Bon Appétit

Emerging trends, opportunities and challenges in Indian restaurant industry

January 2018

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Foreword

The market is highly segmented on account of varying income levels and age bracket of the population. It can be said that "there is a restaurant which meets the needs of every individual in the country".

The Indian Restaurant Industry has evolved and grown significantly over the past two decades and continues to grow at a steady pace. This can be attributed to the changing demographics, increase in disposable incomes, urbanisation and growth of organised retail.

The market is highly segmented on account of varying income levels and age bracket of the population. It can be said that "there is a restaurant which meets the needs of every individual in the country".

Over the past two decades, the industry has witnessed the emergence of domestic brands on a regional and national level and also the entry of foreign brands. Segments such as fine dining, casual dining, quick service restaurants, cafes, etc., are now operating in most urban areas.

The emergence of malls and other destination spaces has fuelled the growth of the restaurant industry. Various formats with innovative themes have become popular places for the youth and family to visit and the growing culture of outdoor entertainment has added to this.

The home delivery space is seeing a change in trend. More and more families are opting for food to be delivered at home. Also, the penetration of e-commerce has been responsible for the growth of this format. The future of this segment is very bright.

This trend coupled with scope for uniqueness and scalability has attracted investment into the industry within India and from abroad. Several success stories of both domestic and multinational companies investing in the industry are examples of these current trends.

In this context, we are happy to bring you the publication 'Bon Appétit – Emerging trends, opportunities and challenges in Indian restaurant industry', capturing key observations and views of the restaurant owners across Mumbai and Bengaluru regarding the emerging trends in the industry in light of the evolving consumer preferences.

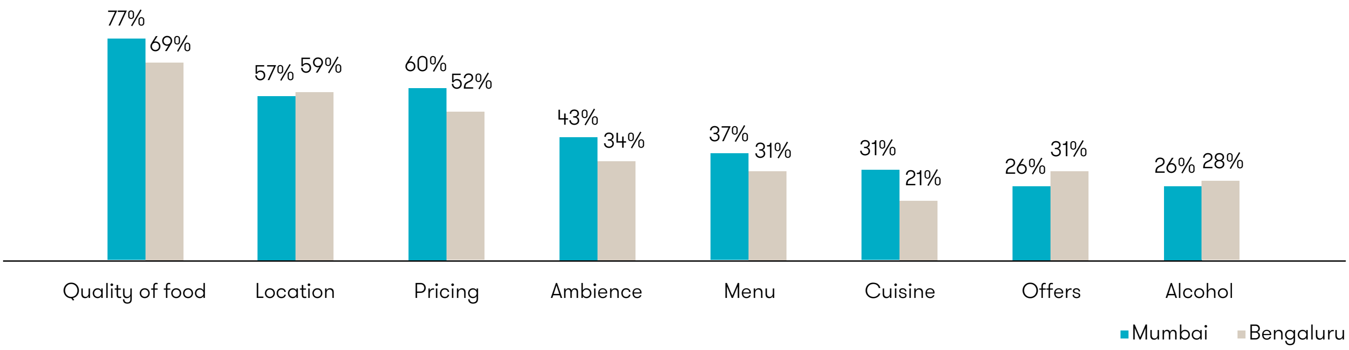
Hope you will find this publication insightful. As always, we welcome your feedback.

Dhanraj Bhagat
Partner
Grant Thornton India LLP

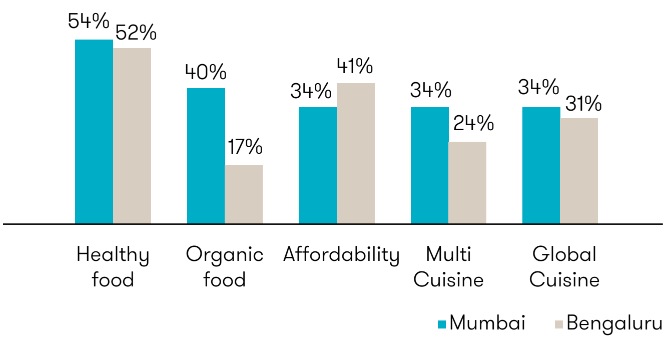
Key drivers and emerging trends

Offering high-quality food ensures success in the Restaurant business

Quality of food is key to the success of a restaurant



Emerging consumer preferences



Quality of food has been highlighted as the critical factor for success of restaurant business followed by 'location' and 'pricing'. This is reflected in the consumer preference for healthy food. For Mumbai respondents, having organic food is more important than concerns related to pricing and preference of a cuisine.

