Iraq and Iran revisited

With the market situation in both Iraq and Iran changing at a rapid pace, AMEFT's guest author MANSCI offers an update on the situation in these two fast-growing markets.

Iraq

FMCG companies absolutely love consumers. The more, the better. So when a country that has been in structural doldrums for a longer time finally moves towards a semblance of normality, the commercial sector takes note. After a four-year break we decided to take another look at Iraq this year, and Iraq proved us right: just that sort of country – infuriatingly complex, decentralised, dangerous, but home to 33 million people (consequently another Saudi Arabia in terms of size), and with a lot of changes in scope, scale and structure since our last look at the market in 2009. Thirty-three million potential consumers – difficult to ignore of course for multinational and regional companies that are rather used to single-digit growth rates elsewhere in their remit these days.
Business was rather difficult after the First Gulf War, with international sanctions creating a trading environment that was not for the faint-hearted. After the Second Gulf War and a transition to a new order in Iraq, would-be suppliers took courage and started cross-border trade, but the political and security situation remained complicated and precarious – meaning that the majority of beverage and dairy exporters to Iraq were fairly content to wave their products goodbye right at the border, with a wodge of cash in their hand. Nice, uncomplicated business – but of course not something that could be called 'active business development'. And those who were brave enough to go after the latter seem to have reaped rewards – and not always with the most conventional methods….

Entry via Kurdistan – the way forward?

Quasi-independent Kurdistan seems to serve as the springboard for market entry for various foreign suppliers, be they companies fancying a steady import business or suppliers that want to go a step further and introduce domestic production. But the Coke story does serve as an example that there are limitations. Even if a company that should have all the know-how necessary for distribution in difficult markets has a plant available in a place like Erbil, can the entire country be serviced from there through a series of warehouses, sub-distributors, agents, whatever? The answer, at least in Iraq, appears to be a resounding 'No'. Transport routes are long, laborious and, rather sadly, increasingly dangerous, and there still seems to be an invisible line roughly towards the centre of the country beyond which a company's distribution capabilities just don't go. So the acquisition of existing facilities has solved this problem somewhat for Coke. Now that Al Waha is part of the fold and the filling of Coca-Cola brands has commenced in both Hillah and Karbala there are far fewer headaches in getting access to regional markets in the country.
But Kurdistan is retaining its appeal. For any Turkish, Arab or Iranian company that is serious about launching distribution of its products in Iraq, Kurdistan remains the starting point. Erbil and Suleymania are now replete with direct sales subsidiaries of many regional companies that might, for the time being, be happy with good distribution in Kurdistan itself and content with at least a trickle of sales into areas south and west of there. And some companies are so happy with their export volumes to their distribution partners in Kurdistan (a certain Lebanese beverage company comes to mind….) that there are now discussions about a possible conversion into domestic filling, through greenfield investment. Not bad for a country that ten years ago was on its knees!

Dairy needs some work…..

The hot bet at the moment is on some serious investment in the country's dairy industry – now that is a sector that is still suffering from lack of activity, with imports dominating by far. If imported chilled products dominate in a traditional market like shanineh or ayran (fermented milk drinks) then you know that there is something seriously amiss in domestic dairy development. Although various regional dairies are looking seriously at setting foot in Iraq to manufacture dairy products locally, it does look for the time being that it will fall to enterprising domestic players to take this step instead. It might be a bit chicken-and-egg we suppose – dairy processing and filling needs serious technology, and technology suppliers most probably still shy away from having their engineers travel to Iraq. But there are finally signs that local dairy output will receive a boost soon.

Attractive features of the Iraqi market …

Iraq's idiosyncrasies may provide a boost to certain groups of suppliers, domestic or otherwise. A large army of a quarter of a million soldiers, for example, needs food and water. The fact that some of Shia Islam's holiest shrines are based in the country's south and attract a large number of pilgrims every year (and yes, they do travel to Iraq, despite the apparent dangers). Here too, all of them need comestibles. And, to this day, the country even has remnants of the old Oil for Food Programme – these days a subsidised distribution programme that works with a system of ration cards (with milk powder and baby nutrition the only remaining dairy or beverage products now covered by this scheme). All opportunities for suppliers who might be geared towards that sort of thing. Iraq (well, Kurdistan at least) has also become home to yet another Majid Al Futtaim expansion for its Middle East Carrefour franchise – not sure yet whether this is an oddity, or a sign of things to come…. But we do take it as a very green shoot! And finally – Iraq is virtually a blank sheet as far as marketing activities are concerned. Everything currently revolves around sorting out sales structures. So the first companies with distribution in place should also be the first ones to make a serious push with above-the-line marketing activity. Here's hoping.

