



Making Kenya's efficient tea markets more inclusive

Main Findings and Recommendations

Kenyan smallholder tea farmers generally received prices closer to those in international markets. This reflects the country's liberalized market structure for tea and the lack of distortions resulting from domestic policies. The close alignment between domestic and international prices may also be due to the efficient organization of smallholders who process and market their tea under the Kenya Tea Development Agency Ltd. (KTDA). However, MAFAP analysis shows that tea prices were vulnerable to short-term shocks due to Kenya's reliance on only a few key trade partners.

MAFAP analysis suggests that, although the tea market is already very efficient, it may be further improved by:

- ▶ encouraging the entry of new buyers at the Mombasa Tea Auction;
- ▶ reducing exposure to shocks by diversifying export markets; and
- ▶ encouraging domestic value addition, processing and labelling.

An analysis of incentives received by smallholder farmers who are shareholders of the KTDA compared to those who are not, could also be useful.

SUMMARY

Tea is Kenya's main export, and the tea industry is one of the country's largest private sector employers. Over 60 percent of Kenyan tea is produced by smallholder farmers and marketed through the KTDA. MAFAP analysis shows that KTDA smallholders receive prices close to world market prices (Figure 1) which indicates that the tea market is functioning efficiently. Nonetheless, the tea market would benefit from more competition at the international auction in Mombasa. Moreover, the tea that Kenya exports has little value added and the bulk of exports go to only a few countries. Furthermore, although "Pure Kenyan tea" is considered to be of very high quality, the prices paid for it in international markets may

not fully reflect this quality. This may be due to the high concentration of market power among a few multinational companies that have a great deal of control over local production, processing and pricing.

Smallholder tea farmers are not a homogenous group, and there may be differences in the level of incentives they receive. In fact, smallholder farmers who are not shareholders of the KTDA do not directly benefit from the company's dividends.

KEY FINDINGS

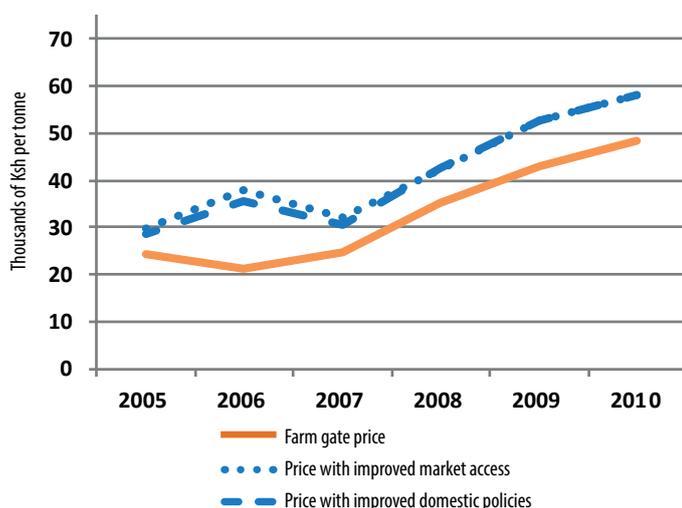
The tea market in Kenya is not affected by domestic policy distortions

MAFAP analysis shows that the prices farmers received for tea were very close to prices that could be expected without policy distortions and with efficient processing and marketing. This reflects the government's objectives of liberalizing the tea market and allowing prices to follow market signals. It is also the result of the KTDA's successful organization of smallholders' tea production, processing and marketing.

Kenya's tea sector is vulnerable because most of the tea is exported to only a few countries

