The impact of Covid-19 on the manufacturing sector in Kenya

May 2020
Introduction

The Covid-19 pandemic has resulted in unprecedented health and economic challenges across the world. While the greatest effect of the pandemic has been loss of life and strain on health facilities, businesses have not been spared.

Nations have put in place stringent measures to curb the spread of the coronavirus which include lockdown regulations that have crippled business operations. This is in response to the clarion call of ‘flattening the curve’ and preventing health care systems from being overwhelmed with Covid-19 cases.

The lockdown regulations put in place have resulted in shut down of industries and massive job losses. Fear looms of an economic recession with far greater magnitude than the 2008/2009 global financial crisis.

The International Monetary Fund (IMF) estimates that the global economy will contract by 3% in 2020 with an assumption that the Covid-19 pandemic fades away in the second half of 2020 and containment measures are gradually eased. Similarly, the IMF has revised downwards the Sub Saharan Africa economic growth prospect for 2020 from an expected growth of 3.5% to -1.6%.

The Government of Kenya (GoK) has undertaken a raft of interventions in response to the Covid-19 pandemic to curb the transmission of the coronavirus since the confirmation of the first positive case of the coronavirus in the country on 12 March 2020. The measures include: cessation of movement from the larger Nairobi metropolitan area, Mandera county, coastal counties of Mombasa, Kilifi and Kwale; imposition of a nationwide curfew from 7pm to 5am with the movement of essential goods and service providers exempted from the curfew; and enforcement of social distancing. This has affected normal business operations in the country.

The GoK has rolled out economic measures to mitigate against the adverse effect of the coronavirus on the economy. So far, the government has adopted an expansionary monetary policy by reducing the cash reserve ratio to increase liquidity of KShs 35.2 billion to commercial banks for further lending.

In addition, the Central Bank of Kenya has further lowered the Central Bank rate from 7.25% to 7% in a bid to lower the interest rate charged by commercial banks. On the fiscal front, tax measures have been instituted to cushion low income earners by lowering the payroll tax, increasing tax relief as well as increasing tax refund payments due to bona fide tax payers. Furthermore, the government has increased allocation towards social protection and increased expenditure in the health sector.

References:
Problem statement

The current response to Covid-19 has confronted both the government and the private sector with decisions that pose a dilemma between containing the outbreak of the virus and economic recovery. While measures instituted to curb the spread of coronavirus are crucial in ensuring that the epidemiological curve of Covid-19 is flattened, they simultaneously hamper business continuity due to disruptions brought about by these measures.

The United Economic Commission for Africa (UNECA) estimates that a one month full lockdown will cost Africa US$ 65.7 billion, equivalent to about 2.5% of its annual gross domestic product. The lockdown regulations, coupled with extreme uncertainty of the duration and extent of the Covid-19 pandemic, will likely lead to a prolonged economic recession that will affect business continuity.

Therefore it is imperative to assess the impact of Covid-19 on the domestic front, in order to institute appropriate policy response that will adequately cushion businesses from the adverse impact of Covid-19 and, as a result, minimize job losses during this crisis period and post Covid-19 period.

Research scope and objectives

A survey was conducted among the Kenya Association of Manufacturers (KAM) membership to uncover the challenges faced by businesses including labour issues, financial constraints, and challenges in production and firm operations arising from the imposed curfew and restriction of movements. Specifically, the survey aimed at:

i. Documenting the challenges manufacturers are facing in the midst of Covid-19.

ii. Understanding what measures have been put in place to combat the spread of Covid-19.

iii. Understanding how manufacturers are adapting to the changes brought about by Covid-19.

iv. Documenting the perception of manufacturers on economic measures put in place by the government in response to Covid-19’s effect on the economy.

v. Providing proposals to address these challenges.

“While measures instituted to curb the spread of coronavirus are crucial in ensuring that the epidemiological curve of Covid-19 is flattened, they simultaneously hamper business continuity due to disruptions brought about by these measures.”

Covid-19 has impacted individuals, businesses and economies across the globe. The manufacturing industry is no exception.

**Highlights**

**Top priorities for manufacturers from the survey**

- **78%** Reducing costs
- **61%** Retaining jobs
- **53%** Improving cash flows

**Response**

More than 90% of respondents have adhered to the guidelines on curbing the spread of Covid-19 such as sanitization points, social distancing and providing PPE equipment.

**Workforce**

Have reduced their casual workforce, while 73% have retained their permanent employees.

**Sales**

91% of non-essential goods manufacturers have seen a significant fall in demand compared to 74% of essential goods manufacturers.
Production
42% are currently operating at less than half their production capacity, while the average utilized capacity for MSMEs is 37%.

