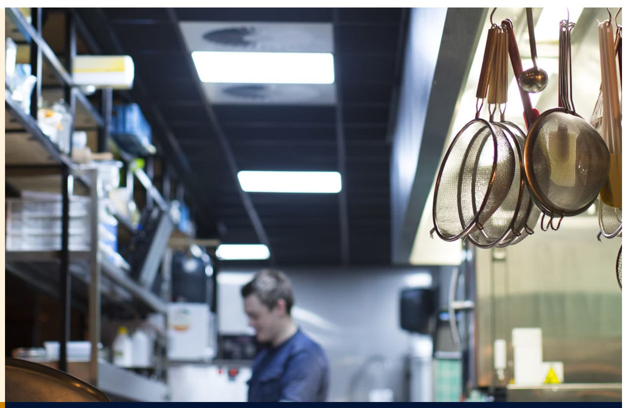
NOESIS
THURSDAY SPOTLIGHT
HQ: Mumbai • Gurgaon • New Jersey • Bengaluru



25 JULY 2024

Delivering Dreams

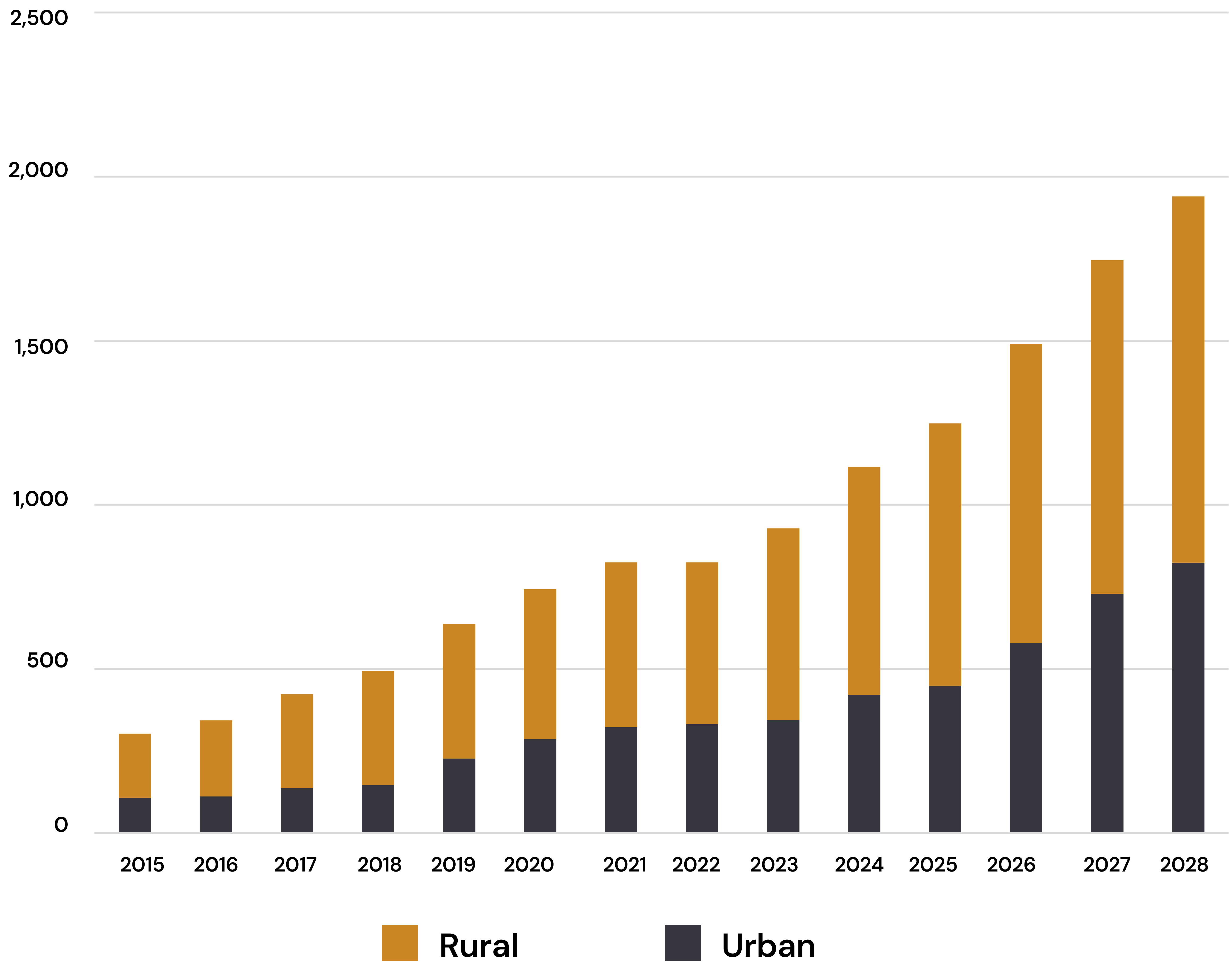
India is currently experiencing a period of economic growth, driven by a growing population and a youthful demographic. This demographic profile has positioned the country as an attractive destination for global investors. Over the past decade, the government's digital, financial, and physical infrastructure investments have laid a solid foundation for accelerated economic expansion in the coming years.

