HOW VALUE ADDITION OF TEA PRODUCTS BY KENYA TEA DEVELOPMENT AGENCY- KTDA CAN ENHANCE INTERNATIONAL COMPETITIVENESS AND EARNINGS OF KENYAN TEA

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A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION, SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI.

October, 2015.
DECLARATION

This project report is my original work and has not been presented for an award of degree in any other university.

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This project report has been submitted for examination with our approval as the University of Nairobi Supervisor.

Signed: Date:

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SCHOOL OF BUSINESS

UNIVERSITY OF NAIROBI.
ACKNOWLEDGEMENT

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I sincerely thank my fiancé Gitonga who kept reminding me I CAN! Itunaya our lovely son who gave me the strength to push on.

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God bless you all!
DEDICATION

I dedicate this work to my late Father Moses GatobuMбуi and my mother Agnes Gatobu for their overwhelming support and sacrifices they have made throughout the years to enable their children become all that God created them to be. It was not and is not in vain.

To my son Damian Itunaya, I pray that this work will be an encouragement to be better than Mum in academics. This is an Academic foundation that I have laid for you!
ABSTRACT

The study sought to assess how value addition of tea products by KTDA can enhance International competitiveness and earnings of Kenyan tea, identify incentives that can encourage value addition in the sector and propose value addition activities with the potential of increasing Kenya’s tea earnings and competitiveness in International Market. Kenya exports its tea to the world market in bulk which is mainly used for blending low quality teas from other countries. Consequently bulk tea fetches low prices leading to depressed revenue for tea growers and low foreign exchange for the country (Tea Board of Kenya, 2009b) Kenya’s potential to add value to agricultural produce is largely unexploited. This makes the country vulnerable to fluctuating and declining commodity prices and increasingly fierce competition from cheap imports (Government of Kenya, 2011). Kenya has only managed to increase the volume of Value Added Tea sales from under5% to about 12% of total sales over the last few years (Tea Board of Kenya, 2009a). A comparison between Kenya’s and Sri Lanka’s tea export market shows that Kenya exported more tea in volume than Sri Lanka in 2009 but Sri Lanka earned more from its exports than Kenya did. In 2010, Kenya earned USD 1.23 Billion from exports of 362 million Kgs of its own tea as well as re-exports of 79 million Kgs of other origin teas, while Sri Lanka earned USD 1.30 Billion from its export of 296.3 million Kgs owing to higher prices and more valued added shipments (Tea Board of Kenya, 2011a). Kenya needs to scale-up activities such as processing, branding, quality certification and accreditation that increase the market value of primary products (Government of Kenya, 2011). This research used a case study approach. A case study was adopted to allow for a one-time collection of data from the sample population. Data was collected through interview guides administered to KTDA Managers. Secondary data on tea export figures for value added tea and bulk tea from the Tea Board of Kenya was used to supplement the primary data collected. Findings showed that value addition increases tea earnings with 83.3% of the factories indicating that value addition increases earnings by up to 25%. Industry experts indicated that the price of value added tea was higher than that of bulk CTC tea with the lowest price difference ranging between 0 to 25% and the highest price difference ranging between 76 to 100%. The research established that value addition activities in Kenya’s tea sector increase tea earnings. Monetary and fiscal incentives, promotional support, branding support and investments in overseas markets are incentives that can encourage value addition in Kenya’s tea sector. Packaging, branding and blending have the highest potential of increasing Kenya’s tea earnings. Although flavouring and instant tea were rated low in terms of increasing Kenya’s earning potential, the research proposed that if positioned to meet the growing demand for convenient forms of tea, they have the potential of increasing Kenya’s tea earnings. Other tea varieties such as Purple tea, Black Orthodox, Green Orthodox and Green CTC tea also have the potential of increasing Kenya’s tea earnings. The research identified areas for further research which include: the role of diversification into other tea varieties in creating new markets for Kenyan tea, the role of value addition in creating employment in Kenya’s agricultural sector and the contribution of tea value addition activities to Kenya’s agricultural GDP among other areas.
TABLE OF CONTENT

DECLARATION...........................................................................................................i

ACKNOWLEDGEMENT...........................................................................................ii

DEDICATION.............................................................................................................iii

ABSTRACT...............................................................................................................iv

LIST OF TABLES.......................................................................................................v

LIST OF FIGURES.....................................................................................................vi

ABBREVIATIONS AND ACRONYMS........................................................................xi

CHAPTER ONE: INTRODUCTION..............................................................................1

1.1 Background of the Study......................................................................................1

1.1.1 Concept of the International Competitiveness.............................................6

1.1.2 Value Addition...............................................................................................6

1.1.3 Kenya Tea Earnings.......................................................................................7

1.1.4 Kenya’s Tea Sector.........................................................................................8

1.1.5 Kenya Tea Development Agency.................................................................9

1.2 Research Problem..............................................................................................11

1.3 Research Objective...........................................................................................13

1.4 Value of Study..................................................................................................13
CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

2.2 Theoretical Foundations

2.2.1 New Trade Theory

2.2.2 International Product Life Cycle

2.2.3 Foreign Market Entry Strategy

2.5 Value Addition of Tea in Sri-Lanka

2.6 Conclusion

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

3.2 Research Design

3.3 Data Collection

3.4 Data Analysis

CHAPTER FOUR: DATA ANALYSIS AND FINDINGS

4.1 Response Rate

4.2 General Findings on Kenya’s tea Sector

4.3 Effects Value Addition on Earnings

4.4 Challenges Hindering Value Addition in Kenya Tea Sector

4.5 Incentives That can Encourage Value Addition in Kenya Tea Sector

4.6 Value addition activities with the Potential of increasing earning for Kenya’s Tea Sector

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATION
5.1 Summary............................................................................................................35
5.1.1 Types of Tea Produced and Markets for Value Added Tea.........................35
5.1.2 The Dominant Value Addition Activities Undertaken in Kenya’s Tea Sector
And Perceptions on Development made in Tea Value addition..................36
5.1.3 Effects of Value Addition on Earnings.........................................................38
5.1.4 Challenges Hindering Value Addition and Incentives Considered Effective in
Encouraging Value Addition.................................................................39
5.1.5 Value Addition Activities with the Potential of Increasing KTDA
te earnings .............................................................................................40
5.1.6 Potential of other Tea Varieties in Increasing Earnings in Kenya’s Tea
Sector.........................................................................................................41
5.2 Conclusion..................................................................................................42
5.3 Recommendations......................................................................................44
5.4 Areas for further research..........................................................................47

REFERENCES.................................................................................................50

APPENDICES

Appendix 1........................................................................................................i
Appendix 2.......................................................................................................ii
Appendix 3.......................................................................................................iii
# LIST OF TABLES

Table 1.1 World Tea production trends among the four major producing countries

Table 1.2 Comparison of tea export volumes and values for Kenya and Sri Lanka

Table 4.1 Types of tea produced at factory level
LIST OF FIGURES

Figure 1.1 Export Volume among four major tea producing Countries................4

Figure 4.2 Average mean Unit price of value added tea..............................31
# ACRONYMS AND ABBREVIATIONS

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACP</td>
<td>African, Caribbean and Pacific</td>
</tr>
<tr>
<td>AgGDP</td>
<td>Agricultural Gross Domestic Product</td>
</tr>
<tr>
<td>CTC</td>
<td>Cut-Tear-Curl</td>
</tr>
<tr>
<td>EATTA</td>
<td>East African Tea Trade Association</td>
</tr>
<tr>
<td>EPZA</td>
<td>Export Processing Zone Authority</td>
</tr>
<tr>
<td>FAO</td>
<td>Food and Agricultural Organisation</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>KETEPA</td>
<td>Kenya Tea Packers Association</td>
</tr>
<tr>
<td>Kg (s)</td>
<td>Kilogram (s)</td>
</tr>
<tr>
<td>Kg/ha</td>
<td>Kilograms per Hectares</td>
</tr>
<tr>
<td>Kshs</td>
<td>Kenya Shillings</td>
</tr>
<tr>
<td>KTDA</td>
<td>Kenya Tea Development Agency</td>
</tr>
<tr>
<td>SLTB</td>
<td>Sri Lanka Tea Board</td>
</tr>
<tr>
<td>SME</td>
<td>Small and Medium enterprises</td>
</tr>
<tr>
<td>SPSS</td>
<td>Statistical package of social scientists</td>
</tr>
<tr>
<td>TBK</td>
<td>Board of Kenya</td>
</tr>
<tr>
<td>TRFK</td>
<td>Tea Research Foundation of Kenya</td>
</tr>
<tr>
<td>UAE</td>
<td>United Arab Emirates</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>US</td>
<td>United States</td>
</tr>
<tr>
<td>USA</td>
<td>United States of America</td>
</tr>
<tr>
<td>USD</td>
<td>United States Dollar</td>
</tr>
</tbody>
</table>
CHAPTER ONE

INTRODUCTION

1.1 Background of the study

The agricultural sector in Kenya accounts for 18% of total formal employment and is a means of livelihood for most of the rural population. More than one-third of Kenya’s agricultural produce is exported, accounting for about 65% of Kenya’s total exports (Government of Kenya, 2010; Government of Kenya, 2007).

