six parastatal textile firms is quite politicized. Often, the Managing Directors and General Managers have no business experience or training, though there are exceptions. For example, the General Manager at Rivatex is a certified public accountant. Significantly, he succeeded in completely transforming his company from a big loser to a fairly profitable enterprise. But his example is not the norm. Top managers of most parastatals lack the business vision, initiative, and toughness required, and, instead, often overload their factories with unneeded staff in acquiescence to political exigencies[1/].

The Government's bureaucracy is often timid and procrastinates long, even years, before making urgently needed financial decisions to rehabilitate some parastatal factories. These delays cost hundreds of millions of shillings, sometimes far more than the costs for rehabilitation.[2/] Meanwhile, shortages of working capital, especially for spare parts, aggravate the factories' problems; and the managers confront daily crises that prevent them from concentrating on strategic improvements, for example, through market studies, personnel training, better work incentives and managerial information systems, and key investments to balance out equipment.

4.2 Vegetable processing

4.2.1 Overall characteristics

Although vegetable processing has a long tradition in Kenya, significant development of the vegetable processing industry started only after independence. According to the "Sessional Paper on Crop Development to Year 2000", 18 December 1988, there were no exports of processed vegetables from Kenya in the early 1960s. About 25 years later, in 1987, Kenya exported processed vegetables with a total value of KSh 700 million. This should be compared with the export of fresh vegetables which approached 1,500 tonnes in 1963 with a value of KSh 3.1 million. By 1987, vegetable export had increased to 36,000 tonnes, or a total value of KSh 1.1 billion.

1/ Coughlin, P., op. cit., 1986 pp. 24-25.

2/ For example, Nzoia Sugar Company was losing about KSh 100 million per year, though rehabilitation would have required around KSh 80 million including an infusion of KSh 30 million for working capital. The losses continued for more than five years before the government decided to both rehabilitate and expand the factory. See: Coughlin, P. "Decisions and their Financial Implications at Nzoia Sugar Company." Paper presented to a seminar on the sugar industry and sugarcane outgrowers' associations, Webuye, 7-10 September 1986.

Export of vegetables in the early 1960s did not involve sorting, grading and packing, to the same extent as is required now. Today, international trade in vegetable is very competitive. An industry has developed which in conventional terms should probably not be classified as simply processing. However, vegetable processing is an important part of the branch which contributes the major part of export earnings.

There are only a few important, larger processing companies, three of which have canning factories processing vegetables for the domestic market and for export. There are only a few firms engaged in freezing french beans, exclusively for export (see Table 4.2.1), and one dehydration plant whose products are also exported. In addition, there are a few smaller plants using vegetables as raw material for processing. These include the manufacture of potato crisps, and tomato sauce.

Since the climate in Kenya permits the growing of fresh vegetables practically all throughout the year, the growth in domestic demand for processed vegetables will not be particularly rapid. For this reason, a major part of the production of processed vegetables must be exported. World markets for processed vegetables are highly competitive and a great number of countries, not least in the Third World, are attempting to increase their exports. The cost of packing material is significant in the total costs of products - on account of this, the supply of intermediate inputs, such as tin cans, at competitive prices is a pre-requisite for increased exports. Consumers in the industrialized countries are being increasingly concerned about the high content of chemicals in processed and fresh food. There is not yet sufficient awareness in Kenya of these changes in consumer preferences.

4.2.2 Major problems and constraints

The branch includes a number of different types of processing industries and technical problems common to the branch as a whole have not been identified. Given that the financial situation of a company is satisfactory, the acquisition of spare parts should not be a problem. They are mostly available from local workshops and imported spare parts can generally be ordered through the same firms. Direct approach to overseas manufacturers is also possible.

One major constraint for exporting fresh vegetables has been the lack of air-freight capacity. Since importers, in the world markets, usually require deliveries of specified quantities and qualities at certain dates, freight constraints will seriously hamper exports of fresh vegetables.

4.2.3 Linkages

Figure 4.2 illustrates the linkages of the vegetables processing branch. The linkage pattern is not very strong and the number of companies registered at the Ministry of Industry, or otherwise discussed by the mission are comparatively few as is shown in Figure 4.2. It is worth mentioning that there are no firms engaged in sorting, grading and packing which are registered in the agro-industry sub-sector. The reason is obviously that the value added is considered marginal and that there is no processing in conventional terms. A modern efficient sorting, grading and packing company requires substantial investments in equipment and is fairly labour intensive. Such a firm could also be a combination of fresh vegetable market supplier and processor of dehydrated frozen or canned products. The mission has not been able to identify a firm in Kenya with this particular profile. A future development might be to process dried soups and so on, based on domestically

available meat extract from the meat processing branch and dehydrated vegetables.

Vegetable processing is sometimes combined with processing of fruits and/or berries. This is also the case in Kenya but not to any large extent.

