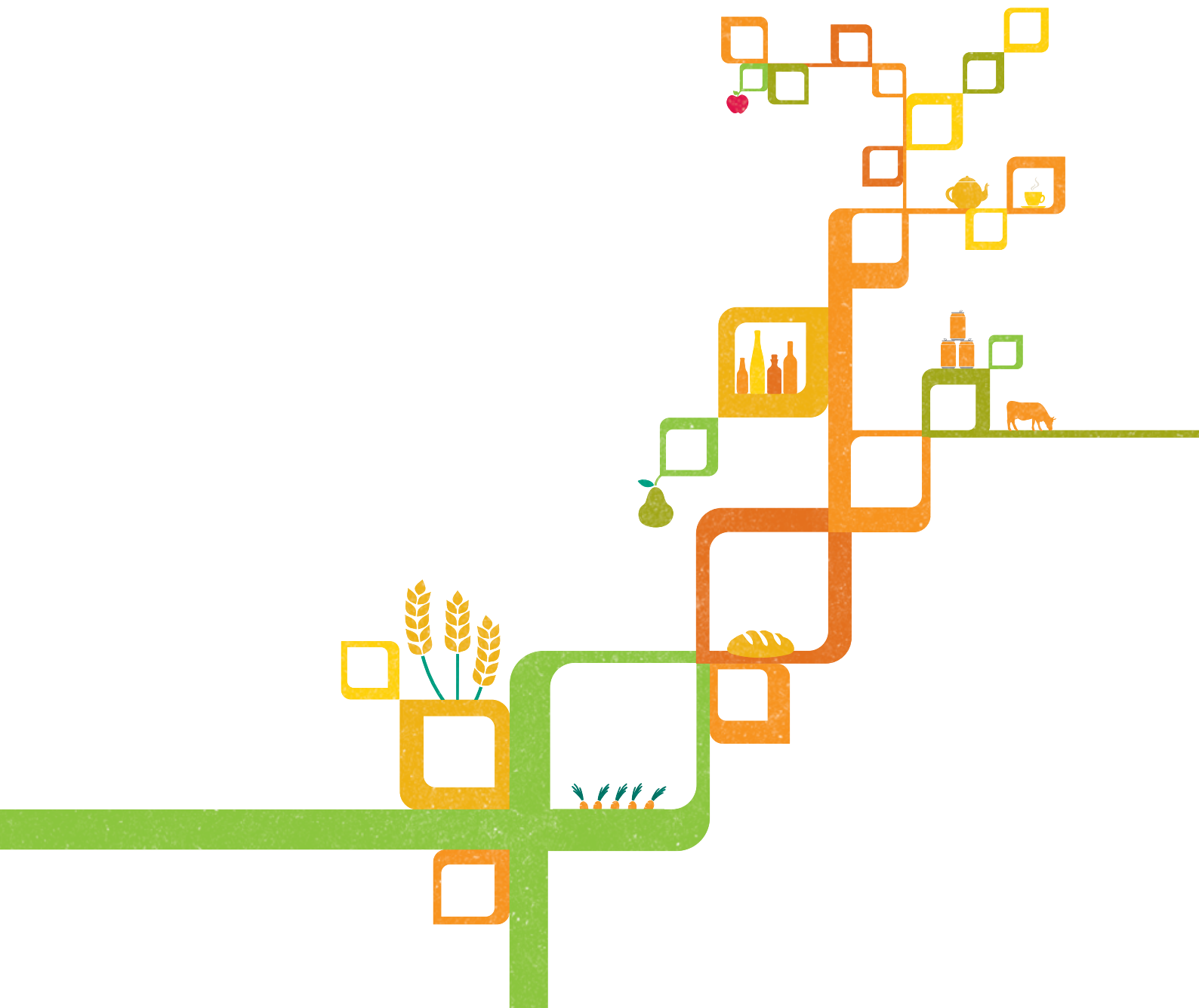


Hunger for growth

Food and Beverage looks to the future



How will your organisation seize growth?

'Hunger for growth' highlights emerging trends and their impact on Food and Beverage businesses worldwide. How will you respond?

Growth strategies

Most Food and Beverage businesses hope to grow via expansion and acquisitions. Is your organisation able to correctly identify where to invest in infrastructure – the right plants, the right machinery, the right information technologies with the highest return on investment? Does your company have internal expertise to identify M&A opportunities, and then conduct effective due diligence? *Are you able to secure financing to support investments, physical expansion or acquisitions?*

Customer relations

Concentrated power among large retailers is here to stay. But savvy executives will develop plans, such as diversifying their customer bases or strengthening their core offerings with strategic acquisitions, which give them options when retailers become uncompromising. *Are you confident that your organisation is getting the highest possible margins from its products and existing customer base?*

Innovation

Consumers want new products, improved quality and lower prices. Retailers want the goods that pull consumers into stores and move products off their shelves. Is your organisation investing enough into research and development? Are you leveraging supplier relationships to enhance new-product-development expertise, as well as technological and operational performances? *Are you using current information technologies and social media tools to market to individuals.*

Government regulations and programmes

Food and Beverage organisations face an increasingly complex set of regulations around the world. Does your organisation have the ability to monitor, measure and document compliance at home and abroad? *Are you aware of government grant and incentive programmes that you can access to support growth?*

Process improvements and cost reductions

Rising commodity costs cannot always be offset by price increases to consumers; ongoing process improvements and cost controls will be vital to maintain margins. Does your organisation have the resources and expertise to evaluate processes for efficiency improvements? *Have you comprehensively reviewed cost structures across your supply chain? Do you know the real cost of production across different product lines?*

Country-specific changes

The global trends in this report will affect individual businesses in unique ways, challenging executives to stay abreast of changes that impact their bottom lines. *How does your company track and assess in-country and global trends and then put in place best practices and successful strategies?*

Every company can benefit from a fresh set of eyes to help identify opportunities, address challenges and minimise risks. As one of the world's leading professional organisations of independent assurance, tax and advisory services – with more than 35,000 people in over 100 countries – Grant Thornton is ready to help.

A global perspective

The Food and Beverage industry is poised for growth around the globe. After years of uncertainty, retrenchment and delayed investments, industry executives are once again looking to invest in new products, new capacity, new distribution channels and new markets. Even in countries still shaking off the recession, executives expect growth and plan to capture market share at home and abroad.

Yet even amid brighter prospects, Food and Beverage executives must choose the right growth opportunities while minimising risks and maximising returns on their new investments. This is especially the case as executives look to:

Capitalise on emerging and growing trends, such as healthy food and beverages and premium/luxury products

Executives at organisations of all sizes must stay abreast of shifting consumer tastes that can turn into tomorrow's Food and Beverage trends. Agile entrepreneurs often seize first-mover advantage with innovative new products, while larger players can exploit economies of scale to develop additional products, leverage established distribution channels, and acquire niche competitors. Many businesses will also rely on complex and voluminous data to better understand consumers, identifying new trends before their competitors.

Innovate products and practices

New products are the lifeblood of growth. But improved business practices generate profit margins – by streamlining operations, investing in automation and new information technology, and marketing via new digital tools. Social media, in particular, represents a seismic shift in the industry's strategy, with businesses devoting as much effort to the consumer 'demand chain' as they previously focused on the supply chain.

Navigate emerging regulations

The global Food and Beverage industry faces stringent food-safety, supply-chain traceability, and product-integrity regulations. Organisations must now track ingredients from farm to table – collaborating with partners throughout the supply chain to minimise financial, operational, legal, and reputational liability that could harm their brands. Proactive executives also recognise many regulatory changes as beneficial to their organisations, allowing them to promote compliance with new standards as a competitive differentiator.

Hunger for growth examines these trends and more. More importantly, it offers perspectives on how executives can manage change and sustain profitable growth by understanding the new industry landscape, developing strategies that leverage new trends and efficiently executing on their plans.



Jim Menzies
Global leader Food and Beverage

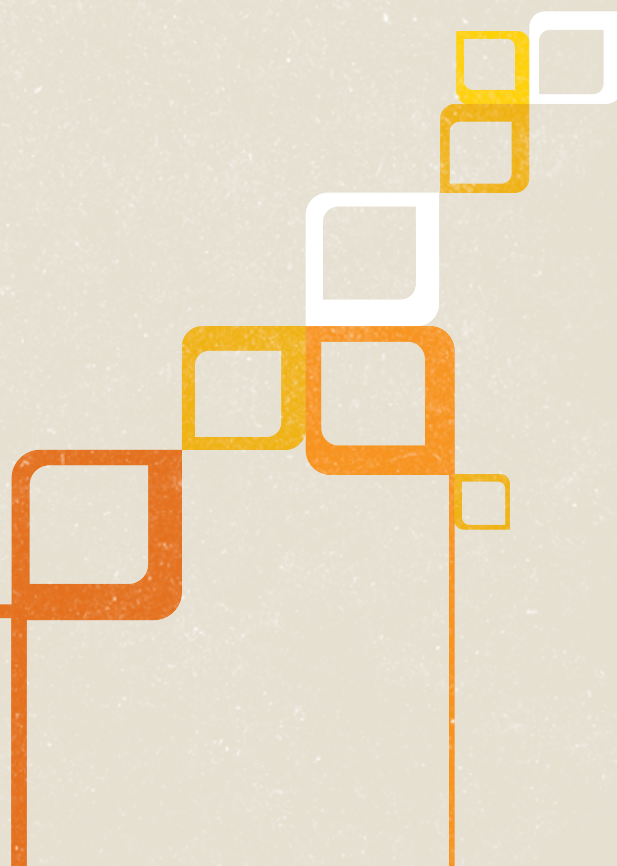
About the study

- Who** 248 Food and Beverage senior executives
- When** May to July 2013
- Where** Australia, Canada, France, Ireland, New Zealand, UK and US



Poised for profitable growth

The Food and Beverage industry is moving in a fresh direction. After surviving a global recession, sector executives are again optimistic about growth – in revenues, profits and, to a lesser extent, hiring. Yet external pressures such as rising ingredient prices and increased regulation, continue to pressure profit margins. Leading organisations will balance investment in growth with strategies that improve efficiency and minimise risk, primarily through automation and information technologies. These investments not only control costs, but also enable detailed pricing and margin analysis to boost the bottom line.