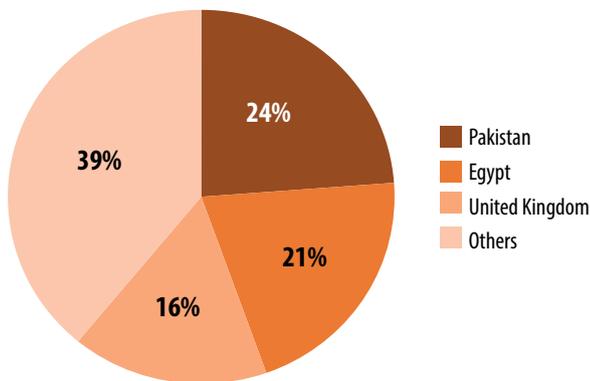
About 95 percent of the tea produced in Kenya is exported, and about 60 percent of exports go to only three countries: Pakistan, Egypt and the U.K. (Figure 2). Heavy reliance on a few export partners, coupled with low domestic consumption relative to production, is one of the major challenges for Kenya's tea industry. This issue was especially pertinent, for example, when Pakistan began to seek out other tea suppliers

Figure 1. Producer prices of green leaf tea in Kenya (in KSh/tonne), 2005-2010



and reduced Kenyan tea imports from 91,000 tonnes in 2005 to 65,000 tonnes in 2006. This resulted in a much lower price for producers compared to the equivalent world market price in 2006 (Figure 1).

Figure 2. Kenya's Major Export Partners for Tea (in %), 2005-2010



OTHER ISSUES AFFECTING THE TEA SECTOR

A few high volume buyers have significant power in international markets and consequently over producers' prices

Kenya's tea market is directly affected by a few high volume buyers who dominate the international tea market. Indeed, only seven companies control 85 percent of the tea consumed in the world. Most of these companies are vertically integrated multinationals that can influence local and international value chains, from farm inputs to production to tea-bag retail. Only six companies account for two-thirds of the tea purchased through the Mombasa Tea Auction. Therefore, these high volume buyers strongly influence auction prices.

The low value added to tea exports limits farmers' ability to obtain higher prices

Most of Kenya's tea is purchased in bulk by multinational companies who then export it to their own processing plants located in consumer countries. Multinationals are therefore able to control blending and packing, two of the most profitable value addition activities, which represent up to 80 percent of the retail price. The control that multinationals have over final processing also allows them to blend higher quality teas, such as the KTDA's black tea, with other lower quality teas in order to raise the quality of the final product. Consequently, the high quality of KTDA tea is not always recognized by final consumers, which may translate into undervalued prices for smallholders. Farmers could potentially obtain better prices if more value could be incorporated into Kenyan tea exports - for example by continuing to develop the blending and packing component of the tea value chain.

Box 1: KENYA TEA DEVELOPMENT AGENCY (KTDA)

The KTDA provides services to all smallholder tea farmers such as:

- supplying farming inputs (e.g. fertilizer), materials and extension services;
- inspecting and collecting green leaf tea; and
- processing and marketing.

In June 2000, the KTDA was registered as a private company and is therefore independent from the government. Its shares are exclusively owned by approximately 150,000 smallholder farmers, who also elect its managers. The KTDA is responsible for marketing almost all tea produced by smallholders (over 450,000 farmers) and operates 63 processing factories.

Farmers who are not KTDA shareholders may be receiving lower incentives under the current marketing system

Although only about one-third of the country's smallholder tea farmers are legal shareholders of the KTDA, all smallholders are required by law to market their tea through the company. Furthermore, farmers who are not KTDA shareholders are unable to elect or serve as elected managers within the company. This may result in the uneven distribution of income between smallholder farmers. An in-depth analysis of incentives received by KTDA shareholders, compared to those received by non-shareholders, could help shed light on these differences.

CONCLUSION

MAFAP analysis suggests that KTDA smallholders receive prices close to their international market equivalent. This indicates that the Kenya tea market is functioning efficiently, with no distortions from domestic policies. However, the prices smallholders receive may fail to reflect the high quality of, and international demand for, Kenyan tea. Moreover, tea pricing is highly vulnerable to shocks due to Kenya's heavy reliance on a few export markets. More efforts are needed to further develop and strengthen the Kenyan tea sector in the context of highly competitive international markets.

Further Reading

MAFAP Technical Note on Tea Production in Kenya (2012)

by Mulinge, W., Monroy, L. and Witwer, M.

Available at: <http://www.fao.org/mafap>

CONTACTS

Website: www.fao.org/mafap

Email: mafap@fao.org

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