



# A REPORT ON INDUSTRY IN LEBANON 1998 -1999

# INDUSTRIAL STRATEGY AND RECOMMENDATIONS

## INDUSTRIAL DEVELOPMENT PROGRAM

Based on the survey results and the assessment and comments of industrialists, the following strategic program was defined for the development of the Lebanese industrial sector.

On the long term, this program aims to help and assist the industrial sector in facing the regional and international changes as well as improve its competitiveness and productivity.

The global market trends imply a review of the industrial sector and its production structures. In this context, this sector needs adequate infrastructure, laws, regulations and all the necessary facilities for its modernization.

On the shorter term, adequate measures must be taken to reduce the obstacles and problems that the sector is facing.

The current crisis consists both in production and marketing problems. The Lebanese industrial production is expensive, while the markets are limited and highly competitive.

Interventions to protect the industry should be avoided. If protective measures are deemed necessary, they should be kept to a minimum and gradually phased out. Instead of protection, the industry should be given full support for its development.

This strategic development program should not be the sole responsibility of the public sector, but instead it requires a close collaboration with the private sector (professional associations and enterprises). The role of public authorities is to provide the proper environment and the necessary institutional framework, as well as all the support for the development of the sector. It is the private entrepreneurs own initiative that in the end will strengthen and stimulate their business.

This industrial program is interconnected

and depends heavily on the other economic sectors as well as the whole economic development of the country. For these reasons, most of the proposed recommendations concern other economic sectors. Additionally, the program tends to protect the workers and consumers rights as well as the environment and a balanced development among all the Lebanese regions.

The industrial development does not only depend on the Ministry of Industry. It also concerns a large number of public institutions. Therefore, an industrial strategic program should involve a global policy and support from many government institutions.

This program should be constantly reviewed and adjusted based on major developments in the sector as well as field surveys. One global survey every 4 to 5 years is not sufficient; the statistical tools must be consistently and continuously reviewed and updated.

### GLOBAL TRENDS

The recovery of the Lebanese industrial sector cannot be dissociated from certain global economic, regional, and international trends. In many countries a recovery requires deep economic changes. However it is different in Lebanon where important structural economic and social changes are not needed as much as simply to amend the existing ones and straighten out some disparities.

Furthermore, certain internal and external economic factors must be taken into consideration, as the Lebanese economy is undergoing a phase of uncertainties and turbulence which urgently imposes the correction of the abuses of the past few years.

Lebanon lost a major part of its economic advantages that it enjoyed before 1975.

Nevertheless, it still offers many opportunities that must be exploited and promoted in order to recover its earlier positions.

An industrial recovery program must integrate the following general trends:

- Opening markets and lifting of trade barriers.
- Introduction and application of international technical and quality standards.
- Switching from comparative to competitive advantages.
- Focusing on general business rather than merely industrial improvement strategies.
- Liberal and simple business regimes.
- Increased private participation in public programs.
- Less government direct intervention.
- Two major government roles: support and coordination.
- Saturation of traditional regional markets.
- Increased transparency, enforcement of rules and regulations, and respect of intellectual property.
- More investment in human capital.
- Increased importance of information.
- Growing importance of foreign direct investment.

### GLOBAL OBJECTIVES

The industrial recovery program involves the definition of global objectives for the improvement of the productivity and competitiveness of the Lebanese industries.

These objectives comply with a strengthening of the open market environment and an improvement of the management of financial and human resources.

The public authorities can offer necessary support and assistance by creating the adequate business environment. On the other hand, the private sector must join efforts to initiate organizational restructuring that will allow them to better compete in increasingly globalized markets.

The main objectives are summarized as follows:

- Improve the business environment
- Encourage industrial investments
- Upgrade industrial performance
- Enhance the Lebanese competitiveness in global markets
- Improve product quality in accordance with international technical and quality standards
- Promote foreign direct investment and partnerships
- Strengthen industrial management and internal structures
- Improve human resources training and technical skills
- Enhance the role of professional associations
- Strengthen ties with international and regional organizations

# 1. IMPROVE PRODUCTION PERFORMANCE

One major factor in the industrial crisis is directly linked to the rising operating costs in the sector. These rising costs are due to many factors. Some result from increases in direct operating costs: inputs -mainly imported-, salaries, energy, and other overheads. Others, indirectly result from the deterioration of the business environment: namely a constraining legal framework, an unfriendly fiscal system and (when available) prohibitive financing costs.