Optimism runs through the global Food and Beverage industry. The vast majority of its executives anticipate that revenues and profits will increase in the next 12 months, with a third expecting sales growth of greater than 10% (Figure 1). Revenue and profit increases are expected by both large and small organisations and regardless of the Food and Beverage sector (Figure 2). Similarly,

both branded or private-label businesses are optimistic about the future (see *In focus: Private label on page 7*). “From 2008 until around 2011, in most of the world, things were tough for all manufacturers, not just Food and Beverage companies,” says Jim Menzies, global leader Food and Beverage. “Recently there have been positive economic indicators, such as housing

starts in the US, the improvement in eurozone economic activity, and consumer-credit delinquency rates heading back to normal. These indicators create optimism in general and specifically for the Food and Beverage industry.”

Fig 1. Revenues and profit growth will outpace employment gains

Expectations for change in next 12 months

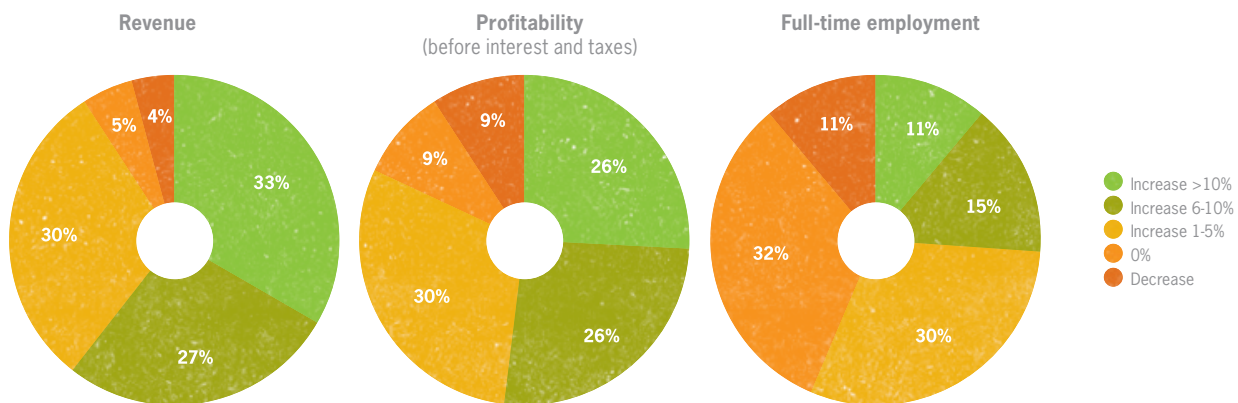


Fig 2. Strong revenue and profit growth expected across the Food and Beverage industry

% of respondents that expect increases in next 12 months by sector and revenues

| By sector | Revenue | Profitability (before interest and taxes) | Full-time employment |
|----------------------------------|---------|---|----------------------|
| Grains/flour products | 97% | 91% | 66% |
| Sugar and confectionary products | 94% | 80% | 60% |
| Dairy products | 93% | 88% | 73% |
| Fruit and vegetable products | 92% | 81% | 65% |
| Seafood products | 92% | 81% | 64% |
| Baked goods including pasta | 85% | 80% | 56% |
| Meat and meat products | 85% | 75% | 56% |
| Non-alcoholic beverages | 80% | 68% | 56% |
| Alcoholic beverages | 79% | 76% | 42% |
| By revenues | | | |
| US \$50 million or less | 92% | 84% | 61% |
| US \$50 million to \$250 million | 86% | 80% | 55% |
| More than \$250 million | 93% | 82% | 48% |

“There are mixed signals,” says Tony Pititto, national leader Food and Beverage, Grant Thornton Australia. “On one hand, expected revenue growth is a worldwide trend for companies in the Food and Beverage industry. Yet to keep profit margins from eroding, executives do not expect to increase full time employment at the same rate.” He points out that while 90% of executives expect revenues to increase in the next 12 months, only about half expect employment to increase. “The emphasis remains on efficiency gains and controlling costs, and sometimes, where possible, on increasing prices in order to ensure that profitability also increases.”

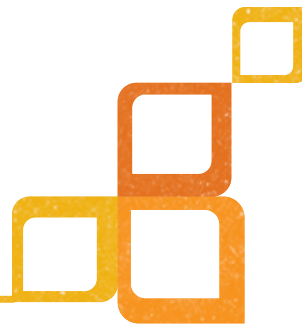
Ciara Jackson, national leader Food and Beverage, Grant Thornton Ireland, says that optimism is more cautious in Europe, where improved cashflow is likely to be re-invested in the business to re-engineer existing processes and to develop leaner, more agile operations. She warns that while Food and Beverage businesses continue to do more with less, leading to short-term profitability increases, these cost-conscious strategies often cause

headaches as firms reach capacity limits. “Executives need to focus their efforts on investment in information technology and automation, to reduce their reliance on additional workforce.”

It is critical for executives to rethink how growth is managed because inflation is a primary driver of rising revenues in many Food and Beverage sectors. Processers in these sectors soon will have difficulty passing along farm and supply-chain price increases to consumers – putting margins at risk. Trefor Griffith, national leader Food and Beverage, Grant Thornton UK, encourages businesses to meet margin pressures with process innovation. “They have to be more efficient, and to have fewer hands on their products. Automation is one solution, but leading Food and Beverage organisations have also seen dramatic gains in labour efficiency via performance improvement programmes such as lean manufacturing.” With direct labour costs accounting for a median 11% of sales, the ability to limit labour costs will contribute to how fast an organisation can grow.

“The emphasis remains on efficiency gains and controlling costs, and sometimes, where possible, on increasing prices in order to ensure that profitability also increases.”

Tony Pititto
National leader Food and Beverage
Grant Thornton Australia



In focus

**Private-label:
Meeting demand with the
right pricing strategy**

Private-label is more important than ever, with more than half of Food and Beverage organisations (56%) generating sales from private-label products. Some 14% earn a majority of their sales via private label.

Executives at Food and Beverage businesses both with and without private-label capabilities are optimistic regarding revenues and profits. But the two product approaches often are managed differently to get those results, says Guy Barthell, Food and Beverage leader, Raymond Chabot Grant Thornton. "Pure private-label businesses frequently leverage their organisational structure and supply chains for high volumes due to lower margins, and so many companies opt to have a mix of both private-label and branded products."

A hybrid strategy can drive the growth of branded products. "Companies with a mix of private-label and branded products often use lower margin, private-label business as a route to creating consistent cash flow that they can put behind growing a brand, which takes a huge investment in terms of time and money," adds Ciara Jackson, national leader Food and

Beverage, Grant Thornton Ireland. "In Ireland, the challenged economic climate and recession have driven consumers toward buying private label. But we're also seeing an extension of new types of private-label products: premium, average and lower-end commoditised goods."

Retailers are particularly keen on developing private-label portfolios across a range of price points. Tesco, for example, sells thousands of private-label goods, ranging from Parioli Italian foods at the premium level to Value brands at the low-cost level. Even upscale European retailers Waitrose and Marks & Spencer generate substantial sales via private labels, such as Essentials and Private Brand, respectively.

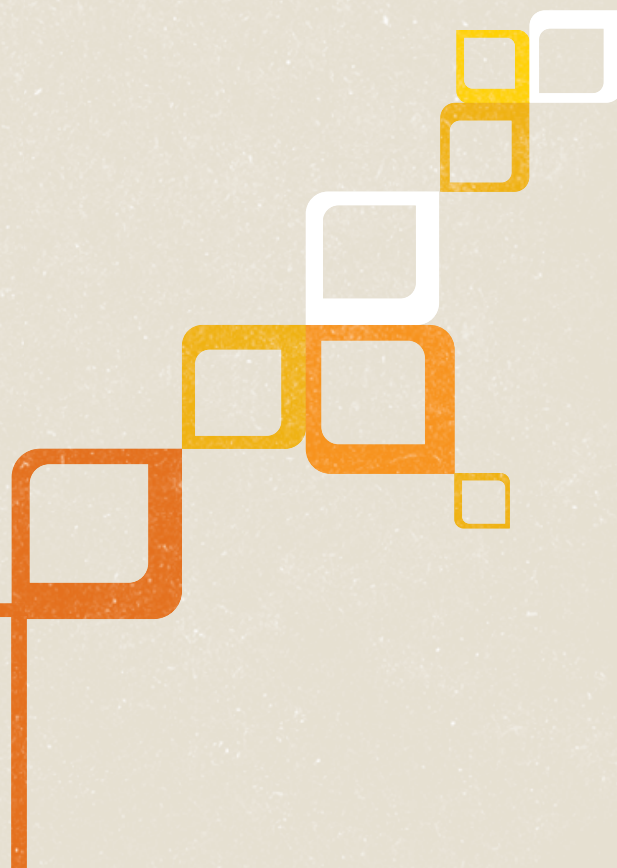
Effective pricing strategies are critical for private-label success, particularly with low-end goods where mistakes can eliminate margins. Pricing analysis should always be conducted within the context of cash flow and capacity, since even private-label products with modest margins are worthwhile if they run on otherwise idle equipment and generate sufficient cash flow.



**56% of
organisations
generate sales
from private label**

Expanding exports drive growth opportunities

The Food and Beverage industry is increasingly global. Rapid advancements in management, logistics and information technology allow businesses to meet customer demand almost anywhere – if they can navigate complex regulations and established, in-country competitors. Leading organisations perform extensive due diligence before entering new markets, including financial modeling and intensive efforts on the ground to meet and understand new customers and distribution channels.



Many Food and Beverage organisations anticipate significant growth in exports over the next two years. This substantial increase will require a corresponding increase in their ability to manage risks associated with export growth. These risks include:

- *product regulations in countries of export*
- *relationships or infrastructure to get goods on shelves, in stores and in restaurants*
- *logistics and transportation costs*
- *inventory carrying costs*
- *product quality and safety risks, especially for perishable food and beverage items.*

Four out of five respondents currently export, with 18% exporting the majority of their sales. Study respondents

currently export a median 5% of sales, and they expect that to rise to 10% in two years. Higher average export figures – 23% currently and 27% in two years – illustrate the high volume of exports among some respondents.

