

a

IFAD
INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT
Executive Board – Eighty-Sixth Session
Rome, 12-13 December 2005

REPORT AND RECOMMENDATION OF THE PRESIDENT
TO THE EXECUTIVE BOARD ON PROPOSED FINANCIAL ASSISTANCE TO THE
REPUBLIC OF KENYA
FOR THE
SMALLHOLDER DAIRY COMMERCIALIZATION PROGRAMME

TABLE OF CONTENTS

| | |
|---|------------|
| CURRENCY EQUIVALENTS | iii |
| WEIGHTS AND MEASURES | iii |
| MAP OF THE PROGRAMME AREA | iv |
| FINANCING SUMMARY | v |
| PROGRAMME BRIEF | vi |
| PART I – THE ECONOMY, SECTORAL CONTEXT AND IFAD STRATEGY | 1 |
| A. The Economy and Agricultural Sector | 1 |
| B. Lessons Learned from Previous IFAD Experience | 2 |
| C. IFAD Strategy in Kenya | 2 |
| D. Rationale and Programme Approach | 3 |
| PART II – THE PROGRAMME | 5 |
| A. Programme Area and Target Group | 5 |
| B. Goal and Purposes | 5 |
| C. Components | 6 |
| D. Programme Costs and Financing | 7 |
| E. Procurement, Disbursement, Accounts and Audit | 10 |
| F. Organization and Management | 10 |
| G. Benefits and Economic Justification | 11 |
| H. Risks | 12 |
| I. Environmental Impact | 12 |
| J. Innovative Features | 12 |
| PART III – LEGAL INSTRUMENTS AND AUTHORITY | 13 |
| PART IV – RECOMMENDATION | 13 |
| ANNEX | |
| SUMMARY OF IMPORTANT SUPPLEMENTARY ASSURANCES INCLUDED IN THE NEGOTIATED FINANCING AGREEMENT | 15 |

APPENDIXES

| | |
|---|----------|
| I. COUNTRY DATA | 1 |
| II. PREVIOUS IFAD FINANCING IN KENYA | 2 |
| III. LOGICAL FRAMEWORK | 3 |
| IV. ORGANIGRAMME – PROGRAMME ORGANIZATION AND MANAGEMENT | 6 |

CURRENCY EQUIVALENTS

| | | |
|---------------|---|-----------------------|
| Currency unit | = | Kenya shillings (KES) |
| USD 1.00 | = | KES 74.8 |
| KES 1.00 | = | USD 0.0134 |

WEIGHTS AND MEASURES

| | | |
|----------------------------------|---|--------------------------------------|
| 1 kilogram (kg) | = | 2.204 pounds (lb) |
| 1 000 kg | = | 1 metric tonne (t) |
| 1 kilometre (km) | = | 0.62 miles (mi) |
| 1 metre (m) | = | 1.09 yards (yd) |
| 1 square metre (m ²) | = | 10.76 square feet (ft ²) |
| 1 acre (ac) | = | 0.405 ha |
| 1 hectare (ha) | = | 2.47 acres |

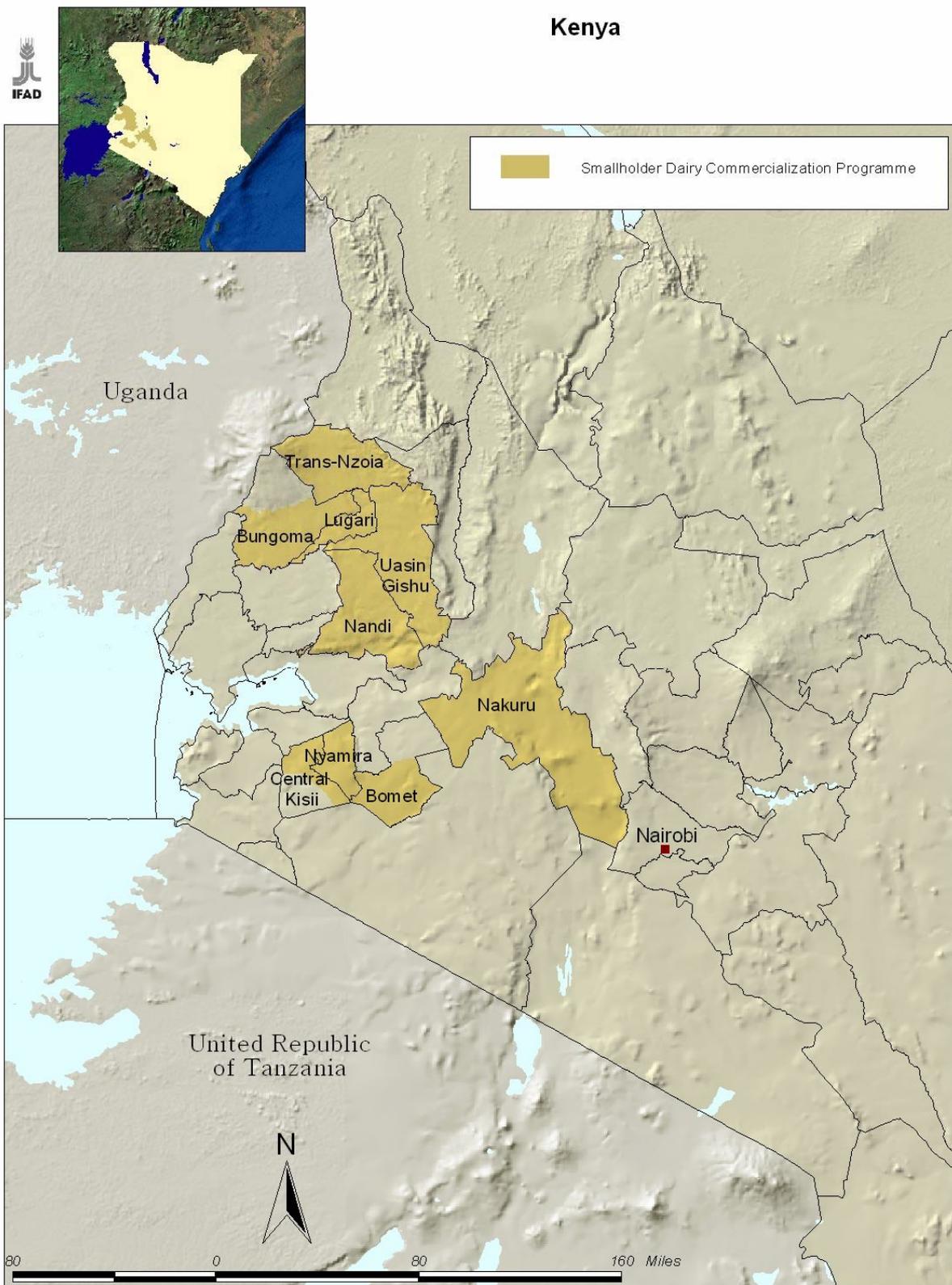
ABBREVIATIONS AND ACRONYMS

| | |
|-------|---------------------------------------|
| COSOP | country strategic opportunities paper |
| MODE | market-oriented dairy enterprise |
| PCU | programme coordination unit |

**GOVERNMENT OF THE REPUBLIC OF KENYA
Fiscal Year**

1 July – 30 June

MAP OF THE PROGRAMME AREA



Source: IFAD

The designations employed and the presentation of the material in this map do not imply the expression of any opinion whatsoever on the part of IFAD concerning the delimitation of the frontiers or boundaries, or the authorities thereof.

REPUBLIC OF KENYA**SMALLHOLDER DAIRY COMMERCIALIZATION PROGRAMME****FINANCING SUMMARY**

| | |
|---------------------------------------|--|
| INITIATING INSTITUTION: | IFAD |
| BORROWER: | Republic of Kenya |
| EXECUTING AGENCY: | Ministry of Livestock and Fisheries Development |
| TOTAL PROGRAMME COST: | USD 19.75 million |
| AMOUNT OF IFAD FINANCING: | Loan: SDR 12.0 million (equivalent to approximately USD 17.49 million) Grant: SDR 590 000 (equivalent to approximately USD 845 000) |
| TERMS OF IFAD LOAN: | 40 years, including a grace period of ten years with a service charge of three fourths of one per cent (0.75%) per annum |
| COFINANCIERS: | None |
| CONTRIBUTION OF RECIPIENT: | USD 920 000 |
| CONTRIBUTION OF BENEFICIARIES: | USD 500 000 |
| APPRAISING INSTITUTION: | IFAD |
| COOPERATING INSTITUTION: | United Nations Office for Project Services |

PROGRAMME BRIEF

The programme. The programme will promote a conducive environment for market-driven development of the informal dairy industry, and will work with smallholder dairy producers and traders to strengthen their capacity to respond to market opportunities by building their understanding of the market and their technical knowledge of production processes.

Who are the beneficiaries? The target group is made up of resource-poor dairy farmers and small-scale intensive dairy farmers with landholdings of less than 1.5 hectares, mobile milk traders and the operators of small milk bars and shops. Approximately 24 000 households engaged in dairy production and trading (representing about 120 000 people) organized into 600 groups in nine districts will benefit from the programme activities, including about 300 mobile milk traders and 90 milk bar operators. As women undertake a substantial share of dairy operations and head a significant number of households, it is expected that they will account for 65% of programme beneficiaries.

