ODI AND MINISTRY OF INDUSTRY, TRADE AND COOPERATIVES: FINANCING LARGE FIRMS IN THE GARMENT SECTOR IN KENYA

TUESDAY 17 JULY 2018, NAIROBI
WORKSHOP REPORT

SUMMARY

- On 17 July 2018, the SET programme at ODI, in partnership with the Kenyan Ministry of Industry, Trade and Cooperatives, convened a group of manufacturing firms, financers, Government representatives and other stakeholders, to discuss challenges in financing of the garment manufacturing sector.
- Growing Kenya's manufacturing industry is one of the areas of focus in President Kenyatta's 'Big Four' agenda and is a key sector for the country's industrialisation objectives, with growing demand in-country and across other regions. However, in recent years the sector's contribution to GDP has declined rather than grown.
- Challenges cited by many local manufacturers include competition from imports of both new and second-hand clothing and a lack of relevant skills in labour-market entrants.
- However, the biggest challenge facing firms is access to finance. Currently, approximately 90% of profit generated by local manufacturing goes to international banks, with minimal involvement by Kenyan banks.
- Several factors behind this trend were explored by panellists and participants, including Kenyan banks' aversion to the degree of risk inherent in manufacturing, a lack of understanding within the banking sector of the way textile and garment firms operate, and the wider business ecosystem being unconducive to local investments (including labour laws, regulation, taxation).
- CDC, the UK Government's development finance institution, posited that administrative issues such as poor cash flow management were endemic to the manufacturing industry and were cause for concern amongst potential investors.
- Connections were forged between potential investors and firms, with potential for a series of meetings convened by the Ministry of Industry to develop these relationships further.

On 17 July 2018, the SET programme at ODI, in partnership with the Kenyan Ministry of Industry, Trade and Cooperatives, convened a group of manufacturing firms, financers, Government representatives and others, to discuss Kenyan manufacturing within the industrialisation 'pillar' of President Kenyatta's 'Big Four' agenda, and opportunities and challenges in the financing of textiles and garment manufacturing.

The workshop sought to bring firms and potential investors together to talk through constraints on both sides, and to begin to build relationships to support investments in the long term. The event led to the development of a financing agreement between Kenya's Co-operative Bank and a large manufacturer, Hela Garments.

OPENING PRESENTATIONS

WELCOME FROM RAJEEV ARORA, TEXTILE ADVISOR, MINISTRY OF INDUSTRY

Rajeev Arora welcomed participants and opened the discussion by proposing: how can Kenya enhance the sustainability of existing manufacturing companies and increase investment into the sector?

Cotton and textiles have been transformative sectors across Asia; now it is Africa's turn. But sufficient financing for manufacturing remains a significant challenge on the continent. How can we bring value to investors and bring sustainability to the value chain?

From l-r: Jaswinder Bedi, EPC; Rajeev Arora, Ministry of Industry.

COMMENTS FROM JASWINDER BEDI, CHAIR, EXPORT PROMOTION COUNCIL

Jaswinder Bedi (Chairman, EPC) opened by positing that the manufacturing industry in Kenya is being held back due to a lack of funding options. In Kenya, the manufacturing sector was worth $360m last year. However, of this amount, very little of this stays within Kenya, with 90% of profit being made by international banks. This is an ongoing missed opportunity for Kenyan banks.

Kenyan manufacturing has suffered in recent years due to international competition in both new and second-hand clothing. It is positive that in the Big Four agenda, industrialisation, and garments and textiles in particular, are key areas of focus. Manufacturing's share of GDP has gone down to 8.7% - far too low – and we now need to grow 36% each year from now until 2022 to meet the target of 15% of GDP.

Global dynamics of manufacturing mean that the markets in the US, Europe, China and India are all growing in terms of per capita consumption. While India and China will supply their markets from Asian manufacturing hubs, there is an opportunity for Africa to become a supplier to the US and Europe in the coming decades.

There are also opportunities regionally, with AfCFTA for multilateral trading, and bilateral agreements too (e.g. with Ghana – which, like Kenya, was among the first countries to ratify the AfCFTA). By 2040, the world's biggest working age population will be in Africa. Manufacturing can help support this demographic challenge.

One of the biggest challenges is a lack of finance. Currently, Kenyan banks do not offer any competitive credit or loan products to garment firms, thereby making firms less competitive and dependent on external banks (outside Kenya) for finance. There is a flight of capital and interest earnings out of Kenya for this reason. Banks in Kenya need to provide lines of credit, reduce interest rates, and take into account customer balance sheets rather than export-firm balance sheets to provide faster and timely funding. Currently EXIM bank India is providing Kenyan firms loans at 11%, which is very expensive, but still cheaper than local tier 1 and tier 2 banks. Banks are borrowing (repo and reverse-repo rates) at very low costs, so why do they need to charge such high interest? It makes Kenyan firms uncompetitive.

PRESENTATION FROM DIRK WILLEM TE VELDE, SET PROGRAMME DIRECTOR, ODI

Dr te Velde began by introducing Supporting Economic Transformation (SET), a programme of analysis, advisory support and convening work funded by the UK Government, to support strategies promoting economic transformation in developing countries.

The SET programme focuses on industrialisation, a key step on the transformation ladder. That the new Kenyatta administration has manufacturing as one of its key areas of focus is an encouraging development. SET programme analysis estimates East African countries need to create 7,000 jobs per day just to keep up with labour market entrants, and manufacturing must play a part in this.

Experience of manufacturing growth in both Asian countries and others in Africa such as Ethiopia shows that the development of special economic zones (SEZs) can be crucial. SEZs can help overcome constraints to growth such as infrastructure and energy supply.

