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Functional Beverages Re-Establishing Roots in the Asia Pacific Region:

Developing a Location Strategy to Capture Growth

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About Tractus

Tractus Asia is a business strategy consulting and operations management firm dedicated to helping clients invest and thrive in Asia and around the world.

We hold over 25 years of experience supporting multinational companies in making strategic decisions around where to locate and how to structure direct investments and in turning those decisions into operational reality. Our team of 60 professionals draws from a variety of diverse areas of expertise, grounded in the countries in which we advise.

For private sector clients, our market-entry and business strategy consulting solutions include initial market research and corporate strategy execution; distributor and partner search assistance; merger and acquisition support; fund raising; site location advisory; and regulator and private-party negotiations assistance. We also provide public sector support, including government advocacy, trade and investment promotion, public policy and economic development program advisory services.

Functional Beverages Re-Establish Roots in APAC

"Functional Foods" are associated with a modern movement of active and healthy lifestyles, but the origins of the phenomena can be found across Asia—from the ancient Vedic texts of India to Chinese traditional medicine and Japanese culture. Eastern Cultures have a long history infusing tea, water, and food with natural ingredients like matcha, ginseng, and moringa that provide health benefits, and companies seeking continued market expansion are eyeing the Asia Pacific Region (APAC) as a primary market for future growth.

A major factor behind the APAC consumer shift toward increasing consumption of functional beverages has been a shift from sugar-based to healthier beverages. While the APAC soft drink market at US$198.8 billion is still substantially larger than that for functional beverages, growth has flattened since 2013. Governments in the region have adopted tax and non-tax policy measures to decrease sugar consumption, and this had led beverage companies to reduce production of high-sugar drinks. Consumers are responding to these policy actions, and a 2020 survey by market research firm FMCG Gurus that found 36% of consumers began drinking less carbonated beverages over the previous 6 months.

Country	Sugar Tax Adopted
Brunei	2017
India	2017
Malaysia	2019
Philippines	2018
Sri Lanka	2017
Thailand	2017

Source: World Bank

APAC represents the largest region of the global US$208 billion functional beverage market and it is also the fastest-growing, propelled by China's increased consumption. While the COVID-19 pandemic did result in a 2.5% decline in the global functional beverage market, it simultaneously accelerated the long-running rise in demand for healthy products as consumers sought to increase consumption of beverages and foods with health promoting properties. FMCG Gurus reported in its May 2020 survey of 18 countries (including APAC economies) that the percentage of respondents reporting that their health consciousness increased significantly because of COVID-19 grew to 63%; and a whopping 80% of respondents said they planned to eat and drink healthier because of COVID-19.

Consumer Trends

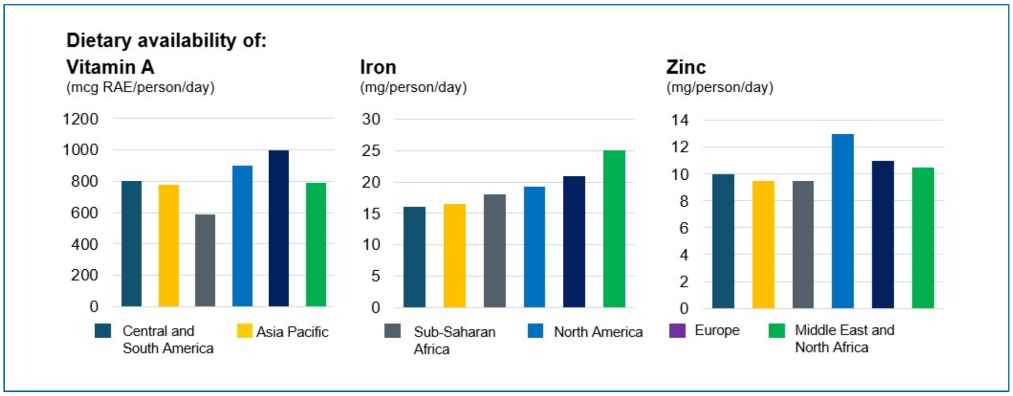
Though consumer preferences vary according to country, culture and values throughout APAC, there is a consistent set of trends driving increased consumption of functional beverages including nutritional diversification, hydration, and the move to plant-based products. Companies with products that align with these trends are increasingly attracted by the region's 4.3 billion consumers in the world's fastest growing economic region.

