

Market insight

Coffee shops in malls in Lebanon: main victims of the smoking ban

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hodema conducted in August 2013 a market study to evaluate the impact of the smoking ban law in the Food & Beverage industry one year after its implementation, with a focus on coffee shops in malls' indoor locations which appear to be the main victims. The study is based on hodema's knowledge of the hospitality market and an analysis of a panel of 6 coffee shop chains in Lebanon among which 4 are international brands and 2 are Lebanese grown chains. All findings are based on hodema's own field research and data gathered from the panel. In this document, we consider "coffee shops" as an outlet generating most of its revenue from coffee based beverages with a limited food offer and a small preparation area unlike "café-restaurants" which have a broad food menu and a larger preparation area.

General context

On August 17th, 2011, the smoking ban, also called Law 174, was passed by the Lebanese Parliament. It dictates that "smoking, lighting a tobacco product or using such a product is prohibited in all enclosed public places, workplaces and means of public transportation." This includes restaurants, coffee shops, bars, nightclubs, and any other tourism or entertainment place. After months of tensions between F&B owners and the Lebanese authorities, the law took effect one year later and the ban was implemented all over the country, on September 3rd, 2012. With this measure, Lebanon follows the steps of neighboring countries such as Jordan, Syria and the Emirates. But unlike most countries where the smoking ban was implemented gradually, Lebanon decided to pass it all at once.

In a country where the cigarette consumption is three times higher than the world average¹ (about 38% of the adult population smokes regularly², and many more enjoy a shisha occasionally), the Syndicate of owners of restaurants, cafes, nightclubs and pastries took the protest against the ban to the street. The movement is striving for "a balanced law that takes into consideration all the [Lebanese] factors, the tourism industry and the economy's need, and is comparable to related laws in several progressive countries"³.

In this challenging context, the owners and managers in the Food and Beverage (F&B) industry, and most specifically the operators of coffee shops located in malls, are facing growing challenges to abide by the law. They are the most affected by the ban, and have seen their sales drop drastically in one year following the law's implementation.

The smoking ban highlights in the F&B industry

Law 174 requires that F&B businesses set up an "outdoor smoking area", at least 5 meters away from the entrance. If covered by a ceiling, this area should feature at least two open facades. Outlets that feature solely an indoor area should be completely non-smoking. F&B owners and managers are responsible for making sure that customers and employees abide by the law, otherwise they can be fined from LBP 1,350,000 to 4,050,000⁴. As for the clients, if they are caught smoking indoors, they have to pay a fine of LBP 135,000⁴ which represents one fifth of the minimum wage.

¹ ERC British consulting group, study published in Le Commerce du Levant issue 5643, Aug 2013

² World Health Organization

³ Extract from an article published in Hospitality News, Issue 89, Aug-Sept 2013

⁴ Tobacco Control official website

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Coffee shops: a large market share in Lebanon's malls

Coffee culture has always been part of the Lebanese roots and the social life often revolves around a cup of coffee, hence the wide expansion of coffee shops all over the country. They gather both male and female clientele who drink their coffee while smoking shisha or cigarettes and playing cards or backgammon. Along with the countless small local and traditional cafés, there are about 20 coffee shop chains spread all over the country with around 15 international franchises and 130 outlets.

Coffee shops, usually located in busy shopping and business neighborhoods, have widely developed in the last few years in commercial centers. The latter have recorded an ongoing growth in the country since 2003 and are favored by coffee shops since they guarantee a minimum customer base, and attract a broad clientele throughout the day including Sundays. Coffee shops became a service complementing the customers' mall experience since they offer the option of resting and eating casually while shopping. Some cafés have gradually become destinations on their own, attracting people who primarily come to eat or chill even before hitting the shops. This explains the large share the coffee shops hold in malls representing an average of 25% of their total F&B supply while 12% are café-restaurants that have an extensive coffee offer.

