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Financial implications of banning foreign brands in India-A case study Approach

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ABSTRACT:

Banning foreign products is the current topic highly discussed by large population in India. People claim there is an increasing threat to health of humans and also has an impact in Indian economy if banning of foreign brands especially food &beverages productsis done by the Indian Government. Since both domestic and foreign investors invest in foreign products it is unambiguous to have its impact on the Indian economy.Research on the health risks associated with the consumption of sugary drinks is more abundant than research on the risks from any other food. Hence a detailed study is done to analyse the impact on those foreign products financially in order to know aftermath effects of banning.

Key words: Foreign brands ban, financial implication, challenges, issues

INTRODUCTION:

The **FOOD & BEVERAGES** industry in India has a total turnover of around USD 65 billion which includes value added products of around USD 20.6 billion. Coca cola, Pepsi, and Nestle are the leading beverage brands that have been ruling the Indian beverage market since past few decades. Among all the beverages, tea and coffee are manufactured as well as exported heavily in the international markets succumbing to the individual demands around the world.

The beverage industry in India constitutes of around USD 230 million among the USD 65 billion food processing industry. The major sectors in beverage industry in India are tea and coffee which are not only sold heavily in the domestic market but are also exported to a range of leading overseas markets. Half of the tea and coffee products are available in unpacked or loose form. Among the hot beverages manufactured in India, tea is the most dominant beverage that is ruling both the domestic and international market even today. The supply of tea and coffee is insurmountable in the Indian beverage industry.

The soft drink market such as carbonated beverages and juices constitutes around USD 1 billion producing 284 million crates per year. In the peak season, the consumption capacity reaches 25 million creates per month and during off season the same goes down to 15 million crates in a month. Pepsi and Coca cola are the two leading brands in the Indian market. The mineral water market in India is a USD 50 million industry and produces 65 million

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crates. Around 4.9 million crates is usually consumed each month but it rises to 5.2 million create inthe peak season.

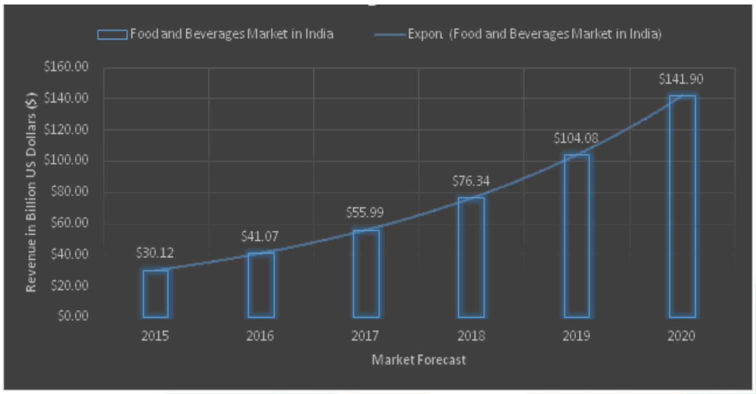

Fig 1: Growth prediction on Food and Markets in India

Source: www.wikiinvest.com

Review of Literature - Beverage Companies in India

Fruit juices, pulp and concentrates, and sauces or ketchups are doing very well in the beverage market in India for the past few years. Various milk products, health beverages, beer, and country liquors have also been contributing largely in the rising demand of beverages in India.

The leading beverage companies in India are also exporting various products especially tea and coffee to the international markets every year. Tea and coffee have registered an excellent growth in the Indian beverage market as these are the most preferred drinks purchased excessively around the world. Among all the leading beverage companies in India, Coca cola has accounted for a thriving growth since its inception. It occupies around 60 percent of the carbonated drink sector in the Indian beverage industry.

Another predominant brand in beverages is Nestle India Limited which occupies 61.85 percent of the total Nestle S.A. Switzerland. The Nestle products are hugely exported to Russia apart from selling in the domestic market.

Indian Food Industry – Statistical connotations

The food processing industry is one of the largest industries in India and ranks fifth in terms of production, consumption and exports. As per the latest data available, food processing sector is expected to reach US$ 258 billion in FY15.

In FY16* (till December 2015), food processing industry constituted 14 per cent to India's GDP through manufacturing.

