

UK Food and Beverage 2020

A growing global appetite



Contents

| | |
|--|----|
| Foreword | 1 |
| Executive summary | 2 |
| A growing global appetite | 3 |
| Export opportunities – the silver lining | 7 |
| Optimising sustainable growth at home | 13 |
| A programme for growth | 19 |
| Endnotes | 21 |
| Contacts | 22 |

Foreword

Food and Beverage 2020 is the third report in the series and provides insights on the issues, trends and challenges the industry faces in the next decade. It is based on discussions with more than 50 chief executives and senior managers at leading UK and global food and beverage companies.

In the previous report, published in 2009, we looked at the rapidly shifting socio-economic landscape and considered a number of strategies to respond to the likely changes following the end of a long period of sustained growth. These strategies focused on addressing changes in consumer behaviours, improving working capital management and delivering better cost efficiency.

Deloitte LLP recently launched *UK Futures*, a programme to assess and facilitate how business can drive wealth creation. It highlights where opportunities may exist across specific markets and industries. It also considers how UK businesses will need new and fundamentally different engines of growth to compete across global markets.

One of the challenges facing UK business is how to respond to global demand moving eastwards at a phenomenal rate – a key theme of *Food and Beverage 2020*. The food and beverage industry is well positioned to exploit its British brands as prized assets – an opportunity *UK Futures* calls iB2C (international business-to-consumer).

The industry has significant scope for expanding exports to emerging markets, while also strengthening its presence in more mature markets. And this at a time when 'Brand UK' has arguably never been stronger, thanks to the success of the Jubilee and the London 2012 Olympic Games.

This report sets the scene for 2020, first by quantifying the food economy and the challenges represented by increasing global demand, and then by examining how UK food and beverage businesses can profit from them.

We hope this report provides you with useful insight on the food and beverage sector, and look forward to discussing its implications for your business.



Lawrence Hutter
Partner
Consumer Business
Deloitte LLP



Mark Hill
Partner
Consumer Business
Deloitte LLP

Executive summary

The rapid growth of the global middle class, driven principally by the developing economies of Asia, will transform the global food economy over the next ten years.

While many sources of imported food will become more expensive, or less available, new export opportunities will emerge that take advantage of the UK's food heritage and its ability to produce high quality foods. At the same time, the UK market will become more attractive to domestic producers as consumers get used to paying more for their food.

The UK food and beverage industry has been slow to seize these opportunities, with less than one in ten small and medium-sized enterprises in the agri-food sector currently exporting. However that situation is set to change. According to Deloitte research, 52 per cent of industry executives recognise that there will be new opportunities for UK food and beverage producers to create profitable export businesses by 2020.

As the middle class populations of developing countries grow, these markets are turning into major food importers. At the same time, countries such as Brazil, China, Indonesia, Thailand, the Russian Federation and Ukraine are forecast to increase their own share of global agricultural trade, effectively intensifying competition.

While increasing exports offer the UK food and beverage sector significant growth, there are also opportunities closer to home. UK food exports were worth £12 billion in 2011, 77 per cent of which went to the European Union. For many small and medium-sized enterprises looking to develop their export business, the EU is an obvious target market. However, the combined value of UK food and beverage exports to Brazil, Russia, India, China and Mexico is less than total UK exports to Belgium. This suggests that there is a major opportunity for UK food and beverage businesses to grow their share of the global market.

Moreover, rising concerns about UK food security and the food deficit added to the risk associated with importing inflation. Securing domestic supply by focusing on improving self-sufficiency will not only help mitigate the pressure on margins, it will also support local producers and manufacturers.

On the demand side, as UK consumers continue to deleverage, they will continue to focus on saving money. Four out of five executives interviewed see the downturn in real consumer spending and the rising cost of food as driving significant shifts in consumption, based on affordability.

Manufacturers are responding by investing in their existing ranges as well as introducing low-cost products and smaller packaging. In addition, they are continuing to develop premium products to cater for a small, but affluent group of consumers. It is also important for manufacturers to align their understanding of consumer preferences and behaviours to their product portfolios. Developing data analytics capabilities will help manufacturers match the right product to the right consumer.

Grocery retail also needs to evolve to meet the challenges of changing consumer behaviours driven by the rapid expansion in digital and mobile technologies, and the emergence of multichannel retailing. In response, retailers are restructuring their store portfolio to concentrate on the fastest growing sectors in the market: convenience and online. They are redefining the role of their physical space to make stores more relevant to changing shopper habits.

Despite major concerns over the continuing volatility, opportunities exist for businesses that are prepared to invest in developing and rebalancing their export portfolios while continuing to focus on operational efficiency and investing in their analytics capabilities. Since 2009, corporates in the food and beverage sector have concentrated on building up their cash reserves, but now is the time to make the important strategic choices that will help drive profitable growth in the decade to come.

A growing global appetite

By 2020 the rebalancing of the global economy towards the leading developing economies of the world will have a profound impact on the UK food and beverage industry. While the sector will face major challenges, this rebalancing will also open up significant opportunities both at home and abroad.

Who will grow our food in the future?

From 1980 to 2009, the global middle class grew by around 700 million people, to 1.8 billion.¹ Over the next 20 years, it is likely to grow by an additional three billion, to nearly five billion people. Rising incomes and urbanisation will lead to changes in diets that will shift consumption to more processed foods, fats and animal proteins. This rapid growth is turning emerging economies into major food importers. By 2030 the world will need 50 per cent more food and energy and 30 per cent more water.² In the last decade, global food prices rose twice as fast as inflation and increasing demand will continue to drive further food price volatility and price increases.³ The recent huge volatility in wheat, maize, soyabean and rice prices has made the situation worse. Nominal prices of the main agricultural commodities are expected to trend upwards by 2021 and are projected to average 10 to 30 per cent above those of the previous decade.⁴

Moreover, emerging markets will increase global competition as they will take a greater share of the expanding trade in agriculture. It is estimated that developing countries such as Brazil, China, Indonesia, Thailand, the Russian Federation and Ukraine will be the main source of global production growth to 2021. More specifically, with fish production one of the fastest growing sources of animal protein, world fisheries and aquaculture production are expected to grow by 15 per cent by 2021. In developed countries a modest increase in dairy products is expected, while in developing regions consumption of all products is projected to increase about 30 per cent by 2021. At the same time, developing countries are projected to overtake developed countries in milk production by 2013, with large increases in China and India.⁵

