

Ten policy priorities for transforming manufacturing and creating jobs in Kenya



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Preface from the Overseas Development Institute

The Overseas Development Institute (ODI)'s Supporting Economic Transformation programme (SET) aims to support developing countries, particularly in Africa, in their efforts to industrialise and transform their economies. SET seeks to analyse the challenges to transformation, identify what policies can help promote transformation and understand how progress can be made. Funded by the UK Department for International Development (DFID), SET works with a range of stakeholders, including governments, academia, think tanks and, of course, the private sector, to drive economic transformation.

SET is honoured to have worked with the Kenyan Association of Manufacturers (KAM) to produce this 10-point plan to transform Kenya's manufacturing sector, which will be critical for the country's economic transformation and the much-needed creation of high-quality jobs. The plan includes seven priorities for public policy and regulation to improve manufacturing competitiveness, and a further three recommendations to explain how to make this happen. A more co-ordinated focus on joint

implementation is the next step to kick-start Kenya's industrialisation.

This booklet is the product of a collaborative effort involving the Office of the President of Kenya, the State Department for the Environment, the State Department for Trade, Kenya Industrial Estates, IDB Capital Kenya, KEPSA, MSEA, TMEA and ICDC, as well as, of course, ODI, KAM and DFID. We are grateful to the inputs received from the KAM Board.

We would like to thank all those individuals and organisations directly involved for their guidance and suggestions throughout the process. I would also particularly like to thank Anzette Were (lead researcher on this publication) and Gituro Wainaina (professor and consultant at KAM) for their excellent work. I am very grateful to Phyllis Wakiaga and Dalmas Okendo from KAM for the fruitful collaboration between KAM and ODI and for guiding the process.

Dr Dirk Willem te Velde
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Foreword by the Kenya Association of Manufacturers

The significance of industrialisation to any economy in the world cannot be understated. Many economic development success stories owe a great deal to the role of the manufacturing sector.

The Kenya Association of Manufacturers (KAM) is at the forefront of championing an inclusive and broad-based economic growth in Kenya that can only be achieved through industrialisation. Our aim is to nationalise the vision and narrative of industrialisation, making it central to every facet of the political and social structure of our country.

We are therefore excited to unveil this 10-point plan at this timely juncture. Having taken stock of how far we have come as a country and appreciating the milestones achieved, this plan underlines the gaps that need to be filled in order for local industry to thrive.

The 10-point plan outlines the need for an export push. Export growth is fundamental to the growth and stability of local industry. It is encouraging to see that the government has begun to invest in infrastructure to fast track the movement of industrial goods to other markets. However, there is more to do to reduce other restrictions to trade, such as increased taxation, non-tariff barriers and labour-intensive regulatory processes that can cause significant delays for goods destined for export.

The 10-point plan addresses the following issues:

- Enhancing discipline in revenue collection through, among other things, increasing the tax collection base to avoid overburdening businesses is key.
- Increasing velocity of money through the economy by ensuring prompt payments – because money is the bloodline of any

economy and if it is not circulating efficiently then the economy weakens.

- Guaranteeing a predictable business environment is a key ingredient in gaining and maintaining investor confidence and would ensure that local industry continues to be stable.
- Ensuring rule of law, transparency and accountability is crucial, as corruption derails the course of development and inclusive growth.
- Raising productivity to world class standards and reducing the cost of living for the poor is critical for our vision of sustainability.
- Access to convenient long-term financing to ensure industry's stability against the whims of the global economy.
- Improved access to, and affordability of land for industrial development and computerisation of the land registry must be prioritised, as should provision of affordable, good quality and consistent energy, and continued investment in infrastructure.
- The development and strengthening of the value chain and increased access to markets are vital.

Kenya has everything it needs to achieve the vision of transforming into an industrial hub. This 10-point plan is wholly attainable if government and industry forge an effective partnership. This guide holds great promise for driving sustainable growth improving the livelihoods of the citizens of this country.

Phyllis Wakiaga
CEO, Kenya Association of Manufacturers

Flora Mutahi
Chair, Kenya Association of Manufacturers



Source: <https://visualhunt.com>

Introduction: manufacturing in Kenya — past performance, strengths and new ambitions

Manufacturing can play a crucial role in Kenya's inclusive growth by absorbing large numbers of workers, including by creating many jobs indirectly through forward and backward linkages to agriculture, raising exports and transforming the economy through technological innovation. Doubling manufacturing jobs and output requires strong leadership to implement the 10-point policy agenda proposed in this booklet.

The performance of the manufacturing sector in Kenya has been weak. While manufacturing has traditionally been relatively sophisticated given Kenya's level of income, it is becoming less so and is failing to keep pace with developments in the sector in other East African countries. Further, the share of manufacturing in gross domestic product (GDP) was the same in 2015 as it was in 1965, and it has actually declined over the last five years to a low of 9.2% in 2016. Today, the sector formally employs 300,000 men and women. However, manufacturing has a critical role to play in sustaining growth and generating employment as Kenya moves towards realising the aspirations of its Vision 2030. At the current annual GDP growth rate of 5.7%, Kenya should double its manufacturing output to reach the government's target of 15% of GDP in five years (see Figure 1). This will also double Kenya's manufacturing jobs.

For Kenya to become a newly industrialised nation by 2030, it must embrace an 'export push', enhance productivity at the firm level

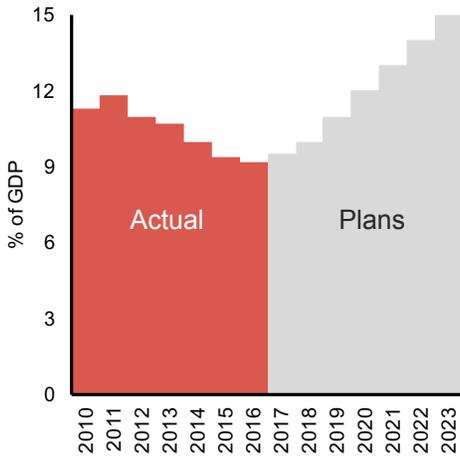
through technology and innovation, and continue to invest in and develop the 'basics' – infrastructure, human capital and institutions. Although efforts to strengthen the investment climate and increase access to affordable long-term financing are important, they are unlikely by themselves to enable Kenya to compete with regional and international manufacturers. It is important to address a number of factors in an integrated way: the export push, the 'basics' and skills development and enhancement, as well as both domestic borrowing and foreign direct investment (FDI). Kenya's manufacturing share in GDP is below average for a country with its level of income, but there is much scope for this to increase as income levels progress (see Figure 2).

As Kenya moves towards implementation of the Medium-Term Plan (MTP) III that covers the period 2018 to 2022, the country must develop a new approach to manufacturing development, which will involve reforms to existing policies in order to align them more closely to the objectives as set out in Vision 2030 as well as Kenya's Industrial Transformation Programme (KITP). New policies and strategies to address the drivers of the manufacturing sector will also be needed. It is against this background that we have developed a 10-point policy agenda to revamp the manufacturing sector in order to create 300,000 jobs as well as to increase the share of the manufacturing sector in GDP to 15% by 2022.

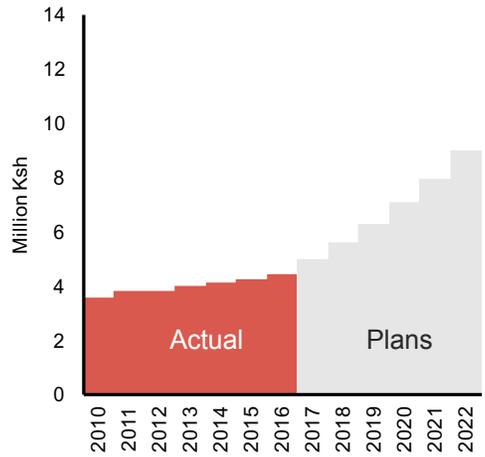
1 Jobs could come from agro-processing and garments (100,000 each) and a further 100,000 from fisheries, the establishment of a food hub, leather, construction and automobiles.