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Fig 2: Export Data -Agriculture & Processed Food Products

Source: Agricultural & Processed Foods products export Development Authority (APEDA)

F&B to become an Rs 3.8 trillion industry by 2016-17.India's food and beverages (F&B) industry will expand at an average annual pace of 24% to reach Rs.3.8 trillion in sales by the year ending 31 March 2017, a report predicted on Tuesday. Fast-food joints, which have the largest market share at 45%, will grow by 16.6% a year, said the report by consulting firm Grant Thornton India and lobby group Federation of Indian Chambers of Commerce and Industry (FICCI), followed by casual dining (32% share) expanding 10.1% annually.

Standalone restaurants, which comprise 22% of the market, is the fastest-growing, the report said, while the cafe segment with 12% market share is growing at 10.7% a year.

Although fine dining constitutes only 3% of the market, the segment is seeing a renewed interest, particularly from multinational chains, the report said.

Fast-food chains such as McDonald's, Domino's Pizza, KFC, Subway, Haldiram's and Bikanervala are estimated to have combined sales of Rs.92,000 crore by 2016-17 as they expand into smaller cities.

There is a large untapped opportunity in smaller towns for quality eating-out chains, said Devndra Chawla, group president, food brands at Future Group and co-chair of FICCI's task force on food retail.

Local fast-food firms are expanding faster at about 37% in terms of number of stores, compared with foreign firms growing at 28% a year.

The study found that although nearly 70% of the sector is still unorganized, it is changing fast. In the next 4-5 years, the unorganized share is expected to fall to 60%, it said.

Indians spend about half of their total consumption expenditure on food, the report said, which seem to be rising among people between 20 and 25 years of age. "Indian consumers are increasingly dining out, particularly in urban areas. Urbanisation, changing lifestyle and food preferences are spurring the organized market," noted the study, adding that about 70% of the young consumers in India are price-sensitive.

The other key driver for the growth in the F&B sector is the rising number of working women and eating-out options.

However, unskilled manpower, lack of quality infrastructure, high real-estate cost, complex licensing and irrational taxation dog the sector, stalling its growth, said Piyush Patodia, executive director, Grant Thornton India. "While GST will be rolled out, the government should look at rationalizing the taxation for F&B services sector first. Licensing also needs to be simplified, something like a single-window clearance," he said.

Realty cost, the study found, is 15-20% of a firm's revenue in India for the sector; while the global average is below 15%—issues that restrict foreign brands from stepping into India. "While India is a large opportunity, foreign brands need to have the appetite for risk before they step into India. It appears to be a difficult terrain with multiple taxes, complex licensing and high operating costs.

Investments in F&B sector

Deals in food processing industry

With the increase in attractiveness of the food processing industry, there has been significant deal activity in this space with mixed contribution from corporate M&A and private equity investments. M&A deals increased from 15-16 deals in 2011 and 2012 to 20 in 2013. Similarly PE deals increased to 12 in 2013. The current year deals indicate sustained interest on Deal Street.

The key trends in the deals by segments are:

• Dairy segment has witnessed primarily PE deals with few M&A. While, PE deals indicate the attractiveness of the consumption sectors (due to growth potential) to PE community, M&A deals, which includes inbound deals, indicate the consolidation trend expected in the sector on the back of growth potential

• Fruits & Vegetables as a segment are yet to evolve for food processing industry. This is evident from the deal space where only two PE transactions took place in the last 3 years

• Grain & Cereals segment has witnessed deals primarily relating to businesses in oil seeds extraction and export of rice

• Consumer products (packaged and beverages) segment witnessed the highest number of deals i.e. 41 in 3 years, of which 22 pertain to beverages and 19 pertain to packaged foods Higher activity in packaged foods is due to the emergence of ready-to-eat/ cook and branded products addressing theconvenience aspect of consumer preferences Higher activity in beverages is driven by the deals in alcoholic beverage space involving leading players in the segment - Diageo plc., United Spirits Ltd, Tilaknagar Industries, etc.

