SESSIONAL PAPER NO. 8/2005

TO PROVIDE GOVERNMENT GUARANTEE FOR KSHS. 2.0 BILLION

TO

KENYA FARMERS ASSOCIATION LTD. (KFA)

TABLE OF CONTENT

KENYA FARMERS ASSOCIATION LTD (KFA)

SESSIONAL PAPER No.8 /2005 TO PROVIDE GOVERNMENT GUARANTEE FOR KSHS.2.0 BILLION

1. INTRODUCTION/PURPOSE

Due to its historical background, activities and geographical network, KFA has been recognized by the GOK as one of the strategic "vehicles" to enhance the Government's efforts towards revitalization of Agriculture and Economic Recovery for Wealth and Employment creation. Thus the Government's policy decision to revive the KFA.

Consequently, in Feb 2003, the GOK commissioned an inquiry team to look into the financial and operational affairs of KFA, that identified the extent of technical insolvency but recommended that the Association could be revived through GOK intervention.

Pursuant to the Inquiry report by the Ministry of Co-operative Development (March/April 2003) which was subsequently presented to the delegates and adopted at the special delegates meeting on 26th of June, 2003. During this meeting, the Board & Senior Management of KFA were removed and an Interim Board & management appointed by GOK to oversee KFA's revival process.

Following the Cabinet approval on 14th December 2004 for financial support to Kenya Farmers Association(KFA) Ltd by way of a Government guarantee for Kshs. 2 billion, this Sessional Paper seeks Parliament's approval for the said financial support.

2. HISTORICAL BACKGROUND

2.1. Kenya Farmers Association growth period

KFA was originally incorporated as a limited company on 20th July 1923. The company changed its name to Kenya Farmers' Association (Co-operative) Ltd on 2nd May 1932.
It was, however, exempted from the provisions of the Co-operative Societies Act through Legal Notice No. 125 of 1968 dated 30th April 1968.

At inception, KFA membership comprised of settler farmers owning large tracts of land. However, after Kenya attained independence, most of the large farms were sold out to indigenous Kenyan's and subdivided into smaller units, giving rise to increased KFA membership (of both small scale and large scale farmers).

With further subdivision of land to below 2 hectares, membership increased and currently stands at 68,956 comprising of 68,830 individual members and some 126 primary co-operative societies.

The primary objective of the co-operative was to promote the economic interest of both its membership and the farming community at large and, in particular:-

- Carry on the business of the co-operative association in all its branches to promote and develop co-operation in agriculture and horticulture, to carry on the business of farmers' marketing and supply in all its branches.
- To buy, sell and deal in maize, wheat, barley and other cereals, Cotton, sugar and every produce of the soil.
- To carry on the business of importers and exporters of all kinds and classes of goods and materials, manufacturers' and distributors' representatives, marketing agents etc.
- To carry on the business of merchants and traders and, either as principal or agent, to buy and sell and deal in both wholesale and retail goods.

The above encompassed the sourcing and supply of farm inputs to its members and other non-members, and to also act as a marketing agency for their farm produce, mainly cereal crops, by pooling resources together and benefiting from economies of scale.

In carrying out the above objectives, KFA developed key linkages with other major players in the agricultural sector, notably the Agricultural Finance Corporation (AFC), Kenya Co-operative Creameries Ltd (KCC), National & Cereals Produce Board (NCPB), Kenya Seed Company Ltd (KSC), Agro-chemicals and Animal healthcare/feeds suppliers, etc as well as the Kenya Government.

Due to the spread and strategic locations of KFA's infrastructure facilities (i.e. go-downs, branches and distribution outlets), the Government and other related institutions found the Association to be a good and convenient vehicle to implement their programmes and projects mainly related to agricultural production and poverty alleviation initiatives. The most notable linkages that evolved over time were: -

- Appointment of KFA by Government to be the principal agency for handling storage, management and marketing of maize and wheat grains, as well as Aid fertilizers.

These functions have since ceased, following market liberalization.

- Appointment of KFA as the main distributor of Kenya Seed Company (KSC) Ltd. seeds of all types besides holding a 12% equity share (previously 28%).

- Channeling of agricultural credit through KFA by state owned Agricultural Finance Corporation (AFC) to cereal farmers (wheat and maize), for provision of farm inputs, with recovery of the same credit when farmers delivered their harvests at the end of each season, until 1991/92 when the agency function was transferred to NCPB and subsequently followed by liberalization of the cereal sub-sector.

- Provision of animal feeds and animal health products to livestock farmers through guaranteed payment arrangements by the Kenya Co-operative Creameries Ltd (KCC) another countrywide farmers' based co-operative organization.

