



BTC TRADE FOR DEVELOPMENT

EXECUTIVE SUMMARY

HOT BEVERAGES IN KENYA AND EAST AFRICA: Opportunities for Fairtrade certified tea, coffee and powdered hot drinks brands

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Exchange rate, 2015: KSh98.18 = US\$1.00

EXECUTIVE SUMMARY

1. PRODUCTION AND TRADE

East Africa is a globally important producer of tea and coffee whereas cocoa production is limited. With the exception of tea, local hot drinks consumption remains low and most production is earmarked for export, generally with little value addition. Consumption patterns are slowly changing, however, as sustained economic growth has supported increases in disposable income, the expansion of modern retail and the entry of global foodservice brands. This in turn has encouraged more processing across tea and coffee, with heightened competition between local brands, as well as greater consumption of coffee, in particular. As hot drinks markets mature in the region, Fairtrade Africa is looking to work more closely with producers and brands to expand the footprint of the certification amongst East African countries.

Kenya plays a pivotal role in the East African tea growing industry, whereas Uganda leads both coffee and cocoa production

Kenya is the third largest global producer of tea, after China and India, producing 399,210 tonnes of tea, equivalent to 8% of global production, in 2015, and accounting for around 20% of global tea export volumes. Although tea is grown throughout East Africa, 153,000 tonnes in 2015 regional production amounted to less than half of Kenya’s (Figure 1).