Why are they poor? The main reasons for their poverty are lack of resources, low levels of and inability to intensify production, and remoteness from the main market centres for dairy products. Low quality of feeds and inadequate feeding regimes, seasonal fluctuations in forage availability disrupting milk supply to the market, inefficient producer organization, weak rural infrastructure, and inadequate access to artificial insemination services all prevent the smallholder dairy sector from realizing its full potential. These constraints are in fact impeding the natural evolution of the industry towards a greater share of milk being sold to processors.

What will the programme do for them? The programme will foster the development of the smallholder dairy sector and related small-scale trading by enhancing the market orientation of operators. This is expected to result in an increase in production, traded products and incomes, and an improvement in nutritional status and food security, thus contributing to poverty reduction among the target groups of smallholder dairy farmers and informal milk market operators. The programme activities will be implemented over six years under five components: (a) organizational and enterprise skills; (b) technical support to smallholder dairy producers, (c) development of the milk-marketing chain, (d) support to policy and institutions, and (e) programme management and coordination.

How will the beneficiaries participate in the programme? The programme beneficiaries will participate through dairy farmers' groups and organizations. A market-oriented dairy enterprise process will assist these groups by promoting a stepwise movement towards becoming successful enterprises or business entities primarily concerned with milk or dairy products. Programme beneficiaries, together with other stakeholders, will participate actively in various consultation bodies to ensure that their constraints, problems and needs are taken into consideration. Initial cost-sharing graduating to self-reliance support for smallholder producers and small-scale processors underpins the private-sector market-oriented focus of the programme and is the key to ensuring long-term sustainability.

Programme cost and financing plan. The total cost of the six-year programme is USD 19.75 million, which will be financed with an IFAD loan of USD 17.49 million and an IFAD grant of USD 845 000 representing about 92.8% of total costs. The Government will cover taxes and duties for a total amount of USD 920 000 (4.7%), while the beneficiaries will contribute approximately USD 500 000, equivalent to 2.6% of the total programme costs. The bulk of loan financing will be directed at capacity-building for smallholder dairy producers and traders, while the IFAD grant will finance long-term technical assistance and policy reform.

**REPORT AND RECOMMENDATION OF THE PRESIDENT OF IFAD
TO THE EXECUTIVE BOARD ON PROPOSED FINANCIAL ASSISTANCE TO THE
REPUBLIC OF KENYA
FOR THE
SMALLHOLDER DAIRY COMMERCIALIZATION PROGRAMME**

I submit the following report and recommendation on proposed financial assistance to the Republic of Kenya comprising a loan for SDR 12.0 million (equivalent to approximately USD 17.49 million) on highly concessional terms and a grant for SDR 590 000 (equivalent to approximately USD 845 000) to help finance the Smallholder Dairy Commercialization Programme. The loan will have a term of 40 years, including a grace period of ten years, with a service charge of three fourths of one per cent (0.75%) per annum. Both the loan and the grant will be administered by the United Nations Office for Project Services as IFAD's cooperating institution.

PART I – THE ECONOMY, SECTORAL CONTEXT AND IFAD STRATEGY¹

A. The Economy and Agricultural Sector

1. **The economy.** Although only 18% of the country is suitable for agriculture, the unique climate and altitude characteristics of these areas have enabled Kenya to have a relatively advanced and highly diversified agricultural sector. Kenya is a well-established exporter of tea, horticultural products, coffee and pyrethrum, and has one of the best developed dairy subsectors in the region. Agricultural production is the mainstay of the economy, providing about 80% of export earnings, although its share in GDP has declined to about 16%. However, if agro-related activities are factored in then agriculture's share of GDP rises to over 50% and the sector remains the main source of livelihood for the majority of Kenyans. The agricultural sector is expected to generate most of the country's economic growth in the future and will be required to play a central role in attaining the Government's poverty reduction objectives. After stagnating for almost a decade, growth reached 4.3% in 2004 and is expected to rise to 5% this year, as a result of the increase in horticulture exports and tourism. Inflation remains low at about 3.5%, but will rise sharply this year as a result of increased oil prices.

2. **Poverty.** The current population of Kenya is estimated at about 31.5 million, and the Government reports that per capita income declined from USD 271 in 1990 to USD 239 in 2002. The proportion of the population living in poverty has risen from about 49% in 1990 to 56% in 2001. Kenya is ranked only 20th from the bottom in terms of human development indicators. The population growth rate is just 2.3%, but has risen this year. This low rate (compared to 4.1% ten years ago) is the combined result of successful family planning campaigns and the increasing toll from HIV/AIDS, now a major cause of death among young and middle-aged Kenyans. Three quarters of the poor live in rural areas. While the poorest inhabit the marginal (mostly arid) lands in the north, over 85% of the poor live in the high- and medium-potential areas covering only 18% of the country.

3. **National policies for pro-poor growth.** In May 2003, the Government launched its Economic Recovery Strategy for Wealth and Employment Creation with a return to economic growth and poverty reduction as the principal objective. The strategy emphasizes: (a) progress in the area of governance and reduction of corruption; (b) addressing health and education; (c) continued structural

¹ See Appendix I for additional information.

reform of the economy; (d) equitable distribution and conservation of natural resources; and (e) promotion of the private sector. The Government has also initiated its Strategy for Revitalizing Agriculture (June 2003), assigning the agricultural sector a central role in generating poverty-reducing economic growth.

B. Lessons Learned from Previous IFAD Experience

4. **IFAD assistance and portfolio.** Over the past 20 years, Kenya has benefited from about USD 147 million in financial assistance – USD 129 million in loans and USD 18 million in Belgian Survival Fund grants.² Working in collaboration with the Government and on the basis of a physical and financial audit of outstanding financial claims for all loans and grants, non-performing projects have been closed and new procedures have been developed to address the complexity of the Government's budgeting processes. In 2000, with some progress towards resolution of financial and project management issues, IFAD approved its first new project for Kenya in over six years.

5. Since 2002, there has been a continuous process of problem diagnosis and discussion with the Government in order to arrive at feasible solutions to improve implementation. A number of issues have required strong and committed follow-up over several years by IFAD, and while progress has not been rapid, it has been positive and sustained. Each consensus reached has been applied across IFAD's ongoing projects and in the design of new projects. The principal lessons that have been taken into account for the proposed programme are:

- (a) In order to ensure timely implementation and transparent financial management, a project coordination unit needs to be established and staffed by competitively recruited personnel. Financial procedures have been simplified: IFAD has been overseeing the establishment of a rolling internal audit function by an audit firm for all IFAD-financed projects in Kenya, and will also be applied under this programme.
- (b) In contrast to previous IFAD interventions that were multisectoral, the proposed programme is focused only on the dairy sector and does not include social support measures, although substantial training will be provided to build capacity for empowerment.
- (c) To improve targeting, clear criteria have been developed for the geographical areas to be covered by the programme and specific target groups of poor dairy farmers and traders have been defined.
- (d) The environmental implications of all aspects of dairying have been examined to formulate sustainable approaches to be supported under the programme.
- (e) To improve the delivery of programme activities to the target groups, long-term technical assistance and policy work financed under an IFAD grant have been included.

C. IFAD Strategy in Kenya

6. While Kenya's agricultural sector continues to have substantial potential, the IFAD country strategic opportunities paper (COSOP)³ revealed the need to focus on the high- and medium-potential areas where the preponderant share of poor people are located. The COSOP underlined the serious situation relative to water access (in a country that is considered water-short by global standards) and the consequences of environmental degradation (which is undermining the potential for agricultural activities to provide sustainable livelihoods for poor rural people and endangering fragile ecosystems).

² See Appendix II for previous IFAD financing in Kenya.

³ Document EB 2002/76/R.10.

In line with IFAD's Strategic Framework, the areas of focus identified in the COSOP are: (a) building local governance capacity; (b) better water management for agriculture and environmental conservation; (c) strengthening market-based agricultural services and greater integration of the poor into national agricultural markets; and eventually (d) support for rural finance. By concentrating on poor people in densely populated rural areas, IFAD will be able to achieve greater impact with lower project management costs with its medium-sized loans of about USD 17.5 million under the Performance-Based Allocation System (PBAS), while also opening the way for a strong focus on market linkage support, in line with the Government's emphasis on agriculture as the principal growth sector for addressing poverty.

D. Rationale and Programme Approach

7. Kenya has one of the largest and most developed dairy subsectors in sub-Saharan Africa, accounting for over 3.5% of GDP and enjoying a growth rate of 4% per annum compared with 1.2% for agriculture as a whole. It is estimated that about 800 000 smallholder farmers presently depend on dairying for their livelihood, although the number may be as high as 1.2 million. These farmers generate jobs for a further 365 000 people, in addition to family labour. The dairy subsector creates demand for wage labour as well as mobile milk trading, and these jobs benefit the very poorest of the rural and urban populations. Annual milk consumption per capita in Kenya is estimated at 125-150 litres for urban dwellers and at only 20 litres for milk-purchasing households in rural areas, although households in milk-producing rural areas consume more than 20 litres per year. Nairobi is the main market for pasteurized packaged milk, followed by Mombasa, Kisumu and Nakuru.

8. With liberalization 15 years ago, the informal sector has become the dominant force in milk trading. About 42% of marketed milk is sold directly from the farm to consumers, and another 32% is sold directly to milk shops, bars and traders. **Thus, about 75% of traded milk is sold outside the processing sector.** This dominance by the informal sector is due to consumer preference for unprocessed milk and inefficiencies in the formal subsector. Informal traders pay higher farm-gate prices to producers than processors, and deliver milk to consumers at prices that are 40% lower than for processed packaged milk. While purchasers boil milk, there are concerns about the public health risks from informally marketed milk owing to the potential for adulteration and poor hygiene in milk handling.