Location determines the accessibility, thereby convenience for a customer, whereas pricing determines the affordability; hence these appear to be the key factors determining consumer preference. In fact, affordability has been highlighted as the key emerging trend in consumer preferences specially in Bengaluru.

Ambience, menu and cuisine are rated a bit higher in Mumbai compared to Bengaluru, where the availability of offers and alcohol are highlighted as the key factors.

Every restaurant that stands the test of time offers a unique value proposition to the customer. The restaurant owners need to build on their strengths and innovate to ensure long-term sustainability.

Dhanraj Bhagat
Partner
Grant Thornton India LLP

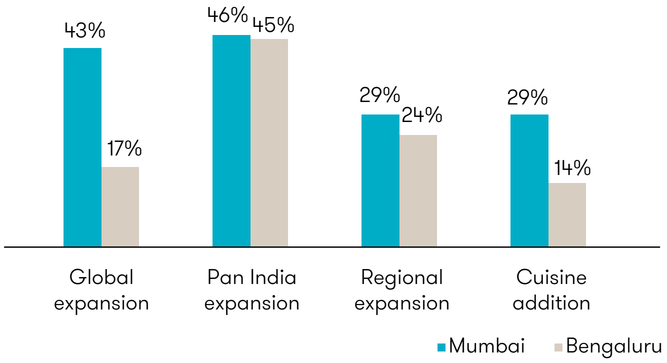
Growth and strategy

Pan-India expansion is the preferred strategy for growth

Pan-India and/or regional expansion have been highlighted as the primary strategy for growth by the respondents. In addition, Mumbai respondents have expressed that global expansion and cuisine addition are two other crucial strategies for expansion.

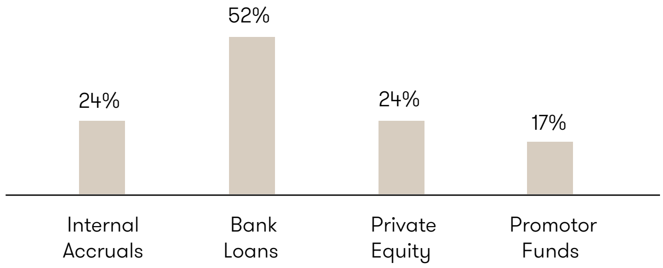
Cuisine addition appears to be in line with the emerging trend in Mumbai-based consumer's preferences for global and/or multi-cuisine.

Global, pan-India or regional expansion strategies appears to be driven by the sources of funds available to the restaurateurs, which is highlighted in the charts below.