Logistics
76% are having difficulties in locally sourcing or importing raw materials and 67% found access to market challenging.

Cashflow
79% are experiencing cash flow constraints while 86% MSMEs are experiencing the same which is affecting their ability to meet tax obligations, pay employees or pay operating costs.

Economic incentives
71% indicated that zero tax on income less than Kshs 24,000 was most helpful while reducing the VAT to 14% was least helpful.
Manufacturers have had to rapidly change focus. The top three priorities for the majority of businesses before Covid-19 were to increase profitability, increase revenue and increase domestic market share. These strategies have now been pushed down the agenda and are overtaken by reducing costs, retaining jobs, and improving cash flow. However, when faced with the dilemma of reducing costs or retaining jobs, the former usually takes precedent and downsizing considerations seem more of a reality.

In spite of the rising costs, most manufacturers have not been able to adjust their prices accordingly. “We have a moral obligation to ensure that at this particular time we won’t take advantage of the situation but be very supportive of our country, Kenya.” – Bobby Johnson, Chair - Metal & Allied Sector. The major focus of 78% of the respondents is to now look at all avenues of cutting costs. Manufacturers are also switching to survival mode and looking to maintain the status quo, downsizing or even contemplating shutting down as uncertainty looms for the foreseeable future.

“We have a moral obligation to ensure that at this particular time we won’t take advantage of the situation but be very supportive of our country, Kenya.” – Bobby Johnson, Chair - Metal & Allied Sector

**Figure 1: Strategic priorities before and during Covid-19**

Source: KPMG and KAM, 2020
The disruption has created opportunities for some businesses to innovate their product offerings. To respond to the heightened demand for Covid-19 related goods, 23% of manufacturers from 10 out of the 14 sectors have either shifted their focus or ramped up production of essential goods such as personal protective equipment (PPEs), bedding, sanitizers, disinfectants, canned foods and immunity boosting products, hospital beds, and ventilators.

Other strategies will need to be adopted to survive such as rearranging factory floor plans to accommodate social distancing, using remote monitoring mechanisms, reconsidering major investments, analysing their supply chain modalities and being more imaginative with their sales and marketing efforts.

10 sectors that are producing essential goods

- Motor Vehicle Assemblers & Accessories
- Chemical & Allied
- Paper & Paperboard
- Energy, Electrical & Electronics
- Leather & Footwear
- Metal & Allied
- Pharmaceutical & Medical Equipment
- Textile & Apparel
- Food & Beverage
- Plastic & Rubber
Response to Covid-19

Many businesses are playing their role in limiting the spread of Covid-19, having introduced accessible sanitization points around the premises, practicing social distancing, providing PPEs such as masks and gloves and launching awareness campaigns. This comes at a cost. Businesses have: reduced their workforce either through layoffs, unpaid leave or paid leave due to the social distancing measures that have been put in place; reduced the number of shifts due to the fall in demand; or increased the shift periods to adhere to the 7pm to 5am curfew. Although working remotely is being encouraged, this is not possible for 48% of manufacturers which increases the risk of spreading the virus.

Additional costs for ensuring proper hygiene practices are in place, for example providing PPEs for employees to mitigate the spread of Covid-19, have added to the burden of rising operating costs. “We are all now incurring extremely heavy costs related to hygiene, security, social distancing” states Anup Bid, Chair - Beverage Sector.

Other measures taken in response to the coronavirus include virtual meetings, psychosocial support, Covid-19 food and hygiene products kits, increased communication to keep staff informed of any updates affecting them and the business, travel allowances, allowing employees to leave the work place early, and sensitization. As the number of Covid-19 positive cases rise, businesses should also consider identifying “high risk” employees based on where staff live in relation to the Covid-19 positive hotspots and take additional precautions such as supporting staff when self-quarantining and health care support.

“We are all now incurring extremely heavy costs related to hygiene, security, social distancing.” – Anup Bid, Chair - Beverage Sector
8 out of every 10 participants are experiencing cash flow constraints while 9 out of every 10 agree or strongly agree that they are facing challenges in being paid by their customers, as they too need to look at their finances and prioritize their payments. What was a common issue before businesses were affected by Covid-19 has been exacerbated further by the pandemic.

62% have indicated that they have negotiated payment plans with their customers. However, as cash trickles in, the pressure to pay interest, loans, taxes, salaries and wages, and other operating costs continues to build. 58% are having difficulties in meeting their tax obligations, 69% are finding it difficult to pay their employees, and 71% are having challenges in paying other operating costs such as rent and utilities. For MSMEs, the numbers are grimmer: 64% are having challenges in meeting tax obligations, 76% are finding it difficult to pay salaries and wages, and 79% are struggling to pay for other operating costs.