Figure 4.2: Linkage vegetable processing branch

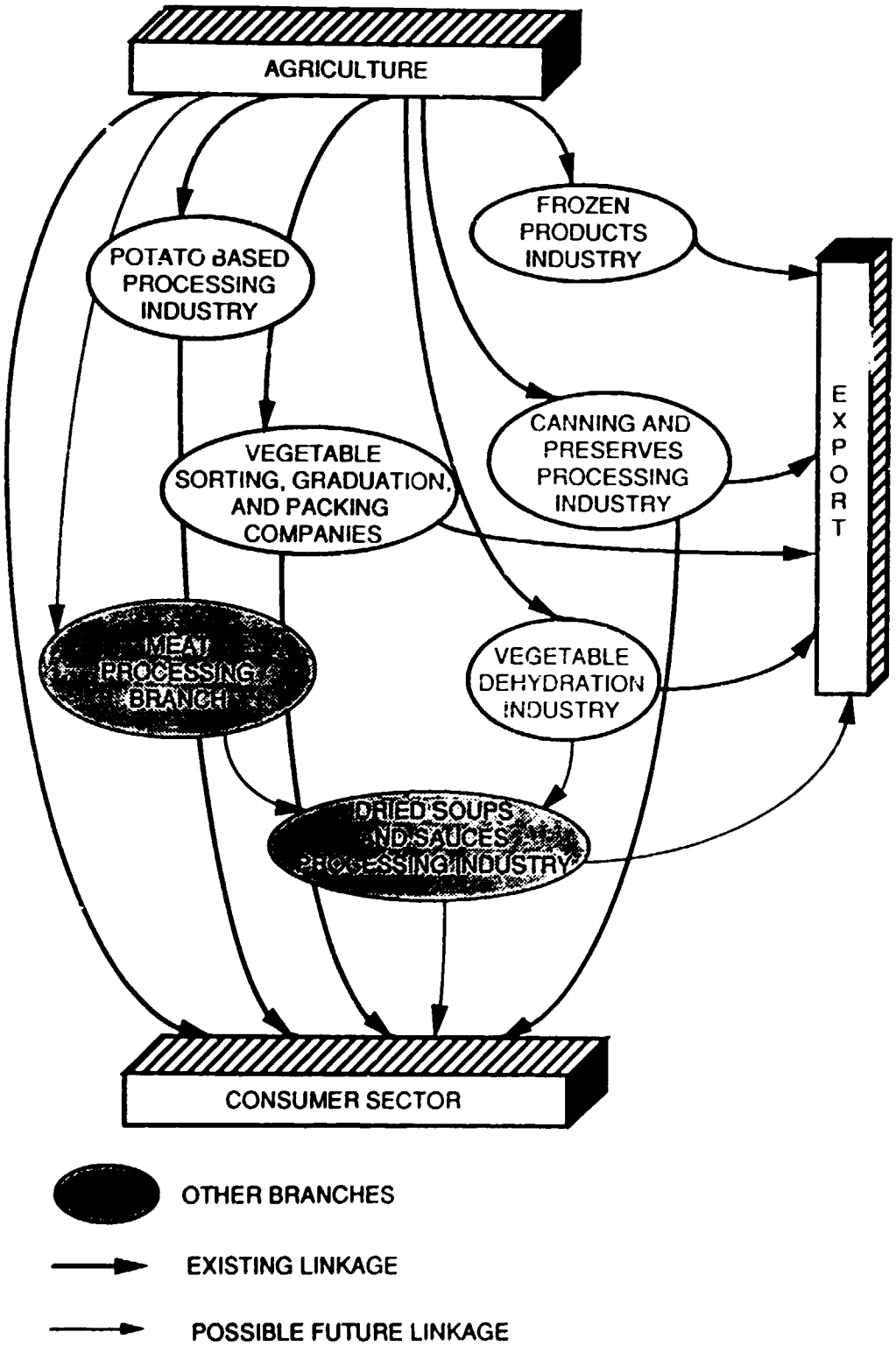


Table 4.2.1: Firms in the vegetable branch of the agro-industry sub-sector

Firm	Location	Product(s)
1. Ngoro Canning Factory Ltd.	Nakuru	Canned french beans
2. Trig-O-Ken	n.a.	Frozen french beans
3. Go-Tresh Agrapha Ltd.	Nairobi	Potato crisp, fried nuts
4. Fine Foods Ltd.	Nairobi	Potato crisp, etc.
5. Ambica Foods Ltd.	Nairobi	Potato chips, etc.
6. Premier Food Industries Ltd.	Nairobi	Canned and boiled products
7. Truefoods Ltd.	Nairobi	Tomato paste
8. Kabazi Canners Ltd.	Nakuru	Canned carrots, beans, mixed vegetables
9. One Shop Enterprises	Nairobi	Potato crisp, fried nuts, etc.
10. Mount Kenya Agro Industries	Kiganjo	Dried onion and pepper

Source: Mission's field survey.
Note: n.a. = not available.

4.2.4 Ownership patterns

The Processing industry branch has registered 584 companies. The branch is almost entirely privately owned, the most important private companies being:[1/]

Company	Location	Product	Number of employees
- Delmonte	Thika	Canned fruits	-----
- Njoro Canning Factory	Nakuru	Canned beans	-----
- Premier Foods Ltd	Ruaraka	Canned, bottled prod.	-----
- Kabazi Canning Ltd	Nakuru	Canned carrots, beans mixed vegetables	
- Tru Foods	Nairobi	Tomato paste, sauce	340
- Tropical Food Processors	Mombasa	------	300
- Frig-O-Ken	Nairobi	Frozen french beans	40
- Kenya Orchards Ltd	Machakos	Fruit jams	-----
- Go-Fresh Agrapha Ltd	Nairobi	Potato chips fried nuts	-----
- Mount Kenya Agro Industries	Kiganjo	Dried onion and pepper	75

The Government has a minority share in Kenya Food Products Ltd. and owns, through ICDC, 100 per cent of the shares in Pan Vegetable Processors in Naivasha.

The above mentioned government participation represents less than 5 per cent of the industry's total output.[1/]

1/ The information given above was obtained from the Horticultural Crops Development Authority, the Ministry of Planning, Kenya National Chamber of Commerce & Industry, and the Bureau of Statistics. Statistics and background material are very difficult to obtain, if available at all, they are usually old and out-of-date.

4.2.5 Spatial distribution

The vegetable processing industry has 16 major companies, which are registered at the Ministry of Industry and the Horticultural Crops Development Authority. They are distributed as follows in Table 4.2.2.

Table 4.2.2: Number of vegetable processing companies, by location

Location	Number	Location	Number
Nairobi	8	Nakuru	1
Mombasa	1	Machaka	1
Thika	1	Kiganjo	1
Njoro	1	Naivasha	1
Ruaraka	1		

Sources: Ministry of Industry, Register of Agro-Industries, 7th September 1989. Horticultural Crops Development Authority, meeting with mission, 1 February 1990.

Note: It should be noted that the two sources did not give the same companies, some were common to both lists, others were only on one list. The above totals are a combination of the different companies on the two lists.

The distribution system for fruit and vegetables is carried out through 32 large wholesale and retail stores and numerous small family owned businesses. Of the larger wholesalers/retailers, 29 are located in Nairobi and 3 in Mombasa.

Associated with this subsector are also 6 fruit juice processors/canners, all of which are located in Nairobi.

4.2.6 Human resources

There is little information on human development specific to the food processing industries in Kenya. What little information that is available suggests that engineers and quality control specialists in food processing industries usually have a degree in food science from domestic universities. However, with the development of food processing industries in Kenya, there may be a need for greater numbers of food technologists with increased technical sophistication especially, for example, in processing techniques such as freeze-drying.

4.2.7 Policies and institutions as they relate to the vegetable processing branch

Many overall government policies significantly affect the vegetable processing branch, although generally in a positive way. The production of vegetables has priority in Kenya's development strategy, because it is a high value product. Moreover, vegetable production can be undertaken efficiently by small and large farms alike. The production technology can be labour intensive, and increasing Kenya's vegetable production could also provide much needed employment.

Vegetable processing mainly uses domestic raw materials and thus provides important backward linkage effects. A large part of processed vegetables are exported and thus fall within a priority area of Government policy.