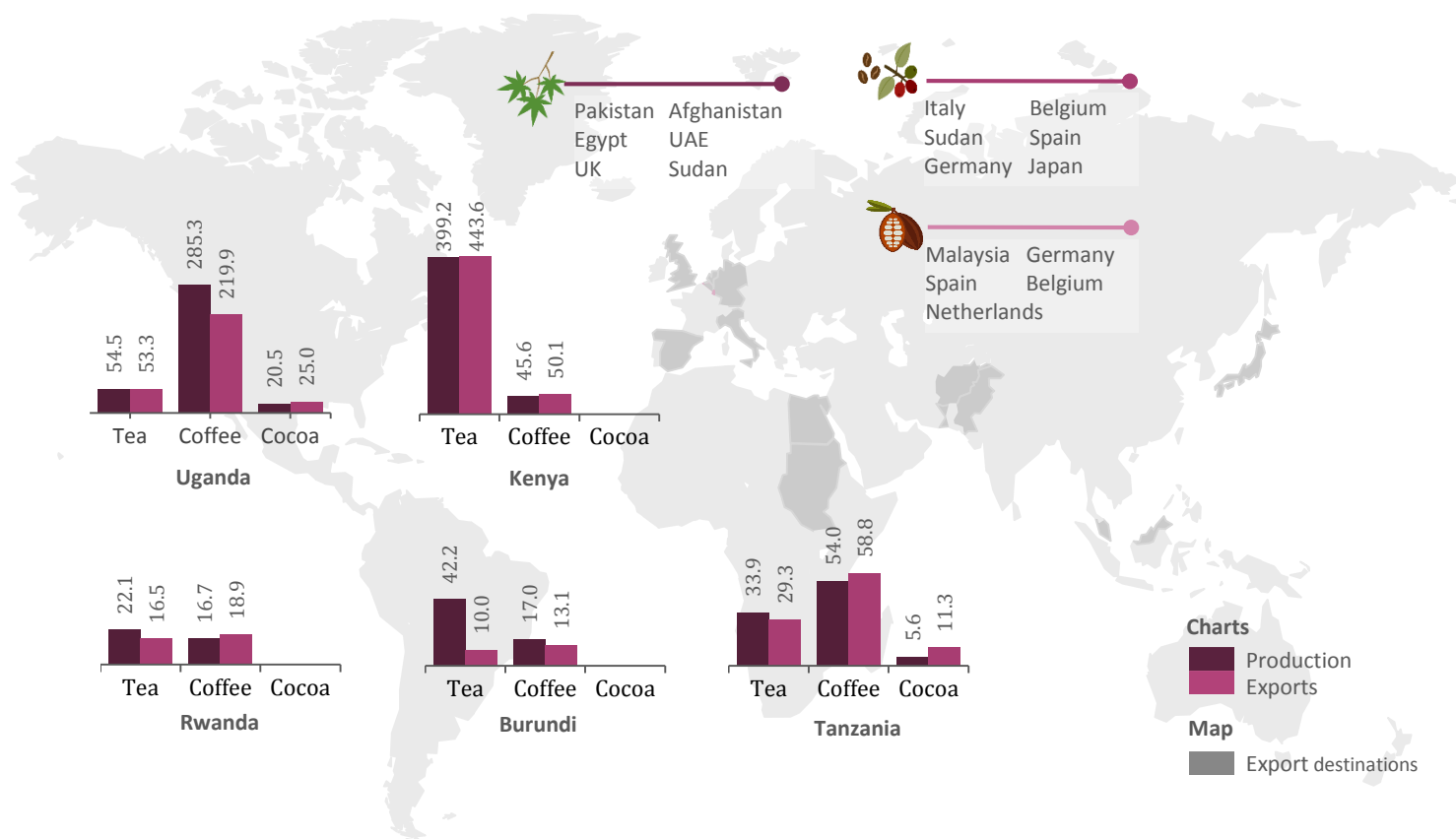


Figure 1 Total Production and Exports of Tea, Coffee and Cocoa ('000 tonnes) 2015 and Key Destinations

Source: Euromonitor International from UN Comtrade Database

Uganda is the leading coffee producer in the region along with Tanzania, harvesting 285,300 tonnes 2015, of which 78% is Robusta, making Uganda one of the world’s largest Robusta producers. Kenya is a small coffee trading country, exporting a quarter of Uganda’s volumes, but is considered a source of high quality mild Arabica coffee for blending and specialty markets, Most coffee in the region is exported, commonly as green beans, with volumes increasing in response to increased production.

Meanwhile, cocoa production in East Africa remains at a small scale, with most of the region's limited production coming from Uganda and Tanzania.

A dual production system characterises the tea and coffee sectors across East Africa: large scale farms, referred to as estates with their own plantations and processing factories, and the smallholder sector. Whereas in Kenya more than half a million smallholder farmers produce two thirds of the country's tea and coffee output, in Uganda large tea estates continue to dominate output. With fewer financial and technical resources at their disposal, smallholder farmers are more vulnerable to the impact of climate change and its effect on already low productivity levels.

Kenya is the major tea and coffee trading hub in East Africa but even here little processing occurs and trade flows remain overwhelmingly oriented towards bulk exports of semi-processed tea and green coffee

Most of East Africa's tea and coffee is sold at auctions in Kenya, namely the Mombasa Tea Auction and the Nairobi Coffee Exchange. Coffee and tea trading systems in Kenya remain centralised and regulated, as opposed to those of Uganda, with recently proposed changes not yet fully implemented in the value chain. Such rigidity continues to inhibit direct contact between growers and buyers in Kenya and prevents the establishment of fairer trade relationships.

Traditionally very little value was added to tea, coffee and cocoa beans in East Africa, which dilutes their potential visibility in the retail market and recognition by consumers around the globe. Although still largely the case, recent government efforts and investment by local companies in Kenya, such as Kenya Tea Packer's tea processing and blending facility and Dorman's coffee roasting factory, will slowly pave the way for increased value added processing, employment and improved working conditions within producing countries.

2. MARKET SIZE DYNAMICS

Developing from a small base in terms of overall consumption, coffee and powdered hot drinks are gaining momentum in East Africa, whereas tea is widely popular and represents a mature market in the region

Local consumption of hot beverages (inclusive of tea, coffee and flavoured powered hot drinks, such as hot chocolate) in the selected East African countries remains low overall, especially on a per capita basis, despite market volumes increasing by a compound annual growth rate (CAGR) of 4.3% from 2011 to 2015. An estimated 53,900 tonnes of the category was sold in 2015 in the region (Chart 1). The three most populous countries, Kenya, Uganda and Tanzania, constitute the largest in East Africa in volume terms.

