



# Opportunities for Supply Chain Consolidation in GCC Food Sector

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## **Malachy Mitchell**

*Managing Director*

I am pleased to introduce a Farrelly & Mitchell report focusing on the GCC food sector. From our Middle East base in Riyadh, our team has been compiling data over several years and has developed a deep understanding of the local marketplace, which has formed the basis for this document.

Globally, the food and agriculture sectors face many uncertainties in relation to price, supply, and demand. In particular, the GCC food & beverage sector offers several opportunities for growth. However, both existing businesses and new entrants are presented with a market that is complex and constantly changing.

At Farrelly & Mitchell, we believe that understanding global issues and how they impact local markets is essential to delivering real value to our clients. We are not a typical advisory firm, i.e., we specialize in just one industry – food and agribusiness. Our service offering extends from the farm to consumer, helping clients to increase profits, improve supply chain efficiency, and acquire or divest food businesses.

We predict a range of challenges and opportunities for GCC food companies in terms of supply chain development. In particular, family businesses need to transition and restructure to position themselves for growth. The retail sector, a key driver of the GCC economy, is fragmented, with expectations of gradual consolidation.

The outlook for food and beverage companies in the Middle East, who can adapt their operations in accordance with the fast-changing environment, is likely to be positive. In terms of investment, we are witnessing strong local interest in food opportunities. Moreover, several food companies based in the EU and across the world are increasingly interested in expanding and establishing operations in GCC.

I would like to thank various contributors who have put this report together. I hope you find it provides useful insights. We would welcome your feedback.

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If you would like to discuss any of the ideas in this report or how they can be implemented, please contact us. Our contact details are included at the end of this report.



## Executive Summary

A growing population and increased income levels have fueled significant growth in the food sector in GCC countries in recent years, with this growth expected to continue. An increased dependence on imports due to the shortage of arable land and water, favorable demographics, and changing consumption patterns are the key drivers of the GCC food sector. The growing reliance on food imports and rising demand create a need for a developed and specialized food supply chain network that ensures adequate supply.

Continuing consolidation in the retail sector and intensifying competition due to the accelerated entry of global retailers (hypermarkets/ supermarkets) indicates the need for differentiated strategies, collaborations and adjustments by domestic retailers if they are to maintain competitiveness and prevent loss of market share. We believe additional investments and collaborations by various stakeholders across the food supply chain are required to achieve economies of scale and minimize wastage and costs. This will inevitably lead to further consolidation in the supply chain.

- ▶ **GCC requires a robust logistics and supply chain management network to ensure quality and timely supply of both local and imported products.** There is significant growth in the number of and sales at hypermarkets and supermarkets, with food products representing the bulk of these sales, reflecting the need for a specialized and developed food supply chain system.
- ▶ **We believe that the GCC food retail sector will witness a wave of consolidation.** The GCC food retail sector is fragmented. The sector also acts as a key driver of the GCC economy. The GCC retail sector is gradually consolidating, with international and domestic retailers competing for market share. In our opinion, further consolidation seems imminent. Larger players are best positioned to capitalize on this trend.
- ▶ **The global food supply chain has evolved and become ever more efficient in developed markets such as North America, Europe, and the UK. Generally the opposite is the case in GCC.** The UAE is the sole exception, with food logistics forming a core component of the logistics industry and some well-established large distributors catering to the food retail sector.

- ▶ **Leading companies are investing in their supply chain, with reduction of cost and complexity to achieve efficiency remaining the key focus area.** From our experience, consolidation in the supply chain will lead to more timely delivery of food products, reduced wastage and higher economies of scale. More centrally controlled, specialized and sophisticated distribution systems will emerge across the supply chain.
- ▶ **Rising concerns over food safety to drive increased usage of information technology and sophisticated supply chain solutions.** Supply chain transparency can also be improved using track and trace technologies.
- ▶ **Family businesses need to restructure to grow and compete with international players.** Retailing and trading are the most popular sectors for family businesses in GCC. With the entry of global players to the retail sector, we believe family businesses face challenges in terms of maintaining market share and sustaining operations. In our opinion, collaboration with international strategic investors/partners can help family businesses in GCC gain knowledge, expertise, and technologies to reposition themselves.
- ▶ **Rising demand for food, the government's focus on food security and consolidation in the food retail sector are expected to drive investments in the food sector in the form of M&As in the GCC.** Strategic players will see M&A as a way to expand their geographic footprint. On the other hand, for sovereign wealth funds, it will be about gaining food security at the primary production level.
- ▶ **There is significant potential for use of private labels by GCC retailers.** Over the past three years, the share of private label sales in GCC increased from 3% to 10%. However, it remains well below that in mature markets, such as the US (22%) and Germany (32%), where private labels form a sizeable part of the retailer's value proposition. In our opinion, to achieve 15–25% share in overall sales, retailers will have to modify their approach, making private labels an integral part of their growth strategy.



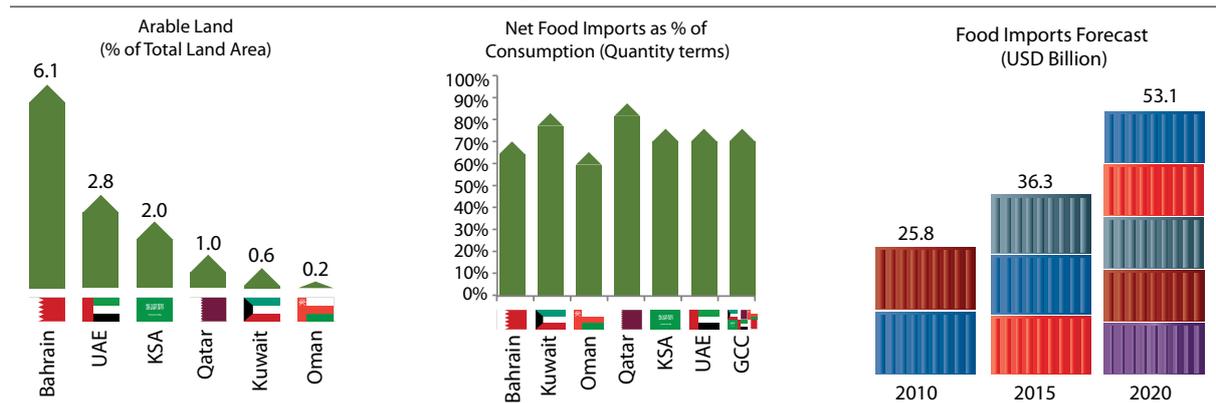
# GCC countries rely heavily on food imports

According to the Arab Agricultural Development Organisation (AADO) statistics for 2012, net imports account for 78% of food consumption in GCC. In fact, food imports in the region are expected to more than double to USD53.1 billion by 2020 from USD25.8 billion in 2010. Due to limited arable land and scarcity of water caused by the region's extreme climatic conditions, agricultural output has been inadequate to meet domestic demand. According to AADO, the total arable

land in GCC is much lower than that in some of the developed and developing economies. In Saudi Arabia, which is the largest food producer in GCC, just 2.0% of the land area is suitable for cultivation. The corresponding figure for the UAE is 2.8%. The challenges this situation presents is evident when compared to the situation in other markets such as the US (38.9%), the UK (35.3%), India (87.5%), and China (21.5%). In terms of food production, Saudi Arabia dominates with 7.6 million

**Imports account for 78% of the total food demand in the GCC**

Limited arable land and output makes GCC heavily dependent on food imports



Source: AADO, Farrelly & Mitchell Research, EIU

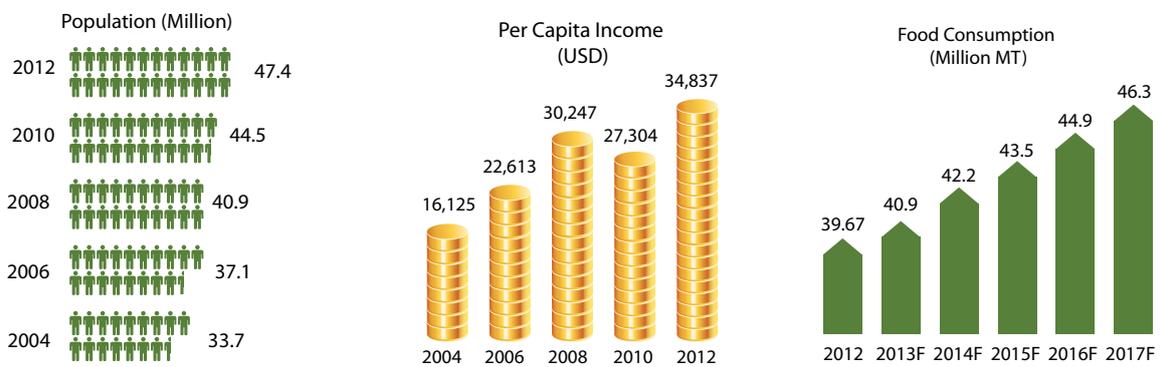
**Increasing population and rising income levels to boost food consumption**

metric tons (MT), or 70% of the GCC output, in 2012. Demand for food in the GCC region is growing significantly. This is largely driven by increasing population, rising income levels, and urbanization. The GCC population is expected to surpass 50 million by 2020 from 44.8 million in 2011. During 2004–12, per capita income in the region increased at a CAGR of 9.9% to USD34,837. Furthermore, the urban population in GCC

grew 57% from 23 million in 2000 to 36 million in 2010.