Currently valued at approximately $4 trillion, it's projected to double in size over the next 7-8 years, reaching a staggering $8 trillion. This signifies a period of exceptional growth, with the nation poised to create as much wealth in the coming decade as it has in the past 77 years combined.

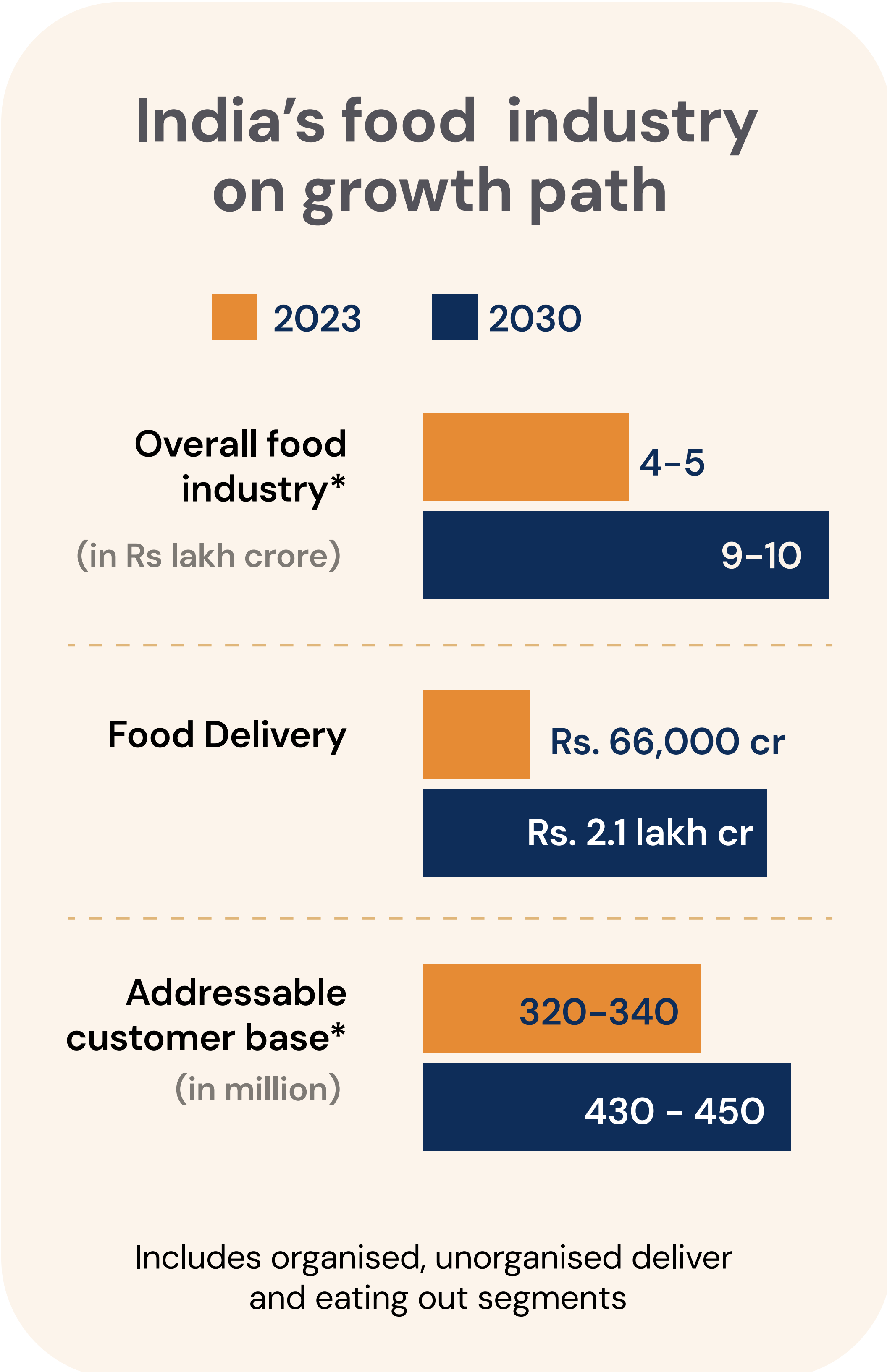
A growing and increasingly young population, coupled with rapid urbanization, is driving a surge in consumption. As incomes rise, households earning more than USD 8,000 per year are projected to double from 25% in 2021 to over 50% by 2031. This growth is translated into an increase in middle-class population from 97 million in 2018 to 132 million in 2030, as projected. This has already caused the consumer basket to shift from necessities to luxury, travel, and out-of-home dining, among other things.

