



Impact of COVID-19 on the manufacturing sector in Kenya: **One year on**

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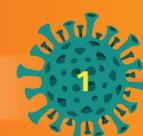
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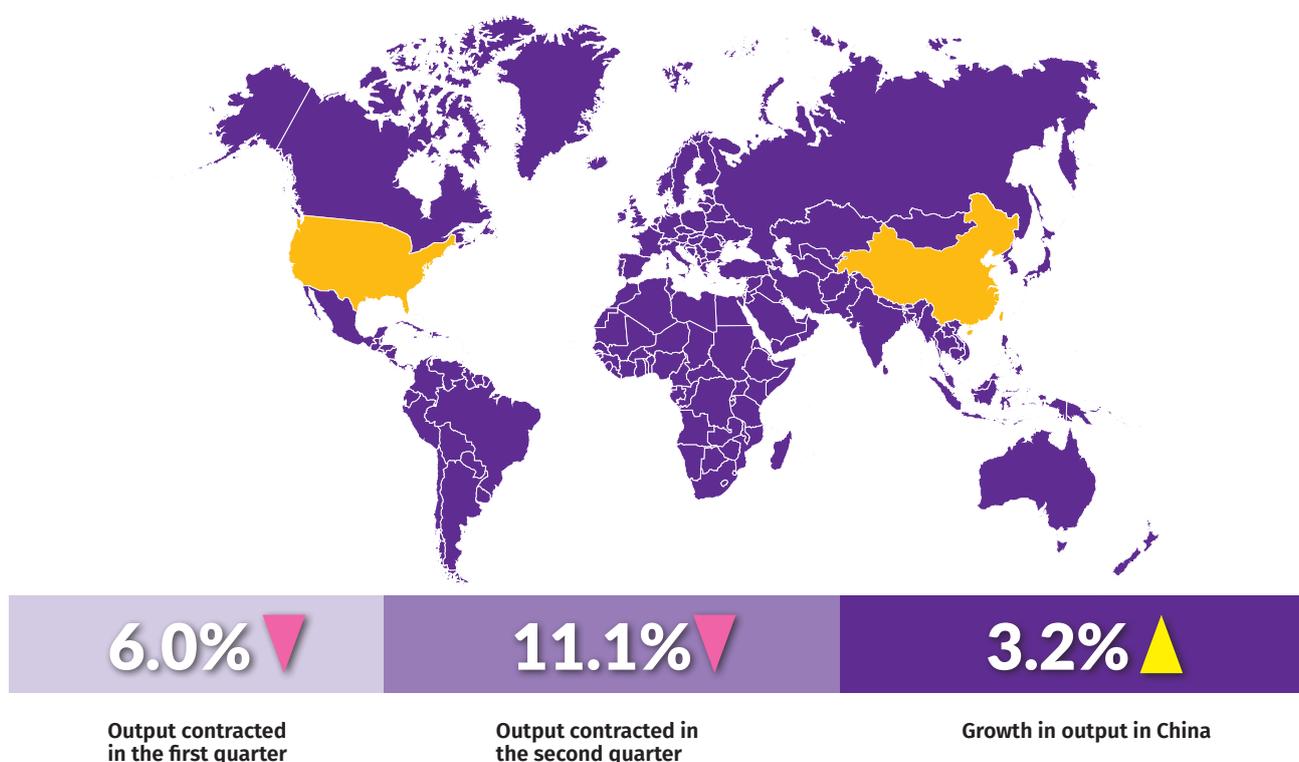
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1. Background

The onset of the COVID-19 pandemic in March 2020 triggered a health crisis that escalated to an economic crisis with severe impact on both global demand and supply. This resulted in a slowdown of production as countries introduced COVID-19 containment measures that ranged from restriction of movements to shutdown of business operations, in some cases.

Global manufacturing output had been on a decline since 2019 partly due to trade uncertainty caused by Brexit, and trade tensions between the US and China¹. However, the pandemic aggravated the drop in manufacturing output in the subsequent quarters of the year 2020. Global manufacturing output contracted by 6.0% in the first quarter of 2020 and a further 11.1% in the second quarter (Table 1). The contraction of manufacturing output in the second quarter of 2020 occurred in all regions, except for China which registered a 3.2% growth in output. A similar pattern was witnessed in the third and fourth quarters of 2020, with China recording a rise in its manufacturing output while other regions recorded a contraction in their output, albeit at a lower magnitude compared to the second quarter of 2020.



¹ https://www.unido.org/sites/default/files/files/2020-06/World_manufacturing_production_2020_Q1.pdf

Table 1: Estimated quarterly growth rates of world manufacturing output

	Share in world MVA (2015) (%)	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021
World	100.0	-6.0	-11.1	-1.0	2.0	12.0
Industrialized Economies	56.3	-2.4	-16.3	-5.6	-1.4	1.5
North America	19.3	-2.2	-16.0	-5.6	-2.8	-0.6
Europe	22.0	-4.3	-19.2	-5.7	-0.9	2.6
East Asia	13.3	0.0	-13.0	-5.8	-0.4	2.7
China	27.5	-13.9	3.2	7.9	8.3	38.2
Africa	1.7	-1.5	-15.0	-3.5	-1.5	0.8
Asia & Pacific	8.9	-3.0	-23.3	-6.4	-0.5	2.5
Latin America	5.2	-3.2	-24.2	-3.9	2.1	5.4

