6th FOOD WORLD

INDIA 2012

Global Convention for Food Business and Industry

PROCESSED FOOD IN INDIA: ENABLERS AND BARRIERS

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Foreword

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Indian economic growth is powering great shifts in our lifestyle. What we eat and when, how we shop, and how we share food are all changing at a fast rate. The packaged food market has witnessed strong annual growth for several years now, and this growth trend is likely to further accelerate in the light of ongoing shifts in the demographic, economic, cultural, regulatory and competitor landscape.

Our findings, based on extensive secondary and primary research, suggest that this will indeed be the case. In fact, our bottom-up estimates of growth for each sub-category within the market, in the context of ongoing trends and international examples, suggest that India's packaged foods market could well exceed current growth expectations.

This means a great opportunity for companies who serve the Indian consumer, for the agricultural sector, for several ancillary sectors, and for investors. Moreover, it is an opportunity with the potential to impact positively on employment, economic growth, and quality of life in India. However, for us to realize the full potential of this opportunity, we must first clearly identify the biggest enablers that will drive success and the barriers most likely to hinder it. Our task then is to develop and execute action plans that will optimize the first, while mitigating the second.

We hope that this report will be read in this light and will be useful to all those involved with the sector, directly or indirectly.

Nikhil Prasad Ojha

Dr Arbind Prasad

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Introduction

The Indian packaged food market, including confectionary, dairy, baked goods, sauces and household staples such as packaged rice, was worth Rs. 1 lakh crore at the end of 2011.[i] With rising incomes, favourable demographics and changing lifestyles, this sector has grown at over 13% per annum over the last few years.

This report outlines the key factors that will shape the growth in India's packaged food industry, and also estimates likely growth over the next few years. It is structured in four parts.

In the first section, we look at the drivers and potential barriers to growth. Based on extensive secondary research, we present four major drivers: the foundation for growth, demographic shifts, market-player interventions, and policy. We also discuss three potential barriers to growth: infrastructure, ease of doing business, and profitability challenges.

In the second section, we provide a snapshot of the recent qualitative research conducted by Bain & Company to understand shifts and trends in consumer preferences towards packaged foods.

The third section focuses on likely growth, looking at industry and analyst estimates and historical trends. We compare these to Bain's bottom-up, category-level forecasts, which incorporate insights from the first two sections. Based on these, we argue that conventional forecasts underestimate the growth potential of the packaged food sector because they do not fully capture the way in which different trends and shifts are having a multiplier effect. We also look outwards and argue that international examples provide a strong indicator of how this sector is likely to evolve in India.

Finally, in the fourth section we discuss the key stakeholders in the sector and outline what industry participants can do to ensure that this growth potential is achieved.

Key findings:

1. Despite problematic infrastructure, India's existing agricultural and food processing output provide a strong foundation for growth in the packaged food industry

2. Changes in demography, disposable income levels, and lifestyle have created a rapidly-growing domestic market for packaged food, with discernible patterns in consumption

3. These factors result in a multiplier effect, so that the growth potential for the sector is higher than current industry and analyst estimates

4. For companies, market share can be increased by investing throughout the value chain, targeting young consumers and creating 'value-added' products

5. Different categories of packaged foods are at different stages of product maturation and will require carefully targeted investment and product development

Our report depicts an industry in an exciting period of expansion, with many opportunities for companies and government to work together. An expanded packaged food market will result in increased choice, quality and hygiene standards for the consumer and improved profitability for companies. If the examples of market leaders are followed, it can also result in improved agricultural standards, better conditions for farmers and reduced wastage.

1. Drivers and barriers to growth

India's size and recent economic growth has led to much excitement about the potential for growth in new markets. Despite the recent slowdown, per capita GDP is set to rise at 7.4% per annum in the next two decades[ii], and will almost certainly create significantly higher consumption. With a domestic market of 1.2 billion people, there is clear potential for packaged food purchasing to continue on the trajectory of growth seen in recent years.

Our research identifies four key factors that will drive the development of the packaged food industry over the next two decades:

Driver 1: India's status as a world hub of food production and processing lays the foundation for expansion in packaged food production

India's agricultural strength is due to a unique combination of natural resources, low production costs and a vast skilled labour force. The nation contains the world's second-largest arable mass, with diverse geo-climactic zones and abundant livestock. This natural wealth makes India the global leader in milk production, the second-largest producer of fruit and vegetables, and the third largest producer of fish[iii].