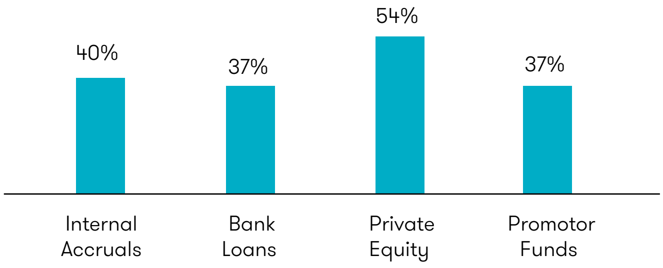


Sources of funds for expansion

Bengaluru



Mumbai

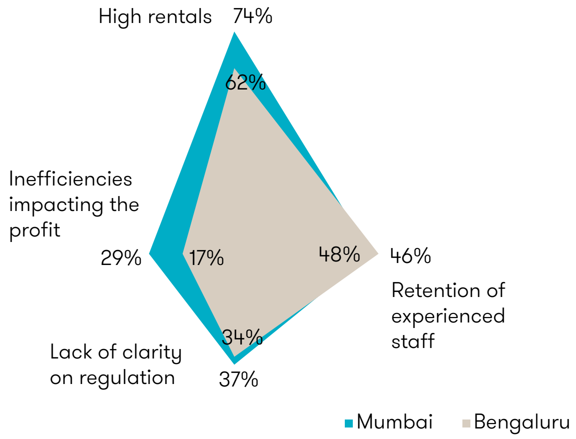


Mumbai's preference for global expansion appears to be driven by the expectation of funding from Private Equity firms and cuisine addition from the availability of internal accruals, promoter fund and/or bank loans, whereas Bengaluru sees bank loans as the primary source of funding for pan-India and regional expansion.

Key challenges & opportunities

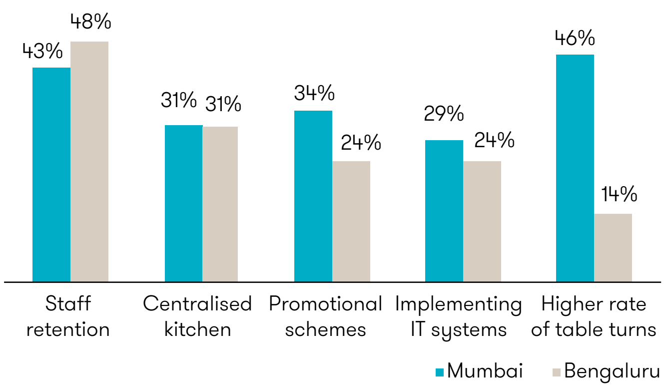
High rentals and retention of experienced staff are the top two challenges

Top challenges faced by the industry



High rentals followed by difficulty in retaining experienced staff have been the key challenges of the restaurant industry in Mumbai and Bengaluru.
While lack of clarity on regulations has also been mentioned as an area of concern, Mumbai respondents expressed that inefficiencies in the operations have been adversely impacting the profits.

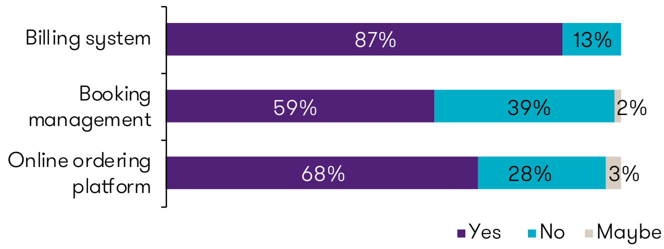
Key drivers for efficiency and profitability



While these challenges exist, restaurateurs feel that a sustained focus on staff retention, centralised kitchen, promotional schemes and implementation of IT systems, will help a restaurant in becoming efficient and more profitable.

Mumbai respondents rated higher rate of table turns as the second most important factor after retention of staff.

Trend in IT systems adoption



One of the key initiatives, which helped the industry in reducing inefficiencies, is the widespread adoption of the IT systems for billing, booking management and online ordering platforms. The survey revealed while billing software has been installed in most of the restaurants across Bangalore and Mumbai, booking software has a lesser coverage.

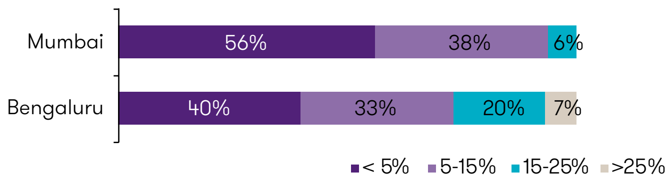
Restaurants are also investing in online ordering platforms due to the recent emergence of home delivery as an additional source of income.

While many respondents are seeking help from third party vendors for these systems, majority of them have mentioned that they are yet to move on to cloud based systems which should help them rationalise the cost of IT infrastructure and systems.