To help ease some of those pressures, 66% of businesses have taken action to negotiate payment plans with their suppliers and 55% have negotiated payment plans with their banks, while unpaid leave and layoffs account for 39% and 18% respectively. “We need a cash injection into the business to go through the difficult period either in procuring raw materials, paying rent, or paying wages,” adds Suresh Patel, Vice Chair - Chemical & Allied Sector.

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As working capital continues to be a major challenge, 58% of respondents found the moratorium on loan repayments very helpful or helpful and 45% of all respondents and 50% of MSMEs have sought additional financial support from other individuals or institutions such as banks and other financial institutions. However, 39% indicated that they agree or strongly agree that they have difficulties in securing financial facilities from commercial banks, while this figure increases to 46% for MSMEs. Speaking on behalf of the automotive industry, Anthony Musyoki, Vice Chair - Motor Vehicle Assemblers & Accessories Sector explains that “banks are really tightening up the mode of vetting customers, so we have to be very creative in terms of getting financing for our customers as the lenders are a bit skeptical financing certain types of businesses.”

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Figure 4: Response to economic incentives to ease cash constraints

<table>
<thead>
<tr>
<th>Economic Incentive</th>
<th>Very helpful</th>
<th>Helpful</th>
<th>Somewhat helpful</th>
<th>Not very helpful</th>
<th>Unsure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Moratorium on loan repayment</td>
<td>23%</td>
<td>35%</td>
<td>16%</td>
<td>11%</td>
<td>15%</td>
</tr>
<tr>
<td>Payment of pending bills by government of KShs 13bn</td>
<td>27%</td>
<td>26%</td>
<td>10%</td>
<td>21%</td>
<td>17%</td>
</tr>
<tr>
<td>Reduction of CBR from 8.25% to 7.25%</td>
<td>17%</td>
<td>35%</td>
<td>21%</td>
<td>19%</td>
<td>7%</td>
</tr>
<tr>
<td>Reduction of CRR from 5.5% to 4.5%</td>
<td>13%</td>
<td>35%</td>
<td>21%</td>
<td>21%</td>
<td>9%</td>
</tr>
</tbody>
</table>

Source: KPMG and KAM, 2020

53% found the allocation of KShs 13bn to pay government bills to be helpful or very helpful, while 48% and 52% thought the reduced Cash Reserve Ratio (CRR) and Central Bank Rate (CBR), respectively, were helpful or very helpful. Although these initiatives have been welcomed, the effects are yet to be felt in the manufacturing sector. 2019 saw a boost in business confidence, and many manufacturers made heavy investments through bank loans. Interest on these loans still need to be paid even though they have been given a moratorium for 2-3 months. This may not be enough to ease the cash constraints. “The whole automotive sector was geared towards increasing productivity… manufacturers have all invested heavily towards the end of the year…[In 2020], the first 2 months were really good but from March everything just died down so we still have to pay interest on new lines and investments… we cannot now afford a return on investment” – explains Ashit Shah, Chair - Motor Vehicle Assemblers & Accessories Sector.

Some businesses are even resorting to falling back on their own savings and personal finances. According to Amir Parpia, Chair - Food Sector, “people are digging into their own pockets but these are not bottomless pockets.”

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Workforce

Salaries and wages

The impact on employment is a major concern across the manufacturing sector. 69% of the participants strongly agree or agree that they have difficulty in paying salaries and wages. This number increases to 79% for MSMEs. These difficulties have contributed to 39% sending their staff on unpaid leave while 27% have made salary/wage adjustments. Uncertainty plays a significant role in shaking confidence and trust, which has a direct impact on job security and in turn is likely to reduce staff morale and engagement levels, and negatively impact organisation performance. Manufacturers also need to prepare to deal with some of the labour-related issues such as breaches in employment contracts and conflict management that may arise out of layoffs as well as the inability to pay salaries and wages.

Employee levels

In 2019, the manufacturing industry was the highest contributor to employment in the private sector accounting for 15.9%\(^5\). However, during Covid-19 casual labours have so far felt the brunt of the downsizing measures with 40% of respondents indicating that they have already reduced the number of casual labourers. 73% of respondents have retained the number of permanent employees but this is likely to get worse if things do not improve. Although 18% of the respondents have already laid off staff, “at the moment, many employers are holding onto their employees. If the support doesn’t come forward, that [unemployment] figure will increase,” claims Suresh Patel. Other employee management measures include freezing recruitment for new hires or replacements, non-renewal of expired contracts or deferral of signing new contracts, reduction in bonus pay, and redeployment of staff to other departments.

