Financial and Economic Crises: The effect on Lebanon's FMCG Businesses

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Prepared by:

The USAID-funded Lebanon Agriculture
and Rural Empowerment (ARE) Activity

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Overview

It can be argued that Lebanon's current economic and political state is worse than it has ever been since its inception as a modern nation. A banking system that is falling apart, a drastic devaluation of the Lebanese pound coupled with incessant political corruption and stalemate have led to a state of stagflation*. A survey of some of the major supermarket retailers and supermarket suppliers in Lebanon reveals that the current volatile environment is causing the major actors to constantly adapt and recreate themselves just to survive. Please note, the survey only covered supermarkets and suppliers in the Beirut and Mount Lebanon area and included data only on processed food and not fresh produce. The new main challenges being hurled at the industry include, but are not limited to, the unavailability of US dollars in the market, the lack of liquidity in Lebanese pounds at Lebanese banks, the devaluation of the Lebanese pound, the inability to transfer funds for imports and the COVID-19 pandemic. As a result, everyone from importer, manufacturer, distributor, retailer and even down to the consumer is being reduced to pawns in a tactical game of chess and are in a general atmosphere of panic across value chains.

The USAID-funded ARE activity conducted this survey to analyze the volatility of the industry and to try and define possible new market trends. This survey is part of ARE's continued efforts to collect market data that can help guide development efforts. Having this data will help key market actors recognize the problems that are afflicting different supply chains and hopefully guide their efforts to take advantage of the resulting emerging opportunities.