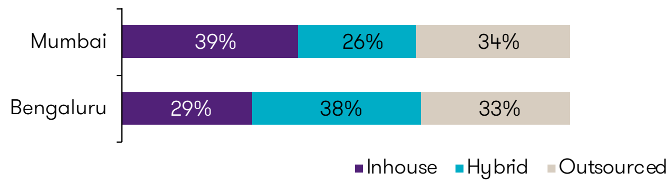
The changing landscape

Home delivery: Scaling new heights

Home delivery and the impact on the industry



Modes of fulfilment



Over the years, home delivery has risen as a major source for increasing revenue in the restaurant industry. With the advent of the online platforms, home delivery has started contributing a higher share of revenue compared to the past, when the same was miniscule. While, less than half of Mumbai businesses get a share of 5 per cent or more revenue from home delivery, it is higher for Bengaluru (around 60 per cent). In fact, some establishments appear to receive more than 25 per cent of revenue from home delivery in Bengaluru.

Managing home deliveries has evolved over the years; the distance covered and the times taken to deliver have been affecting the quality of delivery services. The order booking and fulfilment is carried out in-house or outsourced or through a hybrid model (order fulfilment in-house and delivery outsourced). While the distribution is more or less uniform across these models, both the cities differ in terms of models that work. Mumbai has higher share of in-house model as compared to Bengaluru, which has a higher share of hybrid model.

Outsourced model has got impetus with the advent of technology and the m-commerce platforms connecting restaurants with the consumers. The potential of food delivery space has seen the emergence of start-ups and the private equity/venture capital firms, which have shown keen interest in funding these businesses.

Most businesses now are using technology to advance their operations and the restaurant industry cannot be left behind. Use of technology has brought in lot more convenience to customers, not only within the restaurant premises, but also when one wishes to order a take away. From restaurant reviews to seeing the items on the menu to benefitting from offers/discounts to ordering food from the convenience of home/office, customers is empowered to make a choice by tapping their smartphone screens.

Likewise for restaurateurs, technology is becoming the driver for sourcing quality supplies at real time prices, ensuring quicker food service and turnarounds, building efficient kitchens and factoring in real-time customer feedback for relationship management. The pace of technological transformation is only going to accelerate with continuous innovations and disruptive technology, which is expected to drive consumer expectations and behaviours. The industry needs to be adaptable to every technology-led disruption.

Kuresh Khambati
Associate Director
Grant Thornton India LLP

Deal activity in home delivery space

	Volume	Value
2014	12	181
2015	56	451
2016	32	148
2017*	14	124

*2017 is indicative of the period Jan17 to Sept 17

With the advent of technology-led food delivery businesses, the food delivery space has witnessed significant overall deal traction in 2015 as compared to 2014, with big-ticket PE/VC investments and stake acquisitions in the sector. This was mainly driven by Rocket Internet and Goldman Sacs' USD 210mn investment in Foodpanda and Zomato's USD 60mn fundraise.

The big ticket investments of 2015 were not replicated in the subsequent years. However, 2016 and 2017 witnessed deals like Swiggy (food delivery) raising USD 137mn, whereas Freshmenu (food preparation and delivery) raised USD 16.5 mn and Licious (meat delivery) raised USD 13mn. Foodpanda, Zomato, Swiggy, Freshmenu and Licious have been scaling up through investments and acquisition of smaller players in the industry.

Other business models in this sector like HolaChef (online marketplace for chefs), InnerChef (operates a centralised kitchen and delivers the food) and Chef's Basket (ready to cook packaged food) have also evinced investor interest in the last few years.

Sustainable and adaptable business models (be it in home delivery, global, multicultural, etc), where the offerings are in line with changing consumer behaviour and expectations, have retained the interest of the investors in the industry. Over the last few years, players in the food-tech space have had to pivot their strategies and business models in order to stay competitive in an environment of rationalising investor sentiment

Shanthi Vijetha
Director
Grant Thornton India LLP

Potential fraud risks and measures

While challenges exist, one must be aware of the risk of fraud in this industry. Today, the restaurant industry faces challenges like high real estate and manpower costs, inadequate supply chain and financing issues impacting the longevity of its businesses. One must also consider the risk of fraud that lurks on the horizon and has deep impacts on ensuring whether the restaurateurs make their ventures palatable for themselves and the economy at large.

