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President’s memorandum

Proposal for additional financing to the Republic of Kenya for the

Smallholder Dairy Commercialisation Programme

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| Recommendation for approval  The Executive Board is invited to approve the recommendation for the proposed loan to the Republic of Kenya for the Smallholder Dairy Commercialisation Programme, as contained in paragraph 21. |

Proposal for additional financing to the Republic of Kenya for the Smallholder Dairy Commercialisation Programme (SDCP)

# Background

1. The present memorandum seeks approval for additional financing for the Smallholder Dairy Commercialisation Programme (SDCP) in the form of a loan in the amount of SDR 12.05 million (equivalent to approximately US$17.0 million) on highly concessional terms. The additional financing for SDCP will respond to the Government of Kenya’s request to scale up the outreach, the results and impact of the Programme. It will also support an extension by 3 years of the programme completion and loan closing dates, to 30 September 2019 and 31 March 2020, respectively.
2. The additional financing will be allocated under the 2013-2015 cycle of the performance-based allocation system (PBAS). They will be supplemented by a contribution from the Government of US$ 2.1 million, and a contribution from the programme beneficiaries estimated at US$ 1.1 million.
3. The original IFAD financing of a highly concessional loan equivalent to US$17.5 million and a loan component grant equivalent to US$0.8 million are currently 87% and 100% disbursed. The project completion date is currently 30 September 2016 but this will be aligned with that of the additional financing upon approval.

# Justification for the additional financing

1. Being one of the largest in Sub-Saharan Africa, the Kenyan dairy sector has the potential to generate significant income and employment opportunities for vulnerable smallholders engaged in that commodity. In addition to providing an income, dairying can also contribute to improving household nutrition. SDCP is currently assessed as the best performing IFAD programme in Kenya. The programme significantly contributes to supporting the Government of Kenya in operationalizing an effective approach to support small-scale dairy farmers, processors and traders to engage into dairy farming as a profitable commercial enterprise. The additional financing for SDCP will support the Government of Kenya to scale up the outreach, the results and impact of the Programme through (i) a geographic expansion to sub-counties within current counties of intervention where Dairy Groups and Value Chain stakeholders show potential to graduate to market-oriented farming and (ii) the extension of the outreach of activities/components found to have achieved significant development results.

# Programme description

1. The overall goal of SDCP is to increase the income of the poor rural households that depend substantially on production and trade of dairy products for their livelihoods. This development goal is pursued through two specific objectives:
   * Improving financial returns of market-oriented production and trade activities by small operators through improved information on market opportunities, increased productivity, cost reduction, value adding, and more reliable trade relations; and
   * Enabling more rural households to create employment through, and benefit from, expanded opportunities for market-oriented dairy activities, in particular as a result of strengthened farmer organisations.
2. The activities financed under the additional financing will remain consistent with SDCP objectives. In scaling up the programme’s outreach, lessons learned will be capitalised to enhance SDCP’s approach in the delivery of the programme support to target groups. In particular, in line with Kenya’s pluralistic approach for extension and service provision to smallholder farmers, more emphasis will be put on the use of private service providers and institutional partners for delivering the Programme support to target groups.
3. Regarding the target area, the Programme will continue to operate in 9 districts/counties across 3 regions of the country: Bomet, Nakuru, Nandi, Trans Nzoia, UasinGishu, Bungoma, Lugari (now in Kakamega County), Kisii and Nyamira. Through the additional financing, the focus will be on sub-counties having a required level of production to graduate to commercial activities. Specifically, SCDP will reach out to 600 new Dairy Groups corresponding to 15,000 small dairy farmers. The targeting criteria will consider the groups’ economic activity, level of organization and milk production. In addition 200 small-scale milk traders and 200 operators/processors will be targeted for support.