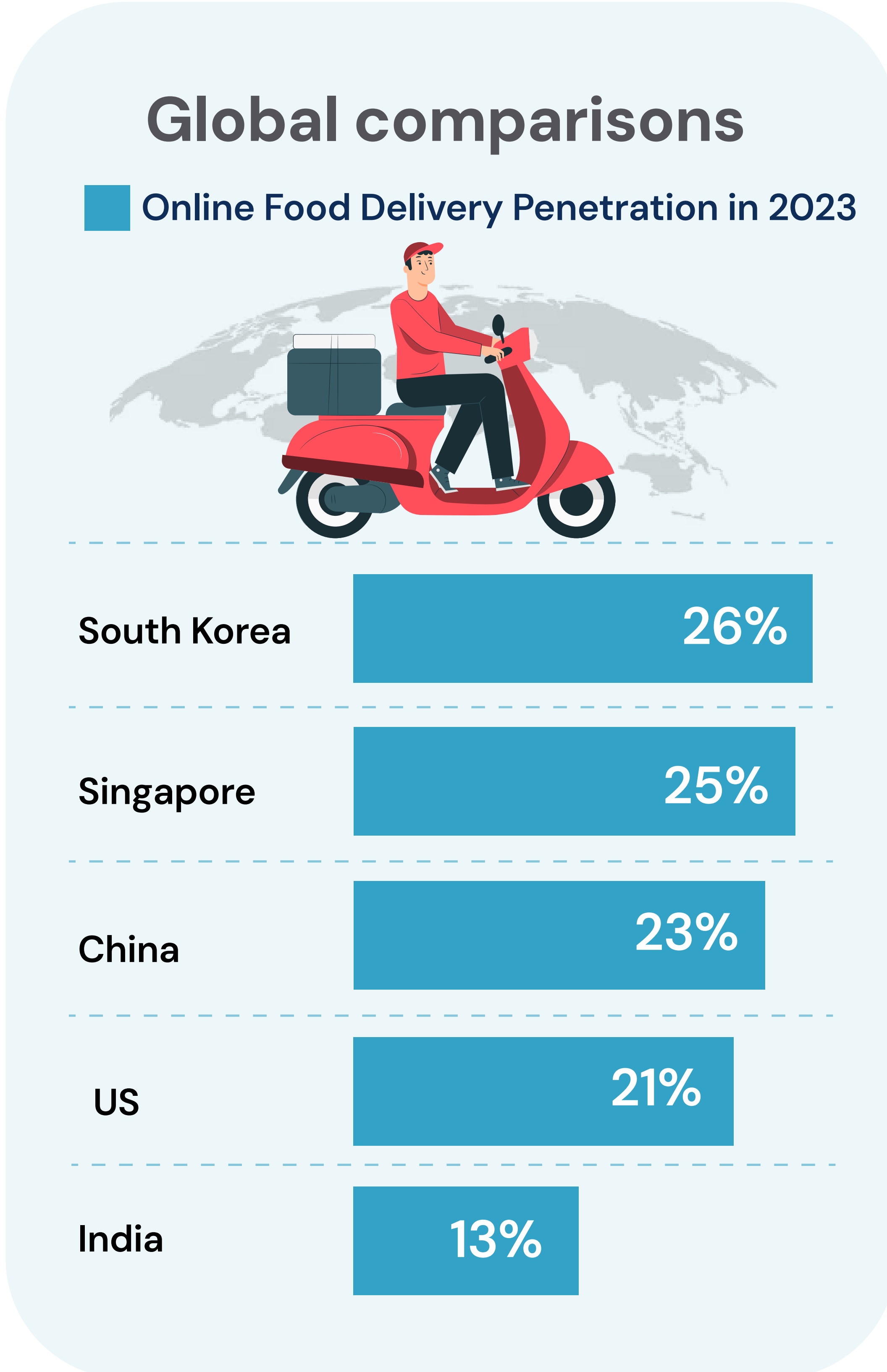
The Indian hospitality industry stands poised to capitalize on a wealth of exciting opportunities. A recent report predicts India's emergence as the world's third-largest consumer market by 2027, a significant leap from its current position. Furthermore, household spending in India is projected to outpace other developing Asian economies, with an annual growth rate of 7.8%.