Heavy industrial investments were made during the past few years, but they were not often justified due to the insufficient business volumes. The investments have tended to decrease over the past few months. They must be encouraged today, by providing incentives in order to re-boost them.

### 1.1 Rationalize operating charges

The operating charges in the Lebanese industry are relatively high, especially that production volumes are weak and prevent the industries from achieving economies of scale.

Expenditures on inputs totaled USD 2.25 billion in 1998, for an output of USD 3.9 billion. Almost 81 % of inputs expenditures are on raw materials and 7.6 % for energy.

These charges were amplified by the general euphoria that accompanied the country's reconstruction plans and the promise of an imminent regional peace. This surge of optimism led to rapid expansions and over-investments in machinery and equipment.

Some of the charges could be reduced or controlled by more efficient resources management. The improvement of certain public services and the reduction of some tariffs may help alleviate these charges, but may not be sufficient to provide the Lebanese industry with any competitive advantage.

These high operating costs imply tight cost controls, efficient use of resources, creativity, innovation, and improved quality in products and services, in order to sustain a competitive advantage.

### Main problems

- Impact of real estate and rental charges.
- High cost of raw materials due to low volumes especially that most of them are imported.
- Lack of information about suppliers.
- High cost of machinery and equipment.
- Lack of economies of scale due to limited markets.
- High cost of electricity, fuel, and telephone.
- Non availability of water and non regularity of electricity supply.
- High cost of overheads (accounting, auditing, publicity, maintenance, transportation...)
- Costs of over-investment due to false economic euphoria.
- Concentration of industries in Beirut and its suburbs.

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Risks & limitations	impact							ts and	H	th	be ted for	Ğ,	ercanol ion.			
Risks &	<ul> <li>Negative on</li> <li>revenues</li> </ul>						• Higher	investments	charges for	although	could	by	consumption.			
r success	appropriate of items	progressive 1 of duties					power	•	roduction					of	network	tion of
Conditions fo	<ul> <li>An ap selection exempted ite</li> </ul>	• A progressivalleviation of duties					• Improved	distribution	e p	capacity			• Improved	ent	electricity netwo	<ul> <li>An acceleration</li> <li>EDL's privatization</li> </ul>
tions	linistries of Industry of Finance + ustoms authorities						Jo	and	Resources	•						
Institutions concerned	Ministries of Indust + of Finance Customs authorities						Ministry	<b>.</b>	Hydraulic							
mpact	t of inputs improved ess						utilization of	technological							gies	
Expected impact	Reduced cost of inputs and improved competitiveness						ıter 1		processes				Cost reduction     Environmental     Environmental     ■    ■    ■    ■    ■    ■    ■	v Environmental profection	¬ New technologies	
	81% of mainly	cost of raw materials not only include the cost of the materials	charges delayed	olume of	re levied		çp	or input		irregular	puterized	- 1	ery high	•		
Keasoms	materials = and are ted	of raw only inc	additiona] niums for	a higher v	s, tc.) that a	oliers.		.4%	ß	ts and	_	systems	ges are very		4	
	<ul> <li>Raw matinputs a imported</li> </ul>	<ul> <li>The cost of raw materials does not only include the actual cost of the materials</li> </ul>	but also additional charges (risk premiums for delayed	payment, a higher volume	charges, etc.) that are levied	by the suppliers.	• Electricity	represent 3	cypellallallal	<ul> <li>Power cuts</li> </ul>	voltage disrupt computerized	processing systems	<ul> <li>EUL charges</li> <li>compared to</li> </ul>	international	electricity	
8	es on raw de other reviewing duties,	and financial s well as the ums imposed	inputs.	-	_		constant	רוגרנוור					ons, and			
Measure	e charge als an by ns	transport and financial charges, as well as the risk premiums imposed	by suppliers on inputs.				Provide uninterrunted	lv.					connec	transformers.		
	Reduc materium inputs custon	tran char risk	oy s			-	• Provide	.vlaans				• Peduce	iddns	trans		