- KFA had a well-established countrywide network of stockists that facilitated increased distribution capacity for farm input supplies and the provision of technical information on use of products.

- All local manufacturers and importers of agro-chemicals and feeds/licks relied almost wholly on KFA branch network for marketing of their products.

All these important linkages contributed significantly to growth in agricultural development.

The Association enjoyed Government support during its growth period and, over the years, developed a large physical infrastructure of storage facilities, branch network and selling centres/stockists for service delivery to the farmers, as well as residential properties all over the country in the main farming areas.

At its peak, KFA operated about 55 branches and selling centres, as well as stockists, around the country and employed over 2000 people.

KFA then accounted for about 50-60% of all the fertilizers imports in the country (as well as handling the Government Aid fertilizers) and fertilizers accounted for about 60% of the Association's business turnover.

2.2 The Decline of KFA

Co-operative societies have not been able to adequately address the challenges brought about by the liberalization due to lack of management capacity, institutional weaknesses, corruption, poor legal and policy framework. KFA was no exception.
The collapse of KFA started in earnest in 1985 following continued political interferences that saw its name and registration change to Kenya Grain Growers Co-operative Union(KGGCU) Ltd in Dec 1984, solely registered under the Co-op Societies Act Cap 490.

This was closely followed by unprecedented market liberalization reforms and downturn of the economy. By 1991, then KGGCU was technically insolvent.
The organization reverted to KFA Ltd in Jan 1996.

Since then, KFA's fortunes moved from bad to worse and the Association is currently beleaguered by massive debts and disillusioned creditors, dilapidated physical infrastructure, limited and highly demotivated staff, as well as poor operational, financial & management controls.

With the poor fortunes of KFA, the core business was, in the passage of time, streamlined & repackaged with trading lines mainly encompassing sourcing, supply & distribution of fertilizers, seeds, agrochemicals, animal healthcare products/feeds, agricultural machinery/implements and assorted hardware etc. through its current open network of 38 branches & selling centers.

The distribution of agricultural machinery & implements ceased some years back whilst the distribution of other core lines, as above, is at far below break-even point due to cashflow constraints.

2.3 KFA's Board and Management

Historically, KFA was managed by an elected Board of Directors and professionally recruited management.

However, since 1984/85, there has been a high turnover of Board members & top management with frequent Government interventions to "rescue" the Association from total collapse. The current Interim Board of Directors and the Chief Executive Officer are appointed by the Government, as part of KFA's revival process, to try and bring the Association back "on its feet", following the recommendations of the Inquiry Report of 2003.

Whilst the GOK has never had any direct shareholding in KFA the historical working relationship (i.e. KFA acting as Government agent in maize/wheat and Aid fertilizers management and distribution), and the pivotal role the Association played in the agricultural sector in its successful years, saw to it that the Government was represented, over the years, in the Board of KFA by:-

(i) PS - Agriculture

(ii) PS – Commerce (up to 1984)

(iii) PS – Treasury (after 1984)

(iv) PS and Commissioner for Co-operative Development (after 1984)

The representation has continued to-date.

3.0 POLICY OBJECTIVE

Agriculture is the engine of growth to Kenya's economy, since agriculture and agro related activities account for over 50% of GDP, and the sector remains the main source of livelihood for the majority of our Kenyan population.

The Government has committed itself to revitalize the agricultural sector in its "Economic Recovery Strategy for Wealth and Employment Creation (ERS) 2003 – 2007". This has further been restated through the launch, in March 2004, of Strategy for Revitalization of Agriculture (SRA) during the period 2004 to 2014.

The key components of the strategy to revitalize agriculture are that of raising agricultural productivity, increasing small holder real incomes and ensuring food security.

Among the constraints identified as hindering and inhibiting the pace of revitalization process include poor distribution, high costs and increased adulteration of farm inputs/supplies, and unfavorable macro-economic environment etc.

Therefore, in order to achieve a significant improvement of access to key inputs in the agricultural sector, the Government will have to support the revitalization of farm input supply organizations such as KFA so as to become more efficient, reliable and a useful key player in the supply of agricultural inputs in areas with agricultural production potentials.

It's, however, recognized in the strategy document that most of the farmer organizations are facing chronic financial and management problems.
In the case of KFA, the organization is technically insolvent and can no longer perform unless it is given a "new lease of life".

4.0 INSTITUTIONAL FRAMEWORK

The KFA still remains a strategic "vehicle" to enhance the Kenya Government's efforts towards economic recovery in a bid to create employment and reduce poverty. KFA, as a service delivery organization, fits well into the relevant government policy papers such as Economic Recovery Strategy for Wealth and Employment Creation (ERS) and the Strategy for Revitalization of Agriculture (SRA).

