MARKET DIVERSIFICATION STRATEGY AND SUCCESS OF FOOD PROCESSING FIRMS IN KENYA

by

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Abstract

Almost everywhere in the world, the private sector plays a critical role in creating and sustaining growth and development. Recognising this, policymakers and other observers have been paying considerable attention to the poor business environment facing firms in many countries, including those in Africa. Largely ignored, however, is the fact that, despite challenging environments, some firms succeed. The research reported in this paper has focused on the question of how and why such firms perform well. Using value chain and internationalisation perspectives, the paper explores whether diversification into new markets—both domestic and foreign – contributes to firm success.

The study surveyed Kenya's food manufacturing subsector, concentrating on locally owned firms employing at least 10 workers operating in the Nairobi metropolitan area. Nairobi Metropolitan, which covers the city and adjacent counties, accounts for over 50% of Kenya's GDP and an even higher proportion of the country's manufacturing activity. Food manufacturing was chosen as the locus of investigation because of its importance, not only in Kenya, but also in many other African countries' manufacturing sectors. To reduce some of the variation in the sector, the sample was limited to five product groups: dairy, grain milling, edible oils, sauces & jams, and snacks The survey, which was conducted between November 2013 and June 2014, covered 48 firms, representing 36 % of the target population. The main findings are that successful firms are good at diversifying their product markets. Their diversification takes various forms, including expanding into new markets within Kenya, tapping regional markets and, in a few cases, exporting into global markets. The study also found that the selling to supermarkets was an important channel for wider distribution of food products. The study concludes that market diversification is a complex phenomenon, which goes beyond simple direct exports to include movement into new types of markets in Kenya, indirect (passive) exports, and investment in production facilities elsewhere. These findings led to the conclusion that well-functioning domestic and regional markets are critical for the success of food manufacturers.

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1   INTRODUCTION[1]

1.1 Background

Businesses want to succeed, and many governments want them to succeed if for no other reason than to provide jobs for local people and taxes for the Treasury. The current development consensus is that sustained economic growth and employment are critical to development and poverty alleviation. Economic growth requires, amongst others, structural transformation, diversification of production, and risk taking by firms (World Bank 2004, Commission on Growth and Development 2008). As is the case in most areas of development, the state plays an important role in fostering economic growth. It can be argued that its key tasks fall under the broad umbrella of facilitating private sector development and regulating potentially harmful consequences (Baldwin et al. 2012, Harrison and Rodriguez-Clare 2010). Nevertheless, the private sector itself is critical in creating and sustaining this growth (Moore and Schmitz 2008, Page 2012, UNECA 2015). The African Development Bank has stated this very clearly: 'The future of African economic growth – and the futures of millions of Africans and thousands of African communities – is closely tied to the private sector' (AfDB 2013).

The business environment has the power to affect the establishment, growth, and development of business (Omosa et al. 2007). In African countries the business environment is frequently described in negative terms as 'hostile' (Eifert 2005), 'uncompetitive' (Eifert 2005; WEF 2013), and ' stressful' (Agboli and Ukaegbu 2006). Even when the descriptions are couched in gentler language, they often mask an underlying belief that doing business in Africa is difficult and, by implication, success is rare. While not denying that the business environment for African businesses is far from ideal, it appears that for some at least, success is possible. The difficulties are both institutional and operational. For example, the World Economic Forum 2012 survey ranked Kenya 106th out of 144 countries, with a Global Competitiveness Index of 3.7. In terms of institutional capability, infrastructure, macroeconomic stability, Kenya was ranked 106th, 103rd and 133rd position, respectively in the same survey. Further challenges include endemic corruption, inflation, high tax rates, insecurity, poor access to financing, inadequate supply of infrastructure, inefficient government bureaucracy, and policy instability (see WEF 2012 p. 218).

Despite these ills, there is a rising recognition that Africa far from being 'The Hopeless Continent' (Economist, 2000) is now 'The Hopeful Continent' (Economist 2010). Media report

that new generations of African firms are turning Africa in the "the new Asia" (Tvedten, et al 2014, UNECA, 2012). Africa is home to firms that are clearly successful (World Bank 2012). Development organizations are increasingly seeing firms, entrepreneurship and private sector development as the solution to many of Africa's perils (McKinsey Global Institute 2010, UNECA 2012, World Bank 2012). Studies carried out in the 1980s and 1990s noted the existence of successful firms, and in at least some countries the business community regularly highlights and rewards companies for 'business excellence' (Bigsten and Soderbom (2006)[2] . What has been lacking, however, is a good understanding of how such successful firms manage to perform well in a negative environment. This study has, therefore, investigated the origins and nature of local firms' success as a means to improve firm strategies and business sector development policies. In particular, it has sought to understand the variations of success and identify the strategies that explain success.

Successful firms exist in all sectors -- agriculture, trade, services, trade, construction – but this study has focused on manufacturing and, in particular, the food processing subsector. Manufacturing for exports has become a major element in strategies for industrial growth in the developing world owing to the experience of East Asian countries. Kenya is one of the African countries to have adopted this strategy of exporting manufactured goods a key component is manufactured food (see Economic Survey 2014: p 119). Food manufacturing subsector in Kenya continues to play a key role in the development agenda and in the achievement of the Vision 2030 targets. The contribution of this subsector is in three-fold: contribution to the GDP, foreign exchange earnings and employment creation (Government of Kenya, 2014; World Bank 2012). The food products subsector contributes a third of total manufacturing sector. It is perceived to be closely linked to the local agricultural sector, though some firms actually import all or some of their inputs in the form of raw or semi-processed agricultural products.

The term 'firm success' can be defined in many ways, depending on the issue and the nature of firms under investigation. 'Success' is closely linked to performance, but is actually a broader term. Success is multi-dimensional, and can be defined in terms of observable qualities such as financial health, longevity or continuation in business, human capabilities, and more subjective factors such as owner satisfaction or the achievement of particular objectives (McCormick 1988, Tineke 2003. Beaver 2007, Simpson et al. 2012). To identify our 'successful firms' we first applied a longevity measure: Each firm had to have been in existence for five years or more. Then using the survey data, we ranked the firms based on four broad indicators (1) Self Perception, (2) Change in Turnover 2007 – 2012, (3) Earnings before interest and taxes (EBIT) for the year 2012; and (4) the Ratio of Turnover to employees in 2012. For each of these

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[2] Source: www.eastafricatop100.com/the-survey/overview/ Last Accessed 15 January 2015

indicators, a score of 0-1 was given totaling 4. These scores were then scaled down to 1 by dividing the whole score with 4 to get an index. A firm was classified as very successful if the aggregated score was between 0.76 -1.0, it was considered successful if the computed index was between 0.5 – 0.75. Firms with a score of less than 0.5 were categorized as unsuccessful. Since the study was on successful firms, all the firms in our case had a success score of between 0.5 and 1.0. Longevity and size were used in the selection criteria, hence they could not be used in the computation of firm success.

