MOVING SUGAR INDUSTRY OUT OF DOLDRUM

PRIVATIZATION PROCESS

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PRIVATIZATION PROCESSES
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LIST OF ABREVIATIONS

COMESA:	Common Market for Eastern and Southern Africa.
FRI:	Factory Recovery Index
GOK:	Government of Kenya
KESREF:	Kenya Sugar Research Foundation
mt:	Metric tonne
SDF:	Sugar Development Fund
SUCAM:	Sugar Campaign for Change
TCD:	Tons Cane per Day
TCH:	Tons Cane per Hectare
KNBS:	Kenya National Bureau
SOSE:	State Owned Sugar Enterprises

EXECUTIVE SUMMARY

Agriculture is a key sector in Kenya economy.The sugar industry as a sub-sector in Agriculture ranks third after horticulture and tea in Gross Marketed Agricultural Product contributing Kshs. 15.94 billion or 7.2% in 2009. The exchequer also receives substantial tax inputs from the industry. For example between 2000-2009 value added tax (VAT) contributions averages Kshs. 2.7 billion annually. The sub-sector directly or indirectly supports livelihoods of about six million people including 2000,000 mostly small scale sugarcane farmers.

This publication underpins the primacy of privatization of the five state owned sugar enterprises (Nzoia, Chemelil, Muhoroni, Miwani, and SONY) in resuscitating the ailing non-competitive sugar industry in Kenya. The origin, objectives and socio-economic importance of the entire industry is traced, followed by a detailed profile of key institutions. Policies legal and regulatory framework for the industry is analyzed. They are deemed ill equipped to propel the sugar sub-sector from doldrums to prosperity.

The performance at farm and factory level for the period 2000-2009 comes next, with elaboration on key constraints hindering increased sugarcane and sugar output. The fluctuations and inconsistencies in production over the years reveal lack of strategic focus to raise output sustainability.

Before sugar industry privatization process is put on course, key reforms identified at stakeholders' forum must be undertaken.The seven reforms amongst others will harmonize the entry and facilitate soft landing for private sector players, including sugarcane farmers as shareholders.

It is desired that the information and suggestions in this publication will adequately equip and guide stakeholders, policy makers and parliamentarians in charting the way forward to a viable and competitive sugar industry in Kenya. Failure to fast-track these fundamental reforms will open flood gates for cheap sugar from COMESA FTA and elsewhere especially after the expiry of safeguard reprieve period in February 2012.

The dire consequences will be the eventual collapse of industry seriously undermining our development goals envisioned in Vision 2030 and our commitment to millennium Development Goals to reduce poverty by half by year 2015.

1.0 INTRODUCTION

The five parastatal sugar companies, Chemelil, Nzoia, SONY, Muhoroni and Mwani are set to be privatized during the ongoing government divestiture programme. This follows a Cabinet approval in December 2008 and is in line with the Privatization Act of 2005.

The sugar industry privatization process is yet another bold government initiative to reform the sub-sector in line with the recommendation of the Sugar Industry Task Force 2003. The anticipated entry of private sector players, is believed will bring in the much needed capital injection to modernize the factories, improve operational efficiencies, bring in expertise, and inculcate better management and good governance styles. This will enhance competitiveness and yet on the other hand, it will reduce political patronage, official bureaucracy, corruption and wastes.

The COMESA Secretariat Assessment report of 2008 on safeguard measures, also underscored the need for a fast tracked government policy to facilitate the privatization of the same 5 sugar companies. This presumably is to make the sub-sector competitive overall, and in preparation for the entry back into full force, COMESA FTA, Agreement on sugar in February 2012. It should be noted clearly that the new players will require soft landing in terms of accomplished policy, legal and institutional reforms. And here the government will be required to take leadership in implementing the stated reforms in view of the urgency to revitalize the industry in order to attain regional and global competitiveness. This paper discusses necessary reforms required to harmonize the sugar industry privatization process.

2.0 OVERVIEW OF SUGAR INDUSTRY

2.1 Evolution of the Sugar Industry

The sugar sub-sector has its origin as private family investments at Miwani (1922) and Ramisi (1927). Post independence Kenya, marked the establishment of six state owned sugar companies, with the government contributing 80% of total equity. These were Muhoroni (1966), Chemelil (1968), Mumias (1973), Nzoia (1978) and SONY (1979). Other private enterprises have also sprung up since then, – West Kenya Sugar Company Ltd (1981), Kibos Sugar & Allied Industry Ltd (2007) and Soin (2006).

2.2 Objectives of the Sugar Industry

The establishment of state owned sugar enterprises (SOSE) was anchored on the government policy Sessional Paper No. 10 of 1965 on African Socialism and its Application to Planning in Kenya. The driving national desires were;

- To promote achievement of self sufficiency in sugar for domestic consumption with surplus for export.
- To promote rural development through ripple effects linked to the sugar industry (schools, health facilities, roads and commercial outlets)
- To create employment opportunities in the rural areas in order to stem rural urban migration.
- To provide raw materials for subsidiary industries.
- To diversify agricultural production base.
- To encourage mixed farming in the sugarcane growing zones.

2.3 Social-Economic Importance of the Sugar Industry

It is estimated that about 6,000,000 (15%) of Kenya's total population derive their livelihood directly or indirectly from the sugar industry.This includes sugarcane farmers, mostly small scale, who supply up to 80% of sugarcane processed at the factories. Besides, the sub-sector is the growth engine for the other industries such as beverages, confectionery, ethanol and pharmaceuticals.The other importance of sugar sub-sector is marked in its contribution to Gross Marketed Agricultural Product.This has consistently risen from Kshs.9.070 billion (2002) to 15.94billion (2009) contributing the on average of 8.4% annually. The exchequer and the other statutory funds also receive substantial tax/cess input from the sugar industry. For the period 2002/2009, these contributions annually averaged

Value Added Tax (VAT) Kshs. 2.7 billion

Sugar Development Levy Kshs. 1.18 billion

Local Authority cess Kshs. 102 million

2.4. Profile of Sub-sector Key Institutions

The sugar sub-sector is characterized by numerous stakeholders, key amongst them being the sugarcane farmers and their out-growers institutions, the sugar companies and service providers.

2.4.1 The Sugar Companies

There are nine (9) established sugar companies eight (8) of which are operational.Their current capacities and proposed expansion and ownership are as shown in Table 1.

Table 1:The Sugar Factories

	Factory	Year of Establishment	Status	Current Capacity(TCD)	Proposed Expansion
Privately owned Sugar Companies					
1.	Mumias	1973	Operating	9,200	**9,200**
2.	West Kenya	1982	Operating	1,320	3,500
3.	Kibos	2006	Operating	700	1,650
4.	Soin	Operating		130	300
State Owned Sugar Companies					
5.	Chemelil	1968	Operating	3,360	4,200
6.	Nzoia	1978	Operating	3.000	7,000
7.	Muhoroni/ Under receivership	1966	Operating	2,200	4,000
8.	Miwani/Under receivership	1922	Stalled	-	-
9.	SONY	1979	Operating	2,970	4,500

Over the years, there has been a consistent widening gap in the realization of the envisaged capacity, posting the country as a persistent net importer with negative impact on foreign exchange balance. The millers are organized under Kenya Sugar Manufacturers Association, (KESMA), through which the collectively negotiate for sugarcane prices and advocate for favorable government policies.

2.4.2 Out-growers Institutions

Most sugarcane farmers belong to membership based organizations commonly known as out-growers institutions (OGIs). There are two categories of OGIs, one based on service provision to members and the other performing the role of lobby and advocacy (See Table 2)

Table 2 Out-grower Institutions (OGIS)

Institutions		Status	Membership/ Affiliates
Out-grower Companies			
1	Mumias Out-growers Co.Ltd. (MOCO)	Operational	65,000 members
2	Busia Out-growers Co.Ltd. (BOCO)	Operational	11,600 members
3	Nzoia out-growers Co.Ltd. (NOCO)	Operational	35,000 members
4	West Kenya Out-growers Co.Ltd. (WECO)	Operational	25,000 members
5	Miwani Out-growers Co.Ltd. (MISOCO)	Dormant	N/a
6	Kibos Out-growers Co.Ltd	Dormant	N/a
7	Chemelil Out-growers Co.Ltd. (COC)	Operational	2,501 members
8	Nandi Escarpment Out-growers (NEOC)	Operational	7,000
9	Muhoroni Out-growers (MUSOCO)	Operational	6,000 members
10	South Nyanza Sugar Out-growers (SOC)	In receivership	N/a
Cooperative Unions			
12	Nandi Sugar Belt	Operational	35 societies
13	Kisumu Sugar Belt	Operational	68 societies
14	Muhoroni Multipurpose	Operational	15 societies
Lobby and Advocacy Associations			
15	KENSGU	Operational	15,000 members
16	KEWOSFAN	Operational	450
17	KESGA	Operational	N/a

2.4.3 Kenya Sugar Board

The Kenya Sugar Board is the industry regulator. It is established under the Sugar Act No. 10 of 2001, to regulate, develop and promote the sugar industry. It is also mandated to coordinate the activities within the industry and facilitate equitable access to the benefits and resources of the industry, by all interested parties. The board's key weakness lies in its inability to implement the provision of the Sugar Act No. 10 of 200. It also lacks capacity to manage Sugar Development Fund (SDF) and regulate sugar imports.