9. For poor smallholder farmers, dairying has long been an activity that integrates and valorizes the benefits of the small farm, improving household nutrition and providing income. There are significant opportunities for increasing dairy sales both domestically and regionally: smallholders are well placed to produce milk, and Kenya already has existing processing capacity and is competitive regionally. There is also major potential for job creation in smallholder dairy production, processing and marketing systems.

10. The following constraints characterize the dairy subsector: inadequate access to markets, low quality of feeds and inadequate feeding regimes, seasonal fluctuations in forage availability disrupting milk supply to the market, insufficient access to artificial insemination services resulting in the use of bulls of unknown genetic potential, inadequate enforcement of regulations on livestock movement, limited and high cost of animal health care, weak rural infrastructure, and inadequate dairy cooperatives and farmer groups. These constraints are impeding the natural evolution towards an increasing share of marketed milk being sold to the formal sector.

11. **Programme role and focus.** Substantial work has already been undertaken relative to the policy framework under the recently closed Smallholder Dairy Project financed by the Department for International Development (DFID) of the United Kingdom of Great Britain and Northern Ireland, while the ongoing Kenya Dairy Development Programme financed by the United States Agency for International Development (USAID) focuses more upstream on larger producer groups and

processors. The private sector is playing an increasingly important role in service provision to producers but there are concerns regarding regulation of service and input quality. The proposed IFAD-supported programme will empower small-scale resource-poor and intensive dairy farmers to raise their milk production, and will support the ongoing process of policy dialogue and reform relating to the dairy subsector, especially with respect to measures to address public health concerns.

12. **Grass-roots approach.** The low level of understanding by smallholder dairy producers of the inputs critical for maintaining and raising milk production means that producers are not demanding the services that they should as market operators. To complement and strengthen the private-sector response, smallholder dairy producers need to understand the critical importance of key services (such as feed, artificial insemination services, adequate health care), and to demand access to such services at competitive prices. Furthermore, they need strengthened enterprise skills in order to earn reasonable income. Smallholder dairy producers also need to be better informed about how the technical choices they make for animal management affects their income. As dairying is important for women, gender proportionality will be respected in all programme activities.

13. A **market-oriented dairy enterprise (MODE)**⁴ process will be at the centre of the programme's approach. The MODE process will help programme beneficiaries gradually increase their income from milk and dairy products. The three pillars of the approach are farmers' participation and empowerment, demand-driven service delivery, and partnerships. The MODE approach is also characterized by a stepwise movement towards becoming a successful business entity primarily concerned with milk or dairy products. There are three steps to the approach: at step 1: groups exist or are set up and operating; at step 2: there is a low level of activity, with some degree of market participation and limited returns; at step 3: a full market-oriented approach is adopted by the beneficiaries and a successful enterprise is put in place.

14. Programme interventions are targeted to support the progressive movement of groups or individuals through the three MODE steps.

- (a) **At step 1** there is increasing collective activity (for example, in the form of contact with input suppliers to purchase feed in bulk) and a clear increase in incomes. Evidence of consistent successful activity (measured at this low level in terms of volume or a slightly increased profit level) will indicate that the group can move on to the next level. The group or individual will decide when and how to take the next step.
- (b) **Step 2.** Following a period of time and based on their broadened perspectives and understanding of market opportunities, the group may decide to build up capacity to expand and assume a higher level of risk. This is a key limiting factor in current group development and represents the most significant step in the MODE process. The bulk of programme resources will support technical training activities to help beneficiaries gain the knowledge to cope with risk.
- (c) **At Step 3,** groups become organized as business entities, and expand and consolidate their activities. They should also be able to demonstrate that they have sustained dairy-based activities generating a profit that provides regular incomes to their members. The entity (for example, a self-help group, women's group, cooperative or company) can then be considered to have progressed to maturity.

15. **Exit strategy.** Programme design makes provision for the start-up of beneficiary organizations from the local to the national level, emphasizes initial cost-sharing graduating to self-reliance, and

⁴ On the basis of a number of successful activities piloted and tested by the Food and Agriculture Organization of the United Nations (FAO) for dairying, the formulation mission has developed the MODE approach, which has been reviewed and finalized by the appraisal mission and the Government.

underscores and supports the move towards private-sector market-oriented development of smallholder producers and small-scale processors and traders as the key to sustainability of programme benefits. By the end of the programme, a range of commercially sustainable and interlinked dairy businesses should be in place, integrated with suppliers of physical and financial goods and services. This will be complemented by a system of representation for smallholders and small-scale processors and traders at local and national stakeholder forums to assure the advancement of their economic interests, and that these interests are reflected in the policy and legal environments. Following evaluation of the approach of the programme by IFAD and the Government, consideration will be given to whether or not the approach should be extended to cover other milk-producing areas of the country.

PART II – THE PROGRAMME

A. Programme Area and Target Group⁵

16. **Programme area.** Specific areas have been identified within nine districts,⁶ on the basis of a Geographical Information System analysis of a series of indicators for milk production and production potential; market access; and incidence of rural poverty. Within the nine districts, 42%-64% of the population is poor.

17. **Target group.** The identification of the target groups has been based on knowledge built up in recent years in Kenya about the informal dairy sector through Government and research experience. The target groups will be resource-poor dairy farmers and small-scale intensive dairy farmers cultivating less than 1.5 hectares; crop-oriented poor farmers with one or more dairy cows and part-time small farmers; mobile milk traders; and small-scale operators of milk bars and shops. About 36% of resource-poor dairy farms are headed by women, and studies have shown that even in households headed by men, women largely have exclusive control of income from dairying. For these reasons, it is expected that about 65% of the direct beneficiaries of the programme will be women.

18. **Targeting approach.** The programme will work on the basis of dairy commercialization areas (DCAs), each made up of a cluster of 500 to 800 smallholder dairy farmers in the nine selected districts. DCAs will be selected on the basis of poverty, market access and milk production criteria for areas where the majority of dairy farmers fall within the four smallholder dairy farmer categories and the two categories of small-scale milk traders identified by the programme. Within the DCA, smallholder dairy groups will be an entry point for interventions. The identified dairy groups will prepare dairy enterprise plans, start and manage their commercialization activities, and move through the MODE process.

B. Goal and Purposes

19. The overall goal of the programme is to increase the incomes of poor rural households that depend substantially on the production and trade of dairy products for their livelihoods. The programme has two purposes: (a) increasing the financial returns of market-oriented production and trade activities by small operators, through improved information on market opportunities, raised productivity, cost reduction, value adding, and more reliable trade relations; and (b) the generation of self-employment and other income opportunities for rural households by the market-oriented dairy activities resulting from strengthened farmer organizations. The programme will work with the Government to enhance the environment for market-driven private-sector development of the dairy

⁵ An extensive targeting study entitled “Targeting Pro-Poor Investment in the Kenyan Dairy Subsector” has been commissioned by IFAD from the Nairobi-based International Livestock Research Institute (ILRI) in December 2003.

⁶ See map for location and names of the programme districts.

industry, and with groups of smallholder dairy producers and traders to strengthen their capacity to respond to market opportunities.⁷

C. Components

20. **Organizational and enterprise skills.** The programme will provide beneficiaries with the organizational, managerial and enterprise skills necessary for them to benefit fully from formal, market-driven commercialization of production, processing and trading. The activities to be financed include: local sensitization workshops, and baseline and training needs surveys; educational exchange tours; and pilot small-scale milk processing and biogas units in each participating district. In addition there will be substantial capacity-building of groups of smallholder dairy producers, processors and traders to move through the MODE process by contracted service providers such as the Dairy Training Institute. A participatory and inclusive approach will be adopted to ensure that individuals, and new and established groups of dairy producers, processors and traders, self-help groups and women's groups, and cooperative societies improve their operations on a solid business footing.

21. Training topics will cover: group dynamics, membership, roles and participation, and gender equity; bookkeeping and accounting, enterprise skills, managerial skills, business contracting, business development and planning, business negotiation and ethics; and general dairy herd management (clean milk production, calf and replacement-heifer rearing, pasture and fodder production, disease control and treatment, and basic dairy feeding principles). Social topics will also be dealt with, such as good nutrition, awareness-raising about HIV/AIDS, environmental conservation, waste disposal and production of biogas; and milk-loss-reducing technologies. Support will be provided to help develop financial products for dairy enterprises by financial service providers. Technical support will be provided to promote linkages between existing financial operators and dairy groups, so that MODE groups are able to prepare bankable investment proposals for local financial operators.

22. **Technical support to smallholder dairy producers.** This component addresses the production issues that currently constrain smallholder dairy farmers' ability to produce milk. To raise productivity, the component will support measures to increase fodder and feed production, improve farmers' understanding of the role of genetics and breeding for dairy animals; technical training in disease control; milk quality assurance and proper handling by small-scale milk traders; and the promotion of low-cost, labour-saving technologies and practices.