Figure 1: Setting ambitious plans to kick-start manufacturing production

Share of manufacturing in GDP



Manufacturing GDP (mn Ksh, in constant 2009 prices)

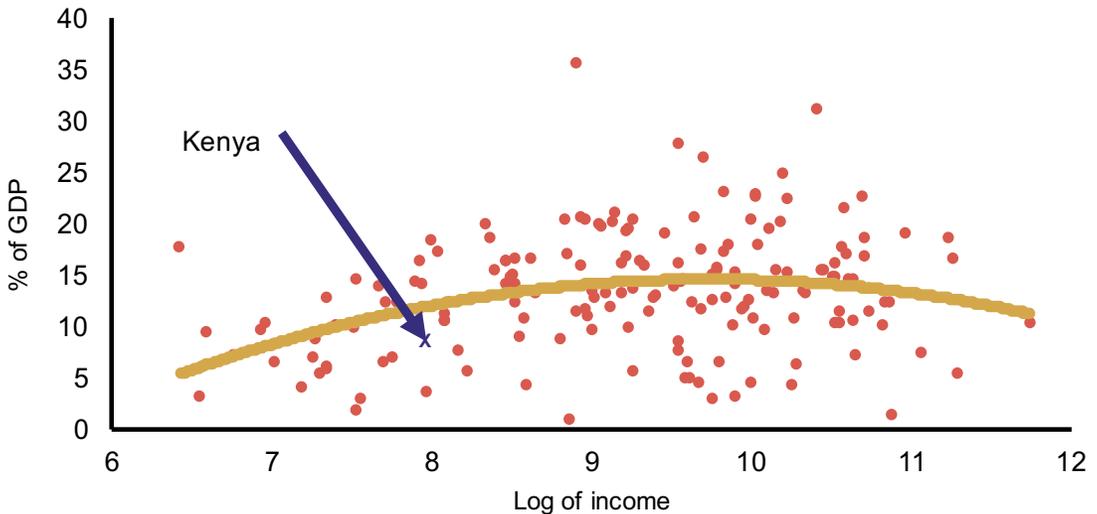


Source: Kenya Economic Survey, Kenya National Bureau of Statistics:

http://www.knbs.or.ke/index.php?option=com_phocadownload&view=category&id=107

Note: Planned increases from 2017 onwards.

Figure 2: Share of manufacturing in GDP vs income per capita



Source: World Development Indicators.

Note: Each dot represents a country (Kenya's arrow is based on Figure 1) (all reporting countries, 2013); the line is a fitted polynomial. Log of gross national income (GNI) per capita purchasing power parity (2011 prices) on horizontal axis.

Asian experiences suggest that export-intensive manufacturing can generate significant numbers of jobs. Although manufacturing is becoming more capital-intensive globally – through automation, for example – Kenya has a window of opportunity of at least 20 to 30 years (owing to rising wages in Asia, growing regional demand and better institutions and policies), in which it can break into global markets for manufacturing. Modern manufacturing is key for economic transformation, as its productivity levels in developing countries tend to match global best practices automatically (Rodrik, 2013). The sector serves as an incubator of technologies for other sectors, has important backward and forward linkages, and helps to increase resilience against macroeconomic shocks.

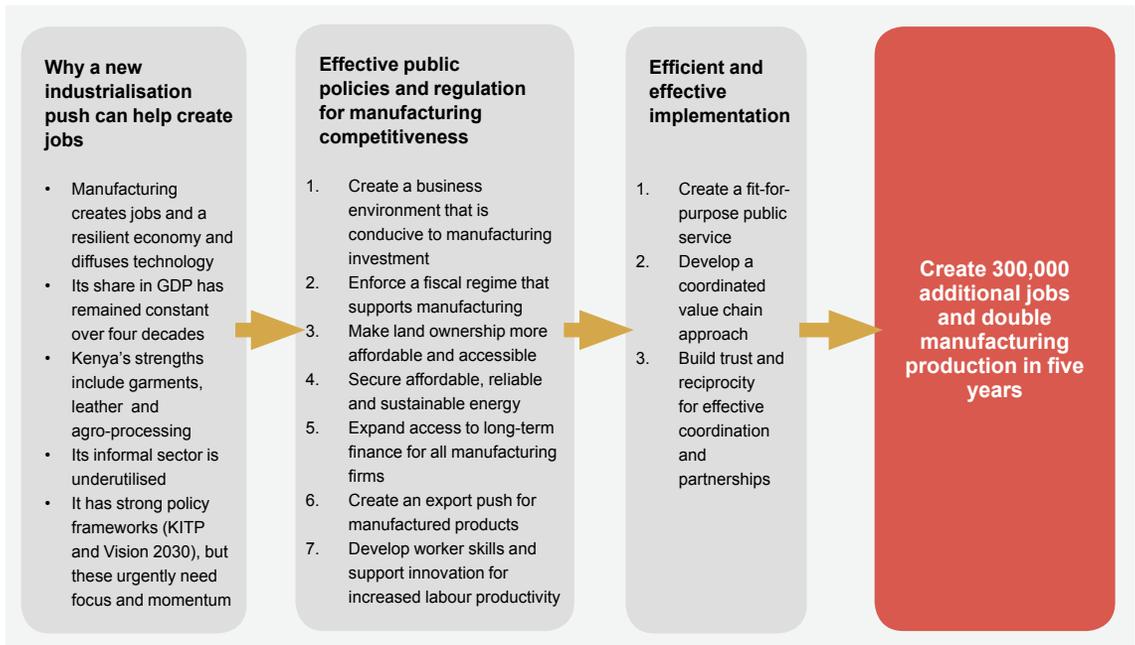
Realising the gains from manufacturing requires a step up in policy support. Political leadership is key to implement a number of technically sound policies and strategies that can develop the critical enablers of manufacturing

(see Figure 3). Practical implementation can only be achieved when government is joined up and works in partnership with the private sector, while building up sufficient public and private capacity to innovate. The Kenya Association of Manufacturers (KAM), the Overseas Development Institute/Supporting Economic Transformation (ODI/SET) and others have discussed closely a number of policy priority options centred on:

- (i) effective public policies and regulation for manufacturing competitiveness, and
- (ii) options for efficient and effective implementation.

In pursuing the 10-point policy agenda developed in this booklet, Kenya needs to (1) build on its current strengths; (2) develop promising sectors; and (3) create momentum and leadership behind existing and new policy proposals.

Figure 3: Policy priorities to kick-start Kenyan manufacturing



Source: Policy priorities in this booklet.

Building on Kenya's strengths

As the country gears up for industrialisation, it is important to be aware of the strengths of Kenya and manufacturing in Kenya that provide a credible foundation for further industrialisation.

- **Geographical position:** Although Kenya has less arable land and rain than many African countries, favourable weather conditions and tropical rich volcanic soils make it a leading exporter of black tea (Kibe and Kimenyi, 2014). Kenya's transport system — including roads, the Mombasa port, and the airports — is more advanced than those of most other countries in the region (though there are bottlenecks at Mombasa). Kenya is one of only two East African countries that are not landlocked, which gives the country a competitive advantage in terms of international trade (Kibe and Kimenyi, 2014). Mombasa port is a distribution hub for the lucrative East African market, providing connections to landlocked neighbouring countries.
- **Competitive economy:** According to the World Economic Forum, Kenya is the most competitive economy in the region. It ranks higher than Ethiopia, Uganda and Tanzania in higher education and training, goods market efficiency, labour market efficiency, financial market development, business sophistication and innovation (Mungai, 2015).
- **Resilience:** The Kenyan economy continues to be resilient, growing at 5.8% in 2016 compared to a continental growth rate of 1.3%. The manufacturing sector grew by 3.5% in 2016 (KNBS, 2017). As of 2016, 300,900 people were employed in the sector, accounting for 11.8% of total formal employment, and manufactured exports increased by 3.7% to KSh 63.1 billion in 2016 (KNBS, 2017). This is despite workers' strikes, terrorist activities, volatility in international oil prices and high costs of production (Arani, 2015).
- **Kenya's industry is already focused on being green:** 86.4% of energy consumed

on the grid is renewable, consisting of geothermal (47%), hydropower (39%), thermal (13%) and wind (0.4%). The primary source of electricity for industry in Kenya is the national grid. Additionally, the Kenya Association of Manufacturers, the largest manufacturing Business Member Organisation, bestows annual Energy Management Awards recognising manufacturers that have been exemplary in energy conservation and management. Further, the country has a policy and legislative environment that enables the green economy through the Environmental Management and Co-ordination Act, which promotes principles of resource efficiency in industry in Kenya. All these factors translate to Kenya being well poised to ensure that industrialisation is green, setting it apart from its competitors.

- **Vibrant informal industry:** A study by the World Bank (2016) on informal enterprise found that almost half (48%) of firms were in informal manufacturing. Labour productivity is much higher in the informal manufacturing sector compared with the services sector. In the past three years, 31% of manufacturing firms experienced expansion, compared with 24% of services firms.