The restaurant industry typically faces the following fraud risks:

1. **Theft of cash and inventory:** Restaurant businesses are cash intensive by nature. Therefore, theft of cash becomes the most prominent and easy to execute fraud scheme, wherein the employees of the restaurant can find numerous ways to siphon away cash. High value inventory is also prone to thefts due to a lack of well-built in controls and mechanisms. The risk of theft gets exacerbated due to the high turnover among junior level staff who find the lure of easy money quite hard to resist.
2. **Intellectual property thefts:** Of late, restaurants have started experimenting with their recipes and concepts, termed as "glocalising" by Riyaaz Amlani, widely acknowledged as one of India's most innovative restaurateurs. These creative restaurants are vulnerable to a different type of threat wherein their competitors/ counterparts in the same business would copy their formats or steal their recipes.
3. **Brand protection:** It's not uncommon to see a rumbled down version of Taj Mahal Palace across India. Other restaurants and cafes too are susceptible to this threat wherein their names could be used to set up a run down version thereby impacting their brand and reputation adversely.
4. **Relationship with investors:** These alliances are fraught with issues of mistrust stemming from the fact that investors/ private equity players do not have visibility about the way the business is managed. To add to their discomfort is often the burgeoning problem of negative cash flows which makes the investors/private equity players wonder about the return on investment. These acrimonious alliances often end in the involved parties parting ways to the detriment of the business.
5. **Partnerships with food service apps for delivery of food:** Customers are buzzing towards food service apps for home delivery, making these apps an integral part of the restaurant industry. Food Panda was in the news recently for all the wrong reasons serving as a clear example of how, if such relationships are not handled well, then both, the app service provider as well as the restaurant will suffer.
6. **Financial misstatement frauds:** The restaurateurs or their employees, in an attempt to present a rosy picture to their partners/bankers/investors may end up misrepresenting the books. This window dressing of financials could be, at times, required to prevent the stakeholders from becoming aware of funds siphoned away from the business.
7. **Fictitious/excess purchases:** The employees of the restaurant in collusion with various suppliers may indulge in purchasing excessive quantities or at favourable rates or simply making payment against fictitious invoices in return for a commission.
8. **Dealing with authorities:** Given the regulated nature of the restaurant industry in India, there are multiple touch points between the government and restaurants. This gives rise to the risk of bribery and corruption which the restaurateurs need to manage.
9. **Theft of customers' personal information:** Credit card thefts are no longer strange in the restaurant business. These businesses pose an easy opportunity for miscreants to steal valuable information and misuse it for their own benefits.
10. **Frauds by customers:** Given the retail nature of the restaurant industry, it is prone to being defrauded by a host of ways in which the customers could defraud them. For instance-

- Use of forged coupons/gift cards,
- Faking an injury and claiming compensation,
- Claiming compensation for deficient services, which are not deficient,
- Availing wrongful refunds through false accusations,
- Eat and walk away without paying the bill, on the pretext of an urgent call

11 **Excessive charges in the name of taxes:** Sometimes employees levy unnecessary charges in the name of taxes on the customer bills which are subsequently pocketed by the employees themselves.

12 **Obtaining requisite licenses or renewing them:** The restaurateurs may feel inclined to cut corners by functioning without a valid license or by not renewing the license. This will have serious impacts in the future.

The restaurant industry cannot afford to adopt an ostrich approach to these problems and hope for a miracle while it buries its head in the sand. The ideal solution would be to take the bull by its horns and adopt modern technologies of integrated software and surveillance, periodic reviews and audits, data mining and monitoring of social media. All these things put together will yield insightful results necessary to take corrective and prompt actions to ensure profitable, ethical and sustained growth.

