INDUSTRIAL MARKET RESEARCH

INDIA WAREHOUSING MARKET REPORT 2018 INSIGHT SERIES #5

Knight Frank

Contract Logistics Led Warehousing

Market Dynamics

The logistics industry in India, although unorganised and underdeveloped, has come a long way from where it was. Growth in consumption demand, coming from rising incomes and population, is driving businesses towards India. This has led to an increase in the demand for logistics services and growth in the number of organised logistics service providers.

Globally, an estimated 86% of the Fortune 500 companies outsource logistics activities to 3rd Party Logistics (3PLs) players. Most of these companies also outsource logistics functions to more than one player in the market to reduce risk, increase efficiency and build a strong network. Comparatively, at 5.7%, India's penetration is far below the fortune 500 average, according to Tata Strategic Management Group. Similarly, the fragmented nature of the Indian logistics industry has also kept the total expenditure of Indian businesses on 3PL services at an estimated 15% of their total spends on logistics in India, according to Frost and Sullivan. Current and forthcoming policy changes such as Goods and Services Tax (GST) and Make in India and emerging customer segments like e-commerce, present several unique opportunities for 3PLs as rising demand for complete logistics management through aggregation of vendors and services gains ground in the country. Logistics companies must leverage this demand for new and differentiated services by suitably building capabilities.

Globally, an estimated 86% of the Fortune 500 companies outsource logistics activities to 3PLs whereas in India, it is as low as 5.7%.

Industries Driving Demand

TABLE 1
Industry wise share in 3PL revenue

INDUSTRY	SHARE IN 3PL REVENUE
Pharmaceuticals and Chemicals	25%
IT Hardware	14%
Engineering	13%
Auto Ancillary	13%
Textile	8%
FMCG	6%
Others	22%

Source: ICICI Direct Research

Demand drivers

- Rapidly growing consumption and last-mile reach: India is a vast country and more than half of the people who form this country's massive consumption base still live in rural areas. Catering to last-mile logistics in remote cities and villages is a critical challenge for the logistics processes of all businesses. It is impossible for most businesses to reach each and every remote location. Thus, a dedicated logistics industry is required to cater to the rapidly growing demand.
- Increasing trade: India's trade growth is expected to be in the double digits for the next decade at least, according to Maersk. The resulting increase in movement of goods that higher trade volumes bring about will prove to be a strong demand driver for logistics services in the future.
- Technology push for logistics operations: New product identification technologies, big data and machine learning have totally changed how the logistics industry operates. Real time data through interlinked systems will also contribute to managing efficiency and reducing costs while maintaining or increasing productivity. Automation can also reduce the need for labour performing unproductive tasks, helping improve labour productivity in the industry. Automation, however, requires huge

investment in technology, which might be unviable for a firm on its own. Thus, private entities will find a 3PL player a much more cost effective and competitive option compared to coping on its own.

- Policy initiatives: Policy initiatives such as GST and Make in India will simplify logistics activities and also streamline 3PL operations to an extent that it would be unviable for most firms to replicate the reach and efficiency levels of dedicated 3PL logistics aggregators.
- Infrastructure development: The Government of India has taken a lot of initiative in the infrastructure department, which includes the Bharatmala and Sagarmala projects to improve connectivity between major metro cities as well as ports, the dedicated freight corridor plan to boost freight movements using railroads and multi-modal logistics parks in various parts of the country to help create an effective logistics landscape in the country.

Critical Factors Impacting 3PL Segment and Outlook

The logistics industry in India is in its nascent stages where it is bound to face mammoth challenges on its way upwards. The sector, as a whole, is not very organised and the industry is competitive, especially in the big cities, where there are numerous unorganised small truck owners and service providers providing stiff competition at razor thin margins. There exist both within-the-industry or internal and external factors that the 3PL firms will have to engage with to promote the industry as well as individual businesses.

EXTERNAL FACTORS

Logistics is a dependent industry. Demand for logistics services varies immensely due to the fluctuations in economic activity. And thus, there are a lot of external factors affecting the industry.

Policy factors

- Make in India – The current government in India is looking to stimulate and promote businesses. Both domestic and international businesses have been called upon to expand their businesses. From April 2017 to September 2017 almost $25 billion has already come in as foreign direct investment (FDI) into India which is 17% more than last year for the same period.[1]
- Substantial public investments in the logistics sector have been planned in the form of multi-modal logistics parks in 35 clusters around India at an investment of $61 billion. The government is also looking to improve the infrastructure in the country.

  In November 2017, the government announced a massive $200 billion project to construct highways across the country. This includes the much sought-after Bharatmala project.
- Minimum Wage Code Bill, 2017 – There is a new minimum wage law, which will affect the logistics industry. It will be illegal to pay workers at warehouses and truck drivers lesser than the minimum wage requirement.
- GST – The tax reform that dissolved the state borders within India, is being looked at as the much-needed push to the logistics industry.
- Ease of doing business – The Indian government is looking at increasing the ease of doing business in India. Thus, further liberalisation of regulations with respect to construction permits, getting electricity and access to licenses and permits can be expected.

