INDUSTRIAL MARKET RESEARCH

# INDIA WAREHOUSING MARKET REPORT 2018 INSIGHT SERIES #1

## GST-REGIME BEARS FRUIT, WAREHOUSING SECTOR WITNESSES SIGNS OF CONSOLIDATION

The Goods and Services Tax (GST), regarded as the biggest tax reform in the history of independent India, was rolled out in 2017. It has replaced numerous central taxes such as excise duty, countervailing duty and service tax as well as state taxes such as value-added tax, octroi and entry tax, local body tax, luxury tax, etc. GST has facilitated the unification of the Indian market. Prior to the GST regime, same products were sold at different prices across state borders owing to want of uniformity in the tax structure. GST has helped eliminate these price differentials and thus created a level playing field.

**Globally, warehouse consolidation cases have witnessed up to 30% reduction in inventory levels leading to over 40% increase in inventory turnover thereby resulting in increased profitability.**

In the logistics and supply chain industry, inventory carrying cost is one of the primary metrics used to gauge supply chain productivity. It is a measure of how much capital is lying idle in resources that could otherwise be employed for more productive uses. Accordingly, the primary aim of any supply chain company is to minimise the inventory carrying cost without compromising on sales. GST is expected to reduce inventory levels and therefore the inventory carrying costs.

Further, with the removal of inter-state entry barriers leading to reduction in cargo movement time and the unification of taxes; there is a strong case for consolidation of warehouses. Warehouse consolidation results in averaging out of variability in individual demand and lead time (of individual warehouses). This eventually results in lowering of risk pertaining to aggregate demand variability. In fact, average inventory level is directly proportional to risk of demand variability and hence a lower risk would result in lower inventory level requirements. This further reinstates the GST-induced advantage of achieving reduction in inventory levels.

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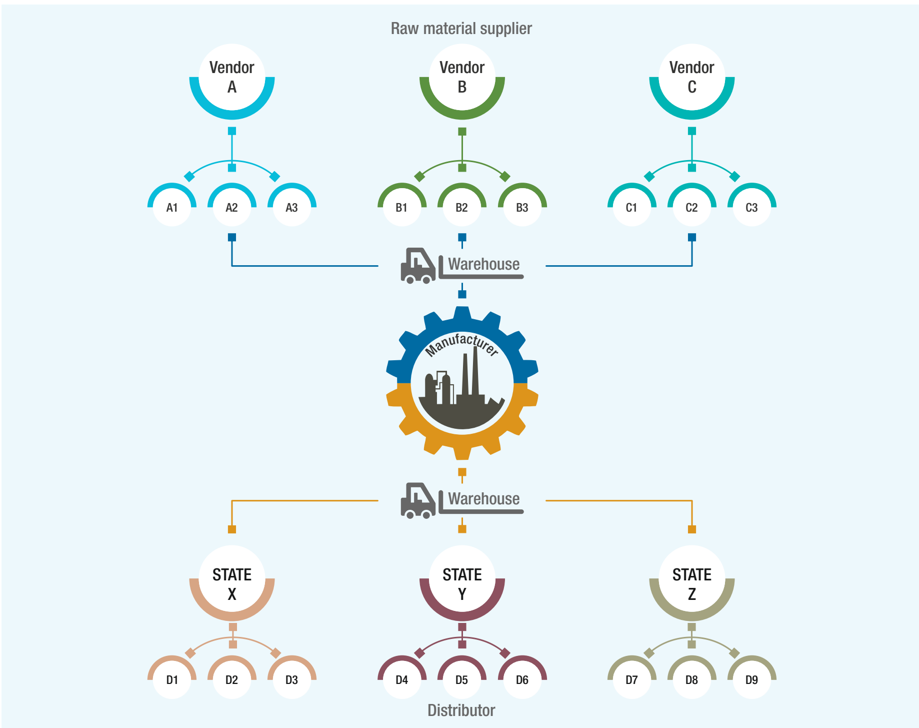
### Warehousing in the Pre-GST era

Trucking and inter-state transportation of goods faced time and cost inefficiencies in this era. Goods carriers would be held up for days at multiple state entry barriers awaiting clearances. Further, payment of local body taxes and state octroi along with compliance charges and permits would add to costs. All these barriers resulted in delayed delivery time which led to cost escalations. And even that varied from state to state and product to product.

To circumvent the hassle and additional tax levied on inter-state sale of goods, most companies had taken to setting up multiple small warehouses to show an inter-state stock transfer and affect the sale within its borders itself. Though it meant higher inventory carrying costs and inefficiencies, this model was adopted by most companies.


FIGURE 1

**Warehousing strategy before GST implementation**




**Source**: Knight Frank Research

## Warehousing in the post-GST era

Warehousing activities carried out for the sole purpose of avoiding tax have become redundant with the introduction of GST. Travel time for inter-state transportation has also come down significantly owing to the elimination of state entry barriers. Trucks are now able to cover longer distances every day, with an improved turnaround time, implying that transporters can carry out their business with smaller fleets. GST has also reduced the costs incurred on taxes and state permits. Both these savings (time and cost) are nullifying the need for multiple warehouses in different geographies.