Managing scarce resources

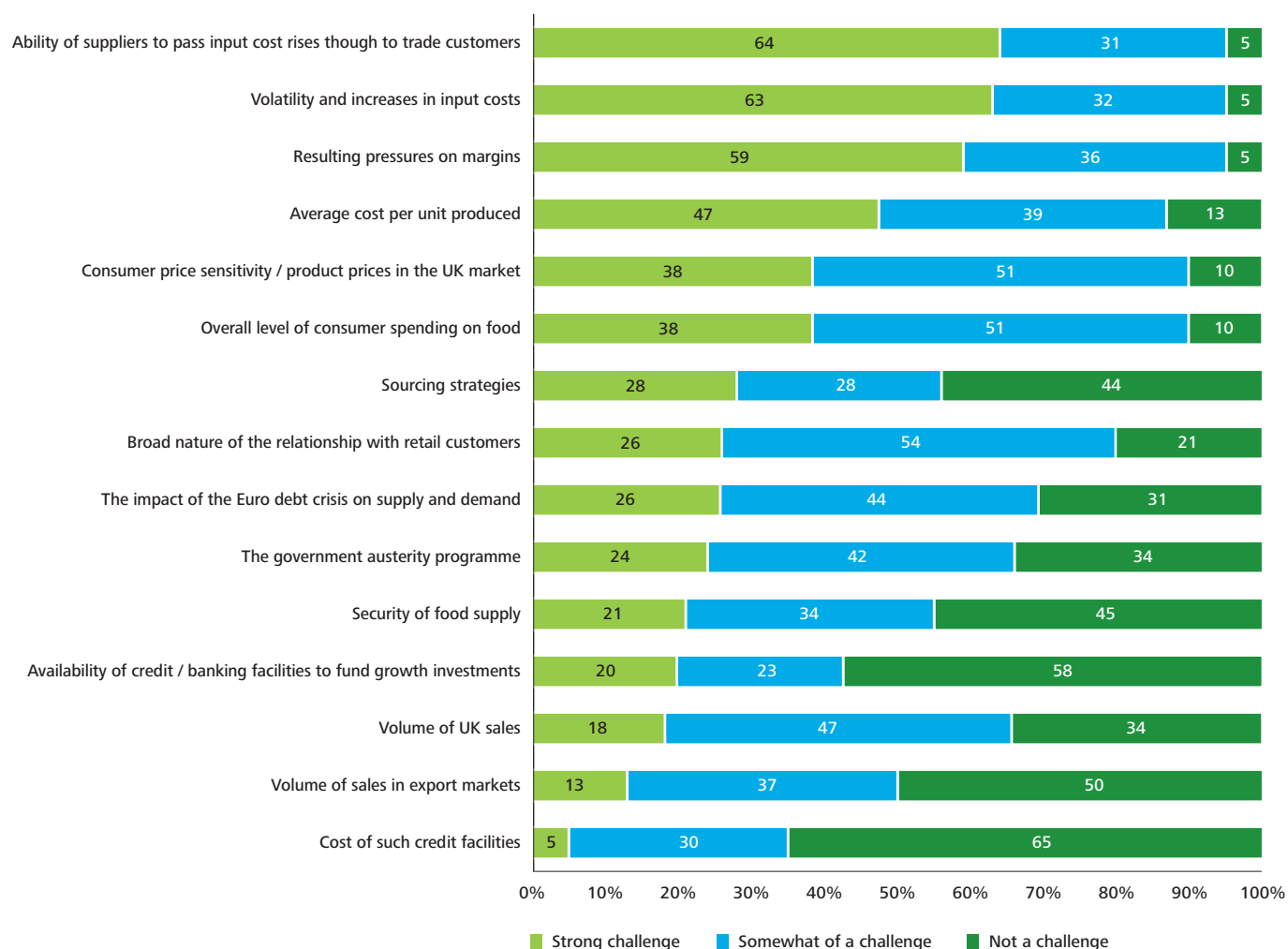
Although the world is overall richer and better fed than it was 50 years ago, those gains are now under threat. International experts have highlighted that the dramatic increase in resource prices is pointing to major food security concerns for at least the next decade. Key issues facing developed economies include dealing with the end of cheap sources of supply while increasing productivity in a more sustainable way, and meeting demand for food from the growing middle class in emerging markets.

The increasing demand for biofuel, which is based mainly on agricultural feedstock, is putting further pressures on scarce agricultural resources. Biofuel production is projected to almost double by 2021.⁶ In addition, a focus on using more sustainable resources will be critical given increasing water scarcity, overexploited fish stocks and the growing consensus that extreme climatic events will become more frequent and have an adverse impact on food supply.

State of the UK food and beverage sector

With the UK increasingly dependent on international trade, its food and beverage sector is heavily exposed to the issues of increasing global demand and the higher costs of food production. The UK has to focus its efforts on managing the risks associated with growing food insecurity. According to findings from a recent Deloitte survey, and structured interviews with senior UK food and beverage industry executives, some of their biggest challenges are the squeeze on company margins caused by volatile input prices and brutal price-led retail competition. Almost two-thirds of respondents said they found it hard to pass input cost rises on to the trade (see Figure 1). Price volatility and the impact it can have on planning was also identified as more of a challenge than average cost per unit; this is likely to endure given that fluctuations in demand are likely to continue.

Figure 1. To what extent is each of the following likely to be challenging for your business over the next 12 months?



Source: Deloitte research 2012

The sector is also experiencing increasing commoditisation of brands and demand for higher service levels from trade customers. Therefore manufacturers are finding it difficult to make the necessary investment in innovation, brand support and new supply chain approaches.

Subdued UK consumer spending is yet another cause for concern. Not only are food and beverage producers faced with a continuing increase in input costs, they must also adapt to changing consumer consumption patterns following a decade of cheap food and economic turmoil that has made consumers more price driven in their consumption choices. UK consumers are going through a massive deleveraging process, and given current economic growth prospects, the downturn in spending is likely to continue. This in turn will have a long-term impact on consumer consumption habits, as a number of trends converge. These include reduced disposable income, changing demographics, an increasing focus on health and dramatic changes in the way consumers interact in a digital world.

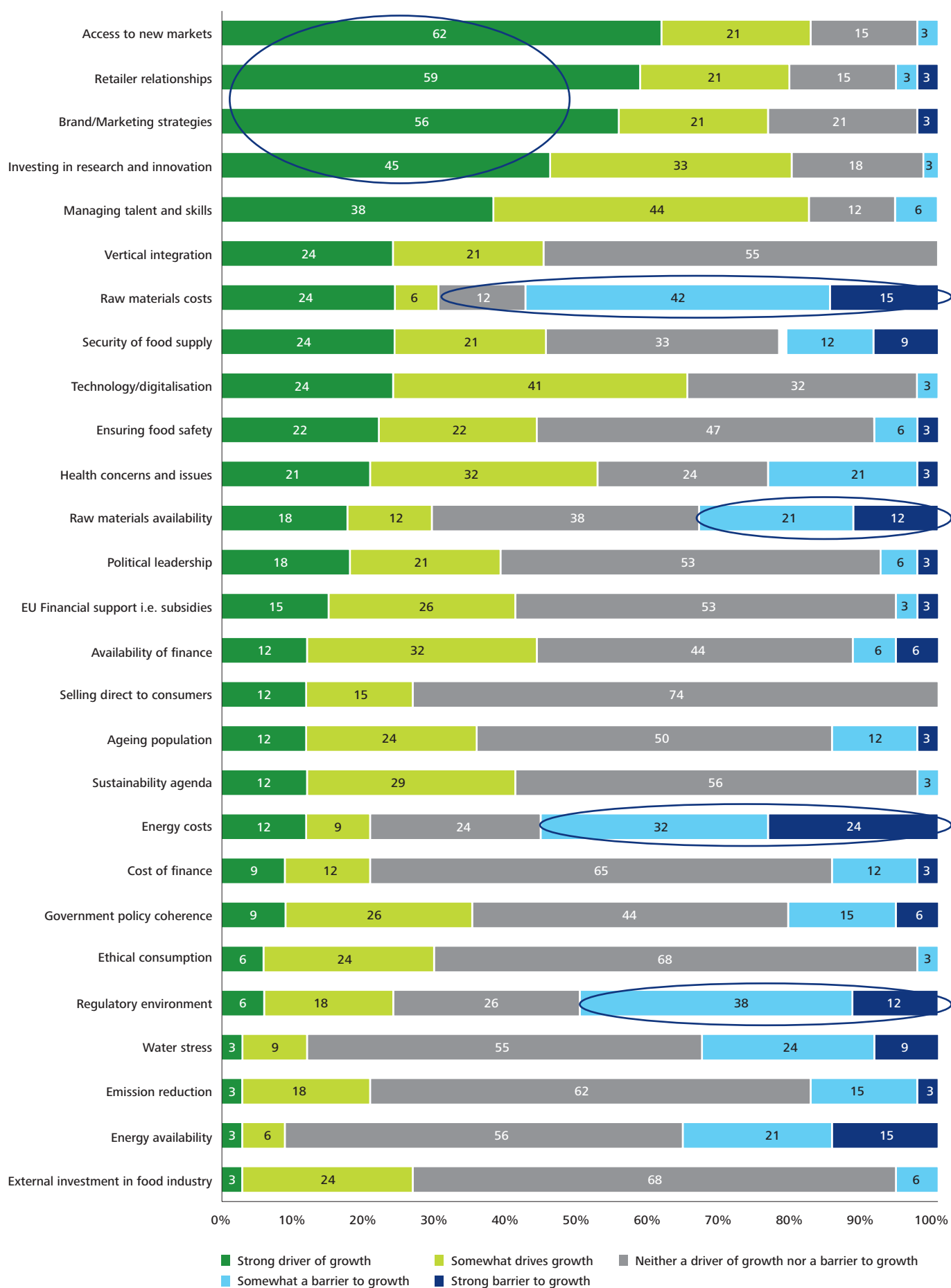
In addition, UK food and beverage companies need to comply with a costly and complex regulatory regime and are under pressure to adopt a more transparent corporate social responsibility agenda. According to Deloitte research, 50 per cent of executives view the regulatory environment as a barrier to meeting their growth targets between now and 2020 (see Figure 2). Tax policy, access to information, labelling and compliance requirements are all having an impact on the sector's growth and competitiveness.

