Indian Restaurant & Food Service Industry Update

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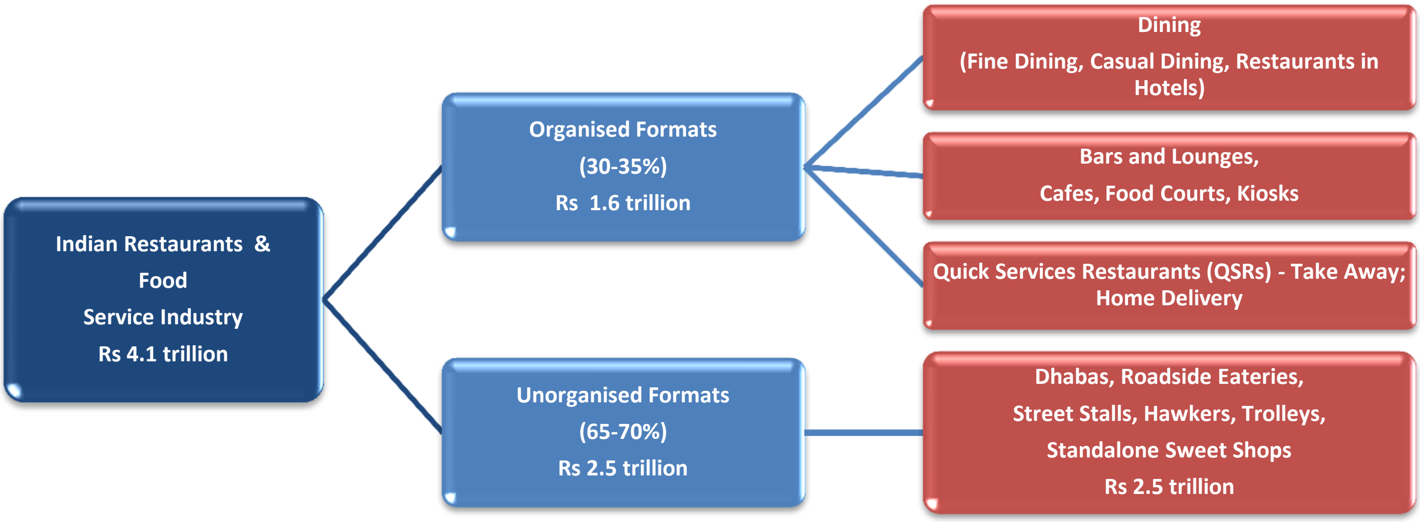
Overview

The Indian Restaurants and Food Services Industry has continued to expand at a healthy pace, aided by y-o-y growth in the incomes and largely unaffected by the prevalent economic scenario that has slowed growth in sectors like manufacturing and infrastructure. The market size of the Indian restaurants and food services industry stands at Rs 4.1 trillion as of FY19 registering a y-o-y growth of about 10.5% and a CAGR growth of 9% between FY14 and FY19. The Indian Hotels & Restaurant Industry's contribution together to GDP and exchequer continues to remain negligible at below 1% till FY19.

The Indian restaurant and food service industry comprises two distinct segments: **organised and unorganised**. The organised segment accounts for about 30-35% of the industry, while the unorganized segment accounts for the remaining 65-70%. The unorganised segment of the industry consists of individuals or families selling ready to eat food through roadside vendors, dhabas, food carts, street stalls, etc. However in line with the evolving consumer preferences and increasing innovation by the organized formats, the industry has experienced a rapid shift towards the organised segment in the recent past. The shift is further fuelled by the foray of large global international brands into the organised food service sector. Quick services restaurants (QSRs) and casual and fine dining restaurants account for about 75-80% of the organised segment, followed by cafes & bakery and pubs, clubs, bars, and lounge (PBCL) accounting for about 8-10% and institutional catering and kiosks with 13-15% share in the organised market.