Consequently, consumption patterns are changing significantly, with the food consumption projected to increase at a CAGR of 3.1% over 2012–17. Consumer spending in the food retail sector is expected to increase by USD27.2 billion from the level seen in 2013 to USD94.7 billion by 2018.

Increasing population and income levels drive food consumption



Source: World Bank, IMF, AADO, Farrelly & Mitchell Research



## GCC requires a robust supply chain network

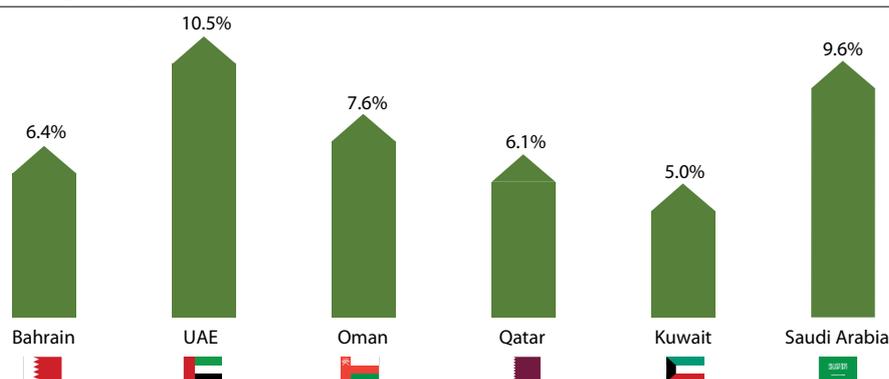
A robust logistics and supply chain management network is required to ensure quality and timely supply of both local and imported products. Following the food price shocks of 2008 (owing to demand– supply mismatch), the government began to focus on ensuring food availability through alternative means. We believe volatile food prices and supply shortages provide an impetus for food supply chain development. Furthermore, there is significant growth in the volume and value of sales at hypermarkets

and supermarkets. Food products represent the bulk of these sales, reiterating the need for a specialized and developed food supply chain system.

A growing number of modern retail outlets, such as hypermarkets, supermarkets, discount stores, and other forms of organized retail, are significantly contributing to the increasing demand for food products. Sales at supermarkets/hypermarkets in GCC are estimated to rise at a CAGR of 9.1% to USD70.1

**Enhanced focus on food availability and growing number of organized retail outlets provide an opportunity for food supply chain development**

Sales growth at modern grocery retail (2013–18, % CAGR)



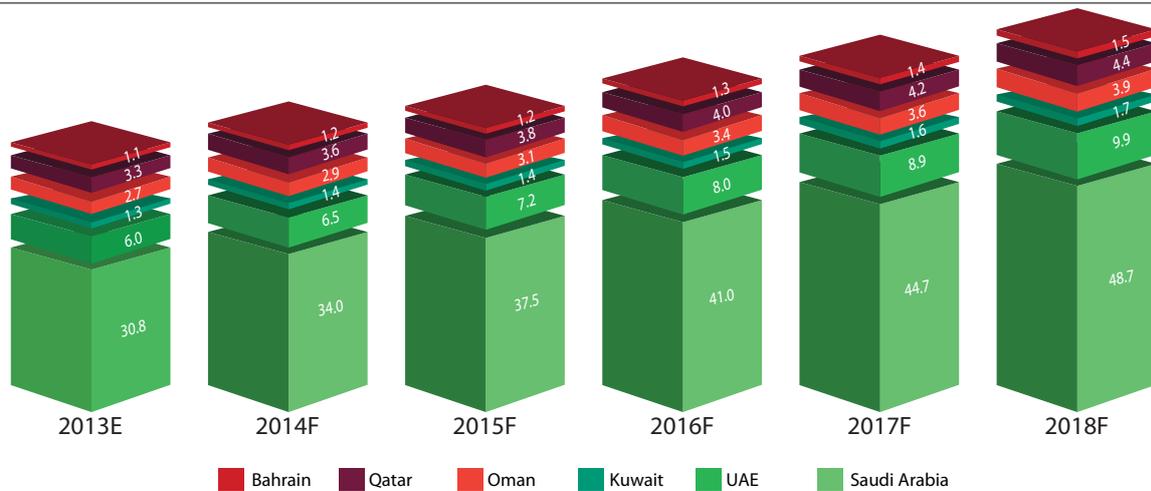
Source: Business Monitor, Farrelly & Mitchell Research

**Organized retail formats in relatively underpenetrated markets are expected to grow at a robust pace**

billion by 2018. In our opinion, supermarket/hypermarket sales in the relatively underpenetrated markets, such as Saudi Arabia, Qatar, Oman, and Kuwait, are likely to grow at a robust pace to 2018. Organized retail formats in these countries are likely to play an even larger role and will consequently sharpen focus on optimization of the supply chain.

Saudi Arabia, the most populous country in GCC, is the largest consumer of food products. In 2018, the Kingdom is forecast to increase its share of GCC food consumption to 71.4% of sales. Although the number of modern retail stores has risen, overall penetration levels remains low, especially in smaller cities, indicating scope for continued growth.

GCC modern grocery retail sales composition and forecast (USD Billion)



Source: Business Monitor, Farrelly & Mitchell Research

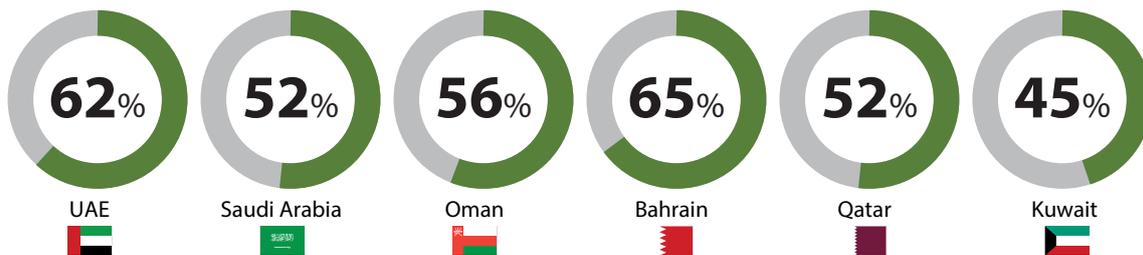
**Low penetration indicates a scope for growth of modern retail stores especially in smaller cities**

Food's share of total retail sales in GCC is likely to increase to from an estimated 47% in 2011 to 50% by 2016. This will heighten focus on optimization of the food supply chain. Total retail food sales in GCC are expected to rise at a CAGR of 7% to USD95 billion by 2018. Saudi Arabia has the largest food retail sector in the region which accounted for 69% (or USD43 billion) of total food retail sales in GCC in 2012. The UAE is the second largest retail market in GCC, with retail food sales of USD8 billion in 2012.

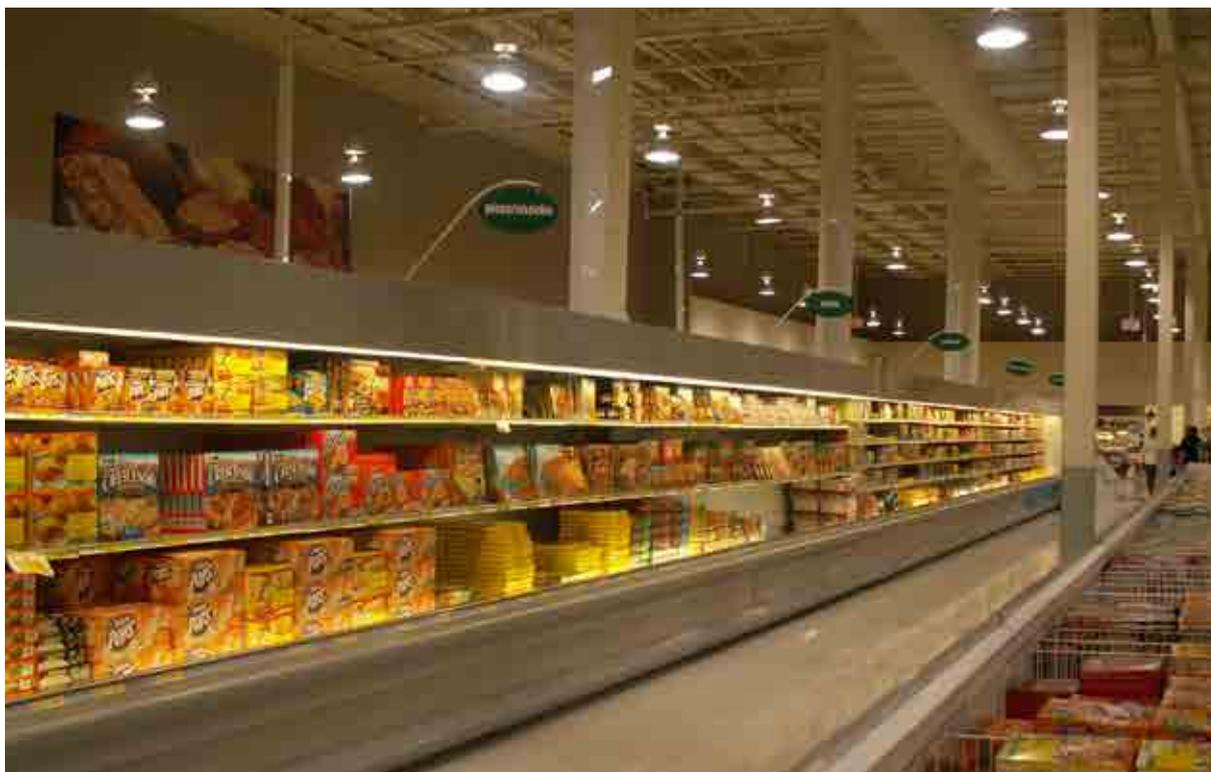
In 2017, the Kingdom is likely to account for 53% of total GCC food consumption, followed by the UAE (22%), Kuwait (10%), Oman (7%), Qatar (7%), and Bahrain (2%).