What does the future hold?

With limited growth in their domestic market, the continued eurozone crisis and the prospect of emerging markets outperforming developed economies for years to come, many food and beverage businesses are starting to explore the opportunities that exist in serving the emerging market consumer. Our research shows that 62 per cent of executives in the sector consider access to new markets as the main growth opportunity. However, it is important not to underplay the opportunities closer to home: for those with little or no export business, the European Union (EU) may provide considerable opportunities given that it is already an established export market for UK businesses. Other growth factors that respondents identified include strengthening retailer relationships (59 per cent), developing enhanced marketing strategies (56 per cent) and focusing on innovation (45 per cent), as shown in Figure 2.

UK consumers are going through a massive deleveraging process, and given current economic growth prospects, the downturn in spending is likely to continue. This in turn will have a long-term impact on consumer consumption habits

Figure 2. To what extent would the following factors help or prevent your business meeting growth target between now and 2020?



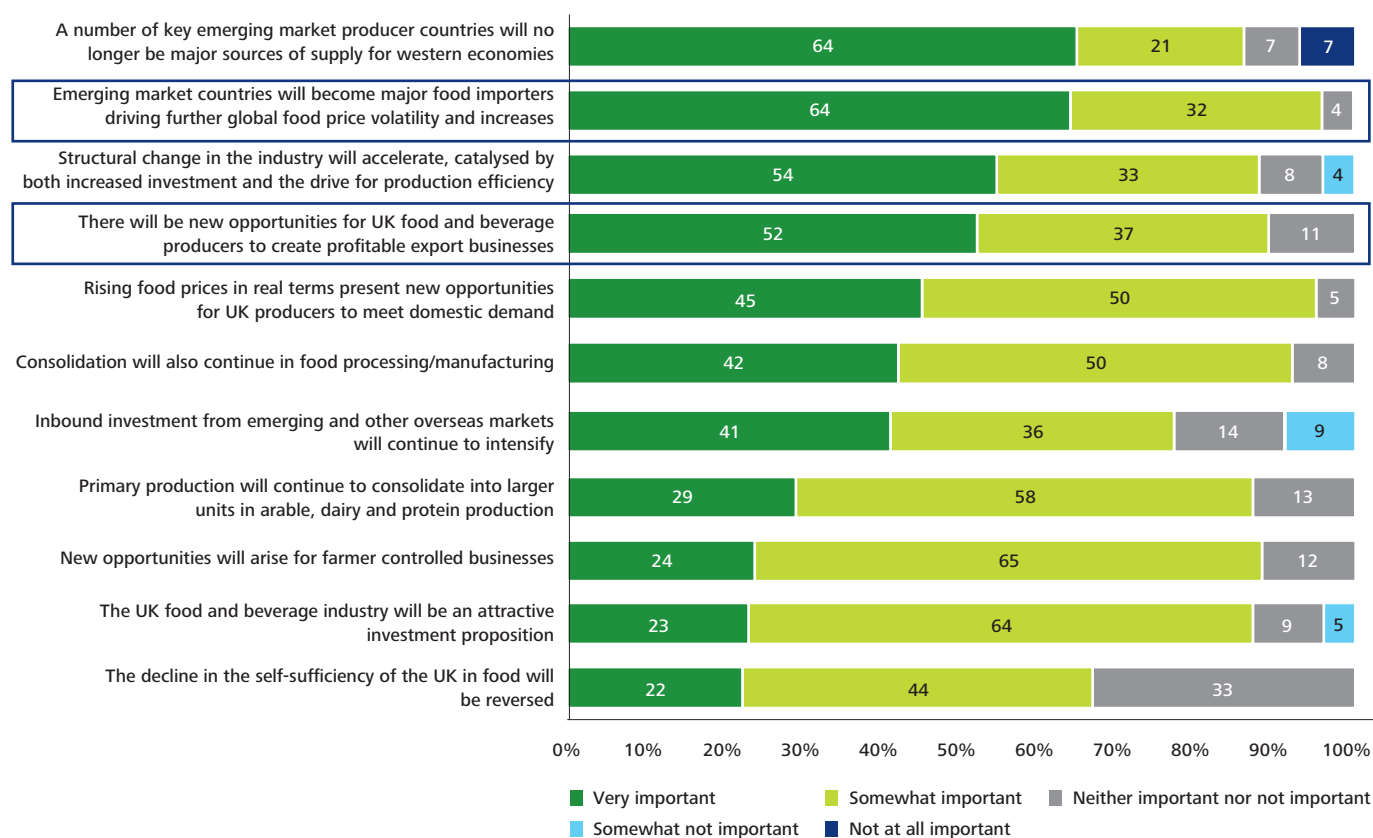
Source: Deloitte research 2012

Export opportunities – the silver lining

Rising food prices are providing new opportunities for UK producers, both to service more domestic demand and to build profitable export businesses.

Deloitte research shows that 89 per cent of industry executives recognise that there will be new opportunities for UK food and beverage producers to create profitable export businesses by 2020 (see Figure 3). Yet currently, in the English agri-food sector, less than one in ten small and medium-sized enterprises (SMEs) export.⁷

Figure 3. Thinking about the impact on the UK food and beverage industry of the rebalancing of the global economy towards the leading developing economies – how important do you think the following will be between now and 2020?



Source: Deloitte research 2012

How big is the export market?

Currently the food and beverage manufacturing sector is the largest in the UK, accounting for 16 per cent of all manufacturing. UK food and non-alcoholic drink exports increased by 11 per cent in 2011 to £12 billion, 77 per cent of which went to the EU, making the UK the world's eighth largest exporter of food and beverage products.⁸ The sector has also been the most resilient and stable of all manufacturing industries throughout the recession, and its continued competitiveness is an important part of the UK's economic growth agenda.

In 2011, significant gains were made with large EU trading partners including the Netherlands, Belgium and Poland, offsetting the continuing drop in demand from struggling eurozone countries such as Italy, Portugal and Spain (see Figure 4). There was also strong export growth both in mature markets such as the United States, and key emerging markets including China and South Africa. However, exports to Eastern Europe, South America and Asia underperformed. Currently the combined value of UK food and beverage exports to Brazil, Russia, India, China and Mexico, which together account for 44 per cent of the world's population, is less than total UK exports to Belgium.⁹ Despite increasing food, beverage and tobacco exports by 5.4 per cent year on year between 2000 and 2010, the UK has lost market share as world exports grew by ten per cent year on year.¹⁰

In future, the UK food and beverage sector needs to focus more of its efforts on the robust increase in demand from the fastest growing markets in Eastern Europe, Central Asia and Latin America. Those markets' per capita consumption of a basket of food commodities is expected to be 30 to 35 per cent higher in 2021 compared to 2000. Exporting to emerging economies will be critical for long-term growth considering that in North America and Western Europe the level of food and beverage consumption will be the same in 2021 as it was in 2000.¹¹ However, developed markets also offer considerable opportunities, not only to established exporters, but also to new and inexperienced exporters looking to build their export business.