Consumers and Purchasing Behavior

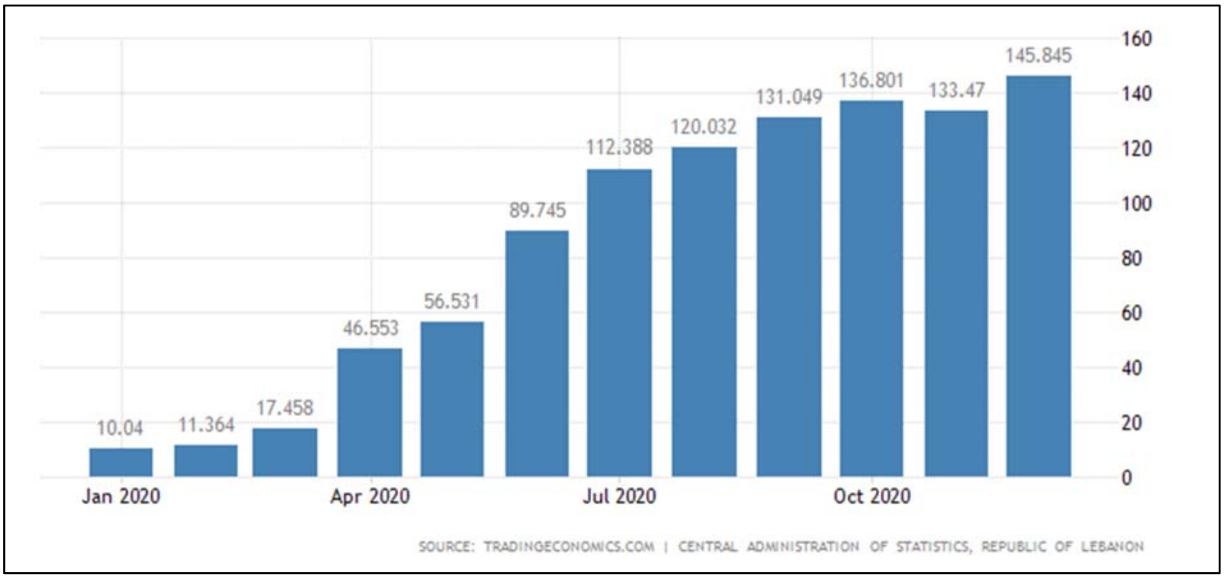
New consumer categories

Regardless of the product, Lebanese consumers are being segregated into two major groups. The ones earning in Lebanese pounds find themselves struggling to survive as food prices have increased by more than 400 percent while salaries have remained stagnant and unemployment has soared. Their purchase power has been drastically reduced to barely cover the bare necessities. According to the World Food Program (WFP), due to a combination of containment measures for COVID-19 and a worsening economic crisis, two out of every three Lebanese households suffered from a reduced income compared to the previous year. According to the Central Administration of Statistics (CAS), Lebanon's consumer price inflation rate rose to an all-time high of 145.8 percent year-on-year in December 2020, up from 133.5 percent in the previous month, as the country faces the worst financial crisis in decades. Food prices jumped 402.3 percent and cost for transportation increased 206 percent. Additional upward pressure came from restaurants and hotels (609.0 percent), recreation, amusement, and culture (227.1 percent), furnishings, household equipment and routine maintenance (655.1 percent), clothing and footwear (559.8 percent), and miscellaneous goods and services (267.5 percent). On a monthly basis, consumer prices climbed 8.15 percent in December. Considering 2020 full year, the

**Stagflation: persistent high inflation combined with high unemployment and stagnant demand in a country's economy.*

inflation rate averaged 84.9 percent, the highest since at least 2013, when the current readings began. (See Graph 1.1 Below)

Graph 1.1-Price inflation



The second group are the consumers that have a source of income in US dollars or comparable currency. Oddly enough, these people find themselves with an increase in purchase power as the dollar today can buy more than it was capable of before the devaluation of the Lebanese pound.

Brand price vs brand loyalty

Prior to the current exceptional situation, FMCG (Fast Moving Consumer Goods) consumers utilized a more natural mix of brand loyalty and price for value comparison while shopping. However, brand loyalty is no longer a decisive factor in spending habits. According to the survey, only about 5% of the consumers that are earning in US dollars or comparable currency still have pure brand loyalty.

The majority, close to 90% of consumers, became solely price driven. Consumer selection of products is being determined mainly by price in most FMCG (Fast Moving Consumer Goods) categories. This is especially true when the imported name brand alternative or the locally manufactured product has proven a worthy substitute. More specifically extreme inflation and the stagnation in salaries have drastically changed the nature and size of the average basket in supermarkets. In fact, retailers are reporting that the average basket size has been reduced in terms of volume anywhere from 25% to 50% while average basket cost in 2020 tripled as compared to 2019. According to *one of our respondents*:

"Our shoppers went from having an average of 20 items per basket down to just 15 and the cost of the average basket went from 91,000LBP in March 2020 to 160,000LBP in February 2021."

Simply put, consumers are buying less than 75% of what they were buying in 2019 and are spending almost double the amount of money to do so.

Another reason that consumers are no longer purchasing as per brand loyalty is because of supply shortages. The volatility of the Lebanese pound, the shortage of liquid USD and the inability of importers to transfer money for import purchases has caused breaks in import schedules. This disruption in the supply chain has only been exacerbated by the world-wide COVID-19 pandemic and more recently, by the August 4, 2020 Beirut Port explosion as a significant number of containers and warehouses at the port were destroyed. It has left consumers with limited choices, sometimes forcing them to only be able to buy whatever brand is available.

Finally, inflation, the fear of continued imminent price hikes, and sparsely stocked shelves have caused panic shopping, where some consumers hoard stocks of goods and other customers, with less purchasing power, are left with very limited options. In short, consumer purchasing, and spending habits have been reduced to tactical reactions to an unstable market rather than the premeditated decisions of the conventional consumer.

Suppliers

New payment terms

To survive, suppliers too have had to adapt strategically. Most notably, suppliers have reduced their payment term facilities. While it was not unusual to get anywhere from 60 to 90 days to pay for purchased products before the financial crisis, these facilities are currently no longer available to retailers. In fact, with the fear of runaway devaluation of the Lebanese pound, most suppliers are requiring payment upon delivery or within a week at most. This forced retailers to pay their outstanding balances to suppliers which decreased their working capital significantly. These new supplier payment terms have forced many retailers to considerably reduce the value of their stock.