The UAE, long considered one of the most developed retail food market, has a 62% penetration rate of modern grocery formats after Bahrain (65%). On the other hand, Kuwait is the only market with less than 50% penetration rate (45%). The GCC region has witnessed significant growth in the volume and value of sales at hypermarkets.

Modern grocery sales penetration (%)



Source: Business Monitor, Farrelly & Mitchell Research



## Fragmented food retail sector in GCC

The food retail sector acts as a key driver of the GCC economy. Saudi Arabia and the UAE together account for three-quarters of the food retail market in the region. The GCC food retail sector has witnessed phenomenal growth in the past few years, outpacing some of the more mature and developed markets such as the US and Europe. All food retail concepts, from hypermarkets to small convenience stores, have shown rapid growth.

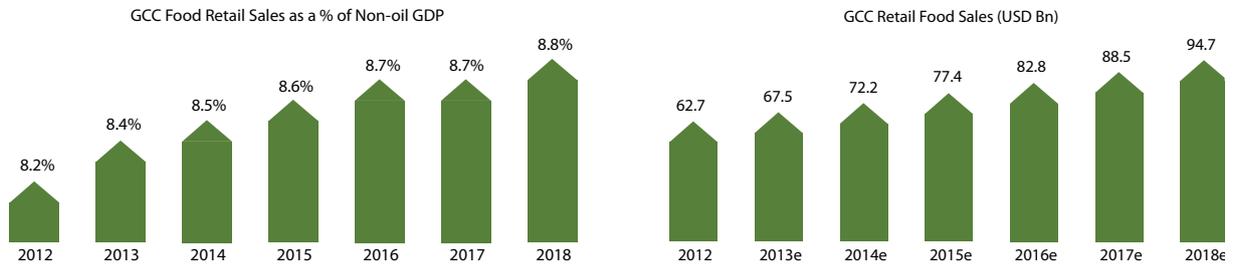
Among public companies, Savola, Almarai, and Americana account for the majority of revenues generated by publicly listed food companies in the GCC. The activities of these major food companies illustrate how the market is evolving. These companies have been highly active, acquiring shares and ownership of other food companies in recent years. The GCC has a fragmented food retail sector dominated by many small and local retailers. Like many developed markets, the GCC food retail sector is gradually consolidating, with international and domestic retailers jostling for market share. Large hypermarkets are likely to

dominate the future food retail landscape. In our opinion, further consolidation seems imminent with the larger players best positioned to capitalize on the trend. We believe a differentiated strategy, the adoption of international best-practices tailored for local market conditions, and the strategic location of stores will help retailers maintain competitiveness and market share.

The top five retailers account for around 13% of the market share in Saudi Arabia and 36% in the UAE. To maintain market share vis-à-vis international retailers, regional players have been actively engaging in M&A activity. For instance, Saudi Arabia-based Panda acquired Giant and Geant stores in 2008 and 2009, respectively, which opened up four regional markets: the UAE, Qatar, Saudi Arabia and Lebanon. International retailers are increasingly contributing toward the transformation of the local retail sector by compelling domestic players to expand or upgrade existing facilities in order to maintain their market share in this highly competitive market.

***Fragmented food retail sector, but consolidation expected in the sector in order to gain larger market share***

GCC food retail sales as % of Non-oil GDP and retail food sales (USD Billion)



Source: Business Monitor/Farrelly & Mitchell Research

### UAE: A pioneer in organized retail with well-established supply chain network

**UAE supply chain currently favors large players, with scope for smaller players to collaborate and achieve economies of scale**

The UAE is considered a pioneer in modern retail in GCC. Its retail landscape has been significantly influenced by the West. Hypermarkets/ supermarkets have succeeded in gaining preference over and are replacing most traditional retail markets in the UAE. The UAE hypermarket/supermarket segment is largely dominated by major international grocery retailers, such as Carrefour (109 hypermarkets/ supermarkets in the Middle East), Spinneys (66 in the UAE), and Geant, and domestic chains such as EMKE and Al Madina.

Both domestic and international players continue to open additional stores to increase their market share. International hypermarket/supermarket chains are continuously innovating and adjusting their operational strategies to stay competitive. Moreover, several domestic retailers are adapting their strategy, targeting both upscale and middle-class consumers by catering to demand for premium foods.

On the other hand, international retailers such as Carrefour and Geant are rolling out additional mini stores in new community centers, which are often located in the outskirts of towns to cater to the residents of these areas. In October 2014, the French grocery giant Carrefour launched its new smaller format convenience stores (known as Carrefour City) in Dubai to cater to smaller neighborhoods.

Although the number of hypermarkets/supermarkets has increased, smaller stores have also grown in number. In addition,

consumer cooperatives have a major presence in the UAE with nearly 25% market share. This rise in the number of smaller stores is primarily ascribed to lack of retail space in sought after highly populated locations. The increasing cost of land and rentals due to high demand for retail spaces, especially in top-tier malls, is also impacting profit margins.

With the changing strategy of retailers, i.e. opening stores at strategic locations closer to consumers, we believe an efficient food supply chain has become an urgent necessity for the overall logistics and retail industry in the UAE. The supply chain is structured to favor large retailers. Although most food items are sourced from local exclusive agents, some major retailers such as Carrefour have started importing food items directly from overseas suppliers, thereby eliminating local agents from the supply chain and allowing them to attractively price products.

Large importers are often integrated with logistics and distribution companies who deliver to wholesalers and retailers, and also manage their own retail stores in some cases. However, while smaller players may not own warehouses, they still have access to rented facilities. In addition, smaller players can collaborate and achieve economies of scale in the supply chain, but not necessarily with current supplier/agents. The food sector has the second highest logistics cost among all major industries in the UAE, with food logistics spending estimated to be nearly 10% of revenues, indicating scope for consolidation to further improve efficiencies.



There is high potential for new players to enter as third-party cold chain logistics providers in the food sector due to a growing market and low competition, as a select

number of players currently operate within the cold chain segment and it requires high capital investment.

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### **Saudi Arabia: Largest retail market with fragmented supply chain network**

Saudi Arabia's grocery retail market, the largest in GCC, is fragmented with the top five firms controlling only 13% market share. KSA had 40,435 retail outlets at the end of 2013, with growth expected across all grocery formats. The number of hypermarkets is projected to increase by nearly 70% (from 197 units to 333), while supermarkets are estimated to grow in number by 54% (from 678 units to 1046) during 2013 to 2018. The increase in the number of hypermarkets is expected to continue in the next five years, as several major food retailers such as Azizia Panda (the largest supermarket chain in KSA with 153 outlets), Carrefour, LuLu Saudi Hypermarket, and Danube plan new outlet openings. Due to the popularity of shopping in hypermarkets and strong revenues, grocery retailers are opening additional hypermarket outlets in major Saudi cities. Hypermarkets constitute a significant component of the total 40,000 retail outlets, accounting for about 18% of total food sales. All supermarket chains in Saudi Arabia are wholly owned by Saudi companies, except Carrefour (a joint venture between French owners and Saudi investors) and LuLu Saudi Hypermarket (owned by the UAE-based Emke Group).