With concerns about food security increasing, it will be important for the UK to continue to focus on food independence as a means to reduce its food trade deficit. In 2011, the UK produced just 52 per cent of the food it consumed compared to 67 per cent in 1989, and had a self-sufficiency ratio of 63 per cent. In 1984, the UK's self-sufficiency ratio was 78 per cent, which was its peak following a steady recovery in the years following the Second World War.¹²

Recognising the importance of the sector to the UK economy, and promising an export-led recovery, the Coalition Government has made it a priority to support UK food exports. According to "A Plan of Action" it will support export growth by:

- opening markets and removing trade barriers
- building a business mindset of exporting as a key route to growth
- encouraging more SMEs to explore overseas opportunities and supporting those who already export to do more
- shifting the focus of the sector towards emerging economies which have the greatest growth potential.¹³

Figure 4. UK exports of food and non-alcoholic drinks: Top 20 countries 2010-11 (£ million)

| Rank | Country | 2010 | 2011 | % change 2010-11 |
|---------|----------------------|---------|---------|------------------|
| 1 (-) | Ireland | 2,712.0 | 2,932.1 | 8.1 |
| 2 (-) | France | 1,354.4 | 1,446.6 | 6.8 |
| 3 (-) | Netherlands | 907.3 | 1,179.2 | 30.0 |
| 4 (-) | Germany | 905.3 | 1,041.4 | 15.0 |
| 5 (+2) | Belgium | 438.1 | 569.3 | 29.9 |
| 6 (-1) | Spain | 612.4 | 558.8 | -8.7 |
| 7 (+1) | United States | 390.7 | 491.4 | 25.8 |
| 8 (-2) | Italy | 442.0 | 432.1 | -2.2 |
| 9 (-) | Denmark | 182.0 | 220.7 | 21.3 |
| 10 (+4) | Poland | 135.1 | 202.0 | 49.5 |
| 11 (-) | Sweden | 149.3 | 177.3 | 18.7 |
| 12 (-) | Norway | 144.0 | 169.5 | 17.7 |
| 13 (-) | Canada | 139.0 | 149.5 | 7.5 |
| 14 (-4) | Portugal | 153.2 | 130.7 | -14.7 |
| 15 (+3) | United Arab Emirates | 91.2 | 128.4 | 40.9 |
| 16 (-) | Russia | 109.4 | 122.6 | 12.0 |
| 17 (-2) | Saudi Arabia | 115.4 | 105.0 | -9.0 |
| 18 (-1) | Hong Kong | 93.2 | 101.2 | 8.6 |
| 19 (+7) | Australia | 63.9 | 99.1 | 55.0 |
| 20 (-) | Switzerland | 77.6 | 91.7 | 18.1 |

Source: HMRC Trade Info, March 2012
Changes in ranking position are versus 2010

What are the opportunities?

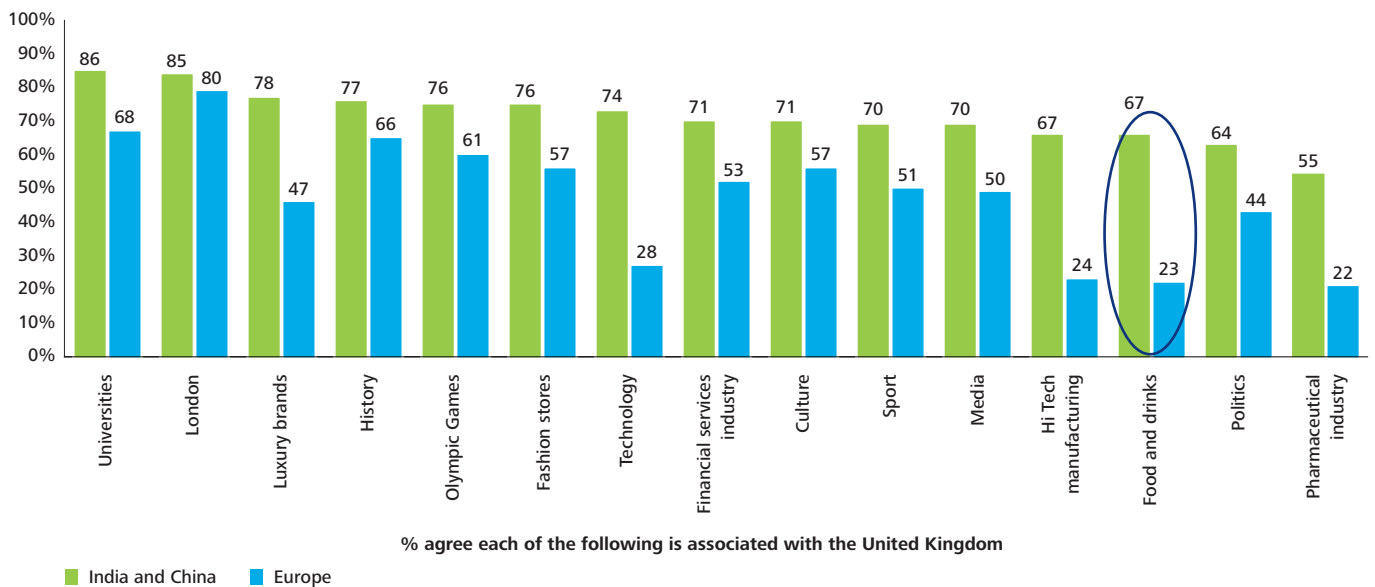
Small players in the sector who are seeking to expand their businesses into emerging economies may want to consider a direct market entry with local manufacturing capabilities. According to a recent joint report by the Coalition Government and the main industry trade bodies, food and beverage companies that export improve their productivity, achieve stronger financial performance and are more likely to stay in business compared to those who do not. Interestingly the research also indicates that among SMEs (which account for 98 per cent of the agri-food and drink sector) those that export tend to do so in response to external customer enquiries rather than having proactively identified an opportunity.¹⁴

Smaller players need to embrace the changes that have taken place in international trade. In the last ten years the removal of trade barriers, the spread of market-orientated economic policies, digital communications and improved transport infrastructure have provided greater access to emerging markets.

The UK food and beverage sector has a strong international reputation for food safety, quality and innovation. In trying to access overseas markets, UK food and beverage companies have a number of competitive advantages including:

- **British heritage brands** – According to Deloitte research, an average of 67 per cent of respondents in China and India identified the UK with food and beverage products (see Figure 5).*
- **High level of innovation** – Outside of the US, the UK had the highest number of new product launches between 2005 and 2011. The UK creates around 8,500 new products each year and is a leader in encouraging global demand for healthier products.¹⁵
- **Product quality and manufacturing skills** – Exporting the skills and technologies to support the development of production facilities in local markets could prove very lucrative. There is an opportunity for UK quality standards to become a benchmark for developing markets. The UK is also home to many multinationals who manufacture both for the UK and international market, helping to increase inward investment.

Figure 5. India's and China's perceptions of the United Kingdom v Europe's perception



Source: Deloitte research 2012

*The research took place in March 2012 and was carried out by an independent market research agency. The sample in China and India is representative of the Internet-connected population. In China, the sample is mostly aged 15 to 34 and male dominated. In India, the sample is mostly aged 15 to 34 and predominantly male.

The retailer's perspective

In recent years European grocers have focused on developing their international presence to reduce their dependence on domestic demand and to increase revenue. Having established a presence in international markets, grocery retailers will look to improve their existing performance to achieve sustained growth. They have learnt some valuable lessons along the way including the importance of customising market models and product offerings to meet local needs and preferences. Because they understand the needs of the local consumer and community, it is important to consider empowering local and regional managers when developing marketing and sales plans. A good property portfolio is also critical, given the difficulty of gaining a foothold when local operators already own the best locations.

While the downturn has inevitably had a negative impact on international expansion, in the longer term retailers will be looking to take advantage of faster growing economies in developing markets. The additional benefit for food and beverage manufacturers is an established infrastructure for selling UK goods to consumers in emerging markets.

Capitalising on new sources of demand

The changing dietary requirements of emerging market consumers will drive demand for value added products as their incomes start to rise. As a result demand for branded products will increase, starting with the lower cost branded products, such as food and beverages before moving on to discretionary goods. Understanding the nature of demand in key export markets requires a detailed analysis of the various consumer segments in each target market and their price sensitivity.

More specifically, targeting the demand for food and beverage products in emerging markets will require careful consideration of the following trends:

- **Unique needs, tastes and values:** requiring products and services tailored to each local consumer segment.
- **Different levels of urbanisation:** ensuring strategic planning decisions are made after having developed a good appreciation for the various tastes and cultural dimensions that define different cities.
- **Purchasing power disparity:** adopting an 'affordable price' strategy to encourage customer acquisition before encouraging them to trade up.
- **Access to better food:** measuring the size of the opportunity for high-value foods.
- **The emergence of two-income households:** defining and understanding the role of convenience to respond to local demand for time-saving products and services.
- **Increasing spending power:** developing trust and strong brand awareness, as emerging market consumers are more likely to consider a lower number of brands.
- **Greater discretionary spending:** responding to the desire to spend on simple luxury (e.g. branded beverages like Coca-Cola and Starbucks).
- **Growth in foreign travel:** ensuring some consistency in communication and positioning as emerging market consumers will gain more exposure to brands, innovation and consumption patterns in other markets.