Going forward, CARE Ratings expects **the restaurant and food service industry to register a growth of about 10.3% CAGR for the next 5 years between FY19 and FY24 to reach Rs 6.7 trillion by FY24**. However, the industry is expected to witness headwinds in the short to medium term with the outbreak of covid-19. The growth will be supported by long term healthy demand outlook backed by higher disposable income, favorable demographics and rising aspirations of the burgeoning middle class, increasing internet penetration, increasing number of women joining the workforce, increasing focus on health and wellness, technological advancements and growing urbanization.

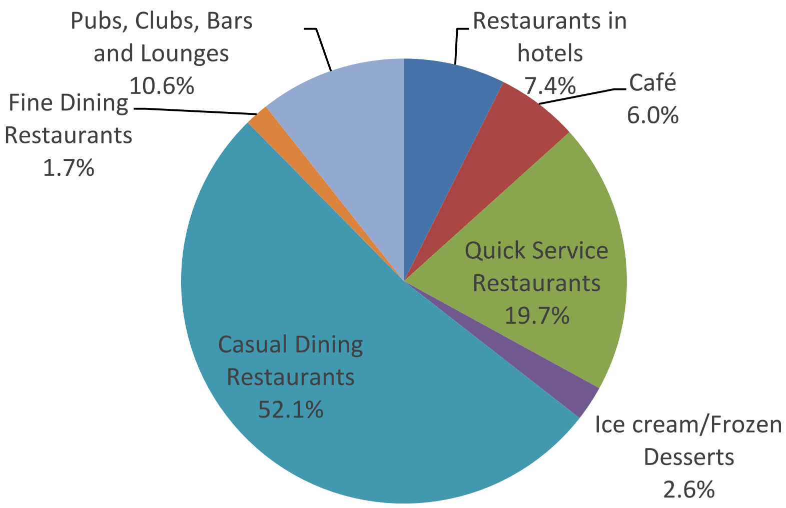
Chart 1: Indian Restaurant & Food Service Industry FY19



Source: Technopak, Company reports

The Indian food services market stood at Rs 4.1 trillion as of FY19, of which the organised market accounted for about 39% (Rs 1.6 trillion) while the unorganised market accounted for the larger share of 69% (Rs 2.5 trillion). Within the organised market, standalone licensed market accounted for the largest share of about 70%, followed by the chain market at 22.5% and the restaurants in hotels that accounted for the balance 7.5%.

Chart 2: Indian Organised Food market segmentation – FY19 (%)



Source: Technopak, Company reports

Quick service Restaurants (QSRs) forms an integral part of the Indian Food industry. The QSRs have both fast food cuisines as well as minimal table services and majorly cater to the millennial and working professionals usually in the age bracket 15 – 40 years. The USP of QSRs is quick deliveries and competitive pricing that attract consumers.

Major drivers of Indian food industry

1. **Favourable demographics**

- The growing Indian population has also led to increase in the 'earning population' (age group 15-60) of the country. The proportion of Indian populace in the age group of 15-60 years increased from 62.5% in 1991 to 66.98% in 2019.
- Considering the huge size of the Indian population, the lower median age implies a higher number of working people thereby clearly outlining the immense earning as well as spending potential of the Indian populace.
- Taking into account the age group below 25 years being one of the highest spending age group, the current age dynamics are expected to boost the retail sales in India. The median age of India is 28.7 years, one of the lowest globally in comparison to 38.5 years in the US, 45.6 years in Japan and 38.4 years in China.

2. **Economic growth**

- GDP registered an average growth of over 7.5% in the last 5 years, i.e. between FY15 and FY19
- Per capita GDP witnessed a growth of over 10% y-o-y and per capita Private Final Consumption Expenditure (PFCE) registered growth of over 11% on y-o-y basis during FY19
- With International Monetary Fund (IMF) and Organisation for Economic Co-operation & Development (OECD) estimations of India becoming one of the fastest growing large economies in the world, the consumer sentiments remained quite positive in FY19 in terms of spending on services registering a growth of about 7.4% y-o-y in FY19. However, the growth was marginally slower compared with previous years on back of uneven monsoon that led to lacklustre agricultural growth and subdued consumption demand.