In addition to hypermarkets/supermarkets, convenience grocery stores, including Bakalas, accounted for 54% of retail food product sales in Saudi Arabia in 2013. Despite a sharp increase in the number of hypermarkets/supermarkets, the number of Bakalas has

not significantly decreased to date as many individuals do not have easy access to hypermarkets/supermarkets. Arabian Food Supplies has small grocery stores located in many Western dominated localities. Meed, a popular corner grocery chain in Saudi Arabia, has 255 modern convenience grocery stores.

Large international supermarket chains such as Carrefour and domestic supermarket chains such as Tamimi and Danube source only a small portion of their stock directly from overseas suppliers. The majority of imported food products continue to be sourced from local importers. Tamimi and Danube, upscale domestic supermarkets, regularly import several food products but without any agency agreement.

Hypermarkets/supermarkets are heavily dependent on merchandising services (stocking shelves and maintaining inventory) offered by importers/distributors. Supermarkets often expect distributors to offer a specific percentage of rebates on total annual turnover, contribute to advertising campaigns, carry out store merchandizing activities, offer 60-day payment terms, rent gondolas, and reimburse for expired items. The listing fees for local distributors (the power to negotiate a lower fee increases if the distributor is large) ranges from USD267–USD17,067 per stock keeping unit (SKU) in major hypermarkets.

***The number of hypermarket and supermarket outlets are expected to increase 70% and 54%, respectively, by 2018***

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### **Rest of GCC: Relatively underdeveloped and fragmented modern retail sector, but gradually gaining importance**

The hypermarket/supermarket segment in Qatar is comparatively underdeveloped compared with other GCC countries, such as the UAE and Saudi Arabia, despite having

favorable demographics. However, with increasing demand from Western expatriates who prefer organized retail formats, the trend is changing, with more retailers entering the

**Modern retail concepts gradually gaining popularity in rest of GCC**

market. With rising demand and changing preferences, large regional players such as LuLu and global players such as Carrefour have started to increase their presence in the country. Al Meera is one of the most popular domestic modern grocery retailers in Qatar.

The structure of the hypermarket/supermarket segment in Kuwait is similar to that in Qatar, with a combination of standalone stores and stores operating in malls. The hypermarket/ supermarket segment is yet to gain the same foothold in Kuwait as it has in other GCC markets although it has significantly strengthened in recent times. Moreover, Kuwait has the lowest modern grocery retail penetration in the GCC region.

The hypermarket/supermarket segment is gradually gaining traction in Bahrain. There is increasing momentum to shift from grocery retailing toward the more Westernized

modern retail outlets, in line with the trend in other countries in the region.

Moreover, Bahrain is witnessing an increase in the number of smaller stores. In addition, a large proportion of expatriates in the country have led to the growth in modern retail outlets.

Independent grocery stores continue to account for majority of food sales in Oman, but changing lifestyles and increasing spending capacity have boosted the demand for organized food retailing. Key food retailers such as LuLu (which opened its 12th store with an investment of USD52 million) account for majority of sales in the hypermarket/ supermarket segment. These players have established supermarkets and hypermarkets within malls or in proximity to malls. In March 2013, French retailer Carrefour launched its 4th hypermarket in Oman.



# Global food supply chain has evolved

The global food supply chain and logistics network has evolved with the development of organized retail. The global food supply chain is transforming in complex ways, driven by economic prosperity, urbanization, and social changes. However, with constantly changing dynamics, companies are continuously facing the challenges of reducing supply chain costs and adjusting strategy to cater for changing consumer preferences in order to maintain competitiveness.

## **Food supply chain ensures quality and timely supply to consumers**

A food value chain is a network of food-related entities that facilitate movement of food products from production through consumption, including pre-production and post-consumption activities. Typical links in the food supply chain include inputs, producer/farmer, processor, distributor, wholesaler, retailer, and consumer. Pre-production generally consist of research

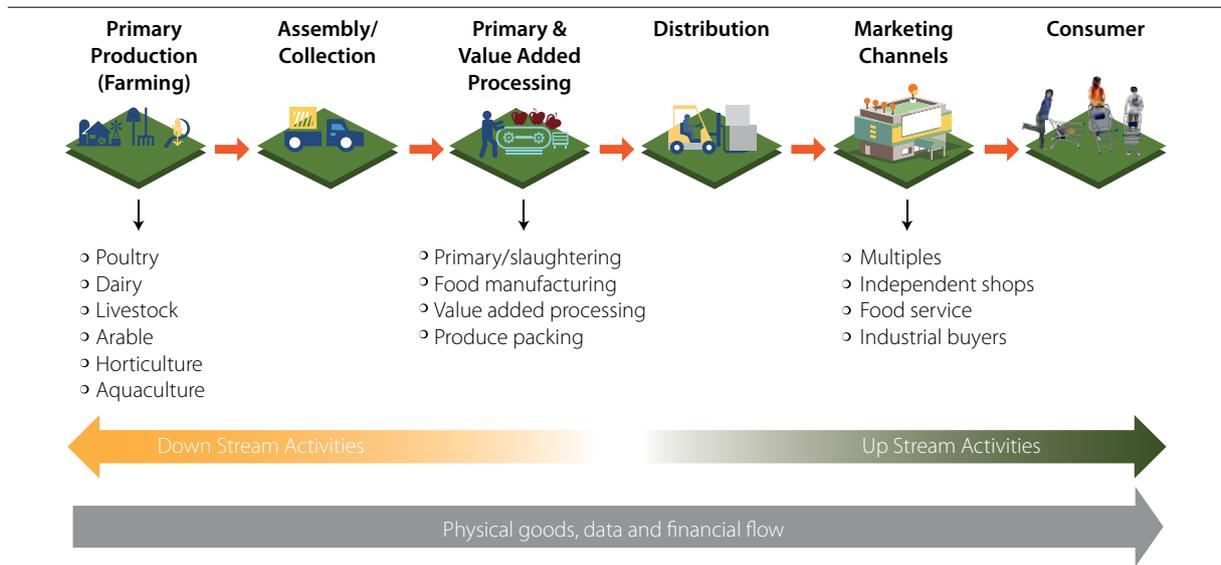
& development related activities, while post-consumption activities include waste management and recycling.

**In GCC, rapidly growing imports and food consumption are driving the demand for modern transportation and logistics systems.** Increased focus on infrastructure and rising food demand provide a significant opportunity within the transport & logistics sector, which includes warehousing (third-party logistics), freight forwarding, sea freight, air freight, and road transport. The transport & logistics sector was estimated to have increased at a CAGR of 10.2% over 2008–12 from USD18.2 billion to USD26.9 billion. Warehousing and road transport, which are important components of the food value chain, rose at a CAGR of 10.5% and 7.3%, respectively, over 2008–12.

The current logistics and transport network in GCC resembles that in Europe in the 1980s, with a large number of small players serving

*GCC's current logistics and transport network similar to that of Europe's in the 1980s*

Food value chain flow

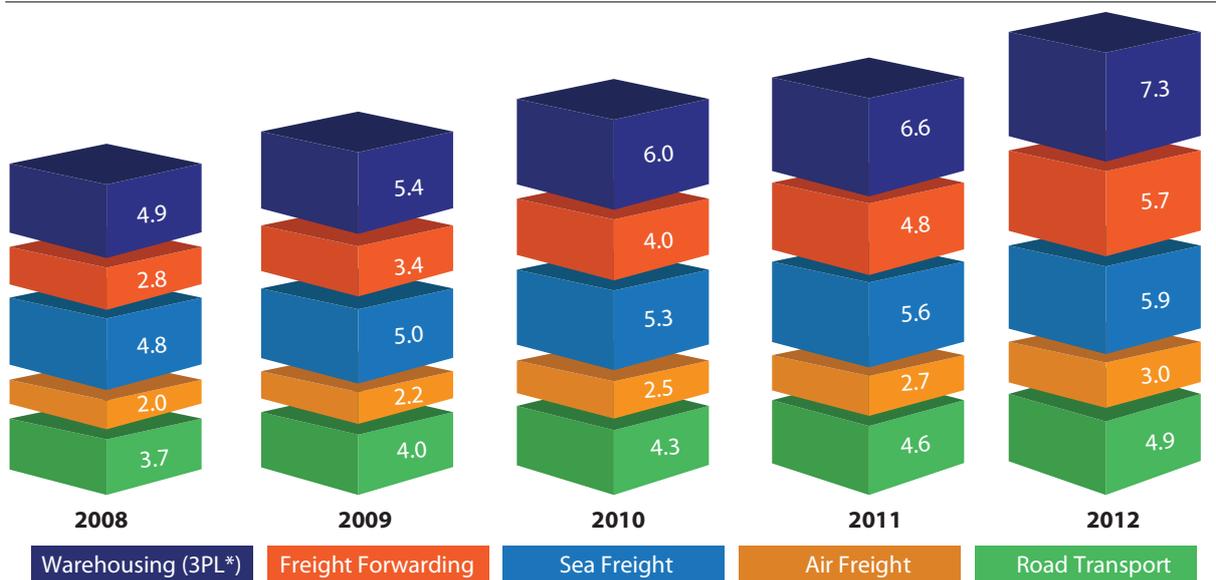


Source: Farrelly & Mitchell Research

the local market based on niche strategies. There are hundreds of small players competing in the freight forwarding, warehousing and transportation segments with lack of clear strategy, scarcity of sophisticated supply chain solutions, and IT capabilities. Before the formation of the European Union, many companies established a national level setup with separate distribution networks in the countries in which they operated, and sourced products from manufacturing units in Europe. A logistics strategy was developed based on the country, with a supply chain offering one-size- fits-all service.