If the support doesn’t come forward, that [unemployment] figure will increase.” – Suresh Patel
58% of participants that previously employed over 100 permanent employees have reduced by 12%, and 25% of those that employed over 100 casual employees reduced to 13%. This in turn has significantly increased the number of employees in the 51-100 and less than 10 employee range. The number of respondents that employ less than 10 permanent and casual staff have increased by 8% for permanent employees, and 19% for casual employees pointing to a significant number of jobs that have already been lost.

The reduction in workforce can be seen more prominently amongst the MSME manufacturers. 41% that previously employed over 100 permanent employees fell to 30% with an increase of 11% employing less than 10 permanent employees. For casuals, the number of MSME manufacturers employing more than 100 employees fell by 8% and the number employing less than 10 employees has significantly increased by 23%.

Working hours

55% of the respondents indicated that the number of hours worked in a day have gone down during Covid-19. Despite the directive of the Government to allow businesses to operate 24 hours, the number of manufacturers working 19-24 hours a day dropped by 28%. Half of the manufacturers that continue to work 19-24 hours are from the Pharmaceutical & Medical Equipment, Food & Beverage, and Paper & Paperboard sectors, as they continue to produce essential goods. The number of manufacturers that have reduced their operating hours to less than 6 hours a day has gone up from 2% before Covid-19 to 26% during Covid-19, while 48% have reduced the number of days they work in a week.
Working remotely

Organisations need to embrace performance management systems that allows for productive remote working to keep employees engaged during this period. 43% of all respondents have already put in place measures to support remote operations, while this decreases amongst the MSMEs with 39% being able to work remotely. Although remote working may be possible for the back office, management level and executive staff of the business, this privilege cannot be extended to the production, warehousing and logistics teams as their presence onsite is crucial in managing the manufacturing, storage and movement of goods.

Working remotely may help employees feel secure in their employment but for others such as the sales teams and merchandisers, they need to be creative as to how to reach consumers with the restricted movement.

Unsurprisingly, the focus on advertising and marketing initiatives has dropped from 44% to 13% of the participants, but 31% of the participants are pursuing online capabilities as part of their current strategy which has not changed significantly from before Covid-19.

Security

Reduced employment, job insecurity and low staff morale also gives rise to theft, pilferage and other fraud-related risks yet only 50% have enhanced their security measures in the workplace and this figure decreases for MSMEs to 47%. Stricter controls need to be put in place and additional risks such as cybercrime need to be evaluated. Regular communication, sensitization and awareness sessions, and emphasizing the company’s values may help lift morale and productivity.
Demand

Even though some manufacturers are classified as essential goods in sectors such as the Food & Beverage, Paper & Paperboard, Automotive, Chemical & Allied, Textile & Apparel and Pharmaceutical & Medical Equipment sectors, the demand for their products in terms of volume has dramatically reduced. Sector dependencies have never been felt more than during this pandemic. 74% of essential goods manufacturers agree or strongly agree that there has been a significant fall in demand, while 91% of non-essential goods manufacturers felt the same. Many businesses are heavily reliant on supplying in bulk to the domestic tourism and hospitality industries, education and catering institutions and non-essential retail trade of which most have come to a grinding halt. Although they may see a rise in retail sales, especially in supermarkets, overall demand remains much lower than what it was before Covid-19.
Sales

An overwhelming number of respondents (93%) have experienced a fall in turnover, with at least 23% registering losses in the range of 65-100%, and 51% between 30-65%. 78% attributed this to a fall in demand of products. 4% have seen an increase in turnover, while another 4% have not seen any changes. The sectors that have seen an increase in turnover are Metal & Allied (18%), Chemical & Allied (6%), Paper & Paperboard (5%) and Food & Beverage (3%). The worst hit sectors are the Textile & Apparel and Timber, Wood & Furniture sectors followed by the Leather & Footwear sector with 61%, 60% and 40% respectively, having a loss in turnover of more than 65%. Even within sectors, the differences range quite vastly such as the Paper & Paperboard sector where “essential goods still needs to be packaged so there is activity on the packaging side, whereas commercial printing and exercise books production has come to a virtual standstill”, as Mohan Krishnaswami, Chair - Paper & Paperboard Sector explains.

For MSMEs, 30% have experienced a loss of between 65-100% and 49% reported losses of between 30-64%. Start-ups and those in decline are the most vulnerable group of all participants reporting a loss in turnover.

Figure 8: Change in turnover

Figure 9: Change in turnover in MSMEs

Source: KPMG and KAM, 2020

Source: KPMG and KAM, 2020
Production

88% of respondents were operating at over 50% production capacity before Covid-19 took effect. This number has now declined by more than half to 42%. The average utilized capacity for MSMEs was 74% before Covid-19, this figure halved and now stands at 37%. Loss of demand has had a huge toll on the production capacity.