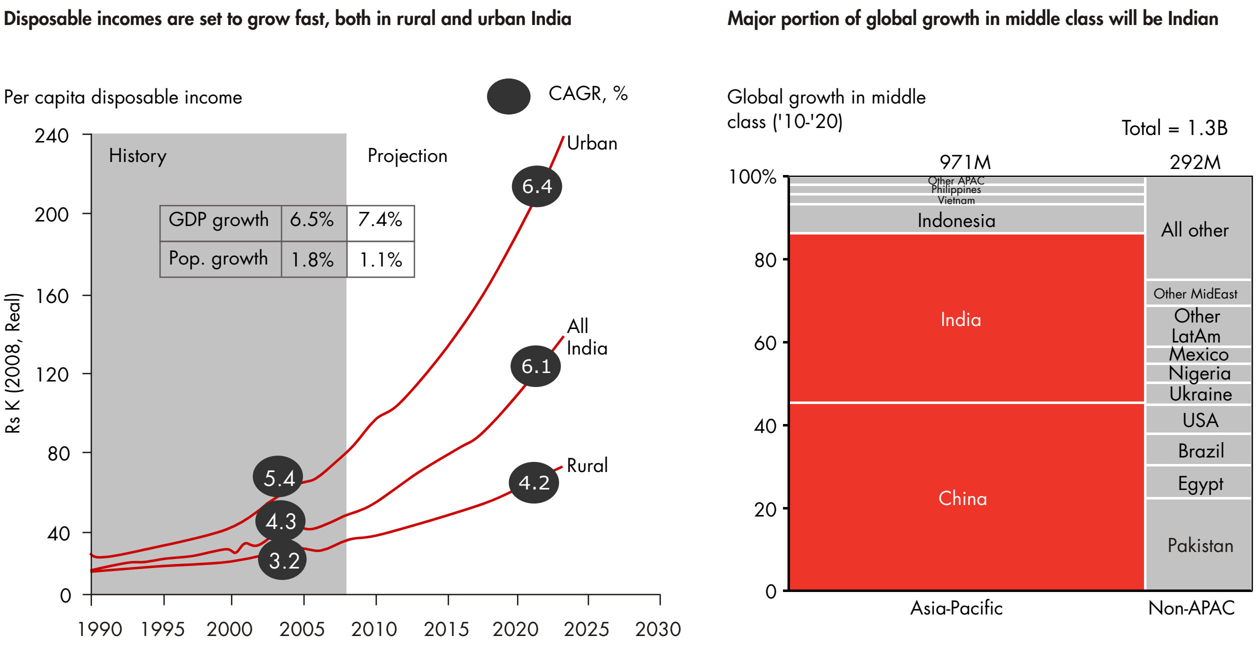
In addition, the Indian food processing industry, essential to packaged foods, is thriving. Currently the 5th largest sector of India's economy[iv], the industry has reported steady growth over past years and shows potential for much expansion, particularly in the export market. Costs of processing and packaging food can be up to 40% lower than parts of Europe[v] which, combined with India's resources of skilled labour, make it an attractive venue for investment.

In and by themselves, these elements may not guarantee growth. However, together they provide the environment needed for the packaged food industry to flourish, a growing momentum to food production and an ecosystem of supply chain and infrastructure.

Driver 2: Demographic change is powering a rise in domestic demand

The next 20 years will see India adding approx. 245 million youth and young adults to the workforce[vi]. At the same time, there will also be a rise in the middle class population, as well as a 6.1% increase in disposable income across the socio-economic spectrum, higher among urban residents. Continued migration from villages to cities means that by 2020 a third of all Indians will live in urban areas – good news for the packaged food market, 78% of which is accounted for by urban areas in 2011.[vii]

Figure 1: Disposable incomes and the middle class population expected to grow



Note: National population estimates as on 1st Jan, 2010

Source: Euromonitor, Lit. Search; Bain MTG Analysis, 2011 and 2012; Indian urbanization econometric model, 2008, IDBI research

Other influencing factors include the number of women entering the workplace and the evolution of the Indian household, from a multi-generational, extended family unit to single occupant or nuclear family households. These changes mean higher disposable incomes and less time for food buying and preparation, both of which encourage a move towards convenience products such as ready meals. The emergence of organized modern trade and new retail formats create more choice for consumers and will facilitate changes in shopping habits.

Driver 3: Growing foreign investment and participation in the sector will stimulate and encourage expansion

In the past decade many multinational corporations have established themselves in the Indian market, increasing competition and providing greater variety for consumers.

Figure 2: Multinational corporations are bringing in new products and brands

Expansion by local players

ITC Limited	• Planning to enter branded dairy
PARLE	• Rebranded "Parle Wafers"; Entered health snack category
CavinKare	• Growing its food business through acquisition of small regional brands
Parle Agro	• Entered Health Snack category through "Hippo" in 2009
marico	• Entered breakfast cereal market by introducing 'Saffola Oats'
emami	• Launching in multiple categories like breakfast cereals, ready-to-eat
BRITANNIA	• Entered flavored yoghurt in 2012
Amul	• Launched chocolate milk Amul Kook Koko in 2011 to target youth

Entry/Expansion of MNCs

kraft	Oreo under Cadbury and Tang under Kraft
Del Monte	Acquired 40% stake in FieldFresh Foods in 2007
FERRERO	Launched chocolate egg product 'Kinder Surprise'
UB United Biscuits	Introduced McVities in 2010
DANONE	Yoghurt (flavored and plain) and Flavored Milk
McCormick	JV with Kohinoor Foods in 2011, planning to launch RTE and RTC brands
ORKLA MTR	Orkla bought MTR and re-launched MTR as a pan Indian brand in 2010
General Mills	Pillsbury Atta in 2008 and expanding to other categories
PEPSICO	Baked snack 'Aliva' and breakfast cereal 'Quaker Oats'
PERFETTI Van Melle	Salted snacks market through launch of 'Stop Not' in 2011
Coca-Cola Minute Maid	Entered Juices in 2011 through 100% Juice

Source: Company websites, Literature searches

The past few years have also seen increases in investment, through joint ventures, foreign institutional investment and private equity (PE). Between 2008 and 2011, PE investment in the food and agriculture sector totaled $650 million (Rs.3,400 crore)[viii]. In the coming years, the Indian government has set an investment target of $20 billion (Rs.104,000 crore) of investment in food-related infrastructure from the private sector.[ix]

Driver 4: Government policy is favourable towards growth

Importantly, the government recognizes the importance of the food production and processing industry and is facilitating expansion. 100% foreign direct investment (FDI) is allowed in the agricultural sector, with plans to establish a venture capital fund to support investment requirements. The decision in September 2012 to allow up to 51% FDI in retail will greatly transform the industry, opening up new possibilities of partnership and bringing increased investment. The government should continue its efforts to bring in greater consensus, working with all players in India's retail landscape to address any concerns.