To achieve its aim, the study sought to answer the overall question of how and why certain Kenyan firms manage to grow successfully under changing and often volatile market and institutional conditions. In particular it investigated the role of market diversification strategies in achieving firm success.

1.2 Objectives of the study
This paper is an attempt to determine the extent to which firm success in food processing sector can be explained by differing market orientation and the degree of diversification. Specifically, this paper was designed to achieve the following objectives:
1. To describe the food processing subsector in Kenya.
2. To document the nature and extent of market diversification among food processing firms in Kenya
3. To determine whether there is any observable relationship between the degree of market diversification of food processing firms and their success
4. To assess if whether firms that mix related and unrelated diversification strategies underperform or outperform firms that pursue one strategy exclusively.

1.3 Methodology
The paper is partly exploratory in nature due to limited knowledge in the field concerning the food processing sector. Two approaches were used to collect relevant data for this paper. The first approach involved assessing the available literature on businesses in Africa and in particular the literature on market diversification. The second approach combined two phases of data collection, namely a mapping and a survey phase, which were conducted between 2013 and 2014. Due to the lack of a usable sampling frame of firms in the food processing industry, the main objective of the mapping phase was to identify the firms in this sub-sector of agri-processing and track their location.

At the end of this phase, 141 firms were identified. The survey questionnaire was administered to all the identified firms that met the criteria of: a) having Kenyan ownership, b) being at least 5 years old, and c) having a labour force of at least 10 employees. At the end of the process,

the survey gathered information from 48 firms as shown in Table 1. The 48 firms were distributed among grain milling, dairy processing, snacks, sauces and jams, and edible oils subsectors. Although the total sample is fairly small, it represents between 28% and 50% of each of the product groups and thus is considered to be representative of the target population.

Table 1: Overview of Interviewed Firms in the Food Processing Industry in Kenya

Product Group	Total Valid Population	Total Interviewed	Per cent Interviewed
Snacks	47	13	28%
Grain Milling	44	13	30%
Dairy	32	13	41%
Sauces & Jams	12	6	50%
Edible Oils	6	3	50%
Total	141	48	

Source: Field Survey 2014

The survey questionnaire included six main sections, including one on markets and key customers. The companies were contacted byphone, in order to make appointments. The interviews were conducted by the project researchers and research assistants with key managers of the companies at the premises of the companies. The interviews lasted from one to two hours and were, in some cases, followed up with an additional visit or a phone call in order to obtain missing information and/or tour the factory. Data was analysed using univariate and bi-variate methods, including correlations, contingency tables, and very basic time-series.

1.4 Organization of the paper

This paper is organised in six sections. Following this introductory section, section two reviews the literature while section three presents the conceptual framework. Section four presents the findings, which are further discussed in section five. Finally, section six concludes the paper and gives policy recommendations.

2   LITERATURE REVIEW

2.1 Theory

The theoretical underpinnings of the study lie in the global value chain approach which has been well described in a wide literature (Gereffi 1994, Kaplinsky and Morris 2001, McCormick 2001, McCormick and Schmitz 2002, Kamau 2009, Cattaneo et al. 2010, Kaplinsky and Morris 2014). In this framework production is only one node in a system of interdependent activities extending from product conceptualization and design to production, and finally to distribution and, in some variants, to recycling (ref).

The value chain concept has several dimensions.[3] The first is its flow, also called its input-output structure. In this sense, a chain is a set of products and services linked together in a sequence of value-adding economic activities. A value chain has another, less visible structure. This is made up of the flow of knowledge and expertise necessary for the physical input-output structure to function. The flow of knowledge generally parallels the material flows, but its intensity may differ. The second dimension of a value chain has to do with its geographic spread. Some chains are truly global, with activities taking place in many countries on different continents. Others are domestic or if they extend beyond national borders, they involve only a few locations in different parts of the world, or the market destinations are mainly neighbouring countries or countries in a regional trading bloc. The third dimension of the value chain is the control that different actors can exert over the activities making up the chain. The actors in a chain directly control their own activities and are directly or indirectly controlled by other actors. Since value chains are basically constellations of human interaction, the possible varieties of governance are endless. In the original conceptualization, some chains are driven or governed by the producers and others by the buyers. 'Buyers' in global value chains tend to be large international retail chains that source their products from producers around the globe. They direct the chain by specifying what is to be produced and by whom, and by directly or indirectly monitoring the performance of producing firms. Such chains are called 'directed' or 'buyer-driven' because the buyer is viewed as driving the entire chain.

The value chain view looks at value creation mainly from a macro and/or national development perspective. The conclusions and recommendations of value chain analysis are generally policy oriented, aiming at helping governments formulate and adopt policies that support value-adding activities and/or at removing or modifying those seen as harmful. Business scholars, on the other hand, use a related concept – 'supply chain' -- aimed at understanding and managing

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[3] The description in this paragraph draws heavily from McCormick and Schmitz (2002).

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the operations of individual firms. Firms with a 'supply chain strategy' aim at managing their inter-firm networks so that they function efficiently and foster profitability. According to some, this micro view compliments the value chain approach by linking it to the realm of strategy (Holweg and Helo 2014).

The general concept of diversification can be applied to not only to markets, but also to products, activities, and any number of other facets of a business. The concept becomes nebulous when an attempt is made to specify what characteristic differences in products or markets are needed to enable some combination of products to be called diversification and others to be called horizontal or vertical combinations (in terms of product markets). The particular strategy of interest in this paper is market diversification. In value chain terms, the importance of the market is clear, since a key dimension of a value chain is its geographic spread, which can be observed in all nodes of the chain (Kaplinsky and Morris 2001, McCormick 2001).

2.2 Empirical Literature

We examine empirical literature in three broad areas: The characteristics of food processing firms in African countries, the nature and extent of market diversification in food processing, and the relationship between market diversification and firm success.

2.2.1 Firm Characteristics

A study of Nigerian manufacturing, which included firms in food processing, found a preponderance of micro and small firms in the sector (Söderbom and Teal 2002). They further found that firm size and legal status are closely related. Over three-quarters (76 per cent) of the small firms are either sole proprietorships or partnerships. In contrast, 61 per cent and 93 per cent of the medium-size and large firms are limited liability companies. In the food sector, they noted that differences in capital intensity between firms of various sizes meant that labour productivity was not a very good measure of firm performance. They, therefore, opted to examine total factor productivity (TFP) instead.

2.2.2 Nature and Extent of Diversification

The study of diversification has long attracted the interest and attention of strategic management scholars and is one of the most frequently researched areas of business (Oyedijo 2012, Schumacher and Boland 2004, Berger and Ofek, 1995). Among others, researchers have examined the antecedents of diversification and the financial performance outcomes of these strategies (Berger and Ofek, 1995). Despite several attempts, however, strategic management research has failed to establish a consistent and clear relationship between patterns of diversification and performance and most of such attempts are inconclusive (Schumacher and Boland 2004) with conflicting results reported from some of the investigations. For instance, while Lei and Schmit (2009) have found that more diversified insurers have better financial performance, Hakrabarti (2007), concluded that diversification is associated with poorer performance for both affiliated firms and independent firms. Apart from the fact that the various attempts to demonstrate the effects of diversification on performance are inconclusive because of the

conflicting evidence emerging from such studies, most of the investigations carried out so far are based on the experiences of companies in industrialized economies.