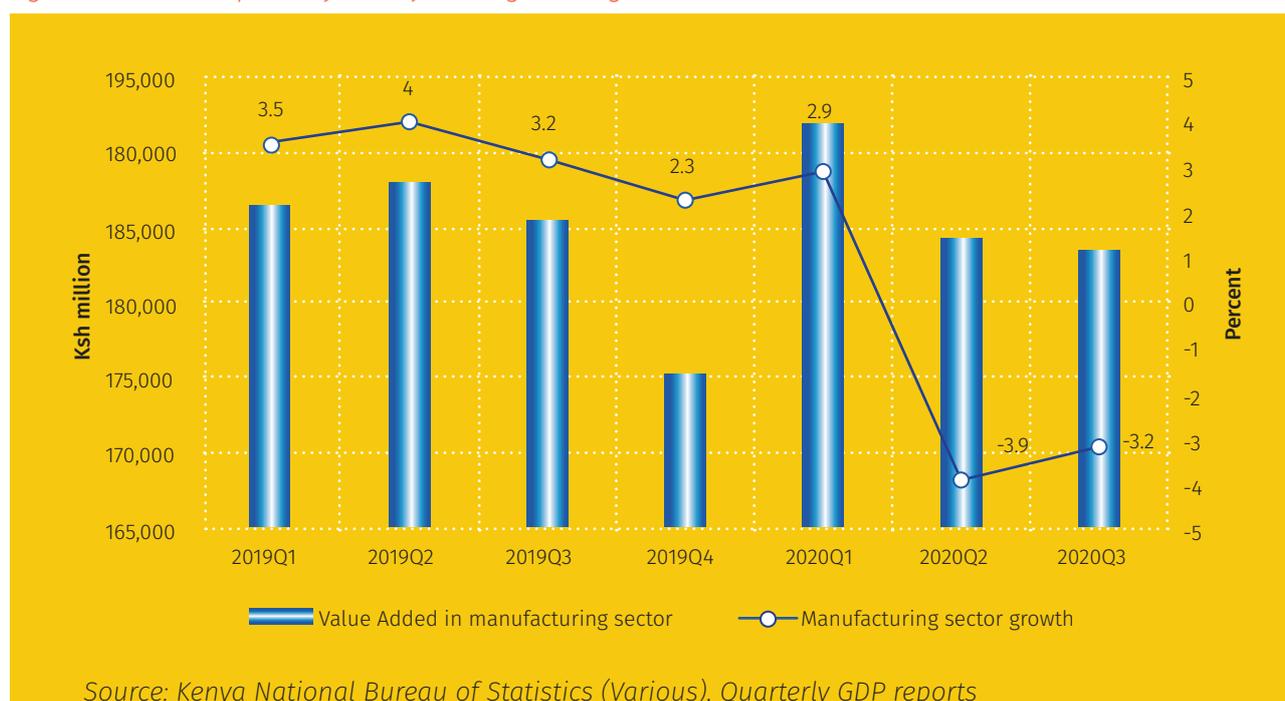
MVA = Manufacturing Value Added

Source: UNIDO World Manufacturing Production, Various Quarterly Reports

In quarter one of 2021, world manufacturing output grew by 12.0%, supported by China's impressive growth of 38.2%. Other regions have experienced a gradual recovery in their manufacturing sector except for North America that witnessed a marginal decline of 0.6% in its manufacturing output. The global recovery of the manufacturing sector has been supported by the gradual phasing out of lockdown measures, and mass vaccination campaigns mostly in the industrialized economies. However, the magnitude of recovery has been uneven, with countries offering different levels of support programmes to stabilize their economies. Whereas global manufacturing output expanded by 12.0% in the first quarter of 2021, Africa's manufacturing output expanded by a modest 0.8%.

In Kenya, available data indicate that the manufacturing sector contracted in two consecutive quarters of 2020 (Figure 1). The manufacturing sector output contracted by 3.9% and 3.2% in the second and third quarters of 2020, respectively. The value added by the sector dropped to Ksh 183 billion in quarter three from Ksh 191 billion in quarter one.

Figure 1: Trends in quarterly manufacturing sector growth rate and value add



Source: Kenya National Bureau of Statistics (Various), Quarterly GDP reports



Kenya experienced a third wave of COVID-19 outbreak towards the end of the first quarter of 2021, which necessitated an enforcement of tighter containment measures, including closure of schools and certain businesses in the services sector, and restriction of movement in and out of certain parts of the country. This was due to a spike in new confirmed positive cases, with the daily positivity rate registering double digits. On 17th June 2021, the Government of Kenya enhanced restriction of movement in 13 counties in Western Kenya to slow down the positivity rate. Kenya has rolled out a COVID-19 vaccination programme, but only a small portion of the population has received a first dose, with even fewer receiving a second dose of the vaccine. In the 2021/22 fiscal year, the Government has allocated Ksh 14.3 billion for the purchase of vaccines. Furthermore, the coronavirus has mutated to new strains that prove to be transmissible, jeopardizing the efforts to contain the virus.

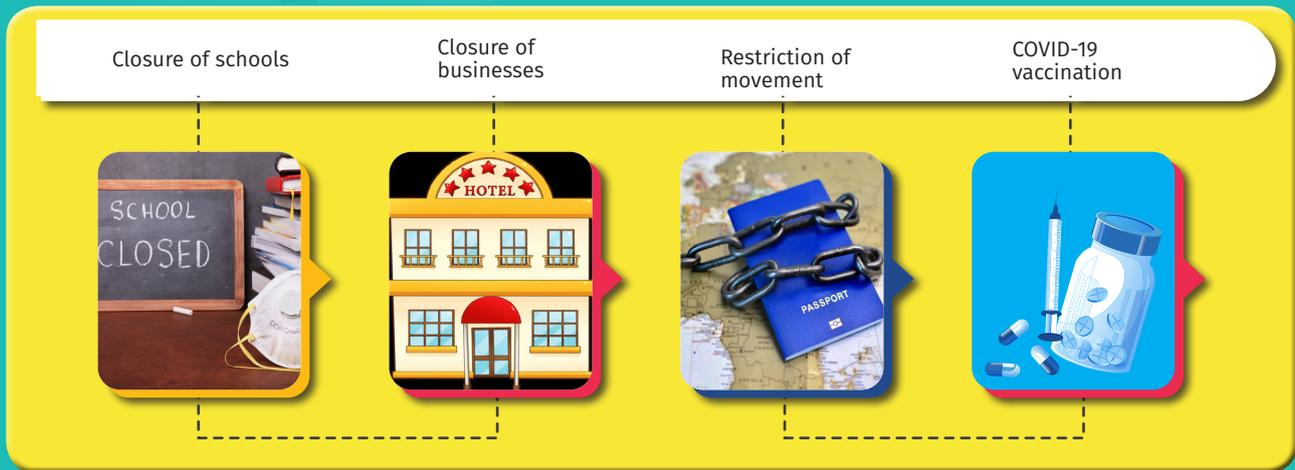
On 20th May 2020, the Kenya Association of Manufacturers (KAM) and KPMG launched a report on the impact of COVID-19 on the manufacturing sector, a few months after the first lockdown was announced. The report highlighted the adverse effects that the pandemic had on business operations, with many manufacturers experiencing reduced demand and depressed production capacity. Additionally, manufacturers faced cashflow constraints and in many cases downsized their workforce. One year on, the pandemic still has a significant impact on the manufacturing sector, with some sub-sectors and manufacturers being more resilient than others. In comparison to 2020, enterprises are currently operating without the economic relief measures that were provided in 2020 to cushion them against the adverse effect that the pandemic has.

