

A fruitful investment opportunity

Express Hospitality presents excerpts from 'Processed Food and Agribusiness in India: Opportunities for Investment', a knowledge paper presented by FICCI and KPMG

The shape of the global food industry is constantly changing and evolving, thereby reinforcing the key themes of health, convenience and value. The global processed food industry is estimated to be valued at approximately EUR 2.5 trillion, and accounts for three-fourth of the global food sales. Despite the large size of the industry, only six per cent of processed foods are traded across borders, as compared to 16 per cent of major bulk agricultural commodities. The US, EU and Japan together account for over 60 per cent of total retail processed food sales in the world.

Trade liberalisation policies through multi-lateral and regional trade agreements have led to a rapid growth in this field. In the Asian region, Japan is the largest food processing market; however India as well as China are likely to grow at a faster rate. The processed food industry is strong in Japan and South Korea, as they are the leading meat importing countries in the world and consumption of meat is high in these countries. The Australian processed food industry is one of the most technically advanced in the world as it produces products of international standards at comparatively lower prices. The US continues to live up to its reputation as the 'breadbasket to the world'. More than one-third of US Food and Beverage (F&B) manufacturers look to foreign expansion to capture additional revenues. Countries in the Sub-Sahara African region, Latin America and parts of Asia which continue to be on the lower-end of technology prowess in food items are inclined to their staple diets, whereas those in Europe, North America, and Japan are on the higher-end of technology, with a sharper shift towards convenience and diet foods.

According to the AC Nielson 'What's Hot Around the Globe' F&B 2006 report, the growth in global F&B categories was recorded at four per cent. Many of the large global players primarily from developed countries are now targeting developing countries in the quest for new opportunities. Developing countries across the globe are now set to account for most of the growth in future food demand. At the same time, newer, emerging markets are showing signs of building infrastructure to modernise their food distribution channels.

Changes in income patterns, demographics, and lifestyles have led to changing eating habits, where consumers have begun purchasing fewer staples and more high valued food items.

According to the AC Nielson "What's Hot Around the Globe in F&B 2006" Survey, 12 product categories showed growth rates of or above the overall average for F&B, including baby food as the fastest growing product area and non-alcoholic beverages as the one contributing the largest value growth amount.

Global trends in food choices across various regions

These trends have created immense opportunities for both manufacturers and retailers. There is a definitive need to acknowledge and address the consumer's requirement for healthy and convenient products. Since consumers are willing to purchase both private labels and branded products, global food markets have become all the more competitive and are looking at expansion beyond their own local boundaries.

Indian processed food industry

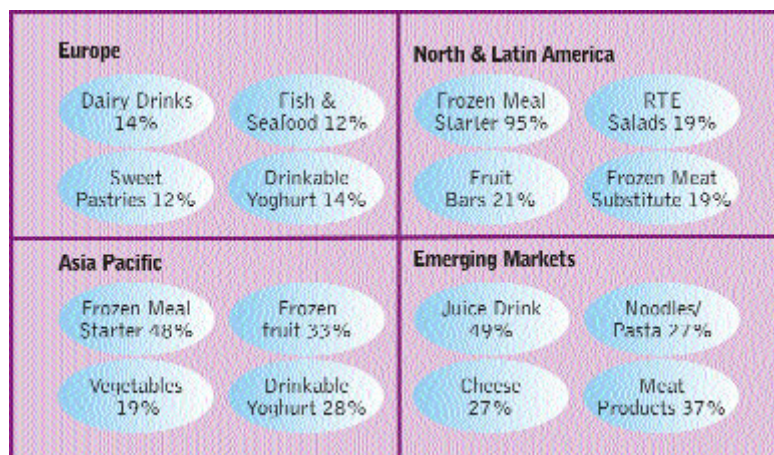
India's agricultural sector, especially with regard to food processing and allied activities is going through a major transformation driven by improving policy environment, increasing

public-private participation and an increasing thrust on the improvement of rural infrastructure. The government is targeting four percent growth for the agri-sector from 2005-2020.

The revival of the agriculture sector is expected to open up a plethora of opportunities for players having strong linkages in the agri value chain. The FPI is expected to be one of the biggest beneficiaries of this entire process. Significant investment opportunities are yet to be tapped in the areas of supply chain management, cold storages, financing, retailing and exports. Historically, the agricultural sector and FPI have been plagued by factors such as low public investment, poor infrastructure, inadequate credit availability and high levels of fragmentation. However, in the last couple of years there have been significant improvements on almost all the fronts.

