

Special Section 1: The growth of the processed food industry in Pakistan: Changing trends and key challenges

The processed food industry in Pakistan has been going through a major change in recent years. The production landscape is transforming from a focus on traditional processed food items (e.g., cereal, biscuits, jam, pickles, juices, spices, etc.) to higher value added products, such as frozen ready-to-cook/fully cooked food, healthier snacks, dressing and sauces, processed meat and poultry. Thus, a large number of firms of varying size have come up in recent years, catering to the rapidly changing needs of highly diversified consumers in terms of age, gender, taste, income, and social background.¹ This trend has gained further support from an expanding network of retail stores where consumers can find every item under one roof. In this backdrop, this note examines some new trends in the food processing industry, and discusses key challenges faced by firms.

1. The industry is responding to rising demand and changing consumer taste and preferences:

The emergence of the middle class, a rapidly growing population, rising number of working women, increased urbanization, and awareness about the significance of nutritious and hygienic food, has drastically changed the business landscape for the processed food industry. As convenience has an immense impact on the food choices of consumers, the demand for food products that reduce both the preparation time and effort has been growing strongly.

The processing industry is also bolstered by developments in the food-based service industry. For example, a number of dine out places (ranging from the traditional *desi* food *dhabas*, food streets, food courts in shopping malls to high end restaurants) are experiencing mushroom growth; people are increasingly using mobile and online food ordering platforms to save time and enjoy food from the restaurant of their choice right in the comfort of their own homes;² and home-made food suppliers are offering

¹ According to Household Income and Expenditure Survey data, the average monthly spending on ready-made food – a subcategory of processed food – by the top quintile has risen from Rs 303 in 2004-05 to Rs 1,009 in 2013-14. Interestingly, the share of spending on all major food items by this quintile has fallen from 39.7 percent to 35.3 percent during this period.

² An increase in the internet usage, the growing confidence of customers in buying online, and the availability of more reliable delivery networks have encouraged customers to opt for web-based food ordering platforms (e.g., Foodpanda, Eatoye, Khaapiyo, and Foodgenie).

food customized to customers' taste and needs. The resulting shift in consumer preferences is fueling demand for processed food industry in Pakistan.

Box SI.1: Why focus on food processing industry?

Food processing helps make the appearance and taste of the product more consistent; increases the off-seasonal availability of many foods items; makes food preparation less time-consuming; and provides access to these foods to a much larger population. It also preserves food nutrients and extends a food's shelf life to aid in long-distance transportation as well as storage.

Due to high interdependence with other activities, agro-industry can play a very important role in accelerating economic activity and creating employment in the country. For example, agro-based industry generates demand for basic inputs (e.g., fertilizer, pesticides, animal feed); processing equipment and machinery; refrigerated vehicles and containers, food grade packaging (including canning and bottling) and chemicals (e.g., additives, preservatives, food colors and fragrant). Furthermore, an effective management of logistics and supply chain (transport, storage, and distribution) becomes critical for the food processing industry, due to limited shelf life and supply uncertainties of agri produce.

The by-products or waste products from food processing can be used as feed or fuel for other industries. For example, animal feed industries can utilize several agro-industrial by-products, such as oilseed cakes and blood, carcass and bone meal. Similarly, waste from fibre crops is used as paper pulp or fuel.

Food processing can also add value to a country's exports. Currently, rice contributes around 50 percent of the country's total food exports of US\$ 4.0-4.5 bln per annum. A focus on building up food processing capacity and smoothing out export logistics can greatly augment export earnings for the country.

A close coordination with the processing industry allows farmers to earn a higher and stable income as (a) the use of technology and acquired knowledge improves yields and lowers post harvest losses; (b) the better use of soil and water resources and control of pests and diseases reduces output volatility both in terms of quality and quantity; (c) farmers receive a premium for value added to their produce; (d) the realized prices are higher as contract farming brings down the number of intermediaries.

Similarly, the use of modern means of communication and an easier global connectivity allows customers to learn about new foods, discover new retailers, and become more conscious about the leading food brands. Furthermore, the launch of several dedicated food channels on television network and the mushroom growth in cooking shows have a major influence on choices that consumers make. While the food processing industry is adapting to the changing taste and preferences of consumers, sometimes it also helps consumers build preferences for their products through aggressive advertisement campaigns. As a result, consumers now have a wide choice of different food items/cuisines offered by some top food processing companies. For instance, where many such companies used to offer ready-to-fry chicken nugget products, now their product range has expanded to both traditional and foreign meals (noodles, pastas, sausages, kebab, samosa, burger patties, etc.).

2. Food marketing and retailing is also evolving

The retail marketing of packaged food products is gradually transforming from a large number of small neighborhood convenience stores or grocery shops to departmental stores and superstores.³ These modern retail outlets are popular as they offer a range of products from different brands in a much more consumer-friendly environment.

These superstores, however, influence the food processing industry in two opposing ways. While the superstores create demand for food processing products, the concentration of the bargaining power held by superstores, together with the intense competition from other producers, exert significant pressures on the food processing industry, and in some cases, may even impact innovation.⁴

In order to overcome the resulting challenges, food processing companies are opting for multi-channel marketing, where these firms not only market directly through their own outlets but also make a wider use of online distribution of food products. This approach is more visible in the case of meat and poultry firms (K&N, Meat One). Some food processing companies are also reportedly entering into exclusive supply arrangements with popular restaurant food chains, thus diversifying their revenue stream.