Further incentives such as high tax rebates, depreciation benefits and reduced custom and excise charges also encourage companies into food processing. Imaginative and targeted policies such as 'Food Parks' are designed to address weaknesses throughout the value chain. By 2017, 50 Food Parks are expected to be built across the country, providing accessible transport and processing facilities to even small farmers.

However, the picture is not all positive. Barriers exist that will need to be overcome if India's packaged food industry is to grow strongly:

Barrier 1: Lack of integrated supply chain and infrastructure

Every year India's farms lose between 20-25% of their fruit and vegetable output – worth an estimated $10 billion (Rs. 52,000 crore) – due to spoilage at various stages[x]. Nearly 90% of food processing units are small-scale[x], operating with limited use of technology to enhance the lifespan of their produce. These problems are compounded by India's poor transport infrastructure, which compares unfavourably to other nations in transit time and transaction costs. An Exim container of foodstuffs, for instance, will take 12-13 days to process in India, compared with just 3-5 days in France or Denmark[xi].

Barrier 2: Difficulties in conducting business

India is currently rated behind the other BRIC nations (Russia, China and Brazil) by the World Bank when it comes to ease of conducting business[xii]. Excessive documentation is an example where bureaucracy gets in the way of efficiency: transporting goods to India requires an average of 11 documents, as opposed to 2-3 documents in France and Singapore[xiii]. The current high rate of 12.5% VAT, along with a complicated range of other taxes such as octroi and excise duty, also affects competitiveness of the sector and can put the price of packaged foods out of reach for many consumers.

Barrier 3: Profitability continues to pose a challenge

In order to be profitable in the packaged foods sector, companies need scale, the ability to charge a premium and an efficient cost structure – each of which is problematic in India. Scale is difficult precisely because India is so vast, requiring time and effort to fully establish market penetration. Low levels of disposable income, a tendency toward value-consciousness and a strong bargaining culture make it hard for companies to charge a premium, particularly with competition from the unorganized sector.

To date, this has been met with no-frills products and small package sizes. However, this strategy reduces profit margins and constrains the potential for enhanced products. These factors combine with India's problematic infrastructure to make efficiencies in cost structure difficult. When we take into account the food industry's vulnerability to inflation and changing commodities prices, the difficulty of striking a profitable balance is clear.

2. Evolution of consumer preferences

It is India's domestic market that causes excitement among commentators and potential investors; and indeed, domestic consumption accounts for the majority of packaged food production in India. With over half of private expenditure currently on food[xiv], India provides an appealing market for new food products.

Here, diversity is important. It may be clichéd to refer to 'Two Indias' but the reality is that there are many Indias, each undergoing a rapid economic and cultural transformation. For the savvy marketer, this is a tremendous opportunity. On the one hand, there are several distinct consumer segments large enough to support customized offerings. On the other, ongoing shifts in attitudes, incomes and lifestyles within each segment create opportunities for new categories or brands.

Bain & Company recently conducted a qualitative study of evolving consumer behavior towards food purchasing. Our purpose was to understand how different consumer segments are behaving, and what's changing: to find out what people buy, how they buy, and why.

India's new consumers

Our research took a cross-section of Indian society, with representatives from different locations (villages, towns, large metropolitan cities and developed market cities), different social strata (lower, middle and upper income brackets), and from different professional backgrounds.

Interviewees were questioned on their shopping habits, expenditure, and typical meals, as well as on qualities they look for in packaged foods and how their habits have changed over time.

The questions focused on four priorities in buying packaged food:

- **Convenience:** consumption driven by difficulty in making/storing items (such as pickles or curd) or by lack of food preparation time (instant noodles or idli batter mix)
- **Taste:** consumers seeking enjoyment or variety (i.e., snacks, new sauces or luxury items)
- **Health:** choices influenced by concerns for wellbeing (for example, low-fat yoghurt or wholegrain bread)
- **Ideology:** choices based on a brand's values (sustainably fished or organic produce)

Figure 3: Our representative consumer types

SAMPLE PROFILES

Farmer; Lives with parents, relatives and two siblings | Chauffeur; Lives with wife, child and two relatives | Contractor; Lives with husband | Home-maker; Lives in HUF | Professional, Lives with wife, parents | Professional, Lives with room-mate

Their answers provide a snapshot of India's varied consumer groups and changing food preferences, summarized below.

Emerging themes

First, these factors can be ordered in terms of importance. For Indian consumers **taste is the first priority**, followed by convenience, health and finally ideology. As a market matures, this can change: in developed markets convenience and health are beginning to override taste.

Second, **affordability and quality remain key decision-influencers**, particularly for categories at the lower end of the social strata. For these groups the local grocer is still a critical player, although less so for consumers in more developed markets.

Third, **consumers across the spectrum are upgrading**. Whether this means a change from preparing all foods from scratch to purchasing certain ready-made items, a move from standard to premium snack items, or the switch from basic staples to enriched, organic or luxury versions, consumers are moving upwards through food categories and prices.

So what?

What this snapshot reveals is not just changes in consumption habits within each segment but a more general pattern. Consumer preferences tend to occur in gradual shifts, as individuals progress from non- to new- to light- to regular-user. Our research shows that as India's different market segments evolve, they move in the same order through the same stages, with a 5-7 year time-lag. Thus the premium currently placed on health by a high-income urban housewife will be echoed in time by a lower-income consumer, who will subsequently begin to purchase items such as soups or breakfast cereals.