With the emergence of a single market (European market) when European countries started opening up, the importance of global sourcing gained attention and companies started to develop pan-European supply chains. In the early 1990s, due to changing consumer preferences, the profits of smaller companies started to decline as large players significantly increased market consolidation activities, leading to numerous mergers & acquisitions. Some transportation and logistics players expanded in size by growing faster than the market rate though customized and broader range of services. Others could not survive, becoming subcontractors to leading players.

Estimated GCC logistics market size (USD Billion)



Source: Booz & Co. Not Too Late Finding Opportunity in Middle East Logistics; \*stands for Third-Party Logistics



Currently, companies are using a combination of both centralized and decentralized distribution networks.

Over the years, developments in the supply chain in the mature markets indicate that even with a highly profitable and fast-growing logistics market, consolidation

becomes imminent. With changing consumer preferences, service providers in the GCC will have to ensure that their service offerings and geographic footprints grow in line with customers' demands. Service providers who offer integrated logistics services, regionally or globally, will be able to build capabilities such as a road network and comprehensive warehousing facilities.

<b>Case Study: Notable developments in industry as a result of Walmart strategy</b>	
Walmart was instrumental in developing the retail sector, especially the supermarket segment, which operates at low profit margins and high volume turnover. Walmart's focus on supply chain efficiency ensured the offering of Everyday Low Price (EDLP) to consumers, with its purchase volumes enabling it to dominate terms with suppliers. With the entry of Walmart into grocery business, retailers struggled to compete with Walmart as they found it difficult to lower operating costs and cut expenses through buying power. This led to a series of major developments in the industry during the 1990s.	
<b>Supply chain cooperation</b>	<p>In 1993, in response to the competition posed by Walmart, supermarkets collaborated to bring about Efficient Consumer Response (ECR), which involved reducing the overall supply chain costs instead of focusing on separate components.</p> <p>Within this system, four efficient strategies were adopted. <u>Store assortment</u> aimed at examining issues related to productivity, optimization of inventories, and store space. <u>Replenishment</u> aimed at optimization of cost and time in the replenishment system using replenishment programs, electronic data interchange, cross docking, new receiving technique, and computer-assisted ordering. <u>Technology</u> was used to remove inefficient promotion practices that do not influence consumer decisions and lead to inflated inventory. The fourth strategy involved <u>improving the effectiveness of new product launches and development</u>, which often resulted in additional costs.</p>
<b>Merger &amp; Acquisition</b>	<p>Although ECR did not significantly impact the pricing power of retailers, it led to higher cooperation across the supply chain. Increasing competition, flat population growth, and lack of organic growth prospects made inorganic growth an attractive alternative to meet the top and bottom line. This was followed by a series of mergers between 1997 and 1999 across the food supply chain, including some large mergers such as that of Safeway (1381 supermarkets) and Dominick (112 supermarkets), Kroger (1398 food stores, 802 convenience stores, and 34 manufacturing plants) and Fred Meyer (800 food and general merchandise stores), and Ahold and Giant Foods..</p>
<b>Grouping of purchasing power</b>	<p>Internet and B2B exchanges were used by large retailers to compete with Walmart as the Internet offered an efficient and economical way to integrate the supply chain.</p> <p>Global Net Xchange and World Wide Retail Exchange were two major B2B retail consortiums that emerged as a challenge to Walmart's Retail Link system operational since 1991 (the company invested around USD4 billion in just 10 years). Retail Link was used by thousands of Walmart suppliers, enabling them to track sales at the store level and replenish inventories as required.</p> <p>Global Net Xchange was promoted by Sears and Carrefour, and included global marketplace procurement and collaborative SCM. On the other hand, World Wide Retail Exchange was established by 17 global retailers, which helped reduce costs and inefficiencies across development, procurement, and supply chain processes by simplifying, rationalizing, and automating processes..</p>
<b>Standardization and integration of supply chain</b>	<p>As a part of the consolidation process, retailers started collaborating with Walmart to develop technical standards. A number of intra- and inter-industry bodies came together to establish standards such as Uniform Code Council (UCCNet) and the Association for Retail Technology Standards (ARTS).</p>

Source: Infosys

*There is a need for sophisticated distribution network, which continue to evolve in developed markets*

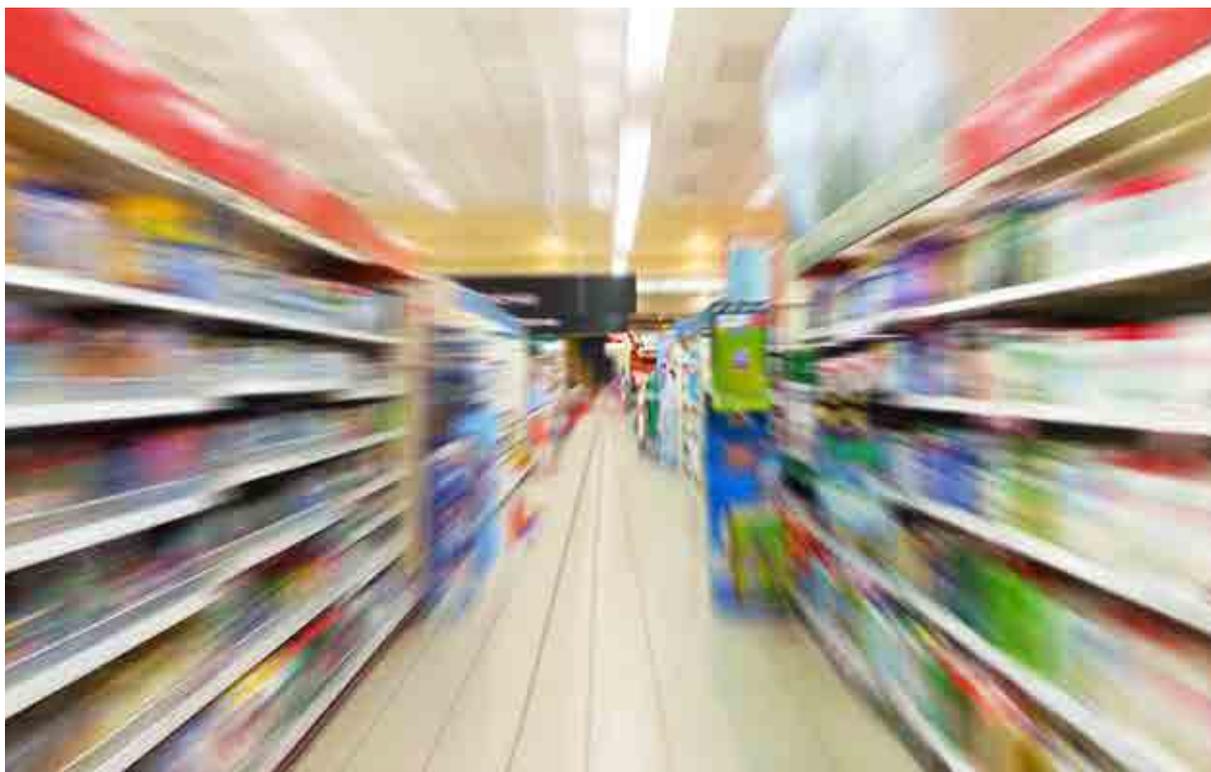
**The supply chain segment in GCC is fragmented and characterized by a number of global, regional and local players, providing a range of logistics services such as warehousing, trucking, and freight forwarding.** Global players include Expeditors and Danzas, while some regional players include Agility and GAC (they have transformed from regional to global players by providing specialized distribution facilities), and Al Futtaim Logistics. Several local players primarily operate in a particular country, such as Global Shipping and Logistics and Mohebi Logistics who operate in the UAE. Agility and GAC are two major players that provide specialized distribution facilities.

**The cold chain segment has significant potential due to growing market and low competition, but it requires heavy capital investment.** Agility, Global Shipping and Logistics, and Mohebi Logistics are some of the

players that operate in the cold chain segment.

Only a few players operate in the third-party food logistics segment, such as Almarai, Almaya, and Choithram, as a number of food manufacturers and traders have their own logistics network, which includes warehouse and transport facilities.

Weak supply chain infrastructure is one of the key drivers of food inflation in GCC, resulting in wastage due to lack of storage facilities and transportation, which in turn adversely affects efficiency and leads to higher costs. The GCC requires a robust logistics and supply chain management network to ensure quality and timely supply of both local and imported products. Significant growth in the volume and value of sales at hypermarkets and supermarkets reflects the need for a specialized and developed food supply chain system.



