

VALUE CHAIN BASED MATCHING GRANT FUND PROJECT

COTTON TO GARMENT APEX STRATEGIC PLAN 2006- 2010

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KENYA COTTON SECTOR STRATEGIC PLAN 2006- 2010

1. Background & Context

1.1 Introduction

As part of private sector development and poverty alleviation, the government of Kenya with assistance from the World Bank is implementing the **Micro, Small and Medium Enterprise Competitiveness Project (MSMECP)** as a public/private partnership. Under this arrangement the private sector is managing and implementing the project under the oversight and guidance of a public/private steering committee.

1.2 Overall Project Purpose

The Kenya **Micro, Small and Medium Enterprise Competitiveness Project** aims to increase productivity and employment in participating MSMEs. The project's objective is to strengthen financial and non-financial markets to meet the demand of MSMEs, strengthen institutional support for employable skills and business management, and reduce critical investment climate constraints on MSMEs through the following three overall components:

- ⇒ Access to Finance;
- ⇒ Strengthening Enterprise Skills and Market Linkages; and
- ⇒ Improving the Business Environment.

One sub-component under the "Strengthening Enterprise Skills and Market Linkages" component focuses on key value chains, initially on a pilot basis and later mainstreamed to other sectors. The pilot value chain program is focused on Pyrethrum, Coffee and Cotton sub-sectors. This strategic plan focuses on the cotton sub-sectors.

1.3 The Value Chain Based Matching Grant Fund Sub-Component

The objective of the pilot value chain based matching grant fund program is to strengthen competitiveness and raise value-added in selected supply chains by enhancing access to business development services (BDS) and strengthening linkages (both between firms and from MSMEs to markets). The core of the component will be a matching grant fund designed to stimulate increased demand by MSMEs for BDS and a supply response oriented toward servicing specific markets on a sustainable basis.

The matching grant fund program will provide financial incentives for eligible training and other BDS, particularly 'knowledge-based' services directed toward improving competitiveness and performance at critical points in value chains. Specifically, funds from the matching grant can be applied towards the purchase of technical assistance to train out growers/suppliers or, at the factory level, to procure process specific technical assistance to improve the quality, cost and delivery of products. For example at the farming level, grant funds can be used to finance on-farm technical training, training in quality control, post-harvest handling and other activities that strengthen the backwards linkage between the corporate intermediary and their growers/suppliers to better respond to demands of the market. Similarly, at the factory level, grant funds can be used to procure total quality management, just in time (JIT) management and other modern production and management techniques to help improve the quality, cost and delivery of companies in the

sub-sector. Other typical sub-sector BDS interventions include market access, technical assistance for processors to international buyers, increasing public-private coordination in extension services, and reduction of specific administrative barriers.

Access to the matching grant fund will be based on commercially sustainable pilot project proposals. Pilot project proposals will be drafted jointly by firms or representative industry associations/networks that define their membership along two or more segments within the entire value chain for an industry, and that have created a pilot project management team (PPMT) for the purpose of executing the pilot project.

1.4 The Cotton Apex Committee

The Government of Kenya through the Ministry of Trade and Industry with assistance from the World Bank is implementing the Value Chain Based Matching Grant Fund Project as part of its Economic Recovery Strategy for Wealth and Employment Creation, 2003-2007. The project is focusing on coffee, cotton and pyrethrum value chains.

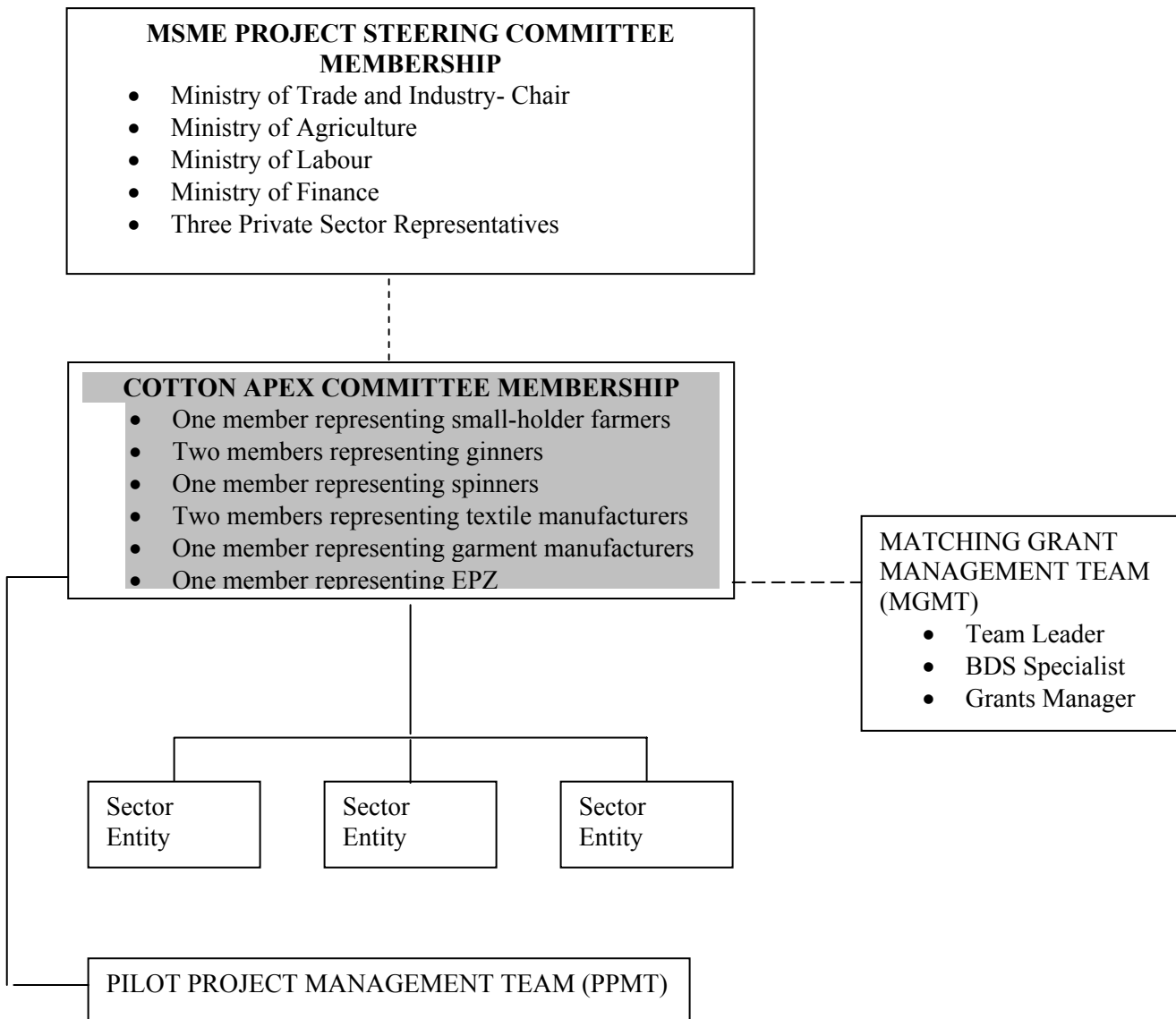
As a first step in project implementation, sector organizations in the value chains were required to convene to form an APEX Committee comprising of key players along the entire value chain. With assistance from the World Bank, the key players in the cotton sector met and appointed seven (7) representatives to form The Cotton Apex Committee as follows:

- i) One (1) member representing **Small Holder Farmers**
- ii) Two (2) members representing **Ginners**
- iii) One (1) member representing **Spinners**
- iv) Two (2) members representing **Textiles Manufacturers**
- v) One (1) member representing **Garment Manufacturers**
- vi) One (1) member representing **EPZ**

Besides taking the lead in preparation of industry-wide strategy that reflects issues identified by the value chain analysis and the vision, objectives and goals of the industry, the Cotton Apex Committee has the following responsibilities:

- Act as the coordinating body to convene all sector forums along the value chain;
- Act as the principal body to develop consensus between various sector entities to help implement industry-wide strategies.
- Serve as a central body within the context of Matching Grant Fund Project to approve project concepts prepared by operators

Figure 1: The Structure Of The Matching Grant Fund Project



1.5 Cotton Sector Analysis

The cotton-to-textile/garment sector in Kenya is far from realizing its true potential. The most important reasons for the current situation are:

- The ubiquitous inefficiencies in the agrochemicals market play a large part in cotton farming costs. Also there are currently no mechanisms in place in Kenya to guarantee the quality of a crucial ingredient in cotton farming: cotton seeds. At the same time no policies are in place to reverse a decline in labor productivity and quality.
- Just like in the cotton sector, the liberalization of 1991 broke up the old production and marketing structure but left a vacuum that damages the interests of cotton producers and ginners. There are no coherent, institutional linkages between the two sectors even though the success of both sectors is very interdependent (ginneries' key input is seed cotton and the key customer of cotton producers are ginneries).
- Uncompetitive electricity prices and expensive chemicals represent significant variable costs and hurt all players in the value chain: the ginners, with high energy consumption because of the outdated machinery, the textile and garments' sector dyeing stage of production, etc.
- Thus, inefficiencies filter up the value chain until the cotton-based inputs become too expensive for the next input use, such as textile and garments producers using inputs from ginneries, and the high value added supply chain brakes. As a result, textile mills producing yarns and fabric for exports don't use domestic lint cotton at all, while the one producing for domestic markets use only around 20% of domestic cotton.
- The government inability to control the imports of used cotton garments and fabrics is hurting the domestic cotton-to-garment industry significantly. Moreover, the sector is increasingly perceived as a high-risk one by the financial sector, which is increasing the costs of borrowing money up to the point of making it unaffordable for small to medium size firms that need modern equipment to improve their mills' productivity.
- Undeclared fabric imports are another major problem in the industry. It is creating a dominance of imported, second hand garments market. This market is not only detrimental to the domestic supply chain, but is also creating a dependency of a large number of people, whose welfare is dependent on the growth of this market. This is a major risk for the sector, as is the garment exporters' lack of a diversification strategy for their exports, which are almost entirely oriented towards the United States and highly dependent on imported materials.

It is along these policy and market distortions that remedies should be sought for the sector, both from the government and the market players themselves. In this sense, an apex organization that would address all these issues and start tackling the problems in the supply chain is overdue.

1.6 The Regulatory Framework

1.6.1 The Cotton Act Cap 335 (1989)

The Cotton Act Cap 335 of 1989 established the Cotton Board of Kenya to provide for the promotion and regulation of the Cotton industry. The functions of the Board include:

- a) To plan, monitor and regulate cotton growing and cotton ginning;
- b) To license and control ginners and other persons dealing with cotton;
- c) To regulate and carry out quality control of raw cotton and cotton ginning;
- d) To regulate the export or import of cotton lint or cotton seed;
- e) To advise the Minister on the pricing of raw cotton;
- f) To regulate and control the quality and supply of planting seed through ginneries;
- g) To carry out and promote research and development in cotton production and processing technology;

- h) To provide training, either on payment or without charge or co-ordinate training for any sector of the cotton industry.
- i) To render other services prescribed by regulations within the Act which include:
 - (i) Prescribing the kind and quality of planting seed and prohibiting the use of any other kind and quality or seed for growing cotton;
 - (ii) Regulating the method of purchase, collection, transport, movement, storage, ginning, baling or otherwise preparing, sale or disposal of any particular kind or quality of planting seed, raw cotton, cotton lint or cotton seed;
 - (iii) Regulating the distribution of planting seed to persons requiring it for planting;
 - (iv) Providing for the requisition of planting seed;
 - (v) Regulating and controlling the method, time and place of planting and growing cotton and the acreage which may be planted by any person;
 - (vi) Providing for the inspection of planting seed, raw cotton, cotton lint, cotton seed, cotton plantations, stores and ginneries and prescribing the class and standard of premises which may be used in the ginning, baling and storage of cotton;
 - (vii) Prescribing either or both maximum or minimum prices to be paid to growers of raw cotton in any area; and different prices may be prescribed for different types of grades of raw cotton.

The major challenges facing the cotton sector revolve around the above issues. Following market liberalization, the roles and responsibilities of the Kenya Cotton Board became unclear. This left an institutional vacuum in the cotton sector. Consequently, there are no effective institutional linkages between cotton producers and ginners.

1.6.2 Cotton (Amendment) Bill 2005

The Cotton (Amendment) Bill, 2005 was published on April 12, 2005. The first reading in parliament has been done. The National Cotton Stakeholders Forum (NCSF) together with Christian Agricultural and Related Professionals Associations (CAPRA) had a meeting with the parliamentary committee on Agriculture and extensively discussed the contents of the bill. The NCSF and CAPRA are waiting for a meeting with the Ministry of Agriculture, to discuss further the contents of the bill. Until this bill is passed, the regulatory vacuum in the cotton sector will remain a challenge.