After all, as they say, the proof of the pudding is always in the eating!

Samir Paranjpe
Partner
Grant Thornton India LLP

News that matters

1. Service Charge conundrum

In January 2017, the Department of Consumer Affairs through a notification has asked the restaurants to not add the service charge mandatorily to the bill.

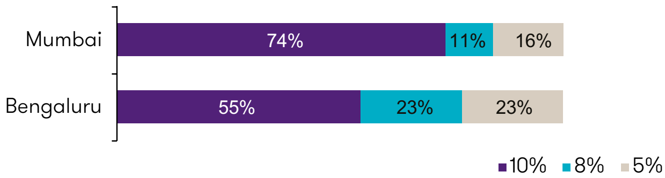
On 21 April 2017, the government of India approved guidelines on service charge, which stipulates that service charge is totally voluntary and not mandatory now. Hence, the space for service charge in a bill needs to be left blank so that the customers can fill it up before making the final payment.

If there is mandatory levy of service charge, customers can file a complaint in the Consumer Court.

Most of the respondents across Mumbai and Bengaluru have indicated that service charge should be mandatorily added to the bill (fixed at 10 per cent). The respondents supported their argument by explaining that service charge is an important component of service staff compensation as it is pooled and distributed between them.

Interestingly, an equal number of respondents in Mumbai (other than the fixed rate responses) are of the opinion that service charge rate should vary based on the experience of the customer.

Response on the fixed rates of service charge as a % of food bill



2. Defining 'portion of food served'

Addressing the nation on 26 March 2017 in the 30th episode of his radio programme Mann Ki Baat, the Prime Minister Shri Narendra Modi urged the nation to fight the menace of 'food wastage', reiterating that preventing food wastage will benefit the economy.

Inspired by the thoughts of the Prime Minister, Minister of Consumer Affairs Ram Vilas Paswan said that controlling the portion of food served is the key to prevent wastage of food and his ministry would soon define portion sizes of food served in hotels and restaurants.

This initiative is aimed at reducing the wastage of food and the government's intention is good. At the same time, it is a rather difficult regulation (if at all it is in place) to be formulated since standardisation across dishes, cuisines, price points, etc is a challenging exercise. Further, implementation of the same would require constant monitoring of the restaurants which in itself a cumbersome exercise.

3. Alcohol ban on highways

In a landmark judgement, the Supreme Court of India, it ordered closure of all liquor shops along national and state highways if they were within a range of 500m from the edge of such highways, directing governments to "cease and desist" from issuing excise licenses after 31 March 2017. The ban came into effect on 1 April 2017.

Also, on 23 August 2017, the Supreme Court clarified that the ban on sale of alcohol within 500 meters of state and national highways does not apply within city limits, granting relief to the liquor and hospitality industry. The order further clarifies that it is applicable to sale of liquor along and within proximity of highways, which provide connectivity between cities, towns and villages and does not prohibit licensed establishments within municipal areas.

The apex court's directive is certainly well meant and for public interest. It springs from the fact that drunken driving is the reason for death of thousands of people each year on our highways.

Having said that, a blanket ban on all liquor outlets operating within specified limit from the highways is a sweeping measure that has put thousands of businesses employing lakhs of people in a tight spot.

Some hotels which, due to their proximity to the highways were sought-after by business travellers and tourists have been hit due to alcohol ban along the highways. Since a large number of domestic as well as foreign customers would avoid dry establishments, lower occupancies affected overall revenues and profitability. Many satellite cities/suburban areas in metro cities in India have been built around the highways and many of the hotels in these cities/areas having in-house bars and pubs were staring at uncertain future. Such uncertainty would have led to enormous losses to business and tourism, which will translate into jobs loss as well as huge revenue losses for state governments.

However, with a clarification in August 2017, the ban has been lifted from the licensed establishments within the municipal areas.