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Wisks &	• Eff	<ul> <li>Entrepreneurs         unaccustomed to         statistics and         public         information</li> <li>Inaccuracy of         data in Lebanon</li> </ul>
	<ul> <li>Urban and rural planning</li> <li>Implementation of the five-year plan regarding water and sewage networks (USD2.4 bln, thus 40% of total</li> </ul>	<ul> <li>Expansion of internet networks</li> <li>An information campaign for SMEs</li> </ul>
	Ministry of Electricity and Hydraulic Resources + Ministry of Environment + Ministry of Public Works + municipalities + CDR	Ministry of the Economy (Trade Information Center) + Chambers of Commerce and Industry + Business directories + Business consultants
	<ul> <li>⇔ Geographic extension and more balanced distribution of industries</li> <li>⇔ Healthier environment</li> </ul>	Supplies the cost of supplies through enhanced competition
	<ul> <li>Unavailability in all regions</li> <li>High risks of pollution</li> </ul>	<ul> <li>Lack of information on supplying sources</li> <li>High cost of supplies</li> </ul>
	• Provide water and sewage facilities.	• Upgrade information systems and create information centers to improve access to market information related to outsourcing and supplying operations (equipment, materials, services).

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Measures	Reasons	Expected impact	Institutions	Conditions for success	limitations
Develop and organize the existing industrial zones and create new ones.  Industrial units occupy 8 million sqm of land, of which 4.8 million are in industrial zones. 76% of the latter are located in Mount Lebanon.  Progressively, all of the industrial units should relocate to industrial zones.	<ul> <li>Insufficient industrial areas, especially in rural areas</li> <li>Very high costs of classified industrial land</li> <li>Some polluting industries in residential areas</li> </ul>	<ul> <li>⇒ Relocation of industries to rural areas where operating costs are lower</li> <li>⇒ Better environmental and urban planning</li> <li>⇒ Private management of the zones would limit the financial charges borne by the public sector</li> </ul>	MOI + municipalities + urban planning authorities + support of industrialized countries	<ul> <li>Proper zone management by the private sector</li> <li>The provision of incentives such as subsidized rental rates and utilities</li> <li>Coordination between administrations and government institutions</li> </ul>	<ul> <li>Coordination         between private         and public         sectors, and         among public         administrations         Reluctance of         industrialists to         relocate         Limited         relocation of         different services         Social         considerations</li> </ul>
Create incubators and business parks. These may be established in the periphery of port and airport areas and oriented towards regional markets	<ul> <li>High costs for SMEs</li> <li>Environment</li> <li>encouraging for innovation and introduction of new technologies</li> </ul>	<ul> <li>⇒ Synergies and costsharing</li> <li>⇒ Introduction of new technologies</li> <li>⇒ Higher export potential</li> </ul>	MOI + ALI +  municipalities +  technical support from international institutions and Governments (experiences in Italy +  H Brazil and Ireland)	<ul> <li>Incentives for joining such programs (for instance, fiscal incentives)</li> <li>Venture capital, local and foreign</li> </ul>	• A constraining business environment

Measures	Reasons	Expected impact	Institutions concerned	Conditions for success	Risks & limitations
• Implement management	• Entrepreneurs with good	□ Improved management	MOI + ALI +	Computerization of	• Reluctance of
programs focusing on	ds but	⇔ Capacity to introduce	Chambers of	enterprises	entrepreneurs
improving quality,	management capacities	innovative products	Commerce and	• Tightening links	
perfo	<ul> <li>Waste of resources</li> </ul>		Industry +	between academic	
and cost effectiveness.	• A changing business	business practices	Universities and	institutions and	
	environment		technical schools	professionals	
			+ professional		
			associations		

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# 1.2 Developing industrial financing systems

Whether trying to renew its industrial base or introduce new technology, the Lebanese industry always finds it hard to be adequately financed. The volume of finance is not the sole headache, but also the range and the variety of the sources. The challenge is, in fact, to optimize the cost, the strings attached or the duration for repayment of any prospective loan. On the other hand, lifting some legal barriers will be of a great deal of help towards a better financing.

With a total of USD 1.6 billion in 1998, loans to the industrial sector represent 12.6 % of commercial bank loans of which USD 75.8 million in subsidized loans and USD 96.6 million in loans exempted from reserves requirements. With an average interest rate of 12 %, the financial charges reached around USD 190 million.

