Introduction

1. Tea contributes immensely to socio-economic development of the country. It is the leading foreign exchange earner contributing about 23% of the total foreign exchange earnings. Tea sector also supports the livelihood of over 5 million Kenyans. In the year 2019, the tea industry earned the country Kshs.117 Billion in export earnings and Kshs.22 Billion in local sales. On the supply side, the domestic sales value also increased from Ksh.15 billion in 2018 to Kshs.18 Billion in 2019.

2. Last year, Kenya produced 458 Million Kilograms of Black Tea in the accounting for approximately 7.6% of the Global tea production, while exporting 496 Million Kilograms which represented 26% of the Global Tea exports over the same period.
3. In spite of the economic and social challenges posed to Kenya and indeed the global community from the Corona Virus (Covid-19) pandemic, tea production and trading have continued unabated, with tea exports being shipped to about 40 market destinations monthly since January 2020.

4. However, the tea value chain in the country has historically been constrained by structural challenges that have collectively undermined the ability of the sector to achieve its full potential in terms of export earnings and contribution to the macro economy including GDP contribution, job creation and better earnings to tea farmers. These challenges have consistently manifested themselves in form of low or declining in tea prices at the auction and low earnings to farmers.

5. As a consequence, there have been fervent appeals by tea farmers and other stakeholders to the Government to intervene and steady the dwindling fortunes of the tea sector. In some extreme cases, there have been instances where some farmers have uprooted tea bushes in protest thus compounding the threats to the tea sector both as a rewarding enterprise to the farmers but also as a significant foreign exchange earner to the country.

6. Furthermore, good performance of the tea sector is a central public policy issue because approximately 70% of tea production in the country is undertaken by small scale tea farmers.

7. These challenges, if not address have the potential to recreate the problems faced by the coffee sector over two decades ago that led to
neglect and/or abandonment of coffee bushes by farmers and the prevailing low coffee production in the country.

8. These real threats to small holder tea farming and the macro-economy have therefore created an urgent need for proportionate Government intervention in the sector in the manner more particularly espoused in the Presidential Directive issued on 14th January 2020.

Framing the Problem

9. The Government has therefore contextualized the challenges facing the tea sector and more particularly the tea farmers into three broad categories namely a dysfunctional tea auction system; control and predatory behaviour of KTDA and its subsidiaries in the tea value chain; and low and unstable tea prices. These challenges and their impact in the tea value chain are elaborated as follows:
1) A DYFUNCTIONAL TEA AUCTION SYSTEM

A major problem facing the tea value chain is a dysfunctional and inefficient tea auction system characterized by lack of transparency, accountability and competition; and prone to manipulation, capture, insider trading and cartelization by value chain players leading to ineffective price discovery, low prices and poor earnings to tea farmers. The structural character of the tea auction in Mombasa in terms management, governance and decision making processes is that it is a club where all value chain players, that have a direct commercial interest in the outcome of the auction process run the auction. This is a serious conflict of interest that predisposes the auction process to capture by vested interests, insider trading, price fixing and other malpractices.

2) ABUSE OF MARKET POWER BY KTDA AND SUBSIDIARIES IN THE TEA VALUE CHAIN

Moreover, the tea sector is undermined by the manipulation and predatory behaviour of Kenya Tea Development Authority (KTDA) and its subsidiaries on the value chain. KTDA that supply over 60% of the tea traded at the auction has consistently used its market power, dominance and influence to undermine the auction, curtail price discovery and exploit the vulnerabilities of small holder tea growers. This has been exemplified by the following overt behaviour by KTDA:

a) Instigation of sale of tea from small holder tea growers through an opaque and non-transparent ‘sale by private treaty’ (commonly called Direct Sales Operation). This process is further
catalysed by a generous credit facility of between 30 to 120 days given by KTDA to buyers without any requirement to provide any guarantees for the teas bought. As a consequence, buyers interested in Kenyan tea do not have any commercial incentives to compete and push tea prices at the auction because of the opportunity to negotiate a sale by private treaty with KTDA outside the auction, sometimes at below the auction prices. Moreover, because KTDA managed factories supply over 60% of tea to the auction, price discovery at the auction and the entire auction process is undermined by this parallel window; and tea prices are depressed. Furthermore, due to absence of any security embedded in KTDA’s sale by private treaty arrangement, significant amounts of farmers’ money has been lost to buyers who were supplied tea by KTDA and refused or failed to pay. In addition, due to lack of transparency and accountability in the way KTDA executes sale by private treaty, the process gives unfettered discretion to KTDA officials and is therefore a fertile ground for rent seeking and other governance transgressions at the expense of small scale tea growers.