Nutritional Diversification and Functional Inputs to Beverages in APAC

Caloric diversification is a challenge across APAC as most diets are heavily reliant on white rice, which lacks necessary nutrients for a balanced diet. The Economist Intelligence Unit's 2019 Global Food Security Index found that APAC ranked fifth out of six global regions in terms of dietary diversification for the three main micro-nutrients: vitamin A, iron, and zinc. Beverages that offer these vitamins and nutrients like

Ensure, Nestlé's BOOST®, and Ovaltine are entering more markets across the region with a keen eye on the largest consumer markets of India, China, Japan, and Singapore.

Table 1



Source: Global Nutrient Database

APAC consumers also typically take a holistic approach to health. The most common ingredient compound used in functional foods are probiotics, which provide many health properties and are found in yogurt, teas, Kombucha and single-serve shots. The sale of fermented beverages globally is expected to reach US$1.7 trillion by 2023, and the APAC region is a major source for that growth.

Staying Hydrated in a Hot Climate

The climate, lifestyle, and on-the-go nature of everyday life across Asia's mega-cities has made hydration a major trend since the early 2010s. Functional Beverages that provide hydration- and are infused with vitamins, minerals, and other health enhancing properties further improve a product's attractiveness to the consumer. The two products most widely consumed for hydration are ready-to-drink teas and functional waters.

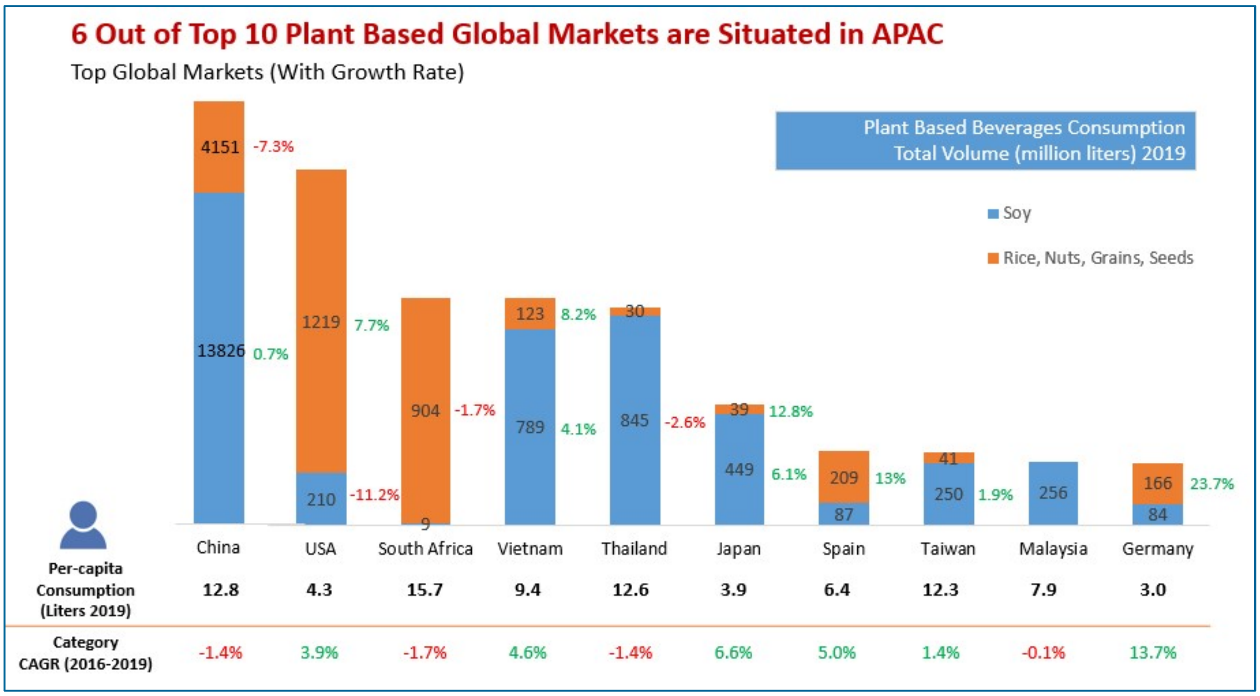
Ready-to-Drink (RTD) teas with electrolyte, protein, vitamin, and mood enhancing supplements are some of the most established functional beverages in APAC - the largest RTD market in the world. Within APAC, Japan accounts for the largest share of RTD consumption with the average consumer spending upwards of US$92 per capita in 2019. When combined with China, the two countries account for 57% of the global RTD market, valued at US$30 billion in 2020. Japanese brands are common throughout supermarkets, convenience stores, and vending machines across the region, but the market is quite fragmented, with competition also coming from companies based in Asia, North America, and Europe. New entrants see the linkage between tea drinking culture and growth in functional beverage consumption as fertile grounds for future growth. APAC will continue to drive the global RTD market, as it is expected to continue its 7.6% Compound Annual Growth Rate (CAGR) well into the middle of the decade.