Although tea is the traditional beverage in all countries, coffee has been the main engine of growth in East Africa albeit off a low base. The dual development of modern retail channels and sustained prominence of traditional points of sale are important variables influencing sales of hot drinks as a whole and coffee, in particular, in East Africa. In addition,

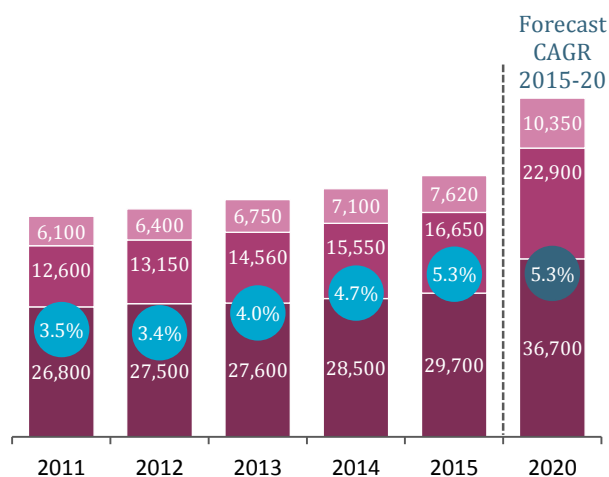


Chart 1 Regional Consumption of Hot Beverages by Category 2011-2020 (tonnes): Tea, Coffee and Flavoured Powered Beverages; YOY % Growth and CAGR 2015-2020

Source: Euromonitor International

Note: Data for Kenya based on annual market research; data for Uganda, Tanzania, Burundi and Rwanda modelled.

affluent urban areas, particularly in Kenya, Tanzania and Uganda, have seen a substantial increase in local specialist coffee shops and chains of cafés serving local coffee products.

Expansion of modern retail and a growing food service sector go hand in hand with consumers becoming more discerning in their tastes

In Kenya, where 27,938 tonnes and KSh18.6 billion (US\$191.0 million) of the category were sold in 2015, continued expansion is increasingly dependent on an accelerated process of premiumisation. Kenyan consumers trading up from unpackaged to higher value packaged, branded products, particularly tea bags, goes hand-in-hand with higher income consumers in urban areas looking to new categories, such as fruit/herbal teas. The expansion of modern retailing to 30% of total grocery value sales also contributes to an increasing amount and variety available in the market.

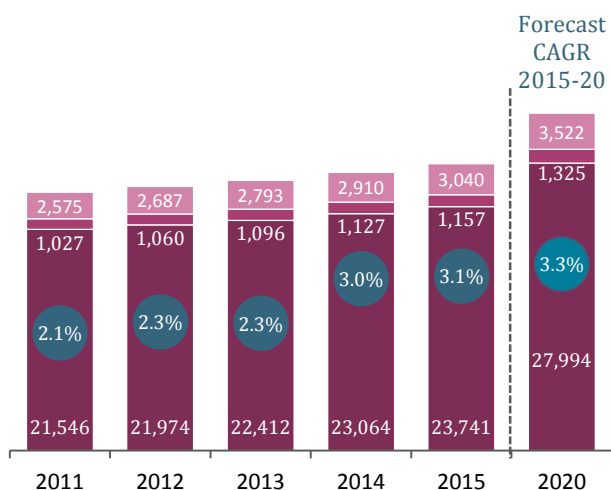


Chart 2 Total Volume Sales of Hot Beverages in Kenya by Category 2011-2020 (tonnes): Tea, Coffee and Other Hot Drinks; YOY % Growth and CAGR 2015-2020

Source: Euromonitor International

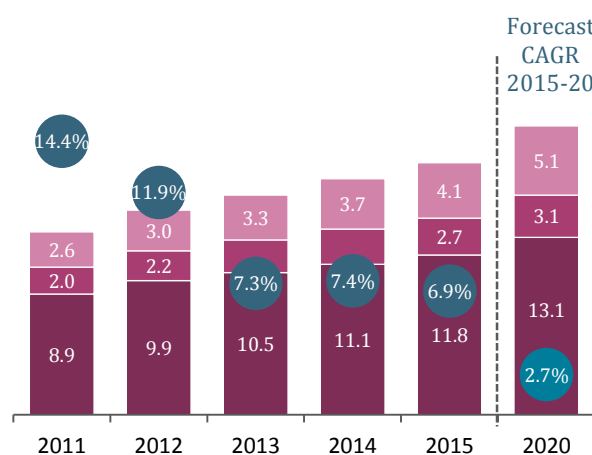


Chart 3 Retail Value RSP of Hot Beverages in Kenya by Category 2011-2020 (tonnes): Tea, Coffee and Other Hot Drinks; YOY % Growth and CAGR 2015-2020

Source: Euromonitor International

Note: Value provided in local currency at retail sales price RSP; fixed exchange rate; historic current prices, forecast constant 2015 prices

Although tea remains the staple beverage in Kenyan households drunk throughout the day at home and at work, coffee continues to make inroads supported by the increased adoption of an urban lifestyle, the growth of a vibrant local coffee shop culture, the opening of new restaurants and chained fast food outlets catering to a growing market, rising familiarity with the product and greater disposable incomes (Chart 2, Chart 3). Particularly young and higher-income consumers perceive coffee as the premium, modern hot drink of choice.

