

theirview

# GST's impact on the logistics sector

*Initial uncertainties could affect the profitability of the sector in the short run, but in the long run, operational efficiency is bound to improve*

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**T**he logistics sector broadly comprises the road transport sector (consisting of unorganized small businesses, trucking, fleets and large transport companies), the storage and warehousing sector and finally third-party logistics (3PL). These can be further classified into big and small players and asset heavy/light companies. Given this classification, comparing industry performance as a whole is a complicated exercise. We tackle this by analysing data pertaining to 166 companies during 2010-2015 from the Centre for Monitoring Indian Economy (CMIE)'s industrial database to arrive at some useful insights into the industry's performance.

We look at two key performance measures—profit after tax (PAT) as percentage of income and profit before interest, taxes, depreciation and amortization (PBITDA) as percentage of income. Between 2010 and 2015, PAT has declined for all sub sectors and shows volatility for the logistics and the storage sector (see graphic). PBITDA is an important measure that reflects operating efficiency and ranges between a low of 7% for the road transport sector to a high of approximately 20% for the storage sector. There is considerable variation between the sub-segments as well as within them, as can be seen from Figure 2.

## WHAT AILS LOGISTICS?

Operational efficiency could have been falling for a variety of reasons, heavily affecting overall transportation costs as the logistics sector has been traditionally beset with several problems. This includes complicated networks, increasing coordination costs across the supply chain coupled with deficient infrastructure, entry taxes and poor vehicle-load-carrying capacities, resulting in delays and damages.

Additionally, the myriad number of taxes had made logistics a cumbersome and costly process. Logistics firms had responded by installing hubs and transit points in many states to avoid the state value added tax (VAT)—goods directly supplied to dealers attract state VAT whereas transfer from warehouse is treated as stock transfer and do not—and also take advantage of demand seasonality across the country. However, this resulted in further complications and a lack of clarity for businesses, leading to allegations of tax evasion.

The e-commerce space with its marketplace model has particularly been at the receiving end of these complaints. Recently, the Karnataka tax department pulled up Amazon for allowing sellers to register fulfilment centres as additional place of business. This led to the state cancelling the licences of many small merchants registered on Amazon. The e-commerce companies, on the other hand, complain that laws have not kept pace with new-age business models. This has also led to states such as Telangana wooing companies by promising streamlined and transparent taxation policies.

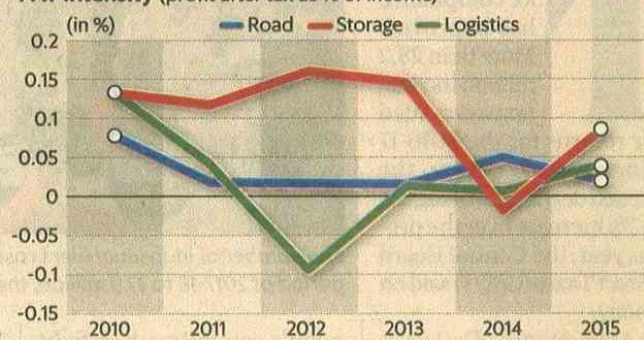
## GST: THE WAY FORWARD

For manufacturers, the goods and services tax (GST) has now replaced the multiple state VATs and the need to have a hub across all states will cease to exist. This will allow firms to redesign supply chains and centralize hub operations to take advantage of scale economies. It will also allow firms to employ efficient practices such as bulk-breaking and cross-docking from a central location. Already, Nagpur, India's "zero mile city", is looking to become the "nation's warehouse" and is witnessing increased investment from retailers and warehouse companies betting on GST transforming the nation's logistics space.

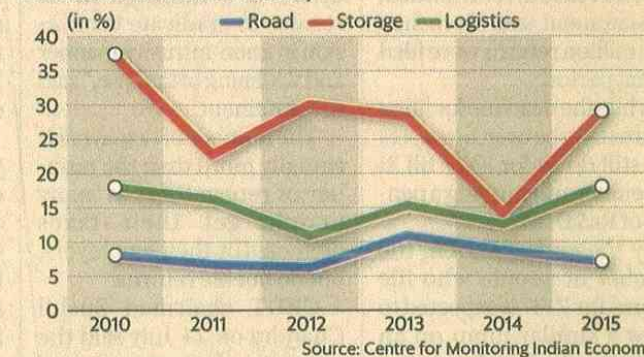
For transport services, the "reverse charge mechanism" can be levied as before but the taxpayer will not be able to claim input tax credit, as the main input cost is fuel which is outside the purview of GST. This may work to the advantage of small/medium transporters who may be unable to comply with tax filings every 20 days. But this can have an impact on businesses hiring the services of transporters and in case of service charge, being liable to pay taxes, cannot claim the input tax credit. So, there is bound to be some friction in negotiation and payment for transport services and a disruption

## Highway to profit

PAT intensity (profit after tax as % of income)



PBITDA (profit before interest, tax, depreciation and amortization as % of income)



Source: Centre for Monitoring Indian Economy

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in the industry as big players might exit pure transportation business and get into more value-added services.

Under GST, the tax on warehouse, storage and other labour services has increased from 15% to 18%. So a third-party logistics provider will now have more incentive to move towards the provision of services that have a high degree of value addition and where input tax credit can be claimed. This can result in consolidation in the storage and warehouse sector.

Ease of entry across states will reduce transportation delays with measures such as the e-way bill, but this requires streamlined IT systems and ready-to-use documentation at the entry points. From the 3PL perspective, the costs of designing a logistics network will be less complex and firms which are asset-light will be able to quickly adapt and benefit more compared to asset-heavy firms.

According to V. Ramaswamy, chief executive officer of Cargowings logistics, a leading transport solutions provider in Chennai, "GST will bring a lot of alignment of value-added services in the logistics sector. This will make way for cutting-edge investments and mergers and one will see a phenomenal increase in asset utilization and increase in operational efficiency. There will be new investment opportunities for technology-enabled mini warehouses along the highways and the sector will witness a fresh wave of technology enabled start-ups."

The logistics sector is being touted as one of the main beneficiaries of the new GST regime. Initially, there is bound to be an increase in compliance and adjustment costs as the frequency of filing returns will increase and the input tax credit will require compliance of each and every player in the entire value chain. This will result in uncertainties and affect the profitability of the sector in the short run. In the long run, operational efficiency is bound to improve. And while GST won't solve many intrinsic problems of India's transport network, it could reduce the logistics costs of companies producing non-bulk goods by as much as 20%, according to an estimate by Crisil Ltd. The impact and overall cost benefits of GST will additionally vary widely across industries.

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