23. With regard to feed resources, the programme will promote the development of extension materials and extension support for on-farm feed formulation, the mixing and use of crop and other residues, fodder/crop rotation systems, and optimization of locally available feeds and fodder. Extension will also focus on improved fodder production and conservation, feed strategies, utilization and rationing of dry season fodder and feed, the promotion of small-scale feed mills, the establishment and operation of fodder bulking sites, and fodder disease control. Training on the importance of unlimited water for lactating cows and on simple household rainwater-harvesting techniques (roof catchment) will also be provided. In addition to training dairy farmers on the significance of genetic potential in milk production, the programme will fund a review of the use of artificial insemination services in the nine districts, and will develop mechanisms to incorporate the smallholder dairy farmers into national breeding programmes and design an appropriate smallholder breed recording system. The programme will also fund a study on the incidence of tick-borne diseases.

24. **Development of the milk marketing chain.** This component focuses on improving market linkages for small-scale milk producers, traders and processors to local milk markets and increases

⁷ See Appendix III for the programme's logical framework.

their access to the formal processing sector. The programme will also support improved contractual arrangements between target groups and milk collectors, cooling centres and larger processors to boost the returns from their milk and dairy products. Marketing and negotiation skills will be a key aspect of capacity-building activities to improve market linkages and access to markets by smallholders. To provide regular market information on dairy products and animal production inputs, the programme will set up a low-cost market information system at the Dairy Information Centre of the Kenya Dairy Board. Gradual adoption of dairy product standards will be encouraged through awareness-raising and capacity-building for milk producers, processors, traders and consumers. The programme will also finance two studies, one on the rural road infrastructure needs of dairy farmers and a feasibility study on initiating a school milk programme. With financing from the IFAD grant, a subprogramme for goat's milk production and marketing by very poor women will also be designed and operationalized.

25. **Support to policy and institutions.** This component will contribute to the creation of policy and legal environments that enable smallholder milk producers and small-scale milk processors and milk traders to meet their economic development needs. The focus of policy work will be on modernizing the legal framework so that it takes account of the informal dairy sector, and strengthening key institutions within the subsector to ensure service provision within a liberalized framework. The programme's policy work will concentrate on supporting the stakeholder consultation process for the pending Dairy Bill, the finalization of the draft Feed Policy, the revision of the Feed and Fertilizer Bills, the development of a National Breeding Policy, and a strategic restructuring study for the Central Artificial Insemination Station. Given the innovative nature of the MODE process, specific training materials and programmes will be developed that are appropriate for dairy farmers and traders. Three years of technical assistance will be provided to the Dairy Training Institute, and the institute will also benefit from curriculum and infrastructure development to strengthen its capacity to provide training in enterprise, organization and technical skills for smallholder dairy and milk trader groups.

26. **Programme management and coordination.** A programme coordination unit (PCU) will be established in Nakuru to coordinate the proposed activities and supervise field implementation of programme interventions in accordance with annual workplans and budgets. The PCU will be responsible for administration and coordination of programme implementation; developing market-oriented training materials and approaches and the contracting of required services; liaison with other dairy donor-supported activities; and programme reporting.

D. Programme Costs and Financing

27. **Costs.** The programme will be implemented over six years at an estimated total cost of USD 19.75 million. The total foreign exchange element is USD 4.17 million, or about 21% of total costs. The programme costs by component are summarized in Table 1 below.

TABLE 1: SUMMARY OF PROGRAMME COSTS BY COMPONENT^a
(USD million)

| Components | Local | Foreign | Total | % of Foreign Exchange | % of Base Costs |
|--|--------------|-------------|--------------|-----------------------------|--------------------|
| Organizational and enterprise skills | 4.15 | 0.63 | 4.78 | 13 | 26 |
| Technical support to smallholder dairy producers | 3.34 | 0.84 | 4.18 | 20 | 22 |
| Development of the milk marketing chain | 2.25 | 0.64 | 2.89 | 22 | 16 |
| Support to policy and institutions | 1.86 | 1.02 | 2.88 | 36 | 16 |
| Programme management and coordination | 3.04 | 0.80 | 3.84 | 21 | 21 |
| Total base costs | 14.64 | 3.93 | 18.57 | 21 | 100 |
| Physical contingencies | 0.08 | 0.06 | 0.14 | 42 | 1 |
| Price contingencies | 0.85 | 0.18 | 1.04 | 18 | 6 |
| Total programme costs | 15.58 | 4.17 | 19.75 | 21 | 106 |

^a Discrepancies in totals are due to rounding.

28. **Financing plan.** The programme will be financed by IFAD, the Government and programme beneficiaries. IFAD will contribute a total of USD 18.33 million, or 92.8% of total programme costs, of which USD 17.49 million will be a loan on highly concessional terms and USD 845 000 will be in the form of a country-specific grant. The IFAD grant will finance long-term international technical assistance, policy development, the stakeholder validation process, and pilot activities in goat's milk production for women.⁸ The Government will cover taxes and duties for a total amount of USD 920 000 (4.7%). The beneficiaries contribution to testing feed technologies and cooling/processing plants is valued at about USD 500 000, or 2.6% of total programme costs, and will be in the form of labour, materials and cash. The programme financing plan by component is presented in Table 2 below.

⁸ Grant-financed activities are indicated by italics in the programme's logical framework provided in Appendix III.

TABLE 2: SUMMARY OF PROGRAMME FINANCING PLAN^a
(USD million)

| Components | Government | | IFAD Loan | | IFAD Grant | | Beneficiaries | | Total | | Foreign Exchange | Local (Excl. Taxes) | Duties and Taxes |
|--|-------------|------------|--------------|-------------|-------------|------------|---------------|------------|--------------|--------------|------------------|---------------------|------------------|
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | | | |
| Organizational and enterprise skills | 0.03 | 0.6 | 5.00 | 98.2 | - | - | 0.06 | 1.2 | 5.09 | 26.0 | 0.67 | 4.39 | 0.03 |
| Technical support to smallholder dairy producers | 0.16 | 3.7 | 4.06 | 91.4 | - | - | 0.22 | 4.9 | 4.45 | 22.7 | 0.89 | 3.39 | 0.16 |
| Development of the milk marketing chain | 0.07 | 2.2 | 2.68 | 87.5 | 0.11 | 3.0 | 0.22 | 7.2 | 3.08 | 15.6 | 0.68 | 2.33 | 0.07 |
| Support to policy and institutions | 0.23 | 8.1 | 2.06 | 71.2 | 0.73 | 20.6 | - | - | 3.02 | 15.3 | 1.07 | 1.73 | 0.23 |
| Programme management and coordination | 0.42 | 10.3 | 3.69 | 89.7 | - | - | - | - | 4.11 | 21.0 | 0.87 | 2.83 | 0.42 |
| Total programme costs | 0.92 | 4.7 | 17.49 | 89.2 | 0.84 | 3.5 | 0.50 | 2.6 | 19.75 | 100.0 | 4.17 | 14.66 | 0.92 |

^a Discrepancies in totals are due to rounding.

E. Procurement, Disbursement, Accounts and Audit

29. **Procurement.** All goods and services financed from the IFAD loan will be procured in accordance with Government regulations and IFAD's procurement guidelines. Procurement of vehicles, equipment and materials will be bulked as far as possible. Goods expected to cost USD 200 000 or more will be procured on the basis of international competitive bidding. Goods costing less than USD 200 000 will be procured through limited international bidding, in which local suppliers may also participate. Contracts costing less than USD 50 000 and national technical assistance will be procured through limited local bidding. Limited international bidding will be used for international technical assistance. Contracting services of NGOs or consulting firms will be based on a model contract that will be prepared by the PCU and approved by IFAD and the cooperating institution.

30. **Disbursements.** An offshore special account denominated in United States dollars will be opened for the IFAD loan by the Central Bank of Kenya. Upon programme effectiveness and at the request of the Government, IFAD will deposit USD 600 000 into the special account to finance expenditures during the first six months. The special account will be periodically replenished in accordance with IFAD guidelines up to the authorized ceiling of USD 1 million against the submission of statements of expenditure and the justifying documentation for the amounts spent. An account will be opened at a commercial bank in United States dollars to receive the IFAD grant funds, and an initial deposit of USD 120 000 will be made into that account in order to finance policy-related expenditures and the recruitment of international technical assistance prior to the declaration of loan effectiveness.

31. **Financial and physical records.** The PCU will maintain accurate and up-to-date records of: (a) the special account and the grant bank account; (b) all programme account statements and statements of expenditure received from programme account-holders, including statement of expenditure receipt dates and details of all payment vouchers; (c) the PCU account; (d) all withdrawal applications submitted to the cooperating institution; and (e) an overall inventory of goods procured under the programme. The PCU will be responsible for checking the documents received from implementing agencies for completeness, consistency and timeliness, and will query any irregularities within 14 days of receipt.

32. **Internal rolling audit.** In line with the other projects funded by IFAD and the Government, technical assistance in the form of the internal rolling audit will be introduced with a view to building on the positive steps the Government has taken towards enhancing financial discipline, management and accountability. The main output of this technical assistance will be accurate and regular financial reports. The internal rolling audit will assist the PCU in identifying financial management bottlenecks as they arise and in facilitating appropriate and timely corrective action.

33. **Programme audit.** All accounts, including the special account and the grant bank account, and statements of expenditure for each fiscal year will be consolidated and audited by the National Audit Office. The audit report will be submitted in long form to IFAD and the cooperating institution within six months of the end of each fiscal year.