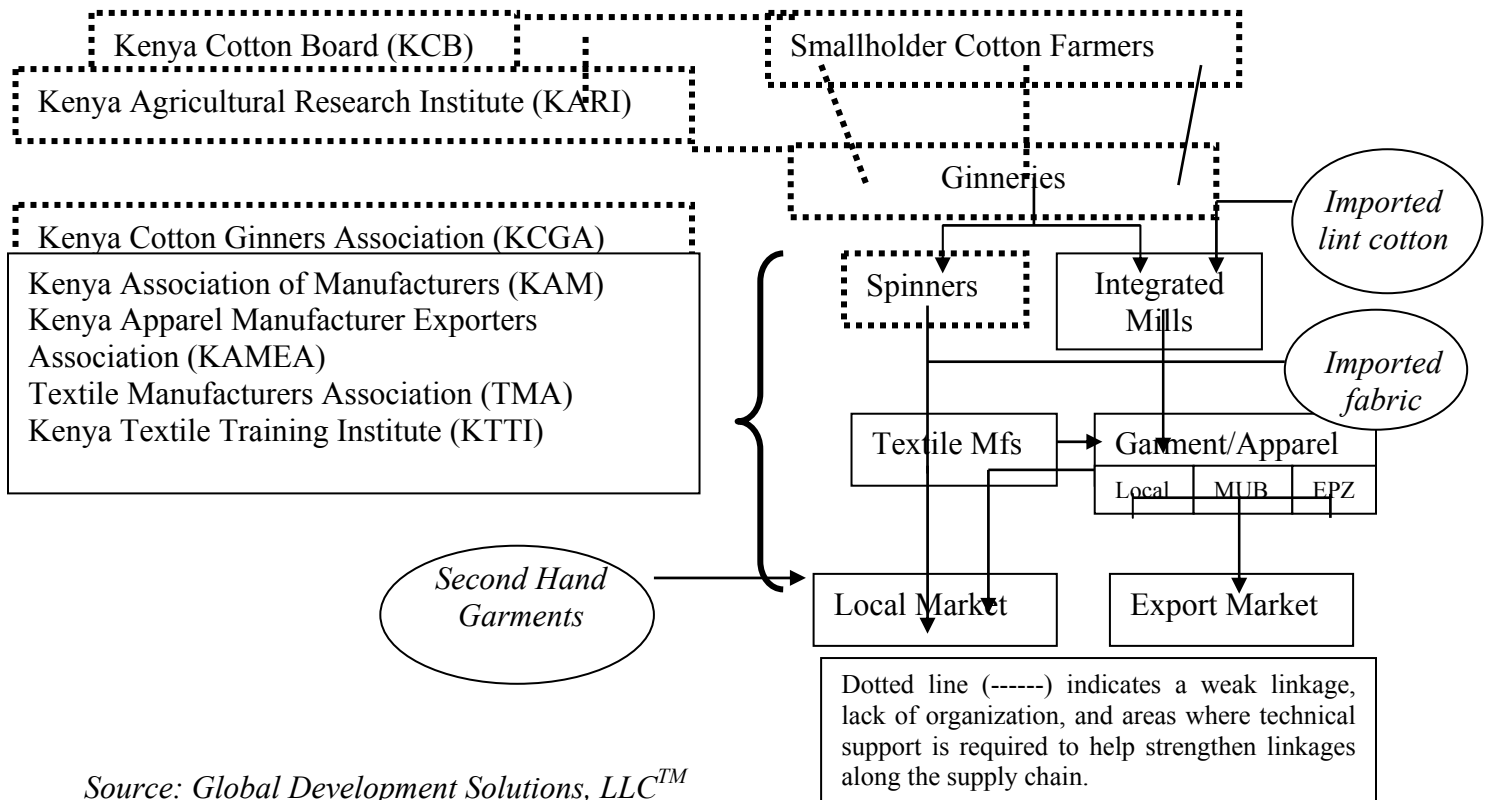
1.7 Cotton-to-Textile/Garment Market and Institutional Support Structure in Kenya

Since market liberalization in 1991, the cotton-to-textile/garment market structure has lacked the kind of market and institutional dynamics required to remain competitive with global players like China, or even with regional competitors such as South Africa and Lesotho. While Kenya's garment sector has successfully rebounded since 1994 after the United States banned several products alleging that Kenya was transshipping goods from Asia, the cotton-to-textile/garment sector is far from realizing its true potential.

The cotton-to-garments supply chain can be divided into four major sectors and a number of sub sectors. The principal sectors are smallholder cotton farmers, ginners, textile and spinners, and garment and apparel manufacturers.

The four sectors are supported in varying degrees by a number of institutions, some of which are highly disorganized and lack both market and political leverage to adequately represent and support their constituents.

Figure2: Cotton-to-Garment Market and Institutional Support Structure
Institutional Support Structure *Market Structure*



Source: Global Development Solutions, LLC™

Smallholder Cotton Farmers: Currently there are estimated 140,000 smallholder cotton farmers spread out across western, Nyanza, Rift Valley, Central, Eastern and Coastal areas, with the highest yield per hectare achieved in the Rift Valley. Farmer groups are not well organized. Since market liberalization, the roles and responsibilities of the Kenya Cotton Board (KCB) have been unclear, thus leaving an institutional vacuum in the cotton sector. This is particularly problematic as there is no apex organization to bridge the gap between cotton farmers and ginners to help coordinate production, improve on-farm practices to increase and support cotton marketing. In addition to the lack of organization among cotton farmers, lack of institutional representation, and the weak linkage mechanism in place between cotton farmers and ginners, smallholder cotton farmers face a problem with low yield, partly given the poor quality of seeds available in the market.

Here, the Kenya Agricultural Research Institute (KARI) should be playing a major role in introducing new seed varieties, as well as to take an active role in seed bulking to make clean and high quality seeds available to the cotton sector. Plagued with a range of institutional challenges, KARI has been weak in responding to the needs of the cotton sector.

Ginners: Currently there are an estimated 24 ginneries operating in Kenya. The disorganized privatization process has left the sector in a state of disarray where in some cases ginneries were sold off for only a fraction of their assessed value. Within the cotton-to-textiles/garments supply chain, the ginning sector is considered the weakest link. The sector is not well organized nor represented, and there is a gross lack of investment in equipment rehabilitation resulting in a low ginning outturn (GOT).

The Kenya Cotton Ginners Association (KCGA) has only recently become more active in organizing the ginning community and representing their interest within both the public and private sectors. However, additional institution capacity building is required to help strengthen the sector, as well as to serve as a representative body to coordinate production, quality control, human resources development, and technical support both within the sector and with the cotton farming sector.

Textile Manufacturers: The textile sector can be divided into at least two sub sectors, namely spinners and integrated mills. Spinners principally produce yarn which is supplied to both textile manufacturers and the garment/apparel sectors. Currently, spinners do not have a separate institution representing their interest, but generally fall under the domain of the Textile Manufacturers Association (TMA) under the Kenya Association of Manufacturers (KAM).

It is not clearly evident that a separate institutional structure is required, particularly as close coordination between spinners, textile manufacturers and garment/apparel manufacturers is essential. In addition to the spinners, there are integrated mills that produce yarn, woven, knitted, and finished fabrics which are either sold directly to local markets or to garment/apparel manufacturers for further processing. Integrated mills represent a bulk of the activities in the textile sector, and are represented by the TMA. However, TMA is generally overshadowed by KAM which represents the interests of the garment/apparel sector.

Garment/Apparel: It is estimated that there are 170 large scale and 74,576 small and micro garment/apparel manufacturers operating in Kenya today. Of these 37 are export oriented and generate a bulk of the revenue for the country. The large scale manufacturers are well represented by KAM, particularly as it is a strategic sector for the Kenyan economy.