This paper seeks to provide further insights on the impact the pandemic has had on business operations in the manufacturing sector one year down the line. This was done through a survey conducted among members of the Kenya Association of Manufacturers (KAM) and holding a focus group discussion with sector leadership. The rest of the paper is organized as follows: section two presents an analysis of the survey findings and its discussion; and the third section concludes the discussion while offering recommendations based on the survey findings. Lastly, an appendix with the survey details is provided.



Insights

The pandemic necessitated a change of focus for business to stay afloat during the turbulent times.



Changing focus

- Reducing costs
- Retaining jobs
- Improving cashflow



Curbing the spread of COVID-19

- Sanitization points instituted
- Social distancing
- Provided PPEs
- COVID-19 vaccinations





Sales

More firms **41%** experienced an increase in sales turnover compared to a paltry **4%** in 2020



Production

The number of firms operating below **50%** production capacity reduced compared to 2020



Liquidity

7 in 10 of the surveyed firms continue to experience cashflow constraints



Workforce

41% of the respondents plan to downsize their workforce



Logistics

37% Increase in sea freight costs followed by delays in the supply of imported raw and intermediate materials used in local production



2. Survey findings

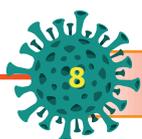
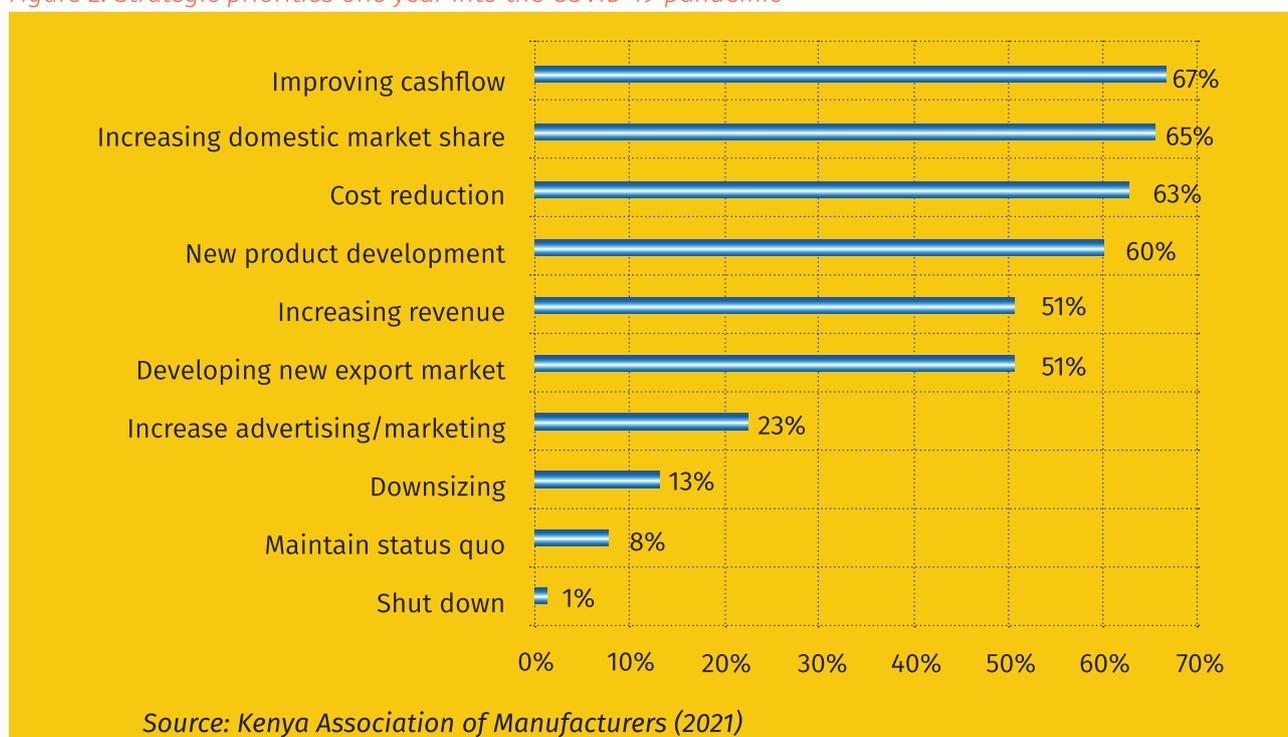
2.1 Changing focus

Before the onset of the COVID-19 pandemic in Kenya in March 2020, the top three priorities for manufacturers were to increase profitability, increase revenue and increase domestic market share. However, the pandemic necessitated a change of focus for businesses to stay afloat during the turbulent times. Reducing costs, retaining jobs, and improving cashflow are the main priorities for businesses.

One year down the line, improving cashflow remains a top priority among manufacturers (67%) as shown in Figure 2. This is followed by increasing domestic market share (65%), while cost reduction was the third top priority.

The pandemic also presented an opportunity for businesses to reengineer their production lines and manufacture new products to the market, especially those that were essential in curbing the spread and/or fighting the coronavirus. The new products included alcohol-based hand sanitizers, personal protective equipment (PPE) and medical ventilators. This is set to continue as 60% of the surveyed firms cited new product development among their top priorities for this year.