The vegetable processing branch is particularly sensitive to the policy instruments used by the Government. To export processed vegetables, the price of the product must be competitive in the world market. Because of this, the price is sensitive to the prevailing exchange rate, and if the Kenyan shilling is overvalued, exporters would find difficulties in marketing the products. Moreover, the processing of vegetables requires important inputs of imported or locally produced goods such as oil products and packaging materials. The prices of these, depend in turn on exchange rates, and import and tariff policies. The vegetable processing branch would clearly benefit from market liberalization, including foreign trade.

The tax system, such as the VAT, export and import tariffs, is being revised and the proposed changes should be beneficial to the branch.

4.3 Ceramic industry

4.3.1 Overall characteristics

The ceramic industry in Kenya is small and presently produces a very limited range of products. Three companies are known to be current producers of glazed ceramic products. Wall tiles, sanitaryware, and tableware are produced by Ceramic Industries (East Africa) Limited. Giftware items - mostly figurines, such as dogs and cats - are manufactured by Atlantis Ceramic Industry. Porcelain Products Limited produces tableware, but on a small scale. These manufacturers are the only producers of glazed ceramic ware in the non-metallic mineral products subsector of manufacturing. All are situated in Nairobi.

There is only one major firm in the industry. This firm is the only producer of items that are basic to the industry: crockery (tableware), wall tiles, and sanitaryware. Therefore, practically viewed, it is the ceramic industry in Kenya. The other firms are very small with negligible output.

A few manufacturers are making unglazed floor tiles, roofing tiles, and bricks, including refractories. Besides these manufacturers of structural clay products, an unknown number of small potters in the informal sector are making earthenware. The greatest number of these producers are in the western regions of the country.

The size of the industry is small, in comparison to the manufacturing sector as a whole. The non-metallic mineral products subsector, comprising ceramics and earthenware, glass, structural clay products, cement and plaster, concrete products, and so on, as a whole, accounts for about 3 per cent of total manufacturing output and 3.2 per cent of total manufacturing value added.

The non-metallic subsector is broken down to one further level in the national accounts: clay (or pottery) and glass products, on one hand, and non-metallic mineral products (cement, concrete, and all other non-metallic mineral products), on the other hand. The manufacture of clay and glass products account for 8.2 per cent of the total output of the non-metallic subsector and 19.1 per cent of the subsector's manufacturing value added.

The average annual rate of growth of the manufacture of clay (pottery, glazed ceramic, and structural clay products) and glass products from 1983 to 1987 was 7.7 per cent. Production increased a further 5.1 per cent between 1987 and 1988. These rates of growth compare to 5.1 per cent and 6.0 per cent growth in total manufacturing in the years from 1983 to 1987 and 1987 to 1988, respectively.

Compared to 1987, the output of floor and wall tiles declined marginally in 1988. During the same period, the production of glass bottles and windscreens for automobiles, the two major products made of glass, increased by 6.9 per cent and 3% per cent, respectively. It appears that the 5.1 per cent rate of growth in clay (including ceramics) and glass products results from strong growth in glass products, which offsets the low or declining growth in the production of ceramic and structural clay products.

It is important to note that the ceramic industry is a labour-intensive branch of manufacturing and, therefore, provides potential employment generation with growth of the industry. It also utilizes local materials for a large proportion of its material inputs. The proportion has increased recently, as the major producer in the branch has made a concentrated effort to use more local clay in place of imported clays, despite resultant problems in production. Despite the large use of local clay, the branch is entirely dependent upon imports for its requirements of glaze, which accounts for about 20 per cent of the total cost of production, or about 60 per cent of the materials of production.

4.3.2 Major problems and constraints

The major problems of the branch are those that are found in the rest of the manufacturing sector, namely, insufficiencies in technical know-how, financial management, and raw materials or intermediate inputs. Nearly all other problems are secondary, though critically consequential.

In a number of enterprises and industrial branches, marketing and import-dependency are other major problems. Presently, marketing is not a major problem in the ceramic industry, but import-dependency is critical. The appearance and quality of the final product in ceramics depends as much on the glazed surface, which is produced by imported glaze, as on the body, which is made of local clay and other minerals.

Import-dependency can be the root cause of production stoppages due to delays in receiving shipments of imports, high financial cost due to working capital being tied up for long periods in the purchasing procedure, and inferior product quality. This latter problem is shown by a recent example at Ceramic Industries. Surplus or waste glaze was reclaimed and recycled when the glaze stocks were exhausted. The dependency on imports was temporarily removed, but the solution created its own problem, which was a poorly glazed surface.

Other problems in the branch are matters of old equipment, lack of replacement parts, lack of local sources of reliable supply and good quality replacement parts or repair services. A major problem the branch faces is the fact that there is insufficient experience and technical capability in ceramic production at the level of top and middle management and a similar shortage of technical capability and skills among supervisors and workers.

A major constraint is the low degree of development of local sources of raw materials. Consequently, the supplies are irregular, of varying and unknown qualities. Some are absolutely not available, for example, glazes and plaster-of-Paris, used in making moulds. The reasons for this constraint are partly due to the small size of the branch, and therefore, low demand for raw materials. Other reasons may be an inadequate geological survey, and also a failure to seek and obtain technical assistance from various potential sources.

Poor product quality is another serious problem and constraint to market expansion. Inferior products are produced due to problems of materials and manufacturing techniques, and to old designs. Consequently, the products are not competitive against imports, without a high protective wall, sales revenue is low, and the branch's potential for export distribution is virtually eliminated.

The branch is constrained by a lack of detailed cost accounting. This is part of the overall constraint of inadequate financial management. Some of the consequences are excessive expenditures on overhead. They were very high relative to total costs of production for the major producer of the branch, during the period of about six years before it was placed under receivership.

Without detailed cost accounting, the managers of the enterprises in the branch cannot know the relative rates of profitability among the various products, and cannot pinpoint the location and occurrence of excessive costs, or unnecessary expenditures. With two out of three companies in the branch under receivership, because of defaults on loan repayments, the indication is that the managers did not adequately monitor the financial position of their companies. Perhaps they made investments that were not well evaluated.

In summary, most problems and constraints in the branch can be traced to the primary problems of gaps in technical know-how, inadequate analysis and management of finances, and deficiencies of one kind or another in raw materials and intermediate inputs.

4.3.3 Linkages

The ceramic industry has very strong backward linkages to the mining of non-metallic minerals and as these are normally located in rural areas, there is a beneficial income generating effect in these low income areas. Some temporary employment is also created during the periods when extraction takes place.