3. Entry of several small scale producers is making the business more competitive

The food processing industry in Pakistan has traditionally been dominated by the two major international players, Nestlé (in dairy, juices, baby food, cereal, confectionary and noodles) and Unilever (tea, dessert, dressing and sauces). Within the local food companies, National Foods and Shan Foods (mainly in spices and condiments); Engro Foods (in milk and cream, tea whitener, and frozen dessert); and Mitchells Farm (confectionary, jam and squashes) are some of the big firms.

³ While superstores, e.g., Metro and HyperStar, have presence in many cities across Pakistan, some of the departmental stores are expanding their network to different cities (e.g., Imtiaz, Al Fatah). Other departmental stores in major urban areas include: Chase up, Bin Hashim, Agha's super market, and Naheed in Karachi; and Rahim, Akbari, Decent and Naqshbandi in Lahore.

⁴ The process of creating new, relevant products aligned with emerging consumer trends, marketing them and bringing the products to retail (vendors) is time consuming. By the time some of these products hit store shelves, trends might be abating. Or a flood of competition particularly from smaller, more agile companies could make it more difficult for that new product to stand out.

Lately, a number of small and medium sized companies, for example, Euro Foods, Pk Meat, Menu, Mon Salwa, Syma, Dawn, FoodMart are also making inroad into the processed food market. Similarly Adam, Cottage and Deen are major dairy-based brands available in retail stores. Some of these firms, as well as some big exporters, are also venturing into frozen sea food business.

4. Food packaging is an important growth driver

Food packing has now enabled today's consumers to look for various options, and compare the value offerings, before making a purchase. Packaging has also helped enhance portability of products and increase their shelf life.

The packaged food industry is constantly innovating to ensure its products are keeping up with the evolving consumer preferences, and that they stand out in a competitive, dynamic marketplace. Thus, all food items are packaged, from plastic bags holding fresh fruit to microwaveable plastic containers for ready meals. Brands are increasingly utilizing the look and feel of a product (color, texture, design, etc.) and effective labeling so that consumers can easily differentiate their brand among dozens of packaged food brands in the market.

Major challenges faced by the processed food industry

1. Informal segment is a major threat – it discourages innovation and stifles growth

A number of the new entrants in the processed food industry belong to the informal sector, which is largely undocumented and under-taxed. The food items produced by these firms are cheaper also because of the low quality standards. These manufacturers pose a major challenge to larger firms in the formal sector who invest heavily in innovation (to make their product differ significantly from those currently in the market) and on aggressive media campaigns (to convince potential customers to buy their products). In simple terms, the entire process of product development and marketing is capital intensive. However, inadequate protection through patents and trademarks allows small manufacturers to easily copy the label and packaging of branded products. Such counterfeit products generally offer high margins to retailers especially in small karyana stores in villages. Thus, making R&D investment in the presence of free riders becomes quite challenging.

2. Quality standards are needed across the entire supply chain

Maintaining the quality of food products is one of the major challenges for the industry. The food quality depends on several factors, such as quality of the raw materials, state of logistic facilities (transport, storage), and conditions at the point of sale, etc. This means, ensuring quality would involve working with every player in the supply chains, such as farmers and wholesalers, transporters and retailers. While large players are in a better position to *integrate* all stages of the production process (i.e., from primary production to retail sales), smaller players focus more on improving the effectiveness of their supply chain through improved coordination. In this context, adopting minimum quality standards at each stage of the process helps in better integration of supply chain. The implementation of globally recognized food safety and quality standards also opens up the export market in developed countries.

3. Small land holding can be a major constraint

The strong competitive pressure compels processing firms to seek economies of scale by integrating farmers into the supply chain. As a result, a number of firms are going into corporate farming.⁵ However, the vast majority of farmers in Pakistan have land units that are fragmented and below 12.5 acres, which makes it difficult to generate economies of scale that would justify the use of mechanization and sophisticated cropping patterns. One possible solution is to encourage cooperative farming which allows economy of scale by forming vibrant clusters of farmers.

Conclusion

A vibrant food processing industry is important for a developing country for its strong backward and forward linkages. It can enhance farm incomes by offering a ready market for farm products, reducing post-harvest losses and generating off-farm employment. More importantly, the food processing industry can be an important source of export earnings for the country.

In Pakistan, the food processing industry has come a long way from traditional processed food items to higher value added products, customized to consumers taste and preference. More importantly, the industry still holds significant potential for growth due to the country's strong agriculture base. However, in order to harness this potential, the industry needs a level playing field (where every entity is properly

⁵ The number of agri farming corporates registered with Securities and Exchange Commission of Pakistan has increased by 44 percent (from 962 to 1,388) during four years ending at June 2015. In comparison, the total number of registered firms increased by 14 percent during this period.

documented and taxed); adequate protection of innovations; minimum quality standards; and a setting that allow firms and growers to achieve benefits from economies of scale.