Figure 2: Strategic priorities one year into the COVID-19 pandemic

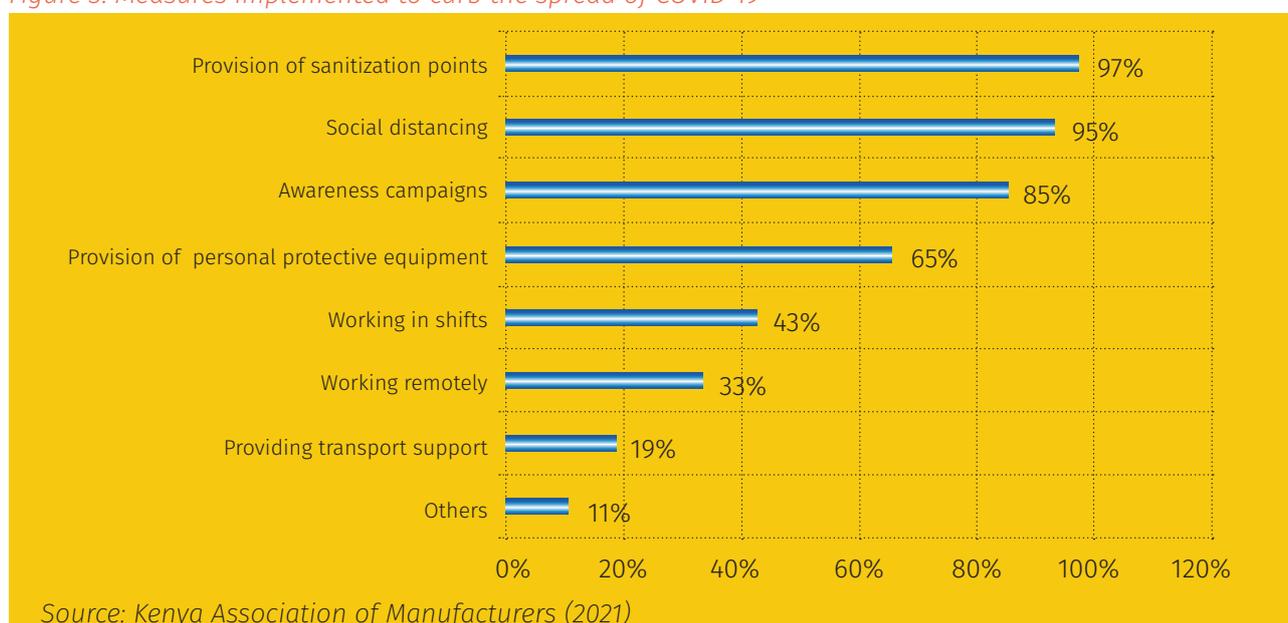


2.2 Curbing the spread of COVID-19 in workplaces

As human capital is a key factor of production, employers have undertaken different measures to curb the spread of COVID-19 in their workplaces in line with the protocols laid out by the government. Manufacturers have placed sanitization points in their workplaces, instituted social distancing, enhanced awareness of measures to curb the spread of the coronavirus, and provided PPEs amongst their employees (Figure 3). The cost incurred in curbing the spread of the coronavirus is being borne by the manufacturers, thereby driving up their cost of doing business. Working remotely from the office and working in shifts is limited given the nature of manufacturing that requires in-person attendance in the production lines or factory floor.

Other measures taken by employers to curb the transmission include provision of internet data and equipment for remote working, fumigation of workspaces, payment for COVID-19 tests when necessary, and arranging for COVID-19 vaccinations in conjunction with the county health departments.

Figure 3: Measures implemented to curb the spread of COVID-19



2.3 Business operations

a) Sales



Compared to 2020, a smaller number of surveyed firms (18%) experienced a decrease in sales turnover of more than 30% compared to 74% of respondents in 2020 as shown in Figure 6. However, 28% of the surveyed firms registered between 1-29% decrease in turnover in 2021 compared to 20% in 2020. The reduction is attributed to a fall in demand of products by consumers. More firms (41%) experienced an increase in sales turnover compared to a paltry 4% in 2020, indicating that some sectors of the economy are picking up despite the challenges still faced in the wake of the pandemic.

The sectors that experienced most reduction in their turnover were food and beverage (15%), automotive (12%) and textile and apparel (12%). More large enterprises (57%) registered a decrease in their sales turnover in 2021 compared to 47% among Micro, Small and Medium Enterprises (MSMEs). This may be attributed to the agility of MSMEs to adapt in the wake of the pandemic.

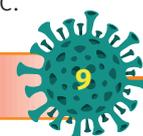
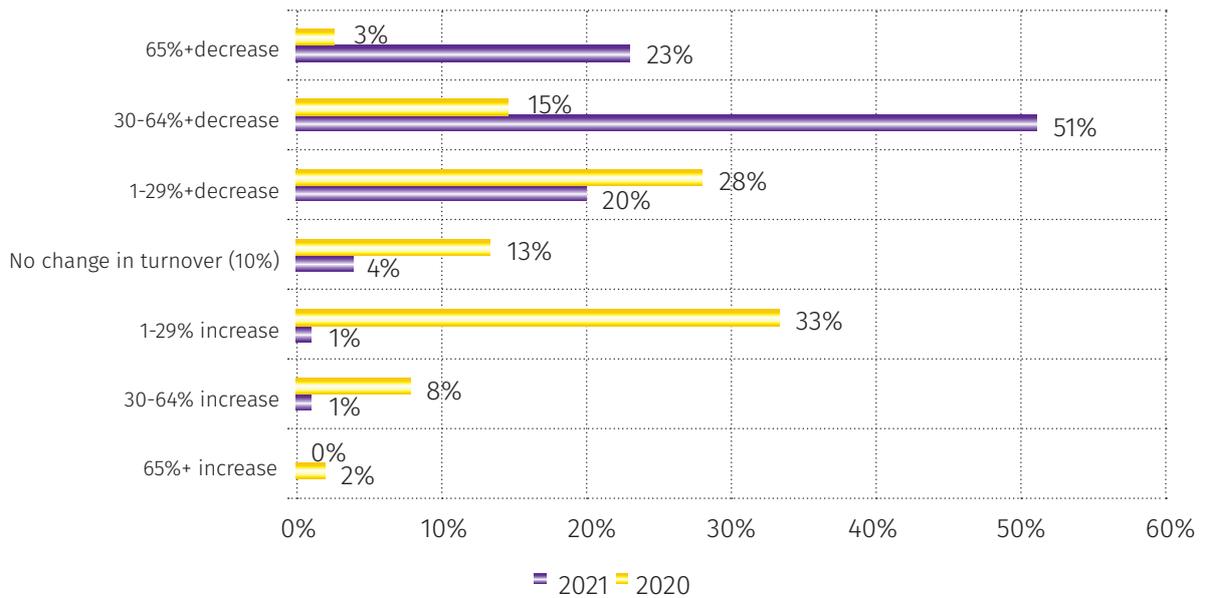


Figure 6: Change in sales turnover



Source: Kenya Association of Manufacturers (2021)

b) Production capacity

The number of firms operating below 50% production capacity reduced compared to 2020. Twenty-seven per cent (27%) of the surveyed firms operated below 50% production capacity in comparison to 55% of the surveyed firms in 2020 (Figure 7). More firms (74%) are operating at or more than 50% of their production capacity compared to 45% in 2020. Automotive, and plastic and rubber sectors were most affected in decreased production capacity, with 17% of respondents in each of these sectors operating below 50% of their production capacity.