There continues to be a lack of coordination between KAM and other institutions down the supply chain, particularly with regards to strengthening linkages between the various sectors, and taking the lead in identifying means of channeling investment and working capital, and technical assistance to reduce the entire industry's dependence on imported input material, and to help redefine the cost structure for the entire cotton-to textile/garment supply chain. The lack of coordination and leadership by the garment sector is reflected in the fact that there is very little evidence to suggest that Kenya will be in a position to comply with new conditions set out under AGOA requiring exporters to the U.S. to source fabric locally or from other AGOA-accredited countries. This is particularly true in the context of expanding opportunities to source fabric from local suppliers.

2. Cotton Sector

2.1 Background

The cotton sector in Kenya is characterized by a large number of small holder farmers (140,000) with a low average yield rate (572 kg/ha of seed cotton) and poor cotton fiber quality. Approximately 384,500 hectares of irrigated and rain-fed land is available for cotton production, of which only 10.4% or 40,000 hectares are currently under cultivation. Given the variety of cotton currently grown in Kenya (HART 89M, and KSA 81M), the production potential of available cotton land is approximately 368,000 bales. However, due to a number of policy and market based distortions, realized production is a mere 8.2% of the potential or 30,000 bales of lint cotton. The production of cotton in Kenya peaked in 1984 with production reaching as high as 70,000 bale of lint cotton per year. This trend, however, collapsed during the 1990s. Until 1991 Kenyan cotton production closely tracked real gross producer prices. Although cotton prices have improved since 1991, when the market was liberalized, cotton production in Kenya continues to remain flat.

Several factors can be attributed to the collapse of the cotton sector and the current lack of responsiveness of cotton farmers to improvements in international cotton prices.

- (i) The lack of adequate planning associated with the liberalization of the Cotton Board of Kenya (CBK), which resulted in:
 - a) Elimination of price guarantees which used to be announced at the beginning of each season;
 - b) Regulatory vacuum resulting from the lack of clarity regarding the role of the CBK;
 - c) Prevalence of poor quality agricultural inputs, particularly contaminated seeds;
 - d) Collapse of input credit mechanisms;
 - e) Collusion between cotton buyers; and
 - f) Inadequate control of lint quality.
- (ii) Collapse of cooperatives that owned most of the ginneries, left cotton farmers without markets for their harvest
- (iii) High cotton farming costs, particularly as they relate to agrochemicals inputs.
- (iv) Growing import of second-hand clothing, and more importantly, sales of illegally imported fabrics, both of which have dampened demand for local cotton and textiles.

2.2 Cotton Sector Profile

Table 1: Kenya's Cotton Sector Profile

1.0 Land available for cotton production	
1.1 Rain-fed production	350,000 ha
1.2 Irrigated production	34,500 ha
1.3 Actual land currently under production	40,000 ha
1.4 Capacity utilization	10.4%
2.0 Production level	
2.1 Rain-fed production (potential)	260,000 bales (lint)
2.2 Irrigated production (potential)	108,000 bales (lint)
2.3 Actual production (2002)	30,000 bales (lint)
2.4 Realized production potential	8.2%
3.0 Farmers in cotton production	140,000 small holder farmers
4.0 Cotton variety	HART 89M; KSA 81M
5.0 Farm size (average)	< 1 ha
6.0 Yield rate (average)	
6.1 Seed cotton	572 kg/ha
6.2 Lint cotton	191 kg/ha
6.3 Seed-to-lint Conversion ratio	2.99:1
6.4 Yield potential	2,500 kg/ha
6.5 Realized yield	22.8%
7.0 Production cost (average)	\$0.26/kg (seed cotton)
8.0 Market price (average)	\$0.31/kg (seed cotton)
9.0 Cotton import	8,709 bales (lint)
10.0 Cotton export	3,266 bales (lint)
11.0 Contribution to GDP	< 2%

Source: Global Development Solutions, LLC™

2.3 Value Chain

The value chain for cotton production can be divided into nine key value adding activities:

- | | |
|----------------------|--|
| (i) Land preparation | (vi) Weeding (3 times/season) |
| (ii) Planning | (vii) Chemical spraying (5 times/season) |
| (iii) Seeding | (viii) Fertilizing (2 times/season) and |
| (iv) Thinning | (ix) Harvesting |
| (v) Stamping | |

2.4 Challenges

Summary of Constraints Faced by the Cotton Sector in Kenya

Policy Based Distortions	Market Based Distortions
Improper liberalization of the cotton industry has resulted in the absence of an apex organization to facilitate market linkages between cotton farmers and ginneries	Sales of poor quality cotton seeds is going unregulated thus contributing to a dramatic decline in per hectare yield rate and poor fiber quality
Tax regime that favors importation of packaged agrochemicals rather than local reformulation and repacking	Collapse of the input credit system has resulted in farmers reducing the use of prescribed agrochemicals, which has contributed to the decline in per hectare yield rate and poor fiber quality

Policy Based Distortions	Market Based Distortions
Restrictive registration process regarding importation of agrochemicals have discouraged competitively priced generics from entering the market, and have also resulted in monopolistic pricing behaviour among select companies in the agrochemicals industry	Sales of poor quality lint cotton is going unregulated thus contributing to a market shift toward reliance on imported cotton and illegal finished fabrics
Lack of enforcement capability has resulted in distribution and sales of pirated and adulterated pesticides	Absence of transparent and market oriented linkages between cotton production and ginning sectors which results in collusion between cotton buyers and reluctance on the part of cotton farmers to improve production and farming practices
Absence of regulatory framework and enforcement resulting from the weakened position and lack of capacity and direction of the CBK	Slow revitalization of the ginning sector is creating a bottleneck in the development of the cotton sector and competitiveness of the textile and garment sectors
	Decline in labor quality resulting from the absence of training and extension services, and the lack of out grower programs to channel technical support activities
	Lack of market infrastructure to support seed oil processing and sales of products

Source: Global Development Solutions, LLC™

3. Ginning Sector

3.1 Background

Liberalization of the cotton industry in 1991 brought a fundamental shift in the primary marketing and processing of cotton. For the first time cotton growers were able to bargain directly with buyers. While this was seen as an advantage for farmers, the stiff competition for seed cotton and the unregulated market led to undifferentiated sales of AR and BR grade cotton in the market. By 1993, the depreciation of the Kenya shilling push cotton prices to an all time high of Ksh 35/kg. By 1995, however, the Kenya shilling had appreciated nearly 100%.

The strong shilling made imported cotton from Tanzania and Uganda extremely attractive, where Tanzania lint cotton could be landed in Kisumu for Ksh 56/kg, while the breakeven cost for Kenyan lint cotton hovered at around Ksh 70/kg. Within a matter of one year, cotton farmers were receiving prices as low as Ksh 15/kg.

Since market liberalization there has been an institutional vacuum to facilitate the primary marketing and processing of cotton. In short, the cotton farming and ginning sectors have been void of an effective market linkage mechanism to help coordinate the production and sale of seed cotton. Taking into account that links between cotton farmers and ginners are perhaps the most critical linkage in the entire cotton-to-garment supply chain, the long absence of an apex organization to bridge the interest of these two sectors has proven to be a crippling factor for the development of the textiles and garment industry.

