



Executive Summary

India is a fast-growing and large emerging market. Although consumption patterns are changing, food and beverages still account for a substantial part of Indian consumption (over 30%) compared to other emerging markets (Brazil at 17% and China at 25%). Within the food and beverage category, in recent years, there has been a shift towards packaged food and beverages and branded products. India is also a large producer of fruits, vegetables and milk. The government is trying to develop the country as a food processing hub, which is likely to boost the Indian food processing sector in particular and the manufacturing sector in general.

Given this background, this report focuses on the non-alcoholic beverage sector and its growth potential in India. Non-alcoholic beverages comprise all beverages that are alcohol-free and include a wide range of sub-sectors, such as carbonated soft drinks (CSDs), fruits and vegetable juices, tea/coffee/milk-based beverages, sports drinks, energy drinks and bottled water. The sector has witnessed continuous double-digit growth in the post-liberalisation period with the entry of a number of foreign and domestic corporates in manufacturing, and the proliferation of products and brands. The sector has significant forward and backward linkages and connects the entire agriculture value chain—from farmers to consumers. This report examines the contribution of the sector to India's economy in terms of its contribution to the GDP (gross domestic product), manufacturing sector, employment, FDI (foreign direct investment) inflows, technology transfer, exports and development of the agriculture value chain. It analyses the barriers faced by the sector and suggests policy measures to enhance the global competitiveness of Indian industry, generate employment, facilitate exports and inflows of FDI, develop India as an agro-processing hub and link it to the global production network. The report is based on a primary survey and secondary data analysis.

The study shows that globally the non-alcoholic beverage sector is undergoing changes in terms of product variety, business models and markets. Companies are customising their products to meet customer and market requirements. While developed countries continue to be the large markets for non-alcoholic beverages, both production bases and consumption are shifting to developing countries such as China and India. Unlike China, India is a much smaller player in the global non-alcoholic beverage sector not only in terms of manufacturing, foreign investment inflows, research & development (R&D) base and exports, but also in terms of per

capita consumption of non-alcoholic beverages. India, with its large consumer base and availability of raw material and cheap labour, thus has huge untapped potential to develop the non-alcoholic beverage sector.

When one examines the global regulations pertaining to this sector, there is a significant difference between developed and emerging markets. While all countries seem to follow some common global standards such as the Codex standards, they customise it to their own requirements. In developed countries, regulations related to food safety standards, consumer and environment protection are more rigid, but they are also more transparent and better implemented, which has enabled the non-alcoholic beverage sector to grow and reach its potential. In developing countries, the regulations are evolving and their implementation is an issue. Since India is in the process of implementing the Food Safety and Standards Act, 2006, and other regulations that are likely to impact the non-alcoholic beverage sector, the report recommends that the country can learn from global best practices.

The secondary and primary data on the Indian non-alcoholic beverage sector highlights that non-corporate manufacturers dominate (around 75%) in terms of numbers, but corporate manufacturers dominate in terms of value, volume of sales, investment, employment generation and percolation and use of technology. The non-alcoholic beverage sector accounts for over one per cent of India's GDP and its share in the GDP is rising. The performance of this sector is better than in other manufacturing sectors and it is projected to have high double-digit growth for the next 10 years. It has the potential to create four indirect employments for each direct employment. The study found that the corporate sector works closely with contract manufacturers and has enabled a number of small manufacturers to gain scale economies. Although data on the share of the sector in investment and FDI inflows is not available, company-level information shows that companies are investing substantially in technology and skills upgrading, and in R&D in product development, customisation of products to local tastes and process upgrading. Through their backward linkages, they have enabled farmers to become more productive and efficient and have streamlined the supply chain. The non-alcoholic beverage sector has strong forward linkages—even corporate manufacturers work closely with non-corporate retailers, providing them with the necessary technology, such as storage facilities and freezers. Around 50 per cent

of corporate manufacturers have taken measures to conserve water and large companies have invested significantly in waste management and recycling technology.

The survey of retailers highlights that the Indian retail sector is undergoing rapid changes with the entry of corporate retailers and the development of new retail formats. The private labels of large corporate retailers may compete with corporate manufacturers, but large retailers offer opportunities to small manufacturers to become a part of their supply chain. Globally, corporate manufacturers work closely with corporate retailers and this model can be replicated in India. Both corporate manufacturers and corporate retailers focus on streamlining the supply chain and thereby help to reduce delays, leakages and wastage in the supply chain. In a competitive scenario, these benefits can be passed on to the farmers and manufacturers in terms of higher prices for their produce/products and to consumers in terms of lower prices that they pay. This report also found that in India both corporate and non-corporate retail will co-exist and grow in the food retail business. At the same time, the growing corporatisation of retail will give an impetus to brand and product proliferation, thereby enhancing consumer choice.

Although Indian consumers are changing and they have shown increasing preferences for product variety and are becoming more brand-conscious, they still have a strong preference for homemade beverages and traditional beverages such as coconut water. Thus, per capita consumption of non-alcoholic beverages in India is low. The Indian consumer market is large and unsaturated and with the rise in GDP and per capita income and the evolving retail structure, it is expected that the consumer demand patterns will change and the demand for packaged beverages will grow. This report found that both traditional and packaged beverages will co-exist in India and the prices of products play an important role in consumers' purchase decisions.