Figure 7: Production capacity



Source: Kenya Association of Manufacturers (2021)





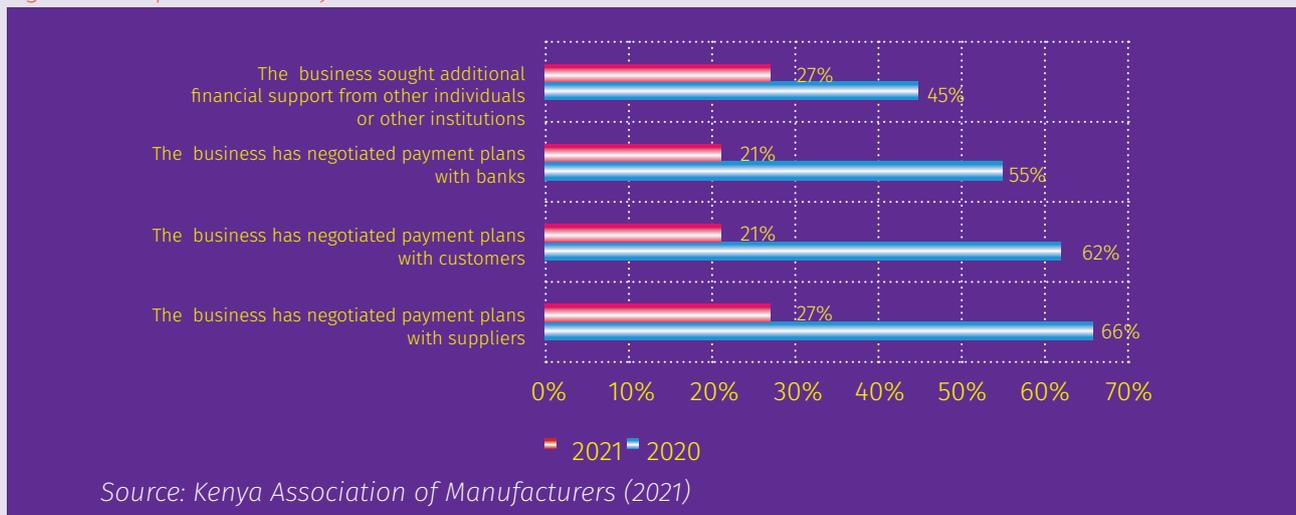
c) Liquidity

Seven (7) in ten (10) of the surveyed firms experience cashflow constraints, with most businesses seeking additional financial support from non-banking institutions, and negotiating payment plans with their suppliers (Figure 8). The liquidity challenge faced by businesses is due to delays in payment of tax refunds due by the Kenya Revenue Authority (KRA), depreciation of the Kenya shilling against the US dollar that has driven up the import bill, and requests for extension of credit period by wholesalers and distributors. However, businesses response to relieve cashflow challenges has been lesser compared to 2020. While 66% of surveyed firms negotiated payment plans with their suppliers in 2020, only 27% of the surveyed firms have done so in 2021. Similarly, the number of firms that reached out to commercial banks to restructure their loans more than halved in 2021.

When the cost of steel goes up, your working capital requirement also proportionately goes up, and this highlights how important working capital is during such disruptions. I do not think the banks are in any mode of supporting the additional requirements at the moment because of the situation that they are also going through. Going forward, inadequate working capital is going to be a major challenge, which means you will be unable to bring in those tonnages that your ideally require to produce your finished product.

**- Bobby Johnson,
Chair- Metal & Allied Sector**

Figure 8: Response to cashflow constraints

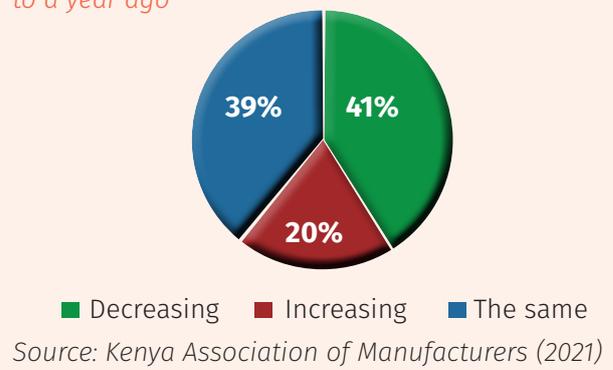




d) Workforce

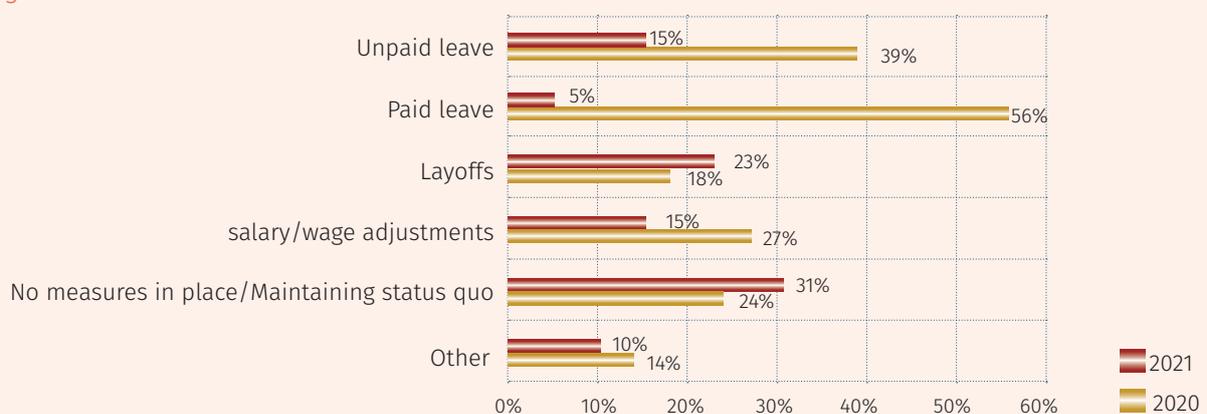
The adverse effects of the pandemic coupled with investor uncertainty continued to drive down employment levels among the surveyed firms, with some facing difficulties in paying salaries and wages to their employees. This comes amidst an increased cost of doing business due to COVID-19 employee-related support, and reduced productivity per worker because of operating in shifts to enable physical distancing in factories. Forty-one per cent (41%) of the respondents plan to downsize their workforce compared to 20% who intend to hire more employees (Figure 9). The effect is more felt by manufacturers of non-essential goods, as half of them plan to reduce their workforce compared to 36% of manufacturers of essential goods.