Demand for hot beverages in Kenya is expected to accelerate further, growing by 17.5% in total from 2015 to 2020. Increasing demand from the country's middle-income population, together with new product development, increasing differentiation especially amongst niche products, intensive marketing and the entry of new players, are some of the key drivers expected to boost consumption and values sales within the total hot beverages market over 2015-2020.

3. COMPETITIVE ENVIRONMENT

Local manufacturers, such as Kenya Tea Packers (Ketepa), reign over the tea, while Nestlé is the overwhelming leader within coffee in Kenya thanks to its popular instant coffee brand Nescafé

Kenya's competitive landscape is concentrated with around a dozen major players across coffee, tea and powdered hot drinks (Chart 4). However, the market is showing signs of intensifying competition with

entry of new players and brands, including private label, offering innovative and affordable products. As a result, prices especially for coffee, are anticipated to become increasingly affordable for low- and middle-income consumers, which in turn will boost consumption volumes.

Ketepa's leading market share is confirmed by survey results indicating that it also tops consumers' preferences, with 60% of consumers favouring it, followed by Fairtrade-certified Kericho Gold. The brand is also very visible across all retail outlets, along with Kericho Gold and Fahari ya Kenya.

Nescafé instant coffee by Nestlé Foods Kenya's has the second highest market share for the hot drinks category overall and also leads consumer choices for coffee. Fairtrade-certified Dormans is also prominent in consumer minds but ranks lower in overall market share. Cadbury's high market share reflects its large in-store representation among powdered hot drinks and popularity amongst Kenyan consumers.

Innovation by local players, who also maximise on trade relations to export their products, is expected to create a new pool of consumers. Fierce competition within the market is also foreseen to push local and international leaders, among them Nestlé Foods Kenya, to add value in packaging and taste.

"Made in Kenya" claims are quite prominent on several tea and coffee packages. However, the absence of a standard label for claims on provenance across locally produced brands suggests it is not a major factor for brand differentiation used by manufacturers. "Coffee Kenya", a trademark for Kenya Arabica coffee registered by the Coffee Directorate in Kenya and globally, is the exception. Consumers also did not rank buying local in their top five purchasing criteria for hot drinks.

4. HOT DRINKS ON RETAIL SHELVES

Stores located in upper income neighbourhoods offer a more sophisticated choice of hot beverages especially for tea and coffee

With tea the most popular hot drink, Kenyan supermarkets and hypermarkets devote the most shelf-space to it. Coffee's prominence on retail shelves is lower, as expected given Kenyan consumption habits and preferences. A surprising variety is available for chocolate-based drinks outside the clear market leaders Nestlé and Cadbury.

Leading retailers adapt their offer depending on store location and the socio-economic profile of its target customers. The shelf space dedicated to both the tea and coffee assortments tends to be larger in grocery stores catering to middle and upper class consumers as well as expatriates. The coffee offer is mainly limited to instant and single use sachets in stores targeting low-income Kenyans, whereas retailers addressing more affluent consumers also tend to sell premium instant coffee, fresh ground coffee and even coffee pods.

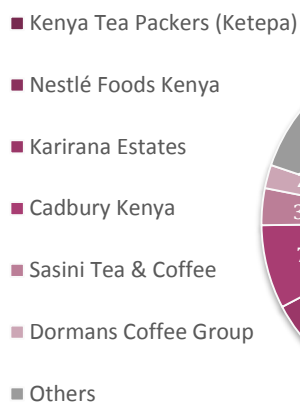


Chart 4 Hot Beverages Market Retail Value Share % by Company 2015

Source: Euromonitor International

Domestic brands dominate across all hot beverages categories, with local brands significantly more affordable and clear price differential between cheaper local and premium imported powdered hot beverages. Loose tea is notably cheaper than tea bags on average but 62% of consumers surveyed, particularly younger age groups, reach for tea bags when buying their favourite hot drink. For coffee similarly, consumers are willing to pay for the convenience of instant coffee despite its higher price when compared to fresh coffee.