Deals in supply chain and logistics Space

As supply chain linkage between the agriculture sector and food processing sector was critical for driving the growth in food processing industry, there have been deals in supply chain and especially cold chain space. The key highlights of the deals in the supply chain and logistics space the theme for these transactions has been storage and preservation

• Cold storage and logistics have witnessed more transactions, primarily private equity investments

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• Agri-warehousing is the next segment which witnessed private equity investments in Sohanlal Commodity Management and GramcoInfretech

Company name	Period	Financial/Strategic Stake
Diageo Plc United Spirits Ltd	November 2012	Deal :USD 882 Strategic stake: 25.02%
India Hospitality Corp Adelie Food Holdings Ltd	April 2012	Deal : USD 350 Acquisition stake:100%
Groupe Lactalis SA Thirumala Milk Products Private Limited	January 2014	Deal:275 Acquisition 100%
Wilmar International Shree Renuka Sugars	February 2014	Deal: 200 Controlling Stake N.A.
Roquette Freres Riddhi Siddhi Corn Processing Private LimitedStarch business of Riddhi Siddhi Gluco Biols	April 2012	Deal:190.00 Majority Stake 60.00%
Diageo Plc United Spirits Ltd	January 2014	Deal:138.00 Increasing Stake to 28.7% 2.40%
Hassad Food Co Bush Foods Overseas Pvt Ltd	April 2013	Deal:100.00 Majority Stake 51.00%
December Bunge Ltd Amrit Banaspati Company Ltd	January 2011	Deal: 78.00 Acquisition 100%

Table1: Top M&A Deals

The number of transactions and emergence of new brands and players in the food and beverage space in the last few years is a testament that both the consumer and the investor are actively participating in the growth of this sector which has a strong growth potential. Government' support and push to bring about real estate correction and supportive logistics infrastructure will further boost the growth. Also, appropriate human resource talent for service and technology for production is the need of the hour. All this together will perhaps will help create a truly national brand in India, something which we have only a handful today.

TWO major examples can be looked after One Pepsico and another coco cola company.

COCO COLA:

Coca-Cola was created in 1886 by John Pemberton, a pharmacist in Atlanta,

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Georgia, who sold the syrup mixed with fountain water as a potion for mental and physical disorders. The formula changed hands three more times before Asa D. Candler added carbonation and by 2003, Coca-Cola was the world's largest manufacturer, marketer, and distributor ofNon -alcoholic beverage concentrates and syrups, with more than 400 widely recognized beverage brands in its portfolio.

Coke in India

Coca-Cola was the leading soft drink brand in India until 1977 when it left rather than revealsits formula to the government and reduces its equity stake as required under the Foreign Exchange Regulation Act (FERA) which governed the operations of foreign companies in India.

After a 16-year absence, Coca-Cola returned to India in 1993, cementing its presence with a deal that gave Coca-Cola ownership of the nation's top soft-drink brands and bottling network. Coke's acquisition of local popular Indian brands including Thumbs Up (the most trusted brand in India21), Limca, Maaza, Citra and Gold Spot provided not only physical manufacturing, bottling, and distribution assets but also strong consumer preference. This combination of local and global brands enabled Coca-Cola to exploit the benefits of global branding and global trends in tastes while also tapping into traditional domestic markets.

Leading Indian brands joined the Company's international family of brands, including Coca- Cola, diet Coke, Sprite and Fanta, plus the Schweppes product range. In 2000, the company launched the Kinley water brand and in 2001, Shock energy drink and the powdered concentrate Sunfill hit the market.

PREVIOUS INCIDENT OF BANNING COCO COLA IN INDIA:

In 2006, Coco cola was banned in 3 states due to pesticides found in soft drinks. A study released by the Centre for Science and Environment (CSE) found an average pesticide residue of 11.85 parts per billion in 57 samples of Coca-Cola and PepsiCo drinks produced in 12 Indian states. This is about 24 times higher than limits agreed, but not yet enforced, by the Bureau of Indian Standards.

This is the second report from the centre, based in Delhi. A previous study released in 2003 found that four pesticides were in Indian fizzy drinks. This time five pesticides were found in cola samples collected from across the country.The CSE said pesticide levels were not necessarily any higher in cola than in any other foodstuffs consumed daily by Indians. The difference, insisted the environmental thinktank, is that soft drinks do not have substantial nutritional value, which would make drinking them worth the risk.

Some of the media sources also witnessed the banning of coco cola:

1 "Toxic effect: Coke sales fall by a sharp 30-40%," The Economic Times, 8/13/03, p 1.