## Leading companies investing in supply chain

In developed markets, where the food supply chain is highly efficient, 56% of total food losses occur at the consumer end of the food value chain. In contrast, for developing countries, food losses at the consumer end accounts for only 14% of the total. Approximately 60% of total food waste in these countries occurs during production, handling or storage. Food losses first occur at the pre-harvest level; thereafter, inefficient and poor post-harvesting activities add further to those losses. In the case of developing economies, losses primarily occur due to attacks from rodents, insects, and lack of storage facilities.

The high rates of food loss and wastage at the earlier stages of the food value chain in developing countries indicate the need for centrally controlled, specialized and sophisticated distribution systems across the supply chain. Moreover, supply chain transparency can be improved using track and trace technologies. Minimizing operational supply chain costs is the main objective of all GCC players. Furthermore, optimization of transportation, which forms a major portion of supply chain cost, is another vital focus area.

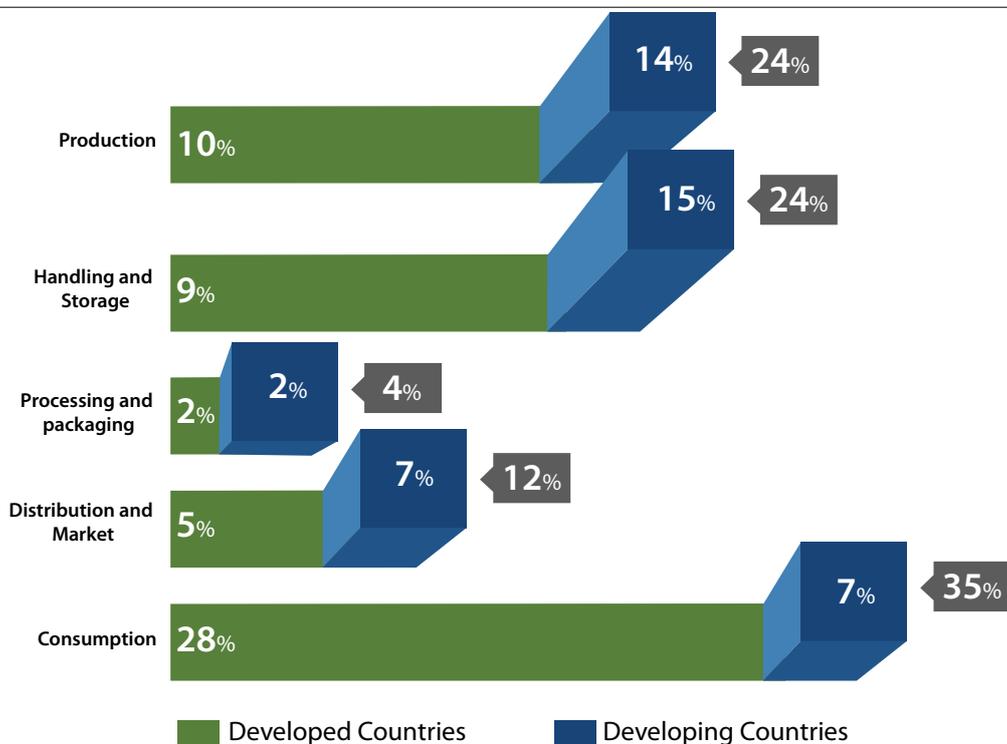
Leading companies around the world are investing in their supply chain, and focusing on reducing cost and complexity to increase efficiency. In our opinion, consolidation in the supply chain will lead to more timely delivery of food products, reduced wastage and higher economies of scale.

**The GCC's logistics sector ranks well below developed and some emerging markets indicating scope for development.** Recent expansion of the GCC's retail sector has outpaced expansion in developed markets such as the US and Europe. Retailers such as Panda and LuLu opened 100 stores in one-third of the time compared with mature retailers such as Sainsbury's, Morrisons and Waitrose. However, GCC logistics indicators are well below that of developed markets and some emerging markets. According to World Bank's Logistics Performance Index 2014, the UAE is the top logistics market in GCC with an overall rank of 27, followed by Qatar at 29.

The GCC countries are ranked well below developed nations such as Germany (1), the UK (4), US (9), Japan (10), and France (13).

*Majority of food losses and wastages occur at initial stages of the value chain in developing countries*

Food losses by stage in the value chain, 2009(100%=1.5 quadrillion kcal)



Source: WRI analysis based on FAO. 2011. Global food losses and food waste - extent, causes and prevention. Rome: UN FAO, Farrelly & Mitchell Research

Compared with some emerging markets, Oman (59) and Kuwait (56) are ranked below China (28), South Africa (34), and India (54).

**GCC players must partner with companies providing optimized supply chain solutions to stay ahead of the**

**competition.** This would enable knowledge and data sharing in terms of food storage best practices, consumer trends and inventory levels. Collaboration and partnership with key suppliers, service providers, and other supply chain firms will benefit companies in building a long-term strategic relationship.

Logistics Performance Index rankings (2014)

Country	Overall LPI Ranking	Logistics Quality and Competence	Timeliness	Tracking and Traceability	Infrastructure
Germany	1	3	4	1	1
UK	4	5	7	5	6
USA	9	7	14	2	5
Japan	10	11	10	9	7
France	13	15	13	12	13
UAE	27	31	32	24	21
China	28	35	36	29	23
Qatar	29	28	34	32	29
Saudi Arabia	49	48	47	54	34
Bahrain	52	51	119	42	49
India	54	52	51	57	58
Kuwait	56	59	60	50	43
Oman	59	73	67	80	57
Brazil	65	50	61	62	54

Source: World Bank



### Benefits of different types of collaboration

M&A	Cooperatives	Joint Ventures	Exclusive & Non-exclusive Alliances	Contracts
Portfolio diversification	Economies of scale	Knowledge and skill sharing	Skill sharing	Secure supplies
Geographic expansion	Increase bargaining power	Cost and risk sharing	Cost sharing	Extracting value additions
Vertical integration to secure supplies and internalize margins				
Synergies extraction				

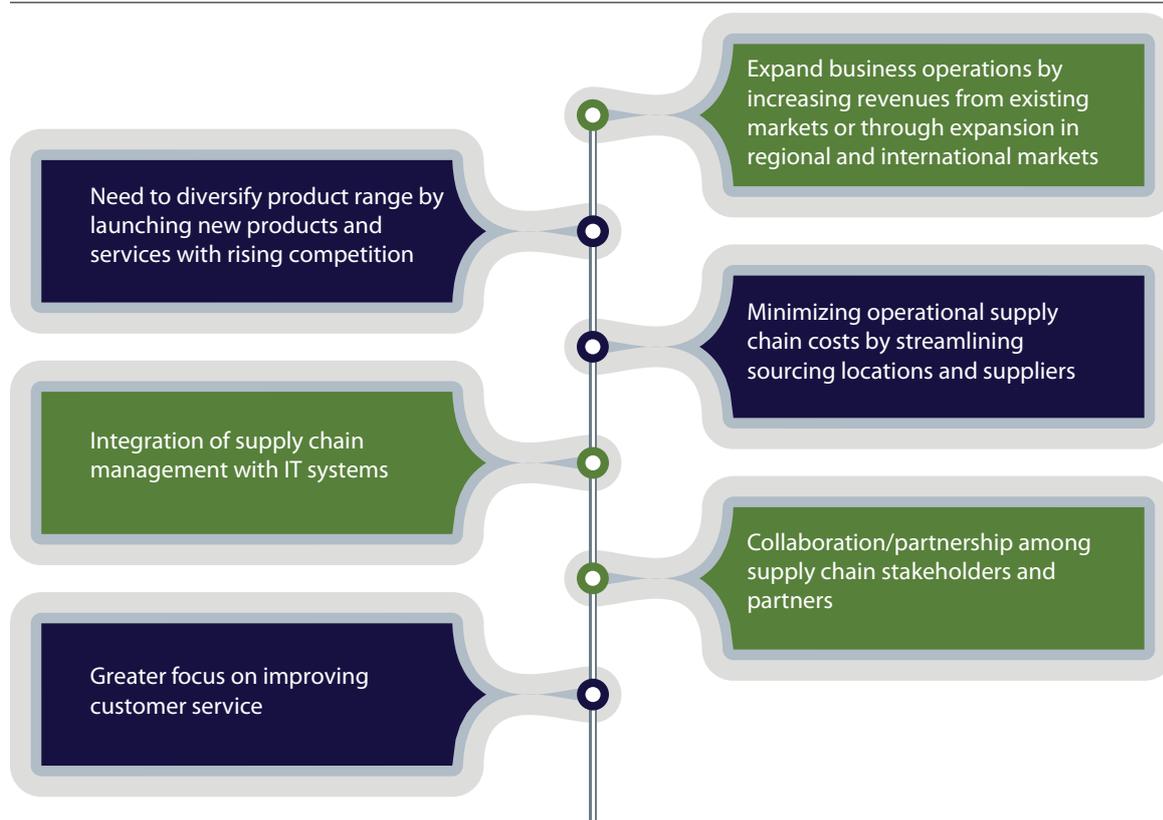
Source: KPMG

Moreover, collaboration with other players within and beyond each link in the value chain, such as between private players, and private and public sectors, would provide access to new skills and resources, and drive innovation. In addition, these partnerships would not only provide greater visibility along the supply chain but also help reducing costs. Collaboration could be in several forms such as mergers & acquisitions, joint ventures, contracts, and exclusive and non-exclusive alliances.

