Mega Trends in the Indian Logistics Sector for 2015-16

Frost & Sullivan - Knowledge Partner at

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Prospects of the logistics sector in a country are dependent on factors or trends that drive or restrict growth. However, each of these factors impact different stakeholders in the logistics sector differently, and therefore, the perspectives and ways to deal with the impact of a trend would be different for each stakeholder.

This “Logistics Summit 2015: Mega Trends in the Indian Logistics Sector for 2015-16”, is a joint initiative between Frost & Sullivan and the Confederation of Indian Industries (CII) Institute of Logistics. It aims to highlight major trends that are expected to significantly impact growth prospects of the Indian logistics sector during 2015-16, and understand the perspectives of key stakeholders on how to deal with the impact of these trends.

In this context, the following four major trends or Mega Trends were identified to be covered in this summit:

1. GST Impact and Preparing for Post GST Scenario
2. Impact of Revised Land Acquisition Act on Logistics Infrastructure Growth
3. Impact of Enhancing Regional Transport Links in South Asia
4. Impact of e-commerce on Logistics Sector

_Gopal R_
_Global Vice President_
_Transportation & Logistics Practice_
_Frost & Sullivan_

_Srinath Manda_
_Program Manager_
_Transportation & Logistics Practice_
_Frost & Sullivan_
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Overview of the Indian Logistics Market and Outlook
Indian Logistics Market Size and Segmentation

The Indian logistics market recorded revenues of about US $104.10 billion in 2014, witnessing a growth of about 4.9 percent over the previous year. Transportation accounts for about 60 percent of the market revenues.

Exhibit 1: Segmentation of Indian Logistics Market, 2014

- Transportation: 60.1%
- Warehousing: 24.5%
- Freight Forwarding: 10.1%
- Value Added Logistics: 5.2%

Source: Frost & Sullivan Research

The Indian logistics market is likely to witness consistent growth of around 6-7 percent every year during the period 2014-2020 and reach revenues of about US $150-$160 billion by 2020.

Exhibit 2: Revenue Forecast for Indian Logistics Market, 2014-2020

Source: Frost & Sullivan Research
Mega Trends in the Indian Logistics Sector for 2015-16
Mega Trend 1: GST Impact and Preparing for Post GST Scenario

Trade Tax Reforms in India and the Introduction of GST

The trade tax system that prevailed in India until 2005, was described in an expert committee report as “archaic, irrational, and complex – according to knowledgeable experts, the most complex in the world”, thus needing a major overhaul.

Over the past several years, significant progress has been made to improve the trade tax structure in India, broaden the base, and rationalize rates. To address the issues with existing tax structures, several initiatives have been taken by the Government, with the first major initiative being the introduction of a Value Added Tax (VAT) System. Burden of multiple taxation existed at the Center and states prior to introduction of VAT in 2005.

Subsequent to the success of the VAT regime, the Government embarked on efforts for implementation of a much more refined and globally preferred tax system known as Goods and Services Tax (GST) in 2007.

GST is defined as a ‘nationwide uniform taxation system’ which replaces multiple taxations by central and state governments in a country. The concept is that a specific product or service would have the same level of taxation across the entire country irrespective of being manufactured and sold in different sub-national territories (states). Across the world, GST is the most popular trade tax regime practiced by over 150 countries.

Two models of GST are prevalent – one with a single level national tax system and another with two component tax structures, with one component being levied by the central government and another by state governments, but both being taxed together simultaneously as a single transaction. The single level tax system is the most prevalent system across the world. However, it is considered suitable for countries where the central government holds absolute unilateral power of administration and taxation and state (or provincial) governments depend on the central government for all resources.

Since India is a sovereign nation where both Central and State Governments have distinct administration and taxation powers awarded by the Constitution, the single level taxation system is not considered suitable, and hence the dual model of GST is being adopted by the country.

Prominent Features of India’s GST Model

The proposed GST model for India is expected to subsume (absorb or replace) most of the existing direct and indirect taxes levied by the Central and State Governments on all products and services.
Currently, power to levy service tax lies only with the Central Government, however, with GST, even State governments will be privy, so necessary constitutional amendments are being worked out to provide States with appropriate power.

The GST system works on the basis of taxing only the component of value addition at each level of goods or services supply by off-setting the tax paid already at the previous level of the value chain. Thus, it automatically incorporates a mechanism that compels every level of the value chain to ensure that the appropriate tax has already been paid in the previous level. Certain products such as petroleum and gas, alcoholic products, and farm produce are exempted from GST's purview.

The uniform GST regime in India is likely to be implemented in all likelihood by early 2016. The new Government has progressed from the efforts initiated by the previous Government and has been able to address/clear most concerns of various states whose incomes are likely to be affected due to this regime. Given that the onset of GST would require transformation of distribution (and therefore logistics) practices of most industries, both logistics service providers and users need to prepare for the change.

Such a nation-wide uniform tax regime is expected to have a profound and permanent impact on most manufacturing industries in the country and their logistics operations. As a result of this new tax model, the individual state administrative borders are expected to become nullified / irrelevant for most industries, thereby driving them towards rationalization of their logistics operations and infrastructure. This would eventually require the logistics service providers to restructure their operations and infrastructure.