F. Organization and Management⁹

34. The lead executing agency for the programme will be the Ministry of Livestock and Fisheries Development. The lead agency will work with the Ministry of Cooperative Development and Marketing, the Department of Social Services (within the Ministry of Gender, Sports, Culture and Social Services) and the Ministry of Agriculture to provide extension services and community

⁹ See Appendix IV: Organigramme – Programme Organization and Management.

mobilization services. Other partners at the regional, district and divisional levels will be the Kenya Dairy Board, the Kenya Agricultural Research Institute, other relevant stakeholders in civil society and the private sector, and dairy farming groups.

35. A programme national steering committee composed of representatives from the concerned ministries and key stakeholders (processors, producers and traders) will be established and chaired by the Permanent Secretary of the Ministry of Livestock and Fisheries Development. The national steering committee will meet every six months and will ensure that programme activities are implemented in line with national policies and procedures, and are coordinated with other development programmes. The steering committee will review all programme reports and annual workplans and budgets. The programme coordinator will be the secretary to the committee.

36. The **PCU** will be established within the Ministry of Livestock and Fisheries Development and staffed by individually contracted competent personnel. The unit will be based in Nakuru and will be responsible for day-to-day programme coordination, the management of contracts and support services by implementing partners, the timely preparation of the annual workplans and budgets and supervision of programme implementation activities. An international technical advisor will be recruited for the first three years of the programme and will be based at the Dairy Training Institute in Naivasha.

37. A **district programme coordinating team** will be responsible for coordinating and supervising activities in each of the nine districts and will be composed of the relevant government technical officers, the regional officer of the Kenya Dairy Board, and representatives of the Kenya Agricultural Research Institute and any NGOs involved in dairy activities. The district livestock officer will be the focal point and will be responsible for the supervision and follow-up of implementation at the field level. In collaboration with the district programme coordinating team, criteria and arrangements for site and beneficiary selection will be finalized by the PCU for inclusion in the programme implementation manual. **Divisional planning and implementation teams** will undertake planning and implementation activities with dairy groups within dairy commercialization areas, including the preparation and follow-up of dairy enterprise plans with groups.

38. **Monitoring and evaluation.** The monitoring indicators for the programme have been developed in line with government standard indicators for development programmes and IFAD's Results and Impact Management System (RIMS), and data are expected to be disaggregated by gender.¹⁰ The programme will finance a baseline survey to establish data benchmarks, a mid-term review and a programme completion report.

G. Benefits and Economic Justification

39. **Beneficiaries.** The programme is designed to reach 24 000 households organized into 600 groups over six years. Assuming a 60% adoption rate of programme initiatives among group members, about 14 400 smallholder dairy farmers will be expected to benefit from the programme. The representation of semi-intensive (resource-poor) and intensive producers is expected to be 85% (12 240) and 15% (2 160) respectively. Furthermore, about 15% of the semi-intensive category are expected to graduate to an intensive system, while 300 traders and 90 milk bar operators/milk processors will also benefit. It is expected that about 65% of beneficiaries will be women.

40. **Benefits.** The programme will foster the development of the smallholder dairy subsector and related small-scale trading and their integration into the national milk market. This is expected to result in an increase in production, traded products and incomes, and improved nutritional status, thus contributing to poverty reduction among both the programme's direct target group – smallholder dairy

¹⁰ An initial set of indicators by component can be found under the "Objectively Verifiable Indicators" column of the programme's logical framework in Appendix III.

farmers – and the programme’s secondary target group – the rural and urban poor involved in the informal milk market. The programme will enhance the enterprise skills of the target group, promote greater efficiency in production methods and improve animal health. Returns on family labour are expected to increase by about 70% for semi-intensive dairy farming and 200% for intensive farming. Investments in simple processing equipment (coolers) have an internal rate of return of 132%-192%. Investments in small milk-trading activities have a rate of 389%, and investments in the activities of milk bar operators or small-scale processors have an internal rate of return of 298%. The overall rate of return for the programme is 25%, which drops to 17% if benefits are delayed by two years.

H. Risks

41. Milk prices in Kenya have been affected in the past by subsidized skimmed milk powder from developed countries and this risk still exists. However, overall global demand for dairy products is expected to grow in the coming years, and prices are predicted to remain relatively high. Furthermore, Kenya is part of the East African Community, which will adopt a common tariff of 25% on milk and dairy products in 2006. Since the programme seeks to avoid formalization of beneficiary groups other than to the extent that they become commercially oriented, viable enterprises, issues may arise about their legal status vis-à-vis access to financial services. The programme aims to address this risk by explicitly promoting better linkages with local financial service providers and providing training to groups on how to access financial services. In the past, the Government has been slow in approving legislation to support policy reforms for the dairy sector. However, there is now revitalized commitment by the Government to reform the dairy subsector, and the Dairy Policy has been unlinked from the draft Dairy Bill. The policy is expected to be finalized by the end of 2005, and the draft Dairy Bill should be submitted to the Cabinet by the end of 2006. Grant funds from IFAD will support these processes.

I. Environmental Impact

42. The environmental issues relevant to the proposed programme are: water pollution and depletion; disposal of animal waste; disposal of waste milk at the farm level; and milk-processing effluents. Two health hazards can be linked to dairy production. At the farm level, the manure and residual feed mixture become a breeding ground for flies that can transmit diseases. The non-biodegradable plastic bags widely used for milk packaging by informal milk traders could cause deaths in infants and livestock if ingested.

43. The programme will be implemented in areas receiving annual bimodal rainfall of 1 000 mm or more. At the farm level, the target groups practise mixed farming with efficient nutrient cycle management, so animal waste is unlikely to enter the natural water systems on which they depend for domestic use. Informal milk traders handle about 55% of milk produced and link producers directly to consumers – the remaining milk enters the market through the formal distribution channels. Any waste milk is used to feed calves or pigs. The milk processing plants promoted by the programme will comply with existing environmental management regulations relative to effluents from organic and inorganic waste. Measures to minimize the multiplication of flies will be included in training activities. With regard to packaging materials to be used by milk traders, the development of environmentally sustainable guidelines and regulations will be an output of the programme for the informal sector. The overall negative environmental impact of programme activities is likely to be minimal and the programme is classified as Category B.

J. Innovative Features

44. The programme’s focus on improving the productivity of the informal dairy subsector and its inclusion of milk hawkers in the target group will facilitate integration of the subsector into the formal milk value chain. The programme’s market orientation, substantial private-sector involvement and

systematic support along the milk and dairy product value chain are innovative in the Kenyan context. So too is the marked inclusion of programme beneficiaries in policy dialogue and legislative processes, thereby allowing many of them to contribute to subsector orientation and development. Other programme innovations include specific implementation modalities for targeting, information and technology in support of the MODE approach; contracting out private-sector service providers; and an activity to develop financial products suited to the dairy subsector.

PART III – LEGAL INSTRUMENTS AND AUTHORITY

45. A financing agreement between the Republic of Kenya and IFAD will constitute the legal instrument for extending the proposed financial assistance to the recipient. A summary of the important supplementary assurances included in the negotiated financing agreement is attached as an annex.

46. The Republic of Kenya is empowered under its laws to borrow from IFAD.

47. I am satisfied that the proposed financial assistance will comply with the Agreement Establishing IFAD.

PART IV – RECOMMENDATION

48. I recommend that the Executive Board approve the proposed financial assistance in terms of the following resolution:

“RESOLVED: that the Fund shall make a loan to the Republic of Kenya in various currencies in an amount equivalent to twelve million and one hundred thousand special drawing rights (SDR 12 100 000) to mature on or prior to 15 December 2045 and to bear a service charge of three fourths of one per cent (0.75%) per annum, and to be upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented to the Executive Board in this Report and Recommendation of the President.

RESOLVED FURTHER: that the Fund shall provide a grant to the Republic of Kenya in various currencies in an amount equivalent to five hundred and ninety thousand special drawing rights (SDR 590 000) and to be upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented to the Executive Board in this Report and Recommendation of the President.”

Lennart Båge
President

**SUMMARY OF IMPORTANT SUPPLEMENTARY ASSURANCES
INCLUDED IN THE NEGOTIATED FINANCING AGREEMENT**

(Negotiations concluded on 17 November 2005)

1. The Ministry of Livestock and Fisheries Development (the “Ministry”) of the Government of Kenya (the “Government”) will open and thereafter maintain – in a commercial bank proposed by the Government and acceptable to IFAD – a grant bank account denominated in local currency for the purpose of receiving grant proceeds to finance the programme. The grant bank account will receive funds from the grant account that have been paid into an exchequer account in United States dollars.
2. The Ministry will open and thereafter maintain – in a commercial bank proposed by the Government and acceptable to IFAD – a current account denominated in local currency for receiving financing agreement proceeds from the special account for the purpose of financing programme operations. The treasury of each programme district will open and thereafter maintain in the local branch of the same bank, an account in local currency to finance district programme operations.
3. **Rolling internal audit of Government/IFAD-funded projects.** The Government will solicit comments from the Attorney-General on the draft contract documents for the rolling internal audit and the financial capacity-building of ongoing Government/IFAD-funded projects to be carried out by the agreed-upon service provider, and will thereafter forward the contract documents to the respective accounting officers of the lead programme agencies for signing not later than 31 December 2005. The contract documents for the proposed programme will be signed by the accounting officer of the Ministry within three months of financing agreement effectiveness.
4. **Dairy policy and dairy industry bill.** The Ministry will engage in a consultative process with relevant dairy industry stakeholders to finalize a draft dairy policy and a dairy industry bill for submission to the Cabinet for approval not later than July 2006 and July 2007 respectively.
5. **Licence categories.** The Ministry will ensure that:
 - (a) licence categories for small-scale milk processors and for milk bar and shop operators are established not later than July 2006;
 - (b) the Kenya Dairy Board (KDB) develops a licence category with an accompanying training programme for smallholder dairy traders not later than December 2006; and
 - (c) the KDB examines the manner in which mobile milk traders are to be integrated into and recognized as part of the milk chain not later than December 2006, and develops an appropriate licence category not later than July 2007.
6. **Kenya Dairy Board.** The Ministry will ensure that the KDB’s board of directors has adequate smallholder representation from the dairy sector.
7. **Memorandum of understanding.** The Ministry will enter into a memorandum of understanding with the National Agricultural and Livestock Extension Programme to define areas of collaboration, in order to encourage synergy and avoid duplication of programme activities, not later than 30 December 2006.
8. **Gender focus – implementation, programme staffing and management.** The Government and each programme party will ensure that implementation modalities are gender-sensitive, that women beneficiaries are equally and fully represented in all programme activities and that women benefit adequately from the programme outputs. Gender training and the assistance of gender experts will be

provided under the programme. The equitable participation of women will be pursued within the PCU. The selection and appointment of key programme staff will be conducted in a gender-sensitive manner and, all other things being equal, preference will be given to women candidates.