2 "Controversy-ridden year for soft drinks." Business Line, New Delhi, 12/30/03, p 6.

3 "Toxic effect."

4 "Hard Truths About Soft Drinks." Center for Science and Environment, Press Release, 8/5/03.

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5 "No standards for world-wide pesticide residues in soft-drinks." Business Line, New Delhi, 10/03/03 p 9.

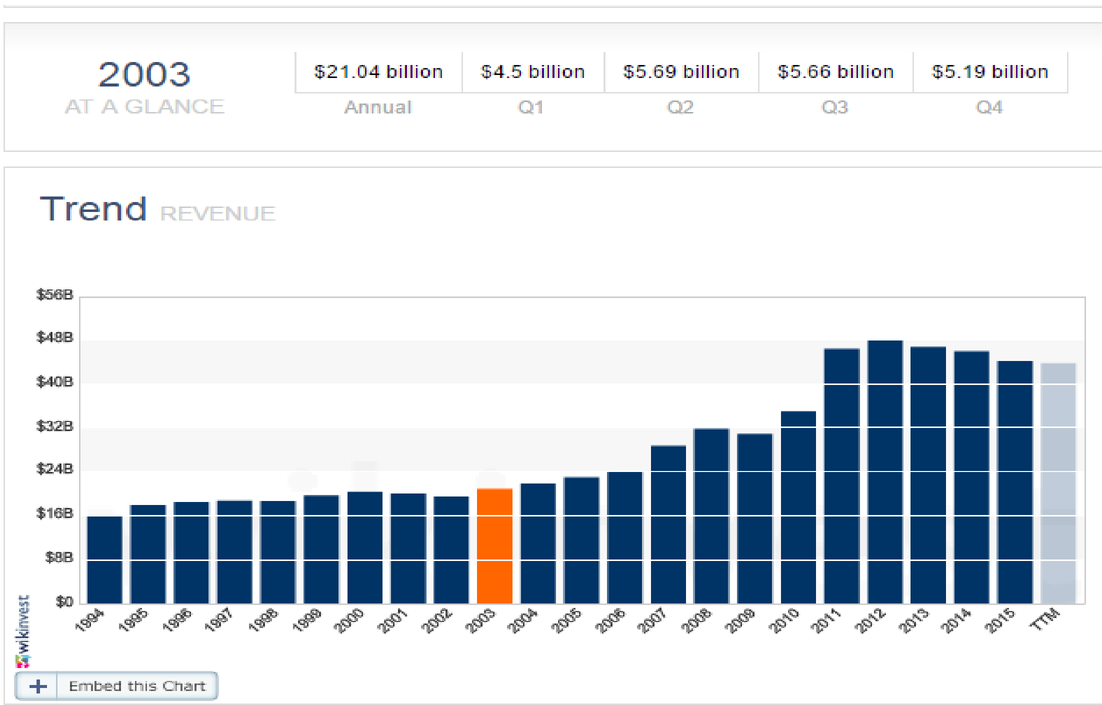

Fig 3: Revenue status of coco cola in 2003
Source: www.economictimes.com

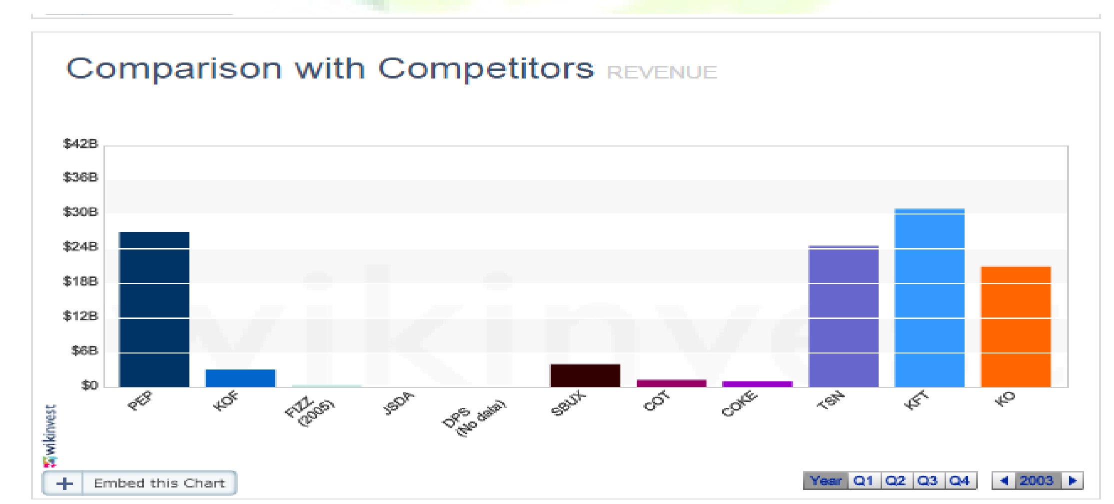

Fig 4: Coke's revenue in comparison with competitors
Source: economictimes.com

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IMPACT:

It is seen that coco cola managed to earn its revenue considerably when compared to previous year i.e, 2002 where it seems to be slightly lower than 2003. But we are also able to see that COKE had second lowest market share when compared to other competitors due to banning impact on coke in majority of states.

It may be recalled that Coca-Cola, the world's number one player, was present in India for a long time in collaboration with an Indian producer but was thrown out in the late 1970s. It reappeared in India following the economic liberalization era - but after its rival, world's number two, had already entered in a big way following a long and tough fight against the opposition from the domestic producers.

When Coca-Cola re-entered, it installed a new milestone. It acquired the well flourishing India's top player, Parle. Since then it is basically a fight between the two American giants. Others are playing a peripheral role, as adjuncts to the two MNCs. World's third biggest player, Cadbury Schweppes, had also made an entry but was gobbled up by Coca-Cola.

When Coca-Cola acquired Parle brands, it was, in fact, buying the bottling facilities, the marketing network, and the established consumer preference during the market build-up. The brands were a drag on the global brand.

Since Coca-Cola was not interested in brands (like Thumps Up), it did not promote them. The result, at least, in the short run was a loss of the market to the competitor. Coca-Cola decided to market more effectively the Parle brands. It had in its armoury Coke, Thumps Up, Limca and Fanta. The latest to enter market was Parle's erstwhile Rimzim, alongside Portello, a black currant flavoured drink, very popular in Srilanka.