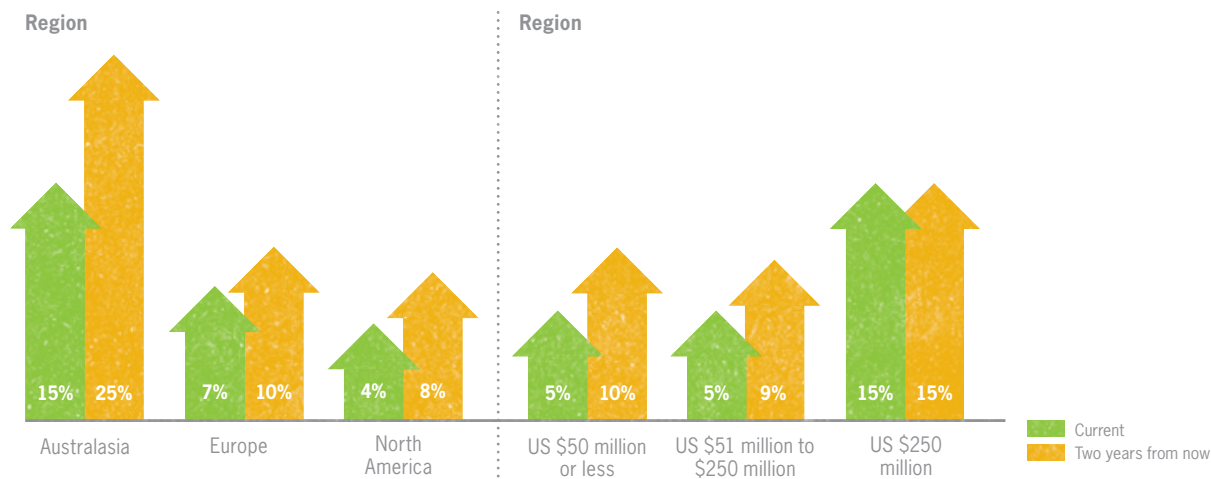
Exports vary considerably by region and by company revenues (Figure 3). High exports from Australasia reflect rising demand from China, India and other Asia Pacific countries, and are driven by high exports from New Zealand. Low exports from North America in part reflect a focus on huge domestic markets. Large companies are more likely to have developed the relationships, management structure and logistics to support an international customer base and, thus, higher export volumes.

“Increased export trade is an inevitable consequence of the global supply and demand imbalances particularly in China and Asia.”

Simon Hunter
National leader Food and Beverage
Grant Thornton New Zealand

Fig 3. Food and Beverage exports will rise around the globe

Median exports as percentage of total sales



The rush toward new markets is driven by the need to diversify revenues across economic boundaries as well as bottom-line growth. Food and Beverage study respondents that export are more likely to anticipate increased profits (84% v 76% of non-export organisations) and employment (62% v 40%).

Simon Hunter, national leader Food and Beverage, Grant Thornton New Zealand, says, “Increased export trade is an inevitable consequence of the global supply and demand imbalances, particularly in China and Asia. This opens up opportunities, but poses real challenges as multiple players chase the same opportunity in competition with local suppliers.”

Top new markets Food and Beverage respondents intend to enter in the next two years include:

- *Southeast Asia (excluding China): 43% of respondents (63% of Australasia respondents)*
- *China: 38% of respondents (57% of Australasia respondents)*
- *North America: 32% of respondents*
- *Western Europe: 30% of respondents*
- *Middle East : 26% of respondents*

Exports offer enticing opportunities, but only for those executives willing to do their homework — studying local regulations, meeting with in-country retailers and wholesalers, completing market research on price points and competitors, and interviewing consumers. Executives also need to think through how they will supply the market, not just logistically but with an eye toward tax and regulatory compliance. Transfer pricing strategies, for example, can often determine whether a given product is profitable or unprofitable.

In some countries, Food and Beverage businesses band together to promote their goods internationally. For example, in Ireland a number of seafood companies have pooled their resources – in a new business model known as “coopetition” – to export to new markets.

“Increased export trade opens up opportunities, but poses real challenges as multiple players chase the same opportunity in competition with local suppliers.”

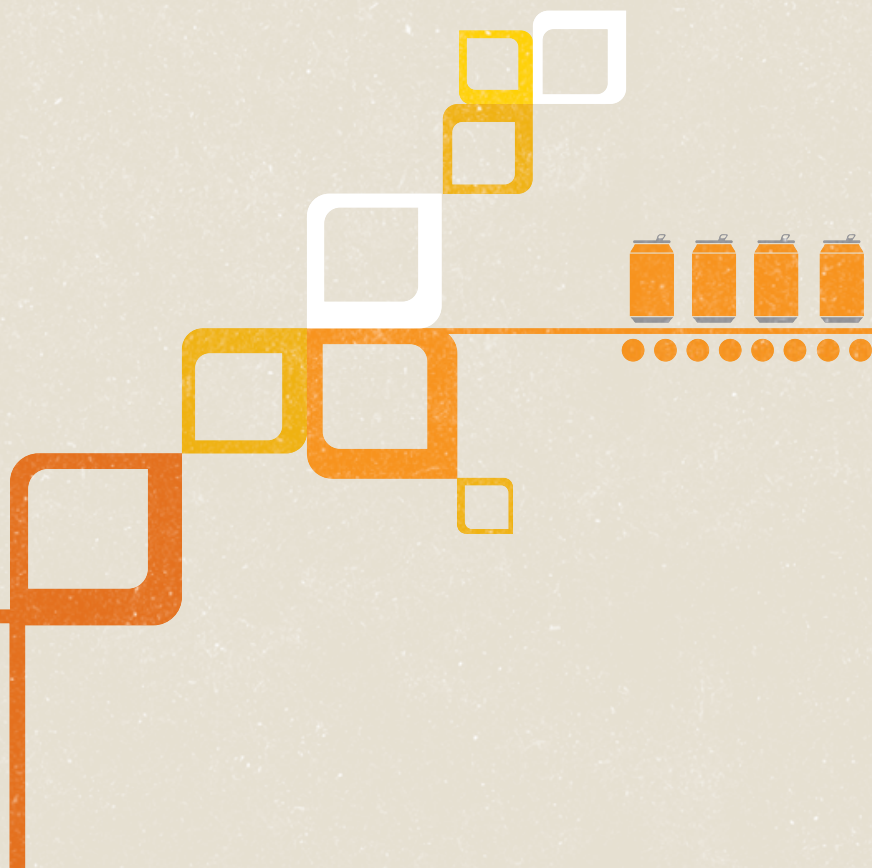
Simon Hunter

National leader Food and Beverage
Grant Thornton New Zealand

Investing in growth and productivity

Many Food and Beverage businesses expect to build or expand plants, develop new product capabilities and enhance research and development. A good proportion are also planning to implement new information technologies and to pursue mergers and acquisitions.

Few organisations can fund these efforts from cash flow. Leading organisations will complete detailed growth plans that prioritise their investments by return on investment. They will then use this analysis to secure cost-effective financing – whether through traditional banking relationships, alternative financing, or partnerships with suppliers and customers.



More than three-quarters of executives report that their organisations will increase spending on equipment, new product development and information technology (IT) in the next 12 months (Figure 4). Some businesses are catching up on investments postponed during the recession, while others focus on growth through innovation or acquisitions.

Reasons for investing vary dramatically by region. For example, Canada's Barthell says the Food and Beverage industry there has remained dynamic through the recession, with continuing investments for equipment and IT. But executives in countries with sluggish economies remain cautious.

"Investment in Europe will focus on equipment and new product development," says Vincent Frambourt, national leader Food and Beverage, Grant Thornton France, "but this will occur carefully as Food and Beverage consumers continue to be driven by price considerations. Companies are most willing to invest in the application of equipment to support specific

new products, and in information technologies to develop better enterprise-wide systems for planning, scheduling, demand-management, and sharing consumer and market information."

Griffith in the UK sees much of the industry's investment as defensive, in an effort to fend off margin pressure. "Food and Beverage executives are investing in equipment primarily to be more efficient. In terms of new product development, it is tough because businesses, especially Food and Beverage companies, have to innovate. That is the key to future growth. Supermarkets will eventually stop carrying your goods if you are not innovating and offering them something new for their shelves. They will look to alternative providers with new products."

Griffith says that, despite difficult market conditions in Europe, some businesses have shown strong growth by developing new consumer brands. "By focusing on niche areas with quality products and propositions, they have

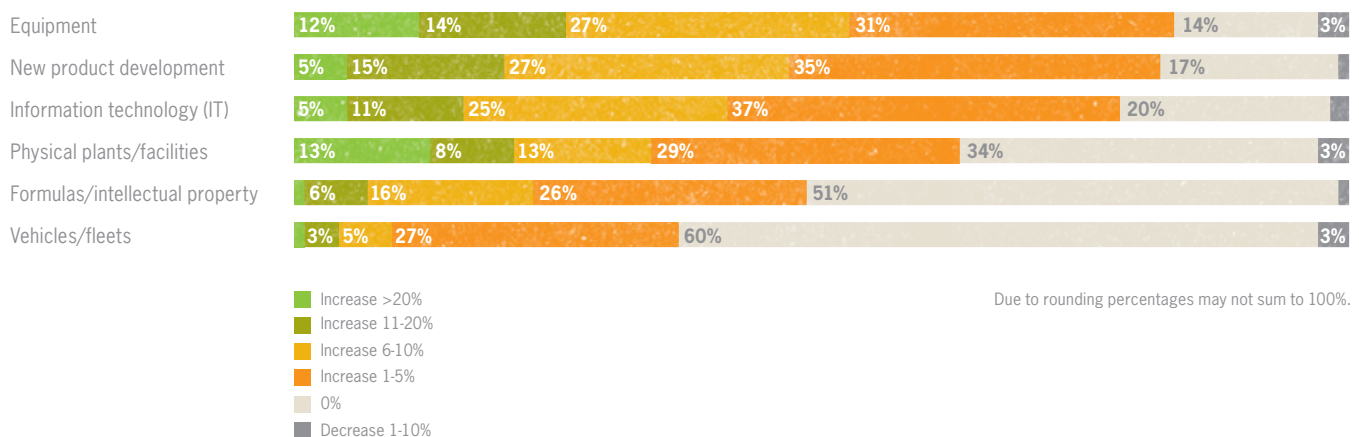
been able to shake up categories, replacing both own-label products and older and underinvested brands. The highest profile of these up-and-coming brands is probably Innocent, but there are a host of other examples, such as Dorset Cereals, Tyrells and Ella's Kitchen, which have all developed strong brands in the UK and are successfully growing overseas."