APAC's functional water market is currently valued at US$3 billion and is projected to grow at 5.36% CAGR over the next five years. Although simple flavored water is popular in the region, trends indicate that functional waters offering additional health benefiting properties will be the dominant product in the future. Drinks that have been successful in the region support health by boosting electrolytes, or offering micronutrients that boost immune response.

Non-Dairy Alternatives- Sustainable Supply Chains moving Closer to the Consumers

Global plant-based dairy companies have also turned their sights to Asia following success in North America and Europe. The 4.3 billion consumers in the region, with a high percentage being lactose intolerant, provide the largest global market for plant-based milk, ice creams, and yogurts regardless of whether they are derived from soy, oats, almonds, cashews, or other products. APAC is expected to be the fastest-growing global market for plant-based dairy products, a sector that is seeing 7.6% growth annually, and APAC is where 6 out of the world's 10 largest markets for plant-based products are located.

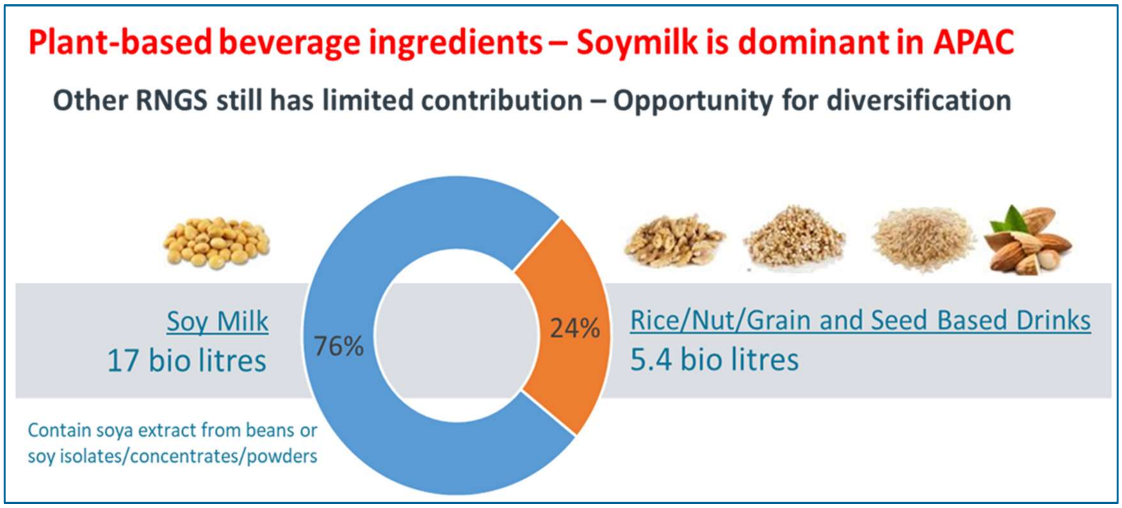
Table 2



Source: Compass 2019

Plant-based milk is the most common non-dairy alternative product found across APAC, with soy-based products being the most widely available. Although soy holds the dominant position in this category with a US$4.7 billion market share, consumers are not averse to non-soy alternatives. Asian and Western companies have expanded their products to include plant-based milks from rice, nuts, grains, and seeds (RNGS) that include oats, peas, almonds, walnuts, and other plants that are not native to the region. These commodities are also being processed into other non-beverage products. Vietnam's exploding consumer class is eating fewer animal products due to COVID-19, with 29% of consumers expressing that value. India's large vegetarian consumer base – about 375 million people - is also seen as a fast-growing segment for plant-based alternatives.

