## Introduction

The manufacturing industry is a diverse and complex field, encompassing a variety of sectors. Despite the variation in sectoral activities, the regulations set for the industry are still binding. In Kenya, the manufacturing sectors include but not limited to chemical and allied metals and allied, food, beverages and tobacco, textiles and garments and pharmaceuticals. This report will delve into the food, beverages and tobacco sector and will examine the various factors which drive the sector in Kenya. Each category within the sector will be analyzed separately. Additionally, it will provide a brief highlight of the companies and entities which are notable as strong market competitors in each category. Finally, a conclusion will be provided, summarizing the key points.

**The Food Sub-Sector**

Kenya is largely an agricultural country, lying within a geographical region which supports the growth of various crops both for commercial and domestic consumption purposes. The food sub-sector locally is divided into formal foodstuff vendors and open air markets. The former caters for the high-end and middle-class population while open air markets are more popular with the low-end consumers. Open air markets are famed for being price-friendly and possessing a wider variety of common household-demanded fresh produce. For purposes of this report, however, formal foodstuff vendors will be analyzed.

In Kenya, formal foodstuff vendors include supermarkets and hypermarkets. The retail food market is made up of 5 large players and a number of smaller entities. The top 5 in order of revenue from food sales are Nakumatt Holdings Limited, Tuskys Limited, Uchumi Limited, Naivas Limited and Ukwala Limited respectively. Most of their produce is sourced from local farmers, with a minor addition from importers.

*Barriers to Market Entry*

Entry into the retail food market is hampered by the fact that there is a very high level of competition among already established retailers and brands. Advertising campaigns as well as the opening of numerous branches countrywide has endeared the brands, especially Naivas and Ukwala which cater to the middle-class, with Nakumatt most notable for its high-end clientele. The first 4 aforementioned retailers, in addition to having supermarkets, have hypermarkets, capable of serving a broader client base through increased stocking capabilities.

In recent years, retailers have engaged in buying out competitor brands in a bid to increase their market shares and crowd out competition. Examples of this include the anticipated acquisition of South Africa-based food retailer Shoprite and the 2015 acquisition of Yako Supermarkets. This has allowed Nakumatt to expand its footprint and present strong barriers to potential market entrants.

**The Beverages Sub-Sector**

Under this category, beverages will be split into carbonated soft drinks and beer, since these are the main products with a significant market share in the country and possessing elaborate data.

## Carbonated Soft Drinks

In Kenya, the soda market is largely dominated by international players, although local manufacturers have made attempts to gain significant market share. Within the country, the stand-out companies involved in carbonated soft drink manufacture are the Coca Cola Company and Kuguru Food Complex Limited. East Africa Breweries Limited also made an attempt to enter the carbonated soft drinks market, although its success has been limited. The Coca Cola Company set up operations in the country in 1948, and currently has bottling plants in, among other locations, Embakasi in Nairobi. The portfolio of the company includes carbonated soft drinks as well as bottled water. The former has brands such as Coca Cola or simply Coke, Fanta and Sprite while the latter includes Dasani, Vitamin Water and Smart Water. It has a national employee count of about 1,335. The company has also engaged in sponsorship deals, with such ventures as the Coke Studio musical project and football tournaments across the country. The other notable player in the carbonated soft drinks market is Softa. Falling under Kuguru Food Complex Limited and in formal product distribution since 1992, the manufacturer was set up in 1988. The company is noted to have actively entered the carbonated soft drinks market in 1998, and its portfolio includes the *Softa* and *Babito* brands of soda.

### *Barriers to Market Entry*

Market entry into the carbonated soft drinks market has been hampered by the dominance of the Coca Cola Company. Financial advantages as well as a large chain of distributors and aggressive advertising campaigns have edged out smaller competitors. While the company has depots countrywide, the Softa brand has been reduced to competing only in selected regions in the country, notably Central and Rift Valley regions in Kenya. Other barriers to entry into the market include a poor transport system and inadequate energy as well as limited technological capabilities. Most raw materials and additives are sourced from rural areas, but with most roads still not in dire need of repair and upgrading, there are often delays or delivery cancellations altogether. The limited power availability has restricted production scales, with the cost of electricity also a major concern. Technological limitations have limited Kenya's carbonated soft drink manufacturing level to largely bottling as compared to more advanced African countries such as Egypt and South Africa whose production stages are more advanced. Consumer tastes and preferences have also created a barrier to entry, with most consumers opting to go for established rather than new brands.