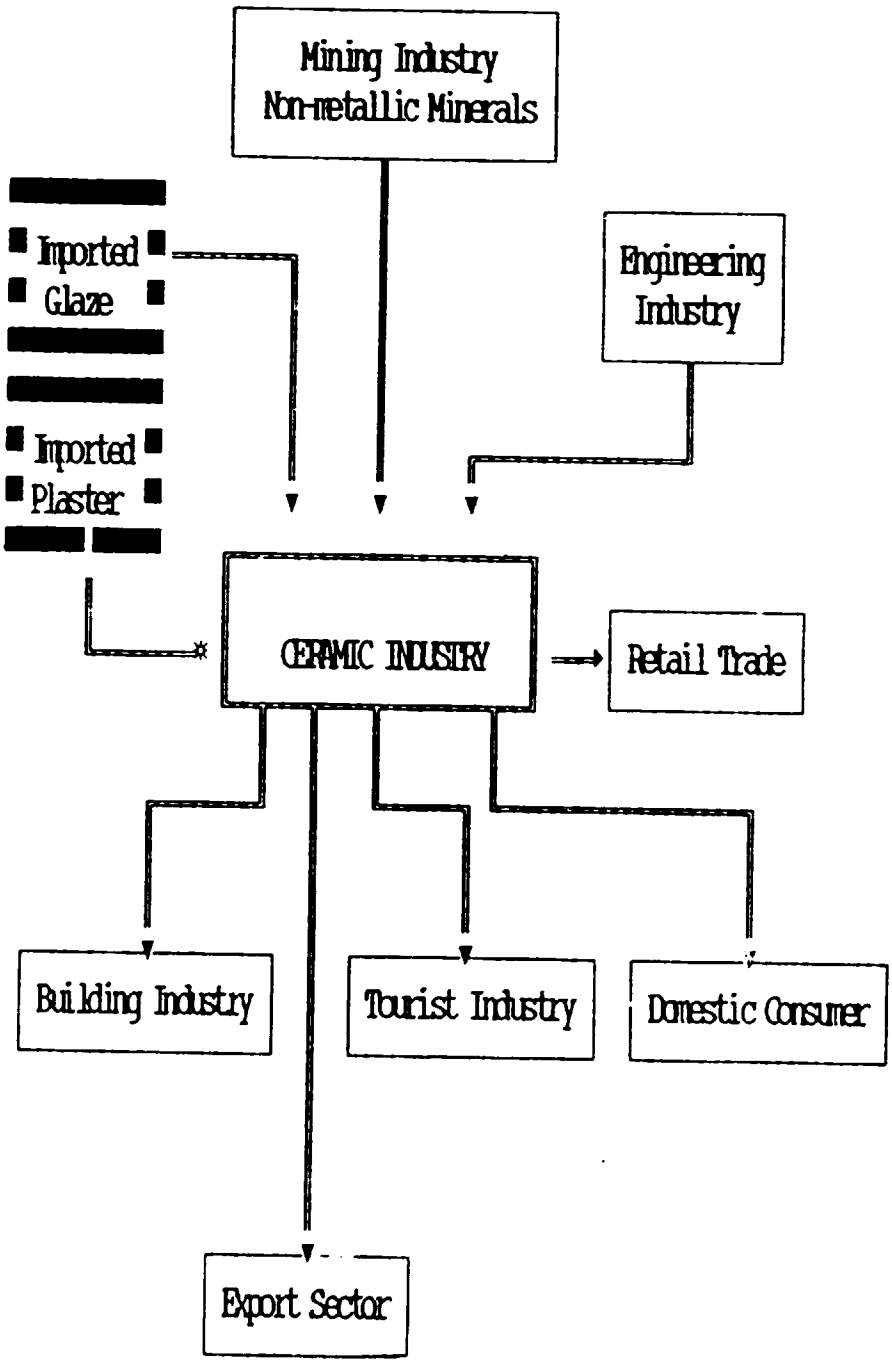
Backward linkages also exist to the engineering industry for the supply of spare parts and consumables but unfortunately some engineering concerns cannot supply the required items at the right quality. Improvement in the training of the machinists in this sector would enable the linkage to the ceramics sector to be strengthened.

Forward linkages exist to the building industry, which uses large quantities of sanitaryware and tile products. The value of sanitaryware in normal construction contracts in Kenya can amount to 15 per cent of the total, the majority of which is imported. Development of the ceramics sector would strengthen this linkage considerably with considerable savings in foreign exchange expenditure.

Forward linkages also exist to the domestic consumer and the tourist industry, crockery being sold to both individuals, supermarkets, hotels and restaurants. In all cases, the products are substitutes for imports.

There is some potential for exporting a small proportion of production into the regional market, once the volume of production has been increased and quality standards improved.

Figure 4.3: Ceramic industry - linkages



4.3.4 Ownership pattern

The formal sector contains only three main companies concerned with the manufacture of whiteware ceramics. The industry is dominated by one major company. This company was a private company until the beginning of the 1970s when ICDC bought a 20 per cent share of the company. In 1980, ICDC, together with ICDC Investment and the Development Financing Company of Ken. ., DFCK, acquired the remaining stock of shares, except for 8 per cent which remains in private hands. ICDC and ICDC Investment holds 75 per cent of the shares and DFCK holds 17 per cent, this gives ICDC complete control of the company. The company went into receivership in 1988. The question of new ownership was not settled at the time of the mission's visit (February, 1990).

Of the remaining main companies, one is a small private company which produces a small amount of giftwares. The other company was founded by the previous Managing Director, of the major company in the industry. The company went into receivership in 1987 and has now a limited production of tableware.

4.3.5 Spatial distribution

All of the main companies are located in the Nairobi area. The concentrated distribution of ceramics companies in Nairobi, is a natural consequence of the fact that the major market for the products is in the Nairobi area. A second factor is that the local raw materials for ceramic manufacture are within a reasonable travelling distance of Nairobi and the deposits are easily accessible from major roads.

4.3.6 Human resources

In 1987, wage employment in the ceramics industry in Kenya was recorded at less than 1,000, but there are a significant number of people engaged in the small or cottage scale sector of the ceramic industry. Because of the underdeveloped nature of this sector, no institution has been established as yet to provide formal training for ceramics. What domestic training that is available is inadequate and provided on-the-job. However, small numbers of Kenyans are sent abroad for advanced training. Unfortunately, funds for such training are limited. In short, human resource development for the ceramic industry in Kenya is woefully inadequate and is a major cause of the industry's current problems.

4.3.7 Policies and institutions as they relate to the ceramic industry

The performance of the Kenyan economy began to improve in 1985 after a few poor years due to drought and other external circumstances. In 1986, the GDP growth rate rose to 5.5 per cent per annum. Inflation declined to 5.7 per cent due to the government's constrained expenditures and economic management in the preceding years. 1985 was a good year in the Kenyan economy, and as the planners were in the early stage of writing the 1989-1993 development plan, the government produced Sessional Paper No. 1 of 1986 on "Economic Management for Renewed Growth." New directions in policies were being formulated for liberalization of the economy.