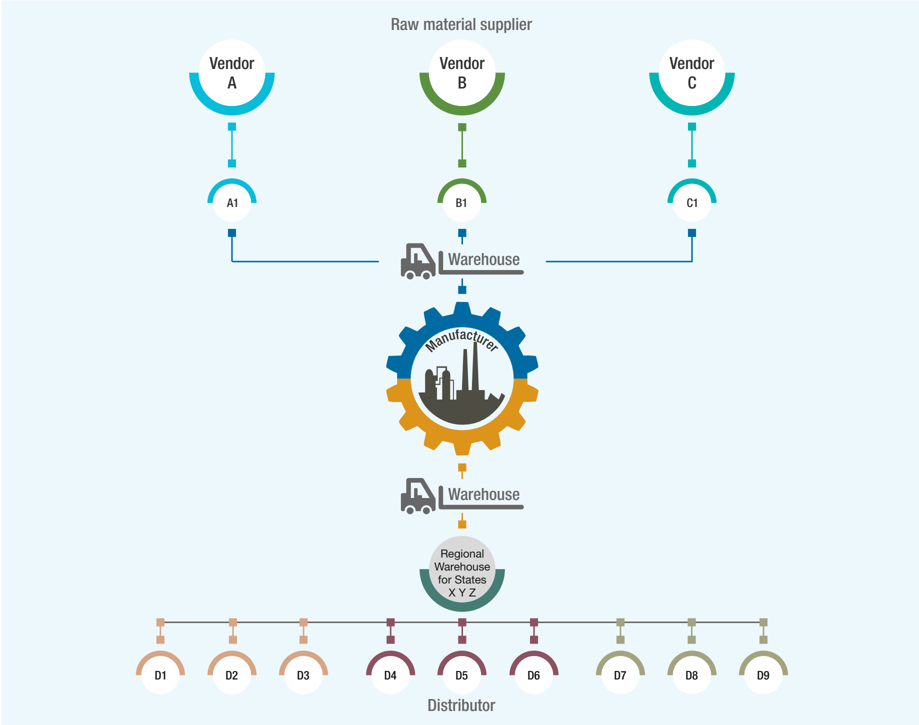
Currently, companies are enjoying the immediate benefits from removal of check points. According to our survey, this has led to average cost saving in the range of 3–7%, which varies across several industries. However, the time savings are substantial. For example, earlier the travel time between Delhi–Chennai, which used to take 5–6 days, has come down to 3–4 days in the GST era. Trucks are able to cover longer distances every day with an improved turnaround time ensuring that the transporters can carry out their business with a smaller fleet. Once the system for generating e-way bills is implemented by all states, the benefits courtesy reduction in travel and turnaround time would be higher.

**Faster movement of goods** will enable reduced inventory holding levels. **Reduced inventory levels** directly impact the requirement for warehousing space and facilitate the growth of fewer, larger warehouses that allow companies to leverage enhanced economies of scale. Accordingly, companies have begun **warehouse consolidation** and benefit from **reduced inventory carrying costs.**

**Warehousing activities carried out for the sole purpose of avoiding tax have become redundant with the introduction of GST. Travel time for inter-state transportation has also come down significantly.**

FIGURE 2

**Warehousing strategy post GST implementation**




**Source**: Knight Frank Research

## Industry-specific consolidation trends

According to industry interactions and primary surveys, the level of consolidation in warehousing will vary across industries.

- **Consumer durables (Fast moving consumer durables or FMCD) manufacturing companies foresee up to 40% reduction in their total number of warehouses.** However, this number may wary within the industry as the scale of operations differs from company to company. Manufacturers will benefit from this downsizing as it would mean lesser inventory carrying costs. However, at the same time, local distributors and retailers would need to increase their inventory holding capacity to prevent stock outs. This means savings for manufacturers will come at a cost for the distributors and retailers. But these costs would be one-time and significantly less than the ones borne by the manufacturers earlier. Therefore, with time, warehouse consolidation would benefit all players in this industry.
- **The fast moving consumer goods (FMCG) industry, on the contrary, has indicated a relatively smaller extent of consolidation in their warehouses.** Owing to a shorter shelf-life and a voluminous demand for these products, it is necessary that FMCG warehouses be located near the consumption clusters. Thus, the only scope for consolidation in FMCG lies in their intermediate warehouses that fall in between factories and feeder hubs.
- **In case of temperature-controlled warehouses, cold-chain companies have indicated that they are unlikely to consolidate on a large scale, at least in the next 3-5 years.** Huge capital investments needed for building the temperature-controlled infrastructure **is the primary bottleneck for such companies.** Any short-term alterations to the existing supply chain would mean more costs initially as infrastructure standards cannot be compromised on. Hence, a planned phasing out and integration of temperature-controlled warehouses, done over a period of time, is when the industry will benefit from post-GST consolidation.

**Consumer durables manufacturing companies foresee up to 40% reduction in their total number of warehouses. However, in case of temperature-controlled warehouses, they are unlikely to consolidate on a large scale for another 3-5 years due to huge capital investments.**

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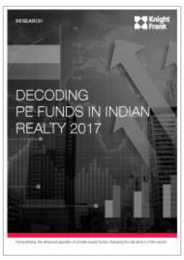

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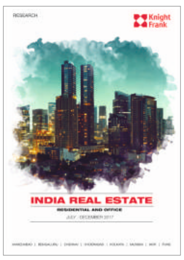

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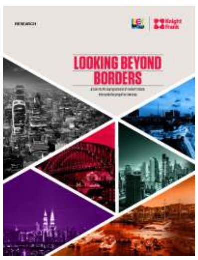

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