9. **Pest management practices.** As part of maintaining the sound environmental practices required by IFAD, the Government will ensure that all implementing agencies observe appropriate pest management practices under the programme and, to that end, the Government will ensure that pesticides used under the programme do not include any pesticide proscribed by either the Food and Agriculture Organization of the United Nations or the World Health Organization.

10. **Insurance of programme personnel.** The Government will insure all programme staff against health and accident risks to the extent consistent with, and in accordance with procedures under, its customary practice in respect of its national civil service.

11. **Monitoring and evaluation.** The Government will ensure that the PCU establishes a participatory planning, monitoring and evaluation (PPM&E) system within 12 months of financing agreement effectiveness. The PPM&E system will be based on the findings of the baseline survey. The PPM&E indicators will be refined through a participatory process during the programme's first year, and will include the indicators required under IFAD's Results and Impact Management System (RIMS).

12. **Suspension.** IFAD will suspend, in whole or in part, the right of the Government to request withdrawals from the loan account if the audit report required by the financing agreement has not been satisfactorily completed within 12 months of the financial reporting period set forth therein.

13. **Conditions of effectiveness.** The following are specified as conditions precedent to the effectiveness of the financing agreement:

- (a) The Ministry has allocated to the PCU two four-wheel-drive vehicles in good working order (certified by the Ministry of Public Works), with drivers, and has renovated the office space within the compound of the district livestock production office in Nakuru to accommodate three professional PCU staff and their support staff;
- (b) the Government has duly opened the special account;
- (c) the financing agreement has been duly signed, and the signature and performance thereof by the Government has been duly authorized and ratified by all necessary administrative and governmental action; and
- (d) a favourable legal opinion, issued by the Attorney-General or other legal counsel acceptable to IFAD, and in form and substance acceptable to IFAD, has been delivered by the Government to IFAD.

14. **Conditions precedent to withdrawal**

- (a) The following are specified as conditions precedent to withdrawals from the loan account:
 - (i) The Ministry has signed contracts of employment with the programme coordinator, programme accountant and procurement officer;
 - (ii) The national steering committee has been duly established and has held at least one meeting, with minutes taken of the proceedings;
 - (iii) Dairy commercialization areas in each programme district for programme year 1 have been identified;

ANNEX

- (iv) The Ministry has shortlisted five suitably qualified and experienced candidates for the position of technical advisor of the Dairy Training Institute for final selection and approval by IFAD; and
 - (v) the Government has entered the budget estimates for programme year 1 into the printed estimates based on the annual workplan and budget approved by IFAD.
- (b) Notwithstanding paragraph (a) above, withdrawals up to a total of USD 130 000 may be made from the grant account for national technical assistance and workshops for policy support.

APPENDIX I

COUNTRY DATA

KENYA

| | | | |
|--|-----------------------|---|--------|
| Land area (km² thousand) 2002 1/ | 569 | GNI per capita (USD) 2002 1/ | 360 |
| Total population (million) 2002 1/ | 31.35 | GDP per capita growth (annual %) 2002 1/ | -0.9 |
| Population density (people per km²) 2002 1/ | 55 | Inflation, consumer prices (annual %) 2002 1/ | 2 |
| Local currency | Kenyan Shilling (KES) | Exchange rate: USD 1 = | KES 76 |
| Social Indicators | | Economic Indicators | |
| Population (average annual population growth rate) 1996-2002 1/ | 2.3 | GDP (USD million) 2002 1/ | 12 330 |
| Crude birth rate (per thousand people) 2002 1/ | 35 | Average annual rate of growth of GDP 1/ 1982-1992 | 4.4 |
| Crude death rate (per thousand people) 2002 1/ | 16 | 1992-2002 | 2.0 |
| Infant mortality rate (per thousand live births) 2002 1/ | 78 | Sectoral distribution of GDP 2002 1/ | |
| Life expectancy at birth (years) 2002 1/ | 46 | % agriculture | 16 |
| Number of rural poor (million) (approximate) 1/ | n/a | % industry | 19 |
| Poor as % of total rural population 1/ | n/a | % manufacturing | 13 |
| Total labour force (million) 2002 1/ | 16.3 | % services | 65 |
| Female labour force as % of total 2002 1/ | 46 | Consumption 2002 1/ | |
| Education | | General government final consumption expenditure (as % of GDP) | 19 |
| School enrolment, primary (% gross) 2002 1/ | 96 a/ | Household final consumption expenditure, etc. (as % of GDP) | 71 |
| Adult illiteracy rate (% age 15 and above) 2002 1/ | 16 | Gross domestic savings (as % of GDP) | 10 |
| Nutrition | | Balance of Payments (USD million) | |
| Daily calorie supply per capita | n/a | Merchandise exports 2002 1/ | 2 094 |
| Malnutrition prevalence, height for age (% of children under 5) 2002 3/ | 35 a/ | Merchandise imports 2002 1/ | 3 277 |
| Malnutrition prevalence, weight for age (% of children under 5) 2002 3/ | 21 a/ | Balance of merchandise trade | -1 183 |
| Health | | Current account balances (USD million) | |
| Health expenditure, total (as % of GDP) 2002 1/ | 8 a/ | before official transfers 2002 1/ | n/a |
| Physicians (per thousand people) 2002 1/ | n/a | after official transfers 2002 1/ | 84 |
| Population using improved water sources (%) 2000 3/ | 57 | Foreign direct investment, net 2002 1/ | 50 |
| Population with access to essential drugs (%) 1999 3/ | 0-49 | Government Finance | |
| Population using adequate sanitation facilities (%) 2000 3/ | 87 | Overall budget deficit (including grants) (as % of GDP) 2002 1/ | n/a |
| Agriculture and Food | | Total expenditure (% of GDP) 2002 1/ | n/a |
| Food imports (% of merchandise imports) 2002 1/ | 12 | Total external debt (USD million) 2002 1/ | 6 031 |
| Fertilizer consumption (hundreds of grams per ha of arable land) 2002 1/ | 314 a/ | Present value of debt (as % of GNI) 2002 1/ | 37 |
| Food production index (1989-91=100) 2002 1/ | 124 | Total debt service (% of exports of goods and services) 2002 1/ | 14 |
| Cereal yield (kg per ha) 2002 1/ | 1 484 | Lending interest rate (%) 2002 1/ | 19 |
| Land Use | | Deposit interest rate (%) 2002 1/ | 6 |
| Arable land as % of land area 2002 1/ | 8 a/ | | |
| Forest area as % of total land area 2002 1/ | 3 a/ | | |
| Irrigated land as % of cropland 2002 1/ | 2 a/ | | |

a/ Data are for years or periods other than those specified.