Recent estimates suggests that there are approximately 24 ginners with an installed capacity of 132,375 tons per annum distributed across 327 gins in varying states of disrepair. Ginneries in Kenya rely principally on roller technology, a technology available since 1935, but appropriate for the type of fiber characteristics most commonly found in

Kenyan seed cotton. In ginning, ginning outturn (GOT) or the ratio of lint to seed cotton produced by the ginning process, is a critical factor that defines the competitiveness of the ginning sector. The potential GOT for the two cotton varieties grown in Kenya, namely HART 89M and KAS 81M, is between 40 – 42 percent. In reality, however, the average GOT achieved by most ginneries in Kenya is approximately 33%. The under performance of Kenyan seed cotton can be attributed in part to poor staple length of seed cotton, and the dilapidated state of ginning equipment, some that lack drying and moisture-restoration devices.

3.2 Sector Profile

Table 2: Kenya's Ginning Sector Profile

1.0 Number of ginneries	24
1.1 Cotton Board of Kenya	1
1.2 Cooperatives	6
1.3 Private investors	17
2.0 Ginning capacity	
2.1 Number of gins	327
2.2 Total ginning capacity	132.375 tons
3.0 Technology in use	Roller technology
4.0 Average capacity utilization	24%
5.0 Ginning outturn (GOT)	
5.1 Potential	43%
5.2 Actual	33%
6.0 Cotton purchasing method	
6.1 Direct purchase from farmers	77%
6.2 Intermediary/brokers	23%
7.0 Cotton purchasing schedule	Ad hoc
8.0 Average price for seed cotton paid by ginneries	Kshs 15-23/kg
9.0 Out grower schemes	Limited, principally to provide credit for purchase of pesticides

Source: Global Development Solutions, LLCTM

3.3 Value Chain

In addition to procuring seed cotton, the ginning process can generally be divided into five stages of value adding activities:

- (i) Drying/cleaning;
- (ii) Ginning;
- (iii) Cleaning/packing;
- (iv) Transportation; and
- (v) Administrative costs

The highest value component of the ginning value chain, of course, is the cost of seed cotton, which constitutes 86% of the total value. This is followed by cleaning/packing (3.9%) and drying and cleaning (3.1%). The value of raw material inputs, namely seed cotton, dwarfs the other factors associated with ginning.

Consequently, containing the cost of producing seed cotton would have the largest single impact on the delivered price of lint cotton. Given the fragmented market structure, the ability of ginneries to work with their seed cotton suppliers to help reduce the cost of producing seed cotton is expected to play a critical role in improving the competitiveness of the entire cotton-to garment supply chain.

3.4 Challenges

Summary of Constraints Faced by the Ginning Sector in Kenya

Policy Based Distortions	Market Based Distortions
The ginning sector is devoid of a strong institutional representation to help develop and implement a long-term strategy with the cotton farming community that would improve both yield and quality of seed cotton	A critical shortage of investment in upgrading or replacing dilapidated ginning equipment
Institutionalizing mechanisms to define grade and price for seed cotton	Low GOT due to the poor quality of seed cotton and outdated ginning equipment
Absence of institutional support infrastructure to assist ginners expand out grower/supplier programs to help improve seed cotton yield and quality	Low capacity utilization due to limited supply of seed cotton
VAT on spare parts contributing to the high cost of equipment maintenance and the pace of investments in upgrading dilapidated ginning equipment	No market mechanisms to help consolidate harvest from a large number of smallholder farmers and to transport seed cotton to processing facilities
Absence of technical support institutions to help improve the quality and productivity of factory labor force	Reliance on expensive imported packing material with limited drive to expand local sourcing
Absence of institutional infrastructure to facilitate dialogue across the entire farm-to-finished product supply chain to help coordinate and improve responsiveness of value adding activities that help create demand for primary inputs while at the same time enhance the competitiveness of finished goods	Absence of a planning cycle for sales of harvest due to the lack of contractual mechanism between farmers and ginners, and disruptive behavior by intermediaries/brokers
Uncompetitive electricity pricing policy that has a rippling effect across the entire farm-to-finished goods supply chain	No incentives nor support infrastructure to invest in human resources to improve labor productivity

Source: Global Development Solutions, LLCTM

4. Textile Sector

4.1 Background

In 1983 Kenya had 52 textile mills operating with an installed capacity of 115 million square meters per annum. Since then market liberalization, an increase in imports of second hand clothing, exchange rate fluctuations, inequitable import duties and a host of other factors have contributed to the dwindling of the textile sector to the point that today, it is estimated that only 8 integrated textile mills are still in operation.

When military conflict in East and Central Africa escalated during the mid-1970s, Kenya became the staging ground for international humanitarian aid. As a result, used and rejected clothing from Europe and the United States entered Kenya duty free to be redistributed as a part of a humanitarian aid package. Eventually, however, imported new and used garments and fabrics began entering the local market.

By 1990, the import of new and used garments and fabrics captured 54.7% of the Kenyan market, thus effectively choking the local farm-to-finished goods supply chain in the cotton and textile sectors. The Kenyan Government reacted by imposing a duty on such imports, but the Government's efforts to limit the import of second hand garments and fabrics has enjoyed limited success. Data from 2001 suggests that the total textile demand in Kenya was 225 million square meter equivalent, where 57.5 million square meter equivalent or 25.5% is supplied through domestic sources, while the remaining 74.5% of demand is met through imported goods.

4.2 Sector Profile

Table 3: Kenya's Textile Sector Profile

1.0 Number of companies currently operating in the sector	52
2.0 Production capacity (per annum)	
2.1 Spinning (in millions)	
2.1.1 installed capacity	30 tons
2.1.2 actual production capacity	20 tons
2.2 Weaving (in millions)	
2.2.1 installed capacity	115 m ²
2.2.2 actual production capacity	83 m ²
3.0 Total Textile Demand (2001)	225 million square meter equivalent
4.0 Local Fabric Production (2001)	57.5 million square meter equivalent
5.0 Imported Textile Goods (2001)	167.5 million square meter equivalent
6.0 Import of Woven Fabric (2002)	
6.1 Quantity	4,265,699 m ²
6.2 Value	Ksh 508,119,781
7.0 Export of Woven Products (2002)	
7.1 Quantity	1,041,655 m ²
7.2 Value	Ksh 51,802, 299
8.0 Key Export Markets: Yarn	
Democratic Republic of Congo	6.5%
Malawi	5.8%
Sudan	0.5%
Tanzania	29.8%
Uganda	49.3%
Zimbabwe	5.3%
Other COMESA countries	2.8%
9.0 Key Export Markets: Fabrics	
Democratic Republic of Congo	0%
Malawi	0%
Sudan	7.3%
Tanzania	35.2%
Uganda	21.3%
Zimbabwe	22%
Other COMESA countries	14.2%