… and not so attractive ones!
The simple biggest challenge for suppliers seems to be the might of the wholesalers in Iraq. Not surprising that, in a fragmented AND unstable market, wholesalers should hold the key to a brand's success or failure. Everybody wants a piece of the cake, but the wholesalers know that the only alternative to them is investment in depots, warehouses, long-haul trucks, distribution vans, branded vizicoolers – in other words, this is only something for the big boys like Pepsi, Aujan, Al Safi Danone, Al Yasra, Coca-Cola…. The rest need to contend with extraordinarily large wholesale margins and payment terms that would make your eyes water anywhere else in the world….
And finally, there has been a definite change in approach by Iraqi authorities in recent years, attempting to transform the country from everybody's dumping market to a more organised, and stable, destination for exports. New regulations, especially regarding product and labelling certification at the border, have helped to keep the more cowboy-ish regional suppliers at bay. So would-be suppliers, take note – market development is definitely up for grabs. But we believe the days of the cash transactions at the Turkish, Jordanian (certainly Syrian!), Kuwaiti and Iranian borders are probably nearing their natural end. A more measured, and serious, approach to sales in Iraq is probably required. Not an easy feat, we grant you – especially with international companies still not happy to ease their travel bans to Iraq – but we do see movement on the part of your competition, so half an eye and half an ear is definitely advised.

Iran
After a strong drop in 2012, consumption of commercial white milk (packaged and branded) is expected to keep declining in 2013, albeit slightly. While the cessation of the subsidised milk programme was the driver behind the drop in consumption in 2012, other factors were more important in 2013. The strong devaluation of the local currency against the US dollar was the major driver behind the drop in the size and importance of the aseptic cartons segment and indirectly behind the increase in volume and importance of other pack types. In addition, due to the growing sanctions, settling payments in US dollars or euros to international suppliers of raw materials – including packaging materials – has become an issue for most dairies.
The school milk programme has diminished in size recently. Some local dairies lost interest in the school milk programme as the authorities refused to increase prices. This, coupled with insufficient funds, will translate into little development in the school milk programme. It is estimated that only 7.9 million students were recently included in the programme and the number of portions per student dropped to 25 only per annum. This suggests a significant decrease over last year's volume. Currently, only kindergartens and elementary schools are included in the programme in addition to some preparatory schools. Short-life milk in single cups remains the dominant pack type and its importance is set to increase with UHT milk prices becoming relatively expensive.

Raw milk situation and recombining
Retail prices for raw milk rose strongly in 2012. This was partially due to increasing demand from local manufacturers of milk powder. In response to this development, the authorities allowed the big dairies to import milk powder to force farmers to lower their prices. Large volumes of milk powder were actually imported by the dairies and the price of raw milk fell, partly because demand for locally-produced milk powder dropped when extra volumes were imported. Imported milk powder is used primarily in the ice cream industry. Large volumes of flavoured milk powder are also recombined. In fact, it was reported that even some mixing happens in the production of short-life milk as well when the supply of raw milk is inadequate. On the other hand, the increase in imported fodder prices remains the most important factor behind the increases in raw milk prices. Dairy farms were warned that imported fodder prices would increase after the presidential elections. This will no doubt be reflected in higher commercial milk prices and add more pressure on the supply of milk in aseptic

cartons and other pack types. Earlier this year, official price for one litre of 3.2% fat content raw milk was at IR 9,600. Of course, better-quality raw milk with a higher fat content means higher prices. In fact, major dairies have established an incentive system to encourage dairy farms to deliver higher-quality raw milk.

Costs and retail prices

Retail prices rose strongly in 2012 due to the increasing production costs. The general increase in the price of white milk in 2012 in all packaging types was driven by the rise in raw milk prices, among other reasons. However, the production of UHT milk has become more expensive than other pack types. Aseptic cartons are imported and subject to forex changes. In addition, it was reported by a couple of suppliers that the production process for UHT milk is actually more costly than for pasteurised milk. The cost of producing plastic bottles on the other hand is subject to changes in the price of oil. However, on average, the cost of any empty bottle is now about one-third the cost of an empty 1000ml aseptic carton. Of course, the distribution costs and level of return are higher for chilled milk.

Exports

Even though production costs have increased tremendously in the last couple of years, in regional terms and due to the devaluation of the Iranian rial, Iranian long-life milk is becoming more competitive in US$ terms. However, exports of white milk remain unimportant. In fact, ice cream and cream are the most important export items among all dairy products. We actually expect export activities, at least by the major dairies, to be on the rise from 2013 onward.

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