Introduction

Agriculture is one of the main pillars against which all aspects of society rest. Through it, food products as well as manufacturing inputs are obtained. It is therefore vital for any developed or developing economy to maintain a healthy and vibrant agricultural industry. The promotion of business entities involved in agricultural production and ensuring they have adequate market for their produce has been top on government agendas, particularly governments heavily reliant on agriculture for balance of payment balances. One such agriculture-reliant economy is Kenya's. With vast tracts of fertile land and a significant quantity of unemployed labor, Kenya is one of East Africa's most active agricultural countries, yet in other ways it holds immense potential to become even bigger. This report covers Kenya's agricultural scene, with specific emphasis on New Kenya Co-operative Creameries. The report will examine the company from a historical perspective as one of the most significant agriculture-related entities in the country. In addition, it will cover the performance of the company as well as the risks to which the company is exposed in its operations. The aim is to present New Kenya Co-operative Creameries as an investible entity for local and foreign consumers alike in a bid to position Kenya as an agriculturally upright nation capable of competing on a global scale.

General Overview

The state of milk production in Kenya has had its share of ups and downs. With an economy heavily reliant on agriculture, it is critical that farmers receive subsidies to encourage increased or sustained production. In recent years, however, farmers in the country have faced difficult times ranging from adverse climatic conditions to lower than average returns in the face of high production costs. It is such production costs which make Kenya's output uncompetitive in the international market. compared to Uganda, where the cost of production is KES10 per liter, Kenya's cost of production per liter sits at between KES16 and KES18. The result is costs passed on to consumers as high prices, with a liter of milk retailing at an average of KES103 in Nairobi compared to an average of KES80 in Durban, KES83 in Cape Town and KES84 in Johannesburg. With regard to harsh climatic conditions and what would be termed as production methods needing updating, average milk production per cow in Kenya is about 7 liters compared to 20 liters per cow in South Africa. Not only does this affect farmers, it also eats into milk processors' profits and overall repute through forcing them to charge hefty prices for their output. It thus rests upon the Government and other involved stakeholders to take steps towards improving Kenya's dairy product competitive appeal.

Corporate Analysis

About New Kenya Co-operative Creameries

New Kenya Co-operative Creameries (abbreviated as NKCC) began life in 1908 with the construction of the Kipkelion Creamery by a white settler known simply as Mr. Watts. In colonial times the white settlers relied on agriculture for subsistence and for internal trade purposes, taking up large tracts of fertile land in Kenya's Central and Rift Valley regions. In 1925, Kenya Co-operative Creameries (or KCC) was founded with Lord Delamere (Hugh Cholmondoley) as its chairman. The company is notable as being one of the longest running in Kenya, into the post-colonial era. Mr. D.N. Kuguru was its first African chairman, taking over in 1965 from previously settler management. Perhaps the most famous initiative by KCC was its free school milk program, which availed milk to majorly primary school-going pupils, a program that ran from 1979 to 1992. The Government of Kenya under then President Daniel Toroitich arap Moi took up the program under what was called *Maziwa ya Nyayo* (Swahili for 'Nyayo's milk'. The term Nyayo is a moniker associated with former President Moi).

KCC operated successfully through the 1980s with little competition and ran almost entirely as a monopoly. However, gross mismanagement plagued the milk processor in the 1990s, which saw farmers go without payment for their milk deliveries. This not only diminished milk production and supply, it also cost KCC its reputation, dominance and millions in revenue. Entrepreneurs saw the collapse of KCC as an opportunity to cash in on the lucrative dairy market and moving into the 2000s, there was increased competition. This saw the coming up of a number of brands, the likes of which include *Brookside*, *Tuzo* and *Ilara*, among others. In order to keep up with competition and remain relevant, major reforms had to be undertaken. When KCC went bankrupt in the late 90s into 2000, the Government took over operations which effectively made KCC wholly Government owned. It was registered formally as a state parastatal in 2005 and its name was subsequently changed from KCC to its current New Kenya Co-operative Creameries Limited, NKCC.

NKCC has made a remarkable recovery in the years following its take-over, sparking calls by farmers for privatization of the processor. Farmers want an 85% stake in the company, with part of the remaining 15% being issued to the public. Discussions over such a move have been on-going since 2010 but it is worth noting that as at May 2016, NKCC is still 100% owned by the Government of Kenya. It is still unclear whether the push for privatization will be successful owing to the stalled nature of the discussions.