"In Europe, companies are most willing to invest in the application of equipment to support specific new products and in information technologies to develop better enterprise-wide systems."

Vincent Frambourt
National leader Food and Beverage
Grant Thornton France

Fig 4. Most will increase investments

Investment changes in next 12 months



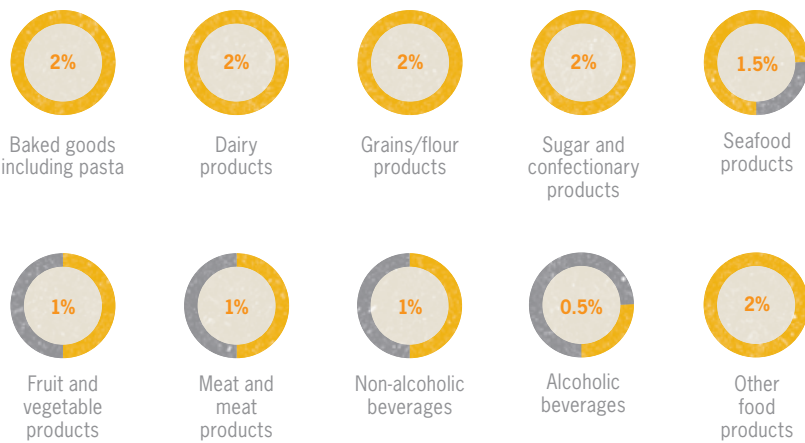
Unfortunately, innovation is expensive. Four out of five Food and Beverage study respondents expect new-product development costs to increase in the next 12 months. Current R&D expenses among Food and Beverage respondents overall are a median 2% of sales. Median R&D expenses, although a small percentage of sales, vary significantly by Food and Beverage sector (Figure 5). For example, some sectors spend four times as much as others.

Even within stagnant economies, specific sectors are expected to outperform the rest of the industry – spurring innovation and investment.

The dairy sector in Ireland, for example, will undergo expansion after an EU quota system is removed in 2015. “It is likely that milk volume in Ireland will expand by 50%, which is huge,” says Jackson of Ireland. “We now see the large milk companies investing heavily to have the capacity to deal with that increased volume when it comes in the next couple of years. Some companies still face a challenged banking system in Ireland, especially small- and medium-sized companies, but large corporations are not struggling to raise financing. In fact, we have been helping a lot of clients restructure their debt and make cash more available to them.”

Fig 5. Investing in new products

Median R&D expenses as percentage of sales



Study participants could identify more than one sector

In focus

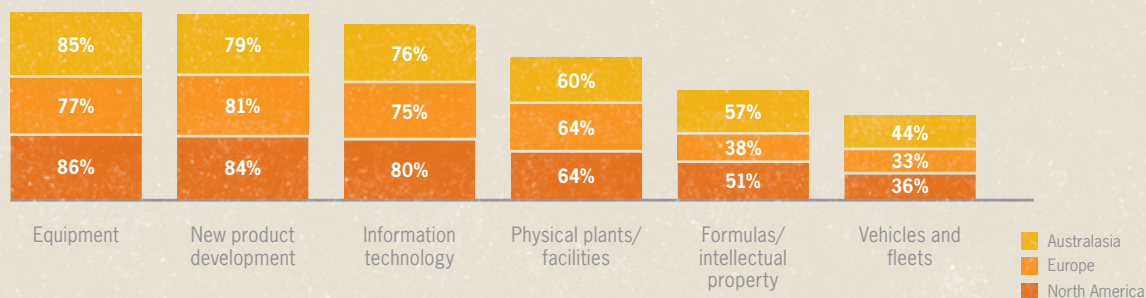
Who's investing in what

The likelihood of investment increases varies by Food and Beverage sectors as well as by region. The sectors with the highest percentages of respondents expecting to increase category investments are:

- new product development: sugar and confectionary products (90% will increase investments in the next 12 months) and grains/flour products (88%)
- equipment: meat and meat products (88%), fruit and vegetable products (85%) and dairy products (85%)
- information technology: fruit and vegetable products (82%) and seafood products (81%)
- physical plants/facilities: meat and meat products (64%) and seafood products (64%)
- formulas/intellectual property: grains/flour products (53%) and baked goods including pasta (53%)
- vehicles and fleets: dairy products (51%) and non-alcoholic beverages (44%).

Fig 6. Fewer European businesses will increase investments

Investment increases by region



90% of sugar and confectionary sector increasing investment in new product development

Fig 7. Plans to increase capacity

Actions in the next 12 months (5 = Highly likely – 1 = not likely)

| | 5 | 4 | 3 | 2 | 1 |
|---------------------------------|-----|-----|-----|-----|-----|
| Build or expand a plant | 24% | 17% | 13% | 17% | 30% |
| Acquire a company | 8% | 7% | 15% | 18% | 52% |
| Leadership succession or change | 5% | 7% | 15% | 18% | 55% |
| Acquire a unit or division | 5% | 5% | 11% | 14% | 64% |
| Close or downsize a plant | 5% | 2% | 6% | 9% | 78% |
| Partial sale/recapitalisation | 3% | 2% | 4% | 9% | 81% |
| Sell a unit or division | 2% | 5% | 7% | 13% | 73% |
| Be sold | 2% | 2% | 8% | 12% | 75% |

Building or expanding a plant is the most likely action that study respondents will take in the next 12 months (Figure 7). In addition, nearly half of Food and Beverage executives consider expansion via M&A as a viable strategy to strengthen their market positions.

“Companies are looking at how they can survive market and regulatory changes,” says Dexter Manning, national leader Food and Beverage, Grant Thornton US. “To do so, they have to get better at what they do best – becoming more strategic and more focused. That often means getting rid of non-core businesses and activities, and investing more heavily in core product lines and markets. By acquiring competitors in core businesses, they can get more leverage in market pricing and more economies on the cost side. They can exploit their size within their supply chain and improve speed-to-market.

These executives and companies face great uncertainty in the world and in their markets, and so they are becoming increasingly strategic in how they focus time, effort and investment.”

Approximately half of Food and Beverage respondents are likely to require additional funding in the next 12 months. Those expecting to acquire a company or business unit, or a building programme, are even more likely to need additional funding – 73% v 44% of respondents not pursuing acquisitions or building.

The best way to find that capital varies by region. “In Canada, the banking system remained intact throughout the recession,” says Menzies. “This stability — coupled with low interest rates — means that capital has been available to Food and Beverage companies for acquisitions, expansions, and product and process improvements. It has been – and still is – a good time for Canadian companies to finance growth of all kinds.”

Australia has experienced similar inflows of capital from overseas parties, including Asia, interested in acquiring Australian Food and Beverage companies. “We see many executives seeking financing and financing expertise,” says Pititto, “whether for identifying potential acquirers or acquisition targets, or for capital-

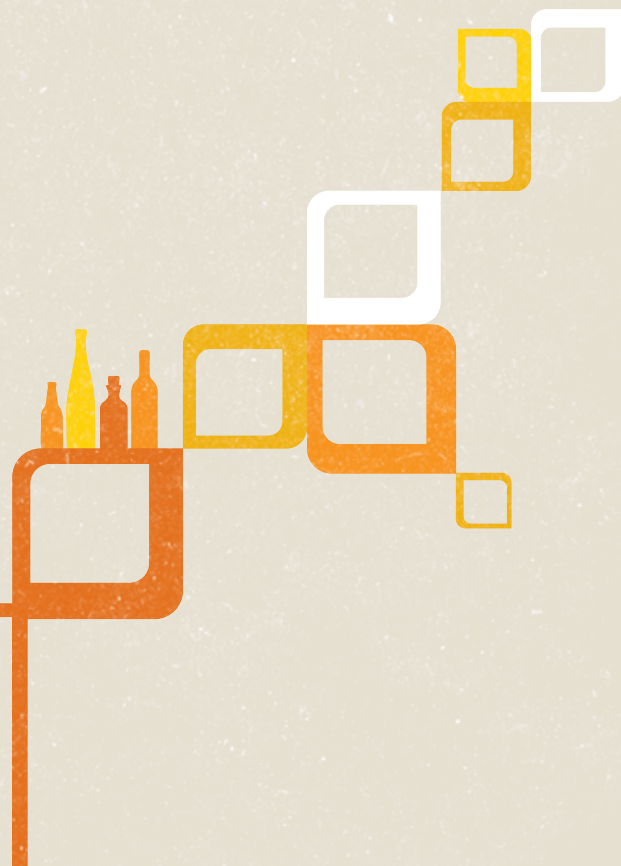
expenditure opportunities. There is also increasing interest in obtaining assistance for accessing government grants and tax opportunities associated with innovation, investment and expansion.”

In European markets, capital has been less readily available, forcing many companies to get more productivity out of existing assets and resources. “Rather than expand,” notes Griffith in the UK, “they will look at processes, such as logistics and shipping patterns, and try to maximise those. They will look at their production lines and try and make those as efficient as possible rather than put in additional lines.”

Converting concerns into opportunities

Despite their optimism, executives in the Food and Beverage industry remain concerned about new regulations and supply-chain vulnerabilities.

These leaders know that failure to comply with these new standards can lead to regulatory sanctions and to major financial risks if tainted products reach the market. Yet leading organisations also see new regulations as opportunities to differentiate themselves by highlighting quality in their products, practices and supply chains.



Food and Beverage executives are concerned about expenses, with more than two-thirds of them expecting every cost studied to increase in the next 12 months (Figure 8). Rising commodity prices are a particular concern, since the price of raw materials account for a median 45% of every sales dollar for food businesses.

To counter rising expenses, executives are becoming increasingly comfortable with passing along costs to customers. After years of pricing stagnation, they see a public willing to spend more for what they want. “The public is increasingly aware of the complex nature of the Food and Beverage industry, especially after negative food news such as the horsemeat scandal in Europe,” says Jackson of Ireland. “They are starting to understand that good food comes at a price. We have started to see it with some products in Ireland, where the consumer has begun to accept the need for price increases.”