Market entry model

Successful market entry will be dependent on a well researched strategy, followed by implementation in collaboration with local management. The strategy should explore ways to adapt the proposition and product positioning to local preferences and lifestyles, but still focus on the UK food and beverage manufacturers' core competencies. There is considerable demand for UK products in emerging markets as they are. Local market adaptation should focus on the acquisition of local market insights into consumer behaviours and preferences, and ways in which they can benefit from the current demand for UK products.

Exports case study: Mackie's of Scotland

Already a successful producer of Scottish ice cream, Mackie's of Scotland launched its brand of potato crisps in 2009 in a joint venture with Perthshire-based potato company Taypack.

A two-time winner of Scotland Food & Drink Excellence awards including "Product of the Year", and currently Sainsbury Scottish supplier of the year, the range of crisps now has nine flavours.

Export sales will account for ten per cent of Mackie's £4 million turnover in this current year and the company is now becoming established in the biggest grocery retail market in the world – the USA which has a crisp (aka chips in the US) market of £3 billion. Following a very successful show at Expo West in Los Angeles, California in March 2012 Mackie's crisps are now stocked with several major retailers including Central Market, Fresh Market and Fresh and Easy. In addition to supplying product into Hong Kong, Singapore and Dubai on a regular basis, Mackie's has opened new markets in Japan, Canada and Bahrain this year. Planned attendance at trade shows such as SIAL in Paris, Gulfoods in Dubai and Expo west for a second year running will ensure Mackie's continues to grow its share of the export market.

George Taylor, Director of Mackie's at Taypack:

"We consider an international approach to be vital to the continued growth of our brand – our aim is to become a successful global manufacturer of snacks."

"We have to work carefully to target the best opportunities for a speciality snack with our Scottish provenance and flavours. Our continued success overseas is a testament to the fact that consumers from around the world love our products, our natural flavours and the fact that we grow our own potatoes here in Scotland."

Optimising sustainable growth at home

To remain competitive, the UK food and beverage sector needs to address a series of challenges linked to production efficiency, security of supply, changes in consumer behaviours, new value propositions, intense retail competition and a complex regulatory regime.

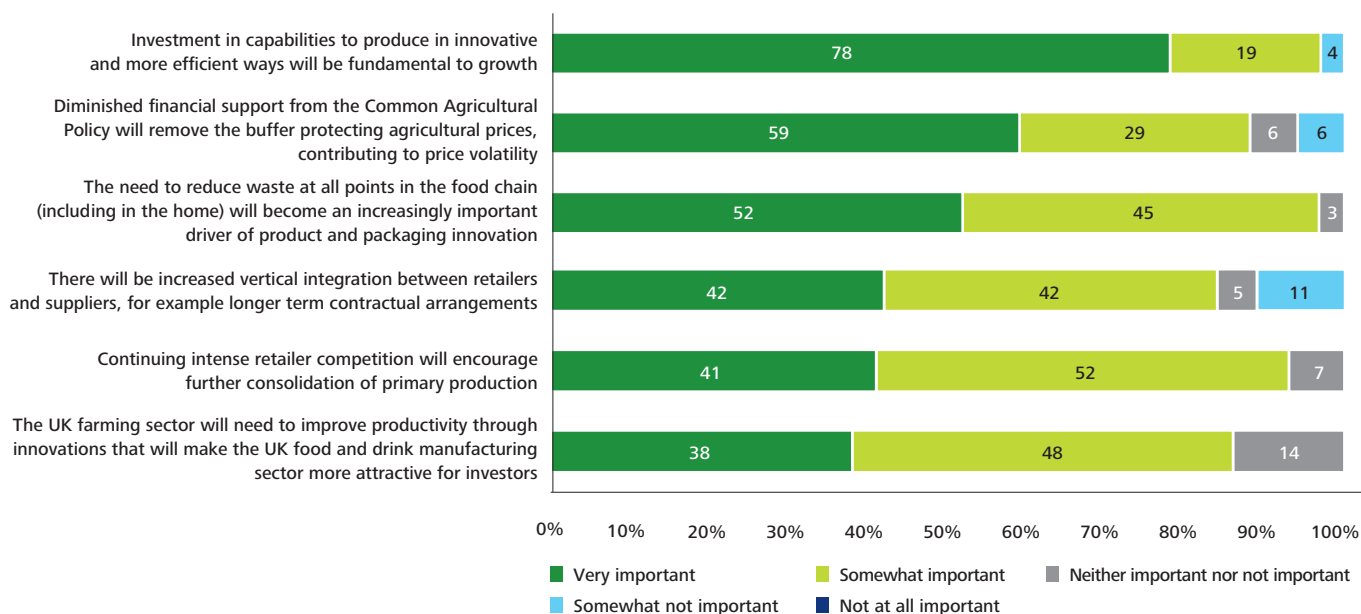
Rethinking sourcing and focusing on vertical integration to achieve efficiencies, security of supply and growth

The UK food and beverage sector's attempt to maintain low consumer prices while remaining competitive has been weakened by shifts in global demand and supply and the difficult economic environment. In an effort to ensure security of supply, manage price volatility and protect margins, companies are rethinking their sourcing strategies, and how they can improve productivity. Particular areas of focus for investment include R&D, better planning and forecasting tools, and technologies to reduce operational costs and increase efficiencies.

With the decline in the UK's food self-sufficiency likely to be reversed, there is a strong incentive to become more innovative and productive, and make it more attractive to produce in, and purchase from, the UK. Nearly 80 per cent of respondents said that investing in innovation is fundamental for growth (see Figure 6). At the same time, 52 per cent recognise the importance of reducing waste throughout the food chain and the role this will play in driving product and packaging innovation. In achieving efficiencies the sector may also need to identify new sources of revenue. For example many of the sector's waste streams have potential value as sources of energy, or as feedstock for other processes.

Structural changes in the industry in the form of further vertical integration will also accelerate as a result of increasing investment to drive production efficiency and insulate companies from economic volatility. Consolidation is inevitable and will take place at the primary production level, in food processing and in manufacturing. More than 42 per cent of executives interviewed consider further vertical integration between retailers and manufacturers as very important for developing the UK food and beverage market to meet both domestic and international demand. Such moves can pay higher returns by protecting companies from supply and demand disruptions while giving them greater flexibility over their distribution network. In the case of the large food and beverage consumer goods companies, this involves moving into a complete 'field to fork' supply chain format.

Figure 6. Impact of the shifts in global demand and supply on the UK food and beverage industry sourcing strategies between now and 2020



Source: Deloitte research 2012

Changing consumer behaviours

With UK shoppers in a recession mindset many are changing their spending habits and trying to increase their savings. To retain market share in a more competitive sector, companies are investing in data analytics – the practice of generating and protecting revenue through deep understanding of the customer – to improve consumer retention and conversion, while responding to the continued growth in demand for convenience and healthier products.

Addressing shifts in consumer spending

Four out of five of the executives interviewed see the downturn in real consumer spending, and the continuing increase in the cost of food in real terms, as driving significant shifts in consumption patterns based on affordability (see Figure 7). This is forcing manufacturers to rethink their brands and product ranges: value-engineering existing products, introducing low-cost products and smaller packaging alongside the higher-end items which cater for the smaller but more affluent group. They also have to improve customer and product profitability through more effective brand and trade support to protect margins and secure sales. With the emergence of digital shopping channels, the connected consumer interacts more often with retailers and manufacturers, giving companies access to ever more detailed data about who their customers are and how they behave. Investing in acquiring customer and pricing analytics capabilities is becoming critical, not only to create meaningful and actionable insight, but also to respond to it by optimising product offerings and price architecture. Seventy per cent of senior executives interviewed said that they thought data analytics will play a very important role in informing product innovation, customer targeting and demand planning (see Figure 7).