Product Portfolio

NKCC is primarily known for its milk processing and sale. The latter it does post-packaging in its various plants, before distribution occurs. The company processes and distributes fresh milk under the brand names *KCC* and *Gold Crown* in variants of ordinary milk, ultra-heat treated milk, fat-free milk and powdered milk. Related derivatives include yoghurt under the *KCC Delite* and *LA* brand names, as well as cultured milk (known locally as mala) in flavored and non-flavored variants. Milk production has increased substantially, from 5 billion liters to 5.4 billion liters annually. NKCC also produces cheese, butter and ghee, all by-products of its milk processing operation.

The milk producer offers added services to farmers which can also be listed under its product portfolio. Its Agri-Life Business Platform provides farmers with artificial insemination, dairy cattle insurance, milk transport, biogas production, animal feeds and training for farmers, among other services.

Brand Distribution

NKCC has its head office in Nairobi. however, the company enjoys nationwide distribution through depots and a large retail chain which includes restaurants, supermarkets, shops and kiosks. The steady demand for milk and related dairy products has seen the company’s sales relatively stabilize, although the company still has to contend with stiff competition from other processors. In a move aimed at expanding its operations, NKCC has begun exports of its products to Tanzania, South Sudan and Malawi.

Industry Risks

This section examines probabilities which may affect the agricultural industry in the country in its entirety as opposed to uniquely affecting NKCC as an individual entity. It includes technology, tastes and preferences, barriers to entry and product obsolescence as the guiding factors.

Tastes and Preferences

Consumer tastes and preferences vary with time and product, and therefore it is in a company's best interest to keep up with the dynamics of tastes and preferences to maintain steady demand to match supply. In the Kenyan dairy product scene, customers are drawn by a number of factors key among them being price comparison and product appearance. While there has been little to complain about from NKCC's pricing, its product appearance has scarcely changed over the years. The lack of visual appeal in comparison to newer market entrants saw consumers less excited about taking the same packaging for years on end. This is especially true with the younger generation and children who prefer bright attractive packaging and innovative product offerings.

Technology

Dairy products are some of the most perishable consumables, with milk only being able to go for about a day before going bad. As such, technological input has had to be employed by any dairy product processor to not only keep its products fresher for longer but also to diversify its product portfolio and remain relevant. In this respect, NKCC has invested in ultra-heat treatment of milk, where milk thus treated is able to remain fresh for comparatively longer. Not only this, such milk does not demand refrigeration as is ordinarily the case, allowing lo income consumers with no access to refrigeration to store and consume milk over a relatively longer period than was previously the case. Additionally, NKCC has diversified into powdered milk production, employing previously unutilized technology. Powdered milk lasts longer compared to its liquid form, only requiring that the powder be kept dry when in storage. By so doing, has allowed itself to supply milk to the remotest parts of the country in a cooling-independent manner. Livestock production in present times has also been revitalized by technological advances. Key among these is the production of cattle with better milk quality, improved acclimatization capability and lower upkeep costs. In this regard, NKCC has invested in embryo-technology in a bid to reduce costs to farmers when acquiring and keeping heifers.

Product Obsolescence

With the collapse of KCC in the 90s and the entry of new market players, companies involved in the industry and specifically in dairy product processing face the possibility of having products becoming obsolete. Milk in general remains milk, as does yoghurt, butter and ghee. However, product differentiation is necessary for an entity to distinguish itself and give consumers reason to opt for its product over the next company's. NKCC has had to employ creativity to avoid having its cultured milk losing its grip on the market, by introducing a flavored variant. Its cheese is also available in several variants. The more a company can keep its product offering fresh the higher its chances of avoiding product obsolescence calling for hurried and often expensive new product development drives.

Barriers to Entry

In any given industry, the establishment of barriers to entry is necessary to some extent. This has the effect of discouraging free entry and exit which would make the industry susceptible to oversupply and substandard products with minimal remedial options. Additionally, it allows existing market players to retain a health level of control and dominance, as well as compete for larger market shares. Barriers to entry are set up through, among other means, the regulation of an industry. The agriculture scene in Kenya is primarily regulated by the Government under Ministry of Agriculture, Livestock and Fisheries. NKCC is a state-owned entity as at May 2016, and one of the mandates of the Ministry is the representation of state corporations as well as research support. The Kenya Dairy Board is specifically involved in the oversight of the dairy sector in Kenya, catering to aspects such as product quality, dairy standards setting, premises checking and product safety. With stringent requirements in place, unscrupulous milk merchants have been prevented from entering dairy product processing and marketing, ensuring that NKCC has to compete with less firms than would otherwise be the case.

Company Risks

As the title suggests, company risks are specific to a given business entity and affect it based on its individual characteristics. For purposes of this report, NKCC's company risks will be considered in terms of operational and financial diversity.