Figure 9: Probable change in workforce compared to a year ago



Out of the surveyed firms, 23% have laid off a part of their workforce compared to 18% who did so in 2020 (Figure 10). Sending employees on leave persists; however, the number of firms doing so has reduced significantly, especially those sending employees on paid leave. Fewer firms (15%) have adjusted salaries of their employees compared to 27% of firms in 2020. Other measures include a freeze on salary increments and organizational restructuring to adjust the responsibilities for staff.

Figure 10: Labour relation measures



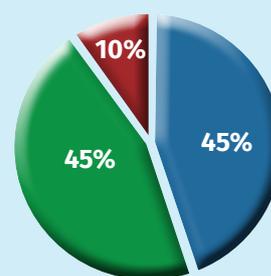
e) Logistics

Most of the firms have been negatively affected in their logistics operations by the COVID-19 pandemic. Forty-five per cent (45%) of the surveyed firms cited that their logistics operations had been significantly affected by the pandemic, with a similar number experiencing moderate disruption in their logistics (Figure 11). Only 10% of the respondents reported that their logistics operation had not been affected.

The most significant logistical challenge reported by the surveyed firms was an increase in sea freight costs (37%), followed by delays in the supply of imported raw and intermediate materials used in local production, as shown in Figure 12. For example, sea freight of a 20 foot container from China main port to Mombasa port was US\$ 800-900 in March 2020, but it increased to US\$ 2,500-3,000 in March 2021. The main reason for increased sea freight cost is increased demand of imported goods by the United States economy, particularly from China, which is on a steady recovery from the pandemic.^{2,3} Other challenges include increase in raw material costs in the international markets which, coupled with the delays and increased cost of logistics, and the depreciation of the Kenya shilling, has driven up the cost of importing materials into the country. For instance, price per ton for crude palm oil has increased to US\$ 1,300 in June 2021 compared to US\$ 700 before the onset of the pandemic, approximately 86% increase in price. According to the World Bank, increased demand from China and global economic recovery will increase steel prices by about 30% in 2021 compared to 2020.

The Kenya shilling depreciated by 4% against the US dollar to trade at an average of Ksh 107.43 in May 2021 from Ksh 103.74 in March 2020. Thus, on account of exchange rate depreciation, the price of imported raw materials increased by at least 4%.

Figure 11: Response on how the pandemic has affected logistics operations



■ Significantly affected
■ Moderately affected
■ Not affected

Source: Kenya Association of Manufacturers (2021)

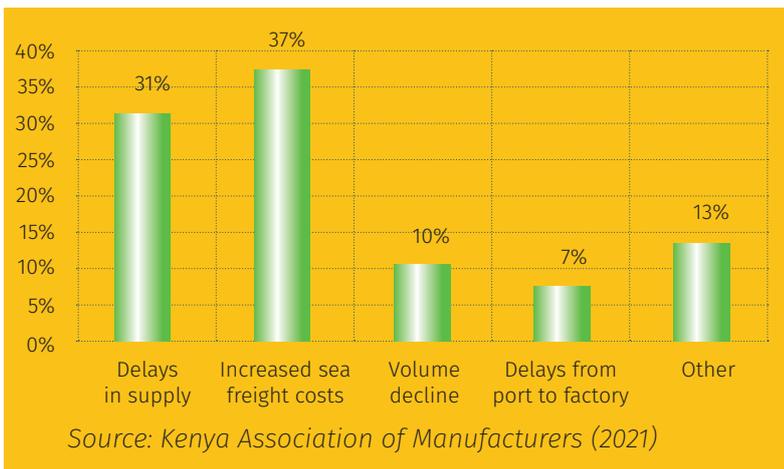
Kenya is a secondary producer of steel and hence has to import the raw materials that go into the manufacture of steel in the country. We are dependent on the international prices, which have currently skyrocketed, I would say actually doubled in the past six months.

- Bobby Johnson,
Chair- Metal & Allied Sector

2 <https://www.npr.org/sections/money/2021/06/15/1006381735/how-chaos-in-the-shipping-industry-is-choking-the-economy>.

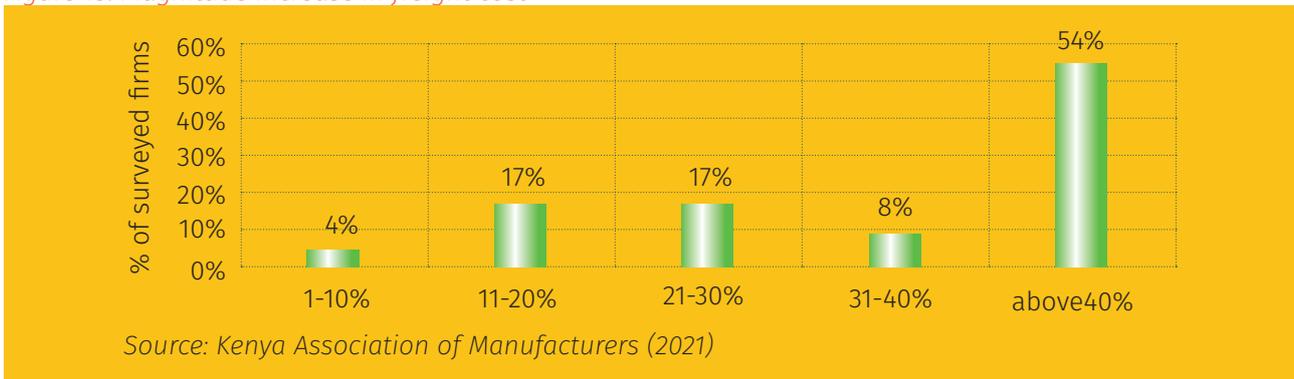
3 https://apnews.com/article/global-trade-business-03afb2924c164f98c9947ca5f700d6c6?utm_source=npr_newsletter&utm_medium=email&utm_content=20210614&utm_term=5469835&utm_campaign=money&utm_id=5409172&orgid=151&utm_att1=economy.