The report countered some of the popular beliefs. For instance, all survey participants pointed out that allowing FDI in multi-brand retail alone cannot bring down inflation or help to streamline the supply chain, as has been envisaged by the government. It will depend on whether a single Goods and Services Tax (GST) is implemented and how the food processing sector in general and the non-alcoholic beverage sector in particular is treated under the GST. The treatment of the sector has to be such that it faces uniform low tax, and

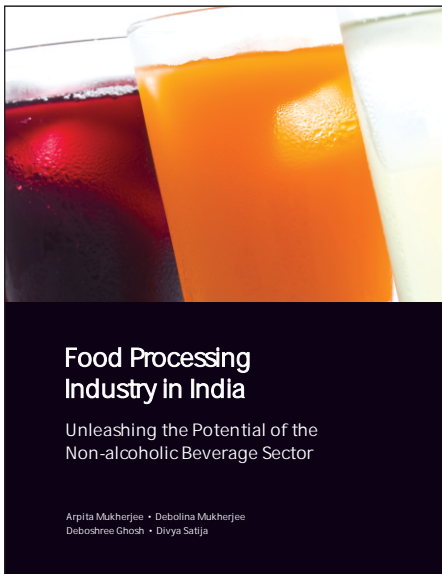
other fiscal and regulatory barriers to the interstate movement of goods are addressed. Herein, India can learn from the experiences of countries such as the UK, Canada and Australia that have used low taxes to streamline the agro-supply chain. Similarly, it is often argued that bottled water is a luxury commodity and, therefore, it faces high and differential taxes across states. In a country like India where it is difficult to get clean drinking water, such measures are anti-poor. The report strongly recommends that bottled water should be taxed at par with juices to increase affordability, especially knowing that access to safe and hygienic potable water is limited in India and there should be uniform low taxes for all non-alcoholic beverages across different states for consumer health and safety reasons. Contrary to popular belief, the report found that the subsidies given to the industry for cold chains or setting up of manufacturing facilities do not meet industry requirements. In fact, the high cost of doing business and the high and multi-layered taxes erode the benefits of subsidies and, therefore, the country is not receiving the desired investment from the corporate sector in areas such as cold chains and food processing. In fact, instead of subsidies, if the government streamlines the tax process, enhances transparency in governance and provides the necessary infrastructure, investment will automatically flow.

The report emphasises that to protect consumer health and safety, the government should take strong measures against spurious and counterfeit products. Government and industry interactions in this regard will be mutually beneficial. A number of reforms have to be taken at the state level. For instance, there is an urgent need to have uniform classification for the non-alcoholic beverage sector by the State Pollution Control Boards and all states should classify non-alcoholic beverages under the 'orange' category along with other food processing industries as is done by some states (such as Himachal Pradesh and Orissa) and the central government. This will streamline the clearance process for setting up manufacturing facilities.

The report highlights that India's ability to develop as a manufacturing hub for non-alcoholic beverages is inhibited by poor infrastructure. This includes power shortages that lead to an increase in overall production costs due to the need to install captive power units; limited availability of land near consumption centres, which requires production units to be set up at remote areas, thereby increasing sourcing and transportation costs; the high cost of

land acquisition and cumbersome procedures that make investments unviable; inadequate and poor quality of surface water, which is crucial for the non-alcoholic beverage sector; and poor road conditions, delays in interstate borders, capacity constraints of Indian Railways and inadequate cold storage and warehousing facilities, which result in significant wastage in the supply chain. The competitiveness of the non-alcoholic beverage sector is further impacted by the inconsistent supply and poor quality of agriculture raw materials, rising raw material prices due to inflation and restrictions on imports. High duties on intermediate products, such as packaging materials and multi-layered taxes that vary across states, have adversely impacted processed food manufacturing in India. A number of complex regulations affecting the entire supply chain have not allowed the sector to reach its full potential.

Thus, unlike other emerging markets such as China or Brazil, India is not a part of the global production network in the agro-processing sector. Given that India has the raw materials and an abundant supply of manpower, the country has the potential to develop as a non-alcoholic beverage manufacturing hub and an agro-product sourcing destination. This will only be possible through a package of reforms initiatives that are presented in Chapter 7. It is important to understand that because the Indian economy is liberalising and globalising and the country is actively engaged in trade agreements, unless we initiate reforms at a rapid pace, Indian companies will also relocate to other countries and use the FTA (free trade agreement) route to cater to the Indian market. Hence, India should continuously strive to be a competitive, efficient and attractive investment destination through appropriate policy initiatives.



Food Processing Industry in India

*Unleashing the Potential of the
Non-alcoholic Beverage Sector*

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Deboshree Ghosh and Divya Satija**

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About the Report:

The report is the first exhaustive study on the non-alcoholic beverage sector as a case study for reforming the Indian food processing sector. It examines the contribution of the sector to the Indian economy through development of manufacturing, creation of employment, increase in investment, technology transfer, enhancing exports, and linking Indian agriculture to the global production networks. The report covers agriculture, manufacturing, retail and consumers. Based on secondary information analysis and a nationwide primary survey, it identifies the barriers faced by the food processing sector, in general, and non-alcoholic beverage sector, in particular, and suggests policy reforms which will enhance the GDP growth, create employment, attract investment, improve India's trade balance and enable the country to become a part of the global processed food value chain.

The report provides information and market entry and operations strategies to businesses in emerging markets such as India; it enables policy makers to prioritise policy reforms and students can benefit from this industry specific study. The report is the first of its kind which analyses the recent changes in Indian government policies including the policy of allowing 51 per cent FDI in multi-brand retail.

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