1/World Bank, World Development Indicators CD ROM 2004

2/UNDP, *Human Development*, 2000

3/UNDP, *Human Development*, 2004

PREVIOUS IFAD FINANCING IN KENYA

| Loan/Grant Number | Project Name | Approved | Current | Board Approval | Loan/Grant Effectiveness | Current | Cooperating Institution | Project Status | Disbursed of Approved |
|----------------------------------|---|--------------------|-------------------|----------------|--------------------------|--------------|-------------------------|----------------|-----------------------|
| | | Amount (USD) | Amount (USD) | | | Closing Date | | | |
| A. Investment Projects | | | | | | | | | |
| 25 | Second Integrated Agriculture Development Project | 17,000,000 | 2,184,000 | 18-Dec-79 | 19-Jun-80 | 30-Jun-90 | WB/IDA | Closed | 15% |
| 132 | National Extension Project | 6,000,000 | 4,961,000 | 13-Sep-83 | 22-Dec-83 | 30-Jun-91 | WB/IDA | Closed | 83% |
| 188 | Animal Health Services Rehabilitation Programme | 8,000,000 | 6,734,000 | 30-Apr-86 | 2-Dec-87 | 31-Dec-93 | WB/IDA | Closed | 84% |
| 238 | Kwale and Kilifi District Development Project | 8,000,000 | 3,565,000 | 25-Apr-89 | 13-Mar-90 | 30-Jun-96 | WB/IDA | Closed | 45% |
| S-27 | Coast Arid and Semi-Arid Lands Development Project | 15,700,000 | 14,201,000 | 12-Dec-90 | 9-Jul-92 | 30-Jun-00 | UNOPS | Closed | 54% |
| S-39 | Eastern Province Horticulture & Traditional Food Crops | 10,970,000 | 8,887,089 | 2-Dec-93 | 14-Jul-94 | 31-Dec-07 | UNOPS | Ongoing | 62% |
| 366 | Western Kenya District-Based Agricultural Dev. Project | 11,650,000 | 6,228,000 | 5-Dec-94 | 27-Jun-95 | 31-Dec-03 | UNOPS | Closed | 15% |
| 422 | Second National Agricultural Extension Project | 9,370,000 | 747,000 | 11-Sep-96 | 29-Nov-96 | 31-Mar-98 | WB/IDA | Closed | 8% |
| 547 | Central Kenya Dry Areas Project | 10,920,000 | 10,919,000 | 7-Dec-00 | 1-Jul-01 | 31-Mar-09 | UNOPS | Ongoing | 22% |
| 599 | Mount Kenya East Pilot Project for NRM | 16,740,000 | 16,740,000 | 11-Dec-02 | 1-Jul-04 | 31-Mar-12 | UNOPS | Ongoing | 3% |
| 620 | Southern Nyanza Community Development Project | 15,557,000 | 15,557,000 | 18-Dec-03 | 10-Aug-04 | 31-Mar-12 | UNOPS | Ongoing | 8% |
| Total Investment Projects | | 129,907,000 | 90,723,089 | | | | | | |
| B. Grant Projects | | | | | | | | | |
| BSF-1-KE | Pilot - Farmer's Group and Com. Support Project (Siaya) | 1,860,000 | 1,860,000 | 4-Jan-85 | 4-Jan-85 | 14-Jan-92 | UNOPS | Closed | 100% |
| BSF-7-KE | Farmers'Group and Community Support Project | 6,500,000 | 5,785,000 | 11-Dec-90 | 18-Oct-91 | 31-Dec-96 | UNOPS | Closed | 89% |
| BSF-6-KE | Nyeri - Dry Area Project | 3,500,000 | 2,345,000 | 29-May-91 | 18-Oct-91 | 31-Dec-01 | UNOPS | Closed | 67% |
| BSF-2-KE | Kwale and Kilifi District Development Project | 215,000 | 197,800 | 7-Sep-93 | 7-Sep-93 | 30-Jun-97 | IFAD | Closed | 92% |
| BSF-6-Sup02 | Kenya Women Finance Trust - Phase I | 210,000 | 210,000 | 7-Sep-93 | 7-Sep-93 | 31-Dec-96 | IFAD | Closed | 100% |
| BSF-6-KWFT | Kenya Women Finance Trust - Phase II | 750,000 | 720,000 | 26-May-97 | 26-May-97 | 30-Sep-02 | IFAD | Closed | 96% |
| BSF-33-KE | Central Kenya Dry Area Project | 4,100,000 | 4,100,000 | 30-Oct-00 | 1-Jul-01 | 31-Mar-09 | UNOPS | Ongoing | 39% |
| BSF-11-Sup | Kenya Women Finance Trust - Phase III | 1,500,000 | 1,500,000 | 6-Oct-03 | 2-Apr-04 | 31-Dec-09 | IFAD | Ongoing | 26% |
| Total Investment Projects | | 18,635,000 | 16,717,800 | | | | | | |

LOGICAL FRAMEWORK

| Narrative Summary | Objectively Verifiable Indicators (OVIs) ^a | Means of Verification (MOV) | Assumptions |
|---|--|--|--|
| <p>Development Goal To increase the income of poor rural households that depend substantially on production and trade of dairy products for their livelihoods</p> | <ul style="list-style-type: none"> Household income | <ul style="list-style-type: none"> Baseline and impact surveys Household surveys | <ul style="list-style-type: none"> Relevant legislation framework enacted and enforced Relevant policy approved by government |
| <p>Programme Purposes (i) to improve the financial returns of market-oriented production and trade activities in the smallholder dairy sub-sector (ii) to expand dairy related employment and income-generating opportunities in rural areas</p> | <ul style="list-style-type: none"> Volume and share of milk marketed/total produced Average price of milk at farm-gate Lower production costs per litre of milk No. of new jobs and enterprises in the dairy sector | <ul style="list-style-type: none"> Baseline and impact surveys PCU monitoring and evaluation (M&E) reports Price records from low cost market information system (LCMIS) Household surveys Group enterprise reports/records | <ul style="list-style-type: none"> Equitable conditions for dairy sub sector trade in the East African Community Ongoing demand for milk and dairy products |
| <p>Outputs (by component)</p> | | | |
| <p>A. Organizational and Enterprise Skills Smallholder dairy sub-sector market orientation is enhanced through: A.1 improved group organization A.2 training delivered to groups A.3 MODE approach applied A.4 enhanced capacity of farmers, traders and small-scale processors for business planning and enterprise development research/analysis (MODE/individuals) A.5 improved dairy enterprise financing available A.6 dairy enterprise plans A.7 improved negotiation skills and contracts</p> | <ul style="list-style-type: none"> Group constitution elaborated and used 500 groups trained in improved milk production, reduced losses and enterprise development broken down by gender Increased sales' value by 15% Profitable balance sheet Enterprise Plans prepared by groups At least five financial Dairy Enterprises Products developed One plan finalized per group Improved contracts developed between producers and processors/traders | <ul style="list-style-type: none"> Groups'/individual records (M&E system) Training reports from service provider/training institution Groups'/individual records (M&E system) Dairy Enterprise Plans prepared and printed for the group PCU activity reports/technical consultant reports Number of entrepreneurs accessing financial products Written model contracts available | <ul style="list-style-type: none"> Current policy and legal framework are supportive of group activities Timely implementation of group development and range of capacity-building activities by PCU/service providers/training institutions |

^a OVI's in *italics** indicate programmed activities to be financed by an IFAD grant of USD 845 000

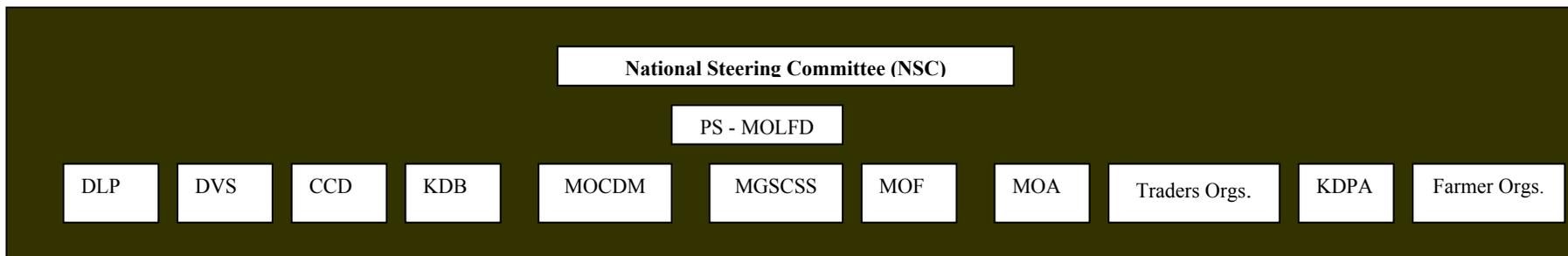
| Narrative Summary | Objectively Verifiable Indicators (OVIs) ^a | Means of Verification (MOV) | Assumptions |
|---|---|--|--|
| <p>B. Technical Support to Smallholder Dairy Producers Smallholder dairy farming productivity enhanced and production costs reduced through:</p> <p>B.1 increased technical capacity on appropriate feed strategies (production, sources, conservation and utilization of fodder) and enhanced availability of good quality feed and fodder</p> <p>B.2 establishment of small-scale feed mills</p> <p>B.3 improved linkages to commercial inputs stockists</p> <p>B.4 reduced cost of milk production</p> <p>B.5 improved capacity of public and private sector providers to deliver good quality and cost-effective AI/breeding and other technical services</p> | <ul style="list-style-type: none"> • 25% increase in fodder production at farm level • Fodder availability at farm level during the dry season • Number of small-scale mills established and functioning • Number of small-scale dairy farmers using industrial/purchased inputs (fertilizers, concentrates fodder seeds, etc.) broken down by gender. • Milk production cost reduced by 23% • 10% increase in no. of farmers using by gender artificial insemination (AI) services • Less than two AI shots/cow on average • Smallholders actively involved in the breeding services by gender | <ul style="list-style-type: none"> • Farm-level records and surveys (M&E system) • Impact surveys • Stockist records • Annual reports • Farm-level records and surveys (M&E system) • Reports of AI service providers • Dairy Recording System Kenya • Less than two shots per cow • Membership records of breeding organizations | <ul style="list-style-type: none"> • Milk price remains attractive • High competition among producers for farmers milk • Harmonization/privatization of breeding and AI service provision |
| <p>C. Development of the Milk Marketing Chain Market linkages of smallholder dairy farmers strengthened through:</p> <p>C.1 establishment of an effective LCMIS</p> <p>C.2 Dairy Information Centre set up</p> <p>C.3 information gathering and elaboration of a strategy for local infrastructure improvement (e.g. roads)</p> <p>C.4 groups of dairy farmers and milk enterprises better able to market their products</p> <p>C.5 improved linkages with existing financial service providers</p> <p>C.6 short-term training on milk processing</p> <p>C.7 successful School Milk Programme tested and ready for up-scaling</p> <p>C.8 <i>Goat milk production and marketing*</i></p> | <ul style="list-style-type: none"> • No. of clients requesting info from zero baseline by gender • Cost-recovery/sustainability by end of programme • No. of users grow by 25%/year after PY2 by gender • Opportunity cost/feasibility report produced and shared with community • Uptake of strategy by Government/other partners • No of groups trained broken down by gender • No. of post-harvest projects financed by gender • No. of new dairy financial products mainstreamed by FIs • 65 short term training courses held, attendance by gender • Uptake of School Milk Programme by Government/other partners • 12 pilot programmes set up • <i>No of women's groups provided with goats on cost sharing basis, additional income generated*</i> | <ul style="list-style-type: none"> • Service-provider annual reports • PCU annual reports • KDB report • Funding approval/project documents from CDF/Local Authority Transfer Fund or other funding partner • PCU annual reports • Annual reports of FIs • PCU/Training reports • Funding allocated by Government/other partners • PCU activity reports • PCU activity reports and household surveys | <ul style="list-style-type: none"> • Kenya Dairy Board (KDB) focuses on information needs of smallholder dairy farmers • Sufficient research capacity to design and carry out study • Dynamic financial institutions (FIs) interested to target market-oriented dairy sector • No liquidity constraints among FIs serving smallholder dairy sector • Government/schools interested in School Milk Programme |