2.4.4 The Kenya Sugar Research Foundation

The foundation was incorporated in 2001, with the sole objective of conducting research and undertaking technology transfer.Though amply funded by the Sugar Development Fund is activities are yet to impact on the industry performance and betterment due to low adoption rate of their recommendations by millers and sugarcane farmers.

3.0 POLICY AND LEGAL FRAMEWORK

3.1 Government Policies and the Sugar Industry

The sugar industry plays a key role in agriculture and the government has severally responded to its problems, constraints and challenges, through several national and sectoral policy papers. Key amongst these are Economic Strategy for Wealth and Employment Creation 2003 - 2007 as conceptualized in Strategy for Revitalization of Agriculture, Sugar Industry Task Force 2003, National Sugar Conference October 2004 and Draft Sessional Paper for Revitalizing Sugar Industry 2008. Despite these policy profiles, it has been severally noted that government policy with regard to a number of critical competitive and efficiency factors for the sugar industry has remained unclear. In order to achieve the anticipated industry resuscitation programmes, a critical success factor will require supportive and assertive government policy, embraced by all target actors and beneficiaries.

Most medium and long term recommendations are abandoned midstream.The Sessional on Revitalization of Sugar Industry 2008 and Sugar (General) Regulation are yet to be adopted, gazzeted and implemented. Another key policy document marking time at the Ministry of Agriculture is the recommendations of the Sugar Industry Privatization Committee 2009, yet privatization is critical to resuscitation of the sugar sub-sector.

3.2 New Constitutional Dispensation

Things are set to change drastically under the enacted new constitutional dispensation. Whereas overall agriculture policy will remain the mandate of national government, the country government's functions and powers will oversee agricultures crop husbandry under Fourth Schedule part 2.This may mean that sugarcane production will be under the docket of County governments which also according to article 185 gives Counties legislative authority over the development and management of infrastructure and institutions.This will affect eleven (11) out of forty seven (47) Counties.

3.3 Legal and Regulatory Framework

Under the Kenya Order of 1973 and the unplanned liberalization, the industry strolled to the brink of collapse. The sugar industry is now regulated under the Sugar act No. 10 of 2001. But immediately after its enactment, it became apparent that the Act was ill equipped to respond to the problems of the sugar industry. Many of its provisions are being scuttled by government related key players including the Kenya Sugar Board. On the 24th March of 2005, the Sugar (Amendment) Bill, 2005 was published through a Kenya Gazette Supplement No. 15 (Bills No.4). The object of the bill was to address the lacunae deemed present in the Sugar Act 2001 and thereby respond to the key challenges of the sugar industry. Five (5) years down the lane, the Bill has not been tabled for debate in parliament and accordingly, now may not reflect the realities of the industry today.

4.0 PERFORMANCE OF THE SUGAR INDUSTRY

4.1Overall Performance of the Kenya Sugar Industry (2000 – 2009)

A host of production constraints both farm and factory based, some cross cutting, others zone specific, continue to threaten the very survival of the sugar industry in Kenya.The combination of the constraints limits the industry ability to produce adequate sugar for domestic consumption and at competitive cost that are remunerative to both the sugarcane farmer and the miller.

4.2 Factory Performance

General performance of the Kenya sugar factories has not been consistent.Whereas production largely went up, it fluctuated from year to year in a way that reveals lack of strategic focus to raise output sustainably.Table 3 shows fluctuations in sugar production between 2000 and 2009, with a low of 377438 tonnes in 2001 and a high of 548207 tonnes in 2009.The average annual production for the period is 478,991 tonnes.The country is a net importer as demand on the average exceeds supply by between 87,633 tones (KNBS official) or 211,201 tones annually (2000-2009) (KSB). It is interesting to not disparity between Kenya Sugar Board and Kenya National Bureau of Statistics consumption figures

According to SUCAM study report 2008 factory performance remains a major limitation to increased sugar output and growing of sugarcane.

Table 3 Sugar Production, Consumption, Imports and Exports 2000-2009

YEAR	PRODUCTION	CONSUMPTION (KSB)	IMPORTS	EXPORTS	CONSUMTION (KNBS)
2000	401984	617270	118011	2088	493082
2001	377438	630065	249336	3600	535698
2002	494249	652129	129966	12046	509308
2003	448489	663780	182225	11300	536886
2004	516803	669914	164020	11580	497561
2005	488997	695622	167235	21760	582798
2006	475670	718396	166280	13533	582936
2007	520404	741190	230011	20842	712871
2008	517667	751523	218607	44332	648474
2009	548207	762027	184531	1952	-
Mean	**478,991**	**690,192**	**181,022**	**14,303**	**566,624**

NB 1;

Source: Statistical abstract, 2009, Kenya Sugar Board Year Book 2009

Kenya National Bureau of Statistic (KNBS), Kenya Sugar Board (KSB)

4.2.1 Factory Constraints

1. Limited grinding capacity

Total rated milling capacity is 23,460 tones cane per day as available out of which on the average, 13,285 tonnes per day is available and usable (56.63% .capacity utilization)sugar annually way above the average of 47,8991 (2000 – 20001). This gap constitutes Kshs. 14 billion industry revenue foregone (at current 2010 ex-factory prices). The proposed capacity expansion is estimated to raise total factory daily capacity 4500 tonnes. Public owned factories are unlikely to attain this expansion until they are *privatized*.

2. Factory Recoveries

Between 2000-2009 cane recoveries among sugar factories in Kenya has slightly slipped from 9.35 TC/TS to over 10TC/TS. These recovery ratios are below those our regional competitors down south such as Swaziland and Malawi (7-9 TC/TS). The industries in these countries have cane varieties of high sucrose content (minimum 14% pol compared to Kenya's average for the period of 12.7% pol).

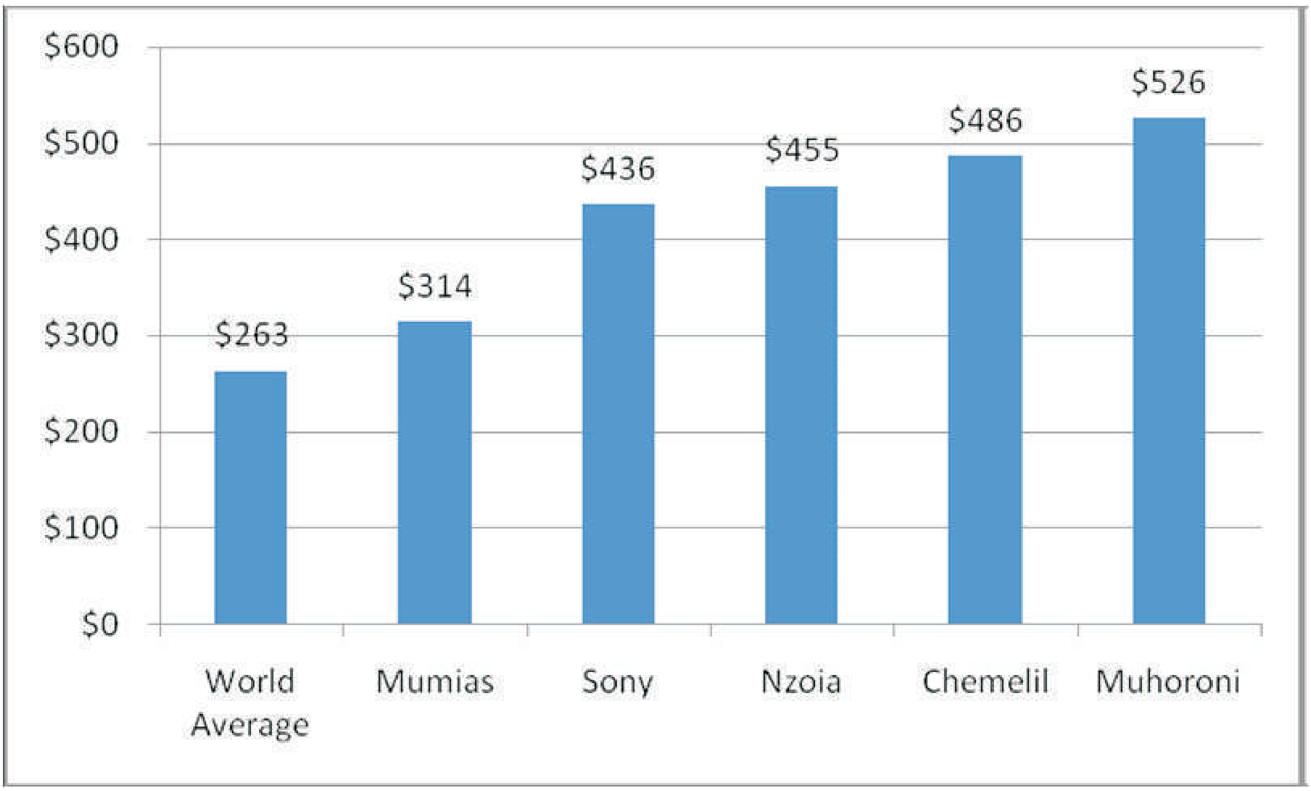
Cane recovery at the factory is affected by a number of factors including the sucrose content and cane variety, age at harvesting, handling and transportation (no extraneous matter, no delay in delivering to the mill)

Table 4 Kenya Sugar Industry Cane Recoveries

YEARS	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Sugarcane Milled ('000 mt)	3908	3690	4576	4313	4506	4845	4889	5202	51.66	56.22
Sugar made ('000 mt)	409	378	489	447	513	491	475	519	518	549
TC/TS Ratio	9.54	9.75	9.35	9.66	9.37	9.86	10.29	10.03	9.97	10.23
Cane quality Pol %	12.45	12.11	13.28	13.0	13.16	12.86	12.54	12.50	12.71	12.33