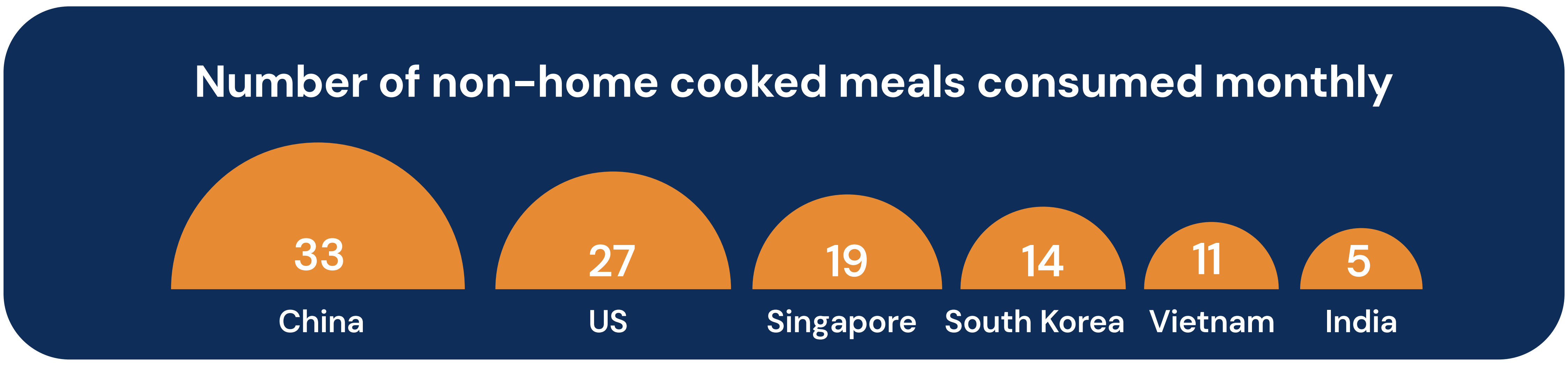
Internet Users Across Regions (Millions) FY2015-2028 (E)



Another significant factor driving the impressive growth of consumption in India is the country's high rate of internet penetration. As of FY 2024, India boasts a remarkable estimate of 1,116 million internet subscribers. This growth has been phenomenal, with internet users surging to a projected 1940 million in FY 2028. The overall rural subscribers are expected to increase from 344 million in FY2023 to 824 million in FY2028 at a CAGR of 18%. The urban subscribers are expected to grow from 584 million in FY2023 to 1,116 million in FY2028 growing at a CAGR of 13%. The primary driver of this expansion has been internet adoption in Tier 1 cities, followed by Tier 2, Tier 3, and rural areas. This widespread internet access has empowered a large portion of the Indian population to access e-commerce platforms with ease.