Macro studies have investigated how countries have diversified their markets for processed food (See, for example ITC 2012), but empirical studies that examine such diversification at the firm level are few. One particularly useful study makes a clear distinction between two forms of export diversification that are often confused Yoshino (2007). The first is diversification of product composition (product diversification); the second is diversification of export markets (market diversification). This study takes the second approach to diversification, namely the diversification of product markets. We have, however, extended the definition to include not only export markets, but also venturing into new markets within the country.

Market diversification can be measured quantitatively or qualitatively. Yoshino (2007), for example, uses a simple quantitative measure of the number of different markets served. More qualitative measures might include groupings such as formally constituted regional trading blocs, neighbouring countries, countries with shared ethnicity or colonial heritage, as measures of diversification.

Others have considered whether the diversification itself is related or unrelated (Montgomery and Singh (1984). The key issue is whether a firm's businesses are related from a strategic point of view. Relatedness might involve the firm's manufacturing processes, marketing requirements, research issues or management. The concept of relatedness seems most applicable to product diversification, but particularly in the marketing issue can be applied also to market diversification, especially at regional or Continental levels.

The mechanism of i entry into export markets was first traced by Johanson and Vahlne (1977, 1990) who observed two patterns in the internationalization of the firm. The first is that the engagement of a firm in a specific country market seems to develop according to an establishment chain that by which at the start there are no regular export activities, followed by a period in which exporting takes place via independent representatives, then later through a sales subsidiary, and finally – though not in all cases – through a manufacturing plant in the target country. The second is that firms tend to first enter markets that are more like their own environment in terms of language, culture, political system, etc., and only later enter countries that are very different later.

2,2.3 Diversification and Performance

The impact of diversification on the performance of firms in other institutional environments especially the less developed economies has not received much attention thus limiting the generalizability of findings and the development of a global theory of diversification (Oyedijo 2012). The extent to which firms in the less developed countries are using the diversification option, the nature of the diversification strategy they are pursuing and the extent to which such diversification moves help to improve the firms" financial performance and growth are not yet extensively explored.

Literature has suggested that firms which developed through related diversification outperform both those that remained specialized and those which developed through unrelated diversification. These findings were later questioned (Montgomery and Singh 1984). The results of empirical studies linking patterns of diversification to financial performance remain unclear. Some of the specific evidence available from the research on diversification shows that profitability increases with diversity but only up to the limit of complexity. Results from other studies suggest that the management of the process of diversification may be a more important influence on performance than the type or mode of diversification itself (Berger and Ofek, 1995). Other studies have concluded that corporate performance is dependent on strategy implementation rather than the strategy itself. Therefore, it clear that a universal prescription of the benefits of diversification may be unlikely to be found. From a contingency perspective, the likely success or otherwise of diversification may be greatly dependent and determined by the circumstances of an organization such as the level of industry growth, market structure, the firm size, the resource situation of the organization and the firm's institutional environment. The issue is further complicated by the failure to distinguish clearly between market and product diversification.

Yoshino (2007) found a positive correlation between market diversification, measured by the number of different markets served, and export intensity. Yoshino (2007) also identified a pattern of segmentation in market diversification between firms with exports within Africa and those with exports outside of Africa. In particular he notes that firms exporting within a sub-region are likely to expand their markets to other African countries outside the sub-region, but not to global markets such as Europe. He also found strong scale effects in market diversification, with larger firms exporting to more geographically diversified sets of markets than smaller firms. Yoshino (2007) also found that overall, more firms in Africa export regionally than globally. His Kenya data show that 5.6% of all firms export to the East African region, while 2.7% export to other African countries. When firms are broken down by ownership, however, domestically owned firms are less likely than foreign-owned ones to export.

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3   CONCEPTUAL FRAMEWORK

The literature mentions different types of strategies at the corporate level that take into account different directions and types of corporate development. Among them are concentration and diversification strategies. In this paper we focus on diversification as outlined by Oyedije (2012). Literature on diversification suggests both efficiency and agency rationales for diversification. In the agency or "managerial attachment" view, managers diversify, especially by acquisition, primarily to increase their compensation, job security, or span of control. In the efficiency view, product and market diversification allows firms to reduce firm specific risk by holding a greater variety of services (Saunders, Strock and Travlos, 1990). However, risk reduction is not a satisfactory efficiency rationale for diversification. Shareholders in publicly traded firms can always reduce their risk by holding a diversified portfolio of non-diversified firms, gaining the risk reduction advantages of diversification without incurring the costs of managing a large organization. For this reason, diversification would be beneficial only if it provides some kind of economies of scope that support growth and better performance. In this case most firms are not publicly owned through share-holdings, but are private limited companies with very few shareholders. In such cases, diversification for risk reduction may be attractive.

In the food sector, understanding market diversification requires seeing how it affects and is affected by other activities in the chain. The first of these consists of inputs, which are of two basic types: the knowledge and capabilities needed to design, produce, and distribute food products, as well as the material inputs needed for the manufacturing process (see Figure 1). Central to the framework is output, which in this case consists of firm manufacturing processes and their products. On the distribution side are the marketing channels and their destinations in global, regional, and/or domestic markets. Finally, beyond the output and distribution is the outcome of the entire process. We have called this 'firm success', but as will be seen in the findings, success admits of varying degrees.

Figure I: Conceptual Framework

Input	Output	Distribution	Outcome
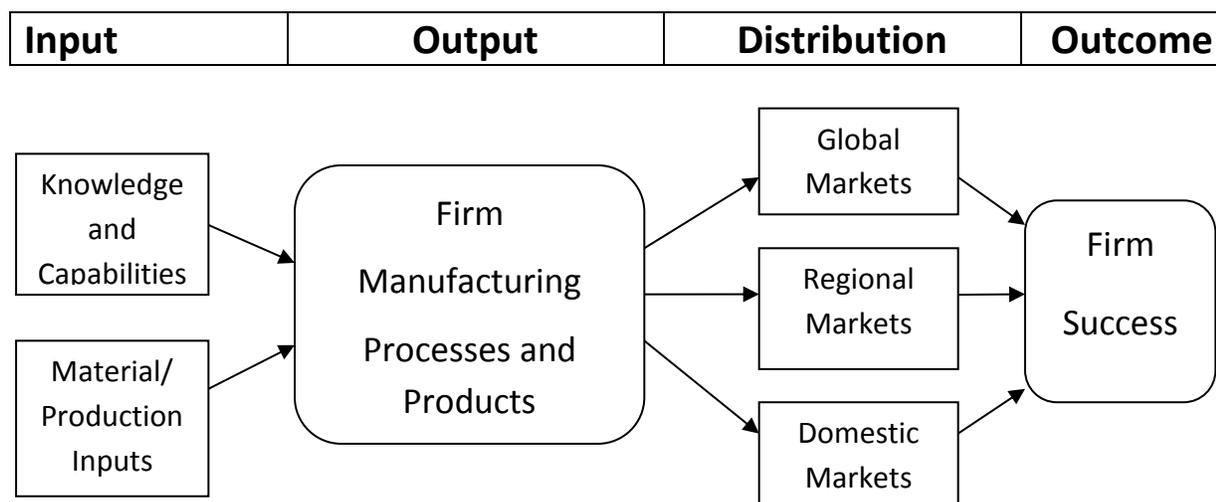
Source: Authors' Conceptualisation