Other constraints include skills, the lack of integrated value chains and crucially, access to finance.

In the past, finance has largely either been internal to firms, or has come from parent companies abroad. When it comes to domestic commercial banking, we find that there is a lack of access to such finance for firms.

We can look to Bangladesh as an example of a country that overcame its financing problem. Part of the solution could be development finance institutions (DFIs), some of whom specifically focus on manufacturing. However, there were also problems within the financial system itself that needed fixing.

ODI looks forward to working with all of those here to work through these various challenges.

PANEL DISCUSSION

Chair: Jaswinder Bedi (Chairman, Export Promotion Council)

Panellists: Anzetse Were (consultant and economist), Tejal Dodhia (Director, Thika Cloth Mills), Jackie Waithaka Mungai (Head, Corporate Banking, Cooperative Bank of Kenya), Anthony Mbeyha (Regional Manager, SMEs, Equity Bank), Tobias Alando (Head of Membership, KAM), Wasantha Perera (CEO, Hela Garments).

Chair: A question for the Cooperative Bank. Why are Kenyan banks not funding manufacturing? Why are foreign banks getting the benefit?

Jackie Waithaka Mungai: Our bank does make offers to manufacturers – but often they are not accepted. There may be a lack of understanding of the manufacturing business within the bank. We know that in other countries, such investments are made more often – we are keen to know what it is that Sri Lankan banks are doing that Kenyan banks are not. Our bank is keen to consider further linkages with large garment firms.

Chair: Kenyan banks are investing based on the local factory's balance sheet, not the exporters' balance sheet. It is not only banks that are not keeping up – also unions.

Anthony Mbeyha: Largely banks do not understand the industry – they need to do more.

Chair: A question for Tejal. In the current environment, how has your mill survived?

Tejal Dodhia: Imports have made the industry very tough in Kenya, as has the dumping of second-hand clothing. Textile mills are also very capital intensive. Garment manufacturing is less capital-intensive, but is labour intensive, so it's crucial for employment. Another issue we've grappled with has been the cost of energy, though Government is working to bring this down.

Chair: A question for Anzetse. What is your research indicating the big challenges are?

Anzetse Were: We need to be open to new financing options – are we open to venture capital, to equity? Banks must become more creative. Value chain financing is important, so banks can see where the finance is going. Then there's also a limitation to where banks can lend – there are very few mills and very few EPZs.

Chair: A question for Wasantha Perera. What is Hela's single biggest issue?

Wasantha Perera: Our single biggest problem: banking.

Tobias Alando: KAM are operating in a regulatory space that needs to address challenges around promoting exports. Problems KAM is working to address on behalf of members include illicit and contraband goods, competitiveness, market access, and the cost of finance.

DISCUSSION WITH THE AUDIENCE

Below are a selection of comments and questions from the audience and panel. Comments have not been attributed to individuals.

- On the subject of Bangladesh as a country that overcame financing issues: Bangladesh began to export to the US in the 1980s, with what was then a $4m sector. A very open system for finance for manufacturers by banks was encouraged, and within five years, exports increased to the billions.
- It is too simple to say that banks are closed off to new opportunities. The policy environment must be addressed more widely, as there are a number of constraints at

local, national (such as taxation, labour laws) and regional levels (such as non-tariff barriers). The entire infrastructure of the financial system needs to change.

- Firms like Hela Garments show that Kenya can compete globally in terms of quality.
- There is an air of desperation about manufacturing firms in Kenya – they must demonstrate to banks that their finance is not firms' only option. Equity funding, for example, could be looked at. Banks, too, must be more creative in the financing options they offer.
- Kenyan manufacturing cannot rely on being part of international value chains – building domestic value chains will be crucial.
- Financing also needs to be done accounting for the complete value chain, looking at backward suppliers, forward linkages, and then assessing a competitive interest rate and providing tailor made products to suit firms
- Large manufacturing firms are capital intensive, but if this is a constraint for banks, they could do to look at SMEs, which sit in the 'value-added' part of the value chain.

CLOSING PRESENTATIONS

SAKTI MUHKERJEE, AFRICA DIRECTOR, CDC

Sakti Muhkerjee introduced CDC as the UK Government's DFI, working with the private sector in developing countries, with poverty reduction the key aim. Sub-Saharan Africa is CDC's main focus area, as this remains where poverty rates are highest.

When CDC makes a valuation of an investment, it looks at (i) risk and (ii) potential for growth and the importance to a country's growth strategy. One key concern CDC has about the manufacturing sector in countries like Kenya is that issues such as poor cash flow management are common and need to be addressed to attract more investment. Related concerns are that it is a capital-intensive sector and that there are concerns about servicing. However, these concerns aren't specific to manufacturing, they exist in other sectors too.

Mr Muhkerjee emphasised that CDC is not a typical lender and should not be compared to a standard bank; CDC's focus is development, and thus it will not make just any investment, it must have development impact. Its view of risk is different to other lenders.

RAJEEV ARORA, TEXTILE ADVISOR, MINISTRY OF INDUSTRY, TRADE AND COOPERATIVES

Rajeev Arora closed the event by positing that capacity building and upgrading of machinery and skills are all important – but capital is the real challenge. We need to identify needs and what is workable and achievable under current circumstances.

Kenya's priorities must be (i) building the value chain from beginning to end, and (ii) building linkages between banks and manufacturers. The private sector must lead this, and we should seek to continue the conversations and relationships being built today.

Jackie Waithaka Mungai, Co-operative Bank and Wasantha Perera, Hela Garments, discussing a new financing arrangement for the firm following the workshop.