The sectors most affected are those considered to be non-essential: textile & apparel, timber & furniture, and automotive sectors where 61%, 60% and 47% respectively have decreased their production capacity by more than 40%. In the automotive industry, “they have lost total sales of new vehicles so all the assembly plants and everything is more or less closed” Ashit Shah states. Without being able to stimulate market demand, manufacturers are likely to continue operating at reduced production capacity.

They have lost total sales of new vehicles so all the assembly plants and everything is more or less closed.” – Ashit Shah, Chair - Motor Vehicle Assemblers & Accessories Sector

Figure 10: Production capacity

Source: KPMG and KAM, 2020
Logistics

76% of the respondents experienced challenges in locally sourcing or shipping in raw materials. An example is the leather industry which has been impacted “because with the lock down people are not able to get the raw hides from up country” Niaz Hirani, Chair – Leather & Footwear Sector explains. This could also contribute to loss in revenues due to unmet consumer demands. 77% recorded an increase in the cost of procuring imported raw materials.

With the majority of raw materials and machinery coming in from countries such as China, India and Egypt, and the added challenges of: seeking credit insurance covers from banks; depreciation of the Kenya Shilling; suppliers invoking the force majeure clauses in their contracts; and other countries imposing their own restrictions, many will not be able to replenish their stocks if the lock down measures are not lifted in the short term.

Currently, 69% of manufacturers have raw material stock levels that could only last for 0-3 months. Businesses may have to resort to looking for alternative sources of raw materials to replenish their stock levels, which may prove to be even more expensive.

On the other hand, only 10% of the respondents have raw material stock levels that can last for more than 6 months which are mostly manufacturers of the non-essential and non-perishable goods as they are unable to sell their products owing to low demand. The added challenge here is that their inventory and warehousing costs remain high.

As a results of movement restrictions and lock down of key counties, 67% of participants have outbound logistical challenges (finished goods to market). Although concessions have been made for food suppliers and other cargo to move between counties during the lock down period, most manufacturers are still finding this difficult.

Exporters have not been spared either with 57% strongly agreeing or agreeing that they are facing difficulties in exporting with limited cargo capacity and increased cost of air freight.

With these limitations, coupled with drastically reduced demand, 3% of businesses are currently not producing any goods mainly from the Timber, Wood & Furniture and Metal & Allied sectors. Building consumer confidence and developing a supply chain strategy within the confines of the movement restrictions needs to be developed to ensure businesses keep moving towards economic recovery.

Because with the lock down people are not able to get the raw hides from up country.” – Niaz Hirani, Chair – Leather & Footwear Sector

Figure 11: Current raw material stock levels

Source: KPMG and KAM, 2020
Economic incentives

On 25 March 2020, the President of Kenya outlined the measures the government intended to take to cushion the country against the economic effects of Covid-19. These measures were submitted to the National Assembly under the Tax Laws (Amendment) Bill, 2020 (the Bill) for consideration and approval. A month since the President outlined his proposals, he assented to the Tax Laws (Amendment) Act, 2020 (the Act) on 25 April 2020.

The reduction in PAYE rates from 30% to 25% has been a welcome move by the manufacturers to cushion a number of Kenyans during this pandemic. 60% of the respondents noted that this move by the government was very helpful or helpful in increasing the disposal income of their employees. 71% of manufacturers found the exemption of tax to those earning below Kshs 24,000 very helpful or helpful. This essentially translates to tax free employment income of KShs 288,000 per annum compared to the previous amount of KShs 147,580. This mostly affects casual labourers who largely fall within the now tax exempt income tax bracket.

60% of the participants responded positively to the reduction of corporate tax from 30% to 25%. The amendment of the corporate tax rates for resident companies was to cushion the companies from Covid-19 and at the same time reduce the tax burden. The full effect may not be felt immediately as companies are yet to pay the full tax rates for the first quarter of the year even though they are currently operating at reduced capacity. Additionally, this incentive may not benefit companies that are in significant tax losses, which primarily arise out of Investment Deduction claims. This coupled with the proposal in the Finance Bill, 2020 seeking to include a provision of a minimum tax may work against cushioning companies in tax losses. If passed into law, it will require these companies to pay a minimum tax based on turnover and strain the much needed working capital.