Source: Global Development Solutions, LLCTM

4.3 Value Chain

Currently, there are 8 textiles mills operating in Kenya, two which do spinning to produce threads, while the remaining 6 are integrated mills that do weaving, knitting, dyeing, and finished fabrics. Cost of milling can vary widely according to the quality and origin of lint cotton used for the process. Textile mills producing yarns and fabrics for export oriented companies tend to rely on imported rather than domestic lint cotton

After seed cotton has been ginned, lint cotton must go through four value adding activities:

- | | |
|----------------|--------------------|
| (i) Combing; | (iii) Weaving; and |
| (ii) Twisting; | (iv) Dyeing |

In addition to other difficulties in accessing affordable financing, other challenges contributing to low productivity in the spinning sector include:

(i) Technical Factors

- Lack of modern equipment which would improve mill speeds and twisting – currently operating at approximately 30% of industry norm
- Do not have regular monitoring of waste to identify specific technical solutions to reduce overall cost of waste – current estimates suggest 1% reduction in waste can lead to savings of Ksh 80,000/month
- No collection and analysis of operational data to pinpoint recurring technical and mechanical problems
- No regular maintenance schedule which would reduce downtime
- Maintenance is slow and of poor quality

(ii) Human Resource Factors

- Limited in-house training in areas such as piecing and doffing, which can result in improved productivity and reduce stoppage
- Poor labor utilization: industry standard for a 'drawing' machine operation is 1 worker to 5 machines. Spinners in Kenya are utilizing an average of 1 worker for 3.5 machines
- Labor productivity is 30% lower than industry norm as a result of low quality of technical skills, lack of in-house training activities, and the absence of local training institutions

4.4 Challenges

Summary of Constraints Faced by the Textile Sector in Kenya

Policy Based Distortions	Market Based Distortions
Uncompetitive electricity pricing policy adding substantially to the cost of production	High dependence on imported inputs, ie. the price of locally sourced lint cotton is high and fiber quality low
High volume of under-declared fabric imports is stifling the revitalization of the entire cotton-to-textiles supply chain. Weak enforcement of customs regulations and oversight by Kenyan Revenue Authority of duty, VAT and IDF charges	Low quality of lint cotton available through the local market contributes to high level of waste in both spinning and fabric production, thus increasing the unit cost of fabrics and finished products
Weak oversight and inspections at Mombasa Port (Port Authority) and a number of strategic border crossings where under-declared fabrics enter Kenya	Disproportionate dependence on imported fabric, particularly taking into account the potential capacity of local cotton farmers and ginners
Weak inspections and enforcement of business regulations and licensing in targeted locations within Nairobi where a small but prominent group of dealers facilitate transactions of under-declared fabrics	High cost of locally produced lint cotton
Existing regulations allowing cargo valued under \$5,000 to enter has unintended consequences	Given the uncompetitive cost of input materials, millers are charging high profit margins, particularly at the twisting and weaving stages
Government is under estimating the impact of allowing under-declared imports to enter the market on the entire cotton-to-textiles supply chain, and particularly on the impact these transactions have on contributing to rural poverty among cotton farming communities	High cost of imported chemicals due to high transport costs and the lack of sourcing options, particularly through local enterprises
Lack of investments by the private sector in upgrading and rehabilitating the ginneries is partly due to the depressed demand for local cotton as a result of unregulated imports of under valued fabrics	High cost of accessing capital (18% for short-term 3 month loan) and high collateral requirements (180%), particularly as the textile industry is viewed by commercial banks as 'high risk'
Weak and sometime non-existent business associations implies need for stronger institutional infrastructure to help mobilize players along the entire cotton-to-textiles supply chain to help self-regulate and place pressure on local enterprises facilitating illegal transactions in under valued imports	Poor labor utilization and labor productivity, particularly due to the lack of in-house training and poor data on tact time
Limited coordination between various business associations to define and implement an industry wide strategy for growth	Absence of modern shop floor management practices and adherence to international standards
	High cost of transport for imported input material

Source: Global Development Solutions, LLC™

5. Garment Sector

5.1 Background

Kenya's garment sector is principally driven by exports to the United States under the AGOA agreement. As of 2002, Kenya surpassed Mauritius to become the third largest exporter of apparel and textiles to the U.S. from Africa generating over \$123 million in export sales. This is a far cry from 1994 when the U.S. shut out several products from Kenya over alleged transshipment of goods from Asia. Currently 37 large scale garment manufacturers export to the U.S. under AGOA of which 25 are located within the export processing zone (EPZ), 7 enjoy MUB status (manufacture under bond), and 5 operate outside both EPZ and MUB.

According to the Export Processing Zone Authority, within the EPZ, textile firms employ about 25,288 workers. On the other hand, however, small and micro garment producers, including small ginneries and retailers handling second hand garments, employ as many as 230,956 workers. The growth in employment among small and micro garment manufacturers is a direct reflection of the continued decline in employment in large-scale export oriented textile, garment and apparel industries. Small and micro garment manufacturers sell most of their products to local authorities, schools and local firms, and operate independently of regional and international export markets. Consequently, the welfare of small and micro garment manufacturers producing garments and apparel is being greatly damaged by the growing import of second hand clothing

5.2 Sector Profile

Table 4: Kenya's Garment Sector Profile

1. Garment Manufacturers	
1.1 Large scale	170
1.2 Small and micro	74,576
1.3 Export oriented	37
2. Export Destinations	
2.1 USA	79%
2.2 Europe	8%
2.3 EAC/COMESA	7%
2.4 Others	6%
3. Total Exports to USA	\$123 million

5.3 Value Chain

In addition to the cotton material, the value chain for a cotton T-shirt can be divided into at least five levels of value adding activities:

- a) Cutting/layering;
- b) Sewing/assembly;
- c) Finishing;
- d) Packing/loading; and
- e) In-factory inspection/administration.

The cost of cotton material dominates the value chain, but as sewing and assembly are the core value adding activity for garment manufacturing, costs associated with this portion of the value chain tend to be relatively high.

5.4 Challenges

Summary of Constraints Faced by the Garment Sector in Kenya

Policy Based Distortions	Market Based Distortions
Uncompetitive electricity pricing policy	The future of Kenya's garment industry is principally dependent on AGOA and the U.S. market, making the entire industry vulnerable to fluctuations in a singular market and policy
High dependence on AGOA suggests a need for a public-private partnership between government and the cotton-to-textiles and garment sector to formulate an achievable diversification strategy to reduce the dependence on a single market/policy	Market failure has had a displacement effect on employment in the industry resulting in a large number of disorganized small and micro garment producers whose livelihood is principally dependent on the success or failure of second-hand garments
Absence of incentives for non-EPZ, non-MUB status garment manufacturers to investment in new capital equipment and rehabilitation	Large scale export oriented manufacturers are highly dependent on price fluctuations and quality of imported material
Need to contain the influx of under declared fabric to help strengthen the relationship between textile and garment manufacturer	High cost of cotton material, particularly imported material, make both domestic and export oriented manufacturers vulnerable to competition
No incentives for producers in the industry to adopt modern manufacturing practices	High labor content and low labor productivity during sewing and assembly suggests a need for intensifying in-house training, and the introduction of world class manufacturing methods, poke yoke, standard operating procedures, and 5S
Absence of institutional infrastructure to help small and micro garment manufacturers organize into economic groups, as well as to link such groups into a larger export oriented supply chain	High rejection rate suggests a need for in house training and integration of modern management practices
Lack of political will to curtail the influx of second hand garments into Kenya	Lack of coordination between the entire cotton-to garment supply chain to improve production and access to high quality, low cost cotton
	Labor intensive garment production, particularly among domestic market oriented manufacturers due to high cost of investment, uncertain market demand and competition from under declared fabrics and second hand garments

Source: Global Development Solutions, LLCTM

6. Vision and Mission Statement

Strategic Vision

"Integrating the cotton-to-garment industry and ensuring global competitiveness"

Mission Statement

"Develop a transparent industry operating in a level playing field producing competitive quality goods benchmarking high yield, efficiency, and productivity to maximize market opportunities."