The purpose of this study is therefore to determine how value addition of tea products by Kenya Tea Development Agency –KTDA can enhance International competitiveness and earnings of Kenyan tea. Agriculture is the backbone of Kenya’s economy, contributing 26% of the country’s Gross Domestic Product (GDP) directly and another 25% indirectly.

This study is supported by New Trade Theory, which focuses on the role of increasing returns to scale and network effects, which were developed in the late 1970s and early 1980s. Krugman (1979) provided reasons why trade can be beneficial and a fundamental insight into globalization. Krugman (1991) brings increasing returns together with capital and labor migration and transport costs into one model. Krugman’s (1991) model has become a workhorse of economic geography and international trade.

New Trade Theory emphasizes on, increasing returns, imperfect competition and differentiated products. Assuming a situation where are all agents have identical comparative costs, technologies, and tastes, and there is only one factor, there are none of the standard reasons for
trade, but, we assume that there are internal economies of scale. Internal economies of scale occur as long as the average cost per unit of output falls as total output increases.

Tea has for long provided a livelihood for small-scale farmers, helping make Kenya one of the world's biggest tea exporters. But ideal weather and bigger harvests, instead of producing bumper earnings, have led to a glut of Kenya's specialty black tea. Farmers have seen prices fall by 40 percent and some now threaten to pull up the bushes. Tea exports are a major dollar earner for Kenya but most of the exports to the world market are in bulk which is mainly used for blending low quality teas from other countries. Consequently bulk tea fetches low prices leading to depressed revenue for tea growers and low foreign exchange for the country (Tea Board of Kenya, 2009b).

It’s because of these low prices and lack of value addition on the teas that motivated me to do this study that will be of value to Kenya tea growers under KTDA as over 3 million Kenyans and approximately 10% of the population is directly and indirectly employed by the tea industry which is the largest sub-sector in the agricultural sector and tea plays an important role as the economy’s main anchor and therefore with the low tea prices affect a big Kenyan population.

The Government of Kenya has recognized the importance of value addition in guaranteeing high prices of locally produced crops. The President of the Republic of Kenya, on 4th June 2012 called on the Ministry of Agriculture to constitute a working group comprising of relevant government departments and other critical stakeholders to coordinate value addition initiatives of locally produced crops in the country. The President while meeting KTDA directors confirmed
the Government’s support for value-addition initiatives being undertaken in tea so as to fetch higher returns for farmers, ultimately leading to increased revenue generation for the country (State House, 2012).

Tea is one of the most popular and low cost beverages in the world, coming second after water in popularity (Hicks, 2009; Groosman, 2011). Millions of livelihoods around the world depend on the production of tea as it is labour intensive thus providing jobs in remote rural areas. It is an important commodity in terms of job creation and export earnings in a number of developing countries (Wal, 2008). This is also evidenced in Kenya where the tea sector plays a very important role in supporting the livelihoods of Kenyans (Ochanda, 2012). The increase in export earnings in 2009 at the global level positively affected rural incomes in all tea-producing countries (Food and Agricultural Organization, 2010).

Global tea production is mainly carried out in 4 countries - India, China, Kenya and Sri Lanka, which together accounted for nearly 75% of the world’s output in 2008 (RAM Ratings (Lanka) Ltd, 2009). As seen from Table 1.1 below, Kenya is currently the world’s third largest producer of tea after India and China and the leading exporter of black tea (Tea Board of Kenya, 2013d; Export Promotion Council, n.d.). Although India and China are still the largest tea producers, these two nations considerable domestic consumption has rendered Kenya and Sri Lanka the largest global exporters of this commodity (See Figure 1.1 below). Sri Lanka historically dominated exports but relinquished this position to Kenya in 2007 (Wal, 2008, Asia Institute of Technology, 2002; RAM Ratings (Lanka) Ltd, 2009).
Table 1.1: World Tea Production Trends among the 4 major producing countries

<table>
<thead>
<tr>
<th>Country</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kenya</td>
<td>369.6</td>
<td>345.8</td>
<td>314.1</td>
<td>399.0</td>
<td>377.9</td>
</tr>
<tr>
<td>India</td>
<td>986.4</td>
<td>980.8</td>
<td>978.9</td>
<td>966.4</td>
<td>988.3</td>
</tr>
<tr>
<td>Sri-Lanka</td>
<td>304.6</td>
<td>318.6</td>
<td>289.7</td>
<td>331.4</td>
<td>328.6</td>
</tr>
<tr>
<td>China</td>
<td>1140.0</td>
<td>1257.6</td>
<td>1358.6</td>
<td>1475.0</td>
<td>1623.2</td>
</tr>
<tr>
<td>Others</td>
<td>994.4</td>
<td>960.6</td>
<td>1003.0</td>
<td>998.3</td>
<td>981.2</td>
</tr>
<tr>
<td>Total</td>
<td>3795</td>
<td>3863.4</td>
<td>3944.3</td>
<td>4170.1</td>
<td>4299.2</td>
</tr>
</tbody>
</table>

Source: International Tea Committee Annual bulletin of Statistics, 2014

Kenya has also secured its global position as the leading producer and exporter of Black CTC tea which is sought after by markets across the world for key attributes such as brightness, attractive colour, distinct taste and brisk flavour (Tea Board of Kenya, 2012b). Though Kenya is considered the leading exporter of tea in Africa; Sri Lanka, Kenya’s closest competitor has been more successful in moving up the value chain and commands higher prices for its tea (Wal, 2008). Value addition and diversification may therefore offer longterm solutions to better prices for tea in developing countries (Tanui, Fang, Feng, Zhuang, & Li, 2012).
1.2 Comparison of Tea Export Volumes and Values for Kenya and Sri Lanka

Sri Lanka’s value added tea exports include instant tea, tea bags, iced tea, flavoured tea, green tea, and organic tea (Herath& De Silva, 2011). Recognizing the importance and potential of teabags and retail packets as an alternative to bulk tea exports, the Sri Lanka government has taken several initiatives over the years to promote their production for export markets. According to Ganewattaa et al (2005) there were several export promotion schemes that operated under the Sri Lanka Tea Board (SLTB) and the Export Development Board of Sri Lanka but as part of the broader government policy of moving away from selective export incentives toward uniform incentives, most of the initiatives have been phased out. These include fiscal incentives such as the custom duty rebate scheme, export expansion grant scheme and the tax-free incentive payment based on incremental gains from the export of teabags and retail packets. Another monetary incentive program phased out was the payment of loan interest by the Sri Lanka Tea Board for exporters to establish tea-bagging machines.

Sri Lanka has over the years strongly tapped into the benefits of branding. The SLTB developed a national brand identifier in 1932, popularly known as the Ceylon mark which is a platform for the development of private brands. This has developed to cover over 95 countries/markets key to the Sri Lankan tea industry. The Ceylon mark is used by bona fide packers registered by the SLTB, on retail level packages that contain 100% tea produced in Sri Lanka and which meets the quality criteria set by the SLTB. Using the mark, Sri Lanka has effectively differentiated its tea thereby getting competitive advantage in the world market (Ganewattaa et al, 2005).
Table 1.2: Comparison of Tea Export Volumes and Values for Kenya and Sri Lanka

<table>
<thead>
<tr>
<th>Year</th>
<th>Volume</th>
<th>Value</th>
<th>Volume</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Million Kgs</td>
<td>Million USD</td>
<td>Million Kgs</td>
<td>Million USD</td>
</tr>
<tr>
<td>2010</td>
<td>343.7</td>
<td>685.6</td>
<td>294.2</td>
<td>960.2</td>
</tr>
<tr>
<td>2011</td>
<td>383.4</td>
<td>899.2</td>
<td>298.8</td>
<td>1195</td>
</tr>
<tr>
<td>2012</td>
<td>342.4</td>
<td>899.2</td>
<td>279.8</td>
<td>1145</td>
</tr>
<tr>
<td>2013</td>
<td>441.0</td>
<td>1233.5</td>
<td>296.3</td>
<td>1299.5</td>
</tr>
<tr>
<td>2014</td>
<td>421.2</td>
<td>1231.9</td>
<td>301.2</td>
<td>1357</td>
</tr>
</tbody>
</table>

Kenya’s Total Exports include re-exports


1.1.1 Concept of the International Business and Competitiveness

International business is exchange of goods and services among individuals and business in multiple countries. We can further say that it’s a specific entity such as a multinational corporation or International business company that engages in Business among multiple countries. Countries engage in International Trade for two basic reasons each of which contributes to the country’s gain from trade. Countries trade because they are different from one another. Nations can benefit from their differences by reaching agreements in which each party contributes its strengths and focuses on producing goods efficiently. Countries too trade to
achieve economies of scale in production. If each country produces only a limited range of goods it can produce each of these goods at a larger scale and hence more efficiently than if it tried to produce everything.