^a OVI's in *italics** indicate programmed activities to be financed by an IFAD grant of USD 845 000

| Narrative Summary | Objectively Verifiable Indicators (OVIs) ^a | Means of Verification (MOV) | Assumptions |
|--|--|--|--|
| <p>D. Support to Policy and Institutions A conducive environment for the development of the smallholder dairy sub-sector created through:</p> <p>D.1 <i>policy and legal frameworks suitable to and agreed upon by relevant stakeholders*</i></p> <p>D.2 strengthening of key institutions relevant to the dairy sector in a liberalized environment (KDB and Central Artificial Insemination Station [CAIS])</p> <p>D.3 upgrading of Dairy Training Institute (DTI) to better respond to the needs of a market-oriented dairy sector</p> <p>D.4 improved research and service oriented training made available</p> <p>D.5 small dairy cooling/processing units successfully tested for technical, financial and market viability</p> <p>D.6 improved milk/dairy products quality standards</p> | <ul style="list-style-type: none"> • Improved government communications • <i>Consultative forums on Dairy Bill complete*</i> • <i>Draft feed policy prepared*</i> • <i>Feed and Fertilizer Bills finalized*</i> • <i>Strategic plan for breed harmonization prepared*</i> • <i>Strategic plan for AI Service Provision prepared*</i> • Shared/satisfactory set of rules, regulations and guidelines governing operations of milk traders • 20% increase in no. of milk traders registered with KDB and licensed to operate legally • Course curricula upgraded/tailored to users' needs • 30% increase in training requests service by dairy operators (by gender) • >10 training modules developed • <i>TA recruited and providing technical support*</i> • Proven financial and technical viability of five types of improved cooling/heating processing units • 30% decrease in bacterial counts in milk traded • 10% increase in no of milk traders registered and trained | <ul style="list-style-type: none"> • Response time to enquiries, improved inter-ministerial networking on dairy information • Gazetting of Bills and government/Cabinet approval of policy • Plan printed by Government following stakeholder consultations • New training guidelines printed and distributed • KDB registrations records • 20% increase in demand for training places after year 2 • Curriculum printed and training capacity defined • Training modules printed • 50% increase in no of training courses delivered • Report on techno-economic assessment of cooling/processing units • Milk quality testing by service provider • KDB records | <ul style="list-style-type: none"> • The Government will continue to support the changes in policy to ensure autonomy and financial sustainability of KDB and CAIS. • Sufficient staff capacity at DTI • Appropriate relevant training programmes by DTI • Sufficient local market for post-harvest processed products |
| <p>E. Programme Management and Coordination Effective coordination, management and implementation of programme activities</p> | <ul style="list-style-type: none"> • PMU established, fully staffed and actually managing activities in programme areas and addressing gender barriers and HIV/AIDS awareness building • Annual workplans and budgets (AWPBs) timely prepared and approved • Percentage of realizations/disbursement of AWPBs | <ul style="list-style-type: none"> • PCU reports • AWPBs • Bank statements • Annual External Audit Reports • Supervision Mission Report | <ul style="list-style-type: none"> • PCU is able to coordinate public and private sector service providers for activities' implementation • Timely financial flows and accounting at district and PCU |

^a OVI's in *italics** indicate programmed activities to be financed by an IFAD grant of USD 845 000

ORGANIGRAMME – PROGRAMME ORGANIZATION AND MANAGEMENT



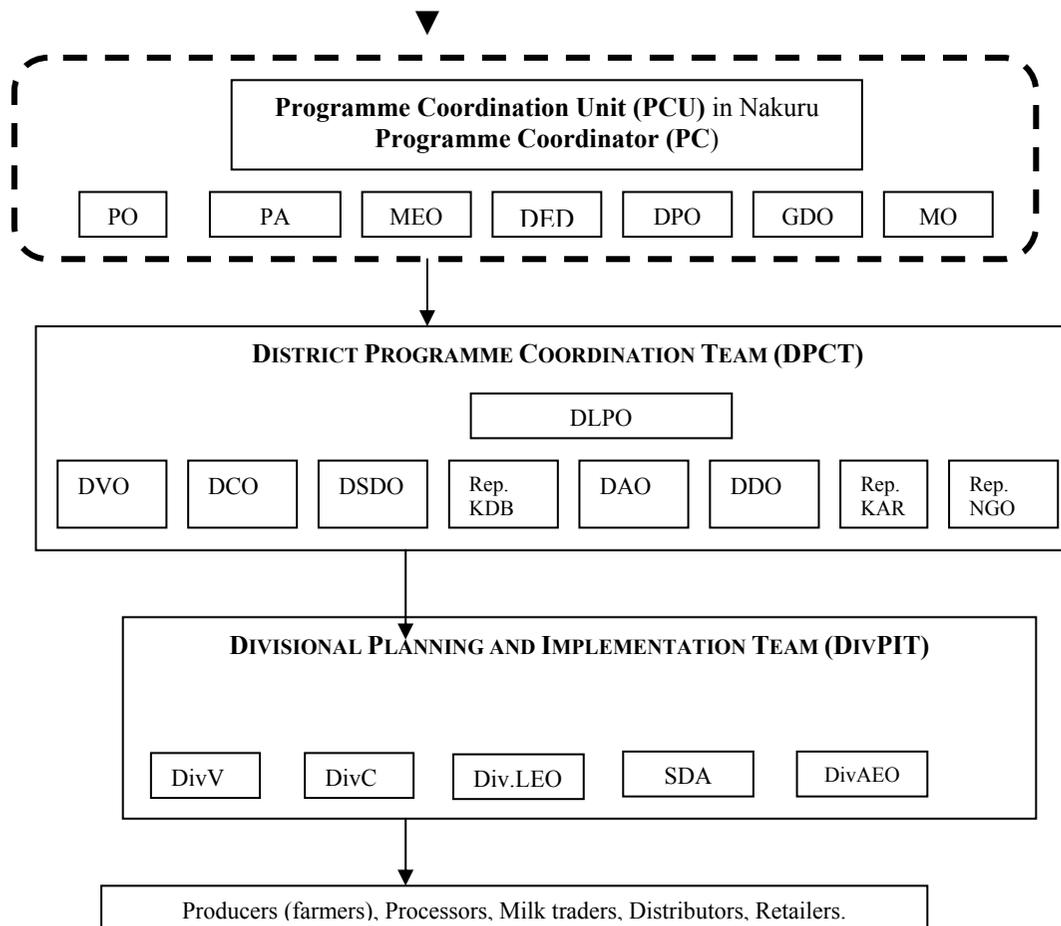
6

Acronyms PCU:

| | |
|------|--------------------------------------|
| PA | Programme Accountant |
| MEO | Monitoring & Evaluation Officer |
| DEDO | Dairy Enterprise Development Officer |
| DPO | Dairy Production Officer. |
| GDO | Group Development Officer. |
| MO | Marketing Officer |
| PO | Procurement Officer. |

Acronyms DPCT:

| | |
|------|---------------------------------------|
| DLPO | District Livestock Production Officer |
| DVO | District Veterinary Officer |
| DCO | District Cooperative Officer |
| DSDO | District Social Development Officer |
| DAO | District Agricultural Officer |
| DDO | District Dairy Officer |
| KARI | Kenya Agricultural Research Institute |



Acronyms NSC:

| | |
|--------|---|
| DLP | Dept of Livestock Production |
| DVS | Dept of Veterinary Services |
| CCD | Commission of Cooperative Development |
| KDB | Kenya Dairy Board |
| MOCDM | Ministry of Cooperative Development & Marketing |
| MGSCSS | Ministry of Gender, Sports, Culture & Social Services |
| MOF | Ministry of Finance |
| MOA | Ministry of Agriculture |
| KDPA | Kenya Dairy Processors |

Acronyms DivPIT:

| | |
|--------|---|
| DivVO | Divisional Veterinary Officer |
| DivLEO | Divisional Livestock Extension Officer. |
| DivCO | Divisional Cooperative Officer |
| SDA | Divisional Social Development Assistant |
| DivAEO | Divisional Agricultural Extension Officer |