While food scares inspire awareness of quality and safety among consumers, they also trigger increased regulation – and increased worries for industry executives (Figure 9).

Regulatory issues are particularly challenging for Food and Beverage businesses that export to multiple countries. “As an export-oriented country, the challenge in New Zealand is to ensure that the whole supply chain works correctly – grower to consumer, in particular into China, which is now the number one export market for New Zealand,” says Hunter. “Labeling, food safety, and food-integrity issues are increasingly important as exports rise – and regulatory compliance becomes more complex.” With a rise in the middle class and expectations of higher food quality in emerging markets, any food scare undermines the image of the processor and of the industry in that country.

“The public is increasingly aware of the complex nature of the Food and Beverage industry, especially after negative food news in Europe. Consumers are starting to understand that good food comes at a price.”

Ciara Jackson
National leader Food and Beverage
Grant Thornton Ireland

Fig 8. All costs likely to rise

Expected cost changes in next 12 months

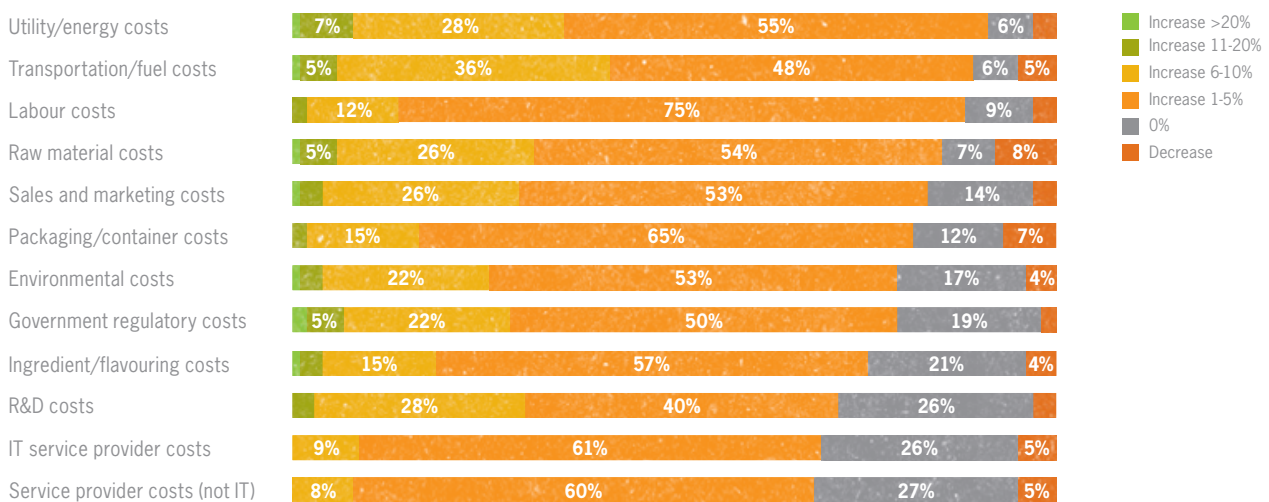


Fig 9. Regulations harm some, but help others

Effects of government actions

| | Significant negative effect | Some negative effect | No effect | Some positive effect | Significant positive effect |
|---|-----------------------------|----------------------|-----------|----------------------|-----------------------------|
| Environmental regulations | 9% | 39% | 35% | 14% | 0% |
| Tax regulations | 11% | 33% | 44% | 9% | 0% |
| Food-labeling regulations | 7% | 31% | 35% | 21% | 4% |
| Food-traceability regulations | 6% | 27% | 29% | 30% | 7% |
| Employee healthcare regulations | 9% | 16% | 60% | 8% | 1% |
| Nutritional guidelines | 2% | 22% | 50% | 21% | 2% |
| Food recalls | 4% | 16% | 66% | 7% | 2% |
| National health targets | 2% | 15% | 58% | 20% | 2% |
| Farm subsidies | 5% | 10% | 68% | 6% | 2% |
| Production quotas | 4% | 10% | 70% | 3% | 1% |
| R&D tax credits | 2% | 5% | 60% | 22% | 5% |
| Government grants and assistance packages | 1% | 5% | 53% | 30% | 9% |

Does not include "n/a or don't know" responses

In the US, it is unclear if proposed rules meant to improve food safety and supply-chain traceability under the Food Safety Modernization Act are even enforceable – leaving some executives to wonder if they need to comply. “Most of our clients have programmes in place, and they’re trying to adjust their programmes to comply with the rules,” says Manning of the US. “But at the end of the day, some executives look at it and say, ‘Well, Congress hasn’t funded it yet, and so they may not be able to enforce it.’ This means that many companies do not expect much impact, especially given US budget deficits and cost-cutting.”

At the same time, US Food and Beverage executives are struggling with changing healthcare and tax regulations. Manning says that many are seeking help from employee-benefits specialists to plan for the impact of the Affordable Care Act, as well as assistance from tax specialists to structure acquisitions and expansions to achieve optimal tax outcomes. “If Food and Beverage companies are not actively reviewing the new healthcare and tax rules and understanding both the federal and the state impacts, then they’re not going to get favourable tax positions. We have got the highest corporate tax rates among developed countries. It is essential that companies thoroughly understand their options. Similarly, they need to understand their opportunities for business incentives, and take advantage of those.”

Governments are not the only powers impacting Food and Beverage businesses. Large retailers also exert massive influence, since three-quarters of Food and Beverage organisations sell into supermarkets or grocery stores. In fact, industry executives rate the power of retailers as the single biggest constraint on business growth (Figure 10). The rise of mega-retailers around the world – Tesco, Wal-Mart, Coles, Loblaws, Costco, etc – has many Food and Beverage leaders wondering how to regain power in these often contentious relationships.



Fig 10. Can retailer power be restrained?

Constraints of business growth (5 = Major constraint – 1 = No constraint)

| | 5 | 4 | 3 | 2 | 1 |
|---|-----|-----|-----|-----|-----|
| Power of retailers | 27% | 26% | 20% | 14% | 10% |
| Challenges finding skilled workers | 10% | 23% | 28% | 28% | 11% |
| Government regulations | 11% | 18% | 29% | 29% | 12% |
| Exchange rates | 8% | 18% | 25% | 22% | 22% |
| Challenges finding food-specific technical/science skills | 4% | 17% | 26% | 33% | 18% |
| Operations capability/performance | 5% | 13% | 25% | 30% | 26% |
| Operations capacity | 7% | 13% | 21% | 31% | 28% |
| Supply-chain performance | 3% | 10% | 34% | 32% | 20% |
| Challenges sourcing capital | 7% | 9% | 14% | 23% | 45% |
| Union power | 2% | 6% | 10% | 30% | 44% |

Does not include “n/a or don’t know” responses

Major retailer dominance is a problem around the world. “Food and Beverage companies cannot do much to fight against retailers’ power,” says Frambourt. “In France, major retailers represent four-fifths of the market, and you cannot take the risk of excluding anyone. Moreover, the large French retailers have expanded their reach to Europe and to emerging countries. Now they ask for rebates based on French volumes, as well as rebates on European volumes. Some larger Food and Beverage businesses are focused on investing in and marketing their brands so that the retailers are ‘obligated’ to maintain distribution of their products, but it is their only means of influence.”

“In Australia,” adds Pititto, “we are in a marketplace where the two largest retailers control some 70% of retail sales.” Grant Thornton industry

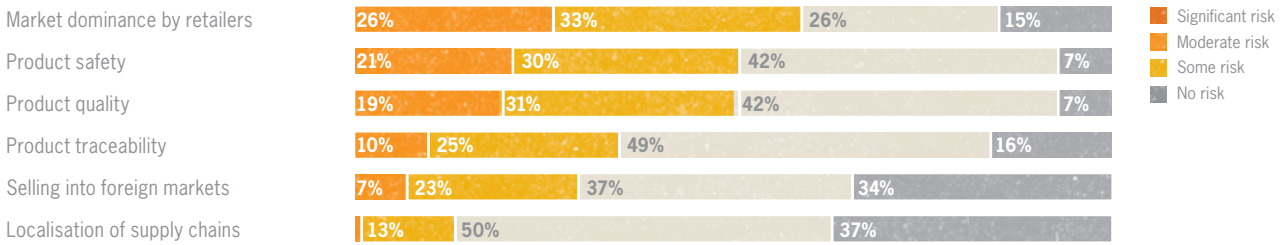
leaders in Canada, New Zealand, and Ireland describe similar retail landscapes, in which a country’s Food and Beverage market is dominated by relatively few retailers. They and others suggest that industry executives improve their bargaining positions by:

- *diversifying customer portfolios: when organisations expand their list of customers, they often have more freedom to negotiate for better shelf space or improved pricing – and to abandon a retailer when its demands become unreasonable. Leading organisations also explore channel diversification into institutions, restaurants, and other non-retail sectors*
- *building a product leader: some organisations consolidate around core products, becoming the principal or major provider of specific goods in specific markets or regions*
- *developing niche markets: smaller businesses can establish brand affinity and awareness through smaller retail channels or digital sales of niche products, developing breakthrough brands that are eventually sought by larger retailers*
- *diversifying product portfolios: larger businesses can assemble a broad range of differentiated products, using the power of their most popular ones to force retailers to help introduce new products or stock lesser-known brands*
- *seeking assistance: in the UK, Food and Beverage businesses can apply to a groceries code adjudicator, arguing that they have been unfairly treated by the country’s largest retailers.*



Fig 11. Many worry about retailer power and product safety

Risks to organisation and its supply chain



More than half of Food and Beverage executives see market dominance by retailers as a significant or moderate risk to their supply chains and organisations. These leaders also are concerned about supply chain risks related to product safety, quality and traceability (Figure 11).