Beer

The Kenyan beer market operates as a duopoly, with 2 brands dominating the market. These are Diageo-owned East African Breweries Limited and Keroche Breweries Limited. Established in 1922, East African Breweries Limited began life as a private company before it went public in 1934. It is based in Ruaraka on the outskirts of Nairobi. Its portfolio includes beers, spirits and non-alcoholic drinks. Beer brands available Guinness, Tusker and Pilsner. Spirits include Johnny Walker, Smirnoff and Baileys while non-alcoholic drinks include Alvaro and Malta Guinness. The company commands up to 90% of the beer market in Kenya, making it the dominant firm in the sub-sector. Based in Naivasha, Keroche Breweries Limited was founded in 1997 and targets the lower-end market with a variety of beer brands, wines and spirits. Summit Malt and Summit Lager make up the beer brands, while wines include Pinotage and Chenin Blanc. Spirits produced by Keroche are Crescent and Viena Ice. As at February 2016, Keroche Breweries Limited operates as a private company.

*Barriers to Market Entry*

Some of the notable barriers to entry into the beer market are the duopoly power possessed by the top manufacturers. Prior to 1997, East African Breweries Limited had dominated the beer market in Kenya. Its financial strength allowed it to out-compete competitors through widespread advertising and it had bargaining power when it came to raw material purchase. There is also interference by external parties, in this case the Kenya Revenue Authority, which imposes very high excise tax, thus increasing the cost of production. Both beer manufacturers have suffered the effects of heavy taxation.

The high cost of power locally also impedes entry into large scale beer manufacture, since the large quantities of beer require continuously running machinery. Kenyan beer manufacturers are yet to embrace internal energy generation the likes employed by international brewers such as Dutch beer manufacturer Heineken. Poor infrastructure such as road networks has also made the transit of raw materials and the finished product difficult.

Additionally, the high price of local raw materials has encouraged greater sourcing of both input and packaging materials from external and cheaper sources. The high price of agricultural input is occasioned by unpredictable weather patterns in the country, with farmers making meager returns from their produce and thus demanding higher prices. Market knowledge presents yet another barrier to entry, especially working in favor of East African Breweries Limited, having been in operation for 94 years. The case of Castle Brewing Company being edged out of operation locally illustrates the consequences of centering a market with insufficient knowledge and competing actively against a local and more established brand. Large established brands also enjoy economies of scale, thus they are better placed to acquire raw materials, which places new market entrants at a disadvantage. They also have better distribution channels, which may additionally work to the detriment of newcomers.

Kenya is a considerably technologically disadvantaged country, partly due to the lack of sufficient power reserves. As such, production capacities are limited, and this disadvantages large international manufacturers who may want to set up in Kenya. Manufacturing machinery is not locally made and must be imported both for start-up and expansion purposes. This creates a barrier to market entry since financial demands are consequently increased.

There is stiff competition in the Kenyan market. The level of competition may serve to both encourage potential investors and it can also work against them. Soft drink manufacturers have found themselves competing with beer manufacturers who seek to diversify their portfolios. An instance of this is the non-alcoholic malt drink competition pitting East African Breweries Limited's *Alvaro* against Coca Cola's *Novida*. Such stiff competition across sub-sectors provides consumers with several consumption options, thus new entrants are forced to differentiate their products or target specific markets in order to command significant market shares.

*Market Opportunities*

There are opportunities in the market, especially where the supply of relatively cheaper input is concerned. In 2015, East African Breweries Limited announced plans to increase its sourcing from East Africa, therefore barley and sorghum farmers as well as manufacturers of aluminum cans stand to benefit. Northern Africa has been noted to post the lowest statistics of beer consumption while Southern Africa has the highest population of consumers in Africa. Lying midway, the East African market is poised for growth and thus presents a reasonable and viable investment destination. Coca Cola, through its Coca Cola Juices Kenya initiative, has also embarked on a similar drive, sourcing juices from local farmers and this has created a market niche for fruit farmers locally.

Various infrastructure projects are also set to ease the transport of raw materials, with railway transport a viable replacement for road transit upon completion of the Standard Gauge Railway project set for completion in 2017. The allocation of funds to County Governments for road upgrades and maintenance is also set to make transportation easier and cheaper.