Developing priority manufacturing sectors

Manufacturing strategy and policy must intersect with all types of firms – including small and informal firms as well as larger firms, both domestic and foreign – and must build on the strengths of each type. Attracting and supporting large, often foreign, firms is important because such firms tend to be more productive and technology-intensive, pay higher wages and employ many people. This requires activities to promote FDI. However, small and medium-sized enterprises (SMEs) and informal firms also need to be recognised. According to the Kenya Economic Survey 2017, 89.7% of the employed labour force in Kenya is in the informal sector. A survey of informality in Kenya by the World Bank

(2016) found that only 1.3% of firms registered when they started up. We discuss a range of priority sectors for formal and informal industry.

Formal industry

The anchor for Kenya's manufacturing sector are Kenya's Industrial Transformation Programme (KITP) and the Vision 2030 Manufacturing Agenda led by the Ministry of Trade, Industry and Cooperatives (MITC). Through these strategies, the government proposes sector-specific flagship projects in agro-processing, textiles, leather and other sectors; the development of Kenyan SMEs by supporting rising stars and building capabilities with model factories; and the creation of an enabling environment to accelerate industrial development. The priority sectors in KITP and Vision 2030 are:

- **Agro-processing:** Only 16% of Kenya's exported agricultural output is processed, and East Africa imports \$3.8 billion in raw and processed commodities for local consumption. The aim is to double the amount of processed agricultural exports, which could create 110,000 jobs and earn \$600 million. Kenya could set up a food hub in Mombasa to serve the growing regional market, creating 60,000 jobs and earning \$300 million. Vision 2030 seeks to develop agro-industrial clusters in Mombasa.
- **Fisheries:** Only 30 of the 8,600 fishing vessels in the East Africa Indian Ocean process their fish in Kenya. Creating a fish processing industry could create 12,000 jobs and earn \$150 million. Vision 2030 aims to develop a fish cluster in Kisumu.
- **Textiles and apparel:** Kenya accounts for only 0.4% of the US textiles market. By building its share in the US and new markets, Kenya could create 105,000 jobs.
- **Leather:** 90% of Kenya's \$94 million of leather exports are unfinished leather. By processing and finishing leather, Kenya could create 35,000 jobs and substitute \$86 million of annual shoe imports. Vision 2030 seeks to develop meat and leather clusters in Garissa and Kajiado.
- **Construction materials:** Kenyan firms serve only 8% of the \$60 billion regional

infrastructure market. Kenya imports \$485 million of basic processed steel, which could be locally produced, creating 28,000 jobs and earning between \$80 million and \$150 million. The development of iron and steel industries is a Vision 2030 flagship project.

Informal industry

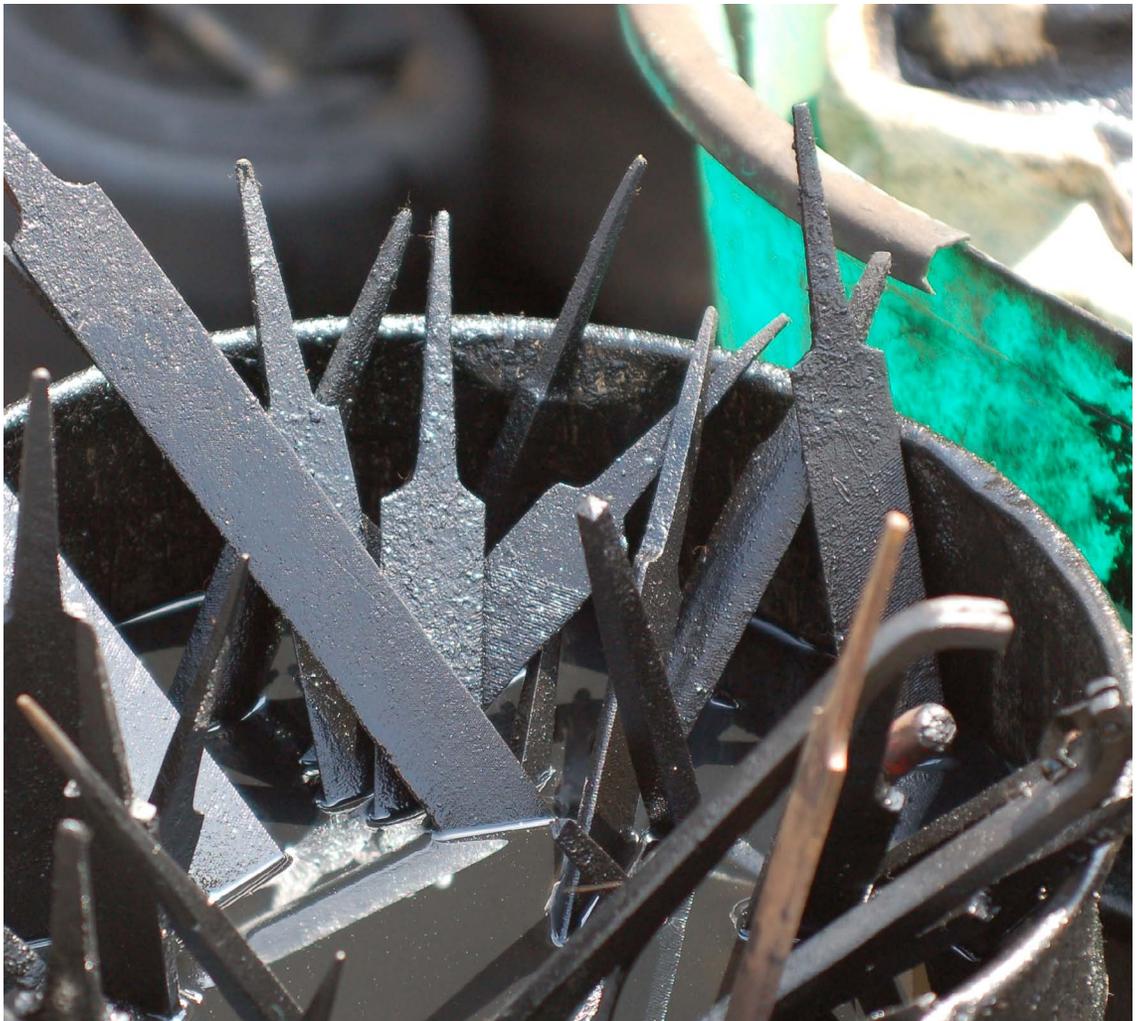
Informal industry or cottage industries (also known as *jua kali*) have several manufacturing sub-sectors such as agro-processing, metal works, furniture, and leather and shoe making. Some of these firms are productive and others create a significant number of jobs, making the sector crucial for manufacturing-led inclusive growth. Research suggests that the strongest sectors in informal manufacturing are the following:

- **Arts and crafts:** Homemade arts and crafts are a popular product for tourists and residents (Deloitte, 2016).
- **Furniture:** The furniture market in Kenya stood at approximately \$496 million in sales in 2013, and East African economies purchase \$1.2 billion worth of furniture annually. *Jua kali* represent more than a third of sales in Kenya (\$160 million). Formal furniture firms hold about 60% of the market, but are the slowest growers. The *jua kali* furniture industry exhibits strong growth; world class ethnic furniture for niche markets is manufactured in areas such as Lamu (World Bank, 2015a).
- **Metal works:** This sector produces a range of products such as charcoal cooking stoves, buckets, pans, kitchen utensils, wheel barrows, watering cans, gates and grills, and small tools for low-income clients. Products such as industrial sculptures and artworks target higher-income clients. Additionally, a few informal manufacturers produce a limited number of spare parts such as silencers, auto upholstery, and rubber bushings. The exact number of informal firms in this sub-sector is not known.
- **Leather:** The informal sector accounts for 10,000 of the 14,000 workers in the leather industry. Kenya is the third-largest livestock holder in Africa, so leather represents a potential area for economic growth and

employment (World Bank, 2015b). In 2017, MITC committed a KSh 130 million revolving fund for SMEs in the leather industry to build workspaces in all of the country's 47 counties.

Despite the potential of the informal sector, there are also severe challenges. In terms of financing, internal funds serve as a source of financing for working capital for 86.8% of firms, which explains why 63.8% of firms cite access to

finance as a severe obstacle. Limited access to land is also a severe stumbling block for 41.3% of firms, while 33% reported corruption as a severe obstacle and 60% reported harassment by government officials. Labour productivity is significantly higher for formal micro firms than for informal firms, but within the informal sector, labour productivity is much higher in the furniture industry and in relatively older firms and firms with more educated managers.