4. Ban on sale of cattle for slaughter

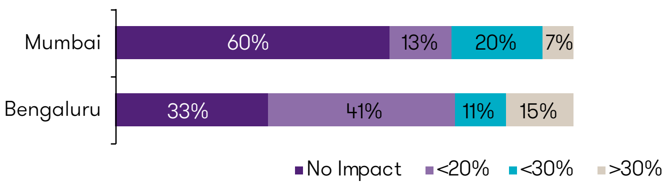
In a move amounting to a virtual ban on unregulated trade of cattle, the Centre, on 26 May 2017, announced strict rules to prohibit sale of animals for slaughter or religious sacrifice at livestock markets and animal fairs. The animals under purview are cows, bulls, bullocks, buffaloes, steers, heifers, calves and camels. The Madurai bench of the Madras High Court had stayed certain portions of the rule, including the requirement that those trading in animal markets should give an undertaking that the animal would not be slaughtered.

On 11 August 2017, the Supreme Court stayed the Centre's new rule on livestock trade that restricted slaughter.

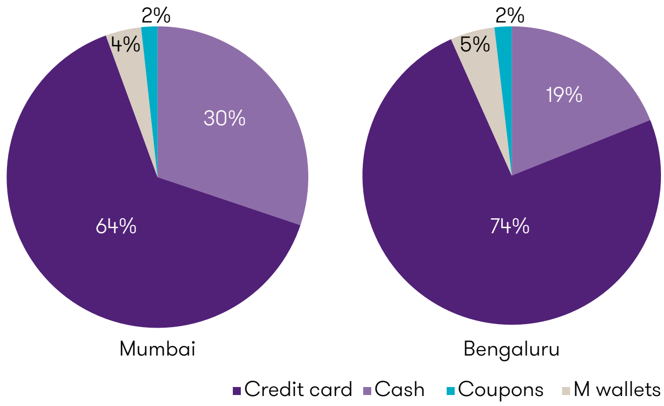
The ban is likely to have a significant impact on the hospitality and tourism industry as hotels, restaurants and catering segments remain one of the largest consumers of beef in the country.

Demonetisation: The aftermath

Share of revenue impacted



Preferred modes of payment

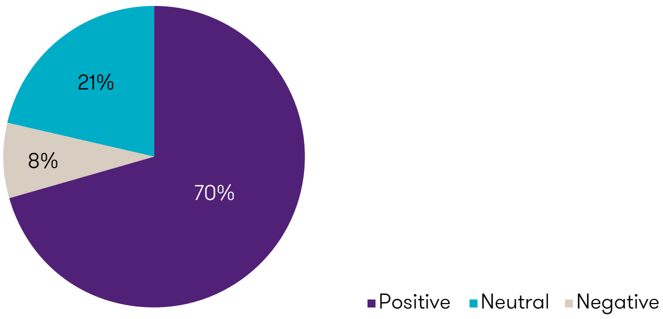


The impact of demonisation appears to have been more in Bengaluru, where only one-third of the respondents say there is no impact of demonetisation, compared to Mumbai, where it was 60 per cent.

The impact does not seem to relate to the modes of payments observed as Bengaluru with low cash component has significant impact compared to high cash component market of Mumbai.

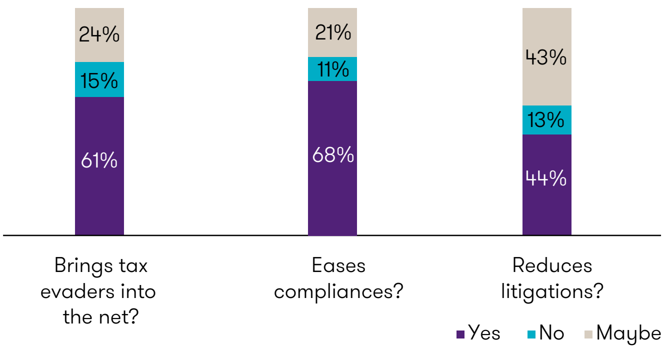
Cash is still a predominant as a mode of payment and accounts for 20-30 per cent of receipts in a restaurant. M-wallets have just started picking up and account for 4-5 per cent of the collections.