KFA was once the leading agricultural inputs provider. Up until 1991, it commanded agricultural input supply services as follows: -

1) Fertilizers - 40 -60%
2) Seeds - 60%
3) Agrochemical - 30%
4) Animal Feeds - 30%

During this period, KFA maintained a turnover in excess of Kshs.2 billion with fertilizers contributing 60% and thus forming the core business of the organization.

The strong linkage between KFA and other institutions like the AFC, KCC, and Kenya Seed Company Ltd (KSC) helped to sustain agricultural production and growth in the agricultural sector.

The absence of KFA in the agricultural input supply market has seen a significant decline in agricultural production, especially cereals (food crops), thus leading to increasing poverty levels. The availability of fertilizers to the farmers has consistently diminished due to high costs, delays in availability and compromise in quality. Since the start of decline of the KFA in 1991, its institutional capacity has been weakened with the subsequent loss of nearly 1,700 jobs.

With its physical infrastructure facilities still largely intact, KFA can easily be reorganized and its capacity enhanced so as to meet the expectations of the small-scale farmers who are vulnerable to manipulation.

5.0 ROLE OF GOVERNMENT

As stated in the introduction, the Cabinet has approved the request by KFA for a Government guarantee of Kshs. 2 billion. Further, the Government had approved debt write-off as shown below-:

5.1 Debts write-off

As a part of its commitment to the revival of KFA, the Government has already provisioned, for write off, the sum of Kshs.842,307,547.00 in the printed Estimates of the 2004/2005 financial year, as part of KFA's Balance Sheet "clean-up".

5.2 Financial Support-Government guarantee of Kshs.2.0 billion

Following the above balance sheet "clean up", the Government is required to provide a Government guarantee for Kshs.2 billion to enable KFA access banking facilities from commercial banks.

Approximately Shs500m of the facilities will be availed in the form of a medium term loan to:-

- Refinance existing Bank debt(s) - approx Kshs.300m.
- Finance physical infrastructure rehabilitation - approx Kshs.50 m.
- Finance capacity building (Human Resources, Information & Communication Technology/Management Information Systems and vehicles etc) - approx Kshs. 50 m.
- Settle preferential creditors e.g. local authorities rates/services and staff. - approx Kshs.100 m.

The liquidation of the existing bank debts (Barclays & National Bank) would allow the release of some 85 KFA's properties, valued at - approx Kshs.700 m (1995), currently held as securities by the two banks.

Notwithstanding any dilapidation, the properties are believed to have substantially appreciated in value in the last ten years as some are in areas that have been zoned as commercial.

It is proposed to sell off the organization's none-core assets, i.e. residential properties, expected to realize between KShs.200-300m in a properly managed sale programme over the next two years or so, which would go to reduce the medium term loan.

The balance of the loan would be repaid over 3 – 5 year from revenue generated through positive trading.

The balance of Kshs.1.5 billion of the proposed financial support will be for working capital, as under-:

- Up to Kshs.100 m would be applied to issue comfort guarantees to seed, agro-chemicals and animal healthcare products/feeds suppliers.
- Kshs.1.4 billion would be for establishing Letters of Credits (LCs) and/or Overdraft (OD) to finance the importation of fertilizers.
- Any overdraft would be purely temporary to meet the local costs of the fertilizers pending sale. KFA anticipates to import approximately 100-125,000metric tons of fertilizers annually out of the country's estimated annual consumption of 350,000 metric tons. KFA will, therefore, be targeting approximately 30% of the fertilizer market.

During the main planting season, KFA would expect to bring in at least 3 shiploads of fertilizers of 25,000 metric tons each per month over three consecutive months. Each shipload costs approximately Kshs.500 m, Cost and Freight (C&F). Thus the need to utilize the LC and/or OD facility in full.

Once operational, KFA will be able to negotiate with its other unsecured but proven creditors on debt rescheduling and instalment repayment plan from revenue generated from trading.

6.0 JUSTIFICATION

KFA was, in the past the dominant player in the distribution of agricultural inputs and was aptly referred to as **"the Farmers Supermarket".** In this role, government price controls aside, **KFA was the reference point for pricing of all agricultural inputs** and the Association was able to obtain large discounts for its members and other farmers, due to its bulk buying capabilities.

Its countrywide distribution network also meant that most farmers in the country benefited from the best quality and most competitively priced agricultural inputs.

The financial assistance being sought from GOK is designed to resuscitate KFA and put it back into business to play the above roles and make farming a profitable activity.