Imports limitations

Moreover, supplier product portfolios are being reduced to only include “fast moving” imports and as many local products as are available. For many suppliers, this has resulted in an up to 70% reduction in imported items.

Parallel imports

Some suppliers have started bringing in substitute brands from Turkey and Eastern Europe as they tend to be less expensive. Furthermore, suppliers are also picking up local brands for distribution to make up for the loss in import supply and sales. Local brands that were only given the opportunity to list a small number of products are now being given the opportunity to display more products as the price sensitive consumer is looking for the locally made brands.

Parallel markets

Larger independent and chain retailers have resorted to buying brand names being produced in parallel markets. For example, a larger retailer can import a container of *Kinder* chocolate produced in the Gulf States or in Egypt to be distributed among its many points of sale for significantly less cost than the *Kinder* produced in the EU. While it certainly does not taste the same as the *Kinder* produced in Western Europe, it has proven to be just one more option available to fill up the empty shelves of supermarkets.

Retailers

Change in planograms

The gaps left in the supermarkets, as less and less imports are available, have caused many supermarkets to reconfigure their planograms. Before, major brands were guaranteed superior positioning and a certain minimum shelf space per category by contract with retailers. More specifically, products were allotted visibility according to their historical performance and/or the popularity of their brand. But with the current shortages and change in the mix of products, supermarket displays are constantly changing.

Adaptive pricing strategies

Survey results reveal that retailers were struggling with their pricing strategies. As devaluation of the Lebanese pound spiraled out of control, physical stock became more valuable than money. The threat of selling a product at a price lower than it would cost to replace it became a very real and constant threat for retailers. Initially, the law in Lebanon only allowed supermarkets to increase their prices according to a predetermined markup on invoices. The markups allowed according to the Republic of Lebanon Legislative Decree 277/1 as passed on June 15, 1972 are shown in Table 1.1 below. Because of the extraordinary economic circumstances an exceptional decree in 2020 was also adopted to provisionally increased these percentages slightly. However, the official markups are still by law those of Legislative Decree 277/1.

Table 1.1: Government Determined Markups for Supermarkets

Product Category	**Markup in 1972**	**Amended in 2020**
Oils, Fats and Hydrogenated Oils	13%	15%
Dairy Products Including Fresh, Powdered, Fermented, and Cheeses	13%	15%
Meat, Poultry, Seafood: Fresh and Processed	13%	15%
Flours, Pulses and Cereals	13%	15%
Produce Fresh and Processed	18%	22%
Sugar and Confectionary Products	18%	22%
Personal Care, Cosmetics, Soaps, Detergents and Disinfectants	18%	22%
Clothing	18%	22%
Drinks: Non-Alcoholic and Alcoholic	18%	22%
Coffee, Tea and Vinegar	18%	22%

For example, if the allowed markup on confectionary items is 22%, a box of biscuits bought at 10,000 LBP could be sold at 12,200 LBP. However, because of the rapid devaluation of the Lebanese pound, by the time the retailer was ready to order more of this same product, the cost of the product could very well have gone up to 14,000 LBP. Under this law, supermarkets could not increase the price of a specific products unless it was purchased at the new higher price and they had an invoice to prove it. However, with several major drops in the value of the Lebanese pound, supermarkets were forced to sell products at a lower price than the actual replacement cost of the product, as in the example above. According to Mr. Oliver Geha, CEO of Metro Superstore s.a.r.l:

> *"The risk of the runaway inflation, coupled by the industry's notoriously low profit margins, is resulting in the dangerous eroding of the supermarkets' working capital."*

Only recently, the Ministry of Economy and Trade in Lebanon has started allowing supermarkets to price according to official supplier "price lists" and not just according to purchase price on invoice. So, whenever a supplier sends a new price list, supermarkets are allowed to raise their prices according to this official price list before actually having bought at the new higher cost. In this way, the supermarket is minimizing the chances of selling any products at under the replacement cost. Now, suppliers are quick to change their official price list with each change in the unofficial exchange rate of the Lebanese pound and supermarkets are quick to follow suit. As a result, many supermarkets are trying to offer more locally produced products as they are less susceptible to changes in the USD exchange rate.