Table 3



Source: Compass 2019

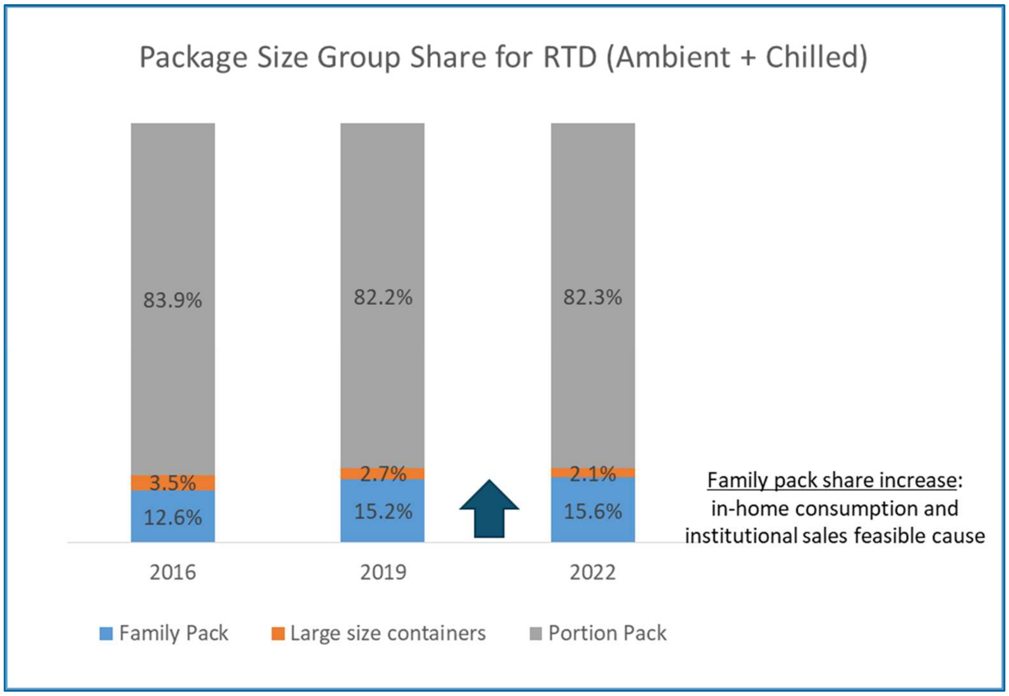
Consumer preferences for purchasing plant-based products are not exclusively derived from the health benefits of non-lactose dairy. Both European and North American companies entering the market are quick to emphasize the sustainability of their products compared to traditional dairy products. Moreover, these new entrants recognize that this is a critical selling point to broaden their consumer base. Sustainability is high among Thai consumers' preferences, with 67% reporting that they believe plant-based foods are better for the environment than meat or dairy.

Lifestyle and Urbanization

Consumers across the region's rapidly growing urban centers seek out beverages that are fast, easy, convenient, and provide them with the health promoting properties that align with their lifestyle. Most importantly, these consumers are willing to pay a premium for a product that provides health benefits whether they are purchasing a RTD tea that is supposed to provide hydration and relaxation, a micronutrient infused water, a probiotic Kombucha, or a plant-based milk. The research firm, Global Data, found in its survey of APAC that 40% of consumers were willing to pay more for premium products. In particular, Singapore is a market where companies can charge a 25*% premium* on shelf price compared to the market of origin price. This is not, however, unique to Asia's developed economies, as companies are also finding they can charge premiums in other fast-growing developing ASEAN economies, such as the Philippines and Indonesia.