Whereas food processing sector may not be seen as a classic buyer-driven value chain in which 'buyers' and/or main customers control the activities that add value to the product (Gereffi 1994, 1995; Staritz 2012), the governance structure is such that the distribution chain is critical for the producing firm. In this case producers influence what is produced and how production is carried out (Staritz 2012). In the typical case, although buyers are not directly involved in production, they nevertheless exercise significant control over manufacturers (Staritz 2012). Market conditions (market growth, size, integration, and segmentation) are central to the success of African enterprises and several studies have examined the changing African market environment (Tvedten, et al., 2014). There are five which influence market conditions in Africa: growing consumerism (despite rampant poverty), increased demands for Africa's resources, new talent, capital inflows, and Innovation.

Firms selling into the domestic market and regional market appear to have a strong say in the governance structure compared to those in the global market. As a result of the variation in the governance structure, firms supply in the first two markets tend to higher levels of success compared to those in the global market perhaps where buyers are more power. Given the variation in the governance structure, market diversifications result in different outcome in the success variable.

A key feature of the business environment is the institutional structure existing for the industry. Institutions have an impact of the success of food processing firms. These institutions affect production, trade and marketing activities in the industry (North 1990). Institutions interact to

produce a set of institutionalised conventions governing how business is conducted in a particular setting (Tvedten, et al., 2014, Whitley 1992; McCormick and Kimuyu 2007). Institutions influence the outcome of the value chain in which a firm is inserted into and hence the success. This is in recognition of the fact that food production takes place in a particular place, with its own formal and informal institutions.

4   FINDINGS

The findings of the study are presented in four sections: Basic firm characteristics, firm performance, market structures, and the relationship of market diversification to firm success.

4.1Basic Firm Characteristics

In addition to falling into different product groups (See Table 1), the firms varied in age, ownership, employment level and employment structure.

By design, the study included only firms that were at least five years old, so relatively new firms were excluded. Overall, the mean age of the firms was 21.5 years. Firms ranged in age from 6 years to 60 years old. The largest group (21 firms or 43.8%) was more than 20 years old (see Table 2). The remaining firms were divided almost evenly into three groups: 16-20 years old (7 firms or 14.6%), 11-15 years old (8 firms or 16.7%), and 5-10 years old (12 firms or 25%).

Table 2: Age of Company in Categories

	Frequency	Percent
5 - 10 years old	12	25.0
11 - 15 years old	8	16.7
16 - 20 years old	7	14.6
More than 20 years old	21	43.8
Total	48	100.0

Source: Field Survey 2014

By far the largest single ownership form was the private limited company (37 firms or 77.1%) (see Table 3). Sole proprietorships (16.7%), partnerships (4.2%), and cooperative societies (2.1%) accounted for less than one quarter of the total. Private limited company appears to be the favoured form of ownership, with mainly smaller firms being sole proprietorships or

partnerships. The single cooperative society is a dairy firm, reflecting Kenya's long tradition of agricultural cooperatives (Wanyama 2009).

Table 3: Company Ownership

	Frequency	Percent
Sole proprietorship	8	16.7
Partnership	2	4.2
Private limited company	37	77.1
Cooperative Society	1	2.1
Total	48	100.0

Source: Field Survey 2014

The distribution of the numbers of employees (see Table 4 see p. 25) Analysis by employment size suggests a skewed distribution (See Table 4). The range of the total number of employees in 2012 extends from 10 to 2,700, with a mean of 367 employees and a median of 78 (See table 4). The range for permanent staff is almost as wide. All firms reported having permanent staff, with numbers ranging from a minimum of 4 to a maximum of 2,000, and a mean of 160 and a median of 40. In percentage terms, permanent staff accounted for between 10 and 100 per cent. The number of female employees ranged from one to 500, with a median of 0 to 80%. The number of permanent employees in administrative positions ranged from one to 400; in percentage terms the range was from zero to just over half (55.6).

Table 4: Number of Employees and Distribution in 2012

	N	Min	Max	Mean	Median
Total number of employees (permanent and casual) in 2012	48	10	2,700	367	78
Number of permanent staff in 2012	48	4	2,000	160	40
Percentage of total employees that is permanent	48	10	100	64	61
Number of permanent female employees in 2012	45	1	500	47	11
Percentage of permanent employees that are female	45	0	80	35	38
Number of permanent employees in administrative functions (white collar) in 2012	46	1	400	28	8
Percentage of permanent employees in administrative functions	45	0	55.6	22	24

Source: Field Survey 2014

Small firms with between 4 and 49 permanent workers were 43.8% of the total (see Table 5). The cutoff for firm size was 10 workers, including both permanent and casual. Thus some firms in the smallest size category had as many as six casuals. Medium-scale firms with between 50 and 100 permanent workers accounted for 15.6%, while large and very large firms were 27.1 and 14.6% respectively.

Table 5: Number of Permanent staff in 2012

	Frequency	Percent
4 – 49	21	43.8
50 – 100	7	14.6
101 – 999	13	27.1
1000 – 2700	7	14.6
Total	48	100

Source: Field Survey 2014

The number of permanent staff can be viewed as a measure of a firm's 'real' size as well as an indicator of its stability.

4.2 Firm Performance/Success

All firms in the study met the minimum requirement for success, namely all were at least five years old, implying that they had survived the difficult initial years during which firms often fail (citation). Obviously, however, some firms were more successful than others. To obtain a ranked list, four additional variables were examined: Respondent's self-perception of

performance, earnings before interest and turnover (EBIT), trend in employment, and turnover per employee. Respondents were also asked to provide a ranked list of qualitative factors that they believed to be contributing to firm growth.

The first component of success is the respondents' perceptions. Respondents were asked their perception of the company's financial performance over the last two to three years. Not surprisingly, a substantial number (19 firms or 39.6%) said their performance was at industry average (See Table 6). An even larger number, however, reported that their performance was either well above 12 firms or 25.0%) or somewhat above (9 firms or 18.8%) industry average.