Focus on innovation and convenience

Many consumers are shopping more frequently, for fewer items, and in smaller retail formats in an effort to control spending. One-in-five executives said that innovation in convenience food will be important between now and 2020 (see Figure 7). With convenience and online channels becoming more important in serving changing consumer habits and needs, there are significant opportunities for manufacturers to deliver product formats which are innovative, add value and support other consumer priorities such as waste reduction. This is particularly relevant given that the UK's current dependency on imported food is partly due to the failure of manufacturers to meet changing consumer demands. By playing a bigger role in the global food market, companies might be able to anticipate and meet new consumer preferences more effectively.

Ageing and health

If there is one segment of the population that is both growing and spending more it is the older shopper. The ageing population is driving greater demand for health and wellness products as well as innovations such as easier to open packaging. Nearly 40 per cent of respondents strongly agreed with the prediction that over half of all retail spending will come from those aged over 45 by 2020 (see Figure 7). Furthermore, demand for healthy options will become mainstream as good nutrition and health awareness grows. This trend will also be encouraged by the education system and through further product taxation and regulation.

Figure 7. Impact of changing consumer behaviours on the UK food and beverage industry between now and 2020



Source: Deloitte research 2012

Brand rationalisation

Brand commoditisation is expected to continue as leading retailers increasingly see brands as a loss-leader weapon in the battle for market share while increasingly focusing on their private label ranges to create value and provide a full service offering to the customer.

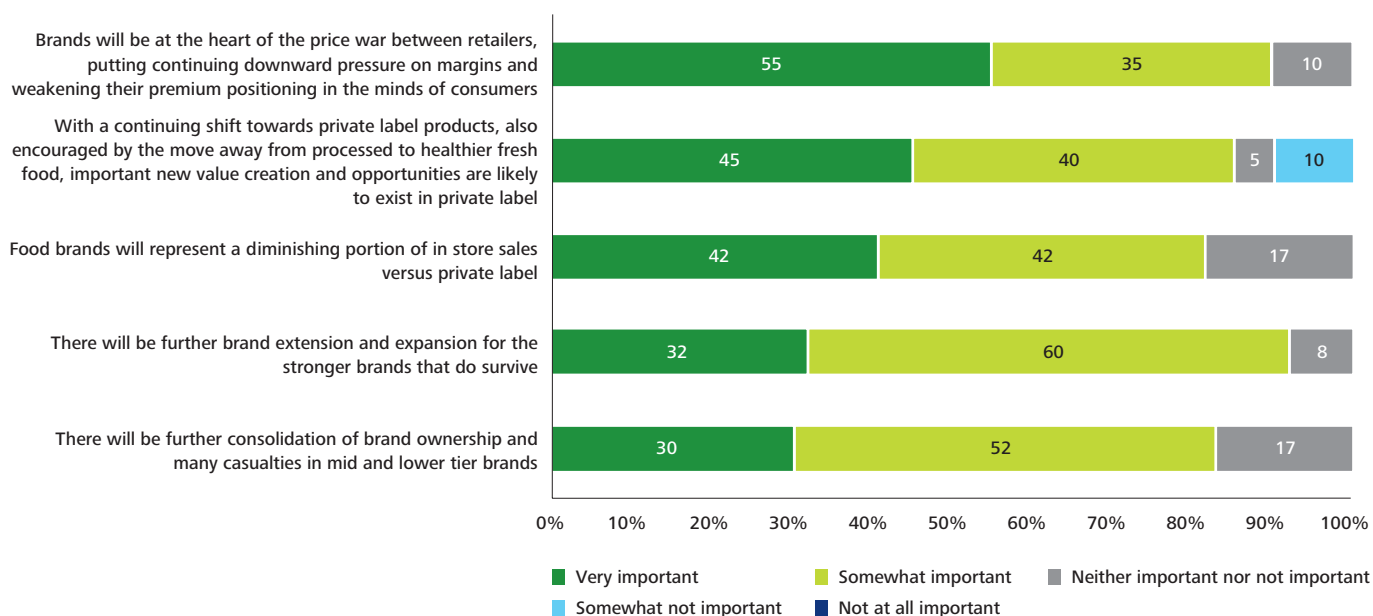
Growing private labels

Many new business opportunities are likely to be in private label goods. This was reflected by the 45 per cent of industry executives who consider new value creation in private labels to be very important (see Figure 8). This in turn will require extremely high levels of production and processing efficiency, as well as higher levels of business model integration between retailers and manufacturers. The manufacturers who will seize these opportunities will be those that combine effective product innovation capabilities, a cost-efficient operating model, outstanding customer service and good retail channel management skills.

Brand commoditisation

According to 55 per cent of respondents, brands will be at the heart of the price war between retailers, putting continuing downward pressure on margins and weakening their premium position in the minds of consumers. More than 40 per cent of respondents expect food brands to represent a lower portion of in-store sales versus private label goods. It is also likely that only the strongest brand owners will have sufficient negotiating power to maintain profitable business in mainstream retail. As a consequence, brand ownership consolidation will continue and many mid and lower tier brands are likely to disappear due to the lack of differentiation. This will also encourage brand extension and expansion among stronger brands.

Figure 8. Impact of further brand commoditisation on the UK food and beverage industry between now and 2020



Source: Deloitte research 2012

Trade environment

UK retail competition will remain intense, keeping a cap on price rises (but not preventing them) and encouraging further consolidation of primary production to maximise efficiency and ensure economies of scale. In an effort to improve food chain operations, in 2013 the government will also be introducing an adjudicator to enforce the Groceries Supply Code of Practice.