We believe the core focus for retailers in coming years will be to develop optimal supply chain solutions. Given the market's size and its increasing complexity, and constantly evolving consumer preferences, retailers can no longer rely solely on the achievement of economies of scale and supply chain rationalization to maintain market share. Retail differentiation will also be necessary and this is likely to be achieved through niche supply solutions. There is a need to recognize the supply chain as a strategic asset and offer a tailored approach rather than a one-size-fits-all approach.

**Collaboration in any form essential for companies to optimize supply chains**

### Key supply chain strategies to maintain competitiveness and achieve economies of scale



Source: Farrelly & Mitchell Research





## Collaboration required for family businesses

Family businesses are very common in all GCC countries. On a sectoral basis, the retail & trading sector has the highest concentration of family businesses, followed by the food & beverage sector. Many family businesses need to restructure and collaborate to grow and compete with international players. Several global retailers have collaborated with local family-owned businesses to expand their presence in the GCC, as it requires lower capital investments, can benefit in faster

government approval, and leverage the local knowledge and experience of the domestic partner. With the entry of global players to the retail sector, family businesses face challenges in terms of maintaining their market share and sustainability of operations. However, these players bring knowledge, expertise, and best practices to the market which can be harnessed by strategic family businesses to reposition their companies for growth.

***Collaboration with global retailers will enable family businesses to gain knowledge, expertise, and best practices to reposition themselves for growth***

Concentration of Family Businesses in GCC (%) by Sector



Source: Booz & Co. GCC Family Businesses Face New Challenges

**Example of Successful Family-Owned Business**

Al Muhaidib Group, a family-owned business, is one of the key strategic players in Saudi Arabia's food distribution sector and has a portfolio of over 200 companies/investments. In 2008, the group merged its Giant Stores with Panda hypermarkets (part of Savola). Moreover, Al Muhaidib Group has regional joint ventures/alliances through Nestle Saudi Arabia and other entities across the Middle East. The group's activities demonstrates how smart investment and strategic collaboration can have a significant positive impact on both participants and the wider sector.

**In our opinion, family-owned businesses need to adjust their operational strategy to remain competitive in the dynamic and changing business environment by:**

- ▶ Reviewing existing businesses to create sharper focus
- ▶ Focusing on profitable businesses rather than concentrating on traditional businesses
- ▶ Creating new guidelines to distinguish between family and business activities
- ▶ Evaluation of new investments with a focus on return on capital



## Investment scenario for food is promising

The food sector, especially processed food, offers substantial business opportunities. Increasing demand and government focus on food security is driving investment in the processed food segment in GCC. The region is gradually emerging as one of the leading food processing and re-export destinations. The demand for processed food has grown significantly and accounts for over 50% of GCC's total food demand. Governments are assisting both domestic and global manufacturers to set up additional manufacturing units. In January 2010, Qatar allowed 100% foreign investment in its agriculture sector to boost production. In 2011, the UAE invested USD258.4 million to procure food processing and packaging machinery.

### **Growth drivers and emerging trends attract investment in the GCC food sector.**

Strong macroeconomic fundamentals, favorable demographics and socio-cultural change are attracting investment in the GCC food sector. Consumer retail spending on food in the GCC region is expected to increase

to USD94.7 billion by 2018 compared with USD62.9 billion in 2012.

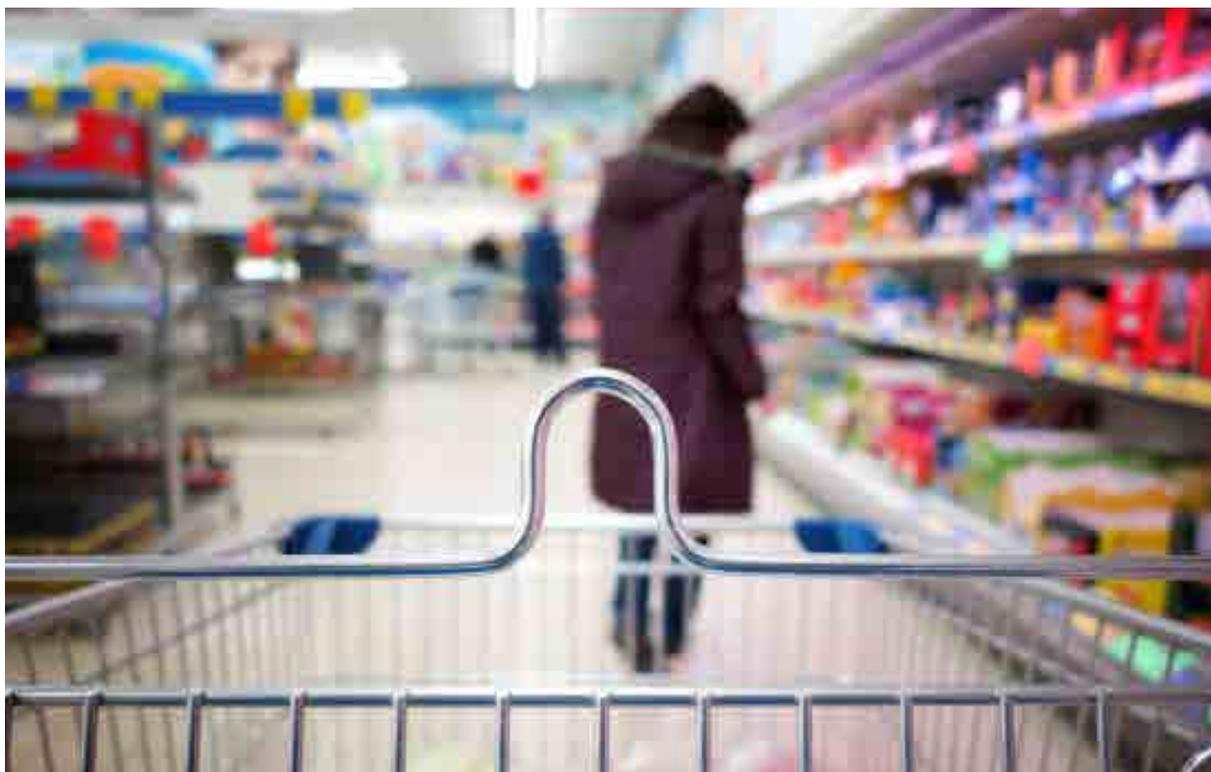
Strategic players see M&A as a way to expand their geographic footprint. On the other hand, for sovereign wealth funds, it will be about gaining food security at the primary production level. M&A activity in GCC's food sector grew for the second consecutive year in 2013 after remaining muted in 2011. The value of M&A deals in the food sector rose to USD936.1 million in 2013 versus USD701.6 million in 2012. Many players are undertaking M&As to expand their geographic footprint. The largest deal was executed by Majid Al Futtaim Holding LLC, which acquired the remaining 25% stake from its partner Carrefour to take full ownership of Majid Al Futtaim Hypermarkets LLC for USD682.5 million in 2013. Almarai, the largest global vertically integrated dairy company, continued its expansion plan for the third straight year by acquiring Mead Johnson's stake in International Pediatric Nutrition Company for USD4 million.