## Components/outcomes

1. During the extension period SDCP is re-focused around three technical components:

**Component 1 - Organization and Enterprise Skills**

1. The objective of the component is to provide Programme beneficiaries, namely smallholder dairy producers, small scale processors and small scale milk traders, and Apex organizations with the appropriate organisational, managerial and enterprise skills to benefit fully from market-driven commercialisation of milk production, processing and trading. To that end during the extension period, activities have been rationalized around the following sub-components: (i) Improved organization, business planning and enterprise development skills; and (ii) Access to finance for enterprise development.

**Component 2 - Technical Support to Smallholder Dairy Products**

1. In line with the value chain approach of the Programme, this component addresses the production constraints which currently limit smallholder dairy farmers’ ability to effectively participate in milk markets. Feed and fodder typically make up 50-70% of milk production costs in the Programme area. On average, the smallholders in the Programme area currently produce 4-7 litres of milk/cow/day. Dairy cattle feed and feeding constitute the greatest limitation to improvement of milk production and cow productivity. Constraints arise from three areas: adequate on-farm availability of feeds for the dairy animals throughout the year; quantity fed to animals even when available in relation to their productivity; and the nutritive value of both on-farm produced fodder and commercial feeds. Low milk production is due to a combination of a number of key factors including lack of technical knowledge on use and conservation of locally available feed and fodder resources, limitation due to poor animal breed, animal diseases and occasionally lack of water.

**Component 3 - Development of the Milk Marketing Chain**

1. The objective of the component is to improve market linkages of small-scale milk producers, traders and processors to local milk markets and increase the smallholders’ access to the processing industry. During the extension period, the support to target groups for milk marketing will be focussed on two thrusts: (i) improvement of market infrastructures and, (ii) capacity building of beneficiaries to improve market access and profitability.

## Expected results

1. Overall, through SDCP support, it is estimated that about 1,058 Dairy Groups corresponding to about 26,462 small dairy farmers and 625 small milk traders, processors and operators will graduate to market-oriented farming with increased incomes, better living conditions and nutritional status. Through their attachment to a household, the benefits of the programme will reach out to an estimated 162,524 household members.

# Programme costs and financing

1. The total programme costs for the additional financing are estimated at US$ 20.3 million over four years as follows: IFAD additional loan for SCDP is estimated at US$ 17.0 million equivalent to 83.9% of the Programme costs. The government will finance the taxes and duties, including actual contribution for staff gratuities evaluated at US$ 2.1 million, representing 10.4% of total costs. Beneficiaries will contribute US$ 1.1 million representing 5.7% of the total costs. The summary of the updated financing arrangements are shown in the tables below.

**SDCP costs by component and financier**

(Thousands of United States dollars)*1*

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Component** | **IFAD loan** | | **Beneficiaries** | | **Borrower/ counterpart** | | **Total** | |
| Amount | % | Amount | % | Amount | % | Amount | % |
| Cross Cutting issues | 348 | 84.0 | - | - | 66 | 16.0 | 414 | 2.0 |
| Organization & Enterprise skills | 4,004 | 84.6 | - | - | 732 | - | 4,735 | 23.4 |
| Technical Support to Smallholder Dairy Producers | 3,628 | 85.5 | - | - | 614 | 15.4 | 4,242 | 20.9 |
| Development of Milk Marketing Chain | 5,887 | 76.9 | 1,149 | 15,0 | 618 | 8,1 | 7,654 | 37.8 |
| Programme Management & Coordination | 3,133 | 97.3 | - | - | 86 | 2.7 | 3,219 | 15.8 |
| **Total** | **17,000** | **83,9** | **1,149** | **5,7** | **2,116** | **10.4** | **20,265** | **100.0** |

**Programme/project costs by expenditure category and financier**

(Thousands of United States dollars)