PEPSI CO:

PepsiCo products are enjoyed by consumers one billion times a day in more than 200 countries and territories around the world. PepsiCo generated more than US $63 billion dollars in net revenue in 2015, driven by a complementary food and beverage portfolio that includes Frito-Lay, Gatorade, Pepsi-Cola, Quaker and Tropicana. PepsiCo's product portfolio includes a wide range of enjoyable foods and beverages, including 22 brands that generate more than US $1 billion dollars each in estimated annual retail sales.

The year 2003 was a tumultuous one for the India operations of soft drink giants Coca-Cola and Pepsi. That year, according to an Economic Times report, the Centre for Science and Environment (CSE) alleged in its report that 12 brands from both the soft drink makers contained pesticide levels many times higher than the permissible limits.

Sales of their products, the report added, took a large hit and for some time refused to show a pick-up despite large-scale damage control.

According to the CSE website, their 2003 study led to the formation of the first Joint Parliamentary Committee looking into the health and safety of Indians. The committee, CSE said, was tasked with verifying the findings, and the organisation claimed that the committee's report "vindicated CSE' findings".

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Unlike its major competitor, the Coca-Cola Company (KO), the majority of PepsiCo's revenues do not come from carbonated soft drinks. In fact, beverages account for less than 50% of total revenue.

Additionally, over 60% of PepsiCo's beverage sales come from its key noncarbonated brands like Gatorade and Tropicana. PepsiCo's diverse portfolio can mitigate the impact of poor conditions in any one of its markets. Strong demand growth in international markets -- the company serves 86% of the world's population and international sales account for 48% of revenue -- is helping to offset a sluggish domestic market and provided the company with opportunities for continued expansion.