The regulatory environment is changing for the better. Though the agri sector in India is one of the highly regulated sectors, the government has been taking selective steps to liberalise and create an encouraging investment climate. The Agricultural Produce Marketing Committee (APMC) Act that deals with the functioning of agri-marketing activities within each state is being amended by various states in order to allow greater private participation and help end users source raw materials or farm produce directly from the farmers. This will not only infuse more efficiency in the system but will also allow increased participation from corporates for contract farming and direct sourcing.

In order to achieve this four percent plus growth in the agri-sector, the government has been increasing investments in the areas of irrigation, storage and post-harvest infrastructure and connectivity. Private participation is increasing across the various segments of the agri-value chain. Corporates are increasingly focusing on areas of contract farming, raw material sourcing and creating agri-linkages. Companies like HLL, ITC, and Pepsi have taken the lead in terms of contract farming initiatives. Contract farming by corporates would not only yield better prices to farmers but also help them access superior farming techniques, better management and risk mitigation methods.



Food processing

According to industry estimates, the processed food market accounts for 32 percent (EUR 21.8 billion) of the total food market which is valued at EUR 67.9 billion. India is the world's second largest producer of food next to China, but accounts for only 1.6 per cent of international food trade. The government aims at increasing this share to three per cent in the next eight years; this indicates vast potential for both investors and exporters.

Though the Food Processing Industry (FPI) has been growing at an average rate of seven per cent, it has the potential to achieve a double digit growth. Fruit and Vegetable (F&V) processing, which is currently amounts to two percent of total production is likely to increase to 10 percent by 2010 and further to 25 per cent by 2025. Value-additions in food products are expected to increase from the current eight per cent to 35 per cent by the end of 2025. Total exports of the FPI have jumped from EUR 4.7 billion in 2002-03, to EUR 13.8 billion in 2006-07. The industry ranks fifth in size in the country, representing over six per cent of GDP. It accounts for around 13 percent of the country's exports, six per cent of total industrial investment, and approximately 12-15 per cent of manufacturing GDP.

With only 2.2 per cent of processing levels for F&V, 35 percent for milk, 21 per cent for meat, six per cent for poultry products and 38 per cent for agri-produce, India's levels are significantly low compared to international levels. Processing of agriculture produce is around 40 per cent in China, 30 per cent in Thailand, 70 percent in Brazil, 78 per cent in the Philippines and 80 per cent in Malaysia. India's consumption of processed food products is also low, considering a population of 1.1 billion and a strong 350 million urban middle class. However, this is expected to change significantly on account of increasing urbanisation, changing lifestyles and increasing income levels, as well as the growth of the organised retailing. Increasing Public-Private-Partnerships (PPP) and enabling measures taken by the government will also boost the growth of this sector.

Though India's agricultural production base is reasonably strong, wastage of agricultural produce is estimated at around nine billion. Value-addition to the agricultural produce in India is just 20 per cent, which could be increased by leveraging on the country's huge raw material base and propelling exports. Organised players remain at the fringes of this market accounting for only a third of the country's total agri-processed products.

The organised sector is relatively small, in comparison to the unorganised sector, with around 516 flour mills, 568 fish processing units, 5,293 fruit and vegetable processing units, 171 meat processing units and numerous daily processing units at the state and district levels. The share of the organised and unorganised sectors varies across different segments of the industry.

India's potential as a market and investment destination

India presents a huge untapped opportunity for the food processing sector enhanced with low penetration levels and a liberal regulatory regime. Increased economic growth, evolving food-consumption patterns, a higher standard of living due to rising disposable incomes and a trend towards nuclear dual-income families, all present considerable potential. Government studies show that an average Indian spends a majority of his income on food consumption.

Recognising an opportunity to grow, multinational food companies have entered this industry to meet consumer demand for convenience and value-added products. US brands such as McDonald's, Pizza Hut and Kentucky Fried Chicken (KFC) have already become household names in India while more are set to enter.

Demographic dividend

India's population is nearly 17 per cent of the global population and is one of the most attractive consumer markets in the world today.

India has observed an upward mobility in the income classes and rising disposable income. According to the National Council for Applied Economic Research (NCAER) data, the consuming class, with an annual income of EUR 701 or above, is growing and is

expected to constitute over 80 per cent of the population by 2009-10. The increase in income levels of the Indian population and the emergence of the consuming class that has a higher penchant to spend, offers great growth opportunities for companies across various segments.

Changing lifestyle and increasing consumer awareness

Over the years, increasing literacy and exposure to developed nations via foreign media and overseas work experience and travel has brought about a change in the mindset and preferences of urban Indians. Increase in the population of working women and dominance of nuclear double income families, especially in urban areas, are other trends shaping the changing lifestyles.