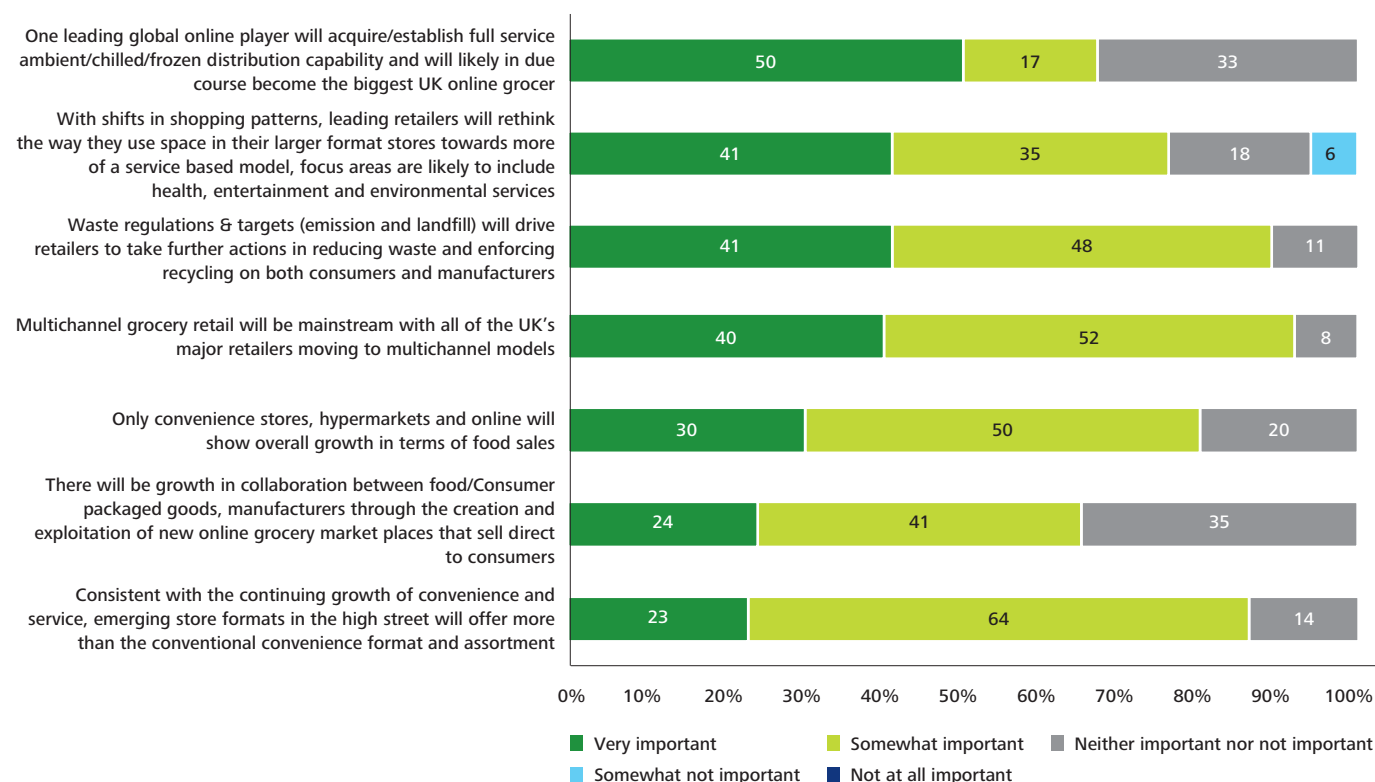
Mix of channel and store formats

Diverging grocery shopping patterns will drive changes in the mix of channels and store formats. They will also drive the expansion of grocery retail beyond a focus on space and location towards a more service-orientated multichannel model. It is widely accepted that only convenience and online channels will show food sales growth. Therefore, leading retailers have to rethink the way they use space in most of their larger format stores. Growth in the range of services available in store is expected with key focus areas likely to include health, entertainment and environmental services. For manufacturers this means strengthening forecasting capabilities, acquiring a better understanding of cost-to-serve and improving inventory management to transform their business operations in line with the change in channel mix.

Direct to consumer

Given the increasing challenges faced by branded manufacturers in dealing with traditional bricks and mortar retailers, 24 per cent of respondents expect increasing collaboration between manufacturers through the creation and exploitation of new online grocery market places to service the consumer more directly (see Figure 9).

Figure 9. Impact of the changes in the mix of store formats on the UK food and beverage industry between now and 2020



Source: Deloitte research 2012

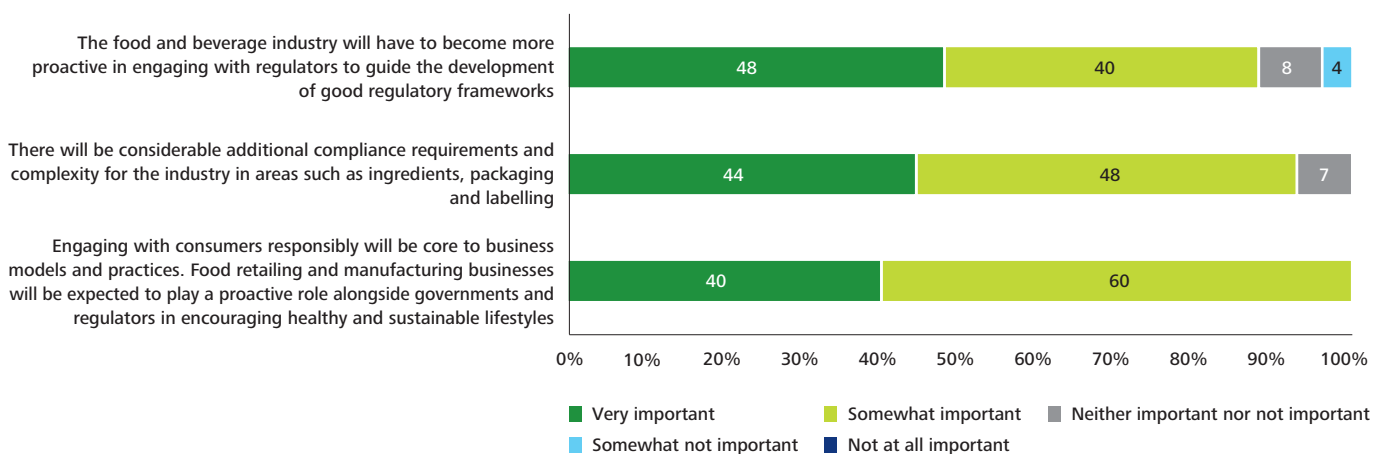
Government intervention and the regulatory environment

The government is expected to become increasingly interventionist with product regulation and taxation driven by the public health and sustainability agendas, as well as the need to reduce fiscal deficits. The food industry will have to anticipate such changes, as well as become more proactive in engaging with regulators.

In particular, the Coalition Government is putting pressure on the food and beverage industry to engage with consumers responsibly by playing a more proactive role in encouraging healthy and sustainable lifestyles. In return, the industry is accepting that it has a greater role to play in building trust with consumers. The industry has already started to engage through a mixture of self-regulation, limiting advertising to children, and reducing sugar and salt content.

Executives are also pointing to the increasing complexity in compliance requirements and regulations related to food safety and public health. Last year Finland and Hungary joined Denmark in taxing certain foodstuffs while this year France implemented a tax on soft drinks. Countries considering following suit include the UK, Ireland, Belgium and Romania, with debates under way in the US and Italy. In future, it will be important for the industry to be more proactive in developing a regulatory framework that does not undermine their ability to compete.

Figure 10. Impact of further government intervention in product regulation and taxation on the UK food and beverage industry between now and 2020



Source: Deloitte research 2012

A programme for growth

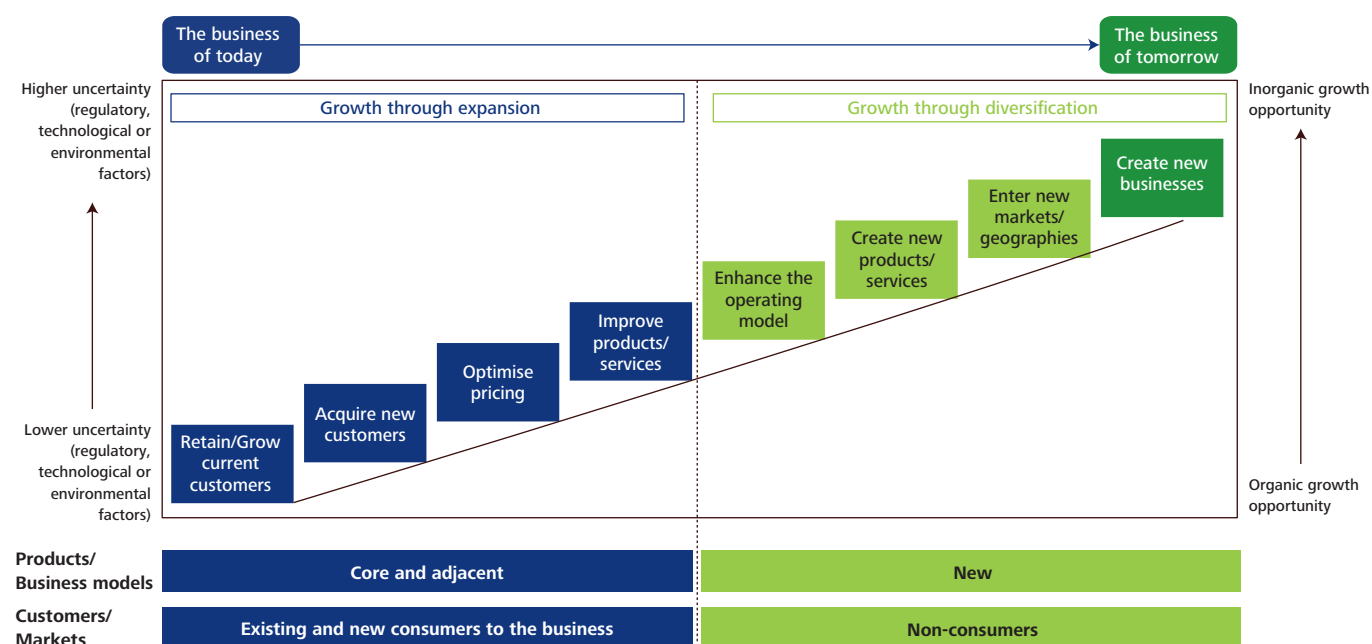
Since our last report was published in 2009, leading corporates in the food and beverage sector have built up their cash reserves and restrained from investing due to economic uncertainty. Given the challenges and opportunities outlined in this year's report, a number of priorities need to be addressed, and a clear growth plan identified.