Cost-cutting

As the Lebanese government controls the maximum profit margins that supermarkets can charge on goods, as explained above, the only way for a supermarket to try and keep a profit these days is by reducing costs. Before the current economic crisis, the major expenses in a supermarket included such things as payroll and rent. With the current inflation and the stagnation in salaries, payroll costs no longer make up a large ratio of sales. Reducing staff will no longer make a huge dent in expense to revenue ratio. Among the adapt and survive techniques that retailers are resorting to for cutting costs include the development of online sales to reduce the cost of brick-and-mortar operations. This option was actually pushed to the forefront by the COVID-19 pandemic and the nationwide lockdown that forced supermarkets to operate only through delivery services. While some traditional shoppers still prefer to call in an order, most supermarket retailers agree that having an online platform is necessary to survive. Still in its infancy, the online shopping trend is proving to be an essential part of any retailer's business model and is already accounting for a significant percentage of overall sales. Retailers agree that online platforms are so important that they must be treated as a separate business unit with its own cost center and not just as an added service to a specific location.

The options for online platforms include platforms like Instashop and My Trolley where several shops are featured on a platform and are administered by a third party (See Figure 1 & 2). Others are using pre-designed template platforms that are a little more customizable (See Figure 3). While the larger chains have already developed their own unique E-Commerce sites. (See Figure 4).

Figure 1

Figure 2

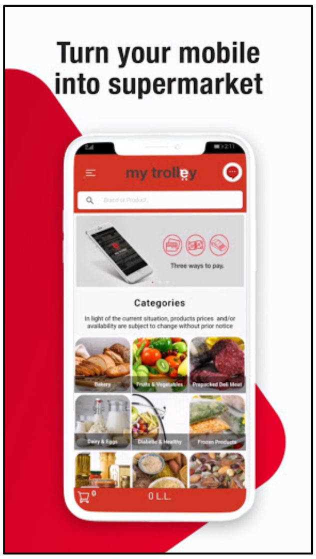
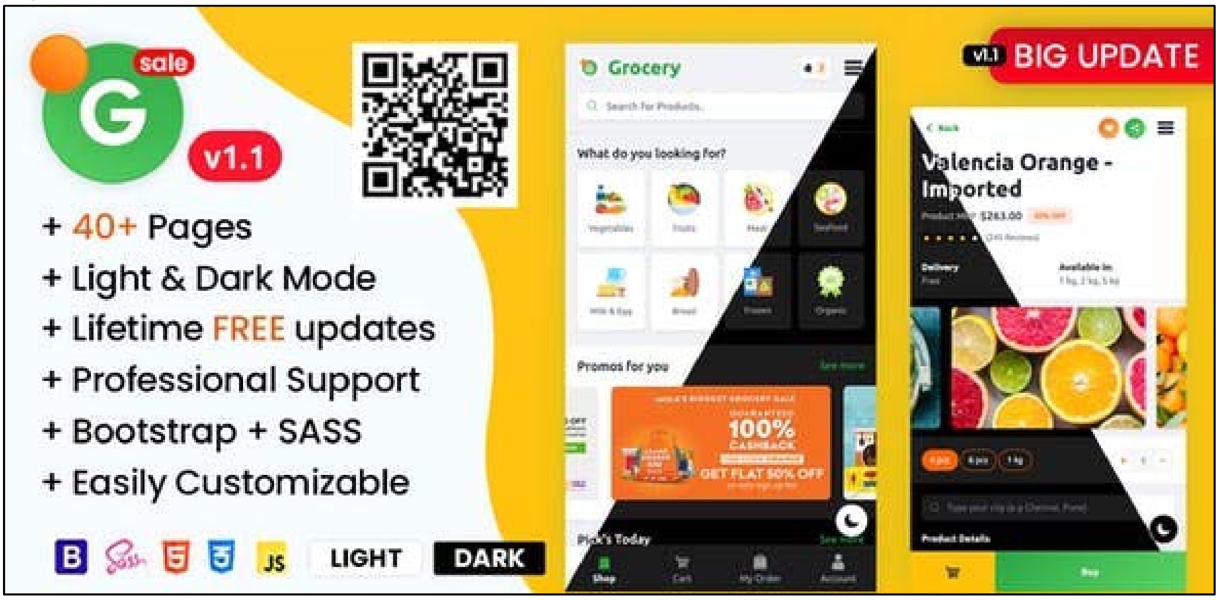