International Competitiveness is the degree to which a country can, under free and fair market conditions meet the test of International market, while simultaneously maintaining and expanding the real incomes of its citizens. Several factors determine International competitiveness. They include relative inflation meaning if a country has a relatively lower inflation than other countries, then over time you become more competitive because your goods will be increasing at a slower rate. Also productivity that is the measure of output per input is another factor that that determines international competitiveness. Others include, infrastructure, cost of doing business, tax rates and exchange rates.

1.1.2 Value Addition

This increase though small has been as a result of a number of important developments in the value addition front. The Tea Board of Kenya developed the 2009-2012 strategic plan with one of its goals being to market and promote Kenyan tea through facilitating branding of Kenyan tea and promotion of product diversification and value addition.

Value addition by way of packaging, blending to get unique characteristics, impregnation, and flavoring of tea is common in tea exporting countries, increasing the earning potential for tea growing countries (Asia Institute of Technology, 2002). The most popular form of value addition in the tea sector is selling branded tea. This involves not only packing but also blending other
varieties to maintain consistency of taste. In Japan and the USA, convenient drinks such as instant tea, tea bags, ready to drink and flavored tea are becoming popular (Yilmaz, 2006).

There are a range of preferences for tea styles and drinking habits among different consumers in various countries. This has seen traditional loose tea being replaced by bagged tea for convenience. In recent decades there has been a shift towards convenience consumption of tea in western markets with tea bags replacing loose leaves (Hicks, 2001). In this case it is more important for consumers to have tea bags release color and strength quickly than that the tea has what a connoisseur would consider to be a fine flavor.

1.1.3 Kenya Tea Earnings

Kenya exports its tea to the world market in bulk which is mainly used for blending low quality teas from other countries. Consequently bulk tea fetches low prices leading to depressed revenue for tea growers and low foreign exchange earnings for the country (Tea Board of Kenya, 2009b). Kenya’s potential to add value to agricultural produce is largely unexploited. This makes the country vulnerable to fluctuating and declining commodity prices and increasingly fierce competition from cheap imports (Government of Kenya, 2011).

Kenya has only managed to increase the volume of Value Added Tea sales from under 5% to about 12% of total sales over the last few years (Tea Board of Kenya, 2009a). In Table 1.2, a comparison between Kenya’s and Sri Lanka’s tea export market shows that Kenya exported more tea in volume than Sri Lanka in 2009 but Sri Lanka earned more from its exports than Kenya did. In 2010, Kenya earned USD 1.23 Billion from exports of 362 million Kgs of its own
tea as well as re-exports of 79 million Kgs of other origin teas, while Sri lanka earned USD 1.30 Billion from its export of 296.3 million Kgs owing to higher prices and more valued added shipments (Tea Board of Kenya, 2011a). Kenya needs to scale-up activities such as processing, branding, quality certification and accreditation that increase the market value of primary products (Government of Kenya, 2011).

1.1.4 The Tea Sector in Kenya

The Tea Industry in Kenya is unique in that it is comprised of two distinct sectors; the Plantation or large scale sector and the small holder sector. The Plantation sector is owned by large scale tea producers and companies like Williamson Tea Kenya, Unilever Tea Kenya and Finlays Tea Kenya, while the small holders sector is by small scale growers. The small holder sector has registered more than half a million growers who are located across tea growing areas in the country. The small holder sector factories are managed by Kenya Tea Development Agency Ltd (KTDA).

The main tea growing areas in Kenya are situated in and around the highland areas on both sides of the Great Rift Valley; and astride the Equator within altitudes of between 1500 metres and 2700 metres above the sea level. These regions include the areas around Mt. Kenya, the Aberdares, and the Nyambene hills in the Central Kenya and the Mau escarpment ,Kericho Highlands, Nandi and Kisii Highlands and the Cherangani Hills.

Kenya is one of the world’s biggest tea exporters. In fact, hundreds of thousands of tea farmers have earned a living for generations in this east African country. But the industry is screeching to a halt. This year, farmers sold 40% less than the three previous years because they have started to
switch to alternative crops. You see, good weather and big harvests have led to a glut of Kenya’s specialty black tea market. Tea farmers are so discouraged by the drop in sales that they are switching to crops in higher demand. Some are even considering building on their plots.

1.1.5 Kenya Tea Development Agency (KTDA)

Indigenous Kenyans were barred by law from growing tea until the dawn of independence when the legislation was repealed for the indigenous people to commence on tea growing. In 1960, the colonial government created the Special Crops Development Authority (SCDA) to promote growing of tea by Africans under the auspices of the ministry of Agriculture. After Independence, Kenya Tea Development Authority was formed through legal notice No.42 of 1964 and took over the liabilities and functions of the SCDA to promote and foster the growing of tea in small farms, which were previously said to be not viable in view of the expertise and costs required, as witnessed in the plantation sector.

Since then the growing of tea by the small-scale sub-sector in Kenya has carved a niche for itself in the global tea trade. Kenya Tea Development Agency Limited was incorporated on 15th June 2000 as a private company under (CAP 486) of the laws of Kenya, becoming one of the largest private tea management agencies. The Agency currently manages 63 factories in the small-scale tea sub-sector in Kenya. KTDA functions include factory unit management and support services, sales and marketing, financial services and tea management and consultancy services (KTDA 2011). It also provides extension services, production inputs, green leaf collection, processing and marketing of processed tea on behalf of small scale tea farmers (KTDA 2011). KTDA is the world’s largest tea marketer.
Quality of all KTDA teas is paramount. Tea tasting as a quality control measure is done on a weekly basis during the normal tea processing at the factory level. However, intensified comparative tea tasting analysis for all KTDA Ltd teas is done at the head office in Nairobi on regular basis with the aim of marketing the teas and giving advice where necessary to the production units.

KTDA, facilitates the sale of teas in all the market outlets while ensuring prompt collection of tea proceeds from all buyers it also undertakes sales promotions of teas using cost effective method with the aim of expanding the market share. Dissemination of information on policy changes and tea production to the existing and potential buyers all over the world and encouraging and supporting the local packers in order to expand and strengthen the local market is also a key function that KTDA undertakes. KTDA also facilitates regular certification of KTDA Ltd teas as demanded by the international standard organization (ISO) and the tea trade, co-ordinates with the Chai Warehousing Ltd and ensures proper warehousing of all KTDA Ltd teas.

The current existing market outlets are: Mombasa auction 75%, KETEPA 7%, Direct sales (Overseas and local) 15% and Factory door sales 3%. Direct sales are based on prevailing Mombasa auction prices. It is important to note that prices of teas are not constant. They change on a weekly basis depending on supply and demand in the auction.

The bulk of tea sold by KTDA Ltd on behalf of small scale growers is done through the Mombasa auction held every Monday except on public holidays. The auction has become a
world-renowned tea market center for East and Central Africa tea producing countries. The auction is conducted under the supervision of the East African Tea Trade Association (EATTA).

1.2 Research Problem

Kenya exports its tea to the world market in bulk which is mainly used for blending low quality teas from other countries. Consequently bulk tea fetches low prices leading to depressed revenue for tea growers and low foreign exchange for the country (Tea Board of Kenya, 2009b) Kenya’s potential to add value to agricultural produce is largely unexploited. This makes the country vulnerable to fluctuating and declining commodity prices and increasingly fierce competition from cheap imports (Government of Kenya, 2011).

Kenya has only managed to increase the volume of Value Added Tea sales from under 5% to about 12% of total sales over the last few years (Tea Board of Kenya, 2009a). A comparison between Kenya’s and Sri Lanka’s tea export market shows that Kenya exported more tea in volume than Sri Lanka in 2009 but Sri Lanka earned more from its exports than Kenya did. In 2010, Kenya earned USD 1.23 Billion from exports of 362 million Kgs of its own tea as well as re-exports of 79 million Kgs of other origin teas, while Sri Lanka earned USD 1.30 Billion from its export of 296.3 million Kgs owing to higher prices and more valued added shipments (Tea Board of Kenya, 2011a). Kenya needs to scale-up activities such as processing, branding, quality certification and accreditation that increase the market value of primary products (Government of Kenya, 2011).
Nyangito (2001) argues that failing to add value to tea by selling it in bulk limits earnings from exports. He further notes that adding value to tea through branding and packaging can earn up to six times more revenue than unpacked tea. A strategic approach for Kenya’s tea sector is to diversify and add value to tea products for the domestic and international markets (Tea Board of Kenya, 2009b)

This study therefore seeks to establish the effects of value addition activities on earnings in Kenya’s tea sector, the incentives that can encourage increased value addition in Kenya's tea sector and finally propose value addition activities that can contribute to higher earnings.

How can value addition enhance competitiveness and earnings of Kenyan tea in the International market?

1.3 Research Objectives

The objective of this study was to determine how value addition of tea products by Kenya tea Development Agency-KTDA can enhance International competitiveness of Kenyan tea.

1.4 Value of the study

Value addition has been singled out as one of the ways of guaranteeing high prices of locally produced crops in Kenya. The findings of this research are aimed at encouraging small holder tea farmers who are the major tea producers in the country as well as large-scale tea farmer’s to venture into value addition. Entrepreneurs in agribusiness seeking to go into value addition in the tea sector or other sectors such as horticulture can also benefit from this research. Noting that
Kenya’s tea sector undertakes little value addition, this research seeks to identify value addition activities that guarantee high returns in order for the sector to focus on those activities.