Going into the second half of the 1980s, the Government began to review the structure of customs duties on imports and the procedures for issuing import licenses. Presently, policy changes are being made toward further rationalization of customs duties and lowering of tariffs.

The procedure for obtaining an import license is an additional time consuming job for the ceramic industry, which depends on imported glazes for its production. After the license to import is obtained and the glaze is cleared through customs, 40 per cent duty is paid. Glazes are exempt from the 17 per cent sales tax. Most equipment is subject to 20 per cent customs duty and is exempt from the sales tax.

The Government has no policy that is specifically applicable to the ceramic industry. The industry is affected equally with other industries by such institutions as the Investment Promotion Centre and government policies for promoting exports.

The branch is small and there are no institutions specifically for the ceramic industry. The Kenya Industrial Research and Development Institute (KIRDI) and the Kenya Institute of Management (KIM) are two institutions that possibly could offer assistance in the problem areas of the branch.

CHAPTER 5
OBSERVATIONS AND RECOMMENDATIONS REGARDING COMPANIES

The mission examined three companies in detail in order to specify rehabilitation needs at the plant level. These were:

- a vegetable processing company;

- a textile company;

- a ceramics company.

The three companies were chosen from a list of 34 companies presented by the Government of Kenya and the Investment Promotion Centre. Of the candidate companies presented to the mission 10 companies are private and the remainder parastatals. In making the choice of companies, the mission consulted with the Ministry of Industry, other government departments, including the Ministry of Finance, the Ministry of Planning and National Development (MPND), the Investment Promotion Centre (IPC) and representatives of the Kenyan business community and of the country's main bilateral and multilateral co-operation partners.

Although, the three companies finally chosen were all parastatals, they were selected because the rehabilitation package developed for the companies examined, if considered a viable option, could provide ways and means for their subsequent privatization.

This emphasis is in keeping with the GOK's declared intentions to assess privatization as a policy instrument where appropriate. In the missions opinion, an examination of parastatal companies would be a valuable assessment of the possibilities for encouraging an increasing role for Kenyan entrepreneurs in these companies, both as financiers and managers.

The following general observations and recommendations are made with respect to finance, management, organization and marketing, human resources, physical plant and buildings and inputs.

5.1 Financial observations

All of the parastatal companies visited, operated with an extremely high debt load, which they were unable to service from their normal operations. In many cases the companies lacked adequate supplies of working capital and/or access to credits. This lack of funds negatively affects the performance of the companies as in many cases routine purchases can only be accomplished after serious delays. All companies had poor cost accounting systems, which meant that management had no reliable information on the precise costs of production, on which to base their decisions for product pricing.

Recommendations

In all cases it is essential that a financial restructuring is carried out, including the conversion of all, or most, of the debt into equity. In the case where receivership is involved, it is recommended that the company assets be sold to another company, thereby leaving all unsecured creditors behind.

It is recommended that proper costing systems are installed as a matter of urgency in all the companies visited.

5.2 Management, organization and marketing

General observations

(a) Board of Directors tend to contain too many high level persons from government and various institutions, many without any proven business experience at all. They are generally too busy to take part in board meetings but send alternates or nominees that do not have power or status to take any decisions.

(b) There appear to be significant vacancies and deficiencies at middle management levels. Top-management tends to be substandard, especially the political appointees. They generally lack sufficient knowledge of business and marketing and usually know very little about the technical details concerning their company's products.

(c) It is not uncommon for companies to have no sales organization outside the offices, that is, no sales representatives or retailers out in the field. This is partly because some of the companies work in a sellers market. Customers buy their needs either directly at the factory gate or via wholesalers. This means that the customers provide their own transport and the companies do not have to engage in any transport or distribution arrangements.

(d) Many companies never carried out proper market surveys to determine the market for their products. Companies need to undertake an extensive market survey for their products in order to find out their real export potential.

It may not be generally known but the Department of External Trade has Commercial Attachés in 15 countries all over the world. Five of them are located in Europe: UK, France, Belgium (EEC), West Germany and Sweden. The rest are to be found in USA, Japan, Pakistan, Ethiopia, Rwanda, Uganda, Tanzania, Zambia, Zimbabwe and Zaire. In other countries the trade questions are handled by the First Secretary of the Embassy. The Ministry of Commerce is also taking care of the Ministry of Industry's interest in foreign countries.

(e) Management Information Systems are generally non-existent, in the companies, for routine tasks such as accounting, administration, purchase and sales. Kenya Institute of Management will in the near future be able to provide training within this field. At the moment they have not a sufficient number of computer systems available. KIM's services are for their members only. The Government has its own training programme for managers. KIM has 2000 experienced managers as members and who are available as instructors.

Recommendations

(a) The Board of Directors in the companies should be reorganized and professionals from the business community should be brought in and engaged as members. The Board of Directors will then be able to function as a real support to the Management.

(b) Assessments should be carried out of the qualifications of both top and middle managers in companies. Appropriate adjustments and dismissals should be made. Existing managerial vacancies should be filled by qualified personnel. Political appointees of unqualified people should be avoided at all cost. Related available training facilities and technical assistance should be requested from Kenya Institute of Management, and UNIDO (also management support).

(c) Companies need to improve on their sales and trading systems by setting up a network of distributors throughout the country. Also distribution systems, need to be improved or acquired in all the companies.

(d) It is also recommended that those companies who engage, or are likely to engage in export trade make contact with the Ministry of Commerce for support and free advice on how best to begin or maintain export business.

(e) The introduction of computers for establishing for Management Information Systems would be beneficial in many companies together with appropriate training programmes for the management. Training for this is or will be available at the Kenya Institute of Management. Suppliers of computer systems also have training programmes for these kinds of activities.

5.3 Human resources

General observations

All the firms visited suffer from a high turnover in both top and middle managers. Although it appears that many workers have been working for the firms for a number of years regardless of working conditions, they are not necessarily satisfied with their work and positions and are generally demoralized by the low salary and few incentives given to them.

Despite available training facilities and funds (the training levy) provided by the government, the firms do not have a positive attitude towards training their workers. It is partly because the firms cannot afford to release their workers for training and also because the firms do not find it necessary to upgrade their workers' skill level by training other than on-the-job training. In particular, the firms have a very weak maintenance and repair capability due to a lack of qualified engineers and lack of a maintenance culture.

Recommendations

The firms should enhance their human resources by upgrading the quality of employees' skill levels through use of available government or private training institutions. In addition, the firms are recommended to search for better organized and higher quality on-the-job training systems which should give workers better understanding of their work and appropriate skills to produce faultless products.