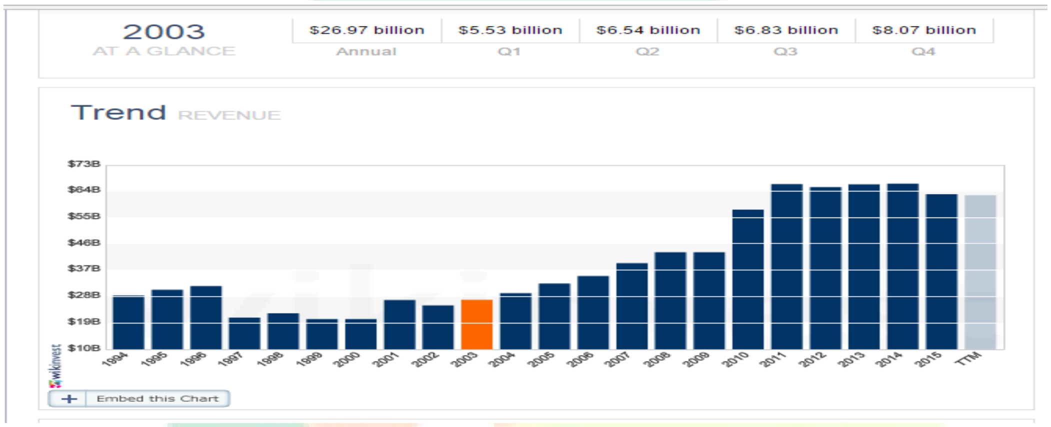

Fig 5: Revenue status of PepsiCo in 2003
Source: www.economictimes.com

In 2006, the Gujarat government directed state-run colleges and schools to discontinue sales of Coke and Pepsi soft drinks on their premises, the Washington Post had reported.

The Supreme Court, the report said, also asked Coke and Pepsi to disclose the ingredients of their drinks. The apex court's mover came days after the CSE, again, said that it found pesticide levels 24 times higher than what was permissible in Coke and Pepsi products.

According to a Bloomberg report from 2006, members of the Bharatiya Janata Party had even called for a nationwide ban on Pepsi and Coke, in the wake of the revelations. Further, BJP activists had also smashed Pepsi and Coke bottles and staged mock funerals, the report said.

PepsiCo is highly exposed to raw materials costs. Prices for the most important input materials, aluminum, PET plastic, corn, sugar, and juice concentrates fluctuate widely.

Relief to Coke – A scenario in 2013

Coca-Cola Co received relief from the Supreme Court in 2013, according to a LiveMint report, when the apex court declined to ban its soft drinks in India but allowed the mandating of a declaration on the packaging and containers that the level of pesticide residue in the drinks was compliant with the permissible limits.

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The apex court, the report added, had been hearing a public interest litigation (PIL) by Sunil Mittal originally filed in the Rajasthan high court, which sought a ban on the sale of Coca-Cola drinks, citing the presence of pesticide residue.

Other PILs filed against the soft drink giants:

A PIL was filed in 2003 in the Madras High Court, seeking to restrain PepsiCo and Coca Cola and their dealers from selling and transporting their products in Tamil Nadu

Another PIL for restraining Pepsi and Coca Cola from manufacturing, distributing and selling of their soft drinks was filed in the Lucknow bench of Allahabad High Court, in 2003

As a major strategic departure, both MNCs were expanding their brand range. Consequent to some diversifying moves, at present, the sales ratio of Coca-Cola between soft drinks and other beverages is 95.5. The company intended to change this to 80:20 in the next three years. Its juice brand, Maaza - acquired from Parle a few years ago - is being given a major thrust. It has plans to go in for canned coffee, iced tea and purified categories under expansion schemes. It has already launched its bottled water brand, Kinley, in the Indian market. Besides, it is intending to acquire domestic brands in the non-carbonated beverages segment.

Year	Rupees (In millions)
2000-01	243
2001-02	262
2002-03	279
2003-04	291
2004-05	310
2005-06	330
2006-07	359
2007-08	373
2008-09	388
2009-10	403
2014-15	479

Table 2:Growth of investments in beverage sector from 2000-2015
Source: www.nseindia.com

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YEAR	MARKET GROWTH RATES
2001-02 - 2006-07	6.5%
2004-05 - 2009-10	5.4%
2009-10 - 2014-15	3.5%
Sensitivity Coefficient	**5.2%**
Prediction	**16.5 -19%**

Table 3: Market growth rates in food & beverages industry
Source: www.nseindia.com

The ICRIER-IBA report said that with the rise in incomes India's non-alcoholic beverage sector has evolved both in terms of product variety and the number of companies in the market.