3. Level of Efficiency

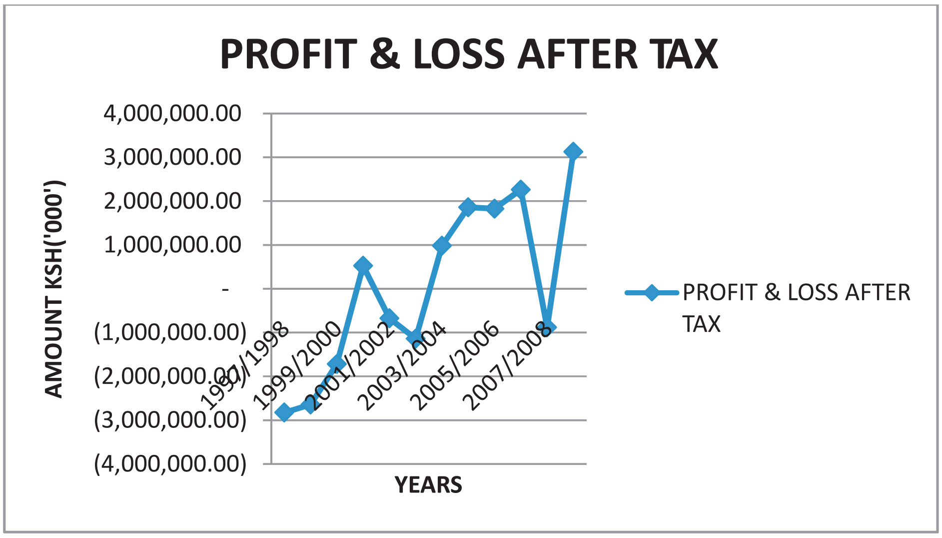
The normal life span of a sugar mill is between 10 to 15 years. By this standard, all the state owned sugar factories are obsolete and cannot achieve international efficiency benchmarks. The level of efficiency in the sub-sector compares poorly with the world average. According to a global survey on sugar carried out in 2005, all public sugar companies with the exception of Mumias Sugar Company produced the commodity at a cost higher than 150% of the world average. Muhoroni Sugar Company was producing at 200% above the world average.



4. Heavy Indebtedness

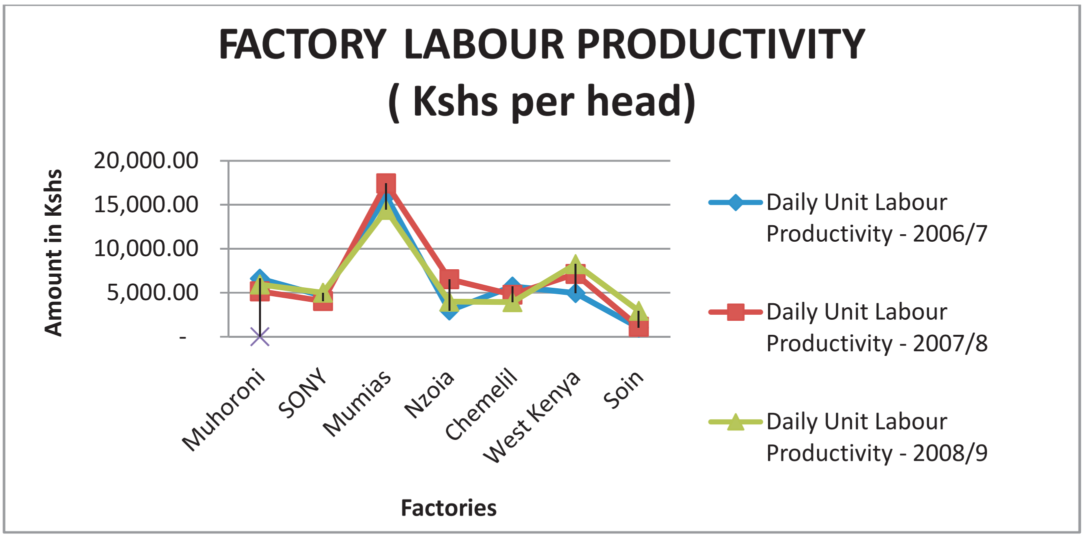
As business concerns, the factories are supposed to generate funds out of their operations. Yet may be except for privately owned factories, the 5 State Owned Sugar Enterprises (SOSE) have been unable to generate enough funds because of the vicious cycle of inefficiency they have found themselves in. they cannot operate profitably because they are perpetually undercapitalized and operating on the verge of bankruptcy (Miwani and Muhoroni Sugar campanies are already in receivership). Chart 1below portrays the profitability trend between 1997 to 2008. Judging from the doldrums these enterprises have sank into, it will be foolhardy to extort the industry to be efficient and competitive without salvaging it from the doldrums. Simply put, *Privatize*.

Chart 1 Profit & Loss After Tax



Another dimension that has contributed to this state of affairs is rampant corruption, waste mismanagement, occasioned by political patronage in top level appointment. Chart 2 below amply illustrates how irrational employment levels reduce labour productivity per man day.

Chart 2 Factory Labour Productivity



4.3 Sugarcane Production

The bulk of sugarcane is grown by small scale growers (up to 80%). Sugar companies also have nucleus estates on which they grow cane which contributes 15-20% of factory requirement.
Sugarcane farmers are mostly organized in associations commonly referred to as Out-growers Institutions (OGI's). Nearly all the (OGI's) have failed to live to expectations in terms of service delivery and advocacy for their members rights.The status of sugarcane production for the period 2000 – 2009 based on area under cane yields and cane deliveries are highlighted below.

4.3.1 Area under cane 2000-2009

The area under sugarcane for the period 2000 – 2009 has been on a steady increase to a peak of 169,421 hectares in 2008 (a 57% rise) as shown in table 5 below.
Possible reasons for the increase are due to entry of new mills, inducement due to reduced indebtedness through government bailout, availability of cane development loans and increase in cane price.

Table 5 Area under cane 2000-2009 ('000' hectares)

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Nucleus Estate	13.7	13.4	12.4	12.4	12.6	13.4	18.4	13.3	14.1	13.6
Out-growers	94.2	103.7	114.4	110.1	118.9	131.4	134.3	145.2	155.3	140.6
Total	107.9	117.1	126.8	122.5	131.5	144.8	147.7	158.5	169.4	154.2

4.3.2 Sugarcane Deliveries and Yields 2000-2009 ('000' tones)

In terms of sugarcane production, deliveries of cane to the factories were constantly on the rise from 2,941,524 in 2000 to 5,610,702 in 2009. However the productivity trend for the period is erratic due to farm production constraints, weather pattern fluctuations aside.

Table 6 Sugarcane Deliveries and Yields (2000-2009)

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Deliveries	3941	3551	4501	4204	4661	4801	4933	5204	5126	5611
AV Yield (TCH)	60.5	63.7	70.7	69.2	73.8	71.5	71.0	71.0	73.0	65.2

4.3.3 Constraints to Increased Cane Production

A study conducted by SUCAM in 2008 identified constraints hindering increased cane production, notable of which are:

1. Complete reliance on rain.

Under the Economic Recovery Strategy for Wealth and Employment Creation (2004-2007) and now vision 2030 and the National Irrigation Act, it is intended to reduce dependence on rain fed agriculture by establishing and encouraging irrigation. So far no funds have been availed to this effect. The only pilot scheme at Chemelil Sugar Company has collapsed.

2. Limited factory crushing capacity

Limited factory capacity occasioned by low capacity utilization and lag in factory expansion/ modernization programme has often precipitated cane harvesting crisis. Cane is left to rot in the farms or harvested too late with dire financial consequences to the sugarcane farmers in terms of loss of production, reduced net revenues and compounded interest. Case in point is SONY where cane age averages over 48 months instead of standard 18 months.

3. Failure to adopt and plant new cane varieties

KESREF has recommended and released sugarcane suitable for various zones. Most of these are early maturing. However farmers are reluctant (including the millers) to adopt the new varieties for two reasons;

First due to low crushing capacities at the state owned sugar mills, farmers cannot have their early varieties harvested in time thus leading to losses for farmers.

Secondly, cane price is still based on weight in contravention of the provisions of Sugar Act No. 2001. Hence the new varieties which are early maturing, deteriorate fast with attendant weight loss to the farmer.

4. Delayed Payment for Delivered Cane

The state owned sugar enterprises are notorious in late payment to sugarcane farmers because of their cash flow problems, bordering on bankruptcy. Lack of enforceable legal Sugar Industry Agreements encourages non-compliance coupled with impunity. This occurs despite the Governments bailouts and writing of penalties and interest owed by mills to Sugar Development Fund. The dire consequences of delayed payment is entrenchment of poverty levels in the sugar belts as farmers are denied timely real and cash income to sustain their livelihood and those of the families. Negative social welfare impacts are manifested in early school dropout, disease prevalence (HIV/AIDS) and rural insecurity.

5. Infrastructure

Infrastructure is a most sugar belt areas is heavily dilapidated. Some roads and bridges are barely passable making transporters to detour to deliver cane to the factories. This makes transport costly to farmers who pay for transport charges. Also, the fleet owners have to bear excessive wear and tear including high machine fuel consumption, which are then transferred to the farmers. Improving the infrastructure is an imperative that would insignificantly reduce the cost of cane to factories and minimize farmers' deductions by the transport contractor. This component is not adequately highlighted in Kshs. 47.7 billion investment proposal (2006/07-2011/2012) to resuscitate the sugar sub-sector. Both sugar development fund grant and cess deductions have proved inadequate to improve infrastructure in the sugar belts.