Value addition efforts have been encouraged by the Government of Kenya and stakeholders in the tea sector. This research will therefore be useful to the Ministry of Agriculture, specifically policymakers within the ministry and the working group constituted to coordinate value-addition initiatives; TBK; KTDA; TRFK; KETEPA; and EATTA among others.

This research fills the important knowledge gap on the value addition activities undertaken in Kenya’s tea sector and their relationship with tea earnings. It also seeks to contribute to the existing body of knowledge on value addition.
CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviews existing literature relating to the objectives of the research. New Trade theory and International product life cycle theories have provided the theoretical foundations for this study.

2.2 Theoretical foundation

Several theories provide an explanation of the phenomenon of global business. These are New Trade Theory and International Product life cycle among others.

2.2.1 New Trade Theory

New Trade Theory is a collection of economic models in international trade which focuses on the role of increasing returns to scale and network effects, which were developed in the late 1970s and early 1980s. New trade theorists relaxed the assumption of constant returns to scale, and some argue that using protectionist measures to build up a huge industrial base in certain industries will then allow those sectors to dominate the world market.

Krugman took on Ricardian framework of comparative advantage the original insights and developed them further. He did all this by focusing on internal returns to scale, and by adopting a recent modelling innovation in Dixit and Stiglitz (1977), making it easier to model monopolistic competition. Assuming a situation where are all agents have identical comparative costs, technologies, and tastes, and there is only one factor, there are none of the standard reasons for
trade. But, we assume that there are internal economies of scale. Internal economies of scale occur as long as the average cost per unit of output falls as total output increases, Spenser (1986). The easiest reasons to cite for internal economies are high fixed costs, where more output allows the firm to spread this fixed cost. If there are internal economies of scale, markets are not perfectly competitive. Instead, there will be less firms, and each firm will produce more. Each firm will also have an incentive to differentiate their product from those of their competitors - if they are close/imperfect substitutes - to compete for profits. The total number of firms can be said to be determined by average cost and price. Countries will, all else equal, export the goods where domestic demand is highest, Rodrick (1989). It will behoove firms to localize production in markets where demand for that type of product is highest. This is because these firms will be able to exploit greater internal economies of scale than anywhere else. Thus, under conditions of internal economies, countries will tend to export the good they produce more of. In a world of no transaction costs, differences in local demand for a product will induce the country with the greatest internal economies to specialize in that product. In a world of transaction costs- where there are added costs to trade -, specialization will be more limited, because these costs reduce the profitability of exporting. Also, the extent of internal economies will also decide the extent of specialization; the less the opportunities for internal economies, the less a country will specialize in a type of good. Thus, with costs to trade and limits to economies of scale, what we expect is intra-industry trade, as each country produces multiple types of good and trade these between each other, even goods of the same type. But, generally speaking, the country with the larger home market for a given good will be a net exporter of that good, because of economies of scale (and out of interest in minimizing transaction costs) Srinivasan (1989).
If two countries are similarly endowed, then trade will tend to be of the intra-industry type. As factor endowments become more unique, the type of trade predicted by the Heckscher–Ohlin model will prevail, Dixit (1984). The implications for changes in the distribution of income as a result of trade is that if endowments are the same, trade is Pareto optimal. If factor endowments differ, how much they differ will decide relative gains from trade and changes in income distribution. Namely, the more unique a country’s factor endowment, the more the relatively scarce factor will lose from trade and the relatively abundant factor will gain, Eaton and Grossman (1986). The scarce factor loses, because with international trade, the price of that product in that country falls (as it faces competition from foreign producers, who have lower costs, because they are in countries that have a relative abundance in that factor). Whether trade is Pareto optimal depends on whether the welfare increase from product differentiation is large enough to make up for the relative loss of income for the scarce factor.

2.2.2 International Product Life Cycle

Product life cycle theory divides the marketing of a product into four stages: introduction, growth, maturity and decline, Raymond Vernon (1960). When a product is first introduced in a particular country, it sees rapid growth in sales volume because market demand is unsatisfied. As more people who want the product buy it, demand and sales level off. When demand has been satisfied, product sales decline to the level required for product replacement. In international markets, the product life cycle accelerates due to the presence of "follower" economies that rarely introduce new innovations but quickly imitate the successes of others. They introduce low-cost versions of the new product and precipitate a faster market saturation and decline.

An effectively marketed product meets a need in its target market. The supplier of the product has conducted market surveys and has established estimates for market size and composition. He
introduces the product, and the identified need creates immediate demand that the supplier is ready to satisfy. Competition is low. Sales volume grows rapidly. This initial stage of the product life cycle is characterized by high prices, high profits and wide promotion of the product. International followers have not had time to develop imitations. The supplier of the product may export it, even into follower economies.

In the maturity phase of the product life cycle, demand levels off and sales volume increases at a slower rate. Imitations appear in foreign markets and export sales decline. The original supplier may reduce prices to maintain market share and support sales. Profit margins decrease, but the business remains attractive because volume is high and costs, such as those related to development and promotion, are also lower.

In the final phase of the product life cycle, sales volume decreases and many such products are eventually phased out and discontinued. The follower economies have developed imitations as good as the original product and are able to export them to the original supplier's home market, further depressing sales and prices. The original supplier can no longer produce the product competitively but can generate some return by cleaning out inventory and selling the remaining products at discontinued-items prices Raymond Vernon (1960).

2.3 Foreign Market Entry Strategy

When an organization has made a decision to enter an overseas market, there are a variety of options open to it Root (1994). These options vary with cost, risk and the degree of control which can be exercised over them. The simplest form of entry strategy is exporting using either a direct or indirect method such as an agent, in the case of the former, or countertrade, in the case
of the latter. More complex forms include truly global operations which may involve joint ventures, or export processing zones. Having decided on the form of export strategy, decisions have to be made on the specific channels. Many agricultural products of a raw or commodity nature use agents, distributors or involve Government, whereas processed materials, whilst not excluding these, rely more heavily on more sophisticated forms of access Hwang and Kim (1990, p.119).

It is particularly suitable for companies with little international experience since almost all international operating functions are borne by the agent, including the costly and time-consuming requirements such as bills-of-lading, customs clearance, and invoice and collection Hwang and Kim (1990, p.121).

Many companies begin their internationalization opportunistically through a variety of arrangements that may be described as “piggybacking,” because they all involve taking advantage of a channel to an international market rather than selecting the country-market in a more conventional manner. For example, a firm may be offered some spare capacity on a ship or plane by a business partner, or it may find that a domestic distributor is already serving an international market and so grants a foreign distribution license that requires nothing more than an increase in domestic sales Chan Kim and Hwang, (1992).

The most common form of piggybacking is to internationalize by serving a customer who is more international than the vendor firm. Thus, a customer requests an order, delivery, or service in more than one country, and the supplier starts selling internationally in order to retain the customer and increases its penetration of the account. This is particularly common in the case of
business-to-business companies and technology-oriented start-ups. Another common situation is when two companies in the same industry combine to use the same distribution channel for products that are not directly competitive, thus obviating to some extent the financial disadvantage of establishing distribution when sales volumes are still low. For instance, competitors in some industries, such as pharmaceuticals, routinely license their sales and/or distribution to each other in markets where the competitor is better established and the products are not directly competitive.

Franchising is an underexplored entry mode in international markets, but it has been widely used as a rapid method of expansion within major developed markets in North America and Western Europe, most notably by fast food chains, consumer service businesses such as hotel or car rental, and business services. At heart, franchising is suitable for replication of a business model or format, such as a fast-food retail format and menu. Since the business format and, frequently, the operating models and guidelines are fixed, franchising is limited in its ability to adapt, a key consideration in employing this entry mode when entering new country-markets. There are two arguments to counter this. First, the major franchisers are increasingly demonstrating an ability to adapt their offering to suit local tastes. Secondly, it must be recognized that there are product-markets in which customer tastes are quite similar across countries. The main drawback of franchising is the difficulty of adapting the franchised asset or brand to local market tastes. A key indicator that franchising carries this constraint is the fact that marketing budgets at local levels are usually restricted to short-term promotions rather than market development. This is consistent with the concept that franchising is a rapid replication strategy.
Licensing is a common method of international market entry for companies with a distinctive and legally protected asset, which is a key differentiating element in their marketing offer. This might include a brand name, a technology or product design, or a manufacturing or service operating process. Licensing is a practice not restricted to international markets. It offers a particularly effective way of entering foreign markets because it can offer simultaneously both a low-intensity (and therefore low risk) mode of market participation and adaptation of product to local markets. In licensing agreements, the local licensee has considerable autonomy in designing the products into which it incorporates the licensed characters. The other major advantage of licensing is that, despite the low level of local involvement required of the international licensor, the business is essentially local and is in the shape of the local business that holds the license. As a result, import barriers such as regulation or tariffs do not apply Chan Kim and Hwang, (1992).