7. Summary of SWOT Analysis

Strengths	Weaknesses
<ul style="list-style-type: none"> - Renewed interest by the industry players - Price to farmer linked to world market prices - Active stakeholders forum (National Cotton Stakeholders Forum) - Renewed focus on the sector 	<ul style="list-style-type: none"> - Lack of an apex organization to facilitate market linkages between cotton farmers and ginneries - Shortage of cotton - Lack of system to ensure quality seeds to farmers - Poor bargaining power of small-holder for purchasing inputs and consolidating harvest - Collapse of farm input credit system - Lack of training and extension services for farmers - Lack of business orientation among small holder cotton farmers - Unskilled labour - Poor regulation for second hand garment imports - Lack of support institutions for skills development - Lack of infrastructure to support seed oil processing - Unregulated sale of poor quality lint cotton leading to preference of imports - Obsolete ginning techniques - Low capacity utilization throughout the value chain - Lack of investment in upgrading technology - High cost of locally produced lint cotton
Opportunities	Threats
<ul style="list-style-type: none"> - Increasing global demand for cotton - Specific budget allocation by the government - Matching grant funding - AGOA - Low-cost labour - Government commitment to revitalization of cotton farming 	<ul style="list-style-type: none"> - High cost of doing business -electricity, infrastructure, agrochemicals - Overdependence on AGOA - Unlimited import of secondhand clothes - Import of fabrics and garments uncontrolled - Restrictive registration process for importation of agrochemicals - Unfavourable public procurement rules - Competition from low cost producing countries like China - Competition from cotton substitutes (non-cotton fabric and garments) - Lack of enforcement capacity leading to poor quality inputs and unfair competition - High cost of capital and high collateral requirements

8. Strategic Issues

A strategic issue is a fundamental challenge facing a sector. Identifying strategic issues enables the sector institutions to focus on the challenges hindering the success of the sector. Failure to respond to a strategic issue can lead to undesirable results from a threat, weaknesses, or missed opportunity. After conducting a comprehensive analysis of cotton sector, the following issues were identified for action in order to ensure the success of the sector.

a) Cotton farming issues:

- Delays in paying farmers
- Low quality planting seeds
- High cost of agrochemicals and transport
- Low bargaining power of farmers
- Lack of extension services and farmer training
- Inconsistent non-transparent pricing
- Low Yield per hectare
- Lack of an apex body

b) Cotton Ginning Issues

- High cost of doing business (cost of ginning, transport, lint and seeds)
- Lack of technical support institutions to help improve quality productivity of factory labour force
- Obsolete ginning techniques
- Lack of incentives for investment in improving labour productivity
- Reliance on expensive imported packing materials

c) Textile/Garment Manufacturers

- Import of fabrics/substandard garments
- Import of fabrics/garments without paying duty and VAT
- Unlimited second hand imports
- Lack of preferential policy on procurement of textiles by the government for its own use
- Cost of doing business (high cost of electricity, low quality of power – fluctuation, high port charges and poor port administration, poor roads/railway maintenance and high interest cost)

9. Strategic Objectives

The Apex Committee came up with the following strategic objectives:

- (i) Reduce cost of doing business
- (ii) Improve transparency in market transactions
- (iii) Improve access to high quality inputs to achieve maximum yield
- (iv) Improve chain wide efficiency, productivity
- (v) Optimize comparative advantage offered by Kenya
- (vi) Influence the GOK policy to ensure transparent and level playing field for all.
 - a. Strengthening
 - b. Influence GOK to enforce existing laws on importation of textiles and related products.

10. Strategic Actions, Responsibility and Monitoring

1. Cotton Farming				
Strategic Objective	Strategy (How to address)	Responsibility (Who to do)	Monitoring / Performance Indicators	Time Frame (By when)
i) Reduce cost of doing business	<ul style="list-style-type: none"> Strengthening formal farmer groups in order to access services and bulk purchases 	<ul style="list-style-type: none"> Apex Committee National Cotton Stakeholder Forum 	<ul style="list-style-type: none"> Over 80% small holder farmers belonging to organized groups 	2008
	<ul style="list-style-type: none"> Develop a system to improve farmers access to microfinance facilities 	<ul style="list-style-type: none"> Apex Committee National Cotton Stakeholder Forum 	<ul style="list-style-type: none"> Over 50% small holder farmers have access to microfinance 	2007
ii) Improve transparency in market transactions	<ul style="list-style-type: none"> Explore STABEX methodology of funding to whole cotton sector (as done in coffee) 	<ul style="list-style-type: none"> Kenya Cotton Growers Association Apex Committee 	<ul style="list-style-type: none"> STABEX in place 	2010
	<ul style="list-style-type: none"> Popularize pricing formulae and set payment deadlines 	<ul style="list-style-type: none"> Kenya Cotton Growers Association National Cotton Stakeholder Forum Apex Committee 	<ul style="list-style-type: none"> 100% of farmers aware of pricing formulae Farmers paid within 30 days after delivery 	2006
iii) Improve access to high quality inputs to achieve maximum yield	<ul style="list-style-type: none"> Create an oversight body to ensure seed quality and certify seeds. 	<ul style="list-style-type: none"> Kenya Agricultural Research Institute (KARI). 	<ul style="list-style-type: none"> Oversight body to test & certify seed quality in place 	2007
	<ul style="list-style-type: none"> Expand out growers /supplier programs to help improve seed quality Arrange financial assistance for ginners to address seed issues 	<ul style="list-style-type: none"> KEPHIS Apex Committee Kenya Cotton Growers Association Ginners Ministry of Agriculture 	<ul style="list-style-type: none"> Existence of a system for seed multiplication Availability of quality planting seeds Budget allocation to ginners 	2008