Economic factors

- According to industry experts, the share of logistics cost in GDP is set to come down by a minimum of 1–1.5% in the near to medium term. This would lead to savings of an estimated $45 billion.
- Skilled labor in logistics is a major issue in India. Industry players have been incapable of investing in manpower development due to the fragmented nature of the industry, the government has also not focused sufficiently on the same.
- Foreign investment into logistics and other related sectors is increasing rapidly. Many logistics players such as DHL and Kerry Logistics have invested heavily in India and have plans to invest further. Many 3PL-using businesses also have plans to expand their capacities and build new operating units.
- High consumption demand all over India means that the need for distribution centres and transportation is high. Changing to hub and spokes model under the newly implemented GST, would mean that the spokes will have to be closer to consumption centres and even from there last-mile reach will be an important factor.
- Infrastructure in India is a major challenge for businesses. Delays in rail freight, bumpy roads and low connectivity make India a difficult market to do business in.
- Fuel price fluctuations adversely impact the transport business.

Social factors

- Land acquisition – Acquiring land is a major problem amidst the social issues related to environment, displacement of people and government bureaucracy.
- Providing jobs to locals – Displacing people from their agrarian occupations, most land acquirers have to promise employment to the local population. In the future, with automation, job losses would lead to further friction.
- Societal Red Tape – Red Tape is very prevalent even in social circles, mainly in rural areas, where the Sarpanch presides over the decision-making processes.

Technological factors

- Automation – Automation-driven technology for the logistics industry is fast evolving into a fully automated system. From inventory management in the warehouse through Warehouse Management System (WMS) to drone delivery, most processes in the logistics services can be done unmanned.
- Data Analytics – With data being used for new identification techniques, routing, space optimisation and monitoring stock data, the face of the logistics industry is changing.
- Technology life cycle – Marginalised technology life cycle means before a newly commissioned technology is delivered to the industry, another newer technology is already available in the market.
- Information flow – In today's digitised world, information is readily available. This changes how consumers make the final decision. This digital revolution has transformed the logistics industry and is constantly improving on productivity and performance metrics. App-based provision of logistics services, transparency in the market by readily making available information such as price, type of service, equipment used, quality standards, product location, etc

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[1] FDI Fact Sheet – September 2017, DIPP

TABLE 2

Stakeholder	Observations
Contract logistics player	Large number of firms operating in the industry
	Short-term or no contracts between the 3PL firms and the users
	Low scope of differentiation of services
	Most firms use more than one 3PL to operate. Therefore, substitution is highly likely in case of an underperforming service provider
New entrants	There are low barriers to entry in the bottom segment of the market, but providing end-to-end pan India services requires huge capital and access to technology
	Economies of scale reaped by the large players in the market
	High operating costs in terms of fuel, manpower and infrastructure maintenance
	Brand identity and high switching cost in case of a new 3PL player
Occupier / User	Little or no threat of backward/forward integration by occupiers
	Notable contributions to efficiency and costs to the occupiers' business
	Standard and undifferentiated services
	Switching cost is negligible, since users usually contract more than one existing 3PLs
	Large business clients
Logistics Service Provider (LSP) / Asset provider	Unorganised and fragmented LSP landscape
	Insignificant threat of LSPs upscaling their logistics processes due to lack of capital
	Threat of backward integration by 3PLs by purchase of required assets
	Availability of substitutes and low switching cost

Source: Knight Frank Research

Future Outlook

The 3PL industry is a complex network chain of resources that not only helps you with moving and storing goods but also optimises the use of those resources and networks. Therefore, 3PL is not an industry that is easy to be in. The pre-GST era in this industry was dominated by the unorganised and fragmented players but this is set to change. The organised players with modern resources and facilities will take over the industry. The transfer of risk from the user to the 3PL would largely be the reason for the shift. The current slump in business is due to a downturn of industrial output, which is expected to take an upturn soon as companies become GST compliant. Businesses will also look to 3PL for the reasons mentioned, which include cost, time and reach, apart from the transfer of risk.

The new entrants in this business will either be disruptors who can leverage the use of technology and differentiate the product offering or forward integrators who do not only wish to use their supply chain but also be providers in the industry. The industry will not see many substitutes, keeping in mind governments have not been in favour of process automation. Thus, the share of organised players will see a significant and sustained rise in time to come.

The 3PL industry is already a complex chain of resources. With the advent of technology, new 3PL players will either be disruptors or forward integrators. However, the industry will not see many substitutes and therefore, the share of organised players will see a significant rise.

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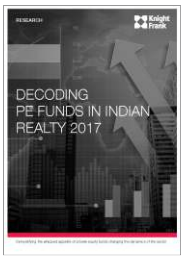

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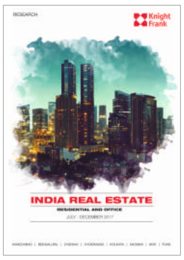

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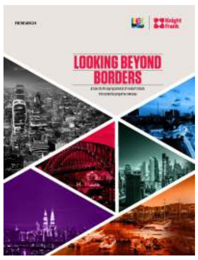

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