Source: <https://visualhunt.com/f/photo/3096979021/7e3356d14a/>

Creating new momentum and leadership behind Kenya’s main industrialisation policies: Vision 2030 and Kenya’s Industrial Transformation Programme

Vision 2030 is Kenya’s long-term vision and plan. It is being implemented through a series of five-year medium-term plans (MTP) at the national

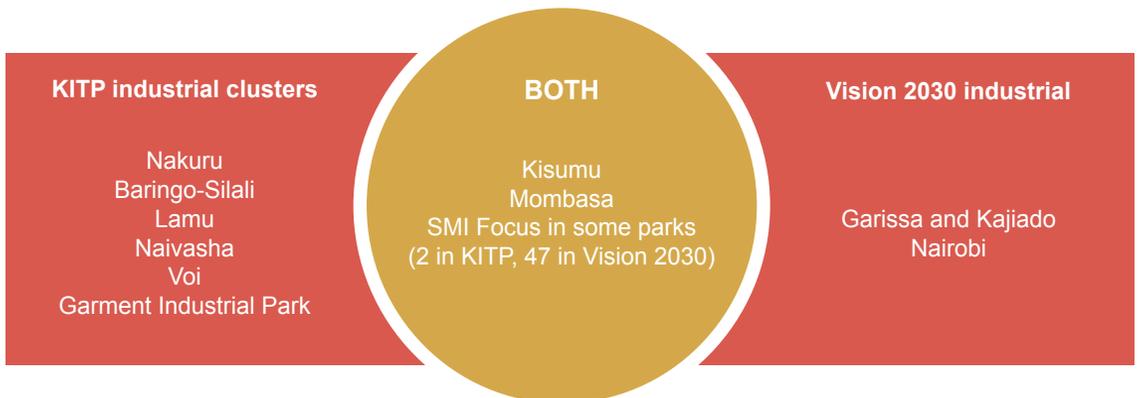
level. Kenya is currently implementing the second MTP, which ends in 2017. The presence of Vision 2030 should be leveraged for industry by linking KITP to the Vision 2030 MTP III. In MTP III, manufacturing should be identified as the sector of focus for the country, with manufacturing-related flagship projects prioritised. Efforts should be made to integrate KITP with Vision 2030 to develop actions implemented in MTP III. Figure 4 presents a summary of the main sectors and clusters within KITP and Vision 2030.

Figure 4: Priority sectors and clusters

Priority sectors



Clusters



Source: Own analysis of KITP and Vision 2030.



Source: <https://visualhunt.com/f/photo/16308564890/937b648d43/>

A 10-point policy plan to create 300,000 jobs and to double manufacturing in five years

Effective public policies and regulation for manufacturing competitiveness

1. Create a business environment that is conducive to manufacturing investment
2. Enforce a fiscal regime that supports manufacturing
3. Make land ownership more affordable and accessible
4. Secure affordable, reliable and sustainable energy
5. Expand access to long-term finance for all types of manufacturing firms
6. Create an exports push for manufactured products
7. Develop worker skills and support innovation for increased labour productivity

Efficient and effective implementation

8. Create a fit-for-purpose public service
9. Develop a coordinated value chain approach
10. Build trust and reciprocity for effective coordination and partnerships

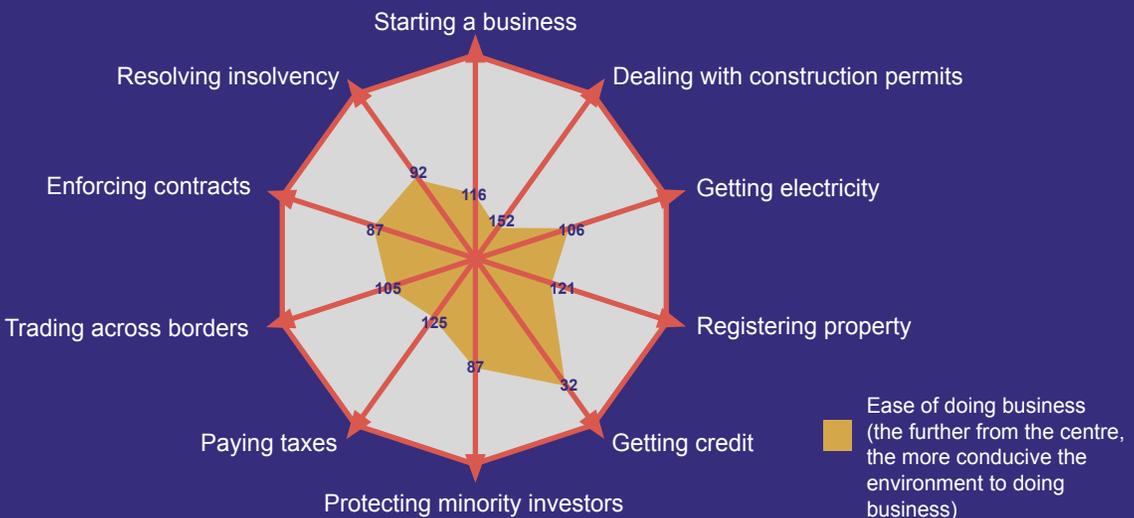
01

Create a business environment that is conducive to manufacturing investment

Kenya's position in the World Bank's **Ease of Doing Business** ranking has improved, moving up 21 places from 113 to 91 in the past year. In comparison, Rwanda has remained at 56, Tanzania at 132, Uganda at 115 and Burundi at 157 over the same time period. The strongest

components in Kenya are getting credit, enforcing contracts and protecting minority investors. The weakest components are dealing with construction permits, paying taxes and registering property – and this is where government attention should be focused. According to the World

Figure 5: Kenya's Ease of Doing Business



Source: IFC (2007).

Economic Forum's Global Competitiveness Index, Kenya has improved its performance, moving up three places from 99 in 2015 to 96 in 2016. In comparison, Rwanda remained at 52, Tanzania at 116, Uganda at 113 and Burundi at 135 over the same time period (and Vietnam at 82, Thailand at 46, Malaysia at 23, Singapore at 2, China at 78 and India at 130). The strongest components in Kenya are labour market efficiency, innovation and business sophistication. The weakest components are the macroeconomic environment, health and primary education, and higher education and training. In the context of industrialisation, government attention should be focused on these weaker components. Another

factor that shapes Kenya's business environment, specifically for industry and manufacturing, is the presence of counterfeits that undercut profits from legitimate manufacturers. Furthermore, the business environment has been negatively affected by devolution and the introduction of fees (known as CESS fees) paid when crossing county borders. Additionally, manufacturers are especially affected by slow government action on the reimbursement of VAT and tax returns, as well as by delays in payment of government contracts. These factors affect SMEs in particular, which often operate in more financially vulnerable contexts.

ACTION POINTS

In order to improve the business environment for manufacturing, the following actions should be undertaken:

- Enact predictable laws and regulations to attract and retain investment to all firms; SMEs and informal industry should receive particular attention
- Improve the business environment, with a focus on construction permits, paying taxes and registering property
- Develop a robust anti-counterfeit policy and enforcement strategy
- Strengthen protection of intellectual property rights
- Address county-level business environment issues (with a focus on SMEs) through the Ministry of Devolution and Planning, county governments and sub-national regional blocs

02

Enforce a fiscal regime that supports manufacturing

A fiscal regime that supports manufacturing will ensure both sufficient revenue generation and efficient procurement and payment systems. Kenya needs sufficient resources to fund the public goods required to support manufacturing, as well as to incentivise investment by and in manufacturing firms through fiscal policy. At the

moment, the exact impact of the fiscal regime on manufacturing is not known. Further, the fiscal regime is not being employed as a tool to catalyse manufacturing. Revenue collection needs more discipline and payment systems need to be improved.