5. CONSUMER PREFERENCES AND SHOPPING HABITS

Tea is by far the most consumed beverage by households in the sample, beating water and dairy

A survey of 501 randomly chosen urban consumers, meeting a lower monthly grocery spending limit of KSh5,000, confirms the preference for tea over any other drink including water (Chart 5). Tea is consumed daily in 94% of Kenyan households, whereas coffee and cocoa are the 4th and 5th most reported drinks with around 65% and 58% of households, respectively.

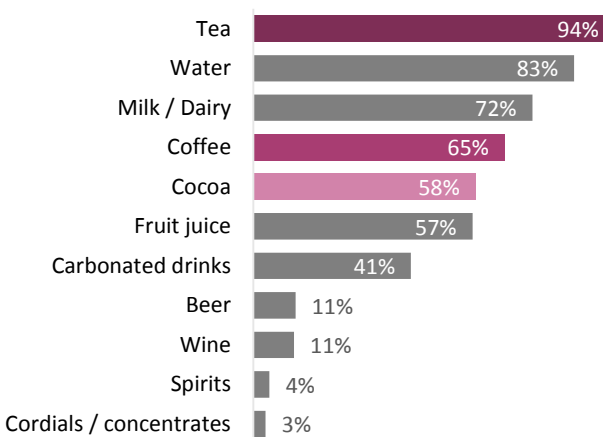


Chart 5 Most Popular Beverages amongst Kenyans

Source: Euromonitor International from consumer surveys conducted in November, 2016 (n=501)

Hot beverages are regularly consumed both at home and at work and at far lower frequency in restaurants as part of a meal on their own or as take-aways. Survey results confirmed that Kenyans are heavy tea drinkers, with 74% of Kenyans drinking at least three cups of tea a day and an average of 4.6 cups per day (Chart 6). Most tea drinkers consume from one to two cups of tea in the morning, but almost two thirds of tea consumers prefer other drinks, including water, soft drinks and others, at lunch time.

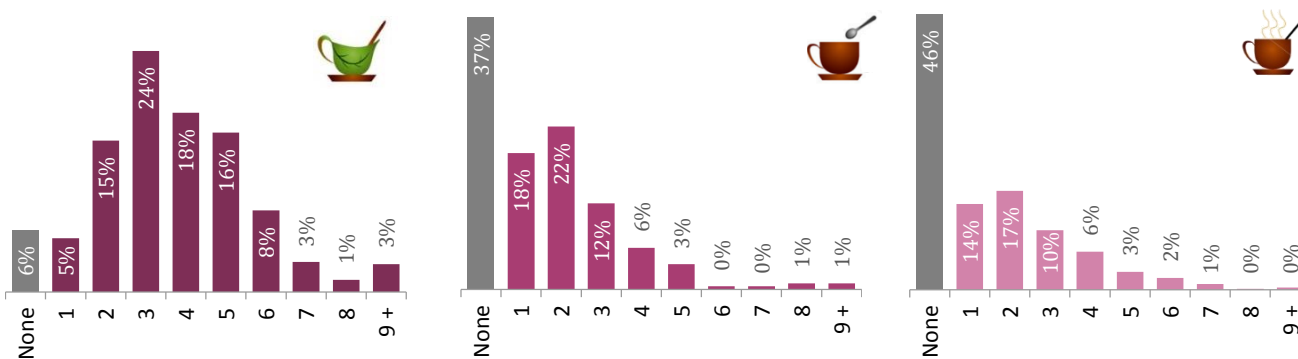


Chart 6 Daily Tea, Coffee and Chocolate-based Hot Beverages Drinking Patterns (Number of Cups per Day)

Source: Euromonitor International from consumer surveys conducted in November, 2016 (n=501)

For coffee, the number of occasional drinkers (once or twice a month or less often) is significantly higher. A slight majority of respondents report drinking only one to three cups of coffee on an average day (52%), and more than a third no coffee at all. Similarly, 46% of respondents do not drink cocoa/hot chocolate on a daily basis or ever, with consumption typically once or twice a week.