Figure 12: Most significant logistic challenge for businesses



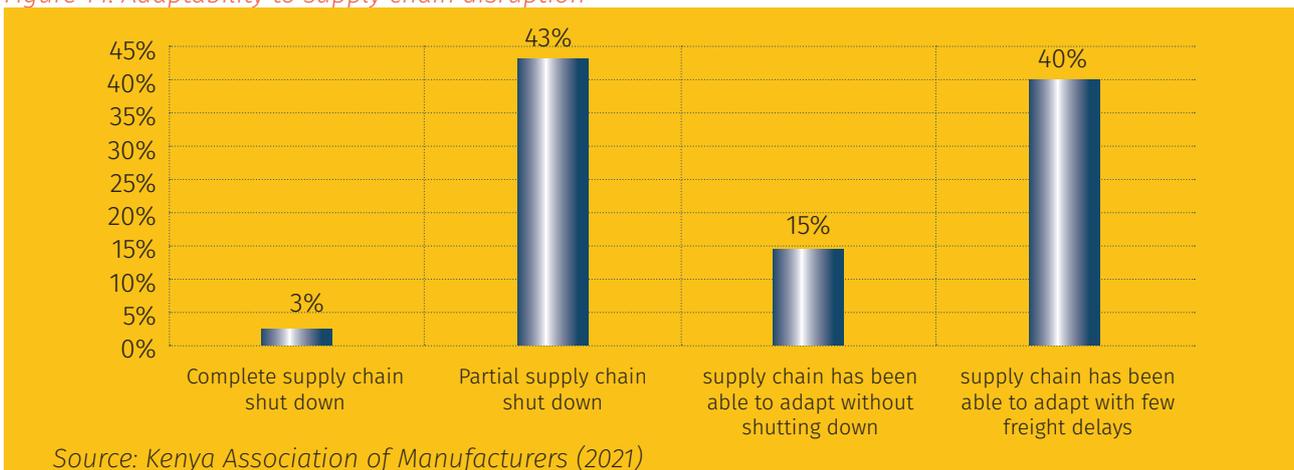
Among the firms that cited an increase in cost of logistics, more than half of them registered above 40% increase in freight costs (Figure 13). Eight per cent (8%) recorded a 31-40% increase while 17% of the surveyed firms recorded 21-30% and 11-20% increase in their freight costs, respectively.

Figure 13: Magnitude increase in freight cost



Only 15% of the surveyed firms that experienced any logistics challenges have an adaptable supply chain model compared to 43% that had partial shutdown of their supply chains and 40% experienced delays in supply (Figure 14). Three per cent (3%) of the respondents have experienced a complete shutdown of their supply chain, rendering it impossible to continue with production.

Figure 14: Adaptability to supply chain disruption



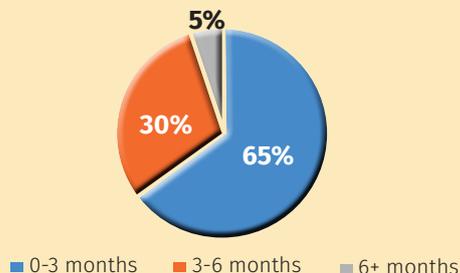
“There have been delays in receiving raw materials and we have actually been running at about 50% to 60% production capacity”
Ashit Shah
 – Chair, Automotive Sector

“Freight cost is becoming an issue and might get us to a place where costs for mwananchi will not be very friendly in future.”
Anthony Musyoki,
 Vice Chair, Motor Vehicle Assemblers & Accessories Sector



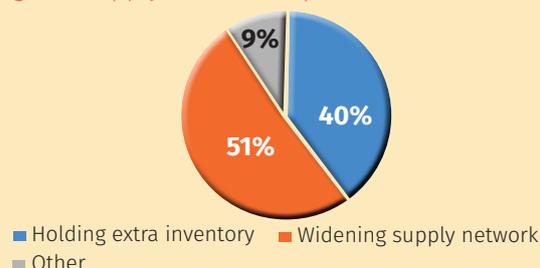
Slightly less than half of the manufacturers face difficulties in sourcing raw materials for their production, with the majority being importers of raw materials. Some of the material inputs include fabrics, active pharmaceutical ingredients, food products for manufacture of animal feeds, steel coils, packaging materials and chemical products used in industrial applications. Approximately 65% of the surveyed firms have raw materials stock that could last them up to 3 months while 30% and 5% of manufacturers have stock levels that could last 3-6 months and above 6 months, respectively (Figure 15).

Figure 15: Current raw material stock levels



Source: Kenya Association of Manufacturers (2021)

Figure 16: Strategies to support recovery against logistic supply chain disruptions



Source: Kenya Association of Manufacturers (2021)

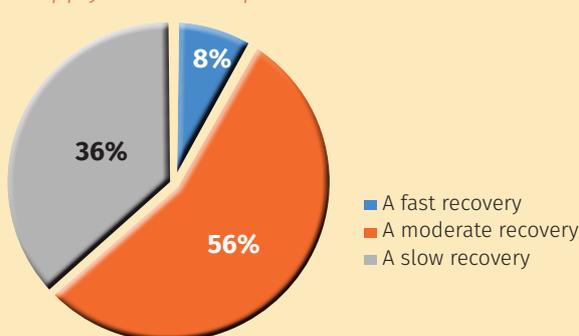
Due to supply chain disruptions, most of the surveyed firms (51%) have resorted to expanding their supply network to replenish their stock while 40% have increased stock levels of their raw and intermediate materials (Figure 16).

The need to source for alternative suppliers and hold more inventories further increases the logistics costs and constrains liquidity. There are opportunities for local sourcing that should be developed as alternative sources. Examples include development of agro-based value chains to support agro-processing and exploiting of available mineral deposits such as iron ore.

We are seeing new investments coming into the industry which are backward integrated that will see Kenya processing its own iron ore, thereby making us self-sufficient.