Source: <https://visualhunt.com>

ACTION POINTS

In order to better leverage fiscal policy towards the development of manufacturing in Kenya, the following actions are required:

- Analyse the current fiscal regime to identify key fiscal constraints for the manufacturing sector and understand how it can better incentivise investment in industry, particularly SMEs. For example, the following options can be explored:
 - Increasing the tax collection base in order to ease tax pressure on the formal manufacturing sector
 - Establishing and operationalising one single Treasury account and implement the law on single accounts with no exceptions
 - Developing and implementing a taxation regime that encourages local competitive production
 - Reviewing the need for time-bound, fiscal incentives in the key sectors of KITP and Vision 2030 (agro-processing, fisheries, leather, textiles and apparel, and steel and iron manufacturing).
- Streamline and harmonise the taxation regime between the national and county governments as well as across county governments
- Develop a fiscal strategy for supporting industry through allocations from national and county government budgets
- Take specific action on government payment systems to:
 - Honour agreed payment terms, which should not exceed 60 days from statement of accounts, and act with urgency to ensure prompt payments
 - Set up supplier portals so that suppliers can electronically track status of orders, delivery schedules, potential product shortages and payments received
 - Ensure all payments to suppliers are made within 30 days
 - Digitise payments and refunds by government
 - Enforce the prompt reimbursement of VAT/tax returns

03

Make land ownership more affordable and accessible

The price and ownership of land in Kenya is a historical legacy that has not been fully resolved and thus negatively affects investment in manufacturing, which is land-intensive. Tensions and conflicts over land ownership, including historical grievances dating back to the early colonial period, have contributed to high levels of pressure for land law reform (Boone and Manji, 2016). Indigenous populations often live on land to which they do not have title; while others live on land that they view as ancestral, the title to which is held by other parties. While the new constitution has taken steps to rectify the issue, as has the government – by passing the National Land Policy (2009) and the Community Land Act (2016) – tensions over land ownership persist. Additionally, at the county level, county governments often do not have land banks that

they can assign to investors. This combination of acrimony over land title and the lack of county land banks dampens manufacturing investment.

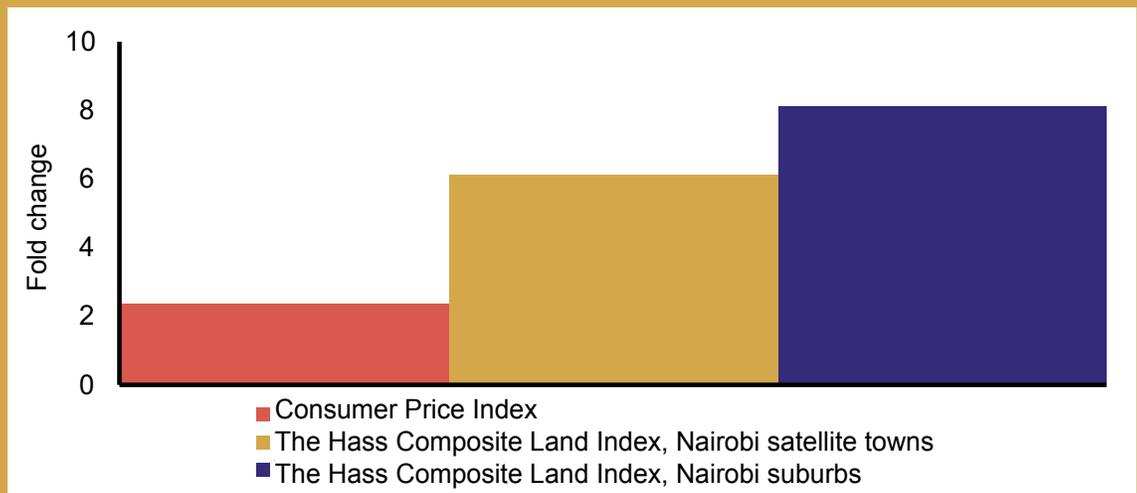
Another issue is land pricing. The price of land in Nairobi increased by a factor of 6.11 between 2007 and the first quarter of 2017, according to Hass Consult (a local real estate company); land in satellite towns around Nairobi has risen by a factor of 8.05. The four satellite towns posting the highest land-price gains are in the vicinity of infrastructure projects that are either ongoing or set to be developed (Hass Consult, 2017). Nearby infrastructure upgrades make adjacent areas ripe for land speculation, and land-price inflation is highly correlated to infrastructure upgrades and is sometimes caused by the announcement of infrastructure projects (Hass Consult, 2017).

ACTION POINTS

In order to address issues of land ownership and affordability, the government should do the following:

- Secure land for anticipated special economic zones (SEZs) and industrial park development before prices are pushed further upwards, as per KITP and Vision 2030
- Proactively create land banks earmarked for industry, through institutions such as Kenya Industrial Estates, as soon as possible
- Follow through on allowing county governments to allocate land to local or foreign investors planning to establish an SEZ
- Digitise the land registry
- Ensure prompt issuance of land titles, including for SMEs
- Address the role of land speculation in pushing up land prices and analyse whether the Land Value Index Bill will help address inflation caused by such speculation

Figure 6: Land price changes and Hass Composite Land Index for Nairobi suburbs and satellite towns, 2007 to 2017 Q1



Source: Hass Consult (2017); World Development Indicators.

04

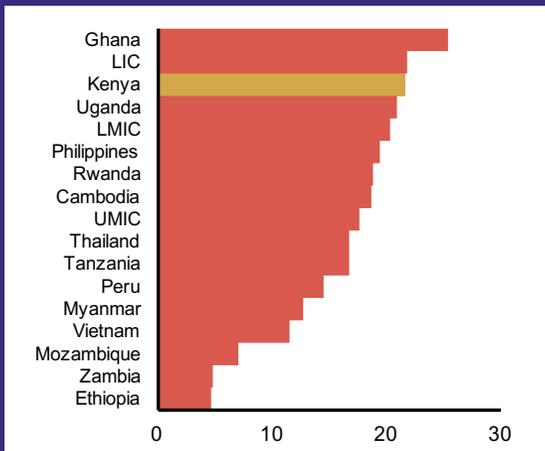
Secure affordable, reliable and sustainable energy

The unreliable availability and high costs of energy are often seen as binding constraints on manufacturing performance. High energy prices reduce profitability, and power outages lead to idle time and force manufacturers to buy generators, which are an added cost in terms of purchases and operations, estimated at 2% of the Kenyan economy (Page, 2016). The

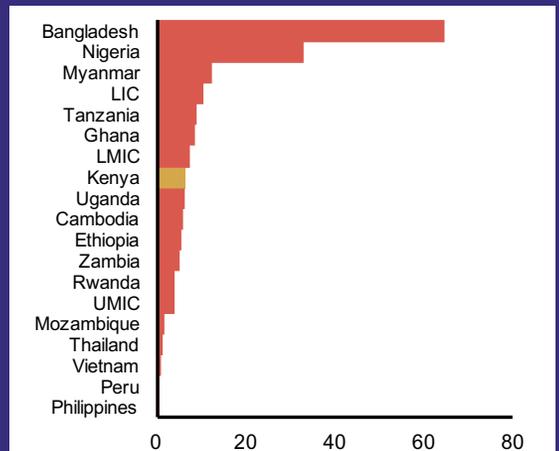
quality of electricity supply is a further problem: fluctuations lower productivity as machines have to be restarted, resulting in a shortened lifetime and the loss of goods being processed. Kenya has one of the highest electricity prices overall and a number of outages regionally each month (see Figure 7).

Figure 7: Cost and reliability of electricity

Energy price, 2016 (US cents per kWh)



Number of electricity outages per month, 2013



Source: Balchin et al. (2016).

Note: In this figure, LIC stands for low-income countries, LMIC for lower-middle-income countries and UMIC for upper-middle-income countries.

ACTION POINTS

In order to encourage affordable, reliable and sustainable energy for manufacturing, the following actions should be undertaken:

- Lower the cost of energy by removing all levies on power costs and apply appropriate tariffs for industrial usage; a reduction of five cents per kilowatt hour would bring the cost down to that in Tanzania
- Address inefficiencies in power generation, transmission and distribution through effective competition and efficient management
- Incentivise investment in power transmission, improve energy quality and create off-grid energy sources for factories; a key step is to improve the investment climate and governance of energy projects
- Prioritise green energy by preparing and developing projects to increase the supply of renewable energy such as the wind power projects, biomass technology, and solar and geothermal energy; Kenya needs at least an additional 1,000MW in the coming decade. Introduce fiscal support schemes such as subsidies, tax policies (tariffs), pricing schemes, and a reward scheme for green production. Increase support for renewable energy research and development and demonstration activities
- Approve and implement an energy policy

05

Expand access to long-term finance for all types of manufacturing firms

If manufacturing is to grow, it needs access to more finance at a lower cost. Manufacturers in Kenya have consistently cited lack of access to long-term finance as a problem. Many of Kenya's manufacturing companies, particularly SMEs and informal industry, are undercapitalised and face multiple obstacles to obtaining access to finance, such as an over-reliance on bank overdraft facilities, the high cost of borrowing, and a segmented and incomplete financial market (Papadavid, 2016). Kenya and other African countries have found it challenging to mobilise resources to address the need for long-term lending to provide capital investments in manufacturing, which, compared to other sectors over recent years, has had weak returns and a high percentage of non-performing loans (Tyson, 2015).