Although Kenyans of all ages tend to favour tea, the survey reveals a slight tendency for coffee consumers to be younger, as the highest percentage of daily coffee drinkers is between 18-34 years old, and male. More women appear to prefer cocoa/hot chocolate.

Reflecting high tea consumption by households, Kenyan consumers replenish tea supplies several times a month or more often, whilst only about 14% buy coffee and chocolate-based hot beverages at least monthly. Supermarkets and hypermarkets are key destinations for all hot beverages purchases while open markets and specialist retailers feature for coffee.

For tea and coffee, quality and taste are key selection criteria for Kenyans, each accounting for 80% share among the survey sample. Around half of respondents reported that value for money is an important purchasing criteria. While quality ranks as the number one criterion for tea and coffee, taste tops the list in powdered hot beverages as the target consumers for these products are primarily children.

6. FOODSERVICE, INSTITUTIONAL AND CORPORATE ORGANISATIONS IN KENYA

Tea and coffee are the most common hot drinks consumed by both foodservice, including restaurants and hotels, as well as institutional and corporate organisations

Institutions and corporate organisations consume locally produced black tea bags, but prefer imported instant coffee for use in their premises with powdered hot drinks not universally offered. Ketepa for tea and Nescafé for instant coffee were most frequently mentioned as the brands of choice. Corporates spend around KSh380 (US\$3.70) monthly - more per person per month than public institutions.

Breakfast (7-11am) and early evening after work (4-8pm) are prime times for the consumption of hot beverages in both foodservice and hospitality establishments surveyed in Kenya. Average volume sales per foodservice and hospitality establishment in Kenya was found to be highest for tea, with the standard coffee options still rather limited in restaurants and cafés excluding specialist coffee shops. Market leading tea brands Ketepa and Kericho Gold along with Nescafé instant coffee dominate foodservice.

Quality and pricing are more important than origin and sustainability or ethical claims as purchase criteria for the institutional channel (Chart 7). In the meantime, product quality and taste are more important than price for foodservice and hospitality players when it comes to buying hot beverages for their customers (Chart 8).

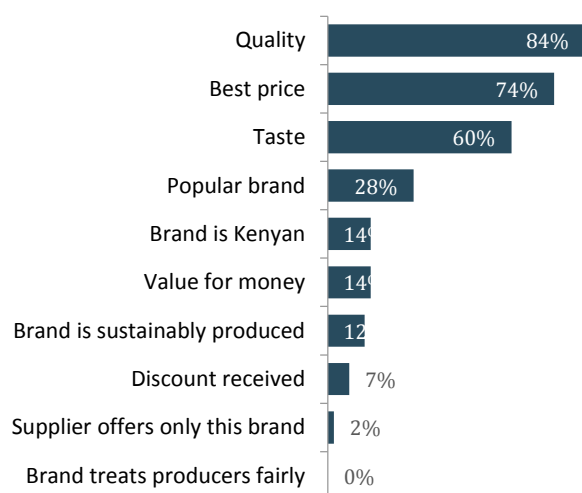


Chart 7 Importance of Factors Influencing Choice of Hot Beverages by the Institutional Channel

Source: Euromonitor International from pulse interviews conducted in November and December, 2016 (n=43)



Chart 8 Importance of Factors Influencing Choice of Hot Beverages by the Foodservice and Hospitality Sectors

Source: Euromonitor International from pulse interviews conducted in November and December, 2016 (n=49)

7. FAIRTRADE IN KENYA

Fairtrade is most prevalent on the production side with Kenya accounting for more than half of the farmers and plantations involved in the production of Fairtrade certified tea in the region.

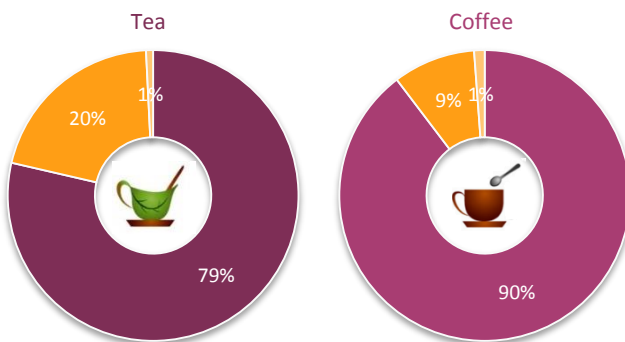


Chart 9 Conventional Tea and Coffee Production, Fairtrade Production and Fairtrade Production sold as Fairtrade Certified, 2015