Growth framework

All businesses should consider the following four questions in developing their growth strategy:

- 1. What is the appropriate growth target?** Value can be driven by identifying growth opportunities within the current business as well as investments in new businesses.
- 2. Where and how to look for growth?** Companies traditionally focus on protecting and growing market share using their current and adjacent capabilities. However these capabilities are often not sufficient to sustain growth, and over the long term new capabilities might be required.
- 3. How to construct a more optimal growth portfolio?** Because sources of growth yield different levels of uncertainty and risk, a company must construct a growth portfolio that aligns with its growth targets and risk tolerance.
- 4. How to effectively execute?** Sustainable growth requires enhancing the business of today by extending the core business, focusing and realigning resources, while creating the business of tomorrow requires identifying new market segments and developing the right innovations to serve them.

Figure 11. Growth framework

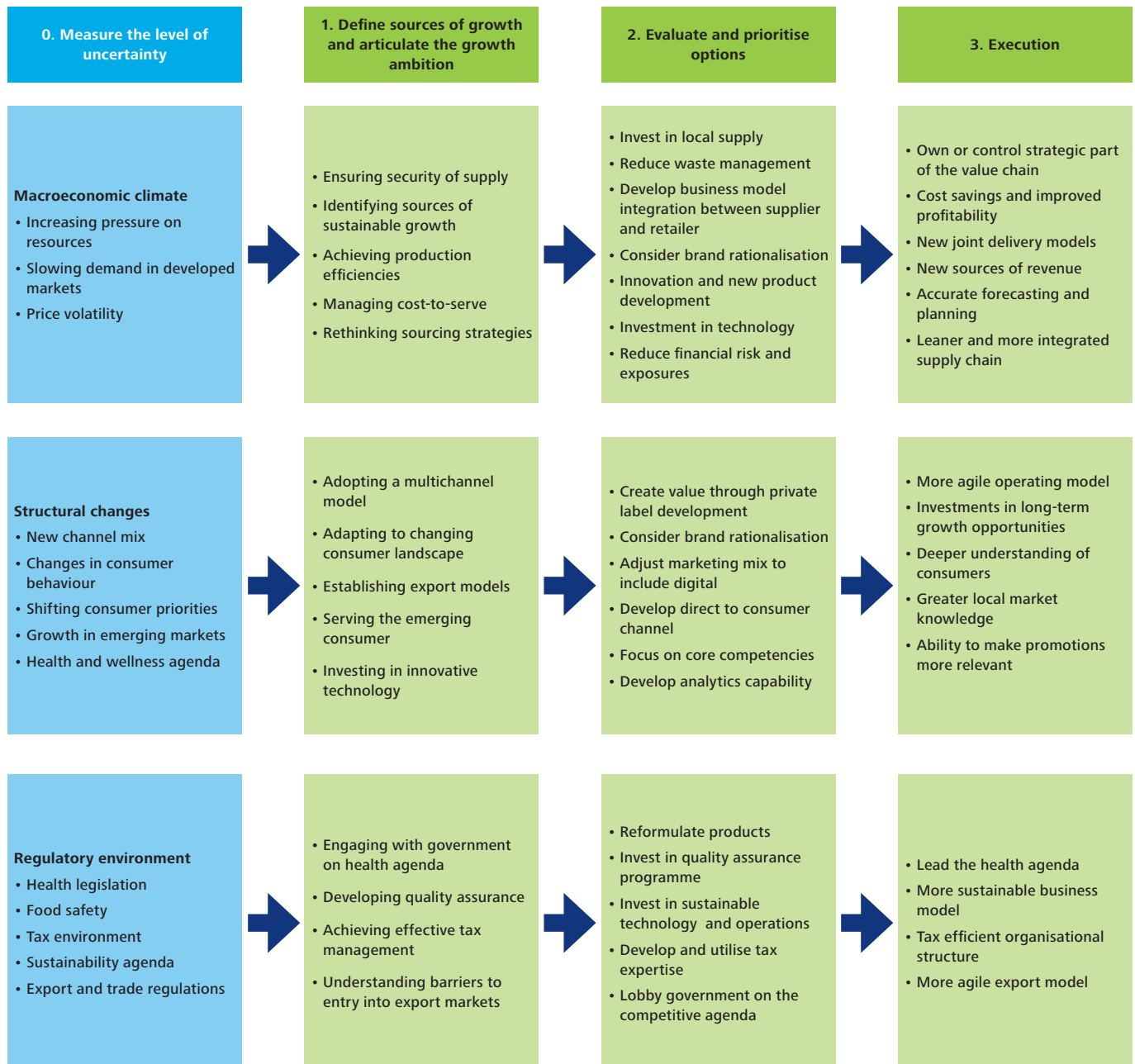


Source: Deloitte Insight, 2012

Food and beverage sector growth imperatives

Looking ahead to 2020, businesses in the food and beverage sector need to define sources of growth and articulate their growth ambitions by applying the same growth framework outlined above. In particular, businesses will need to focus on the areas that contribute the most to their performance: serving a growing middle class in emerging markets, while addressing low growth in developed markets. And they will need to do this within the context of a challenging macroeconomic climate, sector structural changes and the regulatory environment (see Figure 12).

Figure 12. Food and beverage sector growth imperatives



Source: Deloitte Insight, 2012

Endnotes

1. Middle class is defined as the population in the middle of the income distribution bracket. Source: *"The emerging middle class in developing countries"*, Development Centre working paper, Number 285, Organisation for Economic Co-operation and Development (OECD), January 2010.
2. *"Food, energy, water and the climate: a perfect storm of global events?"*, UK Government's Chief Scientific Adviser, John Beddington, 2009.
3. Economist Intelligence Unit and Food and Agriculture Organisation (FAO), August 2012.
4. *"OECD – FAO Agricultural Outlook 2012-2021"*, OECD, FAO, July 2012.
5. *Ibid.*
6. *Ibid.*
7. *"Driving Export Growth in the Farming, Food and Drink Sector, A Plan of Action, 2012"*, Food and Drink Federation (FDF), Food and Drink Exporters Association, UK Trade and Investment, Agriculture and Horticulture Development Board (AHDB), Scotch Whiskey Association, Department for Environment, Food and Rural Affairs (DEFRA), 2012.
8. FDF, March 2012.
9. *"Driving Export Growth in the Farming, Food and Drink Sector, A Plan of Action, 2012"*, FDF, FDEA, UK Trade and Investment, AHDB, Scotch Whiskey Association, DEFRA, 2012.
10. *"Sustainable Growth in the Food and Drink Manufacturing Industry"*, FDF, December 2011.
11. *"OECD – FAO Agricultural Outlook 2012-2021"*, OECD, FAO, July 2012.
12. DEFRA statistics, June 2012.
13. *"Driving Export Growth in the Farming, Food and Drink Sector, A Plan of Action, 2012"*, FDF, FDEA, UK Trade and Investment, AHDB, Scotch Whiskey Association, DEFRA, 2012.
14. *Ibid.*
15. *"The UK Food and Drink Industry: A 20/20 Vision for Growth"*, FDF, 2012.

Contacts

Nigel Wixcey
Industry Leader, Consumer Business
020 7303 5007
nigelwixcey@deloitte.co.uk

Lawrence Hutter
Partner, Consumer Business
020 7303 8648
lhutter@deloitte.co.uk

Mark Hill
Partner, Consumer Business
0117 984 2870
mahill@deloitte.co.uk

Céline Fenech
Research Manager, Consumer Business
020 7303 2064
cfenech@deloitte.co.uk

Notes

Notes

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited (“DTTL”), a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.co.uk/about for a detailed description of the legal structure of DTTL and its member firms.

Deloitte LLP is the United Kingdom member firm of DTTL.

This publication has been written in general terms and therefore cannot be relied on to cover specific situations; application of the principles set out will depend upon the particular circumstances involved and we recommend that you obtain professional advice before acting or refraining from acting on any of the contents of this publication. Deloitte LLP would be pleased to advise readers on how to apply the principles set out in this publication to their specific circumstances. Deloitte LLP accepts no duty of care or liability for any loss occasioned to any person acting or refraining from action as a result of any material in this publication.

© 2012 Deloitte LLP. All rights reserved.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom. Tel: +44 (0) 20 7936 3000 Fax: +44 (0) 20 7583 1198

Designed and produced by The Creative Studio at Deloitte, London. 22015A

Member of Deloitte Touche Tohmatsu Limited