Figure 12: Response to tax incentives

<table>
<thead>
<tr>
<th>Economic Incentive</th>
<th>Very helpful</th>
<th>Helpful</th>
<th>Somewhat helpful</th>
<th>Not very helpful</th>
<th>Unsure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zero tax for income ≤ KShs 24,000</td>
<td>36%</td>
<td>35%</td>
<td>17%</td>
<td>9%</td>
<td>3%</td>
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<tr>
<td>Reduction of corporate tax from 30% to 25%</td>
<td>26%</td>
<td>34%</td>
<td>24%</td>
<td>14%</td>
<td>1%</td>
</tr>
<tr>
<td>Reduction of PAYE from 30% to 25%</td>
<td>29%</td>
<td>31%</td>
<td>30%</td>
<td>8%</td>
<td>2%</td>
</tr>
<tr>
<td>ToT from 3% to 1% for turnover ≤ Kshs 50m</td>
<td>23%</td>
<td>29%</td>
<td>17%</td>
<td>22%</td>
<td>9%</td>
</tr>
<tr>
<td>Allocation of VAT refund of KShs 10bn</td>
<td>24%</td>
<td>26%</td>
<td>15%</td>
<td>18%</td>
<td>16%</td>
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<tr>
<td>Reduction of VAT from 16% to 14%</td>
<td>13%</td>
<td>30%</td>
<td>29%</td>
<td>25%</td>
<td>3%</td>
</tr>
</tbody>
</table>

Source: KPMG and KAM, 2020
Just over half the participants for which the turnover tax (ToT) was applicable found the incentive very helpful or helpful. The ToT is targeted towards the small and micro enterprises that have a turnover of less than KShs 50 million. This is perhaps as a result of these businesses being start-ups or being in business for a period of just one year. The complications of this arise where a qualifying business registers for ToT and the turnover exceeds the upper limit of KShs 50 million before the year end. The government is yet to issue guidelines on how ToT will apply.

GoK allocated Kshs 10 billion to be paid as VAT processed for refunds. Only 50% of businesses found this useful perhaps in anticipation of the funds being disbursed. These funds have not yet been released to the Kenya Revenue Authority (KRA) for claims that have been processed despite 35% of businesses having already applied for this refund. The processing of VAT refunds have been a historical challenge primarily arising due to the lack of cash flows. The Government has experienced challenges in the past as the funds are not always readily available to disperse due to National and County level spending/budgets.

The revised VAT rate of 14% from 16% is currently the lowest in the East African region. Yet 43% of businesses found this incentive to be very helpful or helpful in reducing the cost of manufacturing as well as easing cash flow immediately. Highlighting some of the sentiments, “2% is too negligible to even make an impact… that doesn’t improve the cash position of the company at all” explains Anup Bid. Furthermore, the Tax (Amendments) Act, 2020, also introduced a number of changes to the VAT Act, by taxing goods that were previously zero rated as well as charging VAT on taxes (this is specifically in the case of VAT being charged on excise duty, levies and other fees for sale of petroleum products). This will increase the cost of doing business as the taxpayers will now pay more for fuel.

The above enacted changes took effect from 25 April 2020, with VAT and employment taxes being immediate reliefs for taxpayers, while the corporation tax change being more long term and companies will only be able to benefit from this rate for the 2020 financial year end.

“2% is too negligible to even make an impact… that doesn’t improve the cash position of the company at all.” – Anup Bid
Micro, Small and Medium Enterprises

MSMEs play a major part in promoting growth in Kenya’s economy, and account for the majority of businesses across the country. MSMEs are also a crucial part of manufacturing in this country, due to their role in creating employment in this labour intensive industry. In 2016, MSMEs employed approximately 14.9 million people with 11.8% being in the manufacturing industry6.

The impact of Covid-19 on these MSMEs is felt much harder than larger manufacturers. Although laying off employees would be considered as a last resort, MSME manufacturers are struggling with retaining their staff with the casual workforce being hit the hardest. Access to finance is far more difficult for MSMEs as they are considered as high risk enterprises due to their lack of tangible assets that can act as collateral. With the added challenge of collecting cash from their debtors, having adequate working capital to pay their bills is evidently lower.

MSMEs are at a higher risk of buckling under the pressures of low demand, decreased turnover and rising costs. Nascent businesses need to be further looked into in order to understand how they are coping with the current challenges. For those that are unable to do this, further downscaling and even closing may be the only option.

The results of this survey have highlighted some of the major challenges manufacturers face in the wake of Covid-19. Despite these challenges and uncertainties, 81% of respondents say that they are not likely to collapse in the near future as a result of the impact of Covid-19 but this number reduces to 76% for MSMEs. 64% have already undertaken a risk assessment of their business and have already implemented mitigation measures and contingency plans. But this, of course, has a price.