As a direct result of the governance gaps, between October 2019 and December 2020, KTDA managed teas consistently underperformed the teas from Rwanda and Burundi on month to month basis. It is plausible to postulate that the cumulative adverse socio-economic impact visited on small scale tea growers and the macro-economy by this behaviour by KTDA over extended periods of time is monumental;
b) Imposing of exorbitant, exploitive and grossly opportunistic fees on small holder tea growers by KTDA for management services offered to factory limited companies. The Management Service Agreement between KTDA and Factory limited companies has a management fee of 2.5% of value of tea earnings by the factories. To demonstrate the exploitive and exorbitant nature of this fee, KTDA managed tea factories currently sell between 180,000 to 200,000 million kilograms of tea from over 600,000 small holder tea growers annually. At an average price of about US$3.5 per kg, teas belonging to these small holder tea growers handled by KTDA under the management agreement generate a value of between Ksh. 60 and 70 billion annually. At a management fee of 2.5% of the value of tea sales for management services, KTDA holding and its subsidiaries gobble between Ksh. 1.6 and 2 billion every year as fees.

I consider this fee onerous and unjustifiable for the following reasons:

- Firstly, there is no justification for setting the fees for a management service, just like any other consultancy service as a percentage of the gross earnings of a client. Best practice is to set such fees on a cost reflective lump sum fee basis that includes a reasonable and competitive profit margin for the service provider;
- Secondly, there has been no observable correlation between the growth in these colossal earnings by KTDA and a commensurate growth in earnings by
tea growers. On the contrary, earning by tea growers on a Kenya shilling per kilogram of tea basis have been on consistent decline while earnings by KTDA have increased; and

- Thirdly, the hefty fees and all the other toxic clauses in the management agreement are a result of a lopsided, opaque and highly conflicted contractual management relationship between KTDA and the factory limited companies. The KTDA company secretary also doubles up as the company secretary for all the factories. KTDA and its subsidiaries have literally been negotiating management service agreements with their own company secretary occasioning serious conflict of interests.

It is therefore inconceivable to expect that a contract emanating out of this defective structure can yield a fair and balanced contract that protects the interest of farmers.

c) Retention of large amounts of tea farmers’ money usually deducted at source and misapplication of these monies by KTDA as follows:

- Investments in a litany of subsidiaries ranging from power generation, insurance, tea trading, tea transportation, logistics
and warehousing, micro finance and equipment manufacturing among others with little or no demonstrable direct benefits to tea farmers;

- **Holding large amounts farmers’ money in low interest earning fixed deposit accounts** in commercial banks while syndicating expensive commercial loans for the same tea farmers;

- **Holding large amounts of small scale tea growers’ money with commercial banks that have a weak financial base leading to loss of billions on shillings.** Two commercial banks have over the recent past gone down with billions of small holder tea growers’ money in deposits made by KTDA which demonstrates a general absence of the usual abundance of caution expected of an institution dealing with vulnerable communities;

d) **Orchestration of a litany of Inter-factory loans and advances among tea factories using tea earnings from other factories.** Currently, a number of tea factories owe and are also owed monies by other factories creating a lot of confusion in the sector; and

e) **Inordinate delays in making prompt payments to small holder tea growers despite receiving payments from tea brokers within fourteen days from the date of the auction.** This has decimated the cash flow position of small scale tea farmers who have resulted to tea hawking to cater for their basic needs. In addition, delays in making payments to farmers has had the negative effect of ensnaring tea farmers to borrowing expensively from shylocks and other informal leaders to cater for
basic expenses such as food, health care and school fees for their children

3) LOW TEA PRICE AND PRICE VOLATILITY
Thirdly, tea farmers have been also plagued by a twin problem of low prices and price volatility. While the low prices have eroded direct earnings by tea growers, tea price volatility has led to unstable cash flow for tea farmers.

4. PROPOSED POLICY INTERVENTIONS
In order to address the above challenges and guarantee long term growth and stability of the tea sector, the Government has developed the following interventions for implementation in the immediate, short and medium:

a) Immediate Regulatory Interventions

a) The following regulatory remedies have been proposed for implementation immediately these regulations come into effect:

i. All teas produced in Kenya for the export market shall within two (2) months after coming into effect of these regulations be sold exclusively through the auction process.
ii. Henceforth, sale by private treaty commonly known as Direct Sales Overseas is outlawed

iii. Any teas that are not sold during a particular auction shall be re-listed for sale during the subsequent auction;

iv. All registered tea auction organizers shall establish an electronic trading platform for tea auction. However a tea auction organizer existing before commencement of these regulations shall establish and migrate tea trading to an electronic trading platform within two (2) months from the commencement date of the regulations;

v. All tea buyers shall henceforth submit to the Regulatory Authority (AFA) a performance bond in the form of a bank guarantee equivalent to 10% of the estimated value of the tea they intend to buy to underwrite commercial risks associated with buyers who fail and/or refuse to pay in full for the tea bids they win at the auction;

vi. All buyers shall pay in full for all teas they win at the auction before they take custody and lift the tea for export