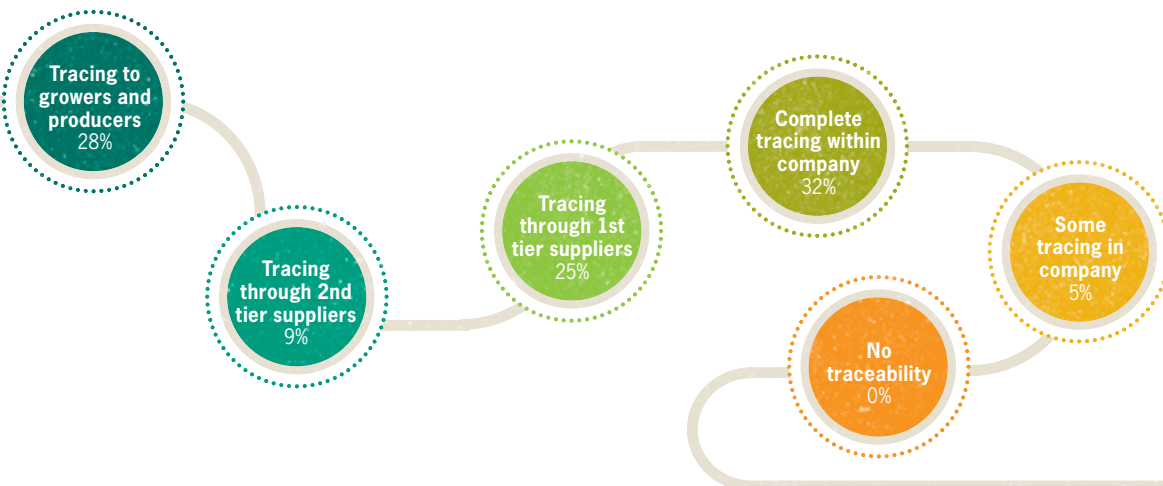
Traceability is a high-profile issue in many regions, often driven by news headlines that both alert and alarm consumers. These cases, though, obscure the fact that most Food and Beverage organisations are acutely focused on safety, quality and traceability. “Supermarkets are spending a lot more time monitoring company supply chains, and that extends back through processors,”

says Griffith in the UK. “They have thrown a lot of ‘red flags’ at their providers when they fail to ensure complete traceability in certain areas, and they demand to know why traceability has not been achieved.” He adds that complications have sometimes arisen when businesses have been forced by retailers to source from certain companies, only to discover that they are unable to sufficiently monitor and control the “preferred” growers/producers. “It’s quite an interesting dynamic at the moment.” adds Griffith. Safety and traceability vary significantly by product type. Ready-to-eat meals, which can contain a long list of ingredients, pose greater challenges to a processor.

Time- and/or temperature-sensitive products and goods more susceptible to bacteria – eg, lettuce, vegetables, fruits, and meats – also pose safety risks. For example, 39% of meat and meat product respondents rate product safety as a significant risk, and 24% of fruit and vegetable product respondents rate safety as a significant risk. Yet just 3% of alcoholic beverage respondents rate safety as a significant risk.

The majority of respondents (62%) trace goods through the first tier of their supply chains or further (Figure 12).

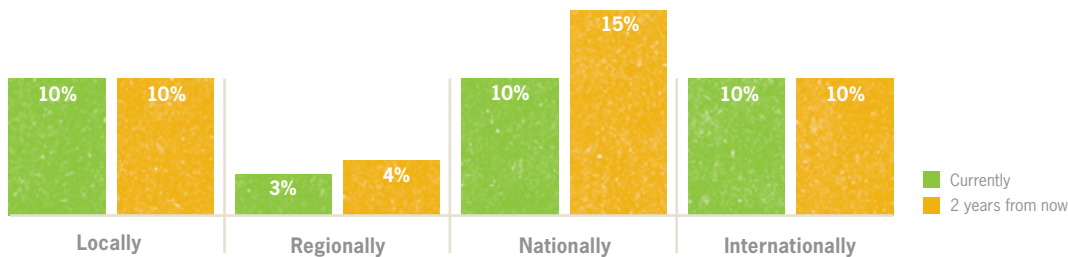
Fig 12. Tracing goods through the supply chain



Due to rounding percentages may not sum to 100%.

Fig 13. Sourcing locally, regionally, nationally and internationally

Percentage of products sourced (median)



The trend toward localisation of supply chains does not currently concern industry executives, in part because only a median 10% of Food and Beverage ingredients are sourced locally (Figure 13). Yet leading organisations are paying increased attention to localisation, as the trend moves from food cooperative to mainstream. Major retailers have begun promoting food based on provenance and freshness because of consumer demand.

“In Quebec, Loblaw’s new strategy is to revive the Provigo brand, and source product more locally or regionally. This is to regain market share lost in recent years with their category strategy,” says Barthell.

“There is no question that localisation is here to stay,” adds Barthell “In Canada and in the US, large retailers – Walmart, for example – are making it an increasing part of their product offering. They are now bringing the source of food into their location decision when they determine where to open a new store.”

Even as localisation takes hold, though, a median 10% of goods are sourced internationally. This causes concern in the executive suites of those organisations: 49% of respondents that source more than half of their goods internationally rate product traceability as a significant or moderate risk, compared to just 31% of other executives.

“There is no question that localisation is here to stay. In Canada and the US large retailers are making it an increasing part of their product offering.”

Guy Barthell
Food and Beverage leader
Raymond Chabot Grant Thornton



“Depending on how the supply chain is structured, and when ownership transfers, Food and Beverage organisations can lose the ability to rigorously monitor product. The best traceability programmes will rely on collaboration among all parties in synchronising compliance practices, risk management, and process-improvement solutions across the entire supply chain.”

Tony Pititto

National leader Food and Beverage
Grant Thornton Australia

“Food and Beverage organisations can lose control of their ability to trace goods when products move downstream and into export markets,” says Pititto of Australia. “And depending on how the supply chain is structured, and when ownership transfers, they can lose the ability to rigorously monitor product. The best traceability programmes will rely upon collaboration among all parties in synchronising compliance practices, risk management, and process-improvement solutions across the entire supply chain.”

Pititto says organisations need to first establish guidelines and product criteria for suppliers, including corporate ethics (such as providing safe workplaces and labour practices). Businesses must then implement systems to monitor suppliers and enforce compliance. At the same time, careful examination of suppliers’ financial performances can provide early warning signals regarding problem suppliers – including lower quality ingredients or delayed deliveries – that can impact the bottom line.

In focus

Advantages in product integrity

Two-thirds of executives agree that the ability to trace goods and ensure product integrity is a market advantage. But they are less likely (54%) to believe that integrity of a supply chain in a specific country can differentiate that country’s products overseas.



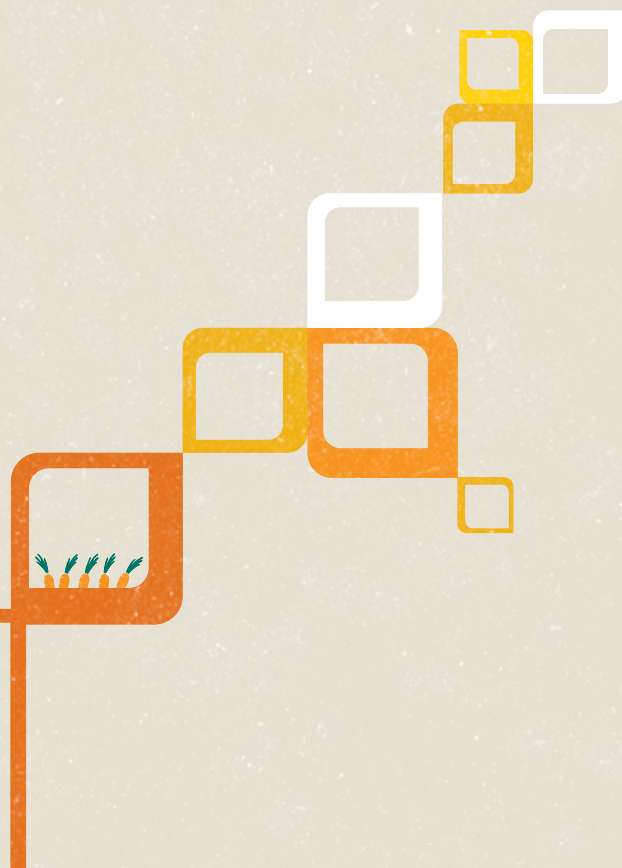
Two thirds of
executives agree
product integrity is a
**market
advantage**

Leading market trends

New Food and Beverage trends often seem to emerge overnight. Yet behind every successful product innovation are years of investment – along with failed investments in other trends that never captured the imaginations of consumers. The challenge for Food and Beverage businesses is to get ahead of the latest trends – with new or reformulated products, new packaging, etc. – but not so far ahead that they take on unnecessary product-portfolio risks.

Leading organisations balance opportunity and risk in taking advantage of emerging trends by:

- conducting extensive market analysis to gauge consumer sentiment
- analysing operations and supply-chain capabilities to support trend-related product launches
- updating their integrated marketing plans to incorporate “demand chain” strategies that allow one-to-one communication with consumers via digital and social media.



Many of today's most popular Food and Beverage trends were niche markets only a decade ago. For example, the gluten-free market in the US has grown to more than \$4 billion, with a compound annual growth rate of 28% from 2008 to 2012. Yet it wasn't until 2007 that the US Food and Drug Administration started examining gluten-free foods¹, and not until this year that it released guidelines on what defines gluten-free (less than 20 parts per million²). Similarly, foods from genetically modified organisms (GMO) only reached store shelves in 1994, but now the vast majority of corn and soybeans in foods are genetically modified. This has led, in turn, to increasing consumer demand for non-GMO foods and GMO labeling regulations.

The rapid emergence of these and other Food and Beverage trends highlights how quickly the industry evolves.

Entrepreneurs satisfy changing consumer demands and then larger players look to acquire the entrepreneurs – and their newfound markets. In 2013, the top five food trends are (Figure 14):

- *premium/luxury*: 60%
- *healthy/nutritious*: 59%
- *locally sourced*: 49%
- *sustainably produced*: 46%
- *convenience*: 44%

Most of the trends position products at the high end of the market due to unique or innovative characteristics. Yet Food and Beverage companies also must pay attention to continued price sensitivity among consumers.

“In the UK, consumer spending on food is less than it was last year and for the first time since World War II, the industry actually contracted by volume.”

Trefor Griffith

National leader Food and Beverage
Grant Thornton UK

“In the UK, consumer spending on food is less than it was last year,” says Griffith, “and for the a first time since World War II, the industry actually contracted by volume. This decline is driven by people spending less on food due to economic considerations, combined with a greater awareness of food waste and recycling. Some price-conscious UK consumers now shop in pairs, to take advantage of buy-one get-two deals and to minimise their in-home waste.”