Most businesses have the resilience to ride the storm by adapting to the new normal. 80% of the participants are either in the growth stage or mature stage of the business cycle and have past experience in operating through uncertain times such as election periods and financial crises.

Taking immediate action will ensure the survival of the manufacturing sector, but getting to the same level as it was before the pandemic will need additional support and take time to build consumer confidence, as the ripple effects may last for several months or even years.

Taking the lessons learnt from other countries that are towards the tail end of the pandemic, such as China who are now operating at a capacity of between 80 to 90%, will help businesses better understand how they too can recover in the shortest time possible.
Clearing outstanding VAT refunds and pending bills

The Government should prioritize clearing all outstanding Value Added Tax (VAT) refunds and pending bills owed to the manufacturers. This is critical in order to avoid systemic bankruptcies in the private sector in general. The government should also rely on systems put in place such as green channel, which is aimed at expediting the processing of VAT refunds.

Re-evaluating tax reliefs

The Government through the Tax Laws (Amendments) Act, 2020, introduced a number of reliefs to combat Covid-19. However, through the same legislation, VAT was introduced on a number of items that were previously zero rated or exempt from VAT. By introducing VAT on these items, doing business has become more expensive. The Government should consider reintroducing the previous reliefs such as: zero rating pharmaceutical products; providing relief on raw materials imported into the country; and reintroducing the higher wear and tear allowances as well as allowing businesses to claim the entire Investment Deduction allowance in the first year of use. The reversal of those tax policies could be enacted through the current Finance Bill, 2020.

Moratorium on changes in the tax regime

The Covid-19 crisis has occasioned severe cash flow challenges to businesses. The government should consider providing a moratorium on tax regime changes during the crisis period to give room to businesses to adjust. An example is the Minimum Alternative Tax of 1% on income under the Finance Bill, 2020 that will be disastrous on loss making businesses that are already tight for cash.

Establishing an emergency rescue fund

An emergency rescue fund could be established, supported by development partners, to identify and support the most vulnerable businesses and entrepreneurs affected by Covid-19. This could include smaller MSME manufacturers focused on retaining employees as this will ease the liquidity challenges and consequently help employees continue to engage in full and productive employment and decent work in line with the United Nation’s Sustainable Development Goal 8: Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all.

Widening the scope of social protection measures

Coverage of social protection measures already instituted by the government through the emergency response fund that are targeting vulnerable groups in society and workers who have lost their jobs, should be widened. In addition to direct cash transfers (helicopter money) to targeted individuals, indirect transfers to individuals through the manufacturers could be considered.

Recommendations

Covid-19 has caused a massive shock to economies, businesses and households. However, adequate support in easing cash flow burdens, addressing rising unemployment, and kick-starting market demand, may help businesses navigate through the Covid-19 crisis. The recommendations are based on the analysis and feedback received from the participants of this survey.
Seeking additional support from lending institutions

To further enhance the liquidity of the manufacturing sector, commercial banks with the support of the Central Bank of Kenya and the national Government should consider instituting additional measures including:

- Increase moratorium for loan repayments including interest to 6 -12 months.
- Decrease interest rates further to about 8%.
- Give the entire loan and overdraft books a full waiver for the 3 months.
- Put a cap on fees for re-arranging facilities due to Covid-19 and an exemption for excise duty on those fees which is currently at 20%.

Re-evaluating regulatory overreach

The current regulatory overreach by government should consider being addressed by undertaking the following:

- Increase corrective actions towards manufacturers with more emphasis on compliance programs, pre-conformity programs, voluntary disclosures, and alternative dispute resolution.
- Fair administrative actions which include expeditious, efficient, lawful, reasonable and procedurally fair actions.
- Uniform approval and verified procedure for closures, demolitions, suspensions of business or its operations or brands.
- Fit-for-purpose agencies acting proactively on their mandates/functions to avoid delays.
- Ease of regulations on importation of raw materials, intermediate goods, industrial spares and machineries especially where ports of origin have been closed down and inspecting agencies are not operating optimally.
- Ease of restrictions through strategic steps, to allow manufacturers producing essential and non-essential goods to operate normally (as before Covid-19) while ensuring strict adherence to health guidelines and movement protocols issued by the Ministry of Health.

Subsidizing the cost of Covid-19 compliance

Subsidize the cost of compliance to curb the spread of Covid-19 including testing employees, PPEs and sanitizers, as well as ensuring adequate supply of water.

Developing a comprehensive rebound strategy

A comprehensive rebound strategy for the general economy should be developed placing particular focus on the manufacturing sector. A sector-based rebound strategy that is currently being developed by KAM could be adopted with the view of overcoming challenges associated with Covid-19. This will ensure Kenya bounces back quickly on the path towards sustainable economic growth and development.

