

Assessment of industry risk is an essential part of credit rating process. The industry risk assessment sets the ceiling for ratings of individual entities within a given industry. It focuses on the degree of cyclicity and the strength of competitive forces along with the extent of capital intensity, vulnerability to technological change, level of regulatory interference and energy sensitivity. All these factors are assessed on a scale ranging from High to Low to assign an overall risk level to each industry. Industry risk categorization for different industries is available on our website under Sector Updates “Industry Risk Analysis” (<https://docs.vis.com.pk/docs/Industryrisk062021.pdf>).

This document explains VIS approach to assess industry risk of Vanaspati and Allied Sector of Pakistan.

Vanaspati Industry in Pakistan

Pakistan is the 8th largest consumer of edible oil (22kg per capita) in the world. Pakistan has a sizable edible oil market showing a strong growth over the years with an increasing demand over the years. The local edible oil demand is met through both crushing of oil seeds and import of cooking oil. Due to high dependence on import, this sector is exposed to exchange rate and supply chain risks. In terms of demand of oil seeds, Pakistan meets cottonseed demand through local production only. The soybean seed is imported only and rapeseed and sunflower seed are both imported and produced locally. In oil, refined palm oil accounts for 98% of Pakistan’s total edible oil imports (4th largest importer globally). Pakistan has healthy demand of Vanaspati Industry products being an essential food item.

OVERALL INDUSTRY RISK

High
High to Medium
Medium
Medium to Low
Low

Economic uncertainty, poor infrastructure, high dependence on imports, high fragmentation and low local value addition all pose serious challenges to this industry. However, being an essential food item, with ever growing population (and therefore demand), vast distribution and local plantation potential there are good opportunities for this industry to overcome the challenges.

Segments in Vanaspati Industry

The industry is categorized into two segments. One is the organized sector with sizeable participants having active advertising campaigns and strong brand equity enabling it to have exposure to the national market. Organized sector has 200 registered oil and ghee manufacturing companies. This group targets middle and high income group. The other segment is larger than the former. This segment is fragmented, focusing on regional areas and middle to low income groups.

Cyclicity Risk

The overall competition risk factor is analyzed through 3 different sub-factors. These are effectiveness of barriers to entry, risk of substitution and risk in growth trends.

Competitive Risk

Barriers to Entry Risk

There is low barriers to entry in this industry mainly due to lower product differentiation and low technical requirement. However, intense competition and fragmentation in Vanaspati industry are the most crucial barriers of entry. The level of competition is high as the competition is not only within the segments (organized and unorganized) but also across segments. Organized sector faces tough competition from informal sector. Within the organized sector the high competition is evident from the fact that leading brands have a market share less than 10%. Moreover, players have limited pricing power and lower margins.

Access to Capital

Access to capital is relatively easy and depends on the size of the seed crushing/solvent extraction, refining, manufacturing, and packaging unit to be established. LCs are widely used while establishing a solvent unit. Also, companies requiring capital for establishing plants fall under the consumer category (FMCG’s) are cash-rich; so financing needs are minimal. Access to capital for working capital requirements is also easy.

Due to low barriers to entry and easy access to capital, the risk of ease of entry of new participant is high.

Risk of Substitution

Risk of substitution can be assessed in two ways: product in itself; and product categories. As for the products, there is no close substitution for edible oil and ghee. On the other hand, product categories can be divided into the following:

- Palm oil and ghee – Cheapest alternatives and consumed by masses (Low risk)
- Sunflower oil, soya bean oil, and canola oil – Slightly expensive alternatives and consumed by primarily the middle class and upper middle class (Low risk)
- Corn oil, coconut oil, and olive oil (Medium risk) – Expensive alternatives consumed by primarily the upper middle class and the upper class.

Having low risk of substitution for the products and low to medium risk of substitution for product categories – an overall low risk of substitution is assessed for this industry.

Growth Trends

The demand dynamics for the products of this industry remain favorable due to growing population, increased health and hygiene awareness, growing urbanization, and increasing per capita consumption. Furthermore, eating habits of majority of the Pakistanis comprises of oil-rich food depicting healthy demand. The edible oil industry of Pakistan is growing at a Compound Annual Growth Rate (CAGR) of 8% at constant 2020 prices (time period: 2006-2020).

Owing to the fact that Vanaspati Industry has high risk of new entry, low substitution risk and low risk in growth trends therefore a high to medium risk is assessed for competition factor.

Capitalization Levels and Technology Risk

Many players tend to import cooking oil and sell it after further processing, storing, and packaging. So, the capital requirement is considered to be low (Pakistan imports 90% of edible oil to meet national demand). However, capital is intensive for players who establish their own seed crushing/solvent extraction, refining, and manufacturing plant. Medium sized players were mostly involved in the packaging and trading business in the last decade. However, they have established their own plants during this decade.

Since the level of capital requirement varies according to players' activity within the industry while generally remaining low for most, a medium risk is assessed for this factor.

The Vanaspati Industry has largely been depending on crushing processes, with minimum involvement and room for innovation in the technology. This industry have low risk for this factor as it has same processes for seed crushing/solvent extraction, and processing as used earlier. Other than that, minimal innovation, R&D, and patents are involved.

Regulatory Practices

Regulations tend to change regularly thus impacting business models. In order to promote the industry and facilitate import of oilseed, the government has reduced the tariffs. Custom duty and additional import duty have been imposed on refined palm kernel oil, vegetable oil and fats. The government then increased duties and taxes by more than 100% between 2018 and the end of 2021.

Due to high import stage taxation and sensitivity of business model on changing regulation a high to medium risk is assessed for this factor.

Energy Consumption

Compared to other industries, this industry doesn't have high energy requirements. Fuel and Power costs constitute less than 5% of the total cost of sales. Energy is available through WAPDA but it is costly and involves issues like frequent load shedding so players prefer to use their own captive power plants which run on coal or bagasse (alternate resources of energy are readily available). Since this industry doesn't have high energy requirements a low risk is assessed for energy sensitivity factor.

In view of all the risk parameters discussed above, overall industry risk for the Vanaspati and Allied sector is 'Medium'

Table 1: Summary of Industry Risk Factors

VANASPATI AND ALLIED SECTOR									
Cyclicality	Competition				Capital Intensity	Technology Risk	Regulatory Framework	Energy Sensitivity	OVERALL RISK
	Risk of Effectiveness of barrier to entry	Risk of Substitutes	Risk in Growth Trends	Overall					
Medium	High	Low	Low	High to Medium	Medium	Low	High to Medium	Low	Medium

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