Fig 14. Yesterday's niche markets are today's new trends

Food trends affecting organisations in next 12 months

| | Positive effect | No effect | Negative effect |
|---|-----------------|-----------|-----------------|
| Premium/luxury food and beverages | 60% | 36% | 3% |
| Healthy/nutritious food and beverages | 59% | 32% | 9% |
| Locally sourced food and beverages | 49% | 43% | 8% |
| Sustainably produced food and beverages | 46% | 49% | 5% |
| Convenience food and beverages | 43% | 50% | 6% |
| Organic food and beverages | 36% | 56% | 8% |
| Private-label brands | 36% | 40% | 24% |
| Ethnic food and beverages | 35% | 60% | 5% |
| Gluten-free/allergy-free foods | 34% | 60% | 6% |
| Functional food and beverages | 29% | 69% | 2% |
| Sustainable packaging alternatives | 25% | 63% | 12% |
| Whole foods (fruits and vegetables) | 22% | 75% | 3% |
| Non-GMO food and beverages | 19% | 71% | 10% |
| Retailers reducing product range/varieties on shelf | 15% | 38% | 47% |

1. *Gluten-free foods and beverages in the U.S., fourth edition*, Packaged Facts.

2. Sheah Rarback, “FDA sets guidelines on gluten-free foods,” *Miami Herald*, Aug. 19, 2013.

While a diverse mix of food trends means opportunity for Food and Beverage organisations, executives hoping to capitalise on them face risks. “This is an incredibly dynamic environment with factors impacting each individual company and market, but one that poses challenges, too,” says Hunter in New Zealand. “How should executives respond to these trends to ensure that their company remains in a competitive position? Which trends will drive the greatest growth and profitability? More importantly, how do you ensure your organisation remains sufficiently agile to seize opportunities and manage the associated challenges?”

Savvy Food and Beverage executives will conduct a careful analysis of market trends alongside a detailed review of their organisation’s competencies and capacities. Pititto says companies should conduct research on product-category growth rates that incorporate demographic, market and competitive factors, presented within a context of firms’ abilities to invest and assume risk. Only when sound opportunities are proven to exist should organisations invest by:

- *developing a brand internally*
- *repositioning or relabeling existing products*
- *structuring alliances, joint ventures or acquisitions with targets already capitalising on the trend.*

Fig 15. Standards are unclear for most food trends

Standards clearly defined for the following food types

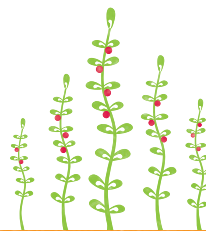
| | Good definition | Some definition | Poor definition |
|--|-----------------|-----------------|-----------------|
| Organic Food and Beverages | 37% | 31% | 17% |
| Healthy/nutritious Food and Beverages | 21% | 38% | 26% |
| Non-GMO Food and Beverages | 19% | 33% | 24% |
| Locally sourced Food and Beverages | 14% | 35% | 35% |
| Sustainably grown and produced foods and beverages | 9% | 33% | 34% |
| Energy Food and Beverages | 9% | 31% | 32% |
| Nutraceuticals | 9% | 18% | 32% |

Some 80% of respondents plan to address trends by developing new products within their existing lines or sectors; others will introduce new packaging formats (60%), pursue new channels (57%), introduce new lines/sectors of products (49%), unveil new packaging sizes (46%), introduce new ingredients/flavours (45%), or use new labeling (33%).

Unfortunately, there is considerable ambiguity around standards that define many new trends. For example, organic food is the food type most clearly defined – but only 37% of executives indicate the category has a “good definition” for the standard. Other trends are rated as having “poor definition” or “no definition” for their

standards. For many product types, executives simply do not know if a standard definition exists (Figure 15).

“Food and Beverage manufacturers are dealing with an environment that is confusing at best, and misleading at worst, in many categories,” says Manning of the US. “Companies may be competing against another product that uses a word such as ‘natural’ in the label, but with a much less stringent definition. You are not comparing apples to apples, and that puts the manufacturer with a real natural product at a disadvantage.” That disadvantage hurts not only sales, but costs, too – because the “authentic” natural company is likely paying more for ingredients, and processing in ways that adhere to higher standards.



Another major factor impacting the Food and Beverage industry is increasing consumer use of smartphones and tablets to find product information as they shop or dine. Sixty-one percent of millennials – and 58% of 36 to 65 year-olds – use smartphones to shop at grocery stores, according to the Sprint

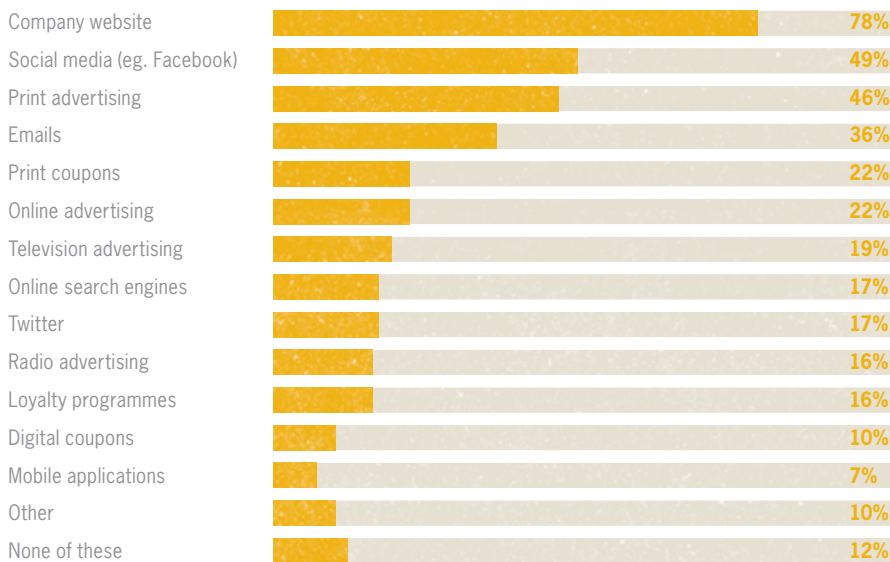
Mobile Moment of Truth Survey. Smartphones are used primarily to:

- *compare price*
- *find coupons*
- *make lists*
- *text/email*
- *research products*³.

With this level of in-store access to information, it is easy to understand why 78% of Food and Beverage executives report that their company websites are the top method to attract and/or retain customers, and that many also use social media and other digital tools to build brand awareness and loyalty (eg emails, online advertising, online search engines, Twitter, and digital coupons) (Figure 16).

Fig 16. Businesses adopt digital tools

Methods to attract and/or retain customers (% of respondents)



“Companies have got to be progressive in offering value to their customers, and that means partnering with all of their retailers via social media in order to sell the maximum amount of product.”

Dexter Manning
National leader Food and Beverage
Grant Thornton US

3. Julie Gallagher, “Smartphone Use Prevalent in Grocery,” *Supermarket News*, Oct. 31, 2012.

In focus

Profitable Food and Beverage respondents

Food and Beverage executives at respondents with higher profits manage differently than those with lower profits. This analysis compares the practices and performances at respondents with profit before taxes and interest of more than 12% (the upper quartile of study respondents based on profit and termed “high-profit respondents”) v those with profits of 12% or less (the other three-quarters of respondents and termed “low-profit respondents”). These findings highlight the potential that many Food and Beverage organisations fail to achieve:

Investments in next 12 months

- 21% of high-profit respondents will increase investment in plants/facilities by more than 20%, and 19% will increase investments in equipment by more than 20%.
- 12% of low-profit respondents will increase investments in plants/facilities by more than 20%, and just 10% will increase investments in equipment by more than 20%.

Commodity prices and controlling costs

- 23% of high-profit respondents indicate that commodity prices will have a “significant effect” on their businesses, and 21% report that controlling costs is a “significant challenge.”
- 42% of low-profit respondents indicate that commodity prices will have a “significant effect” on their businesses, and 47% report that controlling costs is a “significant challenge.”

Exports

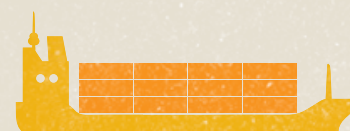
- high-profit respondents currently export a median 10% of their product sales (20% in two years), and 67% indicate that exports are a “major driver” of business growth.
- low-profit respondents currently export a median 5% of their product sales (10% in two years), and 23% indicate that exports are a “major driver” of business growth.

Costs

Most expenses as a percentage of sales are comparable between the two groups. The clear exception is raw-material costs: median 35% at high-profit respondents and 50% at low-profit respondents (Figure 17).

Fig 17. Median expenses as percentage of sales

| | All respondents | Low-profit respondents | High profit respondents |
|----------------------------------|-----------------|------------------------|-------------------------|
| Raw material costs | 45.0% | 50.0% | 35.0% |
| Direct labour costs | 11.0% | 11.0% | 12.0% |
| Transportation costs | 5.0% | 4.1% | 5.0% |
| Marketing expenses | 4.0% | 3.0% | 5.0% |
| Utility costs | 3.0% | 2.0% | 3.0% |
| R&D expenses | 2.0% | 1.5% | 2.0% |
| Profit before interest and taxes | 6.5% | 5.0% | 20.0% ⁴ |



67%
of high profit
respondents indicate
exports
are a major driver
of business growth

4. Represents the midpoint of the upper quartile for respondents based on profit before interest and taxes.

Investments by Food and Beverage businesses in social media will pay long-term dividends. A study by social media marketing firm Syncapse found that the average value of a Facebook fan across all consumer brands is \$174.17 when expenditure, brand loyalty, propensity to recommend, media value, cost of acquisition and brand affinity are taken into account. Fashion brand Zara's fans are worth over \$405.54, compared to the value of a Coca-Cola fan at \$70.16⁵.

Leading organisations are increasingly aware that being digital requires monitoring and measuring the value of online and social media efforts. They also focus on policies to keep social media messaging consistent while minimising risks, with processes to control, counter and mitigate negative exposure from a bad tweet, negative Facebook post, etc. They know that digital marketing efforts cannot occur in isolation – collaboration with customers and suppliers will drive exponentially better results as part of an integrated marketing strategy.