vii. All factory Limited Companies (Tea Factories) shall henceforth register and enlist with the Authority and
auction organizer to participate at the tea auction directly;

viii. A registered tea broker shall offer brokerage services to a maximum of fifteen (15) factory limited companies. Brokers that are already in operation shall continue with their business uninterrupted until the tenure of their registration is due for renewal;

ix. All monies from the sale of tea at the auction shall be remitted directly to Factory Limited Accounts within fourteen (14) days from the auction date less only the agreed commission for tea brokers;

x. Factory Limited Companies shall within thirty (30) days from receipt of proceeds from sale of tea pay tea growers at least 50% of payment for green leaf delivered every month;

xi. The balance due to tea growers shall be paid by the factory limited companies within the financial or calendar year as shall be agreed with the growers

b) In order to address the challenges associated with the lopsided nature of the existing management agreement framework with Factory Limited Companies, the following regulatory interventions are proposed:
i. Any management agency agreement with a factory limited company shall be for a tenure not exceeding 5 years;

ii. The remuneration for any management service shall not exceed two percent 2% of the value of tea sold per year;

iii. Company secretary services shall be excluded from the services offered by management service providers;

iv. Factory Limited Companies shall either recruit in-house company secretaries or outsource the service; and

v. A director or affiliate of a management service provider shall not serve as a director or have a direct commercial relationship with a factory limited company they serve.

1. Short to Medium Term Policy and Administrative Interventions

In order to address other systemic challenges facing the tea sector, the Government propose to engage professional consultants with the necessary experience in the tea industry to provide technical advise on further necessary policy and administrative reforms to improve efficiency and productivity in
the value chain. In particular, the following interventions are proposed in this respect:

a) Undertake a technical study to define a clear migration path and governance framework from the current tea auction structure to an efficient, competitive and responsive Commodities Exchange for tea. In particular, the study will provide technical advise on the governance framework to deal the inherent weakness of the current auction system that includes predisposition to conflict of interest, capture by vested interests, insider trading, dominance in the auction market and ineffective price discovery system.

b) Undertake a study to evaluate the impact of KTDA commercial behaviour on the entire value including and more particularly the earnings to small holder tea growers. In particular, the study would undertake a historic audit and tracing of deductions of money belong to small holder tea growers over the last 10 years, evaluate the management of the KTDA holding and reserve accounts, evaluate and document losses occasioned by the pooled management of farmers’ earning by KTDA including cash held banks and monies held and/or lost to banks in distress, assess the application and use of public and farmers assets
by KTDA, evaluate the risks associated with the sale of tea
by private treaty by KTDA and losses that farmers have
incurred due to this arrangement; evaluate the extent of
application of farmers’ resources in the initial and on-going
capitalization of KTDA subsidiaries and value of these
subsidiaries to the tea growers among other considerations.
c) Undertake a study on the set up, resourcing and
management of a price stabilization fund for tea growers
and develop a framework for implementation of a
sustainable Minimum Guaranteed Return (MGR) for tea
farmers; and

d) Establishment of a steering committee to oversee, monitor
and evaluate implement these policy, regulatory and
administrative reforms and report to the cabinet secretary

This report and the attached regulations are submitted for public
consultations for a period of fourteen (14) days from the date of
this announcement. The members of the public and other
stakeholders are guided as follows regarding this consultation
process:

1. The regulations shall be available immediately on the
websites of both the Ministry of Agriculture, Livestock,
Fisheries and Cooperatives and the Agriculture and Food
Authority (AFA);
by KTDA, evaluate the risks associated with the sale of tea by private treaty by KTDA and losses that farmers have incurred due to this arrangement; evaluate the extent of application of farmers' resources in the initial and on-going capitalization of KTDA subsidiaries and value of these subsidiaries to the tea growers among other considerations.

c) Undertake a study on the set up, resourcing and management of a price stabilization fund for tea growers and develop a framework for implementation of a sustainable Minimum Guaranteed Return (MGR) for tea farmers; and

d) Establishment of a steering committee to oversee, monitor and evaluate implement these policy, regulatory and administrative reforms and report to the cabinet secretary

This report and the attached regulations are submitted for public consultations for a period of fourteen (14) days from the date of this announcement. The members of the public and other stakeholders are guided as follows regarding this consultation process:

1. The regulations shall be available immediately on the websites of both the Ministry of Agriculture, Livestock, Fisheries and Cooperatives and the Agriculture and Food Authority (AFA):
2. A hot line has also been provided at AFA for purposes of providing any clarifications; and

3. The Ministry shall only be receiving written Memorandums from members of the public due to inability to hold any public gatherings in the wake of Ministry of Health guidelines on social distancing among other measures in the management of COVID-19 pandemic.

Signed

Hon. Peter Munya, MGH
Cabinet Secretary

6/4/2022