Table 6: Perception of company Financial Performance over the last 2 -3 years

	Frequency	Percent
Well above industry average	12	25.0
Somewhat above industry average	9	18.8
At industry average	19	39.6
Somewhat below average	4	8.3
Well below average	4	8.3
Total	48	100

Source: Field Survey 2014

The second component of success was the absolute amount of each company's annual turnover for the latest year in the survey. The study examined companies' annual turnover for the years 2007, 2010, and 2012. Table 7 shows the 2012 turnover in groups. The actual range of 2012 turnover was from Kshs. 1.5 million to Kshs. 28.7 billion, with a mean of Ksh. 2.2 billion, and a median of Kshs 122 million for the year. The large difference between the mean and the median reflects the distribution of the data in which 23 firms (47.9% of the sample) have a turnover of Kshs 100 million or less and 8 firms (16.7 %) count their annual turnover in billions of shillings.

Table 7: Company Turnover in Local Currency, 2012

Kshs.	Frequency	Percent
10.1 Billion – 30 Billion	4	8.3
1.1 Billion – 10 billion	4	8.3
501 Million - 1 Billion	4	8.3
101 Million - 500 Million	9	18.8
51 Million - 100 Million	6	12.5
10 Million - 50 Million	8	16.7
< 10 Million	9	18.8
Not indicated	4	8.3
Total	48	100

Source: Field Survey 2014

EBIT (Earnings Before Interest and Taxes) is a measure of an entity's operating profits. EBIT shows an entity's earning power from ongoing operations. By comparing EBIT to sales or total turnover, operating profit margins show how successful a company's management has been at generating income from the operation of the business. High values of EBIT can indicate a company with effective control of costs, or one whose sales are increasing faster than operating costs. A negative EBIT means that the company is operating at a loss.

Table 8: Estimated Earnings before interest and Taxes (EBIT) as Percentage of Total Turnover, 2007, 2010, 2012

	N	Min Percent	Max Percent	Mean Percent	Median Percent
EBIT 2007	38	-8	50	16.75	15.00
EBIT 2010	41	-1	75	17.41	13.00
EBIT 2012	42	-38	79	18.34	15.00

Source: Field Survey 2014

In 2007, 38 firms had data on their EBIT (see Table 8). The range was from -8% to +50%, with only one firm recording a negative EBIT ratio. In 2010, 41 firms reported on EBIT. The mean was 17.41%, while the median was 13.0%. The mean was 16.75% while the median was 15.0%. Of these, one had an EBIT of -1%, while the remaining values were positive. In 2012, 42 firms reported on EBIT. The mean value was 18.34%, while the median was 15.0%. Three firms had

negative EBIT with values of -38%, -9%, and -2%. EBIT for the remaining firms was positive. EBIT data was missing for 10 firms in 2007, 7 firms in 2010, and 6 firms in 2012.

The ratio of turnover per employee (T/E) is one measure of labour productivity. It measures the amount of sales or revenue generated per employee. Industry and product-line characteristics influence this indicator, so it is best used either to track individual firms over time or to compare firms with comparable products (Loth 2015).

Table 9: Annual Turnover per Employee 2007, 2010, 2012

	N	Min Kshs	Max Kshs	Mean Kshs	Median Kshs
T/E 2007	37	40,000	25,000,000	3,640,100	1,200,000
T/E 2010	40	25,714	32,142,857	4,465,307	1,967,742
T/E 2012	44	83,333	47,058,824	6,284,568	2,005,049

Source: Field Survey 2014

In 2007, annual T/E ranged from Kshs 40,000 to Kshs 25 million, with a mean of Kshs 3,640,100 and a median of Kshs. 1.2 million. In 2010, annual T/E ranged from Kshs 25,714 to Kshs 32 million, with a mean of Kshs 4,465,307 and a median of just under Kshs. 2 million. By 2012, the minimum had risen to Kshs. 83,333, and the maximum to Kshs. 47 million. The mean for 2012 was Kshs. 6.3 million but the median had risen only slightly to Kshs. 2 million.

Finally, firms' success was computed by taking firm-level data on perception, 2012 turnover, 2012 EBIT, and 2012 turnover per employee, and using it to create a composite 'success' score. The scores were scaled on a range of 0 to 1. Finally, firms were ranked from lowest to highest on the basis of their scores. The results are reported in detail in Appendix Tables A1 and A2, as well as in summary in Table 10.

Table 10: Mean Scores for Self-Perception, turnover, BIT Turnover per Employee and Overall Success Score by Success Level

Success Level	Self-perception	2012 Turnover	2012 EBIT	2012 Turnover per Employee	Overall Success Score	Scaled Success Score
Level 4: 0.76 - 1.00	.8382	.9706	.7941	.9559	3.5588	.8897
Level 3: 0.51 - 0.75	.5208	.7604	.6875	.7188	2.6875	.6719
Level 2: 0.26 - 0.50	.3571	.5000	.5000	.3929	1.7500	.4375
Level 1: 0.00 – 0.25	-	-	-	-	-	-

Source: Field Survey 2014

Although the division of scaled scores into four groups was carried out, only three of the groups actually had firms. The highest was Level 4, with 17 firms, and a mean scaled success score of 0.8897. Two firms in this group registered a perfect score of 1.00, while the rest followed with scores of 0.94 (6 firms), 0.88 (3 firms), and 0.81 (6 firms). Level 3 has 24 firms with a mean scaled success score of 0.6719, while level 2 has 7 firms with a mean scaled success score of 0.4375. No firms fell into level 1. Appendix Table A2 shows the details of the scoring. As might be expected, the means for each indicator were highest for level 4, lower for level 3, and still lower for level 2.

4.3 Market Structures for Food Processing Firms in Kenya

Most firms in the food processing sector focus on the domestic market for their products. However, over the years firms are diversifying with a significant increase in regional market and a small increase in the international markets. What emerges from the data is that the domestic market remains dominant in the food processing sector, the regional (Africa) market is growing, while the global market has more or less remained constant. We compared the proportion of sales going to different markets as reported by firms in 2007, 2012 and projections for 2015. As shown in Figure 1, between 2007 and 2012, domestic sales declined from 91% to 90% and were expected to decline further to 81% in 2015. This is a clear indication of internalization. Regional sales accounted for 5% in 2007 and 6% in 2012 and were expected to grow to 14% in 2015. Global markets accounted for 5% in both 2007 and 2012 while projection for 2015 was only as 6%. This demonstrates the growing significance of the regional markets for the sector. As firms internationalize, there is a greater focus on neighboring countries.
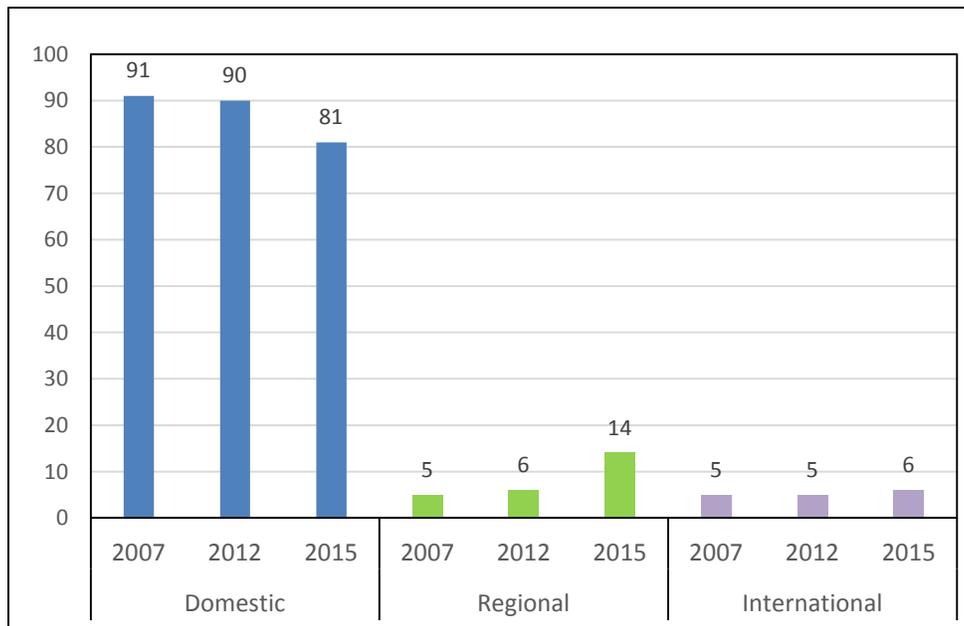
Figure 1: Distribution of Sales 2007 – 2015
Source: Field Survey 2014