Lack of time due to a busy lifestyle and changing consumption patterns has led to an increase in the demand for processed, ready-to-cook and ready-to-eat food, leading to increased brand-consciousness.

Rural market potential

The opposing growth path of the farm and non-farm sectors has widened the gap between rural and urban incomes. Rural areas are home to 70 per cent of India's population and have historically accounted for more than half of India's consumption. Even with increasing urbanisation and migration, it is estimated that 63 per cent of India's population will continue to live in rural areas in 2025.

Higher agri-incomes and a gradual shift from farm to non-farm employment (both with respect to rural India as well as via migration to urban areas) will also see average income levels for rural India increase. Successive NCAER surveys and estimates suggest that as many as 37 per cent of rural households could move into the middle income-and-above consuming class by 2010 - for perspective, this was only 15-17 per cent in the late 1990s.

More and more rural households will join the consuming middle class

This translates to a consuming class of 56 million rural households by 2010 - more than half of India's overall estimated middle class by this time. Clearly, consumption growth in rural India will be given a strong boost, thus opening up the vast and relatively unexplored strata of India to companies.

With these promising trends and India's ready availability of raw materials, India has several competitive advantages in the food processing sector.

Total FDI inflow in the FPI sector

The FPI continues to attract investors. FDI inflows in the FPI from August 1991 to June 2007 stood at \$1,282.06 million, 2.43 per cent of total inflow in value terms.

Recently, India has received an encouraging response from investors in the UK for establishing joint quality control testing facilities for agricultural products and cold storage facilities in the country.

Challenges and opportunities Affordability and cost

In developed countries, the price of processed foods and fresh foods are more or less the same. At times, processed foods are even cheaper than fresh food. In India, however,

due to a variety of factors, processed food prices are substantially higher than those of fresh food. Given the objectives achieved by processing, there is a need to take measures to reduce costs and make processed food affordable.

Infrastructure

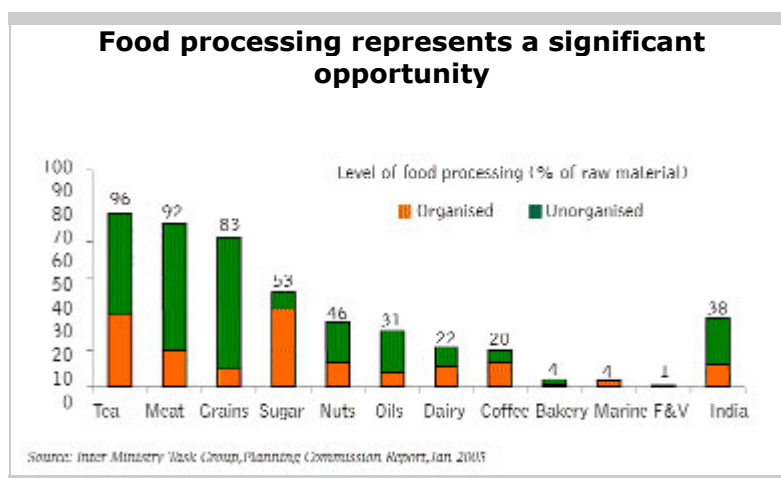
Deficiencies in infrastructure exist across the sector. The cold storage capacity today caters to less than 15 per cent of the produce, this too being of rudimentary nature, with over 80 percent designed only to handle potatoes. There is also a paucity of chilling infrastructure for milk, and a lack of modern abattoirs for the meat processing sector. Fish processing, more specifically for exports, requires a major step-up in infrastructure availability. Physical marketing and warehousing infrastructure also needs to be upgraded.

India's limited controlled atmosphere storage facilities, technologies, protocols and machinery are chiefly imported. India needs to develop expertise to assess and modify, and if necessary upgrade manufacturing capabilities according to its specific requirements. These areas need support and new paradigms of PPP. Government subsidy schemes, partnership with banks, creation of models for JVs, Special Purpose Vehicles (SPVs) for implementation, as well as dedicated infrastructure financing institutions are required to give this area the requisite push.

Financing and credit availability

Inadequate and high cost of credit has been one of the major reasons for the subdued agri-sector growth. According to industry estimates, rural credit penetration in India is just 15 per cent of the all-India average of 40 per cent. Due to inadequate formal credit delivery mechanism farmers have to rely on informal sources, such as money lenders and traders who charge higher interest rates.