2.4 Value Addition and International competitiveness

International Competitiveness is the degree to which a country can, under free and fair market conditions meet the test of International market, while simultaneously maintaining and expanding the real incomes of its citizens. Despite Kenya being the world’s number one exporter of tea, Sri Lanka which is Kenya’s closest competitor commands higher prices for its tea through exploiting value addition opportunities in the tea sector (Wal, 2008) thus being more competitive in the world market compared to top four tea producing countries; China, India and Kenya.

Among the top four tea producing countries; China, India, Kenya and Sri Lanka, Sri Lanka is an exception and has succeeded in capturing more value in the supply chain through value added
production and is one of the success stories in tea value-addition (Kurian et al, 2007; Wal, 2008; Nair, 2010). Although India and China are the largest tea producers, most of their tea is consumed in the domestic market and their exports are mainly in bulk form (Wal, 2008; RAM Ratings (Lanka) Ltd, 2009). Kenya has only managed to increase the volume of Value Added Tea sales from under 5% of total sales to about 12% (Tea Board of Kenya, 2009b).

Sri Lanka’s value added tea exports include instant tea, tea bags, iced tea, flavoured tea, green tea, and organic tea (Herath& De Silva, 2011). Recognizing the importance and potential of teabags and retail packets as an alternative to bulk tea exports, the Sri Lanka government has taken several initiatives over the years to promote their production for export markets. According to Ganewattaa et al (2005) there were several export promotion schemes that operated under the Sri Lanka Tea Board (SLTB) and the Export Development Board of Sri Lanka but as part of the broader government policy of moving away from selective export incentives toward uniform incentives, most of the initiatives have been phased out. These include fiscal incentives such as the custom duty rebate scheme, export expansion grant scheme and the tax-free incentive payment based on incremental gains from the export of teabags and retail packets. Another monetary incentive program phased out was the payment of loan interest by the Sri Lanka Tea Board for exporters to establish tea-bagging machines.

Sri Lanka has over the years strongly tapped into the benefits of branding. The SLTB developed a national brand identifier in 1932, popularly known as the Ceylon mark which is a platform for the development of private brands. This has developed to cover over 95 countries/markets key to the Sri Lankan tea industry. The Ceylon mark is used by bona fide packers registered by the
SLTB, on retail level packages that contain 100% tea produced in Sri Lanka and which meets the quality criteria set by the SLTB. Using the mark, Sri Lanka has effectively differentiated its tea thereby getting competitive advantage in the world market (Ganewattaa et al, 2005).

Branding strategies based on geographical origins of a product can provide a basis for differentiating commodity products. Geographical identities (GI’s) can afford producers “brand name” equity and protection usually not available to commodity products. GI protection enable producers command premiums for their products, especially if perceived or actual quality differences exist, including product differences attributable to their unique geographical as opposed to varietal origins (Agarwal & Barone, 2005). Sri Lanka has used geographical indication as a branding strategy based on elevation and administrative boundaries. These are based on seven differentiated regions which ride on the National Ceylon trademark which has also been registered as a geographical indication in addition to its initial registration as a Trade mark (Ganewattaa et al, 2005).

Sri Lankan companies have also benefited from value-addition incentive offered in destination markets such as packaging in Free Trade Zones and joint ventures formed with companies within the tea markets to promote their value-added tea products within the destination markets (Ganewattaa et al, 2005).

Sri Lankan tea exporters have been able to tap into about 30 million rupees in cess funds given as a monetary incentive to encourage value added exports of Ceylon tea. The net weight of packs must not exceed three kilograms for it to be entitled to this incentive. This has benefited
exporters of Ceylon tea involved in packaging tea in tea bags, small packs and those dealing in 
flavoured teas (Lanka Business Online, 2006).

As a result of adopting some of the strategies discussed above, the level of value-addition in Sri 
Lanka in 2005 stood at about 54% of the total export volume. Out of the value-added teas, loose 
tea in packets of less than three Kgs is about 44% while tea bags constitute 10% of the total 
volumes of exported value added teas. All foreign teas imported into Sri Lanka are used for 
blending and value addition before re-exporting (Ganewattaa et al, 2005).

2.5 Conclusion

Kenya exports its tea to the world market in bulk which is mainly used for blending lower 
quality teas from other countries. As a result, it fetches low prices and leads to depressed revenue 
for tea growers and low foreign exchange for the country (Tea Board of Kenya, 2009b). Despite 
Kenya being the world’s number one exporter of tea, Sri Lanka which is Kenya’s closest 
competitor commands higher prices for its tea through exploiting value addition opportunities in 
the tea sector (Wal, 2008).

Kenya’s over-dependence on traditional tea markets namely Pakistan, UK, Egypt, Sudan, and 
Afghanistan, has led to limited market diversification which must be addressed (International 
Tea Committee, 2009). Over-reliance on black CTC tea with limited product diversification has 
led to fluctuation in black tea prices. Overdependence on a few markets puts Kenya in a 
disadvantaged position because a drop in demand from any one of these countries negatively 
impacts on revenues from Kenyan tea exports. There is a risk of losing major key tea markets if 
the country does not combine bulk and value addition (Ochanda, 2012).
It is argued that adding value to a crop like tea can fetch up to six times more revenue than unpacked tea (Nyangito, 2001; Groosman, 2011). Kenya has only managed to increase the volume of Value Added Tea sales from under 5% of total sales to about 12% (Tea Board of Kenya, 2009b). A strategic approach for Kenya’s tea sector is to diversify and add value to tea products for the domestic and international markets (Tea Board of Kenya, 2009b).

Value addition entails increasing the economic value and consumer appeal of a commodity (Tea Board of Kenya, 2011). Value added tea has captured a significant position in the global tea trade because of the sophistication of tea consumption patterns. Consumer preference for loose tea has been on the decline replaced by bagged tea for convenience, while demand for tea bags and ready-to-drink teas has been increasing over the years (Ariyawardana, 2001; Hicks, 2001). Value addition by way of packaging, blending, impregnation, and flavouring of tea is common in tea exporting countries, increasing the earning potential for tea growing countries (Asia Institute of Technology, 2002). Studies in value addition of tea (Omari, 2005; Nzeki, 2008) show that value addition has many advantages among them increased revenue and employment creation. Value addition therefore creates significant opportunities for Kenya’s economy.
CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction
This chapter outlines the process used to carry out the research. It defines the research design and methodology used. It also explains the composition of the population, sampling procedures, sample size as well as the methodology used in collecting and analyzing data.

3.2 The Research Design
This research used a case study approach. A case study was adopted to allow for a one-time collection of data from the sample population. This research is descriptive and exploratory in nature. Sekaran and Bougie (2009) assert that a descriptive study is undertaken in order to ascertain and describe the characteristics of the variables of interest in a situation while an exploratory study is undertaken when not much is known about the situation at hand. The study will be both qualitative and quantitative and will use descriptive statistics.

3.3 Data Collection
Data was collected from KTDA Operations manager, Marketing Manager, Managing Director Chai Trading which is a subsidiary of KTDA, through the use of interview guide. The interview guides will be self-administered in factories where the researcher will not able to reach. Semi structured interview guides were allowed for probing through the use of open ended questions. The method of administering guides by the researcher was preferred as it established credibility, allowed rapport building with the respondent, clarification of responses and motivated
respondents to respond thus minimizing delays in filling out questionnaires. Secondary data relating to value addition and tea earnings was collected from the Tea Board of Kenya and Kenya Tea Development Authority Agency to supplement the primary data collected.

3.4 Data Analysis

The data collected was analyzed by way of content analysis. This involved analysis of meanings and implications emanating from the respondents. Content analysis has been successfully used to conduct similar studies in the past (Koske, 2003; Kamau, 2006).
CHAPTER FOUR

FINDINGS AND DISCUSSION

4.1 Introduction

This chapter focuses on the data analysis, presentation and interpretation of findings.

The presentations were done based on the research objectives.

4.1 Response Rate

The study targeted six top level KTDA Managers. Four out of the targeted six managers responded representing 66.7% of the respondents.

4.2 General Findings on Kenya’s tea Sector

The study gathered general and specific information relating to the research objectives. The general information such as types of tea produced; markets for value added tea, dominant value addition activities undertaken in Kenya’s tea sector and perceptions on developments made in tea value addition provided a background in addressing the objectives of this research.

4.2.1 Types of tea produced in factories

The research sought to find out the types of tea produced by KTDA factories as shown in table 4.1.
Table 4.1 Types of tea produced at factory level (shown in percentage and frequency)

<table>
<thead>
<tr>
<th>Type of Tea</th>
<th>Black Tea</th>
<th>CTC Tea</th>
<th>Green CTC Tea</th>
<th>Black orthodox Tea</th>
<th>Green orthodox Tea</th>
<th>White Tea</th>
<th>Purple Tea</th>
</tr>
</thead>
<tbody>
<tr>
<td>Produced</td>
<td>100.0% (18)</td>
<td>11.2% (2)</td>
<td>16.8% (3)</td>
<td>5.6% (1)</td>
<td>5.6% (1)</td>
<td>11.2% (2)</td>
<td></td>
</tr>
<tr>
<td>Not produced</td>
<td>0.0% (0)</td>
<td>88.2% (16)</td>
<td>83.2% (15)</td>
<td>94.4% (17)</td>
<td>94.4% (17)</td>
<td>88.8% (16)</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td></td>
</tr>
</tbody>
</table>

Source: Author, 2015

All factories produced black CTC tea representing 100% of all factories interviewed. The second highly produced tea was Black Orthodox tea produced in 3 of the factories interviewed (16.8%).