Figure 4

Figure 3



Manufacturers

Furthermore, survey results also revealed that many local manufacturers are rushing to increase their production capacities, and many are developing and launching new products to try and fill the gaps left in the market by the unavailability of imports. Prime examples include Daher Foods who has added a line of confectionary products (See Figure 4). Mebtico also launched a line of sauces and condiments (See Figure 5 & 6).

Figure 4

Figure 5

Figure 6

Even companies that have been traditionally considered as distributors are now jumping into manufacturing. For example, Fattal is in the process of producing a line of chocolates while Transmed is also launching a local brand of biscuits. Furthermore, smaller manufactures that were struggling to get distribution and for local retailers to sell their products are suddenly in high demand and in some cases are struggling with being able to produce the quantities demanded by the market. Locally produced products like Eshmoon (See Figure 7) and Taqa (See Figure 8) are good examples of such products.

Figure 7

Figure 8

Hence, the devaluation of the Lebanese pound, while very unfortunate, is forcing Lebanon to switch from a market that heavily relied on imports to one that manufactures. However, many raw materials for this surge in manufacturing are still imported and therefore susceptible to the USD exchange rate. Long terms and more sustainable solutions are still uncertain and will require a drastic evolution in Lebanon's supply chains.

Finally, when asked if credit facilities or financing were made available, most of the participants surveyed said that they would use capital to invest in production facilities to produce such staple products as pasta, cereal, chocolate or other fast-moving items where quality imports are still very expensive and the alternatives available are not meeting consumer demands and/or standards. While the market is certainly ready for an increase in local production of FMCG, many such products will rely on imported raw materials to produce. The end result will still be products that will be more competitive in price than the pure imports, however, these products will still be susceptible to the changes in the USD exchange rate. Only the limited products that can be made with locally produced raw materials will have relatively stable prices. Others also emphasized the importance of investing into locally produced private labels so that at least one private label product is available in almost every category, as such products usually have a higher profit margin and can be better manipulated to compete in such a volatile market. Here again, there are discrepancies in the market that will keep some of the locally produced private label products from being able to compete with certain imports. Most notably, how a supplier prices product all depends on the average cost of the dollar that the said supplier is able to purchase. Suppliers that just have imports are forced to price their products at the black-market exchange rate which is at the date this survey was conducted, above 10,000 LBP/USD. However, suppliers that are also exporting have access to "fresh dollars" while others are still able to purchase their dollars from the central bank of Lebanon at the rate of 3,900 LBP/USD. Although, this subsidy will not be available for much longer. This is why, until the date of this report, some imports remain competitive with the price of locally produced products and/or other imports. A good example of such a product is the "Pril" dishwashing detergent that is distributed by Obegi Lebanon. The price of "Pril" is still equal to or even less than some of the locally manufactured dishwashing detergent because Obegi has an export market and access to fresh dollars and can use this fact to counteract the rate of inflation that some of his competitors are subject to. However, how long this trend will last is also uncertain as the ultimate fate and value of the Lebanese pound is still uncertain.