# Main problems

- The non existence of specialized credit institutions providing medium and longterm loans.
- Predominance of commercial banks for formal financing.
- Banks provide revolving credits suitable only for working capital needs with high interest rates.
- Loans are provided through heavy guarantees and collateral requirements accompanied by a prohibitive list of documents to be submitted.
- Even loans from the IFC and other local, Arab and international programs (such as the governmental 5% interest subsidy, Arab trade finance program and EU programs) are brokered by commercial banks.
- Lack of communication between banks and small and medium sized industries for the following reasons:
  - Lack of transparency of the enterprises.
  - Geographic concentration of the banks branches in Beirut and Mount Lebanon.

- The over reliance by banks on real guarantees in their dealing with the prospective borrowers, partly for lack of trust and partly because of the shortages of the legal system.
- The high bank fees on small loans (2.5% for putting on and then lifting a mortgage, costs to obtain official documents, etc...).
- The dollarization of the economy and lending in particular.
- Lack of long term savings culture.
- Delays in collections and high rate of unpaid receivables.
- Undeveloped factoring and discounting system.
- Lack of commercial credit insurance.
- Undeveloped leasing programs. This service is still in its early stage and is unlikely to benefit other than big institutions.
- The recent creation of Kafalat which is a company devoted to guaranteeing loans to small and medium sized businesses (max L.L. 100 million per applicant) is promising but still in very early stages.

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<ul> <li>Simp</li> </ul>			•	,		
	Simplifying credit	<ul> <li>High mortgage charges (2.5-</li> </ul>	sut	BDL + MOI + 1		
proc	procedures and reducing	3%)	commercial banks	Ministry of Justice		
their	their costs	Complicated administrative	made more accessible			
		procedures	for SMEs			
• Mair	Maintain interest	<ul> <li>Prohibitive interest rates due</li> </ul>	Greater access to credit	BDL + MOI +	<ul> <li>Tight control from</li> </ul>	
sqns	for a	to public debt (ranked in the	for SMEs	Ministry of Finance	ks (	ξ
period	od of time and	survey as the most important	⇔ Encourage developing		the allocation of	sector
prog	ssively reduce	problem encountered by	industries and		subsidized resources	finance such
sqns	subsidy rate.	industries, 4.16 over a	entrepreneurship			programs
		of	⇔ Greater     price			<ul> <li>"Addiction" to</li> </ul>
• Exte	Extend the effect of the	• International organizations	competitiveness in the			subsidies
central	ral bank circulars	Ħ	market			
exer	exempting industrial	interest subsidies for long				
loans	s from the	periods of time				
man	mandatory reserves and					
the	governmental 5%					
interest	rest subsidy					
prog	program.					
• Reg	Regulate the problems	According to the survey,		Ministry of Justice +	• Rapid and low-cost	
relai	related to the collection	receivables represent 15% of	risks	commercial and	legal procedures	
oţ	receivables and	sales (around USD600		settlement courts +	• Encourage	
enfc	enforce legal actions.	million)	imply increased sales	Government and	settlement	
		• Abuse of customers	Greater liquidity	Parliament +	brocedures	
		concerning payment periods		Chambers of		
		<ul> <li>Costly and timely procedures</li> </ul>		Commerce		
		in court				