3. **Rising income levels & growing per capita expenditure**

- In the last decade, Indian economy has progressed rapidly. Correspondingly, India's per capita GDP has gone up from Rs 98,405 in FY15 to Rs 142,963 in FY19 at a CAGR of 9.8% fuelling a consumption boom in the country.
- Correspondingly, the per capita personal disposable income surged from Rs 100,439 in FY15 to Rs 145,159 in FY19 at a CAGR of 9.6%. Also, the per capita private final consumption expenditure too rose from Rs 57,201 in FY15 to Rs 84,808 in FY19 at a CAGR of 10.3%. The growth in country's per capita GDP in turn has increased the disposable income of the populace ultimately driving the country's consumption.

4. **Growing spread of plastic money & easy availability of credit**

- The growing use of 'plastic money' i.e. credit and debit cards has resulted in an increased spending amongst the consumers thereby fuelling the demand in the service sector. With the acceptance of plastic money by almost all the service providers in the organised segment, the number of outstanding plastic cards in the country is on a rise. The incentives such as cash-back offer or discounts on selected sales linked to the plastic money have lured the Indian consumer to experience the pleasure of 'cashless spending'.

Chart 3: Credit card transactions (000 Nos)

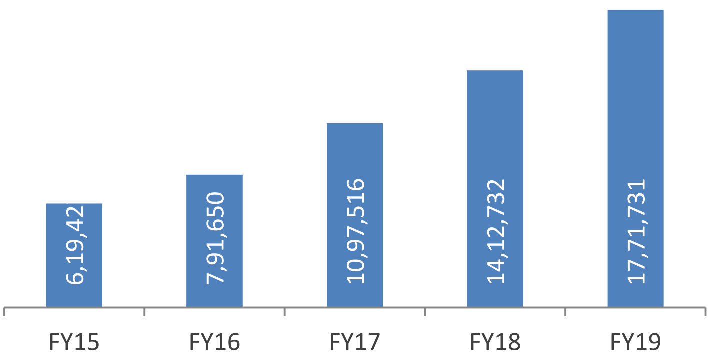
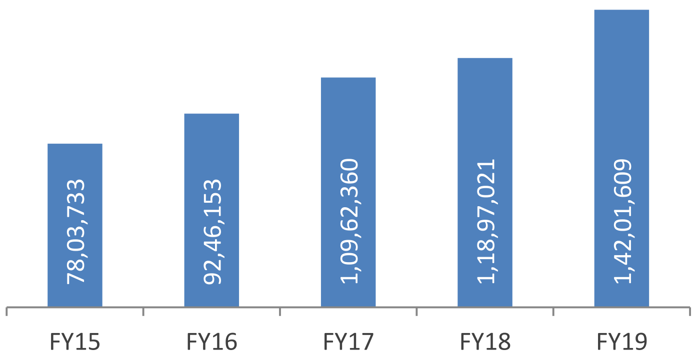


Chart 4: Debit card transactions (000 Nos)



Source: RBI, CMIE

5. Internet penetration & technological advancements

- As of December 2019, India's internet penetration in the urban areas stood at 192 mn users
- Number of active internet users in the country is the second highest globally (after China) and data usage of 9.8 GB per subscriber per month is the world's highest
- With the increasing number of internet users in the country, the food industry in India has seen a sharp growth in demand. As per Telecom Regulatory Authority of India (Trai), broadband subscribers increased from 99.2 million in March 2015 to 661.94 million users in December 2019 registering a sharp CAGR growth of over 61% during the 5 year period.
- Also, with emergence of many online food aggregators such as Zomato, Swiggy, etc, a substantial part of the unorganised market has come under the purview of the organised segment and availability of restaurants options for consumers has increased considerably thereby driving the demand. Deals, discounts and convenience offered by these aggregators also add to driving demand for the restaurants and QSRs.