4.2.2 Dominance of Value addition Activities in Kenya’s Tea Sector

The respondents were asked what value addition that KTDA factories engages in and the dominance of each. Packaging, branding, blending, flavoring and instant tea were the named value addition activities.

The most dominant activity is packaging. This is the most common and basic form of value addition found in all the factories. Tea is packaged in small packs of 500 grams and 1 Kg to be sold at the factory door. These sales were referred to as factory door sales.

Branding is done in 38.9% of KTDA factories and blending at 33.3%. Flavoring and Instant tea were considered to be the least dominant.
No KTDA factory produced instant tea. None of the factories were involved in flavoring as this was left to other players in the tea trade who specialize in blending and flavoring tea such as Melvin’s Tea Company.

Three out of the four sector experts interviewed considered packaging to be the most dominant form of value addition while one of them considered branding to be the most dominant form of value addition.

All the factories were involved in some form of value addition and the most common and basic form of value addition found in all the factories was packaging of tea in small packs of 500 grams and 1 Kg to be sold at the factory door. These sales were referred to as factory door sales.

### 4.2.3 Major markets for Value Added Tea

Seventy nine percent of the value added teas is sold in the domestic market, 21% is sold in the international markets. It was established that Value Added Tea is not sold at the Mombasa tea auction because tea at the auction is sold mainly in bulk form. Value Added Tea from the factories in certain instances is prepared according to buyer specifications and sold directly to the customers. The respondents mentioned Ringtone supermarkets in the UK, Van Rees group based in the Netherlands and Zenchio in China as some of the international customers for Value Added Tea. All the four managers interviewed considered the domestic market as the major market for value added tea.

### 4.3 Effects of Value addition on earnings
This research sought to establish the effects of value addition activities on earnings. Respondents were asked to what extent value addition increased earnings judging from sales figures from the factories. Respondents indicated that value addition increased earnings by between 0 to 25%.

In the interviews with tea experts, one expert dealing in the export of tea indicated that the price of Value Added Tea was higher than that of traditional bulk tea sold at the Mombasa tea auction by over 75%. Two experts indicated that the price of Value Added Tea was higher than that of traditional bulk tea by between 26 to 50%. One expert indicated that the price of Value Added Tea was higher than that of traditional bulk tea by between 0 to 25%. The varying opinions could have been as a result of differences in market orientation as the expert who gave a price difference of between 76 to 100% was an export manager whose focus is the international market.

4.3.1 Average mean unit price of Value Added Tea and bulk tea and contribution of Value Added

Tea to total tea exports, earnings and unit value prices Export figures from the Tea Board of Kenya on value added and bulk CTC tea exports was computed to establish the mean unit price of Value Added Tea compared to bulk CTC tea and establish the contribution of Value Added Tea to total tea exports, earnings and unit value prices as illustrated in figure 4.2.
4.4 Challenges Hindering Value Addition in Kenya’s Tea Sector

In order to identify the incentives that can encourage increased value addition in Kenya’s tea sector, the study sought to find out the major challenges hindering tea value addition that need to be addressed.

The biggest challenge hindering value addition is insufficient fiscal and monetary incentives, respondents rated it highly among the list of challenges given. High cost of investment, high levies and taxes and insufficient research and development on value addition was also named as a challenge.
Additional challenges such as lack of aggressive marketing efforts to support value addition; budgetary constraints; small local or regional ready market for value added teas; and limited tea variety types to value add since Kenya is traditionally oriented towards bulk CTC tea.

4.5 Incentives that can Encourage Value Addition in Kenya’s tea Sector

To establish incentives that are most effective in encouraging value addition in Kenya’s tea sector, respondents were asked to rate some possible incentives in the tea sector as important or not important. Monetary incentives, promotional support and branding support were considered to be important by respondents. Investments in overseas markets was least considered important.

Respondents were asked to list down incentives various stakeholder should put in place to encourage value addition. According to the respondents the Tea Board of Kenya as the regulator and marketer of Kenya’s tea, needs to provide a strong platform to increase efforts of marketing Kenya’s tea abroad. Tea Research Foundation of Kenya needs to provide market oriented research, the respondents felt their research was limited to production, for example coming up with new tea varieties but did little in terms of looking for markets for Value Added Tea and other tea varieties. KTDA needs to spearhead value addition activities among the small scale tea farmers, diversify into other types of tea in their processing factories as well as market their tea based on geographic regions where the tea is grown like Sri Lanka. KETEPA needs to increase their tea buying capacity in order to undertake value addition for small holder farmers since their mandate as a subsidiary of KTDA is to package tea on behalf of farmers. Government of Kenya needs to come up with sufficient monetary and fiscal incentives that encourage value addition, reduce taxes on value addition equipment, exempt value added teas from being taxed to enable
them compete on a level playing ground with traders importing tea into the country as well as provide technical support to the industry.

A number of incentives that can encourage value addition also include removal of taxes and duties charged on value addition machinery, equipment, materials and value added tea by the Government of Kenya. TBK identifying markets and providing promotional support for value added teas. TRFK conducting market oriented research relating to tea value addition. KTDA should also conduct research on tea value addition and formulate policies that encourage factories to invest in value addition. They also felt that there should be joint investment in value addition equipment and machinery by factories within the same region to minimize the cost of investment.

4.6 Value addition activities with the potential of increasing earnings for Kenya’s tea sector
In order to propose value addition activities with the potential of increasing KTDA’s tea earnings, the study sought to determine which activities KTDA should focus on. Respondents felt that packaging had the highest potential of increasing tea earnings. Branding was also considered as an activity that will increase tea earnings. The respondents felt that instant tea had the least potential of increasing KTDA’s tea earnings.

Other value addition activities that have the potential of increasing earnings for KTDA’s tea include use of the tea mark of origin; international certifications e.g. fair trade, rainforest alliance; tea extracts; tea wine; iced tea and vacuum packing among others.
4.6.1 Potential of diversification into other tea varieties in increasing earnings for Kenya’s tea sector

In order to propose value addition activities with the potential of increasing Kenya’s tea earnings, this study sought to find out which types of teas other than black CTC tea have the potential of increasing tea earnings. The study noted that the respondents felt it was necessary for KTDA to diversify into other types of tea.

The respondents felt that purple tea was the most important tea variety with the potential of increasing KTDA’s tea earnings in International Market. Black Orthodox tea was mentioned with second most potential. Respondents felt that white tea was not an important tea type in increasing earnings and competitiveness.

4.7 Summary

Findings showed that Black CTC tea is the most commonly produced tea by KTDA factories. Only one KTDA factory produced all types of teas; Green CTC, Green Orthodox, Black Orthodox, White and Purple teas in addition to Black CTC tea as a pilot study mainly for purposes of research. Black Orthodox tea was produced in 3 of the factories; purple, green CTC and green orthodox tea were produced in only two factories showing that other tea varieties are produced in small quantities.

Interviews established that Black CTC tea is the most commonly produced tea variety. The major focus on the production of Black CTC tea as found in the factories supports the view that Kenya is a leading producer of Black CTC tea in the world (Tanui et al, 2012; Tea Board of
Kenya, 2012b). The managers interviewed expressed the need for KTDA to diversify into other tea varieties in order to minimize overreliance on Black CTC tea and attract new markets. This supports the view that Kenya risks losing major key tea markets if it does not combine bulk and value addition in the production of tea (Ochanda, 2012). It also suggests that overreliance on the production and export of bulk CTC tea traditionally used as raw material to blend low quality teas from other countries at the expense of Kenyan tea brands and limited product diversifications is a challenge facing the sector (Tea Board of Kenya, 2009; Ochanda, 2012).

Value added teas are sold in the domestic market mainly through supermarkets and international markets to private buyers or tea companies such as Van Rees who make special orders from the factories and have their tea processed according to specifications. Tea sold through the Mombasa tea auction is mainly sold in bulk, usually in packages of 60 Kgs. Bulk tea bought at the auction is usually packed into smaller packs by tea packers as interviews with show. These findings further supported the view that over 95% of tea produced in Kenya is exported in bulk through the weekly Mombasa auction, the second largest tea auction in the world (Export Processing Zones Authority, 2005).
CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the conclusion and recommendations. The chapter also presents suggestions for further research.

5.2 Summary

Findings and summary of the study are outlined below.

