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**FIGHTING CORRUPTION AND PROMOTING COMPETITION**

**Contribution from Kenya**

-- Session I --

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## FIGHTING CORRUPTION AND PROMOTING COMPETITION

-- Kenya \* --

### 1. Introduction

1. The inter-relationships between competition and corruption are complex, as recognized in the background paper. However, the key issue of the ways in which rents can be created through granting rights to selected groups or entities is widely noted. This can be equated with monopoly power and rents with supernormal profits.

2. There is a danger in making such a simple equation of taking a naïve view of competition which is entirely static and conforms to the unrealistic assumptions of perfect competition. It is not the existence of rents (profits) that are at issue but whether these reward effort, investment, innovation and creativity. Competitive outcomes are entirely consistent with economic development policies which provide support to a sector – where all firms in the sector have the opportunity to take advantage of the support on offer to aim for the thresholds required. In other words, the playing field can be deliberately skewed to incentivize the building of productive capabilities which would otherwise have been out of reach. And, this can be consistent with vigorous competitive rivalry.

3. Indeed the challenge faced by developing country competition authorities, Kenya's included, is to set out an agenda for competition and development and not to simply oppose industrial policies which seek to build capabilities on the grounds that they are generally rooted in the creation of monopoly rights. While the comparative development record undoubtedly suggests this has happened, it is not necessarily the case.

4. The challenge facing countries like Kenya is to map out an agenda for inclusive growth which embodies a practical approach to competition as a dynamic impetus to building capabilities and complements development policies. This is obviously an imperfect and messy process, where advocacy by the Competition Authority has an important part to play.

5. We highlight recent experience from Kenya which illustrates the challenges.

### 2. Cement

6. The cement industry in Kenya has historically been a tight oligopoly of three firms, with Bamburi Cement being the biggest followed by East African Portland Cement Company (EAPCC). The industry concentration is not surprising given economies of scale and the relatively small size of the Kenyan economy. However, what came to the attention of the Authority was that while Lafarge owned Bamburi cement with approximately 55% of the market, it also had interests in EAPCC and had two directors on the EAPCC board.<sup>1</sup>

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\* Submission from the Competition Authority of Kenya (CAK).

<sup>1</sup> See CAK Annual Report 2012/13 p.21.

7. The Authority approached this situation through provisions of section 50 of the Act. The section provides for unwarranted concentrations of economic power, mainly exhibited through cross-directorships, and was of the view that this arrangement lessens, prevents and distorts the competition process.

8. With cartel conduct being common in cement, the CAK is concerned about arrangements such as these which may undermine competition between producers. Typically producers seek to support their relationships on grounds that this aids stability in production and supply but cases in other countries have shown that in practice such arrangements can lead to substantial supra-competitive mark-ups causing harm to consumers. For example, Lafarge has admitted that it was party to collusive arrangements across South Africa, Botswana, Namibia, Swaziland and Lesotho which involved information exchange through the industry association (the Cement and Concrete Institute).

9. There have also been some new entrants, over the recent past, as well as intentions being announced with firms yet to start production. To enter firms have to secure the rights to limestone deposits. One such firm, Cemtech, sought to secure 99 year exclusive mining rights in the Greater Pokot region from the County Government.

10. Long-term secure input supplies are important given the investment required in a cement plant, and especially in this region which is relatively remote in terms of infrastructure development. However, Cemtech sought to prevent any other entrant being able to exploit any other limestone deposits across the region without Cemtech's approval. This example illustrates the rationale for granting rights as part of ensuring a major investment while at the same time ensuring that this rationale is not allowed to raise unwarranted barriers to entry that would undermine competition and increased participation in future. The CAK provided an advisory opinion to this effect.<sup>2</sup>

### 3. Coffee

11. Unhappiness with the prices received by farmers for coffee have recently led five Counties covering the main coffee growing regions to announce that they are going to intervene to market their coffee collectively.<sup>3</sup>

12. On the face of it this is presented by the counties as being warranted to counter cartels at the levels of buying, processing and marketing of coffee. It is alleged that these 'cartels' are exerting their market power to lower the prices paid to Kenyan farmers. Prices paid to farmers are apparently just 7% of the retail price and as low as 2% of the lower coffee quality grades.

13. This poses a number of challenges for the CAK. The proposed plan involves one group of insiders being tackled by the setting up of another collective organization. Instead, if there is coordination among the coffee buyers and processors this is something that should be addressed directly. However, no representatives of coffee farmers have lodged a complaint with the CAK<sup>4</sup>.

14. The CAK's, *ab initio*, position is that development issues facing farmers relating to the sourcing of inputs, access to credit facilities, and the need for extension services to improve productivity and quality of the crop, are all important areas that can be addressed through agricultural policy. Such policy initiatives

<sup>2</sup> See CAK Annual Report 2012/13 p.25.

<sup>3</sup> Statement by the governors of Meru, Nyeri, Kiambu, Kirinyaga and Murang'a on a Regional Approach for the Coffee Industry, Daily Nation, 24 January 2014.

<sup>4</sup> The CAK has so far written to the Governors with the objective of procuring further information to facilitate enforcement

can be undertaken in a way which does not compromise competitive outcomes. Indeed, competition will mean the services are used most effectively and large subsidies do not go to support unproductive and inefficient farmers.

15. A further set of issues relates to new rivals entering the processing and marketing of coffee so that farmers benefit from competition to purchase their crop. If it is the case that these activities are controlled by a few players who are cooperating together to protect their interests then initiatives to support new entrants (for example, with development finance) could be important to open up the market and have more competitive outcomes. This would be an example of competition and development policies being mutually complementary.