6. Growing female working population

- On the backdrop of growing Indian economy during the recent years, the participation of female workforce in the country's economic activities has increased considerably. The proportion of the female workforce which accounted for 26% of the country's workforce during 1971 has scaled to 31% during 2011. Notably, the percentage of working women involved in the organised industrial activities too has gone up from 27% in 1981 to 47% in 2011 (As per Indian census).
- The higher purchasing power in the hands of 'working-women class' compared to the housewives enhances the ability of the former to spend much more comparatively.
- Further the 'time constraint' factor also needs to be accounted for by the working women while making purchases of various day-to-day requirements. Capitalizing on the same, the organised industry have increasingly emphasized on the 'order online' concept.

Major Challenges faced by the industry:

1. **Input risks**
   A. **Raw material** – With agriculture being the dominant sector of the Indian economy contributing ~15% of GDP in FY19, the availability of raw materials such as vegetables, grains, etc is high. The government has mandated the payments of Minimum Support Price (MSP) for food grains, while the sale of vegetables and fruits happens through Agricultural Produce Marketing Committee (APMC). Hence, there is minimal control or bargaining power with the supplier of raw materials. However food inflation impacts the restaurant industry by increasing the input cost for various food ingredients, which forces restaurateurs to hike the menu price. The price hike becomes difficult during economic slowdown and high inflation scenario which impacts consumers' discretionary spending and consumption patterns.
   B. **Land** - Land for restaurant is difficult to acquire due to different requirements of outlets as compared to other entities. Hence, the trend of restaurants coming up in malls has been picking up in recent times. Also the real estate rentals of prime location have increased in the past years, contributing a significant percentage to the total costs incurred during operations
   C. **Manpower** - The Fine Dining segment of the Indian restaurant industry requires employees with specific skill sets such as fluency in English, training in etiquette and basic knowledge of the workings of the sector. The current system of training in hotel management does not produce enough graduates and getting English speaking staff with basic service skills is proving to be a challenge for the industry. The segment also faces high levels of attrition of 40-50%. The similar issue is also witnessed by other segments like QSRs, where availability of trained and professional chefs and waiters is scarce.
   D. **Technology -** The technology is slow moving in the Indian restaurant and QSR industry. However increasing number of organized players are adopting online and mobile ordering systems to increase their sales.
   E. **Capital** - The restaurant and fast food industry is not highly capital intensive in nature. However, due to the low cash turnaround time, it needs high working capital. Due to assured margins, banks and financial institutions willing lend to restaurants and fast food chains.

2. **Penetration levels & substitutes**

- The industry is largely unorganized; however there has been increasing shift towards organized market in the recent past owing to many international and organised players entering the Indian market. Organised players have presence in urban and semi-urban areas of the country, limiting the penetration. Packaged and Ready-To-Eat foods are significant competitors to the Indian restaurant industry.

3. **Entry barriers**

- India's organised restaurant segment is witnessing intense competition, with a large number of international players keen to enter the industry. The industry has regulatory entry barriers in the form of 10-12 licenses, documentations and permits, permitting easy scalability. The industry is not highly dependent on technology, limiting the need for high capital requirements. However, players have to invest in setting up robust supply chains. A strong distribution network in the form of increasing number of outlets is a critical factor for setting up a restaurant business in the country. The restaurateurs continue to focus on creating a strong brand value and are growing their marketing strategy.

Financials

CARE has analysed the revenue and cost structure of the organised restaurant & food service industry in India. Net sales have continued to register double digit growth of about 12% y-o-y during 9M FY20, comparatively lower than 21% registered during 9M FY19.