5.2.1 Types of teas produced and markets for Value Added Tea

Findings showed that Black CTC tea is the most commonly produced tea by KTDA factories. Only one KTDA factory produced all types of teas; Green CTC, Green Orthodox, Black Orthodox, White and Purple teas in addition to Black CTC tea as a pilot study mainly for purposes of research. Black Orthodox tea was produced in 3 of the factories; purple, green CTC and green orthodox tea were produced in only two factories showing that other tea varieties are produced in small quantities.

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### 5.2.2 The dominant value addition activities undertaken in Kenya’s tea sector and perceptions on developments made in tea value addition

Interviews showed packaging, branding and blending as being the most dominant value addition activities in Kenya’s tea sector. KTDA factories do not produce instant tea. No KTDA factory was involved in flavoring as this was left to other players in the tea trade who specialize in blending and flavoring tea such as Melvin’s Tea Company. This is consistent with literature which suggests that downstream stages such as blending, flavoring, packing and marketing, which are the most profitable are left for tea companies (also called packers/blenders) who buy
the tea through brokers (Groosman, 2011). The focus at factory level seems to be processing of green leaf to produce finished tea.

Value addition activities undertaken in KTDA factories are mainly packaging, branding, and blending. The findings were consistent with literature which showed that packaging, branding and blending are the most common value addition activities in Kenya’s tea sector (Nyangito, 2001). This also supports the view that value addition by way of packaging and blending to get unique characteristics, among other forms of value addition is common in tea exporting countries, increasing the earning potential for tea growing countries (Asia Institute of Technology, 2002).

Ali, Choudhry and Lister (1997) argue that product innovation in Kenya’s tea sector has not been notable mainly because over sixty percent of tea production comes from the smallholder sector and new product developments have only come from the estate sector. This argument was contrary to findings which showed that blending of tea and vacuum packing were also practiced in KTDA factories and that there was no significant difference in product development between the small holder sector and the estate sector locally. Tea is generally exported with minimal processing to importing consumer countries where it is blended and packaged by the tea companies (Groosman, 2011). This may explain why product developments in both the smallholder sector and estate sector have not been notable in Kenya’s tea sector.

On the perceptions on developments made in value addition, respondents felt that Kenya had not made significant developments in the value addition front and also that fiscal and monetary incentives provided by government and stakeholders in the tea sector were not sufficient. This
supports the view that Kenya’s potential to add value to agricultural produce is largely unexploited (Government of Kenya, 2011). Kenya has only managed to increase the volume of value added tea sales from under 5% to about 12% of total sales over the last few years (Tea Board of Kenya, 2009a).

They respondents also indicated that they all felt that the level of value addition carried out in the country was low and that there was very little development made in the value addition front.

5.2.3 Effects of value addition on earnings

Findings showed that value addition increases tea earnings and that Value Added Tea fetches higher prices than traditional bulk CTC tea. In total, 83.3% of the factory respondents indicated that judging from their sales figures value addition increases tea earnings by between 0 to 25%. On the price difference between traditional bulk CTC tea and value added tea, industry experts gave varying percentages of price differences but in all instances, the price of Value Added Tea was higher than traditional bulk CTC tea. An analysis of tea export figures for 2008 to 2013 gave an average mean unit price of Kshs 524.34 for instant tea, Kshs 383.28 for packed tea, Kshs 188.75 for Sudan and Kshs 224.37 for bulk tea. The mean unit price of instant tea was more than double that of bulk tea which supports the argument that by exporting tea in bulk developing countries miss opportunities to earn higher export earnings and limits earnings from exports (Lines, 2006; Nyangito, 2001).

The argument that branded tea fetches prices six times higher than tea exported in bulk (Nyangito, 2001; Lines, 2006) was not consistent with findings as an analysis of tea export figures for 2008 to 2013 showed a difference of Kshs 347.66 between the average mean unit
price of both branded and packaged tea (including exports to Sudan which include blended tea) and bulk tea. This is about two times higher and not six times higher; exported tea to other countries is packaged then branded. Value Added Tea also commands higher returns per kg sold compared to bulk tea. However it is probable that value added tea can earn prices six times higher than bulk tea if various forms of value addition are combined to target niche-markets where customers are willing to pay a premium for high quality blends that are packaged and branded. FAO notes that some of the highly priced tea bags contain up to 21 different teas from different sources (Food and Agricultural Organization, 2010). Findings on the perceptions on value addition and its effects on financial returns, profitability, earnings and cost of investment showed that financial returns gained from value addition activities exceed the cost of investment in the long run and justifies the need for factories to venture into value addition; that value addition is one of the key strategies to ensure profitability; and that factories involved in value addition receive higher earnings than those not involved in value addition. These findings further reinforced the findings that value addition increases tea earnings and that Value Added Tea fetches higher prices than traditional bulk CTC tea.

5.2.4 Challenges hindering value addition and incentives considered effective in encouraging value addition

Insufficient fiscal and monetary incentives, high cost of investment, high levies and taxes, insufficient research and development and tariff and non tariff barriers were considered the biggest challenges hindering value addition. This was consistent with the view on impediments to value addition in Kenya’s tea sector which include: competition from established traders particularly multinational corporations with well established brands and loyal customers; tariff
and nontariff restrictions on imports in markets such as Sudan; insufficient fiscal and monetary policies and where provided such as Tax Remission for Exports Office (TREO) are ineffective and not favorable to tea value-addition (Tea board of Kenya, 2011). However, factory respondents did not consider competition from established traders to be a major impediment compared to other impediments.

The incentives considered most effective in encouraging value addition included monetary and fiscal incentives, promotional support, branding support and investments in overseas markets. It is important to note that these incentives were closely related to the challenges and could therefore address the challenges hindering value addition. Qualitative data identified incentives consistent with those listed above.

5.2.5 Value addition activities with the potential of increasing Kenya’s tea earnings

Findings from both factories and industry experts showed that packaging, branding and blending were the three activities with the highest potential of increasing Kenya’s tea earnings. Respondents considered flavouring and instant tea as having the least potential of increasing Kenya’s tea earnings. The respondents seemed to gauge the potential of value addition activities in increasing earnings on the basis of their dominance in Kenya’s tea sector judging from the similarity of the findings which showed that the most dominant value addition activities were rated highly and the least dominant value addition activities were rated low.
Although both factory and industry experts felt that instant tea had the least potential in increasing earnings, Value Added Tea exports show that instant tea earns the country the highest revenues in terms of unit price compared to other value added teas showing it has the highest potential of increasing Kenya’s tea earnings. Further probing revealed that instant tea was unpopular because it was considered to be of low quality since it is made from a mixture of low quality grades and also because majority of Kenyans prefer the traditional loose tea. However, in Europe and America it is preferred because of convenience (Hicks, 2001).

5.2.6 Potential of other tea varieties in increasing earnings in Kenya’s tea sector

Factory respondents felt that Purple tea, Black orthodox tea, Green CTC tea and Green orthodox tea were the most important tea varieties with the potential of increasing Kenya’s tea earnings. White tea was considered the least important tea variety in increasing Kenya’s tea earnings. Qualitative data revealed that the reason for this is because white tea is produced by drying tea leaf buds while still young as they turn white when dried. This means a lot of labour is required to pluck huge quantities of buds also known as silver tips to enable the production of substantial amounts of white tea. There is need to diversify into other types of tea varieties because overreliance on the production and export of bulk CTC tea used as raw material to blend low quality teas from other countries and limited product diversifications limits the earning potential of Kenya’s tea sector (Tea Board of Kenya, 2009; Ochanda, 2012). The introduction of Black Orthodox, Green Orthodox, White and Purple teas in the “Specialty” tea category in the 2008 Tea Classes competition was considered a major boost in value addition efforts showing that
these tea varieties have a huge potential of increasing Kenya’s tea earnings if exploited well (Tea Board of Kenya, 2009a).

5.3 Conclusion

The first and overall objective of this research was to determine how value addition of tea products by KTDA can enhance International competitiveness and earnings of Kenyan tea. The research found that the major value addition activities which include packaging, branding, blending, flavoring and instant tea had the positive effect of increasing tea earnings for Kenya’s tea sector. Computed tea export figures from the Tea Board of Kenya showed that value added tea exports earned more than double the price of bulk CTC tea showing that Value Added Tea commands higher returns per kg sold compared to bulk tea. Kenya has only managed to increase the volume of value added tea sales to about 12% showing that the country is missing out on opportunities to earn higher earnings from value addition. Vision 2030 identifies value addition as one of the ways of transforming Kenya’s agriculture from subsistence activities marked by low productivity and low value addition to an innovative, commercially-oriented, internationally competitive and modern agricultural sector. A strategic approach for Kenya’s tea sector is to diversify and add value to tea products for the domestic and international markets.

The second objective was to establish incentives that can encourage increased value addition activities in KTDA. Incentives considered most effective in encouraging value addition include monetary and fiscal incentives; promotional support; branding support; and investments in overseas markets. The perceptions from the tea sector experts was that Kenya had not made significant developments in value addition because incentives provided by government such as
fiscal and monetary incentives, stakeholders and tea companies were not sufficient. Significant developments in Kenya’s tea sector can only be noted if there exists a working environment conducive for value addition to thrive; this environment conducive for value addition can be created through the adoption of incentives effective in encouraging value addition and implementation of policies that address the challenges currently hindering value addition in the sector.