The countrywide physical infrastructure of KFA remains largely intact and the historical goodwill from the farming fraternity remains undiminished.

While recognizing that KFA will now operate in a liberalized market place with stiff competition, the following justify the revival of KFA:

- By importing directly, KFA will be able to break the "cartels" of major importers and suppliers (including middlemen) of fertilizers and agricultural machinery/implements as well as benefit from economies of scale and bulk buying, thus reducing and stabilizing the prices of such items to the farmers.

- Given the national distribution network, KFA will be able to reach most farmers directly without going through agents, distributors and stockists (who all need profit margins) thus making inputs even more affordable.

- As an organization with national responsibility KFA will only distribute quality products from reputable manufacturers and/ or main dealers/importers.

- KFA will also resume its historical role of providing field extension services in collaboration with the Ministry of Agriculture and input suppliers for increased agricultural productivity.

- The historical linkages alluded to earlier, with the likes of AFC, KCC, KSC, KPCU and other Primary Cooperative Societies etc will be re established and strengthened to support the country's agricultural activities, in line with stated Government policy strategies.

The above will effectively contribute to the GOK aspirations for revitalization of agriculture by:

- Enhancing efficiency and effectiveness in the supply and distribution of quality agricultural inputs at competitive prices and on timely basis to all farmers.

- Facilitating of lowering and stabilization of farm input prices through the mechanism of supply and demand.

- Encouraging increased mechanization of agriculture by introducing quality and competitively priced agricultural machinery/ implements, thus enhancing farming efficiency and increased food production.

Benefits accruing from KFA's revival will be:-

(i) To the people of Kenya

- Increased agricultural production at lower cost, through supply/provision of quality and competitively priced firm inputs at close range.

- Increased farm incomes and thus potential for creating employment at farm level in the rural areas.

- Alleviation of poverty, hunger and cases of malnutrition, through increased food production and wider supply and availability of food items in the market places at reasonable prices (i.e. food security).

- General improvement in quality of life and standards of living for rural communities.

(ii) To the Government of Kenya

- Achievement of self-sufficiency in food production and thus making savings on unnecessary food imports and creating exportable surpluses.

- Achieving the desired economic growth rates, through enhancement of efficiency in agriculture, which is targeted to contribute about 27% to GDP, and grow annually by 3.1 % between 2004-2007.

- Developing the ability and capacity to achieve and fulfill the agreed UN-Millennium Development Goal No. 1 on eradication of extreme poverty and hunger by the year 2015, including reduction of child mortality rate, and effective combating of pandemic diseases.

7.0 TRANSITION MANAGEMENT

With the proposed financial support, it is envisaged that the Association will be transformed into a financially viable and self-sustaining institution over three years, with the ability to meet its financial obligations.

The Association should also by then be financially attractive to members and other investors, should it be in need of additional capital injection.

It is, therefore, proposed and recommended that the transition period be three (3) years after which KFA will be handed back to its membership.

During the transition period, the Board shall be appointed by the Minister for the time being responsible for Co-operative Development and Marketing and shall be composed of representatives from the farming fraternity as well as and Government of Kenya representatives from the Ministries of Co-operative Development and Marketing, Agriculture and Finance. In total the Board shall comprise of not more than eleven directors.

8.0 ADDITIONAL RESPONSIBILITIES FOR THE BOARD

In addition to the aforesaid, the Board is expected to conclusively carry out the following;

- Implement the recommendations of the Government of Kenya Inquiry Report of March/April 2003 into the affairs of KFA Ltd.

- Reorganize and restructure KFA in order to meet the needs and expectations of the farmers.

- Formulate a viable strategic plan and corporate policy for KFA.

- Ensure that the KFA is returned to a sound financial footing.

- Update the audit position of the organization and ensure the balance sheet is "cleaned up".

- Review and validate the assets and liabilities of the organization.

- Mobilize resources for the revitalization of KFA.
- Interface with the farming fraternity in readiness for the transfer of the organization back to the owners.

9.0 CONCLUSION

Although KFA is currently insolvent, it still has a lot of goodwill from the farmers and there is willingness from the farmers to continue to patronize their organization once their confidence is brought back through the Government revival strategy.

This would encourage the organization to raise more working capital through renewed membership subscription.

The development of appropriate policy and legal framework through the amended Cooperative Societies Act No.12 of 1997 would enhance management capacity and good governance thus ensuring competitive service delivery to the farmers in line with the Strategy for Revitalizing Agriculture (SRA).

PARLIAMENT IS CALLED UPON TO:

- **Approve the policy herein outlined**
- **Approve the provision of a Government Guarantee for KShs2.0billion to the Kenya Farmers' Association Ltd.**

March, 2005