Inefficient transport system leads to extortion (corruption), branded CHUTH BER (handout) demanded by fleet owners, loaders and even company staff from farmers.

6. Cane Transport Costs

High transport cost is a cross cutting constraint in the entire sugar industry. The transport rates vary from zone to zone. These are negotiated mutually between millers and contracted transporters and rarely with participation of farmers' representatives. Contributing factors to high transport costs is foremost poor state of roads infrastructure (in some instances bridges and feeder roads are non-existent) which negatively impacts on fuel consumption, wear and tear of machines. Fuel cost escalation and rising prices of spares likewise lead to frequent increase on transport charges. For the factories that have developed the 4-km band zoning, Mumias has the highest charges per ton per kilometer, followed by Sony and Nzoia at Kshs. 75.5, 70.25, 60.75 respectively for zone A and Kshs.29.45, 26.20, 22.65 for zone E. For those using the 8-km band zonal rates Chemelil is the least expensive followed by West Kenya and Muhoroni at Kshs./ton/km of 36.20, 37.37, and 38.10. Data availed during the study revealed sharp transport rate increases in Muhoroni zone at 45% for zone A and 113% for zone E whereas Nzoia rates remained relatively stable with a mere 2% rise over the years. Looked at from the rate paid per tonne moved over a distance of a kilometer within the adopted bands, then the nearest pay more and the furthest are compensated by paying less See tables 7 and 8 below for transport charges analysis.

Table 7 Transport Charges (4-Km Bands)

	Sony	Nzoia				Mumias	
Zone	Band	Kshs./ton	Kshs./ton/km	Kshs./ton	Kshs./ton/km	Kshs./ton	Kshs./ton/km
A	0-4	281	70.25	265.50	66.87	302	75.50
B	4.1-8	341	42.62	325.08	40.63	365	45.62
C	8.1-12	402	33.50	382.64	31.89	449	37.42
D	12.1-16	463	28.94	440.21	27.51	508	31.75
E	16.1-20	524	26.20	498.91	24.94	589	29.45
F	20.1-24	585	24.37	556.47	23.19	655	27.29
G	24.1-28	645	23.03	614.04	21.93	739	26.39
H	28.1-32	706	22.06	671.61	20.99	815	25.47
I	32.1-36	766	21.28	779.17	21.64	886	24.61
J	36.1-40	827	20.67	786.64	19.67	966	24.15
K	40.1-44	887	20.13			1049	23.84
L	44.1-48	948	19.75			1093	22.77
M	48.1-52					1136	21.85
N	52.1-56					1223	21.83
O	56.1-60					1311	21.85
P	60.1-					1399	23.31

Table 8 Transport Charges (8-Km Bands)

	West Kenya			Muhoroni		Chemelil	
Zone	Band	Kshs./ton	Kshs./ton/km	Kshs./ton	Kshs./ton/km	Kshs./ton	Kshs./ton/km
A	1-8	299	37.37	381	38.1	362	36.20
B	8.1-16	375	23.44	460	28.75	436	27.25
C	16.1-24	435	18.12	561	23.37	640	26.67
D	24.1-32	550	17.18	663	20.71	770	24.06
E	32.1-40	650	16.25	791	19.77	850	21.25

6.1. Suspect Weighbridge Records and Cane Weights:

A farmer should be paid for the exact weight of cane taken from the farm gate. Given the current arrangement, the farmer has no means of detecting whether or not his pay load has been tampered with. This takes many forms – spillage, theft along the way, and corrupting weighbridge scales. For instance in SONY, there was an outcry about underweight cane deliveries as the farmers were however not allowed near the weighbridge to verify the records. In Nzoia and Mumias, spillages, piracy by jaggery owners are rampant. In Nyando sugar-belt, cane spillage is serious. Farmers as a result are being exploited when no account is made of the farm gate weights. The sad example is a case in Mumias where normal stack was given a net weight of 0.02 tonnes. An average stack which should weigh between 6.5 and 7.5 tonnes, records an average 3.5 tonnes to unsuspecting poor small scale sugarcane farmers. Apparently, well connected farmers benefit from this scheme of weight swap by being billed extra tonnages and thereby fleece the sweat of the vulnerable small scale sugarcane farmers. While defenseless small scale sugarcane farmers are robbed of their tonnages, both the transporter and the cane-cutter are paid on exact tonnage concealed in separate cane handling records.

7. *Sugar Cane Production Costs*

Reduction in sugarcane production costs is pivotal to enhancing sugar industry's competitiveness. The majority of small scale sugar cane farmers in all sugar belts depend on contracted services and inputs by millers, out-grower institutions and haulage service providers'. The services and inputs thus provided are subject to arbitrary, often un-negotiated costs and interest charges. Key elements in sugarcane production costs are grouped under land preparation, seed cane supply, agro-chemicals, labor costs transport and interest /levies. The actual cost of these elements, their proportions and cost benefit ratios are portrayed in table 9 for given milling zones. There is very little difference between zonal costs. In Western sugar belts the average total costs for plant and ratoon crops are Kshs. 147,654 /- and ratios Kshs. 73, 7853 / respectively. The single most expensive element is transportation (30.74%) followed by labour (25%), seed cane (15.8%), interest (12%), fertilizer (9.5%), land preparation (9.2%). The same trend applies to ratoon crops. The appropriate interventions to reduce transport costs in particular are addressed under zonal constraints. However, and on top of those it is preferable to take the transport element off the farmer and give it to the miller. The millers have muscles to control cost of transportation.

Table 9 Cane Production Cost

SUGAR COMPANY	SONY				MUHORONI			
1. Costs	Plant	%	Ratoon	%	Plant	%	Ratoon	%
Land preparation	10278	7.0			23115	15.9		
Seed cane	30990	21.1			25520	17.6		
Fertilizers	16473	11.2	16576	18.3	13500	9.3	13500	18.3
Labour	12584	8.6	9299	10.3	11343	7.8	8528	11.5
Farm harvest	15760	10.7	14875	16.5	14000	9.6	11550	15.6
Interest charged	11391	7.8	2984	3.3	11022	7.6	2478	3.4
Levies	2250	1.5	2125	2.4	2000	1.4	1650	2.2
Transport	47160	32.1	44540	49.3	44880	30.9	36240	49.0
Sub total	146876		90399		145380		73946	
Total costs/ton cane	1632		1064		1817		1120	
2.Revenue								
Yields (TCH)	90		85		80		66	
Rate per ton	2500		2500		2500		2500	
Gross revenue	225000		212500		200000		165000	
Net revenue	78124		122101		54620		91054	
Net revenue/ton	868		1436		683		1380	
Return/ shilling invested	0.59		1.59		0.47		1.87	

PRODUCTION COSTS (CONTS)

SUGAR COMPANY	**NZOIA**				**MUMIAS**			
1. Costs	Plant	%	Ratoon	%	Plant	%	Ratoon	%
Land preparation	13223	8.8			13511	8.7		
Seed cane	24054	15.9			25875	16.6		
Fertilizers	14394	9.5	5446	7.5	13200	8.5	5446	7.5
Labour	21524	14.3	14081	19.4	26464	17.0	14081	19.4
Farm harvest	17500	11.6	14000	19.2	16000	10.3	14000	19.2
Interest charged	12401	8.2	980	1.3	12621	8.1	980	1.3
Levies	2500	1.7	2000	2.7	2000	1.3	2000	2.7
Transport	45300	30.0	36240	49.8	46400	29.7	36240	49.8
Total costs/Ha	150896		72747		156071		72747	
Total costs/ton cane	1509		909		1951		1212	
2.Revenue								
Yields (TCH)	100		80		80		60	
Rate per ton	2500		2500		2500		2500	
Gross revenue	250000		200000		200000		150000	
Net revenue	99104		127253		43929		77253	
Net revenue/ton	991		1591		549		1288	
Return/ shilling invested	0.66		2.19		0.35		1.77	
SUGAR COMPANY	**WEST KENYA**				**BUSIA OUT-GROWERS**			
1. Costs	Plant	%	Ratoon	%	Plant	%	Ratoon	%
Land preparation	13905	10.5			13510	7.7		
Seed cane	22125	16.7			23912	13.6		
Fertilizers	15250	11.5	13260	18.1	12492	7.1	12492	12.9
Labour	21250	16.1	14500	19.8	18000	10.2	11400	11.8
Farm harvest	11827	8.9	6400	8.7	16000	9.1	12000	12.4
Interest charged	2000	1.5	980	1.3	12978	7.4	1405	1.5
Levies	2300	1.7	2000	2.7	1840	1	1380	1.4
Transport	43500	32.9	36240	49.4	77280	43.9	57960	60
Total costs/Ha	132157		73380		176012		96637	
Total costs/ton cane	1322		917					
2. Revenue							60	
Yields (TCH)	100		80		80		60	
Rate per ton	2500		2500		2300		2300	
Gross revenue	250000		200000		184000		138000	
Net revenue	117843		126620		7988		41363	
Net revenue/ton	1178		1583		100		689	
Return/ shilling invested	0.89		2.16		0.06		0.71	

8. *Small size of farm plots.*

Diminishing size of farm plots due to population pressure and land sub divisions is a critical issue in all sugarcane growing zones. The range is between 0.2 to 0.8 hectares. These sizes are uneconomical for mechanical farming thus rendering machines cost per unit area exorbitant. Another primary concern is the threat to food security and nutrition. The lending requirements by all financial institutions insist on land as collateral but with higher acreage ceilings thus eliminating most smallholding sugarcane farmers from accessing the loans.