In Kenya, there is a rapidly increasing middle-class population with added disposable income. As such, the consumption of cheap alcohol is set to decrease with more consumers opting for established brands. External investors with a strong brand and equally strong marketing capabilities are thus in a position to penetrate the market despite the presence of already established players. Furthermore, the identified middle-class population has been noted to have a particular taste for international brands. The same trend has been observed in the carbonated soft drinks market, with brands such as Pepsi setting up shop in Kenya.

Although modern production is highly mechanized, there is still a large availability of labor. The Kenyan landscape has a significant educated population with the ability to oversee manufacturing procedure and aggressively market products. The country also has large land reserves allowing the set-up of factories with considerable ease. The Kenyan entrepreneurial culture also presents an added advantage to investors and companies which may seek to set up their brands locally.

**The Tobacco Sub-Sector**

The Kenyan tobacco manufacture sub-sector in Kenya operates as a monopoly, with British American Tobacco being the only player. However, Mastermind Tobacco Kenya Limited which was established in Kenya in 1989 has also made significant effort to make a name in the Kenyan tobacco scene. Founded in 1902 and based in London, United Kingdom, British American Tobacco is one of the largest cigarette and tobacco product manufacturers globally. In Kenya, the company is engaged in both manufacturing and distribution of its product. It is listed in the Nairobi Securities Exchange, with its share price notable for its consistency and ranking among the highest on the bourse. Notable brands by British American Tobacco Kenya Limited include *Embassy* while Mastermind is noted for manufacturing the *Supermatch* brand.

There is a considerable market for tobacco and tobacco products in Kenya. About 20.2% of men and 1.4% of women are active smokers in the country. With the availability of only 2 main companies engaged in the sub-sector, there is also potential for growth with the entry of new market players.

*Barriers to Market Entry*

The tobacco market in the country has faced significant challenges which have created barriers to entry. Taxation of tobacco and its products is one such impediment. The Kenya Revenue

Authority has continuously imposed taxes on cigarettes, which has deterred manufacturers, both current and potential.

Health concerns have also eaten into the tobacco market. A majority of the current generation is becoming increasingly health conscious. Globally and locally, the threat of cancer has gained prominence, with more knowledge on the causes and effects being easily available to the public. With the risk of lung and throat cancer, as well as a variety of other respiratory infections, the consumption of tobacco and related products has suffered a blow. As such, potential market entrants can only bank on international prominence if they hope to significantly make a mark in the industry.

Similar to the carbonated soft drink and beer sub-sectors, the tobacco sub-sector is also faced with the challenge of poor infrastructure and high costs of utilities. This has served to drive up the costs of production such that profit sustenance is becoming increasingly difficult. British American Tobacco has globally and locally had to rely on its international status and prominence to create and maintain its profit margins. On the other hand, local companies such as Mastermind have struggled to make revenues due to their comparatively diminished scale of operation.

Reduced scales of marketing and brand floating to the masses has dealt a blow to potential market entrants. The Government of Kenya, through the Tobacco Control Act, 2007 has placed restrictions on tobacco smoking, advertising and promotion. This presents a challenge to potential market entrants, since their product may not be adequately promoted to the public to allow significant enough sales, preventing their market entry to begin with.

## Conclusion

The food, beverage and tobacco sector in Kenya is largely dominated by foreign firms which have the financial capability to out-compete local entities. This is with the exception of the food sub-sector, which is noted to be dominated by Nakumatt, a Kenyan entity. The retail food sub-sector is considerably under-developed, with the available retailers offering a range of other household products as opposed to specializing on food and foodstuffs. Therefore, a vendor specializing in food would stand a chance of gaining a share in the market, albeit facing stiff competition. The buy-out strategy is a viable option for strong brands with a loyal client base seeking to expand their reach in the local scene as has been evidenced by Nakumatt. There is an opportunity for competitive local manufacturers with sound business strategies, high quality products and strong marketing teams to venture into the beverage and tobacco sub-sectors. A strong distribution chain is vital for brand penetration, and Coca Cola's success is proof of this in the Kenyan market. Although the state of infrastructure in the country is wanting, there are tangible efforts in place to improve the situation, with road and railway upgrades. The move towards local sourcing of raw materials also creates an opportunity locally for farmers, smaller manufacturers and trained personnel. With Kenya moving to a middle-income country and with an ever-increasing middle class, the potential for growth remains unlimited and hence investors would do well to keenly monitor the Kenyan market.