Factors such as lopsided regulatory policies and non-availability of timely and adequate credit have led to the highly fragmented nature of the industry. Lack of economies of scale and uncertainty in raw-material availability has resulted in higher inventory holdings and low capacity utilisation. Due to the unorganised industry structure, most of the units in the FPI are standalone without significant backward or forward linkages. All these factors are responsible for the significant constraints on banks with regard to credit assessment evaluations increasing the cost of borrowing.



Food laws

Currently there are more than twenty Indian laws relating to food, which are administrated by a number of different ministries and departments. Accordingly, food processors have to comply with these rules.

Among the more important food laws are:

- **Prevention of Food Adulteration Act (PFA) of 1954 and the PFA Rules of 1955:** Covers specifications related to food colour, preservatives, pesticide residues, packaging and labelling, and regulation of sales.
- **The Standards of Weights and Measures Act, 1976, and the Standards of Weights and Measures (Packaged Commodities) Rule, 1977:** Designed to establish fair trade practices with respect to packaged commodities.
- **The Fruit Products Order, 1955:** Specifications and quality control requirements regarding the production and marketing of processed fruits and vegetables, sweetened aerated water, vinegar, and synthetic syrups.
- **Meat Food Products Order, 1992:** Administers the permissible quantity of heavy metals, preservatives, and insecticide residues for meat products.
- **Milk and Milk Products Order, 1992:** Regulates the production, distribution, and supply of milk products; establishes sanitary requirements for dairies, machinery, and premises; and sets quality control standards for milk and milk products.
- **The Food Safety and Standards Act, 2006:** In August 2006, the Government of India had passed a new legislation Food Safety and Standards Act. The Act proposes establishment of a new authority, the Food Safety and Standards Authority, reorganisation of scientific support pertaining to the food chain through the establishment of an independent risk assessment body and a new Food Law, merging eight separate Acts.

However, despite these challenges, India presents a significant untapped opportunity for the FPI sector enhanced by low penetration levels and a liberal regulatory regime. The role of food processing has become more critical since food production is targeted to double in the next 10 years.

Potential areas for investments

Infrastructure investments through greater PPP involvement

Poor infrastructure for storage, marketing and distribution of food products in India is one of the key reasons for low processing levels. It is estimated that approximately 25-40 per cent of agri-produce is lost post the harvest season, costing the market around EUR 7.6 - 13.4 billion. Poor infrastructure and an inadequate supply chains are the major reason behind this. It is estimated that by 2012, India's marketable surplus is set to increase by 350 mtpa to 870 mtpa.

40 per cent of the increase or 150 mtpa would be accounted for by perishable fruits and vegetables. Given that India's current storage infrastructure for all food items with different public sector entities and in the co-operative sector stands at 100 mt, the need for investment is evident.

The government has recognised this and announced various policy and fiscal measures to augment the storage capacity. It has indicated an outlay of EUR 2.16 billion over 2002-2007 to augment infrastructure; much of which is in partnership with private players. The government is assisting states who have modified their APMC Acts to develop market infrastructure. It has also announced a 15-25 per cent capital subsidy scheme to

facilitate the construction of rural go-downs and has sanctioned 16 mt of new capacity in the last five years.

Paucity of proper storage infrastructure is an issue for almost all crops; but it is more important for the F&V category due to their perishable nature.

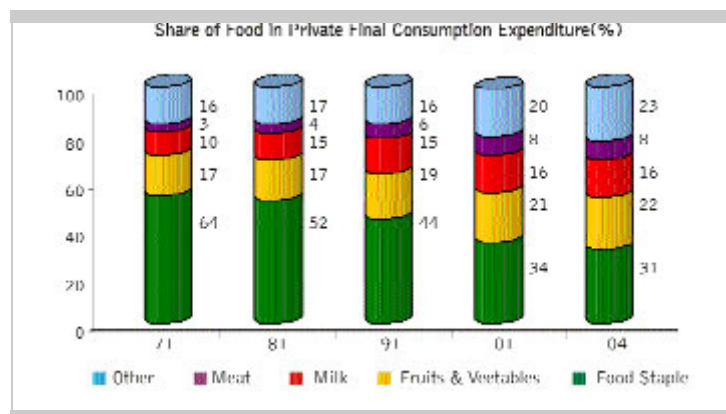
An efficient supply chain is an integral part of the overall strategy of all the players in the organised retail market. This will not only bring down the price of the end-product, but also eliminate intermediaries, by linking farmers directly to the super stores, thus increasing the income levels of farmers.