Operational Diversity

Operational diversity is concerned with aspects such as the number of plants operated by an entity, the number of businesses the entity operates and the product lines it has. NKCC's product lines has already been elaborated on under its product portfolio sub-section, the list covering milk (liquid and powder forms), yoghurt, butter, ghee and cheese. A wide product line provides the company with additional cushioning in the event of reduced demand in any single product by banking on unaffected products.

With regard to its businesses, NKCC is until 2016 only involved in dairy products and ancillary service provision. Since the support services to farmers fall under its dairy processing operation, they are not considered separate revenue-generating businesses in their own right.

The processor has a number of plants spread out in strategic locations in the country. The location decisions are informed by the need to obtain fresh milk from the highest quality livestock and with minimal raw milk travel distance. Plants are located in Kipkelion, Nyahururu and Eldoret, areas renowned for dairy farming and with suitable supporting climatic conditions.

Financial Diversity

As has been diverged, NKCC has not invested in other ventures outside its milk and other dairy product processing activities. Its financial diversity is thus not very detailed, added to the fact that the company does not operate in a public nature. However, based on its continued existence with minimal negative performance reports in local media since its revival as NKCC from its former KCC reputation, it is safe to assume that the company is financially stable. The nonpublic trading nature of the company despite Government ownership has also kept financial reports out of the public domain

Management Analysis

The analysis of NKCC's management, for purposes of this report, will be done based on its financial and operational performance, and its tolerance or averseness to risk. The level of risk that management is willing to take up is key in dictating its performance, based on the specific industry of involvement.

In 2009, the company's newfound managerial expertise guided NKCC to KES500 million in profit, from which it paid KES30 million in dividends to the Government. However, the processor has struggled to make a mark since then. Plans for privatization have slowed down on account of internal problems which have dented NKCC's ability to replicate its 2009 performance. While the company has managed to avoid another bankruptcy, it significantly lags behind its competitors and its senior level management is keen on making changes aimed at rectifying this. Among its top priorities is improvement of the quality of its products, with the company set to buy milk from farmers based on its quality.

Additionally, it emerged that as at February 2016, NKCC owed farmers payments amounting to KES1 billion in the Rift Valley region. This has been contributed to by an accrual system during the company's initial cash crunch which has led to the accumulation of said amount over a 17-year period. Such heavy debt is set to drag NKCC's expansion plans and further delay its planned privatization to facilitate debt clearance under Government supervision. It therefore follows that in spite of attempted changes, the milk processor's management has not lived up to what was expected by majority of farmers and consumers alike. Following its recovery initiative, NKCC is reported to earn over KES400 million annually from exports of ultra-heat treated and powder milk alone.

Management of NKCC is risk averse, understandably so based on the entity's shaky performance in the last two decades. Focus has been around dairy processing with no involvement in diversified ventures. Investment in new technology has also been heavily dependent on Government assistance, significantly slowing down its uptake rate. It is safe to assume that should the privatization bid be successful, management will be more risk tolerant so as to rapidly increase sales volumes and turn NKCC's fortunes around absent strict Government oversight.

Company Analysis

The company analysis section will consider NKCC in terms of its sources of revenue as well as the stability of identified revenue sources. For an entity to realistically operate into the future, it is necessary that its revenue sources be stable to avoid plunging into positions of strained liquidity.

Information available from local media states that the company's involvement and specialization in dairy products is its main source of revenue. In 2015, the company was valued at KES4.8 billion, thanks to an impressive asset base which included buildings, land, cooling plants, vehicles and other machinery. Additionally, the company's revenue stability is informed by the fact that interest owed to the government, which stepped in to bail out the processor from impending (and eventual) bankruptcy, was paid in full by 2010, amounting to KES30 million in dividends. Due to the fact that dividends are paid from profits rather than from capital, NKCC can safely be assumed to be financially stable. Reports indicate that the company's profits, though not in the public domain, have been highly impressive so much so that farmers now consider Government backing unnecessary and strong calls for privatization have been made as aforementioned.

Conclusion

NKCC is an example of the impact of improved management and complete overhaul of operations. Despite KCC's bankruptcy, the Government has worked with farmers to build a brand capable of competing with more vibrant entities in the market. Specialization in dairy products has also served to place the company in positive ground, with expansion of sales beyond national boundaries. Location in areas with high input quantities has reduced costs of raw material acquisition, thus easing the cost deductions which would otherwise have shaved off sums from revenues. The investment in technology has worked to NKCC's advantage, allowing innovation in livestock production, livestock support services and in its product offering for increased market share contention. In this respect, perhaps calls for privatization are justified, if only to tap NKCC's unexplored potential.