Many changes can be expected if this pattern continues. Specifically, we can expect:

- **More consumers**, as new segments (and particularly the rural population) enter the market
- **Greater expenditure**, as each segment increases its spend on packaged foods
- **Changing rationales for buying**, as groups move through the stages of consumption outlined above.

Other trends emerging from this primary research and other industry analysis include:

Experimentation with new brands: Across segments consumers are increasingly willing to try new brands, rather than remaining loyal to one. This has far-reaching implications for marketers, who now need to work not just to attract new consumers but also to retain existing ones.

Exploration of new tastes: Seeking novelty in more than just brands, consumers are starting to play with new formats and flavors. However, this experimentation is best described as cautious. Taste continues to be of paramount importance and new purchases occur within a 'comfort-zone'. In practice, people are more likely to experiment in snacks and beverages than in meal-time choices.

Greater individualism: Consumers are making decisions based on individual preferences within families. What this means is a variety of products on the table rather than one single meal for everyone: perhaps pro-biotic versions for some family members, low-fat versions for others.

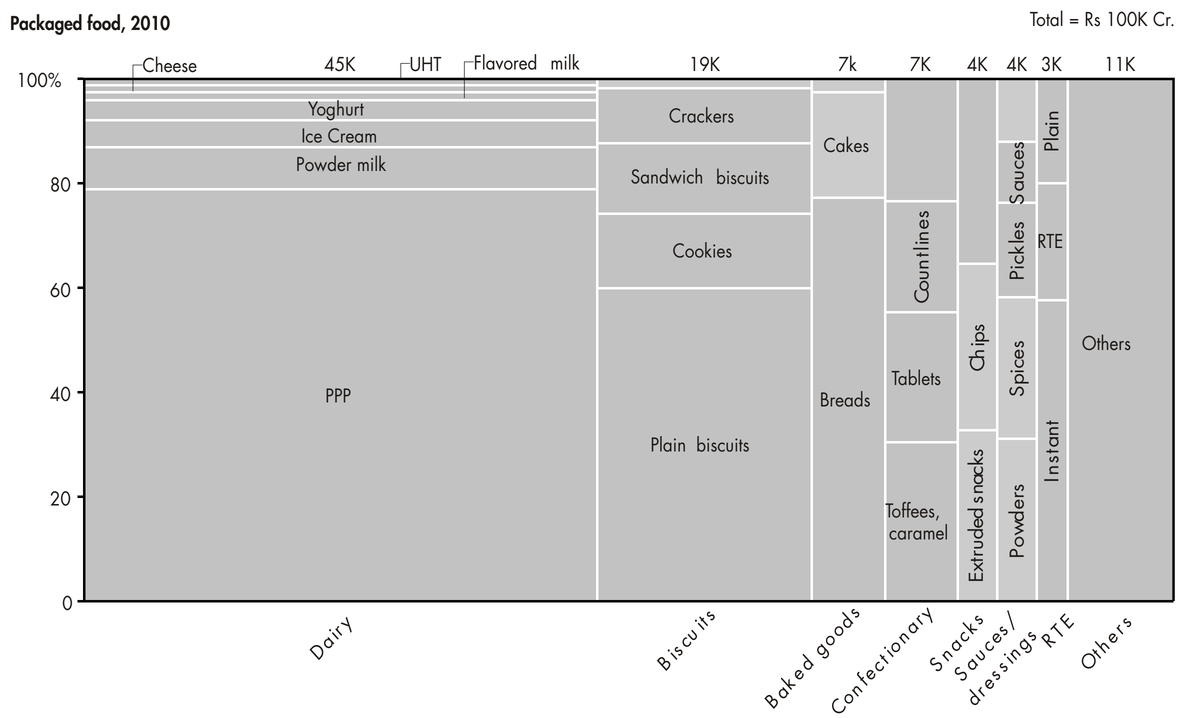
Leapfrogging: Sometimes consumer trends will skip several steps in the regular preferences evolution. For example, a consumer may move from making snacks and/or curd at home to buying elaborate flavoured wafers or low-fat packaged yoghurt.

Influence from restaurant chains: The continued growth of the HORECA sector (hotels, restaurants, and cafés) and the growing Indian propensity to eat out also affect decisions. The result is more experimentation with new flavours, increased purchasing of branded goods; and growth in the consumption of ready-to-eat meals and snacks.

3. Estimating growth

Currently, the packaged food industry is valued at Rs. 1 lakh crore, the majority of which is accounted for by dairy and biscuits:

Figure 4: Packaged foods currently dominated by traditional subsectors



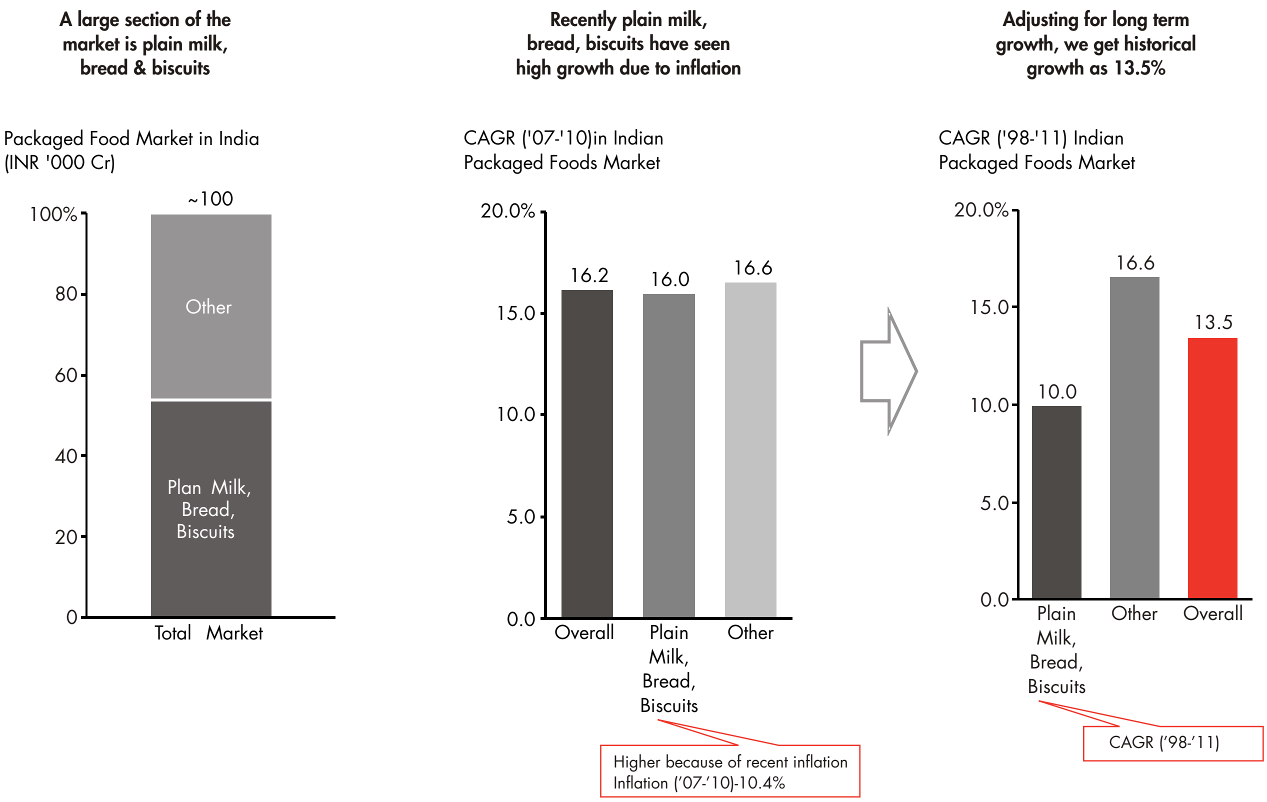
Note: Packaged foods excludes Oil and Fats
Source: Euromonitor, Bain analysis

Growth in this market over the coming years is inevitable. The question is: how much growth? We looked at four ways to forecast this.

Approach 1: Looking at historical growth

Almost half the sector is in plain milk, bread and biscuits. Despite recent high levels of growth due to inflation, a longer-term perspective shows that the average annual growth rate for packaged foods has been 13.5% since 1998. This provides a baseline estimate which could be used to forecast growth for coming years.

Figure 5: Historical growth averaged over the long-term has been 13.5% pa



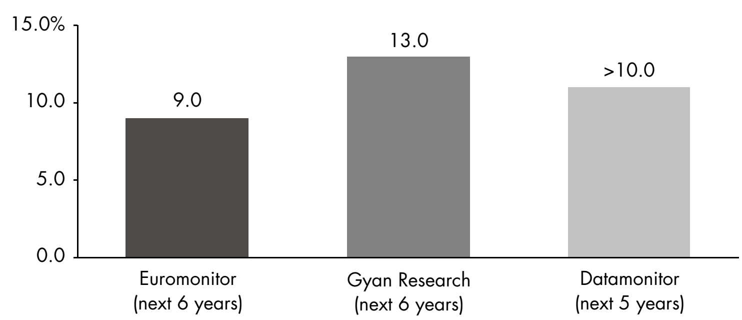
Source: Euromonitor, Bain analysis

Approach 2: Aggregating contemporary forecasts

Analysts predict growth rates for the packaged food sector anywhere from 9% to 13% for the next 5-6 years. At one end of this scale, EuroMonitor points to high inflation and reduced consumer spending power as factors which may limit growth, backed up by Datamonitor's conservative estimate of 10%[xv]. At the other end, Gyan Research's higher figure looks optimistically at the availability of raw materials, changing Indian lifestyles and the promise of favorable regulatory policies[xvi].