The urban 'on-the-go' nature of the typical consumer in Asia has led to a rise in "single-serve" packaging for beverages. This trend requires companies to re-focus packaging from larger family size products typically seen in North America and Europe to single-serve packing—be it in aseptic packaging, plastic bottles, or metal cans, but increasingly focusing on sustainable packaging.

Table 4



Source: Compass 2019

Market Expansion into APAC

Companies with products that align with the trends seen across APAC, eye the market to drive future growth and valuations, and this has made it increasingly competitive. Companies can beat competitors and solidify market share by moving quickly and gaining first mover advantages. But moving too quickly can lead to unqualified decisions. Resulting in lost time, increased costs from fixing mistakes, and ceding market share to competitors that design a focused and systematic approach to market entry.

Tractus has more than 25 years' experience advising companies in the Food & Beverage sector developing and implementing strategies to capture growth in APAC through site selection driven market entry strategy development as well as other services we offer accelerate and facilitate market expansion.

Developing an Asia Pacific Location Strategy for Manufacturing Beverages

The rapid expansion of functional beverage consumption across APAC markets is prompting companies that have seen success exporting to establish a facility within the region to supply the rising demand. As a company assesses establishing a facility, they will consider two primary strategies, (1) identifying a co-packer or (2) establishing a captive facility.

A co-packing strategy provides a lower costs and can also be a faster route to market. Companies assessing co-packers typically adopt two sub-strategies. Under a less capital-intensive strategy, a concentrate is provided to a co-packer who provides toll processing and filling services. In the more capital-intensive strategy, the company will invest in some infrastructure to manufacture the concentrate on-site and deliver it to the co-packer for further processing and filling. In the captive investment approach, a company will invest in a complete beverage processing facility from production through to packaging and delivery.

A manufacturing site location assessment does not need to be an either/or proposition. The site location process can incorporate both manufacturing strategies to determine not only the optimal location, but also the optimal strategy. Regardless of adopting, one, or both, strategies into a site location assessment, defining the search area and the location criteria that drive the screening for each manufacturing scenario is key to arriving at a defensible analysis.

Defining the Search Area

If an Asia-wise site location analysis is not feasible, then defining the search area so that it encompasses the center of market is a key first step. The center of market in APAC is often China, where spending on health and wellness products exceeds US$70 billion annually. A market development strategy we have seen over the last several years, whether for food and beverage or other manufacturers, is a China-for-

China strategy - establishing a facility in China to meet China market demand. However, a plant located in China creates risk for companies that also seek to supply product to other markets across APAC.

Consumers across APAC still have concerns about the quality of food products from China. This hesitancy dates to scandals in the early 2000s that make regional consumers from Japan to Singapore skeptical of purchasing a premium health-promoting beverage exported from China. While the China-for-China strategy is efficient, markets across APAC and particularly those in Vietnam, Thailand, and Malaysia are often used to serve the greater region's demand.

Identifying the center of the market and weighing risks of establishing a single site in China to serve both China and other regional markets is a primary decision that must occur early in a site-location assignment. However, the search area can be as broad as the vision and goals of the company. Tractus has conducted site location assignments across as many as seven countries, including China, and simultaneously evaluated both co-location and captive manufacturing scenarios.

Co-Packing as a Manufacturing Strategy

A difference that arises when defining the search area for a co-location strategy compared to a captive strategy is the need to consider the types of packaging required and the presence of companies that have experience with the required machinery across the proposed search area.

Common packaging materials in APAC include aseptic multi-layer material, plastic, paper, aluminum, and glass. While the region and its consumers are adopting more sustainable values, PET packaging is the most common, especially in China, India, and Japan. Aseptic packaging produced by Tetrapak® is widely used across APAC and accounts for about 35% of the company's global revenue. A recent co-location strategy assignment Tractus advised on included the identification and screening of over 115 companies with Tetra-Pak machines within a multi- country search area. SIG Combibloc® machines are also commonly used throughout APAC, but to a lesser degree than Tetra-Pak, with most of its APAC revenue derived from China, Thailand, and Indonesia. It is therefore important to have a clear understanding of the types of machinery that the co-packer must have, either in the facility currently, or experience with.