The transformation in the Indian agriculture sector and the FPI coincides with the growth of the organised retailing and increased corporate participation. In order to fully leverage on the opportunities in value-added foods, food processing and also food retail, significant ram-up and improvements are required to create world class infrastructure for an efficient supply chain.

Cold chain

India's estimated cold-storage capacity of 19.5 mt is less than 15 per cent of the annual horticulture production and is dominated by potatoes (80 per cent of capacity). The rising focus on horticulture, large-scale corporate participation and the advent of food parks and agri export zones should see cold-chain infrastructure (both storage and transport linkages) being restructured with estimated investments of Euro 5.5 - 6.6 billion over the next decade.

The estimated size of the cold chain industry is around Euro 1.4 - 1.7 billion and is expected to grow at 20 - 25 per cent annually. 100 per cent FDI is allowed in this sector. Existing cold-storage players and equipments include Voltas, Blue-Star and Kirloskar Pneumatic and major service providers are Radhakrishna Foodland and Snowman Frozen Foods, among others. Container Corporation (Concor) is also setting up a countrywide network of over 14 cold-chain complexes for horticulture in Delhi, Mumbai and Bangalore among other places.



Supply chain technology

As the FPI is at a nascent stage in India, sophisticated applications such as demand forecasting, data integration, financial flow management, supply-demand matching, information sharing and good movement synchronisation will enable it to become mature and efficient. The food supply chain in India has become fragmented with the existence of numerous intermediaries and the lack of economies of scale. This logistical vacuum provides lucrative opportunities for players wanting to enter this market.

Food safety management systems

Food safety is a growing concern across both developed and developing nations. This tightening of restrictions and the introduction of the Sanitary and Phytosanitary Agreement by global industry bodies like the World Health Organisation (WHO), have led to increased adherence of safety norms and regulations. Therefore, in order to gain a larger share of world trade, Indian companies will have to strictly adhere to international food safety standards.

Player expansion plans					
Player	Format	Current outlets	Expansion Plans	Expected year	Estimated investment (Euro million)
Aditya Birla Group	More (Supermarket)	14	1000	2010	2070
	Trinethra Super Retail	1	4	na	
Bharti Wal-Mart	Wholesale Stores	-	15	2012	27.6 to 184
Express Retail Services	Big Apple/Big Apple Fresh	16	100	na	23
Godrej Group	Aadhar	31	1000	na	
Heritage Foods	Fresh (Flagship Stores, Daily Stores)	12	100	na	34.5
Pantaloon	Big Bazar	62	100	na	230
	Food Bazar	95	na	na	
	KB's Fairprice Value tores	-	1500	2009	
Reliance Retail	Reliance Fresh	240	471	2010	
	Hypermarket	2	500	2010	5750
	Reliance Town Centres	-	784	2010	
RPG	Spencer's (Fresh, Express, Daily, Super, Hyper)	200	5000	2011	575
Sahakari Bhandar	Sahakari Bhandar	18	na	na	
Subhiksha	Subhiksha	870	150	2009	
Wadhan Food Retail (Spinach)	Super Local, Express	84	1500	2010	276 to 345
<i>Source: Media report</i>					

Machinery

In recent times, quite a number of new technologies, both in processing and packaging, have emerged and made an impact on the shelf-life of food products. These technologies have also matched some consumer trends, such as concerns regarding freshness and health. Despite a considerable increase in the supply provided by the local food-processing and packaging machinery manufacturers, there is ample demand for foreign machinery featuring state-of-the-art technology in India.

Food parks

In a bid to boost the food sector, the government is working on agri-zones and the concept of mega food parks. 30 such mega parks are coming up across the country in various cities to attract Foreign Direct Investment (FDI) in the food-processing sector. These food parks will span around two to three districts in each location and will require a total investment of EUR 71 million each. The government will provide a EUR eight billion grant to set up infrastructure.

Each food park will have a cold storage facility, apart from facilities for sorting, grading, food processing, packaging and quality control, and R&D laboratories, among other facilities. The government has already identified five locations in Maharashtra, Andhra Pradesh, Punjab and Jharkhand and one in the North-East region for the setting up of these food parks. The ministry is seeking to double India's share in the global trade of fresh produce to three per cent in the next eight years, and the setting up of 30 food parks across the country is an important initiative in this direction.

Food retail

The market for branded foods across different segments of the industry is growing by 15 to 20 per cent. For India, food and groceries form the biggest category of the retail pie, accounting for 75 per cent. However, this category has the lowest organised retail penetration of one per cent, which is indicative of the opportunity available for organised retail.

(Source: Indian Express Newspaper)