Jackson advises companies that, “no one size fits all for social media. It should be built around an individual organisation's core values and

reputation. News of food scares race online and are perpetuated via this medium. Food and Beverage businesses must rethink how they communicate with all of their stakeholders. Their reputations can now be built and destroyed overnight.”

“Companies have got to be progressive in offering value to their customers, and that means partnering with all of their retailers via social media in order to sell the maximum amount of product,” says Manning of the US. “For the past 20 to 30 years, manufacturers have been concentrating on the supply chain – how to take cost out of the system in order to maximise profit, and to have the lowest possible cost at retail. That is no longer the mantra. Now it is the ‘demand chain.’”

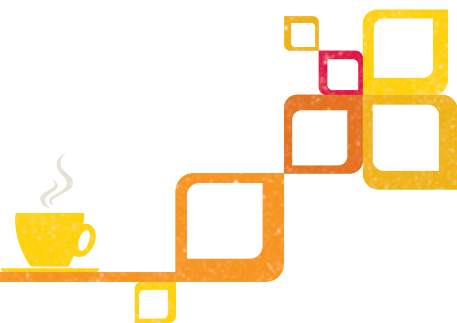
Do businesses really understand what their customers need and want, even before the customer knows what they need or want? They need to be working to have the right, most profitable product available to customers, when they want it, where they want it. So if that customer is in a Safeway store, the manufacturer can know and ping them with a recipe or discount. As technology evolves, businesses need to know more about their customers – where they

are, what they like, what they are most likely to buy – and push out a customised marketing plan for each individual.”

Food and Beverage businesses also will look to technology to help them manage retailers and decision-making. Organisations with high fixed costs, particularly those with large consumer-facing infrastructures (ie all retailers) are fundamentally rethinking their business models, from how space is allocated within stores to how they sell products (both online and offline). Food and Beverage organisations need to align themselves and their technologies with these changes.

Digitisation also includes exploiting massive amounts of complex data (ie big data) to drive business decisions. Big data is leveling the playing field for those businesses that understand and use it for:

- *negotiating with retailers*
- *coordinating forecasts with growers/producers to develop demand-driven products*
- *running scenario analysis to management volatile food-ingredient prices.*



5. Helen Leggatt, “Facebook Fan Value Rises 28% since 2010,” *BizReport*, April 21, 2013.

Methodology in focus

Participant profiles

The Grant Thornton Global Food and Beverage Study was conducted using an online questionnaire. There were 248 total participants, with responses received in May, June and July 2013. Responses were received by The MPI Group (MPI), an independent research firm, and then entered into a database, edited, and cleansed to ensure answers were plausible, where necessary. All respondent answers to the study are confidential. As an incentive, respondents who provided contact information were offered a customised benchmark report. Only MPI and Grant Thornton have access to study data.

Country

| | % of respondents |
|------------------------|------------------|
| Canada | 21% |
| US | 18% |
| UK | 17% |
| Australia | 15% |
| New Zealand | 14% |
| Ireland | 10% |
| France | 5% |
| Location of respondent | |

Employees

| | % of respondents |
|---------------|------------------|
| Less than 50 | 28% |
| 50 - 100 | 15% |
| 101 - 250 | 25% |
| 251 - 500 | 13% |
| More than 500 | 19% |

Food and Beverage sector

| | % of respondents |
|--|------------------|
| Meat and meat products (poultry, pork, etc.) | 24% |
| Fruit and vegetable products | 22% |
| Dairy products (including milk) | 17% |
| Non-alcoholic beverages (including soft drinks) | 17% |
| Baked goods including pasta | 17% |
| Seafood products | 15% |
| Grains/flour products (eg milled products and cereals) | 15% |
| Alcoholic beverages | 14% |
| Sugar and confectionery products | 13% |
| Other food products | 26% |

Respondents could select multiple categories

Sales channel

| | % of respondents |
|--------------------------------|------------------|
| Wholesale/distributors | 78% |
| Supermarkets/multiples | 66% |
| Foodservice | 57% |
| Grocery stores | 53% |
| Restaurants (not fast food) | 39% |
| Convenience stores | 36% |
| Fast food restaurants | 25% |
| Institutions (e.g., hospitals) | 25% |
| Consumers | 23% |
| Government/public sector | 18% |
| Only online | 0% |
| Other | 17% |

Respondents could select multiple categories

Ownership structure

| | % of respondents |
|------------------------------------|------------------|
| Private company | 72% |
| Public company | 9% |
| Private-equity-owned company | 7% |
| Cooperative | 5% |
| Division/unit public | 3% |
| Division/unit private | 3% |
| Division/unit private-equity owned | 1% |
| Other | 1% |

Revenues

| | % of respondents |
|----------------------------------|------------------|
| Less than US \$10 million | 19% |
| US \$10 million - \$50 million | 30% |
| US \$51 million - \$100 million | 18% |
| US \$101 million - \$500 million | 20% |
| More than US \$500 million | 12% |

Food and Beverage global contacts

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Economic perspective:

Optimism of the Food and Beverage leaders bodes well for global economy

The health of the Food and Beverage sector is a bellwether for the wider economy. Eating and drinking is a fundamental part of human life but this means the sector is more exposed to fluctuations in consumption patterns. In leaner times, consumers scale back their Food and Beverage purchases to protect disposable incomes. In better times, these purchases are one of the first things to pick up as consumers flex their increased spending power.

The optimism of business leaders in the sector therefore bodes well for the global economy as the recovery gathers momentum. Growth prospects are noticeably lower in both emerging and mature markets compared with before the financial crisis, but businesses in the Food and Beverage sector seem to be adjusting well to this shifting economic landscape.

Global demographics are also changing. The Chinese and Indian economies are no longer growing at double-digit rates, but more than one in three people in the world live in these two countries. Can producers afford to ignore markets this large? China has lifted more than 600 million people out of poverty since enacting market reforms in 1978 and the burgeoning middle classes are demanding more and higher quality foodstuffs.

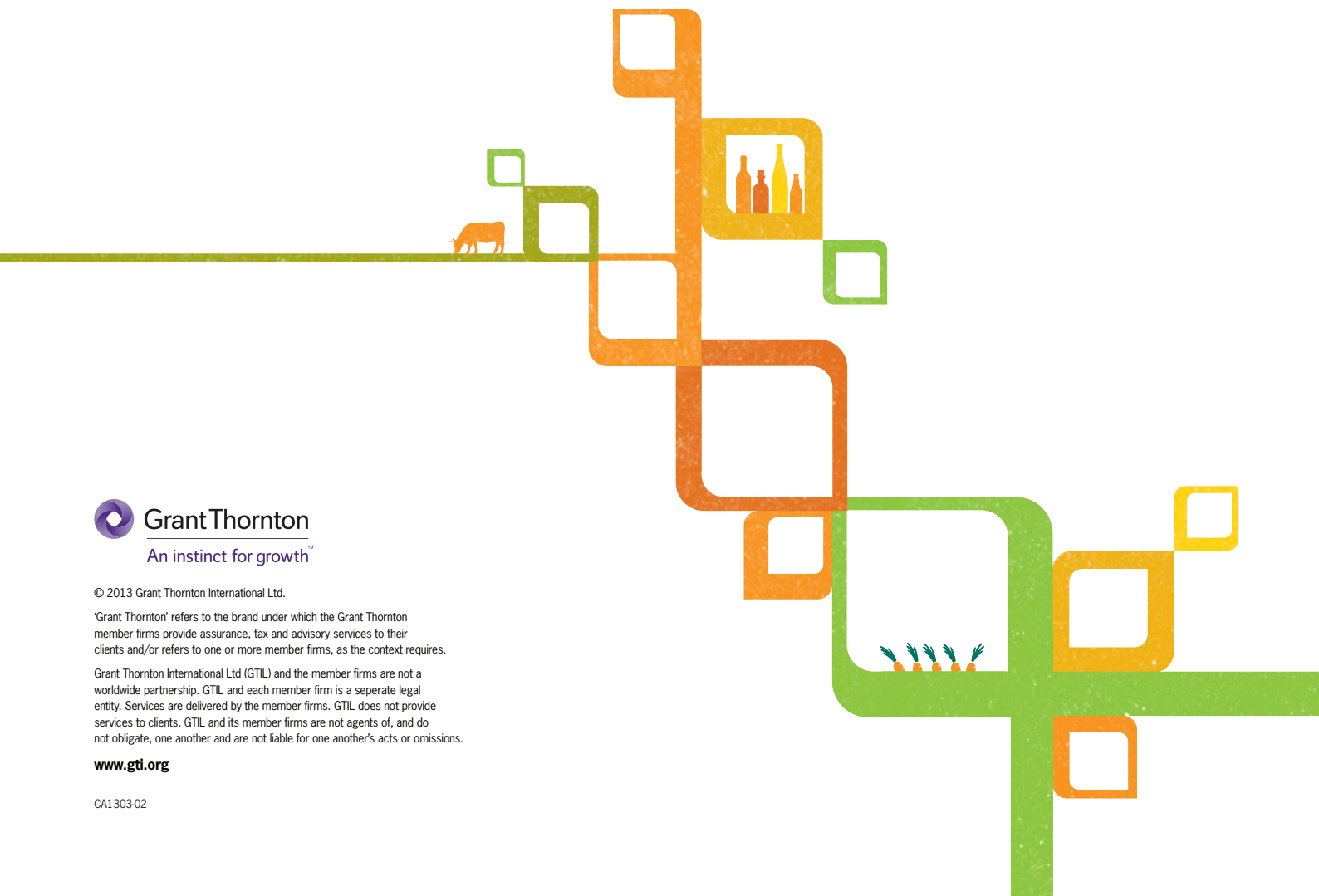
India's population will overtake China's by 2030, and recent government reforms should make it easier for foreign retailers to invest in the economy.

In mature markets, ageing populations are increasingly price conscious as wages fail to keep up with inflationary increases and disposable incomes are squeezed. But they are also more health and ethically aware, so producers need to be able to demonstrate the integrity of their supply chains to satisfy consumers as well as regulators.

Adapting to these economic and demographic changes will require significant business investment in a number of areas, including: digital, especially through the use of social media to engage with younger audiences; and R&D into new products and practices, allowing businesses to capitalise on emerging trends. Those producers that make these investments will be best placed to turn wider challenges into growth opportunities.



Dominic King
Global economist
Grant Thornton



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