Food processing firms in Kenya have a wide variety of customers ranging from supermarket chains, independent retailers, wholesalers, exporters, other firms in the country and abroad, as well as direct customers. The study sought to examine who were main customers for each firm that was in the survey in terms of percentage sales. The data shows that supermarket chains, independent retailers and direct sale to end consumers were the most import in the food processing firms. For the supermarkets, 38 firms out of 48 mentioned this as an important customer. The high growth of this single stop shopping has placed Kenya as a supermarket hub in comparison to the rest of Eastern Africa in supermarkets presence. In 2010, Kenya had approximately 206 supermarkets, Tanzania four (4) and Uganda one (1) (Ouma et al. 2013). By 2015, Kenya had more than 340 supermarkets, Tanzania approximately 30 and Uganda 15, which is a significant growth. In Kenya, the larger-scale supermarkets are located in the main urban areas (Nairobi, Mombasa, Kisumu) while the smaller supermarkets can be spotted in smaller towns. Demand-side drivers behind the rapid growth of supermarkets in Kenya are income growth, change in purchase behaviour and urbanization; the growth of middle class in particular, which is the biggest proportion of Kenyan population constitutes a major customer base of the supermarkets. The increasing number of middle income consumers has led to increased demand for single shopping outlets (McCormick et al 2013), and hence an increase in supermarket chains.

Food processing firms have realized this growing trend of supermarket chains and are eying it as key outlet of their products. Our results indicate a very strong relationship between firm success and the sales to supermarket chains with a Chi-Square which is significant at 5% level of confidence.

Table 11: Three main Customers for the Firms Products

	N	Minimum	Maximum	Mean	Median
Percentage of your sales to: Supermarket chains	38	2	99	49	59
Percentage of your sales to: Independent retailers	32	1	80	23	20
Percentage of your sales to: Wholesalers	20	0	100	31	23
Percentage of your sales to: Exporters	11	0	63	11	5
Percentage of your sales to: Other firms in the country	11	0	100	24	13
Percentage of your sales to: Other firms abroad	3	0	100	33	-
Percentage of your sales to: Direct sale to end customers	24	1	96	20	10

Of the 48 firms in our sample, 38 were using supermarket as an outlet, followed by independent retailers, end customers and wholesalers (Table 11). The percentage sales to the supermarkets by the 38 firms ranged from 2% to 99%, with a mean of 49%. From Figure 2, we can see the importance of supermarkets as an outlet for food processors in Kenya.

Figure 2: Distribution of Sales by Outlets

Source: Field Survey 2014

Turning to all mentions by the firms in terms of their distribution channels, supermarkets still lead with 79% of cases and 27% of the responses, followed by retailers, direct customers and wholesalers (table 12 and Figure 3). Sales through other firms in Kenya and abroad seem not to be popular among Kenyan food manufacturers

Table 11. Main customers by number of firms

	Number of firms	Percentage of cases	Percentage of responses
Supermarket chains	38	79%	27%
Independent retailers	32	67%	23%
Direct sale to end customers	24	50%	17%
Wholesalers	20	42%	14%
Exporters	11	23%	8%
Other firms in the country	11	23%	8%
Other firms abroad	3	6%	2%
Total	139	290%	100%
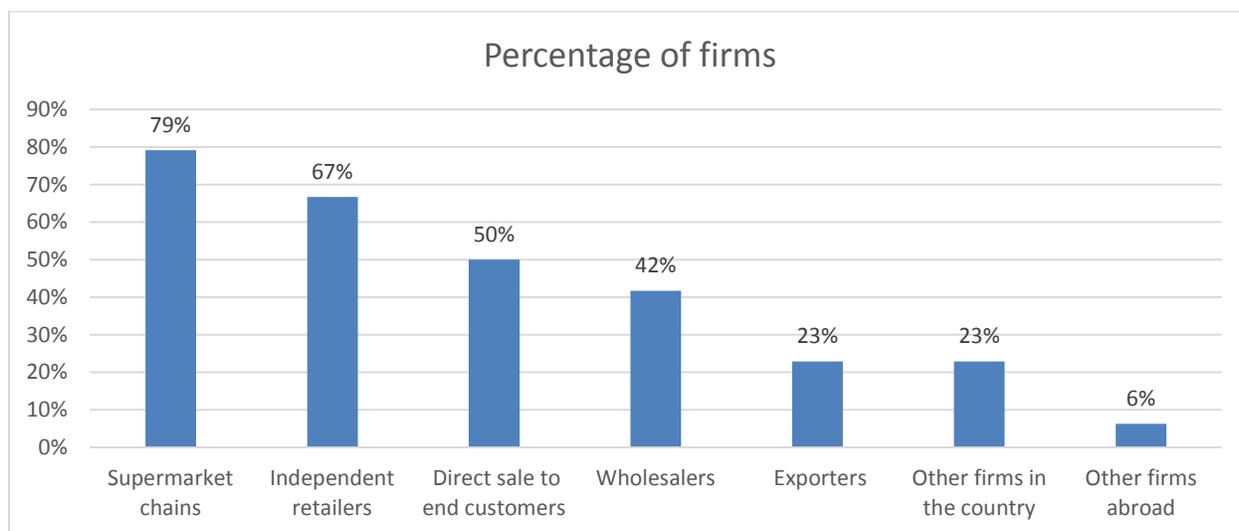
Figure 3: Percentage of Firms with Channels.