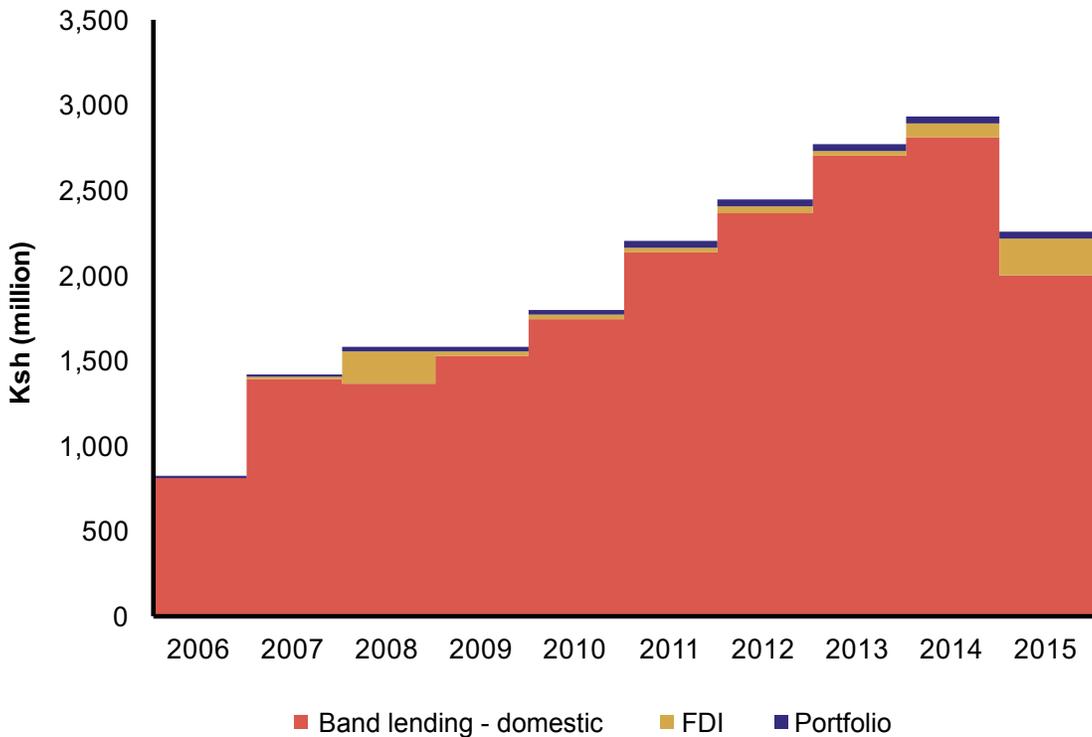
Although aggregate finance for manufacturing has benefited from an increased stock of bank lending to manufacturing – from \$0.8 billion in 2006 to \$2 billion in 2015 (see Figure 8) – the share of manufacturing in total lending declined from 15% to 11% over the same period (Tyson, 2017), and major obstacles to accessing finance remain. In recent years, the share of lending

to manufacturing has fallen by more than the share of manufacturing in GDP, indicating that availability of finance has become an even bigger constraint.

Domestic financing to manufacturing grew strongly between 2006 and 2014, but declined in 2015 and 2016. Finance is heavily concentrated in domestic bank lending which accounts for 89% of all finance, the highest level in Africa. According to Kenya's Economic Survey 2017, total loans advanced to the manufacturing sector decreased from KSh 290.9 billion in 2015 to KSh 277.4 billion in 2016. The number of manufacturing projects approved by industrial financial institutions increased from 251 in 2015 to 365 in 2016, mainly due to a rise in the number of micro and small enterprises financed by Kenya Industrial Estates (KIE). However, financing for projects approved by industrial financial institutions decreased by 4.6% from KSh 1,135 billion in 2015 to KSh 1,083 billion in 2016.

A further challenge linked to expanding **bank lending** is the interest rate cap, which has capped lending rates at 4% above the Central Bank of Kenya (CBK) base rate since August 2016. The

Figure 8: Financing to Kenyan manufacturing, 2006-2015



Source: Tyson (2017).

introduction of the interest rate cap has largely been deemed counterproductive, not only because it has driven a contraction in lending but also because it has influenced banks' expectations of insufficient yield to compensate them for the risk in investing in smaller companies (Papadavid, 2017). Data from the CBK indicates that loan approvals declined by 6% between December 2016 and February 2017, and private sector credit growth fell to 4.3% in December 2016 from more than 17% in the previous year. Further, lending to micro, small and medium-sized enterprises declined in value terms as reflected in reduced lending by large and medium banks (Mwiti, 2017). The governor of the CBK has expressed concern with the interest rate cap and described it as possibly damaging to the economy.

Foreign direct investment in the sector has been muted. The last detailed study on FDI to Kenya was conducted in 2015 and found that 16% of FDI inflows went into manufacturing in 2013 (KNBS, 2015). While it is acknowledged

that Kenya has a steadily improving environment for FDI, barriers still exist – such as difficulty in obtaining work permits, barriers to qualification for Government of Kenya investment incentives, and the fact that foreign investors cannot own land in Kenya (US Department of Commerce, 2016). That said, the forecast for FDI into manufacturing is more positive due to new rules allowing FDI in SEZs and new dynamism in the car assembly sector (CWEIC, 2016).

Access to finance is a particular obstacle for **informal enterprises** (World Bank, 2016). The majority of informal firms surveyed in Kenya use their own funds to finance working capital requirements; internal funds serve as a source of financing for working capital for 87% of firms surveyed. This is followed by money from friends and relatives (used by 35% of firms), credit and advances from suppliers and customers (19%), microfinance institutions (16%), money lenders (9%) and banks (9%).

ACTION POINTS

In order to expand access to long-term finance for all types of manufacturing firms, the following actions should be undertaken:

- Increase the availability of domestic public funds to manufacturing, and to SMEs in particular
 - Restructure the Industrial and Commercial Development Corporation (ICDC), Agricultural Finance Corporation (AFC) and KIE to create a Kenya Development Bank with an Industrial Development Fund committed to manufacturing
 - Develop finance mechanisms targeting informal industry using public funds, such as the Youth, Women's and Uwezo Fund
 - International development finance institutions should provide finance to manufacturing companies or to financial institutions dedicated to investing in manufacturing
- Solve private sector credit supply issues for both formal and informal manufacturers
 - Manage and control the interest rate spread in a way that enhances domestic bank finance to manufacturing, for example by fostering innovation and efficiency in banks
 - Rethink and update risk-assessment tools, especially when assessing SMEs
 - Encourage manufacturers to work with Kenya Credit Reference Bureaus to determine credit worthiness
 - Source funds from the non-mainstream private sector, such as impact investors targeting informal industry, and develop informal industry support services on business plan development, accounting practices, technical skills upgrading and leveraging technology to expand informal industry access to and effective use of finance
- Actively promote FDI
 - Enhance the capacity and role of KenInvest to lead and coordinate investor care
 - Support MITC in the development of public-private partnerships to finance infrastructure around SEZs and industrial parks to develop value chains
 - Tap into new sources of equity finance by offering public guarantees, for example through a Kenyan Export-Import bank