After establishing the packaging type, the screening process can begin by assessing co-packers within the search area against a set of critical, "Must Have" and important, "Want to Have" partner selection criteria. Incorporating the critical and important co-packing criteria into the site selection screening process allows for the elimination of co-packers that cannot facilitate the operational and business objectives of the investment and reveal "red flags" that could compromise the success of the partnership. Often, this process begins with assessing the site characteristics of the potential co-packing partner, determining if the partner's site provides adequate utilities and floor space for the proposed expansion in on-site production and packaging.

Unlike a typical site location assessment, the critical and important criteria will also include factors related to the operational capabilities as well as the reputation, experience, and company values of the partner. Components that can be integrated include assessing a co-packer's commitment to key values like sustainability, as well as financial strength, and experience co-packing similar products.

After concluding the screening process, the pool of potential co-packers will narrow to a qualified "short-list" that meets the established criteria for further evaluation. A factor that is often overlooked at this stage of the process is aligning the company's commercial schedule with an operational timeline that includes procurement of machinery, build-out of a facility, commissioning of the line, and regulatory approvals required for operations. Critical within the alignment is identifying the regulatory approvals needed for sale domestically and for export. Establishing whether the co-packer holds certifications such as HACCP, GMP, ISO, Halal and if those certifications can be incorporated into the product can dramatically reduce certification applications.

Source: Intertek Alchemy Blogpost

Captive Manufacturing

A company forecasting demand in excess of 175 million liters per year will most likely be seeking to conduct a captive manufacturing site location assessment. At the outset of the process will be defining the search area; but under an end-to-end strategy a different set of critical criteria exist that must be addressed to reduce the potential risk they may pose to the investment.

Industrial zones across APAC and particularly in China, Vietnam, and Taiwan have adopted policies to attract high-value investments focused on Industry 4.0 sectors. These policies put thresholds on the revenue generation that must be met and limitations on the building densities. A common practice in the zones along China's eastern seaboard, is that a company must meet tax generation requirements. Tractus has encountered tax generation thresholds for ventures in their first 5 years of operations that vary from US$40 per m^2 to US$111 per m^2. The space required for a multiple line bottling facility with adequate logistics and storage may not be able to fulfill these requirements and zone management are unlikely to compromise on this issue. Therefore, firmly establishing the sale price and volumes upfront in a site location will allow these factors to be incorporated into the search process and avoid risk of disqualifying a site that otherwise meets all other cost and operational criteria.

Zones in China and Vietnam also have plot ratio, or building density requirements. In China, zones mostly require that the facility has a plot ratio of 1, meaning that if the plot is 60,000m^2 , the facility must have 60,000 m^2 of definable floor space under roof. It is not uncommon, however, for some zones to have plot or building density ratios as high as 2.5 to 1. While these ratios may be more negotiable than tax generation requirements, it is critical for a potential investor to have already developed a conceptual layout of a planned facility so that minimum site requirements can be determined up-front in each country. This upfront work will avoid the pitfall of short-listing sites that in the end cannot accept an investment as the facility was originally conceptualized.

Zones may also, according to plot size, place restrictions on available utilities. This is most commonly applied to water and wastewater but can also be applied to natural gas and electricity. Zones in Taiwan and Malaysia can limit water consumption to as little as 330 liters per m^2 per day, which may be substantially below the necessary inputs for a beverage processing facility. Identifying zones without restrictions on water consumption and wastewater generation and those with high levels of excess capacity for water and wastewater, therefore, becomes a key consideration in a beverage facility site selection analysis.

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About The Author
James Meisenheimer is the sector lead for Tractus Asia's Food and Agriculture practice. In this role, he has advised companies seeking APAC expansion on market opportunity, regulatory approvals, and site-location strategies. James is based in Tractus' Bangkok office after joining Tractus in Myanmar in 2017. James may be contacted at James.Meisenheimer@tractus-asia.com.

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