Prior to FY18, several factors such as demonetization, liquor bans in various states along the highways, introduction of goods and service tax (GST), reckless expansions of outlets weighed down on the overall performance of the QSRs and food service industry. However, in FY19, players focus on same store growth, streamlining of processes post GST, food innovations, etc have supported the revenues of the industry. Also, with GST coming in effect, the rate of tax came down significantly from 18% to 5% thereby reducing the total cost for consumers.

- Expenditure as a per cent of Net sales stands at about 75 – 85%, of which cost of raw materials and employee cost account for about 25 – 30% each while the operating and manufacturing cost accounts for about 30 – 35% of the total expenditure for restaurants. Other expenditure such as selling & distribution, admin cost, etc, accounts for the balance 5 – 10% of the expenditure.
- Operating profit margins (%) have continued to register a double-digit growth while the net profit margin stood at 7.8% y-o-y witnessing marginal moderation of about 70 basis points during the 9M FY20 period.

Note: The industry margins are based on the financial results of 2 listed restaurant players

Duty Structure

With introduction of the Goods and Service Tax (GST) from July 1, 2017, service tax and Value Added Tax (VAT) have been done away with.

GST rates (applicable from July 1, 2017)

	Pre GST Regime		Post GST Regime	
	Central Taxes	State Taxes	Central Taxes	State Taxes
Restaurant (without air conditioning)	-	-	2.5%^	2.5%^
Restaurant (with air conditioning)	15% on service component^^	12.5% of food bill 20.0% for alcohol bill	2.5%^	2.5%^
A/c restaurant in 5 star or above rated hotel	15% on service component^^	12.5% for food bill 20.0% for alcohol bill	9.0%^^	9.0%^^

Note: ^ With no input tax credit
^^ with input tax credit

- Liquor however continues to attract state levies like VAT as its kept outside of GST regime
- Restaurants inside Hotels will also levy 5% GST, except for starred hotels with tariffs over Rs 7,500

Source: CBEC

The Government of India allowed 100% FDI in single brand retail under the government approval route and relaxed the 30% sourcing of products clause (for FDI above 51%), proactively contributing to the growth of the restaurant Industry in the country. However, the number of licenses required to set up a restaurant in India continues to be bit challenging for players wanting to set up operations in the country. There are at least 10 to 12 different basic licenses required to set up a restaurant business, although seeking these licenses is not very difficult. Once, obtained the business can be easily scaled up.

COVID-19 Impact on Indian Restaurants & Food Service industry

The National Restaurant Association of India (NRAI) has recommended its members (~5 lakh members) to shut its dine-in operations between March 18, 2020 and March 31, 2020 on account of the outbreak of the corona virus, giving its members an option to voluntarily shut its operations and not mandatorily. Also, the government has mandated the closure of malls, theatres, night clubs, etc in various states thereby affecting the restaurant businesses in such malls in order to promote the practice of social distancing. Despite high spends on advertising focused on the hygiene and sanitisation in stores, supply chains and card machines, the industry has already witnessed about 30 – 50% drop in footfalls for dine-in between February 15, 2020 to March 15, 2020.

The industry has high proportion of fixed costs such as rentals, power and employee costs. During FY19, the industry employed over 7.3 million people.

Outlook

- Going forward, CARE Ratings expects **the restaurant and food service industry to register a growth of about 10.3% CAGR for the next 5 years between FY19 and FY24 to reach Rs 6.7 trillion by FY24**. However, the industry is expected to witness headwinds in the short to medium term with the outbreak of covid-19.
- The growth will be supported by long term healthy demand outlook backed by higher disposable income, favorable demographics and rising aspirations of the burgeoning middle class, increasing internet penetration, increasing number of women joining the workforce, increasing focus on health and wellness, technological advancements, and growing urbanization
- With the surge in investments in the online food ordering business, the industry is expected to witness substantial growth and operations of large segment of the unorganized market are expected to get streamlined into organized market
- Also, in the years to come, premium dining and QSRs are expected to expand their presence in multiple non-metro towns across country.