5.0 REFORMS NECESSARY FOR PRIVATIZATION OF SUGAR INDUSTRY

Following the enactment of Privatization Act 2005 and Cabinet approval in December 2008, the five public sugar companies namely Chemelil, Nzoia, SONY, Muhoroni and Mwani are set to be privatized during the ongoing divestiture programme. It is highly anticipated that the entry of private sector players in the sugar sub sector will transform the industry by injecting the necessary capital for stimulating modernization of the factories, improving operational efficiencies, addressing technical expertise, and bringing on board effective management and good governance styles.These reforms will enhance competitiveness of the industry while at the same time containing political patronage, official bureaucracy, corruption and wastes

SUCAM in consultation with sugar industry stakeholders identified seven areas that are important towards the realization of successful privatization of the sugar industry in Kenya namely restructuring of the debts, cane pricing, out-growers institutions, sugar industry agreements, Sugar Act amendments, sugarcane farmers shareholding and sugar industry financing. Each of these issues is presented below.

5.1. REFORM AGENDA ONE:

RESTRUCTURING THE DEBTS

The five public sugar mills - Chemelil, Nzoia, Muhoroni, SONY and Miwani – which have been lined up for privatization have over the years accumulated huge debts due to inefficiencies, corruption, mismanagement and political patronage. These debts have resulted from commercial loans and unremitted taxes and levies, sugar development fund loans and third party creditors. The last category mainly comprises of unpaid arrears to sugarcane farmers. For accounting purposes, these mills are classified as technically insolvent while Miwani and Muhoroni are already under receivership.

The debts owed to sugarcane farmers are currently treated as unsecured with no guarantee for face value compensation upon sale of these sugar companies' assets. The issue has therefore been contentious because the debts were incurred in contravention of Sugar Act No 10 of 2001 Second schedule Section 6. Whereas some of these debts like in SONY, Nzoia and Mumias have been litigated at the regular law courts and the Sugar Arbitration Tribunal through intervention of KENSGU, those in Nyando sugar belts are only reflected in the companies' book. Failure to settle these debts, upfront, will create conflict and become a disincentive to sugarcane production. These debts should consequently be classified as priority and sensitive with a comprehensive bailout schedule.

It is anticipated that upon privatization, the new investors will inject substantial funds projected at Kshs. 39.1 Billion to factories modernization and rehabilitation. This will result in reduction in demand and pressure on SDF loans from the factories. The reserves realized as a result could therefore be utilized for upfront settlement of farmers' claims in totality either as a grant or long term liability to the exchequer.

5.1.1. Litigation of the farmers Claims

Many sugarcane farmers have in desperation filed claims on monies owed by SONY, Mumias and Nzoia sugar companies. Since 2004, the Sugar Arbitration Tribunal has received 1,197 such cases in regard to these companies. Out of these, only 29 cases have been finalized, 7 withdrawn while 15 dismissed. A total of 1,150 cases are still pending determination. A major challenge facing these cases however is that the Sugar Arbitration Tribunal lacks provision within the Sugar Act No 10 of 2001 to order for execution of cases awarded before the tribunal.

Prior to the enactment of Sugar Act No 10 of 2001 and the establishment of the Sugar Arbitration Tribunal, disputes in the sugar industry were handled by the Regular Courts of Law. Within this system, provision for appeal to the High Court was provided for parties dissatisfied with rulings of the lower courts. Under this arrangement, it is mainly the millers who sought appealed against rulings of lower courts made in favour of the farmers. To date, 519 such cases are still pending before courts of law in Kisii, Migori, Rongo, Homa Bay and Kehancha.

This table indicates that by 2007, arrears owed to sugarcane farmers amounted to only Kshs. 95,000,000.00. This was mainly occasioned by government bailout programme that was rolled two yours earlier. However, by May 30, 2009, these debts had fast accumulated to an alarming level of Kshs. 0.7 billion as shown in the table below.

5.1.2.Arrears Owed to Sugarcane Farmers by Sugar Companies

No.	Sugar Companies	Farmers Arrears in Kshs.
1.	Nzoia	75,493,042.40
2.	SONY	228,100,000.00
3.	Chemelil	293,092,059.85
4.	Muhoroni	136,742,376.00
5.	Mumias	00
6.	West Kenya	00
	Total	733,427,478.25

Source: Ministry of Agriculture parliamentary Question No. 269

For the benefit of sugarcane farmers, it will be important for the government to consider waiving all cane development loans owed by the farmers in terms of principal and compounded interests during the debt restructuring programme. In advancing this argument, SUCAM takes cognizance that most of these debts were due to delayed or none harvesting of cane developed by these loans and debts owed to farmers by the factories. In addition, the farmers have lodged pending claims against breach of contracts resulting from late harvesting of the cane, delayed payment and accounting errors. Several cases of this nature mainly from SONY, Nzoia and Mumias have been filed with the Regular Law Courts and Sugar Arbitration Tribunal as shown in the table below.

5.1.3. Pending Cases Filed by Farmers

ZONE	CASES BEFORE LAW COURTS	CASES BEFORE ABITRATION TRIBUNAL	CASES AWARDED(NOT PAID)
SONY	**217,760,992.00**	**23,477,713.00**	**1, 204,734.00**
NZOIA	**-**	**1,373,495.00**	**-**
MUMIAS	**84,327.00**	**1,113,755.00**	**-**
OTHERS	**-**	**-**	**-**
TOTAL	**217,845,319.00**	**25,964,963.00**	**1,204,734.00**

In total, claims by the farmers' amounts to Kshs. 245, 015,016.00. It is important that these cases are analyzed expeditiously for settlement by the government before closure of the privatization process. It is also important to note that these cases have related costs implications on the farmers and millers. For the millers, the cost incurred on filing defense translates into an operational loss which in total could amount to more than face value of the claims. The table below indicates that filing and maintaining defense is very costly for the farmers. In case they win such cases, this is bound to increase compensation for the cases awarded by over 200%. An example of expense structure for litigation and defense before the SAT are tabulated as below.

5.1.4. Litigation Costs

LITIGATION COST:MILLER AND GROWER: SAT

GROWER FILING COST

ITEMS	No. Cases	KSH	T OTAL '000'
Filling Fees	1,716	2,500	4,290
Instruction Fees	1,716	18,000	30,888
Advocate V.A.T			4,942
TOTAL			40,120

MILLER DEFENCE COST

ITEMS	No. Cases	KSH	T OTAL '000'
Filling Fees	1,716	150	257.4
Instruction Fees	1,716	22,000	37,752
Advocate V.A.T			4,040
TOTAL			44,049

5.2. REFORMAGENDATWO:

CANE PRICING

One of the key interventions of Sessional Paper on Revitalization of Sugar Sub-sector is that 'growers and millers are required to develop a cane payment system that facilitates sharing of revenues derived from cane processing'. Sugar Act No. I of 2001 states that sugar industry is to adopt cane payment system based on sucrose content. Furthermore, one of COMESA reprieve conditionality is that the industry should develop an early maturing and high sucrose content varieties so as to implement payment based in sucrose quality. Despite the existence of these provisions, no implementation timeframes have been put in place towards their realization.

The philosophy behind cane pricing system is to evolve a cane payment that ensures equitable distribution of industry proceeds.The objectives of an equitable payment system should include interlia:

Provision for an accurate assessment of sugarcane by weight or by sucrose content

Setting up of a base price for standard sugar

Dividing the proceeds to cover:

- Growers costs
- Milling costs
- Distribute the balance according to each stakeholder input (e.g. farmer's $\geq$ 64%: Miller's $\leq$36%)

Provision for efficiency incentives that rewards above standard and penalize below standard

Generally, milling costs are classified under cane purchase, sugar processing, financial/administration/cost of sale plus a reasonable profit margin. This information was often guarded sensitively at times by the millers under the guise of Official Secrets Act. However, the growers' costs are a paradox of a choice between sugarcane production cash costs (cash expenses incurred in growing cane) and sugarcane production economic costs (full ownership costs based on sugarcane farming as a fulltime occupation that takes care of overall overheads).There is an urgent need to commission regular studies of full occupants' costs of sugarcane growing and incorporate them in pricing considerations.

Before divesting from state owned sugar factories, it will be necessary that the government put in place systems that will provide for payment of cane based on sucrose content. The formulae to be adopted for sharing of the benefits should be simple and focused on incentives that enhance efficiency at the factory level and improving yield and cane quality. The current pricing formulae has no provision for factory efficiency incentives hence the burden for meeting costs related to factory inefficiencies are transferred to the farmers.
In order to strengthen farmers' negotiating capacity, composition of the pricing committee should be expanded to include representatives from farmers' organizations. These organizations are registered under various acts of Parliament namely the Societies Act, Companies Act Trade Union Acts and Cooperatives Act. In addition, at least two (2) professionals / technical advisors should be seconded by the government initially to the farmers negotiating team.

Before divesting from the state owned sugar factories, the government should also put in place effective policy directives for the establishment of an autonomous cane testing commission to be facilitated by the Kenya Sugar Board with representatives from farmers and millers. The commission should be responsible for spearheading and implementing industry wide payment system based on quality. Given that as a rule of thumb, the cost of cane in price of sugar is higher, the sharing ratio should reflect this by levering the farmers share at equal to or greater than 64%.