Fig.1; Major coffee shop chains in Lebanon in 2013

	# of outlets	Concept origin
Brioche Dorée	2	International
Café Younes	5	Homegrown
Cappuccino	3	International
Caribou Coffee	4	International
The Coffee Bean & Tea Leaf	3	International
Colombiano Coffee House	2	International
Costa Coffee	3	International
Dunkin' Donuts	24	International
Espression Lavazza	2	International
Gloria Jean's Coffees	4	International
Krispy Kreme	6	International
La Mie Dorée	3	Homegrown
Lina's	13	International
La Maison du Café	5	Homegrown
McCafé	13	International
Moka & More	7	Homegrown
Paparotti	2	International
Paul	6	International
Second Cup	5	International
Starbucks	18	International
Grid	2	Homegrown
Total	130	

Fig.2; F&B categories breakdown in the seven major malls of Greater Beirut in 2013

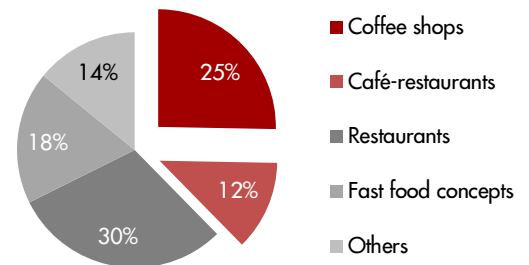
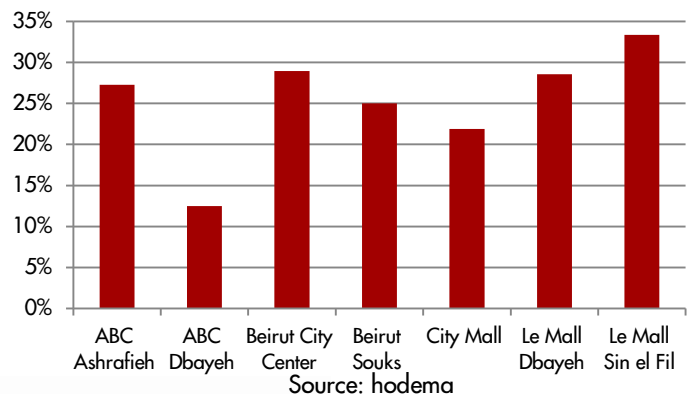


Fig.3; Percentage of coffee shops inside each major mall of Greater Beirut in 2013



Source: hodema

Negative impact of Law 174 on coffee shops in malls

However, since the implementation of the smoking ban, there is a downside of being located inside a mall for a coffee shop. Most commercial centers in Lebanon are closed structures, except for Beirut Souks and some areas in ABC Ashrafieh, and do not benefit from outdoor smoking areas. This makes it difficult for coffee shops to respect the ban especially that they have limited internal design options at hand to adapt their outlets to the legal requirements. Apart from this structural problem, coffee shops in malls are under heavy pressure by the mall managers themselves who are strictly applying the law while outlets outside malls, particularly in areas and regions where the state lacks authority, are enjoying more flexibility and attracting the smokers.

Drop of sales

One year on, the negative consequences of Law 174 on coffee shops located in malls are noticeable. They aroused as an addition to the negative effect of the political instability that had hit the entire F&B industry and to which most professionals had started adjusting.

Since coffee is often associated with smoking, the ban led to a decrease of coffee sales that reached up to 50%¹ in some outlets. This drop was drastic given that their revenue streams rely mainly on

coffee consumption throughout the day (rather than on lunch or dinner services – the latter being limited by the mall's closing hours). As a result of the coffee drop, overall food orders also decreased since most customers order food or a dessert with their coffee.

According to Christine Sfeir, owner of Dunkin Donuts franchise in Lebanon, "the decline was felt overnight with a drop of sales of 30% compared to the day preceding the ban".

Indeed, the average sales per seat of coffee shops inside malls have witnessed a cut by half from an average of LBP 37,500 to 18,000¹ (Fig.4) while the same brand located outdoors or benefiting from a terrace has seen a drop from an average of LBP 29,000 to 24,000¹ (Fig.5).