Food processing firms in Kenya appear not to be very keen on many aspects of internationalization strategy. When asked which strategy they considered important for firm growth, it is only foreign technology appear to be important with a rating of 71.1% (See Table 12). This is followed at far distance by technical assistance from foreign firms and access to foreign capital. Surprisingly, most respondents did not think that inputs from donors and international finance institutions, sales to foreign firms in Kenya and sales to foreign firms abroad were important in explaining firm growth. While we do not have conclusive reasons for this finding, it might be an important issue to explore during the case studies.

Table 12: Importance of Internationalization process in growth and development of the company (percentages)

	No role at all	Some but limited role	Some role	Important role	Very important role	Total
Import of foreign technology	15.6	2.2	6.7	4.4	71.1	100
Access to foreign capital	65.9	6.8	11.4	2.3	13.6	100
Technical assistance from foreign firms	40.0	4.4	17.8	20.0	17.8	100
Inputs from donors and international finance institutions	80.0	6.7	4.4	8.9	0.0	100
Sales to foreign firms present in country	80.0	8.9	6.7	0.0	4.4	100
Sales to foreign firms abroad	73.3	4.4	8.9	4.4	8.9	100

Source: Field Survey 2014

Among many the measures of internationalization are the sales to the export market and imports of inputs from world markets. In our study, we examined the proportion of sales exported and also the proportion of inputs imported (Table 13). Respondents were asked to rate the effort needed to comply with export/import trade regulations. From the analysis, we found that 15 firms were both importing inputs and exporting sales; 18 firms were only exporting sales but not import inputs; and 28 firms only imported inputs. There were 17 firms that neither exported sales nor imported production inputs. Out of the 48 firms, therefore 17 of them did not participate in the goods international market.

Looking at results we are persuaded to conclude that Kenyan food processing firms have low level of internationalization. For example, the average percentage of inputs imported was 21% and a median of 5%. The fact that the median is lower than the mean may mean that there are a few firms which import high proportion of their inputs which pulls the mean upwards. On the export side, the average sale exported was only 10% and a median of zero. This implies that at least half of the firms in the survey were not in export business.

Table 13: Percentage of production inputs imported and percentage of sales exported

	N	Min	Max	Mean	Median
Percentage of inputs in your production (imported)	48	0	100	21	5
Percentage of sales that goes for export	48	0	100	10	0

Source: Field Survey 2014

Respondents were asked to rate the effort needed to comply with export/import trade regulations (see Table 13). Although 17 firms were not involved in the importing of inputs or export of sales, levels of involvement notwithstanding, some of these were by mistake asked the question about effort needed to comply, with the result that only five respondents indicated that the question did not apply to them. Table 14 suggests that more than half of the firms engaged (22 out of 43) in foreign markets felt was difficult complying with trade regulations. Only 9 firms reported that complying with the regulations was easy, while 12 firms reported that it was average.

Table 14: Effort Needed Comply with import and Export Trade Regulations

	Frequency	Percent
Very easy	7	14.6
Easy	2	4.2
Average	12	25
Difficult	6	12.5
Very difficult	16	33.3
Not applicable	5	10.4
Total	48	100

Source: Field Survey 2014

4.4 Market Diversification and Success of Food Processing Firms in Kenya

The overall objective of this paper is to assess the relationship between market diversification and firm success in Kenya's food processing sector. Our hypothesis was that firms that adopted market diversification strategy were more successful than those with localized market. As stated in the literature review, the definition of market diversification went beyond internationalization to include domestic market expansion and entry to niche domestic niche markets.

In this section, we examine the relationship between market diversification variables and success of firms. Our analysis of the relationship between levels of success and destination of sales indicates that firms with regional sales are more likely to be successful at 5% and 10% level of confidence in 2012 and 2015 respectively (Table 15). This confirms the result of market diversification whereby African regional market is growing in terms of importance to food processing firms.

Table 15: Relationship of level of Success to Destination of sales 2007, 2012, 2015

		Overall scaled rank - Overall rank divided by 4 (Scaled to 0 - 1)
Distribution in sales of your products to the DOMESTIC MARKET in 2007	Pearson Correlation	-.160
Distribution in sales of your products to the DOMESTIC MARKET in 2012	Pearson Correlation	-.212
Distribution in sales of your products to the DOMESTIC MARKET in 2015 - Projected	Pearson Correlation	-.232
Distribution in sales of your products to the Regional Market (Africa) in 2007	Pearson Correlation	.033
Distribution in sales of your products to the Regional Market (Africa) in 2012	Pearson Correlation	.147
Distribution in sales of your products to the Regional Market (Africa) in 2015 - Projected	Pearson Correlation	.103
Distribution in sales of your products to the Rest of the world market in 2007	Pearson Correlation	.184
Distribution in sales of your products to the Rest of the world market in 2012	Pearson Correlation	.186
Distribution in sales of your products to the Rest of the world market in 2015 - Projected	Pearson Correlation	.237

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

Source: Survey data 2014

Literature has shown the type of customers a firm sells to have a strong bearing in its success. In this paper we tested the relationship between the main customers and the level of success in food processing industry in Kenya. The results indicate that sales to supermarket chains had a strong and significant relationship with success (Table 16). Literature suggests that Kenyan's have become more interested in doing their purchases in supermarkets that was the case 10 years ago. It is therefore apparent that firms which have linkages with key supermarket chains are likely to be more successful than those which depended on different channels to reach their customers.

Table 16: Relationship of levels of Success to main Customers for 2007, 2012, 2015

		Overall scaled rank - Overall rank divided by 4 (Scaled to 0 - 1)
Percentage of your sales to: Supermarket chains	Pearson Correlation	.026
Percentage of your sales to: Independent retailers	Pearson Correlation	-.231
Percentage of your sales to: Wholesalers	Pearson Correlation	-.436
Percentage of your sales to: Exporters	Pearson Correlation	.334
Percentage of your sales to: Other firms in the country	Pearson Correlation	-.386
Percentage of your sales to: Other firms abroad	Pearson Correlation	.189
Percentage of your sales to: Direct sale to end customers	Pearson Correlation	.140

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).
Source: Survey Data 2014

Surprisingly, exporting seems not to have a significant relationship with success. This could be a pointer to the fact that food processing industry is quite diverse even within the five product lines that we included in our survey. The other argument is that some of the most successful firms in this industry were not involved in exporting. This is an issue that can be pursued during the case study exercise so as to shed more light.

Another factor that appears to be significant as far as internationalization is concerned is the technical assistance from foreign firms. In other words, firms seem to attach significant importance to technical assistance. We therefore set to examine the relationship between the perception on technical assistance and success of food processing firms. Results of this analysis are shown in Table 17. The results show that of the firms which reported that technical assistance from foreign firms was very important, 66.7% of them were in the very successful category. When we compare this with those firms which reported that this was not important or some but limited importance, were in the lower segment of success (66.7% in 0.510 – 0.750 category) and 100% in 0.250-0.500, category. We can therefore conclude that the more successful a firm was, the higher the importance of technical assistance from foreign firms.

