

THE STATE AND FUTURE OF DAIRY SECTOR IN THE EAC

Models that Work and Those that Do Not

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Mr. Manuel Schärer - A technical expert, Supplier Development Manager with Nestlé-Kenya.

Background

The interview on the state and future of dairy sector in the East African Community (EAC) region was conducted by Dr. Birungi Korutaro - a project team leader with Kilimo Trust East Africa and the respondent was Mr. Manuel Schärer - A technical expert, Supplier Development Manager with Nestlé in Kenya.

Birungi: How is Nestlé involved in the dairy business?

Schärer:

One of Nestlé's core businesses procurement and processing of milk. Globally, our largest dairy operations are in India, China, Pakistan and Indonesia. In Africa, we have milk processing plants in Kinshasa (DR Congo), Luanda (Angola) and Zimbabwe.

Africa has a significantly high milk production capacity. In Kenya for instance, the milk output is estimated at 4 - 6 billion

litres per year. However, very little of this milk is processed with most of it traded and consumed through informal channels. More has to be done to structure the industry since it remains dominated by small scale farmers. Priority should be put into measures to ensure development and commercialisation.

It is worth noting that the East Africa region is the milk reservoir of the African continent. However, this sizeable milk production in the region is not matched with equally sizeable processing companies. In addition, there are few international players in the region.

Birungi: What models do you think would be appropriate for big processors like Nestlé to succeed in the EAC region?

Schärer: Any strategies to enable big processors thrive should ease the access to local, regional and international markets. Linking to these big markets would then make value addition viable. A case in point is Fonterra Ltd in New Zealand that opted to export its milk products on realizing that the population in New Zealand was limited. It is an option for Kenya and the region too if we ensured that the processed products can compete internationally in terms of quality and price.

Birungi: What are the challenges facing the sector in the EAC region?

Schärer: Although the opportunities in the region are rather similar, the challenges differ between countries. Seasonality is a challenge. It makes milk supply fluctuate over time hence processing plants are forced to operate below capacity. Seasonality can be addressed through dairy development programmes concentrating on dairy belts.

As a result of seasonality, prices fluctuate following an inverse trend. This makes planning and improvement of the sector

difficult and unpredictable. When farmers have sizeable volumes and prices fall as a result, they reduce their profits because the cost of producing a unit of milk does not fluctuate as much as pricing between and within seasons. On the other hand, when prices are high, farmers do not have milk to sell so they do not benefit. For example, in the current context in Kenya, prices can go as high as Kshs 40 per litre of milk and as low as below Kshs 30 per litre. It is also the same case in Uganda where prices can go to as high as UGX 1,000 per litre and as low as less than UGX 600 per litre. The price spikes are mirrored by volume fluctuations. For processors, this is not ideal in business terms because their cost of running the plants remains relatively the same whether they are operating at full capacity or otherwise.

The state of infrastructure is constraining smallholder farmers from accessing markets. While in Asia it is common to see processors setting-up cooling infrastructure close to the farmers, it is the opposite in the EAC, where the cooling network is mainly centralized in large centers. This challenge has limited the growth of the sector which is largely small scale. The model Nestlé implements is one where the cooling plants are numerous and small, and decentralized in areas where the milk is produced. Currently a lot of milk is produced in the region but not collected.

The quality of milk is another challenge. In my view, there is only a single milk standard called 'good quality'. The East African milk consumer has the same expectations as any other milk consumer in the world. To achieve quality, the value chain should be controlled making the role of a regulator important. The regulator should define standards and enforce compliance. My observation of the dairy sector in the EAC region confirms that although the regulators are in existence, implementation of standards

is still difficult e.g. milk hawking is still rampant.

With improved road infrastructure in the milk producing areas, farmers would be able to deliver milk in its best quality to the cooling centres - within two hours of milking.

Birungi: What opportunities do you see in the dairy sector in the EAC?

Schärer: Market availability is the main opportunity and especially if the region can explore markets beyond its borders. This opportunity would even be bigger if the region could explore the global market where demand is estimated to be growing at 5% against a supply growth of 3% per year.

Milk production in the EAC is significant compared to other parts of the continent. For instance, Kenya and Uganda are producing about 4-6 billion litres and 2 billion litres of milk per year respectively (estimates). This is a lot of milk if only it is properly handled and processed to enter the commercial market. This means working with farmers can yield even more milk that is of improved quality.

Furthermore, the dairy industry is dominated by local investors. There are opportunities of attracting foreign investment through formulation of appropriate policies. It is interesting that there is a larger presence of international dairy companies in West Africa yet the region does not produce as much milk as the EAC. Foreign investors would increase competition by driving dairy development and quality upwards which is a pre-requisite for growth.

Birungi: Do you think foreign investors eyeing the region would have to integrate dairy development as part of their strategies?

Schärer: Although I may not know how other players approach the same issue, for Nestlé, it is definitely the case. If a company focuses only on collecting volumes, chances are that competitors would perform better if they integrate building relations with the suppliers. Nestlé combines milk procurement and dairy development to ensure efficiency and quality, while securing the long-term sustainability of the dairy farming sector. Procurement ensures collection of volumes that meet quality while dairy development encourages growth of business relations between the company and farmers. In Pakistan for instance, Nestlé deals directly with farmers, limiting as much as possible engaging with middle men and works also with women extension. This arrangement significantly increases returns to farmers.

Birungi: What would you say about the financing products and mechanisms available in this region?

Schärer: I would categorize the problem of finance availability and accessibility as a threat to the dairy sector. Money is available in the region but the cost of accessing it is prohibitive. Models that ensure financing is readily available and affordable should be encouraged. Some of those models include matching grants as long as all parties involved are willing to meet their part of the obligation. A financing model that Nestlé has used in some Asian Markets is to negotiate with banks to extend credit to dairy farmers at favourable rates and in return, the farmers would open bank accounts in those banks so that re-payments are made from the monthly income they receive from milk sold. This reduces the risk of default.

Birungi: Do you think an electronic platform can help in addressing the current challenges of the dairy sector?

Schärer: Although I may not have a definite answer to this, I would like to say that some

electronic platforms have worked while others have not brought any change. The use of electronic platforms should be pursued on case by case basis.