Fig.4; Average sale per seat before and after the ban in outlets inside malls in 2013 (in '000 of LBP)

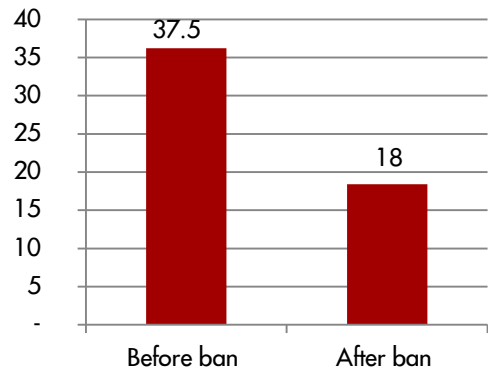
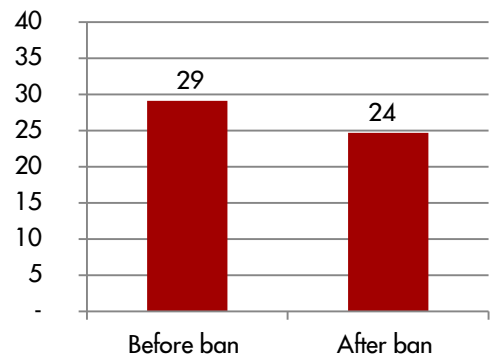


Fig.5; Average sale per seat before and after the ban in outlets outside malls in 2013 (in '000 of LBP)



Source: Studied panel actual figures; compiled by hodema

¹Studied panel actual figures; compiled by hodema

In terms of percentage, the sales of coffee shops in the studied panel located inside the malls have dropped by 25% to 50%¹, whereas the same brand, located in an outdoor area, recorded a decrease of only 15%¹.

This shows clearly that before the smoking ban implementation, coffee shops inside malls were recording higher sales per seat than those located outdoors. Their competitive advantage has weakened.

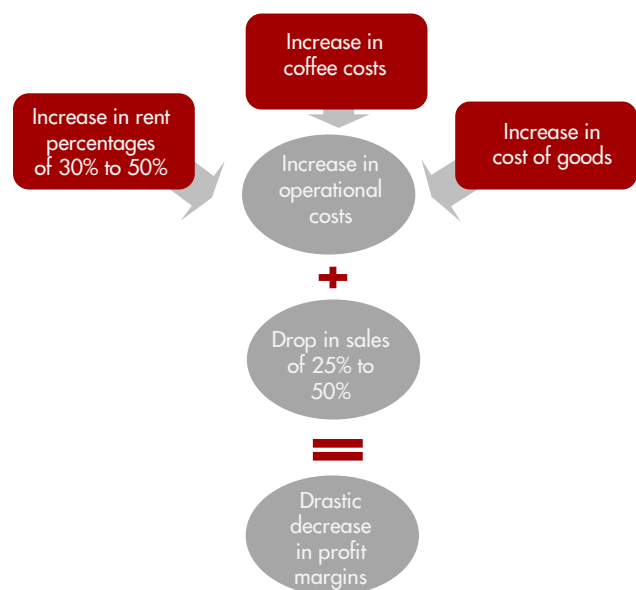
It is worth observing that coffee shops in malls that benefit from a terrace have gained a competitive advantage over those lacking outdoor space; they increased their sales in the last year.

Increase in the operational costs

The second major consequence of the smoking ban on the activity of coffee shops in malls is the increase in costs. Like other F&B establishments, "coffee shops tenants have to face high fixed costs, thus any external negative factor affects directly their performances", says Lina Letayf, owner of La Mie Dorée sal which includes Paul and La Mie Dorée brands.

- **Rent increase from 30% up to 50%¹ in some cases** as a percentage of sale, due to the decrease in sale versus fixed rental fees: "Some in-mall outlets have even seen their rent go from 13% to 55% of sales after the ban implementation, thus shifting from a profitable business to a losing one" says Sami Hochar owner of Lina's. **Based on industry standards, rent should not exceed 20% of sales.**
- **Increase in their coffee costs:** since coffee sales have dropped and foot traffic slowed down, brands are buying smaller quantities of coffee and are no longer benefiting from advantageous rates from their suppliers.
- **Increase of the overall cost of goods:** food sales rose to the detriment of beverages causing an increase in overall costs since, traditionally, food costs are higher than beverage'. Indeed, the food to beverage ratio went from 30%/70% to 35%/65%¹ in some cases since the smoking ban implementation. Hence the addition of food items in the coffee shops menus.

Fig.6; Impact of law 174 on coffee shops in malls in 2013



Source: Studied panel; compiled by hodema

All the above factors drove the decline of profit margins in indoor coffee shops which are forced to reconsider their initial concepts and business models in order to survive.

¹Studied panel actual figures; compiled by hodema

A mandatory shift for the coffee shop concepts?