GST: A positive decision



70% of the respondents feel that the impact of GST on the restaurant industry is largely positive

As

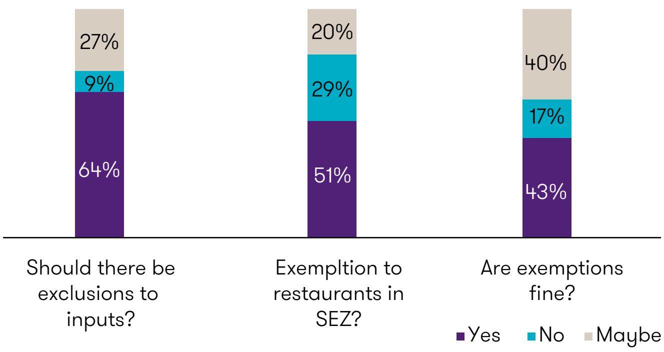


61% of the respondents feel it will bring tax evaders into the tax net

68% of the respondents feel it will ease compliance as it is backed by technology

44% of the respondents feel it reduces litigations

However,



64% say there should be no exclusions

51% feel nil rate/lower rate of GST should be applicable for restaurants in SEZ

43% of the respondents feel all goods and services including the current exempted ones – alcohol, petroleum, real estate, tobacco and raw food - should be covered.

GST introduction and implementation in India throws short term challenges. Over a period of time, it will certainly yield positive results, especially for the restaurant industry, which is largely dominated by unorganised market players not registered under any law. These players will be forced to regularise for sustainability and growth. Further, simplified tax structure and transparent approach would also help in gaining trust and confidence of such unorganised players.

Biren Vyas
Partner
Grant Thornton India LLP

Unified tax will simplify taxation

Today, foreign investors are monitoring the Indian economy closely considering a rise in positive announcements and action steps from the Government of India (GoI), especially after the big announcement of introduction of Goods and Service Tax ('GST') from non-deferral date of 1 July 2017. After arduous journey which was full of challenges, GoI has finally implemented GST which is aimed at gearing up Indian industry in multiple ways like simplification and transparency in taxation, robust credit mechanism, and technology driven support.

GST provides a platform to both government and industry for structured approach and productive focus on business growth as opposed to ambiguous and costly systems.

At initial stage, considering operational challenges, it would be excruciating and might appear negative in some areas specifically at the time of transition. However, on an overall basis, if analysed equitably, GST implementation in India would have positive impacts over a period of time. This would be almost across sectors and industries including food industry.

While food industry in India is divided in various sub-sectors like fresh straight from farm, semi-processed, ready-to-eat and cooked food ready for consumption, the hotel industry has seen multi-fold growth in recent years. Further, the announcement of one rate on supplies by restaurant services and technology support for handling compliance will facilitate ease of doing business.

India's food industry which is largely unorganised, GST implementation will emphasis on standardisation in approach, elimination of malpractices in quality (as services from GST registered dealer would be much safer) and thus, creation of trustworthy business approach for gradual business growth.

On fair analysis of impact of GST implementation on food industry, following points emerge at first instance:

Challenges for food industry under indirect tax regime

- Dual levy of tax in case of hotel industry and lack of uniformity in law in various states.
- Procurement from and preparation by local units, which are unregistered under any law.

Approach under GST regime

- Simplified single levy and standardised approach across states.
- Automation and e-platform for smooth handling of tax function.
- Dealer registered under law would require abundance precaution to maintain safe quality in food and better services.

Focus on the vision:

GST implementation would be a welcome step for industries in India, especially for food sector as players, whether aiming on rapid growth or preferring maintenance mode in business, would need to focus on three things viz., (i) quality in product and services, (ii) transparency in business and (iii) automation with standardisation in approach.

Conclusion:

On a macro level evaluation of GST introduction, it is clear that local units in food industry operating as a part of unorganised market will have to adopt an organised approach. They will need to improve quality of food and services, take higher accountability for business operations and regularise business revenue by depositing taxes along with full disclosure.

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