Source: Euromonitor International from Fairtrade Africa, no data provided for Burundi

Fairtrade is well represented on the producer end with 41 tea factories and plantations, 63 coffee producer organisation and 2 cocoa farmers certified across Kenya, Uganda, Tanzania and Rwanda in 2015. Fairtrade certified production forms a substantial 21% of the total region for tea and 10% for coffee (Chart 9), with Fairtrade being particularly significant in Kenya. Fairtrade certified production volumes have also increased substantially from 2011 to 2015 (a CAGR of 16.4% for tea and 59.5% for coffee), presumably in response to the efforts of Fairtrade working with producer organisations. As production is blended

with conventional produce, a mere 1% of regional certified tea and coffee production in 2015 was sold as Fairtrade certified either locally or abroad.

Only two local manufacturers feature the Fairtrade mark in tea and coffee, making this ethical certification not very prominent on Kenyan retail shelves and in the market

The presence of Fairtrade certified hot beverage products was limited across retail outlets visited during the field research. Hypermarkets and other grocery retailers, such as health food specialist and specialist coffee shops, offer the greatest choice of Fairtrade certified hot beverages brands.

Nonetheless only three brands were noted in stores to carry the Fairtrade label – local tea brand Kericho Gold, including Kericho Gold Attitude Teas, local coffee brand Dormans and the imported coffee brand Percol (Picture 1). Interestingly, most fresh coffee products by Dormans are positioned within the mid to lower price segment and Fairtrade-certification does not appear to attract a price premium in Kenyan retail, with imported tea brands often the most expensive.



Picture 1 Kericho Gold (left) and Percol Fresh Ground Coffee (right) with prominent Fairtrade logo at Nakumatt Village

Source: Euromonitor International

Overall low representation of Fairtrade certified hot drinks with sales growth weakening in the face of increasing competition including from private label brands

Poor presence in retail has translated into low market share for Fairtrade-certified hot drinks. In 2015, volume sales of Fairtrade certified hot drinks in Kenya's retailing channel were estimated at only 165.6 tonnes, up by 13.9% over 2011, and KSh399.4 million (US\$4.1 million), up by 39.5% in absolute terms during the same period. In the face of competition from multinational brands, local players, such as Gold Crown Beverages Kenya, Dormans Coffee Group and Vava Coffee Ltd, have tried to leverage ethically-sourced products, fashionable pack sizes and designs to lure consumers. However, the recent emergence

of private label brands has added to competitive intensity to the detriment of Fairtrade-certified hot drinks in the review period of 2011 to 2015.

Low awareness of ethical labelling and Fairtrade certification in particular is evident from consumer surveys and conversations with foodservice, corporate organisations and institutions

Awareness of ethical labelling in general is low among Kenyan consumers. A majority 56% of respondents are not aware of any of the ethical labels featured by hot beverages, and only 35% of them confirmed they are aware of the Fairtrade logo. UTZ, which was not encountered during the research, and Rainforest Alliance only seen on Percol coffee, were even lower with only 11% of respondents claiming awareness.

Results of pulse interviews with the institutional channel and foodservice / hospitality sectors are aligned with the consumer survey. 30% of institutional respondents and a mere 3% of the hospitality sector appear to have a good understanding of the Fairtrade concept – most respondents struggled to provide examples of ethical certifications without prompting. Values associated with Fairtrade certification were also not considered important purchasing criteria for these sectors with quality, taste and price most important (Chart 7, Chart 8). Nonetheless, when Fairtrade was explained, up to 54% of companies and 85% of hospitality establishments professed willingness to pay higher prices for the Fairtrade certified brands, with 90% of overall respondents expecting improved quality from certified products.

Kenyans express concern with ethical business behaviour and the social well-being of farming communities

Despite low awareness about the Fairtrade certification and its objectives, Kenyan consumers expressed strong concern about ethical businesses practises. Close to 95% of respondents believe that farmers and workers should be treated and paid fairly, that more needs to be done to eradicate child labour in the country, and that more investment is required to support local communities. This strong discrepancy supports calls for more action on behalf of the Fairtrade organisation in terms of educating local consumers about its activities as establishing more partnerships with local companies.