Figure 6: Current estimates of growth range from 9% to 13%

India Packaged Food Growth Rate forecasted by Analysts

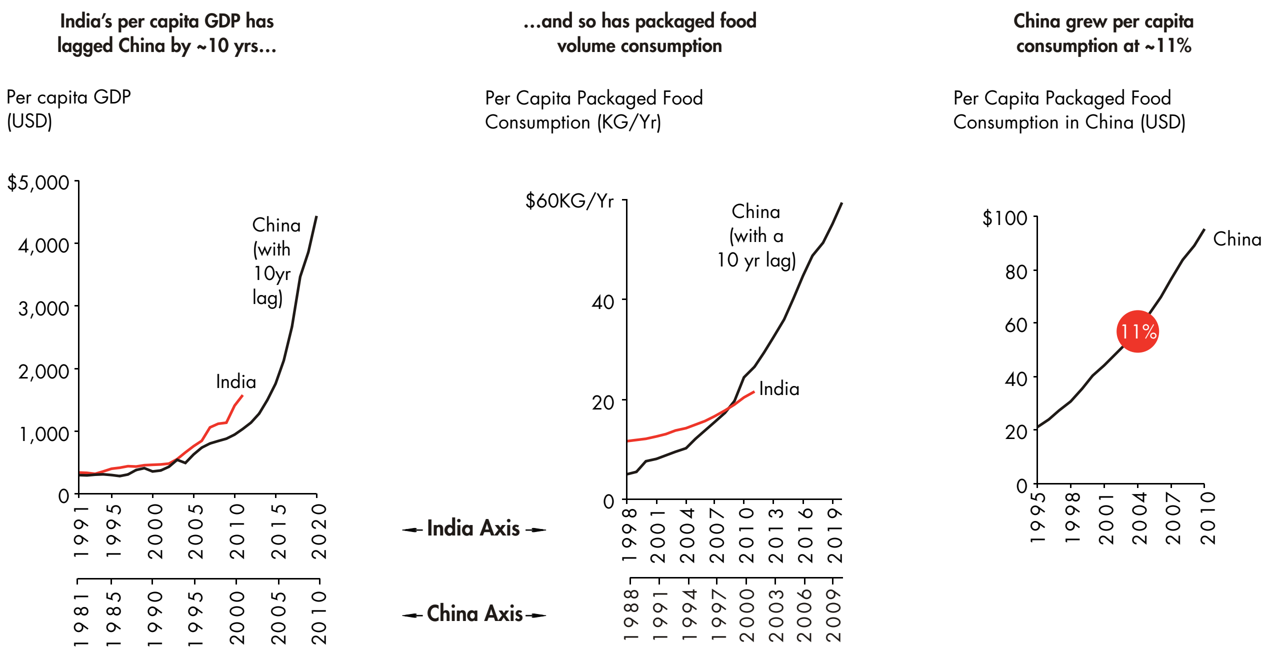


Source: Euromonitor, Gyan Research, Datamonitor, F&Bnews.com

Approach 3: Lessons from China

For decades now, India's per capita GDP has mirrored that of China with a lag of around 10 years. At India's current stage of domestic market development, China witnessed a significant upswing in packaged food consumption.

Figure 7: China's experiences suggest an imminent upswing in packaged food consumption in India



Adjusting for 3% higher inflation and 0.6% high population growth, India market could grow at ~15%

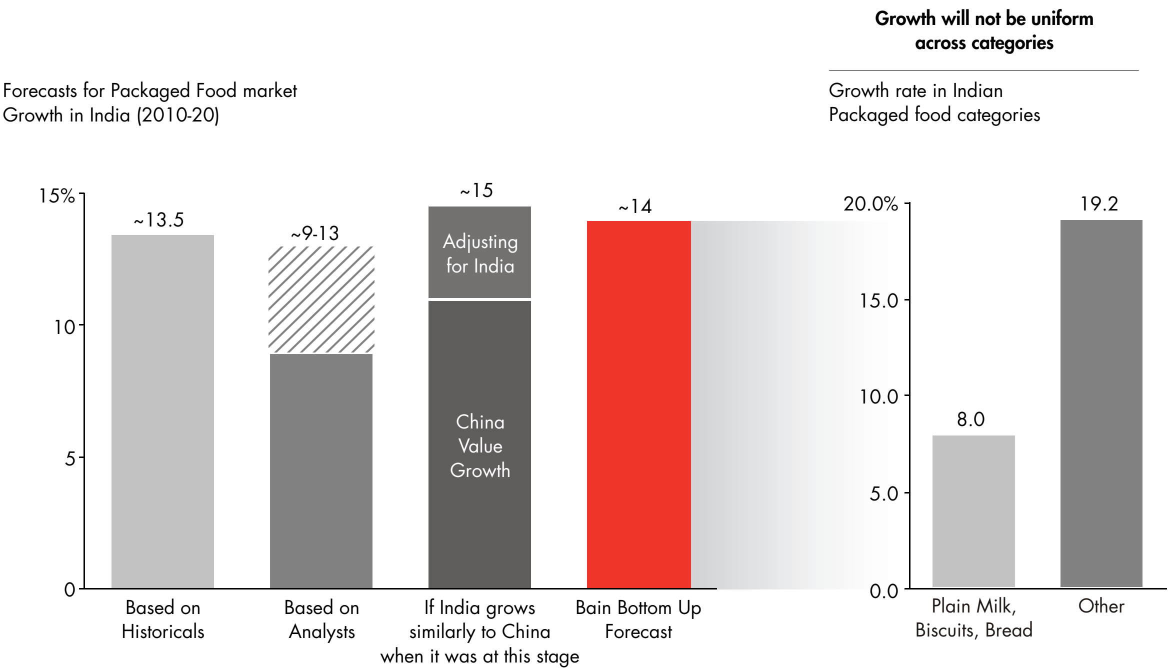
Source: Euromonitor; Netscribes; Hangzhou University; Bain Analysis

Between 1995 and 2010, per capita packaged food consumption in China grew at an annual rate of approx. 11%. Taking into account India's higher inflation and predicted population increase, this promising example means that India's packaged food consumption could reach an annual growth rate as high as 15%[xvii].

Approach 4: Bottom-up analysis of the sector

Obviously, growth will not be uniform throughout the sector. While annual growth in certain emerging sub-sectors may reach as high as 20%, mature categories of the market such as plain milk, biscuit and bread are unlikely to see rates higher than 8%[xviii].

Figure 8: Different categories of the market growing at very different rates



Note: Growth based on China is calculated assuming that per capita consumption of packaged foods grows at the same rate as that of China at the same period in its growth pattern

Source: Euromonitor, Datamonitor, Bain Analysis

These considerations lead us to assess the predicted rate of growth for India's packaged food market at around 14% pa. It's worth noting that this figure, whilst higher than previously predicted, will still leave India behind peer nations such as Brazil and China by 2020[xix].

