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

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1. Background

The onset of the COVID-19 pandemic in the first quarter of 2020 triggered a health crisis that escalated to an economic crisis with a 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 the restriction of movements to shut down of business operations, in some cases.

Global manufacturing output had been on a decline since 2019 partly attributed to trade uncertainty caused by Brexit and trade tensions between the U.S and China¹. However, the pandemic aggravated the drop in manufacturing output in the subsequent quarters of 2020. Global manufacturing output contracted by 6% 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 that 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 second quarter of 2020.

	Share in world MVA (2015) (%)	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021
World	100	-6.0	-11.1	-1.0	2.0	12.0
Industrialized	56.3	-2.4	-16.3	-5.6	-1.4	1.5
Economies						
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

Source: UNIDO World Manufacturing Production, Various Quarterly Reports

In quarter one of 2021, world manufacturing output grew by 12% 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% 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

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

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: KNBS, 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 service 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 enhanced restriction of movement in 13 counties in Western Kenya to slow down positivity rate. Kenya rolled out a COVID-19 vaccination program. However, only a small portion of the population has received a first dose with even fewer receiving the second. In the 2021/22 fiscal year, the government allocated Ksh. 14.3 billion for the purchase of the vaccine. Furthermore, the coronavirus has mutated to new strains that prove to be transmissible, jeopardizing efforts to contain the virus.

On 20th May 2020, KAM and KPMG launched a report on the impact COVID-19 on the manufacturing sector, a few months after the first measures to mitigate the spread of the virus were announced. The report highlighted the adverse effects of the pandemic on business operations, with a large number of manufacturers experiencing reduced demand and depressed production capacity. Additionally, manufacturers faced cashflow constraints, logistics challenges 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 reliefs measures that were put in place last year to cushion them against the adverse effect that the pandemic had on businesses.

This paper seeks to provide further insights on the impact the pandemic has had on business operations, one year down the line. This was done through conducting a survey among KAM

membership 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; the third section concludes the discussion while offering recommendations based on the survey findings. Lastly, an appendix detailing the survey details is provided.

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 business 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 for 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



Source: KAM, 2021

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 PPE among their employees (*Figure 3*). The costs incurred in curbing the spread of the coronavirus is

being borne by the manufacturers, thereby driving up the cost of doing business. Working remotely away 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 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

Source: KAM, 2021

2.3. Business operations

a) Demand

40% of the total surveyed firms reported a drop in demand for their products compared to a year ago while 32% of the surveyed firms experienced an increase in product demand as shown in **Figure 4**. 28% of the surveyed firms experienced the same level of demand for their product as last year. This signals that consumer purchasing power continues to be depressed as the effects of the pandemic continue to be felt. Manufacturers in the Food and Beverage and Automotive Sectors faced the highest decrease in demand of their products. The decrease is due to low demand in the hospitality industry which has a knock-on effect on the food and beverage sector while purchasing of vehicles has declined due to reduced travel and a slowdown in asset financing by lenders.

"The Food and Beverage sector was more exposed because a lot of our members trade with the hospitality and tourism industry, which we all know, was heavily affected"- Amir Parpia, Chair Food sector



Figure 4: Current demand of products compared to one year ago



39% of manufacturers of goods deemed non-essential reported a decrease in their turnover compared to 40% who were manufacturers of essential goods (**Figure 5**). On the other hand, more non-essential goods manufacturers registered an increase in their sales turnover compared to manufacturers of essential goods. This could signal the gradual resumption of pre-COVID consumer patterns.



Figure 5: Essential vs non-essential goods manufacturers current demand of products compared to one year ago

b) Sales

Compared to 2020, a lesser number of surveyed firms (18%) experienced a decrease in their 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 their turnover this year compared to 20% in 2020. The reduction is attributed to a fall in demand of products by consumers. On the other hand, more firms (41%) experienced an increase in their 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.

