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President's memorandum

Proposal for additional financing to the Republic of Kenya for the Smallholder Dairy Commercialization Programme

Note to Executive Board representatives

Focal points:

Technical questions:

Nadine Gbossa
Country Director
Tel.: +254 20 762 1028
e-mail: n.gbossa@ifad.org

Joseph Nganga
Country Programme Officer
Tel.: +254 20 762 4414
e-mail: j.nganga@ifad.org

Dispatch of documentation:

Alessandra Zusi Bergés
Officer-in-Charge
Governing Bodies Office
Tel.: +39 06 5459 2092
e-mail: gb_office@ifad.org

For: Approval

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 Commercialization Programme, as contained in paragraph 20.

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

I. Background

1. The present memorandum seeks the approval of the Executive Board for additional financing for the Smallholder Dairy Commercialization 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 will respond to the Government of Kenya's request to scale up programme outreach, results and impact. It will also support the extension by three 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). It will be supplemented by a contribution from the Government in the amount of US\$2.1 million and a contribution from the programme beneficiaries estimated at US\$1.15 million.
3. The original IFAD financing consisted of a highly concessional loan equivalent to US\$17.49 million and a loan component grant equivalent to US\$0.84 million; they are currently 87 per cent and 100 per cent disbursed, respectively. The current programme completion date of 30 September 2016 will be aligned with that of the additional financing upon approval.

II. Justification for the additional financing

4. Kenya's dairy sector is among the largest in sub-Saharan Africa and has the potential to generate significant income and employment opportunities for vulnerable smallholders. In addition to providing an income, dairying can also contribute to improving household nutrition. SDGP is currently assessed as the best performing IFAD programme in Kenya. The programme contributes significantly to supporting the Government of Kenya in operationalizing an effective approach to supporting small-scale dairy farmers, processors and traders undertaking dairy farming as a profitable commercial enterprise. The additional financing for SDGP will support the Government in scaling up programme outreach, results and impact through: (i) geographic expansion to sub-counties within current target counties where dairy groups and value chain stakeholders show potential to graduate to market-oriented farming; and (ii) extension of outreach for activities/components found to have achieved significant development results.

III. Programme description

5. The overall goal of SDGP is to increase the incomes of poor rural households that depend largely on dairy production and trade for their livelihoods. This development goal is pursued through two specific objectives:
 - Improving the financial returns of market-oriented production and trade activities by small operators through improved information on market opportunities, higher productivity, lower costs, greater value added 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 farmers' organizations.
6. Activities financed under the additional financing will remain consistent with SDCP objectives. Scaling up programme outreach will capitalize on lessons learned to enhance SDCP's approach in delivering support to target groups. In particular, in line with Kenya's pluralistic approach to extension and service provision to smallholder farmers, greater emphasis will be placed on the use of private service providers and institutional partners in delivering programme support to target groups.
 7. In terms of target area, the programme will continue to operate in nine districts/counties across three regions of the country: Bomet, Nakuru, Nandi, Trans Nzoia, Uasin Gishu, Bungoma, Lugari (now in Kakamega county), Kisii and Nyamira. The additional financing will allow for a focus on sub-counties that have the required level of production to graduate to commercial activities. Specifically, SDCP will reach out to 600 new dairy groups, representing 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.

A. Components/outcomes

8. During the extension period, SDCP will be realigned around three technical components:

Component 1 — Organization and enterprise skills

9. The objective of this component is to provide programme beneficiaries — smallholder dairy producers, small-scale processors and milk traders, and apex organizations — with the appropriate organizational, managerial and enterprise skills to benefit fully from the market-driven commercialization of milk production, processing and trading. Activities will be restructured around the following subcomponents: (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

10. In line with the programme's value chain approach, this component addresses the production constraints currently limiting smallholder dairy farmers' ability to effectively participate in milk markets. Feed and fodder typically account for 50 per cent to 70 per cent of milk production costs in the programme area. On average, smallholders in the area currently produce four to seven litres of milk per cow per day. Dairy cattle feed and feeding constitute the greatest limitation on improving milk production and cow productivity. Constraints arise in three areas: adequate on-farm availability of feed for dairy animals throughout the year; quantity of feed given to animals even when it is available, in relation to their productivity; and the nutritional value of both on-farm produced fodder and commercial feed. Low milk production is due to a combination of a number of key factors, including a lack of technical knowledge on the use and conservation of locally-available feed and fodder resources, limitations due to poor animal breed, animal diseases and an occasional lack of water.