Source: <https://visualhunt.com/photo/182694/>

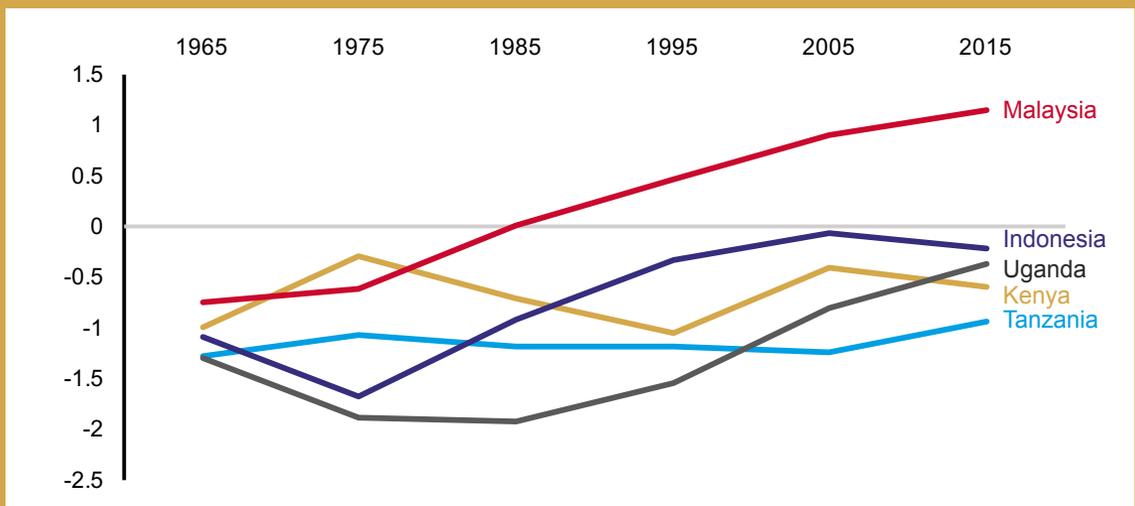
06

Create an export push for manufactured products

Exporting is key for job creation and upgrading. Countries that produce and export more sophisticated products – those that are primarily manufactured by countries at higher income levels – tend to grow faster (Hausmann et al., 2006). More diversified production and export structures are also associated with higher incomes (Imbs and Wacziarg, 2003). Unfortunately, export

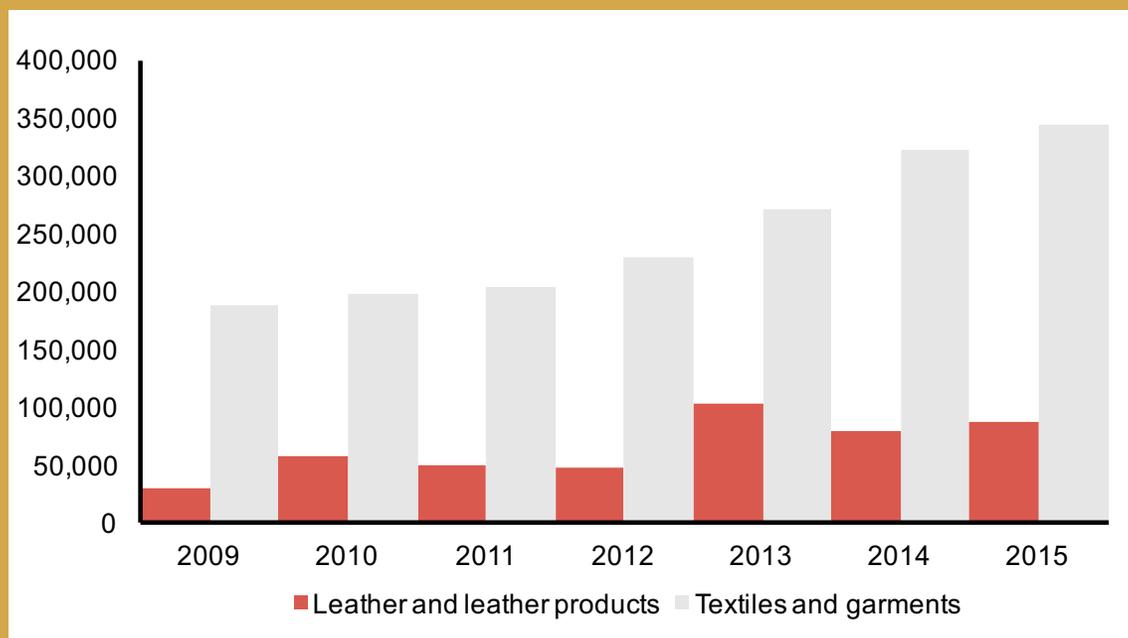
complexity in Kenya has remained at a similar level over the last five decades, while it increased significantly in Indonesia and Malaysia for example, which both started at the same point. Kenya's complexity actually regressed in absolute terms over the last decade, compared to strong growth in Uganda and Tanzania.

Figure 9: Economic complexity index, 1965-2015



Source: MIT Atlas.

Note: Complexity scores are based on export data.

Figure 10: Exports of selected manufactured goods from Kenya, 2006-2015 ('000 \$)

Source: Own elaboration using UNCTADStat data.

Kenya's growth in exports in a few selected manufactured products is promising. The value of garments exports rose by 9% and that of leather exports by 14% annually over 2005-2015, but agro-processing grew at only 6% a year. More recently, the garments sector has performed considerably better than the leather sector.

However, there are threats to Kenya's export markets. Total exports to the East African Community (EAC) registered a 4% decline in 2016 to KSh 121.7 billion, with exports to Uganda and Rwanda falling by 9.3% and 2.5%, respectively. Manufactured products that recorded declines in export earnings from Uganda included cement (34.7%); plastic articles

(29%); soap, cleansing and polishing preparations (32.1%) and alcoholic beverages (28.2%) (KNBS, 2017). Kenya has not yet fully exploited the opportunities offered by the EAC's integrated market, a problem that is increasingly associated with institutional and regulatory barriers to trade in the region (Muluvi et al., 2016). Further, the entry of China and India into the regional market has eroded Kenya's market share from 9% in 2009 to just 7% by 2013 (Sunday, 2017). The World Bank claims that Kenya's trade performance is declining quickly due to an influx of goods from China into Uganda and Tanzania, which are major export destinations for Kenya (Okoth, 2017).

ACTION POINTS

In order to create an exports push for manufactured products, the following three actions should be undertaken:

- Undertake coordinated action to promote exports and to secure market access for Kenyan goods and services
 - Focus on export diversification for KITP sectors into the EAC
 - Agree with EAC member countries on the removal of non-tariff barriers for Kenyan goods into the EAC (such as customs clearance, standards and certification, rules of origin, licences and permits, truck inspections and language barriers)
 - Negotiate better market access for KITP priority sectors through securing stable conditions with the European Union, the UK and the US, and more aggressively develop trading arrangements and export promotion strategies to emerging markets
- Put more efforts into facilitating trade by streamlining customs and building trade-related infrastructure along trade and economic corridors
 - Fast track the implementation of regional infrastructure, such as LAPSET Corridor Program and the Northern Corridor, to facilitate regional market access
 - Remove the Import Declaration Form (IDF) and the Railway Development Levy (RDL)
 - Make use of foreign exchange cheaper for manufacturers to incentivise exports.
- Improve access to manufacturing inputs produced locally
 - Develop and implement policies and incentives to support growth and productivity at producer (farm), processing, and market and distribution levels
 - Address issues in local agricultural markets and value chains and cost of raw materials to reduce cost of inputs (with special attention to SMEs)
 - Develop a network of warehouses and cold storage facilities, services and regulations for key agricultural value chains to link manufacturers to domestic input markets
 - Promote and leverage 'Build Kenya Buy Kenya' by increasing awareness and strengthening branding and marketing of Kenyan products
 - Curb imports when they are due to unfair competition, sub-standard goods or dumping from foreign countries



Source: <https://visualhunt.com/f/photo/15298114215/6e0ed2c5ef/>

07

Develop worker skills and support innovation for increased labour productivity

Labour productivity is essential for manufacturing competitiveness; the public and private sectors can develop worker skills and support innovation. Modern manufacturers seek a new set of skills in workers. The shift away from ‘old-line’ manufacturing towards more advanced, computer-assisted manufacturing has changed the type of worker needed. As processes grow increasingly complex, the need for

specialised and adaptable workers grows as well. Today, manufacturers need workers who either have a technical skill set or possess trade-based skills that machines cannot adequately perform. Table 1 details this skills changeover.