Successful transformation of the sugar subsector will also need addressing the mistrust and suspicion between millers and farmers through attitude change. Currently, the millers view farmers as illiterate peasants while the farmers consider them (millers) as crooks yet they rely upon and need one another for success of their ventures. Continuous dialogue and negotiations will be critical towards realization of this situation.

5.2.1. Sugar Cane Price Formula

$$\text{Price of sugarcane} = \frac{\text{Pol \% cane} \times \text{KR} \times \text{Farmers share} \times \text{(monthly average net price of sugar)}}{1/E\%}$$

Plus % value of by-products; where KR = Expected Mill Extraction X Expected Boiling House Recovery and E% = Extraneous matter % cane

5.2.2. Underpayment of sugarcane farmers by millers

The table below is a variance analysis of determined cane price and actual payment or to be paid

Chemelil

Details	Jan-10	Feb-10	Mar-10	Apr-10	Ma y-10	Jun-10	9-Jun	9-Jul	Aug	Sep	Oct	Nov	Dec
Current cane prices paid Ksh/Tone	2,875.00	2,830.00	2,870.00	2,880.00	2,978.00	2,978.00	2,860.00	2,860.00	N/A	3,025.00	2,925.00	2,925.00	2,925.00
Determined cane price for respective months based on the formula	3,452.00	3,399.00	3,360.00	3,360.00	3,210.00	3,224.00	2,827.00	2,962.00	N/A	3,316.00	3,462.00	3,316.00	3,399.00
Variance	(577.00)	(569.00)	(490.00)	(480.00)	(232.00)	(246.00)	33.00	(102.00)		(291.00)	(537.00)	(391.00)	(474.00)

Muhoroni

Details	Jan-10	Feb-10	Mar-10	Apr-10	Ma y-10	Jun-10	9-Jun	9-Jul	Aug	Sep	Oct	Nov	Dec
Current cane prices paid Ksh/Tone	N/A	2,987.00	2,987.00	2,850.00	2,850.00	2,850.00	2,908.00	2,987.00	Yet to determine	2,897.00	2,897.00	2,897.00	ooc
Determined cane price for respective months based on the formula	N/A	3,316.00	3,481.00	3,357.00	3,069.00	3,210.00	2,906.00	2,984.00	3,316.00	2,906.00	2,984.00	3,316.00	3,481.00
Variance		(329.00)	(494.00)	(507.00)	(219.00)	(360.00)	2.00	3.00	#VALUE!	(9.00)	(87.00)	(419.00)	#VALUE!

Mumias

Details	Jan-10	Feb-10	Mar-10	Apr-10	Ma y-10	Jun-10	9-Jun	9-Jul	Aug	Sep	Oct	Nov	Dec
Current cane prices paid Ksh/Tone	3,148.00	3,148.00	3,148.00	3,148.00	3,148.00	3,148.00	2,652.00	2,850.00	2850	3,055.00	3,155.00	3,155.00	3,155.00
Determined cane price for respective months based on the formula	3,562.00	3,564.00	3,564.00	3,564.00	3,564.00	3,484.00	2,684.00	2,918.00	2,984.00	3,500.00	3,523.00	3,523.00	3,523.00
Variance	(414.00)	(416.00)	(416.00)	(416.00)	(416.00)	(336.00)	(32.00)	(68.00)	(134.00)	(445.00)	(368.00)	(368.00)	(368.00)

Nzoia

Details	Jan-10	Feb-10	Mar-10	Apr-10	Ma y-10	Jun-10	9-Jun	9-Jul	Aug	Sep	Oct	Nov	Dec
Current cane prices paid Ksh/Tone	3,100.00	3,100.00	3,100.00	3,100.00	3,100.00	3,100.00	2,500.00	2,500.00	2500	3,100.00	3,100.00	3,100.00	3,100.00

Determined cane price for respective months based on the formula	3,316.00	3,273.00	3,193.00	3,099.00	3,050.00	3,249.00	2,592.00	2,609.00	2,943.00	3,316.00	3,438.00	3,375.00	3,316.00
Variance	(216.00)	(173.00)	(93.00)	1.00	50.00	(149.00)	(92.00)	(109.00)	(443.00)	(216.00)	(338.00)	(275.00)	(216.00)

South Nyanza

Details	Jan-10	Feb-10	Mar-10	Apr-10	Ma y-10	Jun-10	9-Jun	9-Jul	Aug	Sep	Oct	Nov	Dec
Current cane prices paid Ksh/Tone	2,850.00	2,850.00	2,850.00	2,850.00	2,850.00	2,850.00	2,500.00	2,500.00	2850	2,850.00	2,850.00	2,850.00	2,850.00
Determined cane price for respective months based on the formula	3,374.00	3,374.00	3,233.00	3,246.00	3,157.00	3,142.00	2,441.00	2,609.00	2,820.00	2,991.00	3,111.00	3,452.00	3,467.00
Variance	(524.00)	(524.00)	(383.00)	(396.00)	(307.00)	(292.00)	59.00	(109.00)	30.00	(141.00)	(261.00)	(602.00)	(617.00)

West Kenya

Details	Jan-10	Feb-10	Mar-10	Apr-10	Ma y-10	Jun-10	9-Jun	9-Jul	Aug	Sep	Oct	Nov	Dec
Current cane prices paid Ksh/Tone	3,213.00	3,213.00	3,213.00	3,128.00	3,267.00	3,360.00	3,044.00	3,091.00	3155	3,155.00	3,213.00	3,213.00	3,213.00
Determined cane price for respective months based on the formula	3,289.00	3,144.00	3,144.00	3,094.00	3,067.00	3,326.00	2,910.00	3,067.00	3,156.00	3,294.00	3,418.00	3,510.00	3,363.00
Variance	(76.00)	69.00	69.00	34.00	200.00	34.00	134.00	24.00	(1.00)	(139.00)	(205.00)	(297.00)	(150.00)

Soin

Details	Jan-10	Feb-10	Mar-10	Apr-10	Ma y-10	Jun-10	9-Jun	9-Jul	Aug	Sep	Oct	Nov	Dec
Current cane prices paid Ksh/Tone	2,500.00	2,500.00	2,500.00	2,500.00	2,500.00	2,600.00	2,000.00	2,000.00	2200	2,350.00	2,500.00	2,500.00	2,500.00
Determined cane price for respective months based on the formula	3,316.00	3,189.00	3,189.00	3,144.00	3,067.00	3,131.00	2,672.00	2,758.00	3,174.00	3,316.00	3,316.00	3,316.00	3,316.00
Variance	(816.00)	(689.00)	(689.00)	(644.00)	(567.00)	(531.00)	(672.00)	(758.00)	(974.00)	(966.00)	(816.00)	(816.00)	(816.00)

Kibos

Details	Jan-10	Feb-10	Mar-10	Apr-10	Ma y-10	Jun-10	9-Jun	9-Jul	Aug	Sep	Oct	Nov	Dec
Current cane prices paid Ksh/Tone	3,050.00	3,050.00	2,500.00	3,175.00	3,175.00	3,175.00	2,900.00	2,000.00	3150	2,350.00	3,033.00	3,033.00	3,033.00
Determined cane price for respective months based on the formula	3,316.00	3,200.00	3,189.00	3,161.00	3,082.00	3,337.00	2,877.00	2,758.00	3,413.00	3,316.00	3,564.00	3,543.00	3,421.00
	(266.00)	(150.00)	(689.00)	14.00	93.00	(162.00)	23.00	(758.00)	(263.00)	(966.00)	(531.00)	(510.00)	(388.00)

5.3. REFORMAGENDATHREE:

OUT-GROWER INSTITUTIONS

5.3.1. Out-grower Institutions (Sugar Act No 10 of 2001, Second Schedule Clause 5)

Numerous sugarcane farmers' institutions exist in the sugar subsector and which are classified according to their roles. The first group are those that lobby and advocate for rights of sugarcane farmers, KESGA (registered under Societies Act), KENSGU (registered under Trade Unions Act), and KEWOSFAN (registered under Societies Act). So far it is only Kenya Sugarcane Growers Association (KESGA) which is recognized in the Sugar Act as the out-growers apex body with the sole role to negotiate sugarcane price at the pricing committee on behalf of its members. In its present state, KESGA as farmers' apex body lacks the capacity and grassroots representation. The second group is those that provide general and specific services to grower members- cane production cooperative societies, multi-purpose cooperative unions/ societies, SACCOs and out-grower companies

Presently, it is noted that some these associations are invariably weak in terms of leadership management and financial resources. The institutions eventually disintegrate at some level. Their service provision mandate becomes more of social organizations instead of commercial outfits. They become political and take cultural values of their environment hence nepotism, corruption and mismanagement. Like parastatal milling companies, most service provider out-grower institutions (companies and societies) are heavily indebted and technically insolvent with weak and badly manned structures. A testimony of this is the putting under receivership of Mumias Out-grower Company, SONY Out-growers Company and dormancy of Miwani Sugarcane out-grower Company and Kibos Out-grower Company. Both Nzoia Out-growers Company and Nandi Escarpment Out-grower Company are on the brink of collapse completely unable to service Sugar Development Fund loans advanced to them.