Component 3 — Development of the milk-marketing chain

11. The objective of this component is to improve the linkages of small-scale milk producers, traders and processors to local milk markets and to increase smallholders' access to the processing industry. During the extension period, support to target groups for milk marketing will focus on: (i) improving market infrastructure; and (ii) capacity-building for beneficiaries to improve market access and profitability.

B. Expected results

12. Overall, through SDCP support, it is estimated that approximately 1,058 dairy groups, corresponding to approximately 26,462 small-scale dairy farmers and 625 small-scale milk traders, processors and operators, will graduate to market-oriented farming with higher incomes, better living conditions and enhanced nutritional status. Programme benefits will reach an estimated 162,524 household members.

IV. Programme costs and financing

13. The total programme costs for the extension period are estimated at US\$20.3 million over four years, to be covered as follows: the additional IFAD loan estimated at US\$17.0 million, equivalent to 83.9 per cent of programme costs; government financing of taxes and duties, including an actual contribution for staff gratuities, evaluated at US\$2.1 million, representing 10.4 per cent of total costs; and a contribution by beneficiaries of US\$1.15 million, representing 5.7 per cent of total costs. The updated financing arrangements are summarized in the tables below.

Table 1
Programme costs by component and financier
(Thousands of United States dollars)

<i>Components</i>	<i>IFAD loan</i>		<i>Beneficiaries</i>		<i>Government</i>		<i>Total</i>	
	<i>Amount</i>	<i>%</i>	<i>Amount</i>	<i>%</i>	<i>Amount</i>	<i>%</i>	<i>Amount</i>	<i>%</i>
Cross-cutting issues	348	84.0	-	-	66	16.0	414	2.0
Organization and 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 and 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

Table 2
Programme costs by expenditure category and financier
(Thousands of United States dollars)

<i>Expenditure category</i>	<i>IFAD loan</i>		<i>Beneficiaries</i>		<i>Government</i>		<i>Total</i>	
	<i>Amount</i>	<i>%</i>	<i>Amount</i>	<i>%</i>	<i>Amount</i>	<i>%</i>	<i>Amount</i>	<i>%</i>
I. Investment costs								
A. Civil works	656	84.0	-	-	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

V. Financial management, procurement and governance

14. The State Department of Livestock in the Ministry of Agriculture, Livestock and Fisheries will continue as lead implementing agency at the national level. At the local level, SDCP implementation modalities will be enhanced to ensure alignment with the devolution framework. Accordingly, the Department of Livestock Production is the entry point for programme management at the county level. The counties will, among other things, be responsible for: community awareness and sensitization; the selection of target groups; the participatory identification of collective priorities in the county integrated development plan; the selection of service providers and mobilization of extension services; financial management at the county level; establishing linkages with local stakeholders through the county dairy stakeholder forums; and programme monitoring at the county level.
15. To ensure effective financial oversight, the programme finance team will comprise a financial controller and an accounting assistant seconded from the Accountant General's department of the National Treasury. In addition, each participating county has a sub-county accountant to handle day-to-day SDCP accounting requirements. At the programme level, an off-the-shelf accounting package will be installed to replace the bespoke package currently in use; it will be able to generate expenditure trends by component, category and activities using a chart of accounts coding that will cut across 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 the International Public Sector Accounting Standards on a cash basis. In addition to annual audited financial statements, IFAD will require semi-annual interim financial reports.

VI. Audit

16. 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.

VII. Legal instruments and authority

17. 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.
18. The Republic of Kenya is empowered under its laws to receive financing from IFAD.
19. I am satisfied that the proposed financing will comply with the Agreement Establishing IFAD and the Policies and Criteria for IFAD Financing.

VIII. Recommendation

20. 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,	75% increase average milk yield/animal/day in DG	1,409 liters /cow/year	2,466 liters/ cow/year for initial	Programme M&E	yearly	PCU and beneficiaries	Favourable climate

Results hierarchy	Key Indicators	Baseline	End target	Source	Frequen cy	Responsible	Assumptions
productivity and efficiency of smallholder dairy farming	supported since initial SCDP and 60% new DG		farmers and 2,255 liters/ cow/year for new farmers	surveys/ reports			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