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| ***Expenditure category4*** | ***IFAD loan*** | | ***Beneficiaries2*** | | ***Borrower/ counterpart*** | | ***Total3*** | |
| *Amount* | *%* | *Amount* | *%* | *Amount* | *%* | *Amount* | *%* |
| **I. Investment Costs** |  |  |  |  |  |  |  |  |
| A. Civil works | 656 | 84 | - | - | 125 | 16.0 | 781 | 3.9 |
| B. vehicles and equipment | 3,088 | 69.9 | 1,149 | 26.0 | 182 | 4.1 | 4,419 | 21.8 |
| C. Training and workshops | 9,025 | 84.8 | - | - | 1,622 | 15.2 | 10,648 | 52.5 |
| D. Consultancy | 960 | 88.8 | - | - | 121 | 11.2 | 1,080 | 5.3 |
| E. Other services | 592 | 89.9 | - | - | 66 | 10.1 | 659 | 3.3 |
| **Total Investment costs** | **14,321** | **81.4** | **1,149** | **6.5** | **2,116** | **12.0** | **17,586** | **86.8** |
| **II. Recurrent Costs** |  |  |  |  |  |  |  |  |
| A. Salaries and allowances | 2,035 | 100.0 | - | - | - | - | 2,035 | 10.0 |
| B. Operations | 643 | 100.0 | - | - | - | - | 643 | 3.2 |
| **Total Recurrent Costs** | 2,679 | 100.0 | - | - | - | - | 2,679 | 13.2 |
| **Total** | **17,000** | **83.9** | **1,149** | **5.7** | **2,116** | **10.4** | **20,265** | **100.0** |

1. The combined programme, comprising the original loan and original loan component grant, along with the additional loan financing now under consideration amounts to US$40.0 million as shown in the table below.

(Thousands of United States dollars)

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| ***Expenditure category4*** | ***Borrower /counterpart*** | | ***IFAD Loan1*** | | ***IFAD Add Fin*** | | ***IFAD Grant*** | | ***Beneficiaries*** | | ***Total3*** | |
| *Amount* | *%* | *Amount* | *%* | *Amount* | *%* | *Amount* | *%* | *Amount* | *%* | *Amount* | *%* |
| **I. Investment Costs** |  |  |  |  |  |  |  |  |  |  |  |  |
| A. Civil works | 125 | 16.0 | 400 | 33.9 | 656 | 55.5 | - | - | - | - | 1,181 | 2.95 |
| B. vehicles and equipment | 804 | 12.6 | 1,308 | 20.6 | 3,088 | 48.6 | - | - | 1,155 | 18.2 | 6,354 | 15.88 |
| C. Training and workshops | 1,622 | 8.0 | 9,610 | 47.4 | 9,025 | 44.6 | - | - | - | - | 20,258 | 50.63 |
| D. Consultancy | 121 | 5.2 | 640 | 27.4 | 960 | 41.1 | 615 | 26.34 | - | - | 2,336 | 5.84 |
| E. Other services | 226 | 5.3 | 2,750 | 64.3 | 592 | 13.8 | 220 | 5.14 | 490 | 11.5 | 4,279 | 10.69 |
| **Total Investment costs** | **2,898** | **8.4** | **14,708** | **42.7** | **14,321** | **41.6** | **835** | **2.43** | **1,645** | **4.8** | **34,407** | **85.99** |
| **II. Recurrent Costs** |  |  |  |  |  |  |  |  |  |  |  |  |
| A. Salaries and allowances | - | - | 1,888 | 48.1 | 2,035 | 51.9 | - | - | - | - | 3,923 | 9.80 |
| B. Operations | 144 | 8.5 | 898 | 53.3 | 643 | 38.2 | - | - | - | - | 1,685 | 4.21 |
| **Total Recurrent Costs** | 144 | 2.6 | 2,785 | 49.7 | 2,679 | 90.1 | - | - | - | - | 5,608 | 14.01 |
| **Total** | **3,042** | **7.6** | **17,493** | **43.7** | **17,000** | **42.5** | **835** | **2.09** | **1,645** | **4.1** | **40,015** | **100.00** |