Today, in the light of the current challenging context, owners of coffee shops in malls are reinventing their concepts as an attempt to face the obstacles of the smoking ban and keep up with the competition. Some, such as Brioche Dorée, are adding food items on their menus others such as Paul are planning to focus on their take-away service which sales recorded a lower drop than the dine-in, and enables the clients to enjoy food and beverage without the constraint of the smoking ban imposed in the outlet. Finally, some brands are questioning whether to open in malls or not in the future: "We could consider renting smaller spaces in malls dedicated to take-away", says Massaad Fares, owner of La Maison du Café while others such as Sami Hochar, owner of Lina's "will only open outlets in malls' outdoor locations, or will reconsider changing the business model of outlets in malls by opening kiosks rather than full-fledged coffee shops".

In the case of franchised coffee shop brands, this shift to adapt to the local context and legislation is often leading to conflicting strategies between the Lebanese franchisees and their international parent brand. This may go to the point of closing an outlet.

Uncertain future for coffee shops inside malls

Based on the following main factors tackled in this study, one can question the viability of the coffee shop model in indoor malls altogether:

- Lebanon records one of the highest cigarettes consumption in the world; hence smokers represent an extensive target segment in the F&B industry
- Smoking ban is applied more strictly in Beirut malls than in other areas
- Smoking ban led to a drastic drop of coffee sales, coffee being often associated with smoking
- Coffee shops are highly reliant on coffee sales since their revenue streams are limited
- Drop in coffee sales led to a decrease in coffee order, hence an increase in coffee costs
- In some cases, coffee shops rents in malls reached up to 50% of sales, versus a maximum of 20% in industry standards
- Coffee shops in indoor malls are losing their competitive advantage over outlets located outdoors

In a short to mid-term timeframe, the smoking ban obstacles faced by coffee shops in malls will lead to the closing of many of them, especially the ones lacking outdoor spaces. These failures can have a reciprocal impact on malls who count on coffee shops as one of their main F&B categories.

ABOUT THE AUTHORS



Youmna Maatouk, Consultant

Youmna Maatouk joined hodema in January 2009 as a consultant. Based in Beirut, she led Lebanon office team from November 2009 to July 2012. She previously worked at KPMG Advisory Division in Dubai whereby she conducted feasibility studies for real estate mixed-use development in Dubai and Abu Dhabi. She brings seven years of operational and consulting experience in the real estate, hotel and tourism industries, an extensive knowledge of the real estate industry in UAE and the Food & Beverage operation – procedures and work flow. Youmna holds an MBA in International Hospitality & Business Management from IMHI-ESSEC Business School in France where she was President of IMHI-ESSEC "Traiteur Association" and managed a team of 20 people. Today, she is a consultant at hodema.



Lina Raphaël, Senior consultant

Lina Raphaël joined hodema in 2008 as senior communication consultant after a fourteen years-experience handling communication projects for clients in France, the Middle East, United Kingdom and United States. She worked with large corporate groups such as Club Méditerranée and DHL, as well as public organizations among which New York's Metropolitan Museum of Art as Junior communication executive. She handled the communication of several projects financed by the European Union in Lebanon, for which she produced newsletters, brochures, websites and promotional material. She has a hands-on knowledge of communication dissemination targeting general public and niche audiences. Her involvement was in setting up hodema communication department and achieving visibility targets in international fairs and media, and the elaboration of the F&B reports and articles published by hodema. Since early 2011, she is in charge of the quality control whereby she reviews and monitors documents released by the company. She is a contributing writer for the monthly Lebanese magazine Le Commerce du Levant.

ABOUT HODEMA

hodema is a Lebanese consulting company specialized in the hospitality, retail and real estate sectors with offices in Lebanon and Saudi Arabia. hodema's services cover franchising counseling, concept development, property management, commercialization and marketing support, strategic consulting, operational support, training programs, market and feasibility studies, and quality control for small to large-scale ventures in the MENA region. hodema's clients are restaurants and F&B groups, hotels, spas, caterers, real estate and mall developers and operators, leisure centers, property owners, investment groups, and banks. hodema publishes articles on a regular basis in various specialized hospitality and economic magazines in the Middle East, in addition to a newsletter, professional guides, books and annual reports on the Food & Beverage market.

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