The current reporting channels and organization structures portrays a conflict between the apex body and the primary societies/companies in reaching for audience with regulatory body Kenya Sugar Board, government ministries and the millers. Given the importance of functional sugarcane farmers associations, to the viability of the sugar sub-sector, it is prudent that the government ,KSB, the millers and any other civil society organization be effectively involved in their capacity building to enable them render required services to the sugarcane farmers and to uphold good governance standards. Government should consider as a matter of urgency, commissioning a Task Force to conduct a comprehensive analysis and investigation into the current status of all out-grower institutions (OGIs) and recommend measures for their revitalization. Meanwhile, the Kenya Sugar Board should implement the recommendations of the study they commissioned on structure, establishment and functioning of out-growers institutions as an interim measure.

5.3.2.Indebtedness of Out-grower institutions to the SDF

Indebtedness of Out-grower institutions to the SDF as at 31st January 2008 (Kshs. Millions)			
INSTITUTION	**PRINCIPAL**	**INTEREST**	**TOTAL**
Muhoroni Out-growers Co.	245	36	281
Miwani Out-growers Co.	11	3	14
Chemelil Out-growers Co.	195	22	218
Nandi Escarpment Out. Co.	115	20	136
Soin Sugar Out-growers Co.	117	28	145
Sub-Total Nyando Sugar Belt	**683**	**109**	**794**
Nzoia Out-growers Co.	325	66	391
Busia Out-growers Co.	100	15	116
Mumias Out-growers Co.	194	11	206
West Kenya Out-growers Co.	89	8	98
Sub-Total Western Sugar Belt	**709**	**100**	**811**
Sony Out-growers Co.	371	88	459
Coast Sugar Belt (Ramisi)	**0**	**0**	**0**
TOTAL	**1,763**	**297**	**2064**

5.4. REFORM AGENDA FOUR :

SUGAR INDUSTRY AGREEMENTS

One of the most critical challenges facing successful operations of sugar sub-sector is the persistent reluctance by the Ministry of Agriculture and the Kenya Sugar Board to fully implement the provisions of sugar Act 2001 especially the sugar industry agreements.This is despite the fact that the Act came into force nine years ago.The Act in section 29 (1) provides for sugar industry agreements which should be the result of negotiation involving the growers and millers,growers and out grower institutions,millers and out growers' institutions.

For nearly a decade however, the millers and by extension the government of Kenya have been reluctant to implement this legal requirement and have instead resorted to taking advantage from this situation to reap economic benefits while exploiting the farmers with impunity. Further, erosion of the farmers' economic development has been manifested in:

1. Delay or non-harvesting of contracted sugarcane;
2. Delay or non-payment for sugarcane delivered to the mills;
3. Excessive and compounded interest charges;
4. Arbitrary, falsified deductions and poor weighbridge records;

The continuation in the enforcement of arbitrary millers' designed contracts that are contrary to the Sugar Arbitration Tribunal has been used to the disadvantage of the sugarcane farmers.

1. Why Sugar Industry Agreements Regulations?

- o The agreements define duties and roles of stakeholders (interested parties) and are legally binding to them.
- o They have the strength of contracts, should and must be signed promptly between growers, millers and Out-grower Institutions and any other service providers.
- o They facilitate planning and shift from the ad hoc way of producing sugarcane and sugar, and provides for timely and efficient operations.
- o They have the ability of bringing order to the industry by providing for timely ploughing, planting, harvesting and milling of the cane.
- o They have the ability to improve efficiency in management of the industry from the farm to the factory and ensure effective supply of raw materials.
- o They will ensure timely provision of quality technical advice on cane management for improvement of cane yields.
- o They define the various standards that must be attained and sustained for the industry profitability.

The most important aspect of the sugar agreements is that the draft proposal entitled sugar (general) regulations and any subsequent amendments to it must be exhaustively discussed and agreed upon by all parties on a grapevine pattern.

According to Sugar Act the agreements must be negotiated by all the parties / stakeholders and its details must be read and understood or explained to the parties before appending their signatures. In addition, the parties to these agreements must be made aware of the existence of **Sugar Arbitration Tribunal** as an institution providing mechanisms for dispute resolution.

5.4.1. POLICY DIRECTION ON SUGAR INDUSTRY AGREEMENT

Several policy pronouncements have been focused towards implementation of this agreement as a step towards the vitalization of the sugar sub-sector.

1. **National Sugar Conference 2004**

The National Sugar Conference 2004 made the following recommendations whose main focus is the regulation of the relationships among sugar industry stakeholders.

1. Factories should charge sugarcane farmers at cost for seed cane to support improvements in cane production.
2. Millers to come up with effective strategies for engagement directly with farmers and instead of dealing with them throughout growers institutions.
3. Millers should meet the cost for harvesting and transportation of the cane to the factories as stipulated under the Sugar Act (200) No10 2001.
4. Burning of sugarcane before harvesting should be prohibited.
5. The Ministry of Agriculture to synthesis issues raised at the conference particularly the recommendation with the view to overseeing their implementation.

2. **Kenya Sugar Industry Strategic Plan 2004-2009**

The just concluded sugar sub-sector strategic plan also emphasized on the relevance of sugar industry agreement and made the following recommendations:

1. Regulations governing contracts between Farmers' Out-growers Institutions and millers formulated 2004-2005
2. Regulations governing contracts between Farmers, Millers Out-growers Institutions shall not be flouted 2004-2005

These milestones were not achieved and have been rescheduled to the Sugar Industry Plan 2010 – 2014.

5.4.2. SUGAR INDUSTRY AGREEMENTS

Sugar Act No. 10 2001 and Sugar Industry Agreements

Sugar (General) Regulations (2007)

Section 33 of the Sugar Act No. 10 of 2001 authorizes the Minister for Agriculture acting in consultation with the Kenya Sugar Board to make regulations for the better carrying out provisions of the Act. Currently there is in circulation a draft Sugar (General) Regulations 2007 which expired without being enforced. The document provided for the following agreements:

1. **Under second schedule**

'Agreement between grower and miller on sugarcane farming and supply'

2. **Under third schedule**

Agreement between the Out-grower Institution and miller on sugarcane farming and supply

3. **Under fourth schedule**

Agreement between Out-grower Institution and the miller on sugarcane farming and supply.

4. **Under fifth schedule**

Agreement between independent sugarcane grower and miller on sugarcane (**growing**) and supply.

5. **Under sixth schedule**

Appointment of growers / out-growers members agent or representation **[and add next of kin]**

6. **Under seventh schedule**

Agreement between grower / miller / out-grower institution and sugarcane transporter.

7. **Under eighth schedule**

Agreement between grower / miller / out-grower institution and sugarcane harvesting contractor.

These regulations have been expanded under seventh and eighth schedules to include transporters and harvesting contractors as sugar industry stakeholders.

5.4.3. Recommendations:

- The Draft **Sugar (General) Regulations 2007** which has been withheld since 2007 **should be redrafted** by the technical committee at Kenya Sugar Board **for expedient gazettement by the Minister for Agriculture.**
- The draft document should **be subjected to open debate and negotiation involving all stakeholders especially sugarcane farmers.**
- The responsibility on **who should meet harvesting and transport costs** still remains controversial and has been left out tactfully in the draft document.
- Whereas the failure by the farmers to allow access and facilitate harvesting should be referred to SAT, **action to be taken on the millers for failure to harvest and transport the cane has been avoided tactfully** despite the fact the delayed or non-harvesting of the cane is a key challenge with heavy financial loses to growers and out-growers.
- Charges by the miller omits **one key operation namely survey**. This is a contentious issue since survey forms the basis for actual incurred costs. Currently **farmers are being fleeced with inaccurate or falsified survey records.**
- **Weighing of sugarcane is circumvented** although the Sugar Act 2001 section 29 (6) (a) provides that the millers should weigh the cane at the farm gate, transport and mill the sugarcane supplied from the growers fields. **Regulations under various schedules 2,3,4,5 loosely stipulates that the miller, grower, Out-grower Institution or any other party can install and operate weighbridges** at any point outside the factory. There exist rampant discontents which are justified by manipulation of weighbridge requirements especially in Mumias, Sony, Busia and Kibos Sugar Mills. The department of weights and measurements should be advocated to act on these irregularities.
- The issue regarding **cane pricing has not been dealt with effectively** as witnessed through failure to adhere to the payment formula provided by the sugarcane pricing committee. This regulation should be inclusive in the **implementation of payment by sucrose content** as stipulated in the Sugar Act.
- **Kenya Sugarcane Growers Association has been mandated to inspect records of service provider OGI's** which are prepared on weekly basis. This expansion of scope of a parallel OGI (KESGA) is bound to create abrasive relationship.
- Transporters and harvesting contractors have become parties to the Sugar Industry agreements under schedules seven and eight. They therefore need to be included in part 1 of Preliminary regulations

- Charges by the miller have two separate zoning rates for transport in the scheduled agreements. The branding of zones have been detested the farmers hence should be tabled before the stakeholders for negotiation.
- **Policy statements** are **supportive of direct farmer-miller agreement on service provision.** The Sugar (General) Regulation 2007 draft under second schedule has taken care of this. The millers have the capacity to own and operate the mechanization and transport the fleet efficiently. Over the years OGI's including the giant MOCO have systematically failed the test on this aspect. A thorough study of this provision should be undertaken otherwise in the medium term let the second schedule prevail.
- Under third schedule regulations 14, the **OGI should pay the grower members within thirty days of delivery.** The Sugar Act also provides that **the miller should pay for cane deliveries within thirty days.** These regulations should be **harmonized** unless a revolving fund is established to facilitate advance payment by OGI's.
- **Aspects of seventh and eighth schedules regarding harvesting contractors and transporter agreements** should be subjected to a wider stakeholder's negotiations / debate. The **texts were apparently drawn singularly by the millers** hence repeated use of the word "company". Colossal losses incurred by farmers across the sub-sector have been attributed to these operations.
- Under the second schedule regulations 20 and 21, the age limit for early maturing varieties should be included (this is a key determinant of sucrose content). The miller should not only **pay penalty on loan account**, but also on all standing accounts since a **farmer deposit** could have been out of bank overdraft.