Table 17: Role of Internationalization to the Growth and Development of Your Company: Technical Assistance from Foreign firms by the Level of Success

			The level of success			Total
			0.250 - 0.500	0.510 - 0.750	0.760 - 1.000	
Role of internationalization to the growth and development of your company: Technical assistance from foreign firms	No role at all	Count	2	12	4	18
		%	11.1%	66.7%	22.2%	100.0%
	Some but limited role	Count	2	0	0	2
		%	100.0%	0.0%	0.0%	100.0%
	Some role	Count	0	4	5	9
		%	0.0%	44.4%	55.6%	100.0%
	Important role	Count	2	5	2	9
		%	22.2%	55.6%	22.2%	100.0%
	Very important role	Count	1	2	6	9
		%	11.1%	22.2%	66.7%	100.0%
	Total	Count	7	23	17	47
		%	14.9%	48.9%	36.2%	100.0%

Pearson X^2- ; p = 0.008 (Significant)

Note: One case had missing data

When we examine the relationship between the efforts needed to comply with international trade regulations, the results seem to indicate that more successful firms reported that it was easy or very easy. The less successful firms on the other hand reported that the compliance with export and import trade needed more efforts (Table 18). Of those firms that reported it was very easy to comply with the trade regulations, 86.7% were in the category of 0.510 – 0.750. Those that reported it was EASY all of them (100%) were in the 0.760 – 1.000 category. On the other hand, those that indicated it was difficult 66.6% of them were in the 0.510 – 0.750 category. Similarly majority of those that said it was VERY difficult 56.3 were from the same category of success.

Effort needed to comply with trade regulations in exports and imports is important in explaining success of food processing firms as demonstrated by the Pearson Chi-Square of 0.035. While the results show significant relationship, it is hard to interpret across different levels of success. However, we can deduce that the least successful firms perceive complying with export and import regulations as difficult. It is also evident that firms in this category are not internationalized as most of them do not export their output or import inputs. The pattern

for the middle level and most successful firms is mixed. This therefore calls for further investigation in this issue. Perhaps the case study could provide further insight into the relationship between complying with trade regulations and levels of success in the food processing sector in Kenya. In particular, firms that say they have difficulty in complying with trade regulations need to be asked about the nature of the difficulty.

Table 18: Effort Needed to Comply with Trade Regulations (Import/Export) and level of Success

			The level of success			Total
			0.250 - 0.500	0.510 - 0.750	0.760 - 1.000	
Effort needed to comply with trade regulations (import / export)	Very easy	Count	0	6	1	7
		%	0.0%	85.7%	14.3%	100.0%
	Easy	Count	0	0	2	2
		%	0.0%	0.0%	100.0%	100.0%
	Average	Count	3	4	5	12
		%	25.0%	33.3%	41.7%	100.0%
	Difficult	Count	0	4	2	6
		%	0.0%	66.7%	33.3%	100.0%
	Very difficult	Count	1	9	6	16
		%	6.3%	56.3%	37.5%	100.0%
	Not applicable	Count	3	1	1	5
		%	60.0%	20.0%	20.0%	100.0%
	Total	Count	7	24	17	48
		%	14.6%	50.0%	35.4%	100.0%

Pearson X^2; p = 0.035 (Significant)

Source: Survey Data 2014

Of the five (5) firms that were not exporting sales or importing inputs in 2012, 60% of them are the lower category of success (see Table 18). This may indicate that successful firms were using internationalization strategies. In other words, more successful firms were internationalized.

5 CONCLUSIONS AND POLICY RECOMMENDATIONS

On the basis of the results of this study, we may conclude that success of food processing firms in Kenya is affected by the level of market diversification. Overall, firms with diversified markets appeared to perform better than those which focused. Market diversification in our case entailed growth of the market in the export to other countries as well as market expansion within Kenya. Our observations showed that firms that were expanding within the country were also showing high levels of success. However, the survey questionnaire lacked data specifically targeting market expansion in the country. To support our argument, there is need to pursue this issue during the case studies and/or in future research.

Although not many firms had ventured into the export markets, there seems to be enough evidence to show that firms which export have better performance and were likely to be more successful than those which focused on domestic market alone. However, there was variation with some firms opting to open subsidiaries in the neighbouring countries rather than export into these markets. While this could be an indication of perishability of some food products, respondents were concerned about the non-tariff barriers to exports trade. In their effort to circumvent these challenges, firms opted to open manufacturing plants in foreign markets.

In the export arena, our results show that firms exporting into the regional (African) markets were more successful than those exporting into the global market. Most exporting firms indicated then East African market was a viable one. There was a strong and significant relationship between exports into the African market and success of firms. We can therefore conclude that market diversification and market expansion are important for success of African owned food processing firms in Kenya.

Sales to the supermarket chains play an important role in success of food processing firms. Our results indicate that firms whose main customer was supermarket were more successful that those selling to other customers. Supermarkets retails in Kenya have grown in the size and number in the recent past which has brought a new revolution in distribution chains. While a few supermarkets dominate in the country, there is mushrooming of new types of supermarkets including very small ones in residential areas. Research has shown that even some retail shops are converting to small supermarkets manned by a few people. Our results show that more successful firms were retailing through dominant supermarkets while less successful ones were selling to smaller supermarkets. This was attributed to the delays in payment by most of the big supermarkets where payment period was at times 6 months. The big question here is whether is a 'chicken and egg' scenario whereby retailing through supermarkets makes firms successful or it is successful firms that retail through supermarkets.

While there has been a lot of hype about local firms supplying to the government institutions (public procurement), this did not feature as a viable market for food processing firms in Kenya. In other words, there is no firm that was keen to get government contracts as an outlet. In fact there was only one firm that reported as retailing to the UN which in our view was different from the government contracts. There is need to examine why this market was not lucrative for local firms in Kenya.

In terms of internationalization, firms that were involved in international activities demonstrated higher rates of success. However the most significant strategy was technical assistance from foreign firms. In our survey, the process of internationalisation was largely viewed through export of sales or imports of inputs. The strategy of linkage and networks which is a form of internationalization can be pursued.

Following these conclusions we suggest the following recommendations. There is need to strengthen and enhance the regional trade especially within the East African region. This can be done by addressing some of the known non-tariff barriers which impede export trade of processed foods. There is need to enhance policies that promote cross border trade in the region. There is also need to harmonize health and food standards in the region so as to ease trade procedures in the East African region.

There is need to address challenges that food processing firms face in supplying their sales through supermarkets. One of the most mentioned challenges had to do with delays in payments. These delays in payments have an effect on cash flows for the firms. Small scale firms seemed to be more affected by this compared to large scale firms which could flex their muscles and have their payments delivered.

We observe that none of the firms in our sample were exploring supplies to the public sector through government tenders. It is therefore important to support these firms to access government contracts for food supply.

In terms of areas for further research, we recommend that (1) a study that investigates change in export behaviour whereby food processing firms in Kenya are opting to invest abroad instead of exporting from Kenya, (2) the role of economic integration on internationalization among the food processing firms in Africa. Finally, there is need for research on forms of network and linkages as avenues for internationalization.

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