1. Cotton Farming				
Strategic Objective	Strategy (How to address)	Responsibility (Who to do)	Monitoring / Performance Indicators	Time Frame (By when)
iv) Improve chain wide efficiency and productivity	<ul style="list-style-type: none"> Improve commercial orientation among small holders 	<ul style="list-style-type: none"> Apex Committee National Cotton Stakeholder Forum 	<ul style="list-style-type: none"> Over 50% small holder farmers trained on farming as a business 	2007
	<ul style="list-style-type: none"> Provide extension services and training programs to farmers 	<ul style="list-style-type: none"> Apex Committee Ministry of Agriculture 	<ul style="list-style-type: none"> Availability of extension services in all major cotton farming areas Farmers training programs in place in all growing areas Improved yield per hectare to over 1 ton/ha 	2009
	<ul style="list-style-type: none"> Establish a cotton development organization (CDO) 	<ul style="list-style-type: none"> Ministry of Agriculture Apex committee National Cotton Stakeholder Forum 	<ul style="list-style-type: none"> Effective cotton Development Organization (CDO) in place 	2008
v) Optimize comparative advantage offered by Kenya	<ul style="list-style-type: none"> Increase land under production 	<ul style="list-style-type: none"> Kenya Cotton Growers Association Apex committee National Cotton Stakeholder Forum 	<ul style="list-style-type: none"> Over 100,000 ha under cotton cultivation 	2009
vi) Influence the GOK policy to ensure transparent and level playing field for all.	<ul style="list-style-type: none"> Lobby government to introduce incentives to cotton farmers and other industry players 	<ul style="list-style-type: none"> Ministry of Agriculture Apex committee 	<ul style="list-style-type: none"> Cotton farming incentives in place 	2010

2. Cotton Ginning				
Strategic Objective	Strategy (How to address)	Responsibility (Who to do)	Monitoring / Performance Indicators	Time Frame (By when)
i) Reduce cost of doing business	<ul style="list-style-type: none"> Lobby government to pay for seed already supplied to farmers and provide extension services Develop a system to enhance access to cheaper money 	<ul style="list-style-type: none"> Apex Committee Ginners Association 	<ul style="list-style-type: none"> Government pays for seeds supplied to farmers 	2007
	<ul style="list-style-type: none"> Lobby government to Exempt lint from VAT Create a system for consolidating harvest from small holders for easier and cheaper transportation 	<ul style="list-style-type: none"> Ministry of Agriculture AFC, Government, World Bank Ministry of Finance Ginners 	<ul style="list-style-type: none"> Availability of cheaper money Lint VAT exempt 70% of small holders use a consolidated delivery system 	2008
	<ul style="list-style-type: none"> Lobby government to remove VAT on cotton ginning equipment and other industry charges 	<ul style="list-style-type: none"> Apex Committee Ginners 	<ul style="list-style-type: none"> Cotton equipment VAT Exempted 	2008
	<ul style="list-style-type: none"> Explore ways of expanding local sourcing as an alternative to expensive imported packing materials 	<ul style="list-style-type: none"> Ginners/ Ginners Association 	<ul style="list-style-type: none"> Over 50% of packing materials sourced locally 	2008
	<ul style="list-style-type: none"> Up date the ginning technology 	<ul style="list-style-type: none"> Ginners 	<ul style="list-style-type: none"> 50% of ginners use modern technology 	2009
ii) Improve access to high quality inputs to achieve maximum yield	<ul style="list-style-type: none"> Register ginners as seed merchants 	<ul style="list-style-type: none"> Kenya Cotton Ginners Association (KCGA) 	<ul style="list-style-type: none"> Availability of quality planting seeds to farmers Improved lint quality 	2009
iii) Improve chain wide efficiency, productivity	<ul style="list-style-type: none"> Out source training services for productivity improvement 	<ul style="list-style-type: none"> Apex Committee Ginners Kenya Cotton Ginners Association (KCGA) 	<ul style="list-style-type: none"> Over 50% of ginners outsource training 	2006
	<ul style="list-style-type: none"> Establish a technical support institution to provide training 		<ul style="list-style-type: none"> Existence of technical support institution 	2008
iv) Influence the GOK policy to ensure transparent and level playing field for all.	<ul style="list-style-type: none"> Lobby government (Ministry of Finance) to introduce a levy on fabric and garment imports to provide incentives on investments in improving labour productivity 	<ul style="list-style-type: none"> Ministry of Agriculture National Cotton Stakeholder Forum 	<ul style="list-style-type: none"> Incentives in place for investments in improving labour productivity 	2009

3. Textile/Garment Manufacturers				
Strategic Objective	Strategy (How to address)	Responsibility (Who to do)	Monitoring / Performance Indicators	Time Frame (By when)
i) Reduce cost of doing business	<ul style="list-style-type: none"> Lobby for reduction of government levies on power cost/ Lobby ERB for electricity tariff review Lobby KPA to improve efficiency Lobby government to reduce taxation on fuel Conduct energy use audit and embark on improvement Bench mark against best practice in other industries/countries Link with other donor organizations who provide low cost credit 	<ul style="list-style-type: none"> Kenya Association of Manufacturers Kenya Association of Apparel Manufacturers and Exports (KAMEA) Textile Manufactures Association (TMA) Apex committee National Cotton Stakeholders Forum Kenya Association of Apparel Manufacturers and Exports (KAMEA)/Textile Manufacturers Association Kenya Association of Manufacturers (KAM)/Textile Manufacturers Association 	<ul style="list-style-type: none"> Reduced cost of electricity per unit Improved port administration Reduced tax on fuel Over 60% manufacturers conduct energy use audits and embark on energy efficiency improvement programs Availability of low cost credit to manufacturers 	2009
				2007
				2008
				2009
ii) Improve chain wide efficiency and productivity	<ul style="list-style-type: none"> Develop training programs for productivity improvement along the chain 	<ul style="list-style-type: none"> Kenya Association of Apparel Manufacturers and Exports (KAMEA) Textile Manufactures Association (TMA) Apex committee 	<ul style="list-style-type: none"> Productivity improvement training programs in place Over 70% manufacturing staff trained on productivity improvement 	2009
iii) Influence the GOK policy to ensure transparent and level playing field for all.	<ul style="list-style-type: none"> Lobby KRA officials to enhance compliance on tariff collection Lobby KPA to improve on policing and oversight Pre-shipment regulations to be implemented Lobby government for quantitative restrictions/quotas Lobby government to buy its requirements from local manufacturers - through a subsidiary amendment to the current procurement bill through trade ministry 	<ul style="list-style-type: none"> Apex Committee National Cotton Stakeholders Forum Kenya Association of Manufacturers (KAM) Kenya Association of Apparel Manufacturers and Exports (KAMEA) Apex committee National Cotton Stakeholders Forum Textile Manufactures Association (TMA) Kenya Association of Manufacturers (KAM) Kenya Association of Apparel Manufacturers and Exports (KAMEA) Apex committee National Cotton Stakeholders Forum 	<ul style="list-style-type: none"> Improved compliance on tariff collection Improved policing by KPA Full implementation of pre-shipment regulations Quantitative restrictions in place Preferential status given to local products in textile/garment procurement by government 	2006
				2007
				2008
				2007