Consumption of non-alcoholic beverages is expected to increase by 16.5-19% over the next three years as more people are trading up to packaged drinks, according to a report by the Indian Council for Research on International Economic Relations (ICRIER) and the Indian Beverage Association (IBA) released on Thursday.

Corporate manufacturers of non-alcoholic beverages are expected to grow at an annual rate of 16.5% and non-corporate manufacturers at 19%, according to the report titled Unleashing the Potential of the Non-alcoholic Beverage Sector.

The estimates are based on an assumed gross domestic product growth of 7%, which is much higher than the 5% growth several economists are forecasting.

India's beverage market is largely unorganized, with nearly 75% of the demand serviced by companies in the unorganized sector. But in the past 18 months, the world's largest beverage makers Coca-Cola Co. and PepsiCo Inc. invested heavily towards building capacity and developing bottling infrastructure in the country over the next 7-8 years, to meet the growing demand for packaged beverages.

The sector has seen double digit growth post-liberalisation, and is currently contributing over 1% to India's GDP. With industry leaders such as Coca-Cola and PepsiCo announcing significant investment plans for India, there is a clear indication that the sector offers significant potential for growth in the coming years.

The50-bn-rupee soft drink industry is growing now at 6 to 7% annually. In India, Coke and Pepsi have a combined market share of around 95% directly or through franchisees. Campa Cola has a 1% share, and the rest is divided among local players. Industry watchers say, fake products also account for a good share of the balance.

There are about 110 soft drink producing units (60% being owned by Indian bottlers) in the country, employing about 125,000 people. There are two distinct segments of the market, cola and non-cola drinks. The cola segment claims a share of 62%, while the non-cola segment includes soda, clear lime, cloudy lime and drinks with orange and mango flavours.

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FINANCIAL IMPACT ANALYSIS

The economic implications of a company or industry is measured using a standard means of analysis called an economic impact assessment. In this report we model the contribution of the Indian soft drinks industry, defined to include those involved in the sale of soft drinks through the off-trade and the on-trade, and soft drinks manufacturers (including their head office functions).

The report quantifies the three 'core' channels of impact that comprise the industry's 'economic footprint':

Direct impact: the economic activity supported by the soft drinks industry itself;

Indirect impact: the economic benefit and employment supported in the industry's supply chain as a result of the procurement of goods and services; and

Induced impact: the wider economic benefits that arise when employees of the soft drinks industry and its supply chain spend their earnings, for example in local retail establishments.

From these channels, the industry's total India economic footprint is presented, using three key metrics: GDP, or more specifically, the soft drinks industry's gross value added (GVA) contribution to GDP; Employment, measured as the number of people employed; and Tax, representing the tax receipts paid to the Indian Treasury.

CONCLUSION:

Even though traditional and homemade drinks will always remain popular, packaged beverages are gaining traction with Indian consumers who are now frequently reaching for their more convenient-to-consume counterparts—soft drinks. While consumption is on the rise, soft drink manufacturers have some distance to go before they fully capitalise on the opportunity.

Over the past two years, the soft drink industry has seen a value growth of 11% compound annual growth rate (CAGR) and a volume growth of 5% CAGR. In total, 1.25 billion people in the country drink 5.9 billion litres of soft drinks in a year. This makes India's per capita soft drinks consumption large, but just 1/20th of that of the U.S., 1/10th of Kuwait, 1/8th of Thailand and Philippines, and one-third of Malaysia's.

Thus the banning of foreign beverage affects the Indian economy and has implications in the financial results. Thus the decision on banning not only affects the foreign companies but also the domestic country transactions and also Indian stakeholders working in the beverage sector.

SOFT DRINK SEGMENT- Growth Drivers

Small evolving segments like energy drinks may not be sufficient to either drive the per capita consumption or bring in the desired growth for this category. The first challenge that this category faces is to outpace other impulse consumption and traditional options available and clock high single-digit growth in volume. Moreover, the category is dependent on soaring summer temperatures across the country, and a delayed onset of rain and winter can affect demand.

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The three winning strategies that give growth impetus to India's soft drink category:

- Continuous and aggressive focus on innovations
- Making the category season-neutral
- Focus on execution

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