In order to strengthen morale and motivation, the firms are recommended to provide an incentive scheme for employees. The scheme should not necessarily be based on the salary scale, but could take the form of improving the quality of facilities in the plant. This would provide workers with a better working environment. Motivation would also be helped by the provision

of welfare facilities outside the plant where workers can relax and rest during their break time or after work. The promotion of cultural and sports activities organized by the firms would be another means to motivate employees.

5.4 Physical plant and buildings

The buildings of all of the factories visited were generally in good condition structurally and require little rehabilitation work, except, in some cases, for some relatively minor roofing repairs.

The physical plant in all companies has generally been allowed to deteriorate over many years, due to the lack of spare parts and also, in some cases, due to lack of trained maintenance personnel and scheduled maintenance programmes and procedures. In the one case, where a good engineering department existed, they had been frustrated in their attempts to repair old machines by the lack of the necessary imported spare parts. Failure to import such spare parts was invariably due to the financial constraints on the company, caused by the overall poor performance of the company.

Some attempts had been made by companies to find local suppliers of spare parts for the machines but this was not always successful. Even when local engineering companies accepted an order, sometimes they could not obtain the necessary raw materials to carry out the work. This then delayed the delivery of the spares and often those delivered were of such poor quality that they could not be used. The machine therefore had to stand idle until new spare parts could be made. Such situations reduce capacity utilization and output, which increases unit costs and reduces even further, the ability of the company to purchase the necessary spares required to keep its assets in good condition.

Unfortunately it is a common reaction of the majority of companies, to reduce expenditure on spare parts when the performance of the company starts to deteriorate. This is normally entirely the opposite of what they should be doing. A downward spiral of deteriorating performance, followed by further reductions in maintenance then sets in.

Recommendations

Management of all companies must give priority to the strengthening or establishment of scheduled maintenance programmes and procedures. Priority must also be given to expenditure on the necessary spare parts to maintain the physical plant and buildings in good condition, even when the performance of the company deteriorates. If the company keeps its assets in good condition, it will be in a far better position to recover from a period of poor performance caused by other factors.

5.5 Inputs

Insufficient supply of raw material inputs for agro-based industries is a serious constraint. It is the single most important factor preventing acceptable utilization of processing capacities in the industries that have been investigated. Major reasons for insufficient availability of cotton fibre and vegetables are related to pricing and the incentives given to the producer as well as the inadequacy, or lack of the appropriate organizational structure and routines for production, procurement/collection and payment of the products.

In the case of cotton, orders placed with the CLSMB often go unfilled or partly filled. This unreliability in the supply of cotton is a major constraint affecting the basic profitability of firms in the textile industry. There is also a reluctance on the part of the CLSMB to import needed cotton supplies even though the production of locally grown cotton has been decreasing. There is the additional, but related, point that Kenya needs to improve the quality of its cotton by blending it with imported fibre. At present, the country produces medium-staple, medium-strength cotton that lowers the quality and strength of the yarn and decreases the efficiency in weaving. This is partly why factories manufacturing under bond are reluctant to use local fabrics.

From the national viewpoint, Kenya's textile industry needs more specialization and increasing reliance on domestically grown fibres - cotton and wool. But the government's own institutions have been thwarting that goal through declining real prices and delayed payments to cotton farmers and erratic and insufficient imports of cotton to cover the deficit in supplies in Kenya. The recent increase in the price of cotton from KSh 6 to KSh 10 may reflect a shift in policy to favour cotton production. Still, so long as cotton supplies are severely constrained, individual companies must strive to import more and more synthetic fibres despite the implications for overall national development. The CLSMB has not encouraged factories to import stronger, longer-staple cotton for blending with local fibre to upgrade the end product. This reticence has hampered the textile industry's efforts to secure the domestic market against the many imported - often smuggled - fabrics.

In the case of the vegetable processing industry, world markets for processed vegetables are highly competitive and a great many countries, particularly developing countries, are trying to increase their exports. The cost of packaging materials is a significant part of total product costs. Increased supply of packaging materials at competitive prices is a pre-requisite for increased exports of processed vegetables from Kenya. Also, consumers in the industrialized countries are increasingly concerned about the high content of chemicals in processed and fresh food. As yet, there does not seem to be sufficient awareness in Kenya of these changes in the preferences of consumers in industrialized countries.

The raw material inputs of the minerals for ceramic industries are normally never tested properly on a regular basis, either at the quarry sites or upon delivery to the factory. In addition, the volumes of the materials at each quarry location are not known and the quality variations within the deposits are not known. No stockpiling of raw materials is carried out to minimize natural variations in properties. The factories therefore use raw materials with unknown and varying properties for the manufacture of products, which demand precise knowledge of the properties of all body constituents. The fact that factories have suffered continuously from poor quality and high wastage is therefore not surprising.

The fuel inputs to the companies can frequently be in short supply. This is particularly evident in the supply situation of LPG.

Imported inputs such as Plaster-of-Paris, glaze, decals and spare parts are frequently held up due to lengthy import procedures and slow clearance of goods from the port.

Recommendations

The Government should intensify its efforts to ensure that the supply of cotton to the textile industry is regular and reliable. The CLSMB should urgently examine the need to import supplies of cotton in special circumstances. This need for cotton imports is especially important when local supplies are unavailable and/or there is a need to improve the quality of locally grown fibre by blending it with imported cotton. Improved quality of Kenya's cotton fabrics would greatly increase their export potential.

In order to increase exports of processed vegetables, the Government should take steps to facilitate an increase in the supply of packaging materials at competitive prices for processed vegetables. In addition, the Government should encourage the processed and fresh vegetables industry to pay serious attention to the concern, on the part of consumers in industrialized countries, about the high content of chemicals in processed and fresh vegetables. Kenya, unlike many industrialized countries, grows vegetables in many areas which do not suffer from pollution and upon which chemicals have not been extensively used hitherto. This is an image that Kenya must maintain and exploit to the fullest. The international market for fresh and processed vegetables grown in a relatively pollution and chemical-free environment may well be a market niche in which Kenya would have a comparative advantage. A market survey should be undertaken to assess this possibility.

All raw materials for the ceramic industries must be thoroughly evaluated prior to use on the factory. This must include assessment of the volumes and quality variation at each quarry site. Stockpiling of materials should be a normal production procedure, both to minimize the natural variations and to allow time for testing of the stockpiled material prior to use in production. Any variations can then be forecasted with accuracy, so that adjustments can be made to the body compositions to compensate for these changes.