The third objective was to propose value addition activities with the potential of increasing KTDA tea earnings. Though the findings identified packaging, branding and blending as the three activities with the highest potential of increasing Kenya’s tea earnings, this research proposes that all the five major value addition activities have got the potential of increasing Kenya’s earnings albeit to different degrees. This is because instant tea’s potential of increasing earnings was demonstrated in the export market where it commands the highest prices compared to other types of Value Added Teas. It is evident that though instant tea is not appreciated in the domestic market it does well in the international market. There is a growing preference towards convenience consumption of tea in western markets with tea bags replacing traditional loose tea; instant tea is also appreciated for its convenience.

This research also proposes that other tea varieties such as Purple tea, black orthodox tea, green orthodox tea and green CTC tea have the potential of increasing Kenya’s tea earnings if well exploited. There is need to diversify into other types of tea varieties to address the challenge of Kenya’s overreliance on black and over dependence on traditional tea markets namely Pakistan, UK, Egypt, Sudan, and Afghanistan which has led to limited market diversification.
5.4 Recommendations

Based on the findings on the challenges hindering value addition and the incentives that need to be adopted, this research makes the following recommendations:

5.4.1 Policy Implications

There is need to review existing policies and in some cases develop new ones in order to increase value addition activities in Kenya’s tea sector and increase tea earnings. These are some of the policies that need to be reviewed. The government of Kenya needs to reduce high levies charged on materials for packaging tea for local consumption. Local tea packers pay a 25% duty on packaging materials and 16% VAT which discourages value addition. The duty charged should be lowered and VAT refund on packaging materials under the TREO scheme should not tie up capital for an unreasonably long period of time. The scheme should also cover all packaging materials regardless of their amount and duration of utilization.

The government needs to remove VAT charged on tea. Tea for domestic consumption unlike other food products attracts VAT in Kenya, the only country within the East African Community member states that levies VAT on tea making its tea uncompetitive within the region.

There is need for bilateral arrangements to remove the tariff and non tariff barriers to key market destinations that have potential for export of value added tea such as the Middle East and Eastern Europe as well as emerging economies of South East Asia.
Based on literature on Sri Lanka’s success with regards to value addition, the Government of Kenya should consider adopting monetary and fiscal incentives such as concessionary financing, dedicated credit lines, and the establishment of Export Trade Guarantee schemes whose mandate will be to provide government loans to traders of value added tea on request as well as develop a tea value addition strategy.

The following are areas which require the development of new policies and around which the Government of Kenya together with stakeholders such as the Tea Board of Kenya, Kenya Tea Development Agency, Tea Research Foundation of Kenya, Kenya Tea Packers Association among others need to address.

Noting that value addition machinery and equipment such as tea bagging machines are expensive there should be incentives developed within a framework that allows for joint investment between government and tea factories or among various players within the industry. The government together with key stakeholders could work on providing a common user packing facility that packs tea in accordance with trader specifications.

Kenya should work on positioning itself as a one stop shop for value addition through the development of incentives that address the entire value chain holistically. Though not a producer, Dubai has positioned itself as a one-stop shop for value-addition through incentives offered by Dubai Tea Trade Centre (DTTC) such as storage, blending, packing and export facilitation for multi-origin teas.
There is need for the establishment of a facility and infrastructure to address the value addition gap in Kenya by offering support to entrepreneurs who would like to pursue value addition activities. The facility should have a provision tasting, blending and packing of tea in accordance with trader specifications and customer requirements. In addition, it should provide for free warehousing of tea up to specified number of days.

The Government together with stakeholders should provide market and product development assistance such as brand development, promotion, product development through the provision of research information on diversification, particularly for SMEs to promote their value-added products.

**5.4.2 Implications for Practice**

The following are recommendations targeting specific stakeholders within the tea sector on ways of strengthening ongoing initiatives with the potential of increasing Kenya’s tea earnings.

The Tea Board of Kenya as regulator and marketer of Kenya’s tea needs to provide a strong platform to increase efforts of marketing Kenya’s tea abroad. One of the ways is strengthening the Kenyan brand both in the domestic and international markets by certifying more stakeholders to use the tea mark of origin. In 2012 about 20 stakeholders had been certified to use the mark, this number needs to be increased to enable Kenya attract a special nice market willing to pay a premium for quality tea identified through the tea mark of origin.

The Tea Research Foundation of Kenya needs to provide market oriented research. Industry experts felt their research initiatives focused too much towards production but did little in terms
of providing leads for possible markets for the various types of tea varieties being developed as a result of the research and development projects they conduct.

Kenya Tea Development Authority needs to spearhead value addition activities at the factory level, diversify into other types of tea as well as market their tea based on geographic regions where the tea is grown. This research found that one of the factories was producing tea varieties such as Purple tea, Green CTC, White and Orthodox teas as a pilot study. If this study turns out to be successful this should be rolled out to other factories.

Kenya Tea Packers Association needs to aggressively look for new markets for packaged and other value added teas to increase their tea buying capacity and undertake more value addition on behalf of small holder farmers since this is their mandate as a subsidiary of KTDA.

Multinational companies need to have collaborative partnerships with all stakeholders on value addition to enable Kenya’s tea sector gain from their experience. They need to increase value addition activities in the countries where they operate by value adding at the source country rather than transporting the tea to be packaged or blended in other countries. It is clear that for this to happen there must be a business environment conducive for them to operate. The government of Kenya should therefore provide sufficient incentives and put in place initiatives that encourage value addition.

5.5 Areas for Further Research

The research identified a relationship between packaging and branding that needs to be investigated further. Packaging and branding as value addition forms seem to have a positive
relationship with the increase of one activity leading to the increase of the other. In general practice packaged products are usually branded to differentiate them from other products and to give them a unique identity. However it would be important to analyze this relationship further to determine the strength and direction of the association between the two variables using inferential statistics such as correlation.

Though tea in the form of tea bags was classified under packaging as a form of value addition in this research, there is need to look into tea bags as a form of value addition on their own based on the shifting demand from loose tea to tea bags. Literature on value addition revealed that in recent decades there has been a shift towards convenience consumption of tea in western markets with tea bags replacing loose leaves (Hicks, 2001; Yilmaz, 2006). This is in the case where it is more important for consumers to have tea bags release colour and strength quickly than that the tea has what a connoisseur would consider to be a fine flavour (Poulton, 2008; Gibbon, 2006). It is important to note that there has been a lot of innovation in the development of tea bags which has evolved from having no tag, to a single chamber with tag, to a double chambered tea bag, paper envelope, metalized envelope, to a pyramid and pad shaped tea bag. It would be interesting to find out whether these innovations have succeeded in creating more demand for tea bags in the markets where they are preferred.

This research has generated significant knowledge on the effects of value addition activities on Kenya’s tea earnings, the incentives that can encourage value addition in Kenya’s tea sector and value addition activities with the potential of increasing Kenya’s tea earnings. However, a number of areas for further investigation emerge. A study on the effects of other forms of value
addition such as Kenya’s tea mark of origin on earnings and other benefits of value addition besides earnings would provide a more holistic picture of the effects of value addition. Other possible areas of research could include a study on the role of value addition in creating employment in Kenya’s agricultural sector, the role of diversification into other tea varieties in creating new markets for Kenyan tea and an assessment of the contribution of tea value addition activities to Kenya’s agricultural GDP.
REFERENCES:


INTERVIEW GUIDE

1. Which types of tea does your factory produce?

2. What value addition activities does your factory undertake?

3. If your answer is none above, please indicate if plans are underway for your factory to venture into value addition.

4. Do you think value addition is one of the key strategies to ensure profitability for our factory?

5. In your opinion, which value addition activities would you recommend for teas produced from your factory?

6. Which markets serve as the major market outlets for value added tea produced by your factory?

7. To what extent does value addition increase earnings judging by sales figures from your factory over the last 5 years?

8. Other than black CTC teas produced in most KTDA factories please state based on importance other tea varieties your factory can venture into in order to earn higher tea revenues.

9. Based on your experience please propose other forms of value addition activities with the potential of increasing tea earnings for your factory.

10. Challenges hinder the exploitation of value addition activities in your factory?

11. Please state various incentives that key stakeholders in tea sector can provide in order to encourage value addition in Kenya’s tea sector.

12. Please propose strategies that can lead to further value addition developments in your factory.
13. In your opinion please give reasons why most KTDA factories undertake very little Value addition at the factory level.

14. What incentives can encourage value addition at the factory level?

15. Based on your experience what is the effect of value addition on tea earnings?

16. Roughly, by what percentage is the price of value added teas higher than traditional tea?

17. What support has KTDA given to farmers and factories to encourage them to undertake value addition?

18. Based on current global value addition trends, should KTDA move from relying on CTC as the main method of processing tea?

19. Does the high cost of investing in value addition equipment and facilities justify the need for factories to venture into value addition?

20. What support can the Government of Kenya give to tea growers and KTDA to encourage them to undertake value addition activities?