# Financial management, procurement and governance

1. At the national level, the Lead Agency for programme implementation remains the State Department of Livestock in the Ministry of Agriculture, Livestock, and Fisheries. At the local level, SDCP implementation modalities will be enhanced to ensure alignment to the devolution framework. Accordingly, the Department of Livestock Production is the entry point for programme management at the county level. The Counties will amongst other things be responsible for: (i) Community awareness and sensitisation; (ii) selection of target groups; (iv) participatory identification of collective priorities into the County Integrated Development Plan; (v) selection of service providers and mobilisation of extension services; (vi) financial management at County level; (vii) establishing linkages with local stakeholders through the County Dairy Stakeholder fora; and (x) programme monitoring at the County level.
2. To ensure effective financial oversight, the programme finance team will comprise a Financial controller and an Accountant assistant both seconded by the National Treasury General’s office. In addition, each participating County has a Sub-County Accountant to handle day-to-day SDCP accounting requirements. At the programme level, an off-shelf accounting package will be installed to replace the bespoke package currently in use with the ability to generate expenditure trends by component, category, and activities using a chart of accounts coding that will cut across the budgeting, expenditure requisition and other items. Counties will continue to use simple vote books to record transactions. Financial reporting and monitoring will be conducted in accordance with International Public Sector Accounting Standards on a cash basis. In addition to annual audited financial statements, IFAD will require semi-annual interim financial reports.

# Audit

1. The Kenya National Audit Office will undertake the external audit of the Programme funds and the related counterpart funding in accordance with International Standards on Auditing and the IFAD Guidelines on Project Audits.

# Legal instruments and authority

1. Subject to the approval of the Executive Board, the current financing agreement will be amended to reflect the additional financing. The proposed changes to the agreement will require revision to the allocation of IFAD financing to include the additional resources granted as a loan. The programme completion date will be extended to 30 September 2019 and the financing closing date to 31 March 2020. The additional financing will remain consistent with the ongoing programme objectives.
2. The Republic of Kenya is empowered under its laws to receive financing from IFAD.
3. I am satisfied that the proposed financing will comply with the Agreement Establishing IFAD and the Policies and Criteria for IFAD Financing.

# Recommendation

1. I recommend that the Executive Board approve the proposed additional financing in terms of the following resolution:

RESOLVED: that the Fund shall provide a loan on highly concessional terms to the Republic of Kenya in an amount equivalent to twelve million and fifty thousand special drawing rights (SDR 12,050,000), and upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