Factories dependent on regular LPG supplies should invest in the facilities to enable them to use an alternative fuel, when LPG supplies are insufficient for requirements.

All imported consumables and spare parts should be ordered well in advance, to take into consideration the time required for import procedures and port clearance. Stocks of the most important imported materials, which are crucial to maintaining production, should be held at the factory, whenever possible to cope with unforeseen delays.

CHAPTER 6
GENERAL OBSERVATIONS AND RECOMMENDATIONS

6.1 General policy recommendations

All the companies visited are parastatals and have been operating at a loss for many years. For all of them, the value of the assets are far lower than liabilities. The rehabilitation of these companies would necessitate that the creditors, most of them being public institutions, would have to write off a substantial part of the debts. It cannot be in the interest of Kenya to let parastatals operate at a loss for such prolonged periods. Government policies are clearly needed in this respect.

The Government needs to monitor closely the development of the economic performance of parastatals at all times and would have to make necessary decisions at an early stage so that the use of national resources is optimized.

It was sometimes suggested that the parastatals also perform a social function. This is certainly true in many cases. However, the cost of subsidizing a company must be weighted against the benefits obtained. It may well be the case that the subsidy would produce more social benefits if invested elsewhere. In general, management was not clear as to the objectives of the companies.

It is important to define the objectives clearly for each parastatal. Yearly plans have to be elaborated in line with defined objectives.

In none of the plants visited was there an incentive system, either for the workers or for the management. Management often viewed themselves more as public employees than responsible for the company. Management often felt that key decisions lay outside their control.

Government policy on the future of parastatals is not yet clear. Policy decisions are needed on which enterprises should remain with the public sector and which should be privatized.

6.2 Regional dimensions

The East African Community was formally dissolved in 1977 but trade problems were already evident several years before. The Preferential Trade Area Treaty became operational in 1983 to promote trade within Eastern and Southern Africa. Together with other states in Africa, the Caribbean and the Pacific (ACP), Kenya has signed the Lome Convention. ACP countries benefit from access to the EEC market and nearly all industrial products are exempt from duty and quantitative restrictions.

At present, both the textile and ceramics companies produce mainly for the domestic market. Within the next few years there will be little interest for the companies to expand exports, because domestic demand is higher than production. Moreover, entering the export market would require marketing efforts which may not be justified during the period of rehabilitation.

The vegetable processing company has produced mainly for the European market. If the plant is rehabilitated, there may be a regional demand for dehydrated vegetables, particularly in food processing such as different kinds of soups.

In summary, regional cooperation for the three plants studied is not an immediate objective.

6.3 The manufacturing sector

Manufacturing is a leading growth sector in the Kenyan economy, and it produces about 12 per cent of the nation's GDP. Its potential, however, is diminishing due to declining investment in fixed capital. Statistical information shows a degree of disinvestment, which is confirmed by informal observation. The outlook of manufacturers has been dulled in recent years by fluctuating economic conditions and uncertainties in the business climate.

The sector is helped and encouraged by tariff protection and import controls. It is assisted financially by government policies to support industry, especially through various DFIs. Foreign investors are covered by the Foreign Investment Protection Act. These are positive elements of assistance, but the government also restrains and closely controls the manufacturing sector through numerous licensing, marketing, and financial controls.

Manufacturers must obtain a variety of licenses, depending on details of their businesses. Requirements include licenses for trade, imports, exports, employee entry and work permits, and licenses for manufacturing under bond. Besides the licenses, there are many rules and regulations, for example, the requirements to file returns and pay income taxes, a training levy, and sales tax. Manufacturers must file survey information each year regarding ownership, investment, turnover, employment, and so forth. Recently, they have been required to identify distributors of their products under the Trade Licensing Act, and they are accountable for the authenticity of each of their dealers as a holder of a valid distributorship license. They are accountable also for a variety of conditions that are covered in the Restrictive Trade Practices, Monopolies and Price Control Act of 1988.

Manufacturers are faced with price controls for some items, and not always can they freely purchase their inputs from the market. Many inputs must be purchased from a marketing board, such as the Coffee Board, Tea Board, Sisal Board, Pyrethrum Board, National Cereals and Produce Board, National Irrigation Board, and the Cotton Board. They are subject to financial controls, such as foreign exchange controls, foreign exchange allocations for business travel, controls on the payment of dividends and profits, and so forth, in addition to the already mentioned taxes and tariffs.

The manufacturing sector shows diversity, but individual manufacturing firms produce a wide a range of products. Quality control is largely a missing factor, as well as a lack of regular attention and specialized staff for product and production engineering to improve products and production processes. Management is too often carried out as a routine, as could be expected in a bureaucratic administration. Insufficient attention is given to financial management and maximization of returns to investment through proper cost accounting and analysis. The direction of enterprises do not show the initiative and the venturous drive that is typical of successful manufacturers on the international market.

The Government is aware of the obstacles to production mentioned above. Indeed, significant steps are being taken to remove these obstacles. But it is clear that the Government's efforts in this connection need to be more focussed, integrated and intensified.

In sum, the Government must be constantly aware of the need to provide an enabling environment in which manufacturing can prosper.

CHAPTER 7
SUMMARY OF PROJECT CONCEPTS

7.1 General

- Technical assistance (UNIDO) to establish within a Ministry selected by the Government of Kenya, a specialist consultancy unit with required expertise to undertake comprehensive surveys of rehabilitation needs in Kenyan manufacturing industry, to design appropriately phased rehabilitation programmes, undertake full feasibility studies and market surveys, assist in securing financing, advising on and monitoring the implementation of rehabilitation programmes.

7.2 For all enterprises visited

- Improve the management training of all senior and middle management, especially in the use of management information systems.

- Provide micro-computer and associated training especially to improve cost accounting systems.

- Improve the technical training of production and maintenance staff by means of technical assistance programmes (UNIDO) which would include a limited number of spare parts as part of the training programme.