Kenya’s education system is failing to meet the market needs, as it does not prepare labour market entrants with appropriate skills. Although the quantity of graduates is rising rapidly,

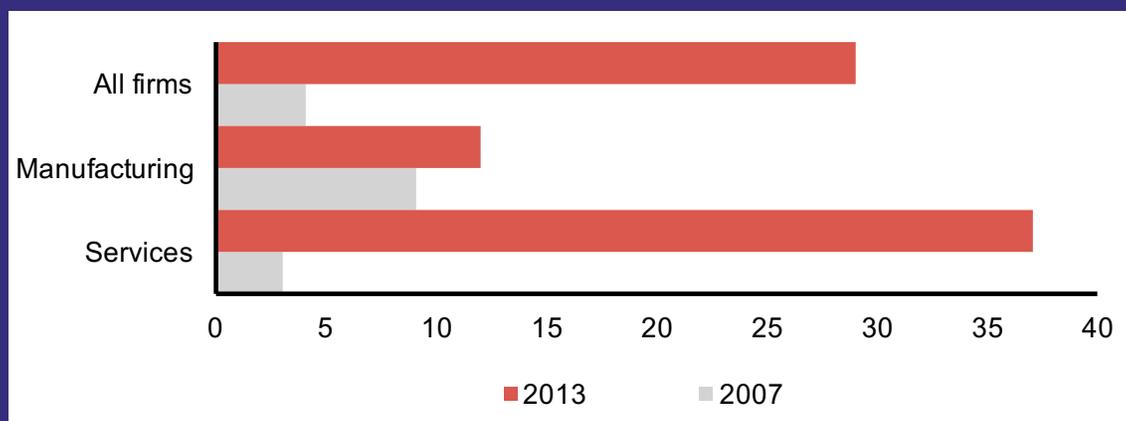
Table 1: Changes in required skills and traits of manufacturing personnel

| Past | Future |
|---|--|
| Learning one or two specific technical roles | Mechanical reasoning, logical trouble shooting, and spatial visualisation |
| Physical strength and flexibility | Personal flexibility, communication and cooperation |
| Ability to follow fixed, unchanging procedures | Initiative, persistence and independence |
| General attention to production and safety procedures | Attention to detail, self-control and dependability |
| Following orders | Making independent decisions |
| Operating, maintaining and designing mechanical machinery | Operating computers or computerised machinery and using computers for a wide range of critical functions |

manufacturers are increasingly complaining about shortages of skills in the labour market (see Figure 11). In 2013, more firms in Kenya were identifying skills as a major constraint than did firms in the rest of sub-Saharan Africa. The mismatch of skills seems to be caused by the quality of the education system — Kenya's education system continues to emphasise

teaching facts over developing analytical and problem-solving skills. The system is also weak in creating job-relevant technical skills and other skills valued by employers, such as accessing information, using computers, solving complex problems and learning new skills while on the job.

Figure 11: Inadequately educated workforce as a constraint (% of firms)



Source: *enterprisesurveys.org*.

ACTION POINTS

In order to develop worker skills for innovation, the following actions should be undertaken:

- Develop an incentives programme for skill development led by the private sector rather than supply-driven, public-sector-led-training
- Promote the acquisition of strong generic (cognitive and non-cognitive) skills and align academic curricula with market demands, particularly at the secondary and tertiary levels
- Emphasise skills that require a certain level of education – ranging from a trade school certification to a bachelor's degree – and that must be learned through experience, training and critical thinking
- Strengthen the links between industry/businesses and academia/educational institutions
- Concentrate on science, technology, engineering and mathematics at secondary and tertiary levels of education
- Focus on innovation and creativity to develop new products and spur growth
- Increase investment in innovation and in research and development
- Leverage the value of unique/disruptive technologies; it is critical to take advantage of advances in robotics, 3D printing and artificial intelligence to drive greater efficiency, lower costs, improve safety and develop the requisite skills in the labour force

08

Create a fit-for-purpose public service

A crucial element of implementing public policies for manufacturing is a public service that is fit for purpose. This concerns the ability both to coordinate action across different government departments and to have the right competencies and an absence of corruption.

Giving at least one public agency sufficient autonomy, budgetary control and political authorisation to override interdepartmental coordination problems and engage in a practical way with credible private-sector organisations is a crucial step (Ansu et al., 2016). Asian experiences suggest that particular public agencies can be turned into highly effective coordinators across government.

Leading agencies must be politically empowered so they can coordinate industrialisation and economic transformation policies across government (building an effective

SEZ, for example, requires land, energy, streamlined rules, and the promotion of trade and investment). Agencies will thus be able to override barriers against effective coordination across ministries, departments and agencies in developing countries and address the kinds of coordination problems that typically arise when ministerial appointments are used to reward the political loyalty of presidential allies.

Public service needs to be competent and free of corruption. Performance contracts in the civil service can help coordination. They are used in Rwanda, and they were also regarded as useful in implementing transport-oriented projects in Kenya in the 2000s (Ikiara, 2017). Strong leadership has also been effective in building industrial zones and attracting investors to Ethiopia in recent years.

ACTION POINTS

In order to improve leadership, coordination and excellence among ministries, countries and public agencies, the following actions should be undertaken:

- Establish a strong industrial policy implementation unit that can coordinate inter-ministerial activity and – led by the presidency – work closely with the Ministry of Industry and other ministries such as finance, transport and energy
- Ensure that this unit can experiment, monitor implementation and receive feedback and adjust policies when needed
- Address issues of corruption decisively and comprehensively
 - Institute transparency and accountability by implementing Chapter Six of the Constitution 2010
 - Introduce and implement sanctions within performance contracting
- Regarding the government's role in the management of the minimum wage:
 - de-peg the piece-rate from the minimum wage
 - peg real wage increments to labour productivity increases

09

Develop a coordinated value chain approach

The promotion of manufacturing requires a coordinated approach by the private sector. Firms in the formal private sector, manufacturers included, are represented by a range of organisations, including the Kenya Private Sector Alliance (KEPSA), the Kenya Association of Manufacturers (KAM), the Kenya National Chamber of Commerce and Industry (KNCCI) and a government-supported Micro and Small Enterprise Authority (MSEA). However, these are often not grouped based on value chains and therefore miss important opportunities to foster activities. If manufacturing is to thrive in the current circumstances, it is important that the sector receives dedicated attention, including from manufacturing businesses, as the recent case of Ethiopia illustrates. Clustering and value chains are two ways in which firms benefit from working together. Private-sector organisations have a dual role in lobbying government for better public

policies for manufacturing competitiveness and in improving coordination to promote the use of better technology and standards in value chains.

Having several private-sector bodies representing the interests of both formal and informal industry leads to a lack of coherence and coordination within the sector. It also contributes to the development of strategies, activities and priority interventions that are not coordinated and do not speak to or complement each other, and certainly do not address constraints within value chains. Manufacturing companies should have one organised voice.

While informal industry has a government docket committed to the entire sector, the larger informal industry does not have a distinct voice or body to represent its concerns. The informal industry is beset by a lack of coherent representation, meaning the sector cannot voice its issues and concerns in a unified manner.

ACTION POINTS

In order to improve leadership, coordination and excellence within the private sector and related value chains, the following actions should be undertaken:

- Encourage formal private-sector coordination by ensuring that different private-sector bodies come together and develop one common action plan for manufacturing
- Strengthen private-sector coordination in rural and semi-urban areas through a single body in each county
- Coordinate action within the private sector to increase firm-level manufacturing productivity
 - Private firms should institute incentives such as flexi-time, bonuses and paid time off to encourage initiative and increase productivity in a coordinated manner
 - Embrace and implement international productivity standards
- Encourage informal industries and associations to register with the Micro and Small Enterprise Authority and use this body to voice concerns and ideas for the sector
- Facilitate and encourage collaboration between formal and informal manufacturers through collaboration along value chains



Source: <https://visualhunt.com>

10

Build trust and reciprocity for effective coordination and partnerships

In order for manufacturing to play a leading role in economic growth, the public and private sectors need to create trust and reciprocity that facilitate effective coordination and partnerships, which are needed to implement policies. The lack of coordination within the public sector and the private sector makes it difficult to build a common understanding between the two parties. Government gets numerous conflicting requests from multiple formal private-sector bodies. At

the same time, the private sector does not have one body coordinating government industrial strategy with which they can raise their issues and concerns. A strong and stable relationship between the private and public sectors that catalyses public–private dialogue and action must be built if the manufacturing sector is to grow effectively over the next few years and if the policies discussed in this booklet are to be implemented.

ACTION POINTS

In order to improve coordination between the public and private sectors, the following actions should be undertaken:

- Find a consensus among formal private-sector associations on key issues in manufacturing through a single body; this body would articulate the issues that need to be addressed by government at both the national and county levels
- Encourage the creation of value chain bodies
 - Categorise manufacturing sub-sectors and single value chain players into a single body to lead interaction with the ministries, departments, counties and agencies (MDCAs) of relevant county governments and national government, with a focus on specific sub-sector/ value chain issues (e.g. agro-processors, pharmaceuticals, construction materials)
- Support the MSEA to better absorb all informal industry from all 47 counties; informal industry should be grouped into sub-sectors that can lead interactions with the MDCAs of relevant county governments and national government

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