The digital age has ushered in a significant shift in Indian lifestyles, with the COVID-19 pandemic acting as a catalyst for the growth of online businesses.

Consumers, increasingly seeking convenience, now favour the comfort of their homes, opting to enjoy meals delivered directly. This trend has naturally spurred the F&B industry to adapt and capitalize on this evolving landscape.

Companies like Swiggy and Zomato have emerged as major players in the online food aggregator platform, capturing a significant portion of the market.

There is a visible growing preference for the convenience and variety offered by online food delivery platforms as research has predicted India will command its online food delivery penetration rising from 12% in 2023 to 20% by 2030.

Beyond online delivery, the entire food services market in India is anticipated to double in size by 2030. This translates to an impressive growth from its current value of Rs 4-5 lakh crore to Rs 9-10 lakh crore. Several factors contribute to this expansion, including rising disposable incomes, the increasing adoption of digital technologies, and a continuous focus on enhancing customer experiences. Additionally, a growing consumer desire to explore diverse culinary options is further fueling the demand for convenient and innovative gastronomic experiences.

A new generation of food enthusiasts is also entering the scene. Young consumers, particularly those in the 16-22 age group, are driving a shift in dining habits. Eating out is becoming less of a special occasion and more of an integrated part of their lifestyle. This trend is reflected in the projected increase in dining frequency. By 2030, the average number of eating-out occasions is expected to rise significantly, reaching 90-95 times per year compared to the current average of 60-65 times annually.

This growth extends beyond just consumers. The entire supply chain, encompassing processors, importers, distributors, wholesalers, retailers, food service operators, hotels, and restaurants, is poised to benefit from India's burgeoning market. The restaurant and food industry, in particular, presents a significant opportunity, as it currently captures only 10% of the total food market, indicating vast room for expansion.

This presents an opportunity for hotels to capitalize on their existing infrastructure and make the asset sweat, this can play a significant role in this dynamic market. While the food and beverage (F&B) department in hotels often operates with tight margins, both hoteliers and restaurateurs can leverage several strategies to unlock profitability and tap into the booming market.

Room Service Revolution:
How Cloud Kitchens are Redefining Hotel Dining

A cloud kitchen is a commercial cooking facility that has no physical dining space and caters only to the delivery of orders placed online. The principle of the cloud kitchen is to utilise space in a way where multiple brands are operating under one roof. The menu is designed in a way where they offer ease of production, the entire chain is run in a way that the order is prepared and delivered in the fastest way possible.

Cloud kitchens also take advantage of the advancing technology, they gather data from their partnered delivery apps like Swiggy, Zomato and Uber Eats and process that data to determine what type of good to produce for specific neighbourhoods and when the demand is likely to be the highest.

The hospitality industry is constantly evolving to meet the changing demands of consumers. One innovative approach gaining traction involves the strategic integration of cloud kitchens within hotels. Cloud kitchens, unlike traditional restaurants, operate solely as delivery-focused facilities, leveraging existing infrastructure within a hotel to generate new revenue streams.

A compelling example of this strategy is ITC's "Biryani and Pulao Collection." This initiative expands its culinary network through the introduction of "Cloud Kitchen by ITC," offering a curated selection of iconic dishes prepared by master chefs. ITC has further diversified its cloud kitchen offerings to cater to a wider range of palates, introducing "ITC Aashirvaad Soul Creations" for North Indian comfort food, "ITC MasterChef Creations" for gourmet North Indian cuisine, and "ITC Sunfeast Baked Creations" for delectable bakery products. With a presence of 23 cloud kitchens across Bangalore and Chennai, ITC demonstrates the significant growth potential of this model within the hospitality sector.

The success of ITC's cloud kitchens can be attributed to several factors. Firstly, cloud kitchens benefit from a lower Goods and Services Tax (GST) rate of 5% compared to the 18% levied on hotel restaurants. Furthermore, by prioritizing speed and convenience, cloud kitchens cater perfectly to the demands of busy customers, as evidenced by ITC's impressive achievement of surpassing one million delivered orders. The average order value of Rs 900 for ITC's cloud kitchens also surpasses the industry standard.