Sectors that experienced the 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



c) Production capacity

The number of firms operating below 50% production capacity reduced compared to 2020. 27% of the surveyed firms operated below 50% production capacity in comparison to 55% of the surveyed firms in 2020 (**Figure 7**). On the other hand, more firms (74%) are operating at 50% or more of their production capacity compared to 45% in 2020. The 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





d) Liquidity

7 in 10 of the surveyed firms experience cashflow constraints with most business seeking additional financial support from non-banking institutions, and negotiating payment plans with their suppliers (**Figure** *8*). The liquidity challenge faced by businesses is brought about by delays in payment of tax refunds due to businesses, depreciation of the Kenyan 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.

Figure 8: Response to cashflow constraints



Source: KAM, 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 you ideally require to produce your finished product" - Bobby Johnson, Chair- Metal & Allied sector.

e) 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 work because of operating in shifts to enable physical distancing in factories. 41% of the respondents plan to downsize their workforce compared to 20% who intend to hire more employees (**Figure 9**). The effect is felt more by manufacturers of non-essential goods, as half of them plan to reduce their workforce compared to 36% of essential goods manufacturers.



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

Source: KAM, 2021

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 downsizing and sending employees in leave has reduced significantly, especially those sending employees on paid leave. Fewer firms (15%) have adjusted the 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



Source: KAM, 2021

f) Logistics

Most of the firms have been negatively affected in their logistics operations by the COVID-19 pandemic. 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 operations had not been affected.

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



Source: KAM, 2021

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 feet container from China's

main port to the Port of Mombasa was US\$ 800-900 in March 2020, but it jumped to 2500-3000 in March 2021.

The main reason for increased sea freight costs is increased demand for 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 logistics cost, and the depreciation of the Kenya Shilling which has driven up the cost of importing materials into the country.

For instance, the price per tonne for crude palm oil has increased to US1300 in June 2021 compared to US\$700 before the onset of the pandemic, a price increase of approximately 54%. 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.

"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 has currently skyrocketed, I would say actually doubled in the past six months."- Bobby Johnson, Chair- Metal & Allied sector.

The Kenyan 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%.





Source: KAM, 2021

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

https://apnews.com/article/global-trade-business-

⁰³afb2924c164f98c9947ca5f700d6c6?utm_source=npr_newsletter&utm_medium=email&utm_content=2021061 4&utm_term=5469835&utm_campaign=money&utm_id=5409172&orgid=151&utm_att1=economy.

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

"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.

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



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**). 3% of the respondents have experienced a complete shutdown of their supply chain, rendering it impossible to continue with production.

Source: KAM, 2021



Figure 14: Adaptability to supply chain disruption

Source: KAM, 2021

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 the 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 between 3-6 moths and above 6 months, respectively (**Figure 15**).

Figure 15: Current raw material stock levels



Source: KAM, 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**).



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

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 to act 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. 56% of firms facing supply chain disruption expect a moderate recovery while 36% expect a slow recovery (**Figure 17**).



Figure 17: Expectation about recovery from supply chain disruptions

Source: KAM, 2021

Source: KAM, 2021

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



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

Source: KAM, 2021

3. Conclusion and policy recommendations

3.1. Conclusion

The economy and businesses cannot recover until the pandemic is contained: This is why experts contend that containing the virus is the open secret towards full reopening of the economy and the most effective stimulus program 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 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 program can ease the problems.

Manufacturing value chains are highly vulnerable to global supply-chain disruptions and external shocks: This vulnerability stems from overreliance on imported raw materials

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

for processing which exposes them 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, weakening of the domestic currency against major foreign currencies and containment measures at the factory level have served to increase cost of production. Factors driving up these costs are beyond the control of manufacturers.

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 household has its origin from the pandemic. Investments in healthcare infrastructure, medical equipment and human resources including mass vaccination through increased budgetary allocation is required. 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 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 spread of the virus in factories. While 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 Ksh9/KwH for manufacturers.
- Zero-rate import declaration fee (IDF) and railway development levy (RDL) for raw materials and intermediate inputs for processing including used in processing including industrial machinery and spare parts.
- Any new tax or increase in existing taxes should be avoided as this would increase costs and reduce profitability and has the potential to slow recovery of businesses and even their collapse.⁵

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

⁵"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

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

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.

Table 2: Response	by sectors
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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: KAM, 2021

Table 3: Response by regional chapters

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

Source: KAM, 2021