5.5. REFORM AGENDA FIVE:

SUGAR ACT NO. 10 of 2001 (AMENDMENTS)

According to Strategies for Revitalization of Agriculture (SRA), the enactment of Sugar Act 2001 No 10 of 2001 alongside other crop Acts including Tea, Coffee, Cotton etc underpinned key government initiatives to undertake policy and legal reforms, to revitalize the agricultural sector. The SRA ushered in an era of reforms that were aimed at streamlining operations of the sugar sub-sector by defining the roles of the industry stakeholders, providing a framework for licensing and registration of millers, importers and exporters, funding of the industry and sharing of the resources between millers and growers as well as the mechanism for dispute resolutions.

It sought to contain political patronage from management of the sugar industry by giving the farmers authority in management of the industry through elective representation at the newly created regulatory body, the Kenya Sugar Board. Management of the industry is however still wrought with a lag between policy formulation and implementation and hence requires certain specific and priority amendments. Lack of political goodwill and commitment in implementing the Sugar Act has retarded positive changes contained in the document. Meanwhile, the millers have exploited loopholes in the Act to their advantage at expense of the farmers while claiming unlimited government support in their undertakings.

The motivation behind the Sugar (Amendment) Bill 2005 was out of the realization that the Sugar Act 2001 had omitted many of the core problems that were facing the sugar industry hence not fully in tandem with ensuing policy framework namely:

1. Recommendations of Task Force, 2003;
2. Strategies for Revitalization of Agriculture and;
3. Draft Sessional Paper for Revitalization of the sub-sector.

It is therefore important that these policy interventions should be entrenched into the Act in order to effectively strengthen the industry. Privatization of the state owned sugar companies is a paradigm shift that will usher in fundamental changes and management of the sugar sub-sector which may only be comparable to sudden the liberalization / deregulation of 1992. Then, the failure by Kenya Sugar Authority 1993 to respond to a liberalized environment through appropriate policy, legal and institutional reforms nearly bought the sub-sector to brink of collapse.

The prevailing environment therefore provides the government with opportunity to revise and issue effective policies to the industry through the Sessional Paper on Sugar Industry 2010. At the same time, the government should spearhead reviewing of the Sugar Act No. 10 of 2001 in order to harmonize it with the requirements of sugar industry privatization process. Consequently, the Sugar (Amendment) Bill 2008 should include inter alia:

1. Ensure that privatized sugar companies share allotment to growers is held at a minimum of 51% as provided for in the Sugar Act 2001 and not as per the privatization commission proposal of 30%;
2. Ensure that sugarcane growers representation in the privatized milling companies is kept at a minimum of 51% in order to give farmers control of the industry business;
3. Bestow upon Sugar Arbitration Tribunal the powers to execute awards through appropriate orders;
4. Introduce a more representative eligibility criteria portraying Affirmative Action especially through providing for the proposed 8th director be a female sugarcane farmer.

5.6. REFORM AGENDA SIX:

SUGARCANE FARMERS SHAREHOLDING

Majority of Kenyans especially those from the sugar belts today view the privatization of state owned sugar companies with suspicion. To some extent, these concerns are genuine because privatization alone may not be the solution to the problems facing the five public sugar companies. Many sugarcane farmers have however expressed strong commitments in ownership and management of privatized sugar companies through shareholding. Consultants hired to oversee privatization of the five state owned sugar mills gave a preliminary recommendation for the sale of shares to a strategic investor with shareholding structure as set below.

Option	**Percentage (%) shareholding**			**Sugar Act 2001 Compliance**	**Consultants preference**
	Strategic investor	**Government/ employees**	**Out-growers**		
1	40	30	30	NO	NO
2	30	0	70	YES	NO
3	51	19	30	NO	YES

Should the Cabinet adopt the consultants preferred choice (51% strategic investor, 30% growers and 19% government), then internal shareholding arrangement Joint Venture Agreement and Articles of Association for the new companies should provide for scaling up of the farmers shareholding of up to a maximum of 51% during the period of amortization.

The provision of majority shareholding by the sugarcane farmers in the privatized companies as contained in the current Act should however not be lost. Inability of the farmers to raise sufficient funds for purchasing the shares within the set deadlines however is a real concern. In Miwani for example, the farmers lacked marketing opportunities to generate income for over 9 years hence poses a strong handicap when it comes to raising resources for purchasing shares.

In the five factories, substantial cane payment arrears belonging to the farmers are also being held making their (farmers) hence weakening their financial base. These challenges give credibility in support for warehousing of the un-purchased shares for a period of 6 years. Mumias perhaps exhibits the worst scenario in the privatization with reference to shareholding be farmers because all the shares sold to them were mopped up by middlemen. This practice led to calls for a radical approach aimed at protecting the farmers' shares and ensuring that their share percentage remains intact. The creation of Mutual Trust Fund to manage the farmers' shareholding as a block has been recommended as a means towards the realization of this dream.

5.7. REFORM AGENDA SEVEN:

SUGAR INDUSTRY FINANCING

In recognition of the dire need for dependable and sustainable funding base for the sugar industry, the Government established the Sugar Development Fund in 1992. The funds sources are Sugar Development Levy (SDL), donors, parliamentary allocations and any other. Utilization targets specifically sugarcane development (21.3%), factory rehabilitation (24.3%), improvement of roads infrastructure (9.1%), research (12.1%), KSB administration (15%) and reserve deposit 18.2%). Regrettably sugar factory SDL collection remains the only active source to date. Between 1992 and 30th June 2005 levy collections amounted to Kshs. 12.5 billion with Kshs. 7.5 billion disbursed. The sugar factories between 200/01 and 2006/07 contributed Kshs. 7.8 billion (annual average Kshs 1.1 billion). By comparison these amounts are inadequate to cater for cane development and factory rehabilitation. Targets (2006/07 to 2010/11) of 16.1 billion and 6.8 billion respectively, even with inclusion of SDL charged on imported sugar the shortfall is grim.

FINANCIAL REQUIREMENT (BILLION KSHS.)

	EXPENSE AREA	2000/01 – 2010/11	2006/07 – 2010/2011 (TARGET)
1	Cane Development (21.3%)	1.6	16.1
2	Factory Rehabilitation (24.3%)	1.9	6.8
3	TOTAL	3.5	22.9

6. STAKEHOLDERS RESOLUTIONS IN RESPONSE TO THE REFORMS

Harmonizing Sugar Policy with Privatization Proposal

1. Industry Debt Restructuring

- Farmers demand that the government as matter of urgency to undertake debt analysis including **the farmers' claims in totality** for upfront settlement before the closure of the divestiture process.

- Farmers also request that the government consider to waiver debts owed by farmers in terms of loans during the debt restructuring programme as most of these debts are due to delayed or non harvesting of cane developed by these loans. This can be included in the Kshs.33 billion of government debts to be waived.

- Facilitate cane farmers' access to affordable credit in addition to SDF with directive on the interest rate.

2. *Sugarcane Pricing*

- Before, conclusion of the disposal of the sugar firms, the government should give directive for Growers and Millers to develop a cane payment system that facilitates the sharing of revenues derived from cane processing;

- Composition of Pricing Committee should be reviewed to ensure fair and balanced representation of stakeholders especially sugarcane farmers.

- In addition, farmers also demand for the government to facilitate two experts as technical advisors during the pricing negotiation.

- The government to establish sugarcane testing unit to ensure that farmers are protected during the sucrose payment system

Revitalize Out-grower Institutions

- Review and restructure the out-grower institutions to enable them provide effective services to cane farmers;

- The government should consider as a matter of urgency restitute the farmers apex body to ensure respect of farmers' rights

1. *Sugarcane Farmers Shareholding*

- The proposed 9 billion government dues to be turned to equity should be shared by the growers equally
- The government to establish Out-growers Mutual Fund and warehouse farmers shares for a period of 6 years.

2. *Merging of the three mills in Nyando*

- The farmers said big NO to proposal to merge Miwani, Chemelil and Muhoroni Sugar Companies

Harmonize Sugar Act with Privatization Proposal

1. Sugar (Amendment) Bill, 2008

Speed up the review of the Sugar Act 2001 to:

- Harmonize privatized company share allotment to growers' as provided in the Act (of at least 51%) with the one proposed by the Privatization Commission (30%)
- Enable establishment of growers apex body with functional structures for effective representation of members rights
- Give Sugar Arbitration Tribunal power to execute decided cases

2. Sugar (General) Regulations 2008

- Gazette Sugar (General) Regulation 2008 to streamline
- Gazette Sugar Industry Agreements to enable farmers and millers work in harmony with each party effectively undertaking obligations and respecting rights of the other. This will ensure a stop to manipulation of growers by millers, out-grower companies and other contractors.

CONCLUSION

Do not allow us (farmers) be punished without putting adequate policy and legal framework in place to manage a liberalized sugar sub-sector. 6 Million Livelihoods are at stake. The Sugar Industry was destroyed because of corruption and bad management in Kenya; do not transfer sugarcane farmers from this state to exploitative nature of capitalists. Give farmers a fair deal.

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