Of those aware of Fairtrade, the concept of 'fair price to producers' is most strongly connected with it

About 66% of Fairtrade-aware respondents identify it with 'fair price to producers', followed by 'equal trading relationships' (Chart 10). Daily cocoa drinkers have stronger associations about Fairtrade for all key associations in part because Kenya's leading chocolate bar by Cadbury was Fairtrade certified. In addition to the top five associations, a number of consumers know Fairtrade to be a global organisation supporting investment in local communities and sustainable agriculture, and ensuring living incomes for farmers.

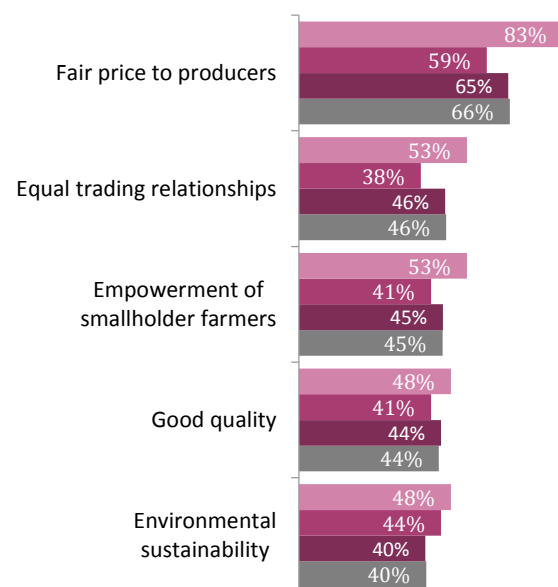


Chart 10 Top five associations with Fairtrade amongst Kenyan consumers (daily cocoa drinkers, daily coffee drinkers, daily tea drinkers and total)

Source: Euromonitor International from consumer surveys conducted in November, 2016 (n=501)

The Fairtrade concept needs to be further promoted, with educational activities considered a priority

Consumer survey results suggest that the key source of information about ethical labelling and Fairtrade in particular is differentiated by consumer age. Messages to market Fairtrade should therefore be tailored

by age segment. Internet, social media and product packaging remain key sources of information about certifications, with all three key channels mainly interesting for younger consumers, whereas more traditional media including promotion via magazines or newspapers and television is better suited to older Kenyans.

8. CONCLUSIONS AND RECOMMENDATIONS

Limited awareness of, but interest in, Fairtrade constitutes an opportunity to mobilise the emerging middle-class ethical consumer in East Africa and demonstrates potential for market growth while working closely with brands for mutual benefit to achieve common goals

Fairtrade has been successful in raising certified production volumes especially for Kenyan tea, leaving room for increasing certified volumes across tea, coffee and the small regional cocoa outputs by refocusing efforts in other East African countries and exploiting the Kenyan achievements as an example in the promotion of Fairtrade certification. Nonetheless, only a fraction of Fairtrade production volumes are sold as Fairtrade certified tea or coffee either locally or abroad. Understanding the reasons behind the resultant loss in certification premium is important as it impacts the expansion of the Fairtrade concept to other producers and brand manufacturers.

To advance Fairtrade's objectives, core marketing concepts should be explored directly with the KTDA and similar organisations, to agree base principles and marketing strategies for Fairtrade certified produce. With increasing market liberalisation, opportunities among specialist tea packers and manufacturers to develop Fairtrade certified brands also need to be explored.

Limited awareness of Fairtrade amongst Kenyan consumers along with only two locally manufactured brands featuring the label has restrained growth in consumption of certified products. However, consumers are generally supportive of the values underlying Fairtrade signalling that Fairtrade certified tea and coffee products in Kenya and probably the wider region hold significant growth potential. Building on these attitudes, campaigns targeted at different groups of consumers, including foodservice and places of work, can increase awareness and recognition of the label and its positive effects on local industry.

Given the competitive nature of the hot drinks market in Kenya, aligning the benefits of Fairtrade certification with strategic brand goals will ensure that packers and manufacturers are motivated to consider Fairtrade certification. Linking Fairtrade with attributes consumers base their purchasing decisions on, namely quality, taste and price, can help elevate Fairtrade as an important brand differentiator. This requires developing close relationships with a range of companies selling hot drinks including multi-brand domestic and international companies and private labels to find direct and indirect ways for cooperation in marketing will help to advance Fairtrade's goals as much as those of brands.