The above enumerated policy recommendations will at best ensure survival of manufacturing enterprises and forestall total collapse of demand (consumption) and create preconditions for a robust recovery.
A survey was sent out to the KAM membership to complete online between 01 May and 07 May 2020. The data collection targeted mainly the senior management of the KAM membership including the Chief Executive Officers, Managing Directors, Chief Operating Officers, Operations and Finance Directors, among others. A Focus Group Discussion (FGD) session was also held with the National Chairs and Vice Chairs of the 14 sectors. The survey drew representation from across the country.

### Analysis of the respondents by sector

<table>
<thead>
<tr>
<th>Sector</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture &amp; Fresh Produce</td>
<td>2%</td>
</tr>
<tr>
<td>Building, Mining &amp; Construction</td>
<td>5%</td>
</tr>
<tr>
<td>Chemical &amp; Allied</td>
<td>10%</td>
</tr>
<tr>
<td>Energy, Electrical &amp; Electronics</td>
<td>3%</td>
</tr>
<tr>
<td>Food &amp; Beverage</td>
<td>21%</td>
</tr>
<tr>
<td>Leather &amp; Footwear</td>
<td>3%</td>
</tr>
<tr>
<td>Metal &amp; Allied</td>
<td>7%</td>
</tr>
<tr>
<td>Motor Vehicle Assemblers &amp; Accessories</td>
<td>11%</td>
</tr>
<tr>
<td>Paper &amp; Paperboard</td>
<td>12%</td>
</tr>
<tr>
<td>Pharmaceutical &amp; Medical Equipment</td>
<td>6%</td>
</tr>
<tr>
<td>Plastic &amp; Rubber</td>
<td>5%</td>
</tr>
<tr>
<td>Services &amp; Consulting</td>
<td>1%</td>
</tr>
<tr>
<td>Textile &amp; Apparel</td>
<td>11%</td>
</tr>
<tr>
<td>Timber, Wood &amp; Furniture</td>
<td>3%</td>
</tr>
</tbody>
</table>
Responses by 7 regional chapters

- Central & Surrounding regions: 26%
- Coast region: 7%
- Eastern & Surrounding regions: 4%
- Industrial Area region: 58%
- North Rift region: 1%
- Nyanza & Western regions: 3%
- South Rift region: 2%

69% of respondents manufacture essential goods
66% are Micro, Small, and Medium Enterprises (MSMEs)
34% are large companies

Size of businesses are defined as:
- Below KShs 10 Million – Micro
- Below Kshs 250 Million – Small
- Between KShs 250m to 1 Billion – Medium
- Over KShs 1 Billion – Large

“Before Covid-19” refers to the period before the first positive case was confirmed in Kenya on 12 March 2020.

“During Covid-19” refers to the current period when respondents completed the survey questionnaire.
We thank the heads of sectors of the KAM membership that participated in the focus group discussion. Your input and insights have been invaluable in providing a collective voice for the manufacturing sector.

- Mucai Kunyiha, KAM, Vice Chair
- Ashit Shah, Motor Vehicle Assemblers & Accessories Sector, Chair
- Anthony Musyoki, Motor Vehicle Assemblers & Accessories Sector, Vice Chair
- Dip Shah, Plastic & Rubber Sector, Chair
- Manoj Shah, Chemical & Allied Sector, Chair
- Suresh Patel, Chemical & Allied Sector, Vice Chair
- Amir Parpia, Food Sector, Chair
- Anup Bid, Beverage Sector, Chair
- Bobby Johnson, Metal & Allied Sector, Chair
- Dr Rohin Vora, Pharmaceutical & Medical Equipment Sector, Chair
- Julius Induswe, Building, Construction & Mining Sector, Vice Chair
- Mohan Krishnaswami, Paper & Paperboard Sector, Chair
- Niaz Hirani, Leather & Footwear Sector, Chair
- Tej Shah, Textile & Apparel Sector, Vice Chair
- Dr Bimal Kantaria, Agro-processing Sector, Chair

The efforts of the KAM and KPMG teams that developed the survey, contributed to the analysis, and put this paper together is much appreciated. A special thanks to Job Wanjohi, Dr. Simon Githuku, Jackson Wambua, Rodgers Agwaya, Reinhard Wanakacha and Robert Ongaki from KAM; and Smita Sanghrajka, Ashini Patel, Maurice Nkinyili, Sandeep Main, Peter Mwangi, Titilope Olajide and Mathew Kamande from KPMG.

We extend our appreciation to all the members for taking the time to participate in the survey especially during these uncertain times.
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Disclaimer

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