*GCC food sector offers substantial investment opportunities in the form of M&As*

## M&amp;A activity in food sector (2013)

Acquirer	Target Company	Transaction Value (USD million)	% Acquired	Target Location
Almarai JSC	International Pediatric Nutrition	4.0	50.0%	Saudi Arabia
ANC Holdings LLC	Dhofar Fisheries & Food Industries Company S.A.O.G	Not disclosed	39.13%	Oman
Qurain Petrochemical Industries	Saudia Dairy & Foodstuff	232.45	28.98%	Saudi Arabia
Ali Zaid Al Quraishi & Brothers; United Biscuits LTD (UK)	Rana Confectionery Products	Not disclosed	100.0%	Saudi Arabia
Gulf Capital Pvt. JSC	Chef Middle East LLC	Not disclosed	100.0%	UAE
Majid Al Futtaim Holding LLC	Majid Al Futtaim Hypermarkets	682.51	25.0%	UAE
Irish Dairy Board Co-operative Ltd.	Al-Wazeen Trading Co.	27.0	75%	Saudi Arabia
International Dairy & Juice Ltd.	Teeba Investment for Developed Food Processing Company PSC	17.12	25.0%	Saudi Arabia
Saudia Dairy & Foodstuff	SADAFCO Kuwait Foodstuff Co. Ltd.	0.018	49.0%	Kuwait
Cargill, Incorporated	Arabian Agricultural Services Co. Ltd., Existing Corn Milling Facility in Al Kharj	Not disclosed	20.0%	Saudi Arabia

Source: Zawya/Farrelly & Mitchell Research



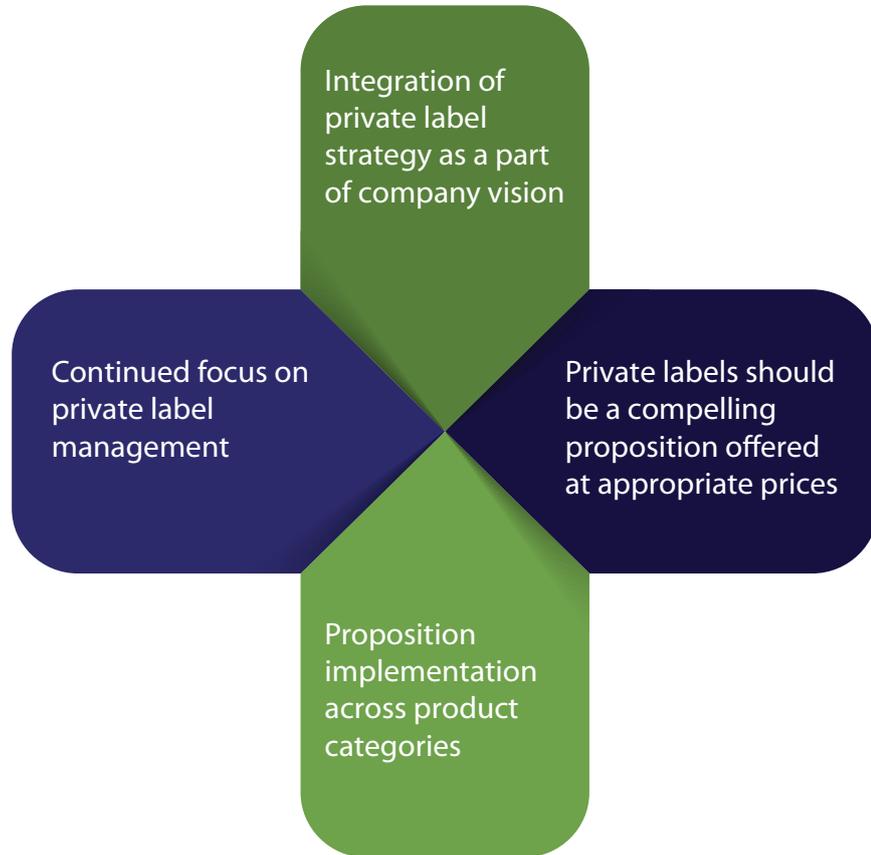
## Considerable potential for use of private labels

A significant potential exists for use of private labels by GCC retailers. Over the last three years, private label products have increased their market share by more than threefold in GCC from 3% to 10%. However, it remains well below the equivalent share in mature markets such as the US (22%) and Germany (32%), where private labels account for a sizeable portion of the retailer's value proposition. Retailers in the US and European market consider

private labels to be a key differentiating factor. For instance, food specialty retailers such as Whole Foods Market, Wild Oats, and Trader Joe's entered the market with organic private label offerings. We believe there is a significant opportunity for GCC retailers in the private label space as these products can be profitable than branded products, enabling retailers to increase gross margins.

***Regional retailers are recognizing private label's potential***

Four-step approach for developing successful private label strategy



**Use of private labels is a key strategy of all major matured retail markets such as the US, UK, and Germany.** The GCC region has been lagging behind major matured retail markets in the use of private labels. However, this situation is gradually changing amid the ever evolving landscape of the

retail sector, with modern retail replacing traditional independent retail trade. To achieve 15–25% share in overall sales, retailers will need to modify their approach, making private labels an integral part of their growth strategy, thereby boosting their revenues and bottom line.



## Analysis & Recommendations

Companies in the food value chain must evolve and adapt to an increasingly complex business environment. The most successful companies have efficient supply chains capable of adjusting to a rapidly changing market. As a result, we believe that companies operating in the food value chain must consider their supply chains as strategic assets.

- ▶ With the traditional and modern food value chains changing rapidly to cater to diversified consumer needs with a range of food products, **we believe an understanding of how the food value chain needs to evolve and collaboration among various stakeholders in the food value chain are important.** Sourcing and timely delivery of food products can be achieved through collaboration among various stakeholders across the food value chain. In our view, supply chain efficiency depends not only on a particular firm's internal efficiency but also on optimization of resources and service exchanges between various stakeholders.
- ▶ Ensuring food safety across an increasingly complex global supply chain while following regulatory compliance is a major challenge faced by the food sector. Rising incidents of food recall and awareness among consumers about adulteration and food-borne illnesses in recent years have increased the focus of lawmakers and regulatory bodies on food safety. As a result, traceability is a major concern. This issue can be addressed through implementation of new technologies across various stages of the food value chain, which will also provide further integration by tracking the progress of food and crops from production to consumption.
- ▶ **Food processors need to work with both upstream and downstream partners in the food value chain to ensure food security, reduce the risks associated with food safety, and improve communication among various stakeholders.**
- ▶ The GCC's food sector presents a significant opportunity for investments and as a consequence increased M&A activity is expected in the coming years. However, we believe each player in the food sector is likely to have different M&A strategies, as some strategic players will undertake M&As in GCC to expand their geographic footprint in regions of high growth. Enhanced focus on food security is likely to further drive public and private sector investments in regional and local food processing and production segments. **In our view, the food sector, especially dairy, red meat, and poultry segments, offer significant investment opportunities for both strategic and financial investors.**

- ▶ Family-owned businesses need to immediately understand and address food supply chain dynamics. For many family-owned food businesses in GCC, an alliance with an international strategic investor/partner can lead to enhanced knowledge, expertise and technology sharing to help reposition these businesses for growth (and survival). **We believe family-owned businesses must adjust their strategy to remain competitive in the current dynamic and changing business environment. In our opinion, many established family-owned businesses require restructuring to compete and grow, and should identify opportunities for collaboration.** Family businesses should review their existing portfolio to increase focus on profitable businesses instead of being dependent on traditional businesses and evaluate new investments with a focus on return on capital.
- ▶ Product innovation and differentiation are essential for small- and medium-scale players to remain competitive as these players will not be able to compete effectively with large players in terms of efficiency and pricing. **We believe food business strategies should include additional focus on developing private labels.** In our view, greater vertical integration within the value chain (e.g., retailer private label programs) will drive consolidation as key players take on additional roles.



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Mohammed Hajjar leads the team at Farrelly & Mitchell's MENA office. He is a seasoned consultant with over 22 years of experience in generating tangible results by transforming the performance of existing organizations or building new ones. He has served as a lead advisor to several CEOs in a variety of industries to prepare companies to go public or expand operations by identifying and implementing adaptive business models that generate value to shareholders.

Mohammed started his career with Andersen Consulting (which later became Accenture) and has evolved through different leadership roles (in the US, Canada, and the Middle East). His experience encompasses different industries, including livestock, poultry & food processing, consumer products, financial services, real estate, government, and healthcare. Moreover, Mohammed has worked with many family groups in the Middle East, preparing multi-industry groups and conglomerates to pursue seamless hand-over to the new generation.

Mohammed and his team have helped clients in the following areas: strategy development, business growth, business setup and launch, IPO preparation, corporate & family governance as well as merger & acquisition planning.



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*Research Analyst*

Michael Sweeney is a research analyst with Farrelly and Mitchell. Previously, he has worked as a researcher in the Corporate Planning and Strategy Unit of Ireland's inward investment promotion agency IDA Ireland.

At Farrelly & Mitchell, Michael provides research support services to client projects. The focus of his work is on the economies of the Middle East and North African (MENA) region and specifically commodity, food and agribusiness markets. He has worked on a diverse range of projects across the agri-food spectrum, including food service, grocery retail, bakery, dairy and poultry.

With IDA Ireland, Michael provided research and analysis of issues impacting on IDA's ability to meet its aims and objectives. He also developed an index for assessing the foreign direct investment (FDI) potential of local areas across Ireland in anticipation of the implementation of the EU Commission's Regional Aid Guidelines 2014-2020.

# **FARRELLY & MITCHELL**

Food & Agri-Business Specialists



Farrelly & Mitchell is a specialist food&beverage consulting firm that provides advisory, M&A and technical services. Headquartered in Ireland with an office in Saudi Arabia, the firm has been operating in the GCC sphere since 2008. The firm achieves results by adopting a hands-on approach, leveraging its industry know-how, extensive contacts and market knowledge to create measurable value.

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