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Measures	Reasons	Expected impact	Institutions concerned	Conditions for success	Figure 6
Help to develop factoring, discounting and systems, commercial credit insurance.	<ul> <li>Collecting receivables results in additional charges</li> <li>Receivables often reach huge proportions in the balance sheets, especially in times of economic slowdown</li> </ul>	<ul> <li>⇒ More efficient management of working capital</li> <li>⇒ Lower market risk and greater liquidity</li> <li>⇒ Easier access to bank credits</li> </ul>	Insurance companies + banks + Ministry of Justice + commercial and settlement courts + Government + Parliament + Chambers of Commerce	<ul> <li>Competitive factoring services</li> <li>Adequate regulations by BDL</li> </ul>	Deficient knowledge of entrepreneurs concerning modern financing techniques
Offer tax incentives to encourage loans from shareholders	Not accepted by tax controllers	<ul> <li>⇒ Promote and develop self-financing in the industrial sector</li> <li>⇒ Increase liquidity</li> </ul>	Ministry of Finance + professional associations + Chambers of Commerce and Industry	zation of regulations	
• Continue efforts towards decreasing interest rates on the	Very high interest rates	charges on companies companies	BDL + ABL + Ministry of Finance	contract serest al mark	Monetary     policy and     stability of the     exchange rate
• Take advantage of the existing Arab and international programs that secure medium and long term financing to small and medium sized industries	• Limited access to foreign financing because of lack of information and limited ability of enterprises to manage external sources of funding.	<ul> <li>⇒ Diversification of financing sources</li> <li>⇒ Access to foreign markets</li> </ul>	Professional associations + Chambers of Commerce + Insurance companies + Regional and international financing institutions + Banks + Lebanese Export Development Council (if set up).	<ul> <li>Continuous and extensive collaboration to increase access to new sources of funding</li> <li>Dissemination on the advantages of such financing</li> </ul>	<ul> <li>Operational costs for banks</li> <li>SMEs might not benefit substantially from these funds</li> </ul>

Measures	Reasons	Expected impact	Institutions	Conditions for success	Risks & limitations
• Create a special fund for industrial micro-credit especially in rural areas.	<ul> <li>Insufficient collateral limits access to credit for small companies</li> <li>Banks unwilling to deal with small customers</li> </ul>	<ul> <li>⇒ Improved management and performance of the small companies</li> <li>⇒ Rural development</li> </ul>	BDL + ABL +  professional associations + Banks + International organizations such as the World Bank and the EU + NGOs	<ul> <li>Adaptation of laws and regulations pertaining to small companies</li> <li>Reduce charges related to credit procedures and documents</li> </ul>	• Low rate of "bankarization" especially in rural areas and for small companies
• Legislate for the creation of specialized credit institutions, particularly an industrial bank	• Industrial lending is not always be within the scope of commercial banks	<ul> <li>⇒ Specialized and adapted financing for industries</li> <li>⇒ Focus on industrial needs</li> </ul>	BDL + Banks + ABL + Government + MOI	<ul> <li>Improving industrial credit management</li> </ul>	• Lack of long- term resources
• Enforce laws to accelerate the execution of mortgage liens in case of default.	• Mortgages are insufficient guarantees	<ul><li>⇔ Greater security for lenders and suppliers</li><li>⇒ Improve liquidity</li></ul>	Ministry of Justice  + Commercial  courts  +Government +  Parliament	Simplified legal procedures and rapid court decisions	• Social and political obstacles
<ul> <li>Create new financial instruments and authorize banks to discount commercial papers (discounting invoices).</li> </ul>	Insufficient liquidity	<ul> <li>⇒ Stability and rationalization of commercial papers</li> <li>⇒ Greater liquidity and sales</li> </ul>	Ministry of Justice + BDL + Government + Parliament + Banks	• Efficient courts and settlement systems	<ul> <li>Risk of abuse and fictive operations</li> <li>Insufficient ransparency of companies</li> </ul>

Reses &	• •	id • Resources for the program of
Conditions for success	<ul> <li>Set up a National Institution for the Guarantee of Exports</li> <li>Improve commercial information</li> </ul>	<ul> <li>Monitoring to avoid abuse</li> <li>Good management to avoid waste of resources</li> </ul>
Institutions	BDL + Government + Parliament + Banks + ALI + Regional and international financial institutions	Government + ALI     + the suggested     National     Institution for the     Guarantee of     Exports
Expected impact	⇒ Encourage exports ⇒ Reduce financing of export operations	<ul> <li>⇒ Extension of exporting opportunities to new markets</li> <li>⇒ Limiting the costs of prospecting new markets for the exporter</li> </ul>
	No institutions for export financing	Very high costs of prospecting for small companies
Measures	Prepare a special financing program for the exporting industries with extra facilities from the banking sector (regarding guarantees, fees and interest rates).	Create a financing       Institution to support prospecting new comarkets.

### 1.3 Promoting industrial investment

Despite an increase in industrial investments in 1998 (USD 373 million) compared with 1994 (USD 192 million) levels, these investments have somehow slowed down during the past 3 years. Already in 1998, the annual investments were less than the depreciation expenses (USD 423 million).