Beyond immediate financial gains, ITC leverages existing institutional synergies to maximize the effectiveness of its cloud kitchen model. Collaboration with FSSAI ensures adherence to regulations and facilitates the development of packaging solutions specifically tailored for fresh food delivery. Additionally, ITC employs a "digital-first" approach to gather valuable consumer feedback, which informs the development of future FMCG products. The company's culinary expertise honed within its hotel business further strengthens the cloud kitchen offerings, while its experience in industrial ready-to-eat and frozen food production provides a distinct advantage.

Let us explore the pros and cons of cloud kitchen

PROS	CONS
Enhanced operational efficiency	High Competition
Brand Expansion Opportunities	Needs expertise
Reduced Capital Investment	May need deep pockets
Requires minimum area	Increased reliance on technology
Competitive Pricing	Delivery Dependence
Economies of scale	Limited customer connection

While cloud kitchens have emerged as a lucrative option for food service businesses during the pandemic, the transition is not without its complexities. For many restaurants, particularly smaller establishments, successfully operating a cloud kitchen requires a clear understanding of the underlying unit economics. This model demands a distinct skill set compared to traditional restaurants.

Despite the potential benefits, sustaining a cloud kitchen may not be feasible for all players. Only established businesses with relevant expertise, significant financial resources, or strong investment backing are likely to thrive in this competitive environment.

Beyond the Lobby: How Hotels can Lease F&B Space for a Win-Win Partnership

The hospitality industry has witnessed a rise in a mutually beneficial arrangement: hotels leasing their food and beverage (F&B) space to established brands. This model offers a strategic partnership for both parties.

Our analysis indicates that the ground floor represents the most valuable commercial space within a hotel. By strategically utilizing this prime location, hotels can partner with a well-established brand to attract a wider guest base. This strategic collaboration can lead to a significant increase in foot traffic within the hotel, ultimately generating additional revenue streams.

The hotel can also ditch the traditional hierarchy which the Director of F&B follows, instead, brands opting for the lease can make decisions which are aligned with the brand, not only the decision making is faster but the hotel can also control the standards of the restaurant without actually devoting a lot of resources. Hotels can offload menu development, staffing, and daily restaurant operations responsibilities to the lessee. This allows them to focus on their core competency of providing exceptional guest experiences within the hotel itself.

Tapri at the Jaipur Marriott and Asilo at the St. Regis Mumbai are prime examples of successful partnerships between hotels and established F&B brands. Hotels can choose between a fixed rental structure or a revenue-sharing model. The rental structure provides a guaranteed annual income, while the revenue-sharing model offers the potential for higher returns based on the F&B brand's performance. This collaborative approach presents a win-win scenario for both hotels and F&B brands. Hotels gain reliable income, streamline operations, and enhance their guest experience. Established F&B brands benefit from reduced startup costs, a strategic location, and valuable marketing exposure.

PROS

Attracts a new set of customers

Both parties can benefit from the branding

Restaurant has the freedom to manage its operations

CONS

Restaurateur is required to open at unprofitable times

The hotel and restaurant are can wind up in a conflict

Restaurant and Hotel values may not align

Having considered the potential challenges associated with both owning and leasing a restaurant space, the optimal course of action remains a case-by-case analysis. Several factors influence this decision, including the property's location and its potential attractiveness for independent operation by the hotel owner. While challenges may not be eliminated, fostering a collaborative partnership with a restaurant operator offers a compelling path for hotels to optimize their food and beverage operations and maximize the value of their commercial space.

Conclusion

The hospitality industry is no stranger to change. Unlike some sectors, it's highly susceptible to unexpected challenges, often being the first to feel the impact of economic downturns or shifting consumer preferences. This vulnerability is particularly evident in India, where a concerning 59% of hospitality establishments fail within three years, with an even steeper 26% failure rate in the first year alone.

However, within these difficulties lies an opportunity for innovation. As established brands face existential crises and closures, new concepts are emerging to cater to a broader market. By embracing these innovative partnerships, hotel brands can strategically position themselves for optimal growth and survival in this ever-evolving landscape.

Written by Shaina Desai, with strategic inputs by Noesis Consulting and Valuations Team & Raj Shah, Founder & CEO of Asian by Kilo.

Sources- CBNC, Economic Times, Business Standard, 360 Real Estate Commercial, GAIN, The India Opportunity