Kanayo F. Nwanze

President

SDCP Logical framework

| **Results hierarchy** | **Key Indicators** | **Baseline** | **End target** | **Source** | **Frequency** | **Responsible** | **Assumptions** |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Goal**  Income increased for poor rural households that depend substantially on production and trade of dairy products | 80% of 26,462 small dairy farmers and 625 small milk traders, processors and operators representing 27,087 households, reaching out to 162,524 household members: (i) increase income from dairy products by 50%; (ii) Reduce incidence of malnutrition by 30% and (iii) Increase HH assets ownership by 20%. | Average income K.sh 386/day/ household  16.4% children of less than 5 years malnourished;  HH ownership assets are respectively 40.29%; 12.48%; 38.71% and 15.52% for radio, TV set, Mobile phone and Bicycle. | Average K.sh 579/day/household  11.4% Child malnutrition  HH ownership of 52.38%; 16.22%; 50.32% and 20.18% for radio, TV set, Mobile phone and Bicycle | RIMS baseline and impact surveys, household survey | Year 1/4 | PCU | Favourable conditions for dairy trade |
| **Development Objectives**  Increased financial returns and employment opportunities from market oriented dairy production and trade for smallholder that depend substantially on dairy products for their livelihoods | Gross margins of dairy enterprises increased by 30%, for DG members carried from initial SCDP and 15% for new members from extended period  20% increase employment opportunities in initial DGs and 15% in new DGs supported | Gross margins is K.sh 4,801/cow/ month  21,298 people employed | K.sh 6,242/ cow/month for DG members from initial SCDP and K.sh 5,521/cow/month for new DG members  25,557 people employed | DG members records | Annual | PCU and GD members |  |
| **Outcome 1**  Improved organizational and managerial skills for smallholder dairy groups | 90% DGs since initial SCDP, 75% new DGs and Apexes deliver cost-efficient services to members | 458 Dairy groups | 862 Dairy groups | Programme M&E reports | Year 2 and 4 | PCU | Supportive Policy and legal framework |
| **Outputs 1**  1.1. Improved group organisation and business skills to access benefits from marketing of milk and dairy products | 90% DGs supported in initial SCDP and 75% new have reached MODE 3 | 0 | 862 Dairy groups in MODE 3 | Programme M&E surveys/ reports | Year 2, 3 and 4 | PCU | Quality services from public and private service providers |
| 1.2. Improved access to financial services of targets groups | 80% DG members and small scale traders accessing formal financial services (at least 60% women) | 14,066 DG members (50% women) | 21,170 DG members and small scale traders (at least 60% women) | Programme M&E surveys/ reports | yearly | PCU |  |
| **Outcome 2**  Increased production, productivity and efficiency of smallholder dairy farming | 75% increase average milk yield/animal/day in DG supported since initial SCDP and 60% new DG | 1,409 liters /cow/year | 2,466 liters/ cow/year for initial farmers and 2,255 liters/ cow/year for new farmers | Programme M&E surveys/ reports | yearly | PCU and beneficiaries | Favourable climate conditions and no disease outbreak |
| **Outputs 2**  2.1. Enhanced smallholder dairy farmer production and management skills | 80% of farmers using recommended technologies and management methods | 13,175 farmers have used recommended technologies | 21,170 farmers expected to use recommended technologies | Programme M&E surveys/ reports | Yearly | PCU | Resources and skilled personnel available |
| 2.2. Increased smallholder farmers technical capacity on appropriate feeds and feeding management | 80% farmers adopt recommended fodder management practices | 13,175 farmers adopt improved feeds/feeding practices | 21,170 farmers adopt appropriate feeds and feeding management | Programme M&E surveys/ reports | Yearly | PCU | Resources and skilled personnel available |
| 2.3. Improved capacity of public/private sector providers to deliver cost-effective AI and other technical services | 80 % of targeted farmers access quality AI services  DTI has residential facility for training of farmers | 13,175 farmers have accessed AI | 21,170 famers access IA  DTI residential facility completed | Programme M&E surveys/ reports | Year 1/2/4 | PCU | Favourable policy for privatisation of breeding and AI services |
| 2.4. Improved availability of low cost technologies in programme area | 60% smallholder dairy farmers invested in viable technologies at low cost | 6,741 farmers invest in low-cost technologies | 15,877 dairy farmers invest in low-cost technologies | Programme M&E surveys/ reports | Yearly | PCU |  |
| **Outcome 3**  Market linkages of small-scale milk producers, traders and processors to milk markets improved | 50 % increase in volume of milk delivered by farmers to processors | 1,143,376,180 litres | 1,715,064,270 litres | Programme M&E surveys/ reports | Yearly | PCU | Equitable conditions for dairy sub-sector trade |
| 3.1. Sub-county governments invest in improved rural infrastructures for enhanced market access | A feasibility study of rural infrastructure carried out for resource mobilization by county governments | None | Study completed for resource mobilization | Programme M&E surveys/ reports | 1 | PCU | County commitment to funding infrastructures |
| 3.2. Improved capacity of dairy groups and small-scale processors to market their products | 20 % increase in milk with added value sold by small-scale certified processors and traders | 171,506,427 litres sold by small-scale certified processors/traders | 205,807,712 litres | Programme M&E surveys/ reports | Yearly | PCU | Stable demand for milk and dairy products |