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GST-Implications for the Distribution channel

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Introduction

Fiscal costs have remained a key determinant of supply chains in India, with manufacturing bases and distribution networks engineered to harness fiscal benefits. The availability of differential tax structures across geographies has remained one of the key decisional elements for structuring the supply chains, procurement patterns and distribution networks in India. With that consideration, the Goods and Service Tax (GST) stands as an inflexion point in India's fiscal landscape. It marks the transition from an existing origin-based taxation regime to a destination-based taxation regime. The introduction of GST is expected to remove the cascading effect of taxes by moving to a common tax base and subsuming various state and central taxes into Central Goods and Service Tax (CGST) and State Goods and Service Tax (SGST). The introduction of such a common tax structure will significantly impact the procurement patterns, supply chains and distribution networks of manufacturing firms. This will present both opportunities and challenges for firms doing business in India.
Taxation has always been a key area of importance for companies and channel partners. The VAT system was definitely an improvement over the earlier one in the sense that it is more transparent and curbs tax evasion to someextent, thus generating more revenue for the government. Being less cumbersome, it reduced administrative costs as also easing the taxburden on the final consumer.A major problem with VAT is the way it taxes inputs and outputs. Inputsare taxed at 4 percent and outputs at 12.5 percent. Taxing inputs andoutputs at different rates are problematic because what is input in onecase can be output in another. For instance, sugar is an input for arestaurant but for a household it is an output.2 Therefore, there is apotential tendency to avoid output tax as the tax is relatively higherthan input tax (a margin of 8.5 percent).For companies as the VAT (Value added tax) regime got implemented the first big challenge was to understand the classification of their goods into a particular tax category. Once that part was resolved it was observed that there are lots of differences in how a product category gets treated in which category by state. Here it

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is pertinent to mention the case of Memory chips. In state of J&K VAT on memory cards is taxed in 4% category where as in most of the other states it is taxed in 12.5% category. Now this creates a very genuine pricing problem for companies as the basic price of the product can't be varied accordingly and hence the issue of excise. If the company doesn't change the basic price then it causes price instability among states and hence a clear cut channel problem. It is a scenario that is tailor made for the wholesalers. Now when I say wholesaler it is important to clarify that it is to be taken as a channel that is not authorized by any company but operates only when there are price differences and encashes on these differences. This is a channel that will supply material to the authorized channel of the company the same company product but at a low price as compared to company itself. This set of transactions harms both the company and the government. Company as it shakes the faith of existing channel on company price list and company announced schemes, hence causing a channel conflict. As far as government since the basis of these transactions is tax evasion the transactions are from clean and tax evasion leads to loss to treasury.

Another area of concern with the existing VAT regime is the tendency of state governments to levy surcharges on certain product categories. The classic example is the petroleum products and alcohol leaving companies to fend for themselves and also leave the channel partners mid way.

So the GST regime will be a pleasant relief for the channel members . In this paper few points or observations about the possible impact of GST on various stakeholders in channel are discussed basis the author's own experience in corporate.

Now the Distributors can go interstate

Distribution was considered to be a local business, majorly because of taxation hassles. Now with the coming of GST and simplification of tax regime a distributor can operate in more than one states doing business for the same company in multiple states.

Less hassles for border area distributor

Distributors in border areas like Chandigarh , Dabwali can now operate in a much larger canvass as compared to earlier. A distributor in Chandigarh tricity needed to have three different warehouses to cater to Chandigarh, Panchkula and Mohali as all three had different taxation structure and needed to be treated separately whereas residents of all these three areas were coming to Chandigarh for shopping since it had the lowest taxation of all three. In case of Dabwali there are houses whose one gate of house opens in Punjab and other gate opens in Haryana. These common subset areas were breeding grounds for tax evasions and pushing the material without paying proper taxes. Similar is the case with Paonta sahib a border area of Himachal Pradesh with Utrakhand. These small townships were a major sale point for distributors of

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these areas. There are various whole sellers operating in these common subset areas who take pride in telling their tales of being able to push material through into other state during night . The simplification and unification of tax regime will make the genuine distribution a viable option and will help the companies gauge the real strength of the area and device its schemes accordingly.

Companies can do away with a requirement of multiple warehouses just because of tax implications.

A look at the distribution costs of FMCG companies clearly shows that it constitutes a sizeable 2-7% of turnover. The implementation of GST will eliminate CST. Thus companies can function and take decisions based on commercial perspectives and not the tax impact. Thus the number of warehouses required to service demand is expected to decline and the need to set up depots in less cost effective locations will be eliminated. In other words, FMCG companies will be able to optimize logistics and distribution costs in the GST Era.

Company name	Distribution costs/Sales (%)
Britannia	7%
Colgate	3%
Dabur	2%
GSK Consumer Healthcare	5%
Godrej Consumer Products	3%
Hindustan Unilever	5%
ITC	3%
Marico	5%
Nestle	5%
Procter & gamble Hygiene & Healthcare	4%
Tata Coffee	3%
Tata Global Beverages	2%
VST Industries	2%
Emami	3%

Source: ACE Equity

Not surprising that the FMCG companies are eagerly waiting for the GST roll-out. Godrej Group chairman, Adi Godrej, has said that the GST implementation will be the major growth driver for FMCG. As per the group, GST taxation system will lead to price reduction of around 4-5% across consumer categories boosting consumption. As per Marico, GST is expected to improve fiscal efficiency and enhance GDP growth rate which will favour the FMCG industry.
In Chandigarh companies are forced to have a separate warehouse because of difference in taxation and at times keeping this warehouse running is not a profitable equation for company as the cost of warehousing is more than sales generated. For a distributor based out of Chandigarh to cater to Purwanoo and Kalka is possible but he has to arrange for separate warehousing to cater to different areas.

Less price manipulations means consumer confidence in company pricing will be more.
In a simplified and unified Tax regime the price fluctuations will be less as the major reason for differential pricing today is because of tax changes. With a unified system even if an area is given certain special support by organization the outflow of goods to non special support areas will make the company rethink its pricing. When consumer is aware that there is no price difference between his neighborhood shop and retailer in a bigger town he will be a more assured customer and an improved customer confidence will lead to better sales .

Will give a boost to organized retail
Organized retail stores will be able to leverage more there advantage of centralized purchasing with the advent of GST. Since the advantage to an organized retailer lies in its Bulk buying it was not getting possible because of differential taxation structures across states. With a price and size advantage these stores will get a real push under the GST regime.

Increased Channel Conflicts
With a lot of advantages that we have discussed this is going to be a concern area for companies . In the previous point we discussed the oxygen that this new regime will provide to organized retail but at the same time it will bring the Modern retail in conflict with tradional trade when it will come to price advantage. Since the organized retailer has more purchasing power owing to its size the local retailer will be unable to match the might of the organized retailer and hence may get into a price disadvantage situation. Such a situation will be very tricky for an organization to handle will require a lot of effort on part of company to resolve the conflict.

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Delhi is big wholesale market for almost all kinds of products, even with differential tax structure the whole sellers in Delhi are influencing markets up to Madhya Pradesh and even further. A common tax regime would mean the predatory instincts will further get emboldened. This will be a serious challenge for the companies to handle .

Conclusion

GST as the FM says has the potential to add 2% to the nations GDP growth. Surely it is going to be a big thing for the distribution channels and various companies will have to find ways and means of taking advantage of this gigantic tax regime change. This regime change in long run seems to be helping the channel growth and companies also to streamline their operations across various Markets.

References

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