The euphoric growth period induced by the launching of the ambitious reconstruction program between 1993 and 1996 brought about heavy industrial investments. With the economic situation turnaround, the Lebanese industry has to carry overcapacities of production in many sectors, especially in the construction branches.

On the other hand, in some other industries, the equipment and machinery were not renewed and consequently the technologies used do not respond anymore to the current market demands.

The rapid changes in the production processes require increasingly heavy investments. The small size of the enterprises, their family character, and the absence of adequate financing channels have limited their investment potential. Added to that, the lack of industrial buildings and mostly industrial land available for rent, the industrialists are forced to invest heavily in such expensive assets which represent about 25% of the total assets in the sector.

The foreign direct investments have increased during the past few years in Lebanon, but they remain relatively weak compared with the actual potential of the industrial sector. The external investments are desired not only for the cash flows that they introduce but most importantly for the business opportunities that they open up and the new technology flows that they bring along.

Lebanon must create the right business environment to encourage foreign direct participation in the industry.

### Main problems

- High level of self-financing.
- Limited availability of long-term loans and leasing.
- Lack of availability of land for rent.
- High cost of building rentals.
- Heavy load of building and land outright investment due to lack of land rentals and high cost of building rentals.
- Lack of institutional investment due to absence of transparency and family-oriented businesses.
- Weak industrial culture due to short-term minded investors.
- Slow activities of the Beirut Stock Exchange. Only 4 industrial groups are listed on the B.S.E. Insufficient by any standard.
- Lack of a clear and well-defined legal framework for the B.S.E.
- Weak stock market culture.
- Increasing opportunity costs due to high level of T-bills returns.

Haritations	• Lack of public resources	<ul> <li>Absence of a leasing culture</li> <li>Lack of long-term resources</li> </ul>	<ul> <li>Under-developed financial markets</li> <li>Constraining regulations</li> </ul>
Conditions for success	<ul> <li>Dissemination of information on these programs</li> <li>Workshops to train SME entrepreneurs</li> </ul>	<ul> <li>Competitive rates</li> <li>Simplified</li> <li>procedures</li> </ul>	<ul> <li>Improved</li> <li>transparency</li> <li>companies</li> <li>Willingness to open capital to external investors</li> </ul>
Institutions	EU + Kafalat + BDL + Banks + ABL + Ministry of Finance	BDL + Banks + Leasing companies + legislation authorities	Banks + BDL + legislation authorities + ALI associations + consultants
	<ul> <li>⇒ Development of new businesses</li> <li>⇒ Better guarantees</li> </ul>	<ul> <li>⇒ Encouraging         investment         ⇒ Rationalization         of         investment decisions to         avoid overcapacity</li> </ul>	<ul> <li>⇒ Diversification of the industry</li> <li>⇒ New and relatively high-yield industries</li> <li>⇒ Boosting entrepreneurship</li> </ul>
	<ul> <li>Insufficient guarantees and collateral for SMEs to access credit</li> <li>High cost of banking credit</li> </ul>	<ul> <li>High share of self-financed assets (land, equipment, buildings). Total assets:         USD3.8 billion; Bank credits including credits for operating: USD1.6 billion; hence over 70% of self-financed assets.</li> </ul>	<ul> <li>Innovative and performing investment is based on risk-taking</li> <li>Venture capital is practically non-existent</li> </ul>
Measures	Reinforce the role of Kafalat as well as European Union programs aiming to develop small industrial	• Encourage leasing programs	Encourage venture capital funds and authorize commercial banks to take part in such activities

# Promoting industrial investment - Short-term measures

Measures	Reasons	Expected impact	Institutions concerned	Conditions for success	Risks & limitations	
Encourage joint ventures	• Weak capitalization of	□ Intensification of	EU + World Bank	An encouraging legal	• Insufficient	
with foreign companies	iies	ransfer	+ IFC + BDL +	framework	opportunities	
+ multinational companies).	Limited growth potential	opportunities	Dalins legislation	• An attractive	• Social and	
Accelerate			authorities + professional	business environment	political instability	· •
implementation of MEDA		management	associations	• Adhere to the	•	
				agreement		
Reinforce IFC programs + Arab lending and participation in industrial projects.						