There are two important conclusions to be drawn. First, growth will continue to be strong going forward and will be somewhat higher than anticipated. Second, growth is going to be especially intense in select categories which have emerged in recent years, such as flavoured milk and instant noodles. In contrast, categories that are basic and large today, such as bread and spices, will see slower growth going forward.

4. Key market success factors

To achieve this predicted annual growth rate of 14%, industry players must work hard to engage with the Indian consumer and create a suitable environment for growth. This report ends with an outline of critical factors which will affect profitability and outcomes for companies.

Success Factor 1: Secure quality input

Packaged food demand is racing ahead of India's agricultural production capacity and is beginning to cause shortages. Following the example of market leaders such as Lay's, Amul and ITC, companies must pay attention to the back end of production, working intensively with each stage of the value chain. This might involve:

- **Training farmers** to improve produce yields, through contract farming, better seeds or improved farming methods
- **Supporting research** to improve produce
- **Investing in infrastructure**, such as transport or processing machinery
- **Working with vendors**, encouraging them to promote certain products
- **Educating consumers** about the benefits of packaged food, such as improved product quality, variety and health

Case Study: Amul

Amul's example shows how companies can develop scale while continually nurturing their supply base. In growing its share of the dairy market, Amul has invested in:

- **Collection infrastructure:** providing logistical support to transport milk from distant locations to processing sites has allowed the company to include farmers with no previous access to the market.
- **Quality standards:** easy-to-understand measurements, 'quality circles' and weekly feedback sessions make it easier for farmers to comply with standards and ensure reliable supplies of market-ready produce.
- **Training and support:** Amul representatives provide veterinary care and educational services, low-price animal feed and support with accounting at a village level.
- **Technology:** innovations such as embryonic transfer have improved cattle breeding and e-kiosks provide farmers with instant access to information.

This sustained engagement with each level of the supply chain has consolidated Amul's position as Asia's leading dairy producer.

Success Factor 2: Connect with young Indian consumers

India's population has a median age of 25.5 years[xx], with young consumers more likely to purchase packaged food. Cadbury, Lay's and Pepsi all provide good examples of sustained and targeted marketing campaigns. They have also introduced country-specific products, helping to establish their brands as in tune with the tastes of India's youth market.

Success Factor 3: Focus on value-added products

Moving beyond basic offerings allows companies to increase market segmentation and penetration. Enriching products with nutrients, offering low-fat alternatives or promoting low-sugar options for diabetics are examples of ways in which brands increase market share by catering to the health-conscious. In the same way, luxury products (such as Cadbury's Silk range) sell at a premium and yield higher profit margin. In beverages, premium spirits account for just 8% of category share but provide 35% of industry profits[xxi].

Success Factor 4: Select the right categories

The market for packaged foods is evolving and companies must choose their entry point based on two criteria: whether the category is large and growing (therefore open to scalability); and / or whether it is not mature (therefore open to innovation and new brand competitors). To take biscuits as an example: savoury snacks are a rapidly-evolving category; whereas mass sweet biscuits are a mature subsection of the market. Operators in this subcategory would need greatly different products and marketing campaigns to achieve growth.

Success Factor 5: Do what it takes to be in the Top 3

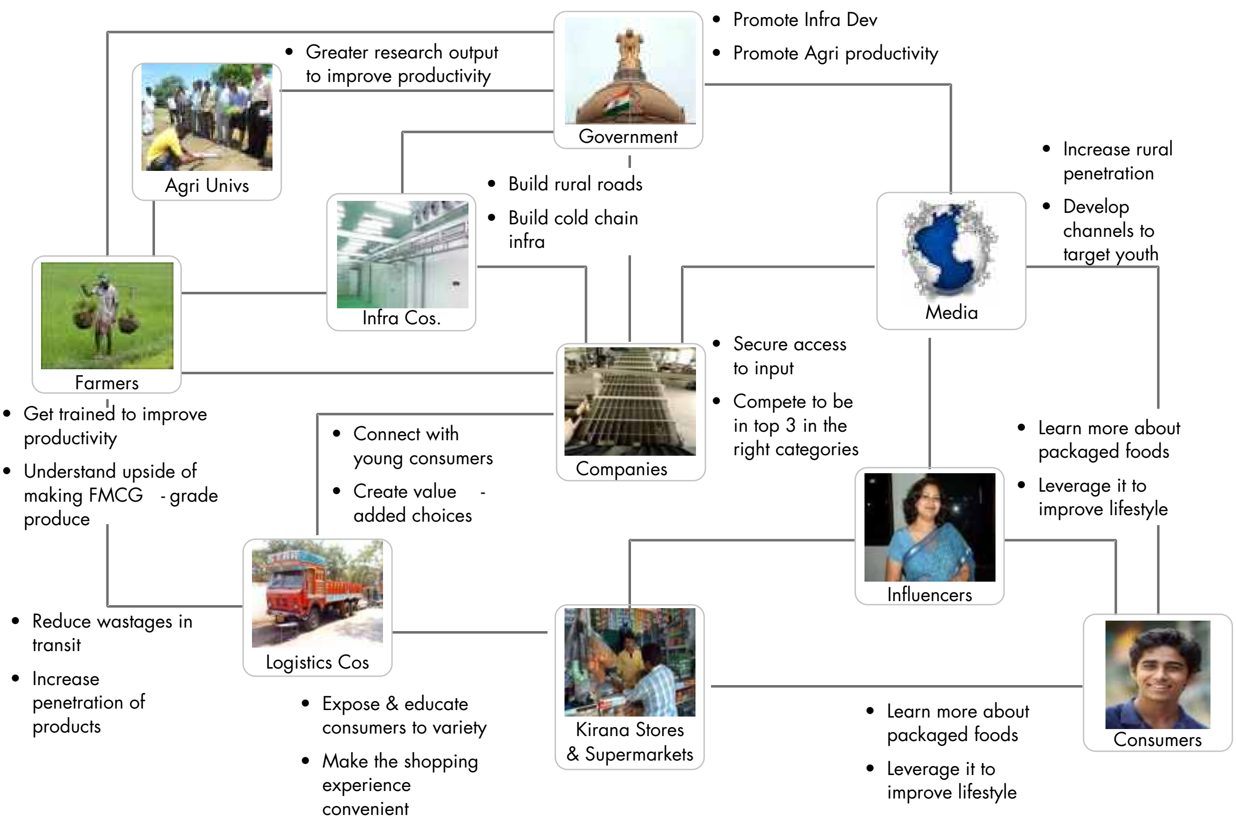
India's unique retail environment, with crowded sales channels and little direct interaction between consumers and products, means that brands must work hard for recognition. However, doing so is critical. Companies must choose carefully where they enter the market and do so based upon their strengths. Sustained, profitable growth in packaged foods is not easy, and in India - more than elsewhere - it's critical to establish a leadership position.