**- Bobby Johnson,
Chair- Metal & Allied Sector**

Figure 17: Expectation about recovery from supply chain disruptions

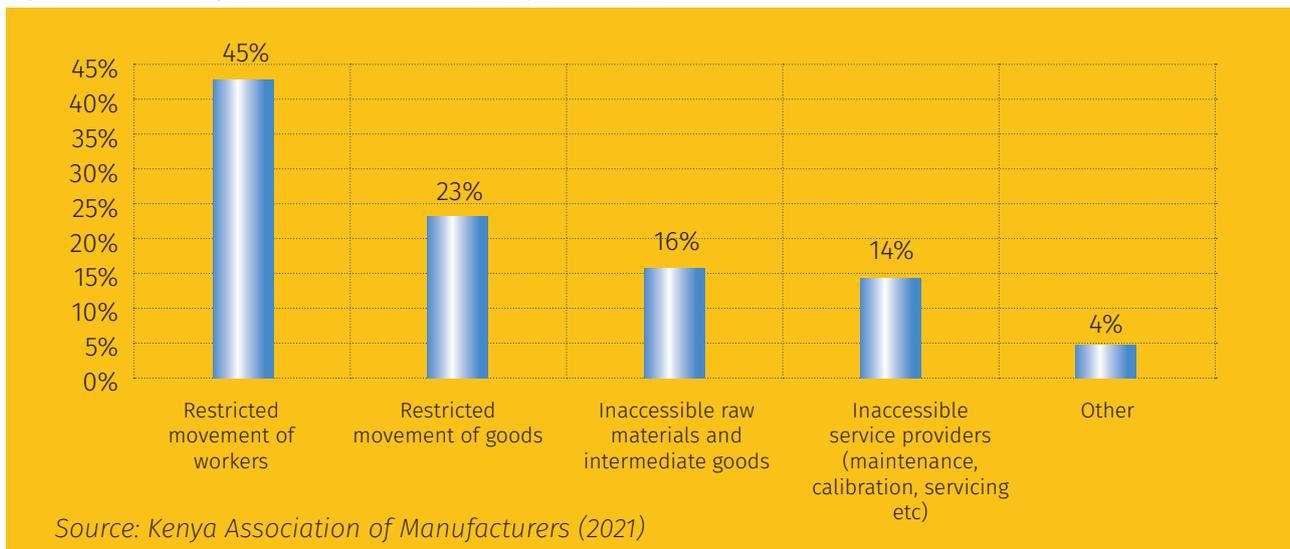


Source: Kenya Association of Manufacturers (2021)

Fifty-six per cent (56%) of firms facing supply chain disruption expect a moderate recovery while 36% expect a slow recovery (Figure 17).

Domestically, fewer manufacturers currently face logistics challenge considering the imposition of a nationwide curfew compared to last year, in which COVID-19 containment measures included restriction of movement in and out of selected counties. However, the challenges that manufacturers continue to face include restricted movement of skilled workers and goods, inaccessibility of material inputs for industrial production, and service providers crucial to smooth operations of plant and machinery (Figure 18).

Figure 18: Challenges faced as a result of imposition of a nation-wide curfew



3. Conclusion and policy recommendations

3.1 Conclusion



The economy and businesses cannot recover until the pandemic is contained: Containing the virus is the open secret towards full reopening of the economy and the most effective stimulus programme imaginable.⁴ The virus will determine the pace of economic and business recovery.



A year after the pandemic, most of the challenges continue to persist: The survey findings have revealed that liquidity constraints; depressed demand, particularly for the most vulnerable value chains such as the food and beverage and automotive sectors; operational difficulties such as paying salaries; and logistical constraints and associated costs continue to weigh down the manufacturing sector. A sizeable and well-designed economic stimulus programme can ease the problems.



Manufacturing value chains are highly vulnerable to global supply-chain disruptions and external shocks: This vulnerability stems from over-reliance on imported raw materials for processing, which exposes them to high logistic costs and exchange rate movement, especially weakening of the domestic currency.



The pandemic has increased the cost of manufacturing in 2021 relative to 2020: International prices of most raw materials and sea freight costs have increased tremendously. Moreover, weakening of the domestic currency against major foreign currencies and containment measures at the factory level have served to increase the cost of production. The factors driving up these costs are beyond the control of manufacturers.

⁴ <https://www.project-syndicate.org/commentary/covid19-virus-will-decide-when-economy-can-reopen-by-anne-krueger-2020-07>.

3.2 Policy Recommendations

Continuous strengthening of the healthcare system should be prioritized: This is based on the understanding that the current economic crisis and negative impacts on businesses and households has its origin from the pandemic. Investments in healthcare infrastructure, medical equipment and human resources including mass vaccination through increased budgetary allocation is required. The vaccination drive by the Government can be complemented by the private sector by allowing them to procure vaccines. This will reduce chances of recurrent outbreaks and consequent implementation of confinement measures, which will serve to destroy surviving businesses and livelihoods. There are also risks of confinement fatigue and more infectious variants.

The Government should avoid cost-increasing policy interventions: The cost of manufacturing has increased tremendously on account of increased prices of raw materials in the international markets, surging sea freight costs, weakening of the Kenya shilling and cost of containing the spread of the virus in factories. While the factors increasing costs of manufacturing are largely external, the Government can alleviate the pain by offering the following support to manufacturers:

- Reduce the cost of electricity to Ksh 9/KWh for manufacturers.
- Zero-rate Import Declaration Fee (IDF) and Railway Development Levy (RDL) for raw materials and intermediate inputs for processing, including for industrial machinery and spare parts.
- Avoid any new tax or increase in existing taxes as this would increase costs and reduced profitability and has the potential to slow recovery of businesses, and even lead to their collapse.

The Government introduced 16% VAT on imported machinery last year which none of us actually expected. The automotive sector had plans to expand and go into new lines, but we did not see this coming. We need to look at where we can have a more advance notice of certain things coming into place, instead of just taking us by surprise.

Ashit Shah,
– Chair, Automotive Sector

Development of domestic value chains: Opportunities for local sourcing such as in agro-based value chains, exploitation of existing mineral deposits such as iron ore, metal scrap will go a long way in cushioning manufacturers from external shocks. The economy and businesses will become more resilient.

Addressing demand and liquidity challenges facing businesses: Persisting challenges such as depressed demand and liquidity constraints can be alleviated through speedy implementation of stimulus programmes, procurement of locally manufactured goods by the government, payment of pending bills, and tax refunds by the Kenya Revenue Authority.



Appendix

An online survey was sent out to the KAM membership to participate between 18th May and 4th June 2021. The data collection targeted mainly the senior management of the KAM membership, including the Chief Executive Officers, Managing Directors, Chief Operating Officers, Operations and Finance Directors, among others. A Focus Group Discussion session was also held with the Chairs and Vice Chairs of sector leadership under KAM. The survey drew representation from across regional chapters in the country.

Appendix Table 1: Response by sectors

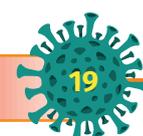
Sector	% of respondents
Agriculture & Fresh Produce	4
Automotive	7
Building, Mining and Construction	4
Chemical & Allied	19
Food & Beverage	13
Leather & Footwear	3
Metal & Allied	7
Paper & Paperboard	4
Pharmaceuticals & Medical Equipment	9
Plastic & Rubber	8
Services & Consulting	5
Textile & Apparel	13
Timber & Furniture	4

Source: Kenya Association of Manufacturers (2021)

Appendix Table 2: Response by regional chapters

Chapters	% of response by chapters
Central and surrounding regions	15
Coast Region	5
Eastern and surrounding regions	8
Industrial Area Region	51
North Rift Region	13
Nyanza/Western Region	5
South Rift Region	3

Source: Kenya Association of Manufacturers (2021)







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