ANNEX 1

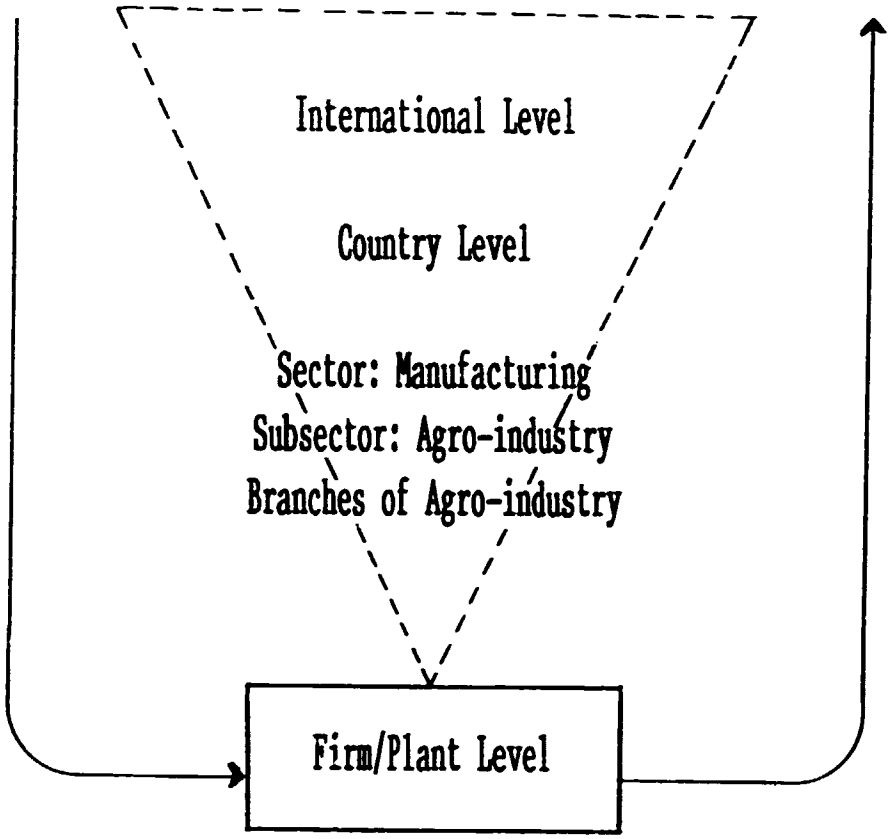
The UNIDO integrated "Top-Down/Bottom-up" approach to rehabilitation

Until now, most work in Africa on industrial rehabilitation has not been systematic or comprehensive, and international co-operation has also suffered from these shortcomings. Rehabilitation has been viewed either as the treatment of a plant's technical problems - without analyzing the real causes or their ramifications - or as a macro-economic issue. In the first case, technical assistance activities have often been carried out in isolation from governments' fiscal, monetary and economic policies, without taking into account financial requirements, market possibilities, and the availability of raw materials and intermediate outputs. This approach has frequently resulted in rehabilitation projects that were too narrowly focused. Concentration on solving individual problems runs the risk of other problems being ignored. In the second case, the diversity of economic activities and economic potential at the micro-level is not always appreciated.

The concept of industrial rehabilitation obviously needs to be broadened and integrated: it should combine an understanding of both macro-economic forces and real problems at the plant level. Manufacturing enterprises should be studied in relation to their total economic environment. Diagnostic analyses and remedial action programmes should cover the entire range of technical, managerial and technology issues at the plant level as well as the overall financial, commercial and structural issues at the branch and macro-economic levels. An approach covering all these issues would be a top-down/bottom-up approach. It would start with an examination of the macro-economic level, descend through the sector, subsector and branch levels, and arrive finally at the plant level. On the basis of this approach, industrial rehabilitation would become an exercise in securing the optimal use of existing capacities and resources for future, general industrial growth: it would become part of an attempt to regenerate the African industrial development process.

The integrated, multidisciplinary approach can be summarized in Figure 1 below. In order to assure that rehabilitation is not impeded by environmental factors, the "top-down" analysis is followed by an assessment of each firm in terms of its rehabilitation climate, from the bottom up. In other words, an effort is made to assess what changes in the economic and institutional environment (e.g. government tariff policies, regulations concerning allocation of foreign exchange, etc.) constitute preconditions to successful plant level rehabilitation. By examining the plant in its total working environment from top-down to bottom-up, UNIDO believes it can identify the means for firms to achieve long-term viability.

Figure 1: The Plant in its working environment: Top-down/Bottom-up approach



Top-Down:
Analysis of Working Environment as it Affects Individual Plants

Bottom-up:
Recommended Changes in the Working Environment

The Top-Down/Bottom-up approach leads to three main tasks. The first is to identify suitable enterprises where scarce foreign exchange and other investible resources will be most efficiently used to upgrade production and company performance, thus ensuring the greatest impact on overall growth. In particular cases, industrial rehabilitation may actually lead to plants being recommended for closure. In such cases, even though important social and political implications have to be considered, shut-downs cannot be excluded. The established concept of rehabilitation often restricts the view of decision-makers to existing industrial structures, whereas a wider and more forward-looking regeneration concept might help all parties concerned to see closure as a necessary part of an attempt to establish an industrial structure with better prospects for sustained growth.

The second task is to combine the plant rehabilitation process with a restructuring programme of the industrial sector as a whole so as to ensure growth, domestic economic integration, and/or the provision of support industries and services. Such a programme will entail investment in new capacities in industry, infrastructure, services and primary commodity production. The third requirement is to adjust the policy and administrative framework to support better the domestic and international efforts towards the industrial regeneration objective.

Rehabilitation can thus been seen to be a process that has technical, technological, organizational and managerial implications. It also has economic, financial, marketing, design and engineering aspects. Similarly, restructuring at the subsectoral level should take into account economic and financial aspects, as well as the general and technical management structure, product technology and range, and domestic and foreign markets. The wide range of issues involved implies that human, physical and financial resources should be concentrated on a few manageable projects or markets, and attention should be focused on technological developments and market trends.

As the approach covers a wide range of issues successful implementation requires the mobilization of resources from domestic entities, both public and private, and from foreign multilateral, bilateral, commercial and financial bodies. The activities of these entities should be co-ordinated to provide the appropriate assistance to plants, subsectors and overall industrial regeneration.

The Top-Down/Bottom-up approach also suggests a concentration on a few important firms in key subsectors with good backwards and forwards linkages to other firms, industries and sectors, especially primary sectors such as agriculture and other natural resource sectors.

Emphasis on a few strategic firms with good linkages in key subsectors concentrates resources where they can have most impact. It also maximizes the multiplier effects of any given investment. In that, should these firms be successfully rehabilitated they will exert a significant "pull-effect" on other similarly placed firms. They thus become the motors to start the regeneration process going and provide the dynamism for more widespread economic growth.

In sum, the application of the Top-Down/Bottom-up approach will assist African Governments to link the macro-industrial, macro-economic, branch-level and project issues to decisions taken on rehabilitation and upgrading of production. The approach is also expected to increase the rate of survival of particular plants or sub-sectors being rehabilitated, if due consideration is given to the context in which the selected plants or sub-sectors operate. Industrial rehabilitation must be a dynamic, forward-looking concept. Restoring industry is not sufficient, for both the world and economic conditions change rapidly. Ignoring these changes might lead industry back to its prior unacceptable state.