Conclusion

Making a profit in India's packaged foods market may not be easy. However, the current moment represents a tantalizing opportunity that food companies cannot afford to ignore.

To succeed in this sector, participants must plan and act smartly. But they must also bear in mind the existence of multiple stakeholders. Bain & Company's value-web, below, demonstrates the network of relationships and dependencies that form the packaged foods sector. In order to create new markets or win in existing ones, companies must recognize these dependencies and work productively with each element, as several leading players have already done.

Figure 9: The packaged food industry relies on a complex web of relationships



Source: Bain analysis

Each player in the value-web can benefit from the expansion of India's packaged food industry, and each has a part to play in promoting expansion. The sector as we see it is at an exciting point of inflection, with accelerated growth beckoning around the corner. How sharp that inflection point will be depends, to some extent, on developments within the policy and macroeconomic context. But for companies which understand this context, and are prepared - and able - to seize the opportunities presented by India's new markets, the prospects are bright.

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1 USD = INR 52

About Bain

Bain & Company is a global business consulting firm with offices around the world. It helps management teams and boards make the big decisions: on strategy, operations, mergers & acquisitions, technology and organization. Bain was founded in 1973 in Boston and its consultants have worked with over 4,600 major firms across every sector globally. Bain consultants measure their success in terms of their clients' financial results. Bain's clients historically have outperformed the Standard & Poor's 500 industrial index by 4:1.

In India, Bain has served clients since 1995 and formally opened its consulting office in 2006 in Gurgaon near New Delhi and in 2009 in Mumbai. Its India operations have grown rapidly and it has become one of the country's largest business consulting firms. In fact, Bain India is one of the fastest growing offices within the Bain system of 48 offices across 31 countries.

Bain's India consulting practice has worked in over 30 industries, with clients including large Indian corporates, MNCs and private equity firms. Bain consultants have worked with firms in sectors ranging from consumer products to infrastructure to telecom to financial services to healthcare. Their project experience includes growth strategy, M&A/due diligence, post-merger integration, organizational redesign, market entry and performance improvement. Our robust analytic tool kit and fact-based approach, coupled with our ability to draw lessons across industries, enables us to deliver innovative strategies that create value.

Bain India is also home to the Bain Capability Center, or the BCC, set up in 2004 in Gurgaon. The BCC supports Bain case teams across the globe to develop results-driven strategies.

Bain also believes strongly in supporting the wider community. Bain India formed Bain Prayas to lead community initiatives, some of which are:

- Collaborating with NGOs like Pratham and Ummeed to promote child education
- Pro bono consulting services to NGOs like CRY
- Bain consultants are working pro-bono with Dasra, a strategic philanthropy foundation, to help NGOs. Bain has also published widely-read India philanthropy reports

Bain has been recently awarded the title of "Best firm to work for" by Consulting magazine for the 10th straight year.

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About FICCI

Established in 1927, FICCI is the largest and oldest apex business organisation in India. Its history is closely interwoven with India's struggle for independence, its industrialization, and its emergence as one of the most rapidly growing global economies. FICCI has contributed to this historical process by encouraging debate, articulating the private sector's views and influencing policy.

A non-government, not-for-profit organisation, FICCI is the voice of India's business and industry.

FICCI draws its membership from the corporate sector, both private and public, including SMEs and MNCs; FICCI enjoys an indirect membership of over 2,50,000 companies from various regional chambers of commerce.

FICCI provides a platform for sector specific consensus building and networking and as the first port of call for Indian industry and the international business community.

Our Vision

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Acknowledgements

This report was prepared by Nikhil Prasad Ojha, Partner; Rohithari Rajan, Principal; and Sandeep Lodha, Principal, of Bain & Company who are all based in New Delhi.

The authors thank consultants Teemish Gupta and Aayesha Ghanekar for their contributions with research and analysis, as well as Anna Phillips for her editorial support. They appreciate the efforts of Pankhuri Nagalia in supporting the report. They also thank Mukesh Kaura and Sumeet Chopra for their design support.

The authors wish to thank FICCI for helping develop the perspectives outlined in this report, and the many interviewees who shared their views on the market.

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