**Impact of GST on Manufacturing (Logistics Service User) Industries**

In case of a majority of consumer goods industries, manufacturing plants are placed in locations or states which offer tax rebates or lowest tax structures, even though the locations are non-optimal from a geographic distribution perspective. For example, several companies have put up their production units in states such as Uttarakhand, Jharkhand, and Jammu and Kashmir. In the post GST scenario, no tax rebates or varying tax structures would be allowed across states and there would be uniform taxation across the country. As a result, manufacturing plants are likely to be placed in locations which have close proximity to raw material production hubs, and multiple transportation networks.

In the current scenario, raw materials are transported from various source hubs to manufacturing plants in select locations (as explained earlier) and finished goods are transported from these plants again to individual state warehouses spread across the country. State level distribution involves transporting goods from these warehouses to distributors/dealers (typically at district level) and finally to retailers. In the post GST scenario, raw material transportation might become minimal and finished goods
transportation is likely to be in the form of large consignments between the manufacturing plant and regional warehouses. Secondary transportation is likely to be done directly from regional warehouses to distributors or dealers (typically at district level) and is expected to comprise smaller consignments with an optimized frequency.

At present, all manufactured goods are first transported to a company’s own warehouse in each geographic region and deliveries to clients done from there with the specific region’s tax applicable for the transaction. Since the tax applicable would be same irrespective of where billing and deliveries are done, large orders are likely to be delivered directly from manufacturing plants to client locations (plants/warehouses).

Currently, companies need to have specific warehouses for each state because selling stock stored in one state to another attracts sales tax from both states. This means significantly high level of investments in assets and inventory holding costs than ideally needed. State level warehouses are likely to be replaced with regional hub level large integrated warehousing facilities, thus significantly bringing down the number of warehouses for a company. Various value added logistics functions such as packing, kitting, labeling, etc. are also likely to be performed at these warehouses.

After GST implementation, about 6-8 major regional hubs and 3-4 smaller hubs are expected to be formed as part of reorganization of overall distribution infrastructure for majority of the manufacturing industries. Each of these hubs is likely to be structured in the form of a wheel-spoke (Hub-and-Spoke model) with a city closest to the central point of the regional hub emerging as the primary distribution center for that respective hub.

On an average, the maximum boundary limit or coverage radius for a regional hub from its central location is expected to be about 500 km, considering the fact that it facilitates fulfilling goods deliveries even at the boundary level town within a day’s time. In the current scenario, covering such a long distance is not possible because of several hours lost in waiting at interstate border check posts and similar administrative establishments of each state.

Most of the consumer goods industries (including FMCG, Pharma, electronics, etc.) are expected to follow these new regional hubs for their distribution. However, industries that are highly concentrated in select locations (including automotive, minerals, metals) due to source material proximity are likely to continue their current operational model.
Impact of GST on Logistics Service Providers (LSPs)

In general, LSPs are likely to need restructuring of their assets and operations to create an optimal network and infrastructure for fulfilling changed operations of customers in the new scenario. LSPs serving any specific industry would have to realign their operations to match the restructuring of those respective industries.

At present, LSPs have warehouses located closer to the major distribution centers or manufacturing plants of key clients, even if the locations are logistically unviable. In post GST scenario, LSPs are expected to build large integrated warehouses in specific well connected ‘central geographic locations in each region’ which can be termed as logistically suitable locations.
Currently the transportation volumes are not uniformly distributed across the country for any LSP due to regulatory controls on goods transfer and usage of different LSPs for each region by the clients. The scenario of free-flowing movement of goods across the country due to GST would result in LSPs gaining larger volumes and nationwide contracts from clients.

In addition, currently most LSPs have a large share of medium sized trucks (8-16 ton carriers) in their fleet and a very low share of large truck-trailers or small trucks. To fulfill the large and long-distance consignments in the new scenario, LSPs would need a significantly larger share of heavy trucks (above 20 ton carriers), and also mini-trucks to fulfill last mile delivery efficiently.

**Expected Major Benefits and Challenges Due to GST**

Based on the potential impact of GST, a few major benefits and challenges for the logistics sector as a whole has been listed below:

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**Exhibit 4: Expected Major Benefits and Challenges for Logistics Sector Due to GST**

<table>
<thead>
<tr>
<th>Major Benefits</th>
<th>Major Challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary and secondary distribution activities might get streamlined</td>
<td>Understanding the new tax structure could be highly challenging, especially for LSPs serving multiple user industries</td>
</tr>
<tr>
<td>Interstate movement will become simplified and presume importance</td>
<td>Obtaining / establishing regional distribution hub infrastructure in optimal locations could mean high investment burden / risk</td>
</tr>
<tr>
<td>Simplified distribution network with optimal regional warehousing hubs supported by satellite facilities</td>
<td>Need to revamp fleets, get new mix of vehicles etc., could mean a large investment burden / risk</td>
</tr>
<tr>
<td>Rationalization or revamp of transportation fleets</td>
<td>Matching the realignments in transport routes and volumes of goods would be major challenge</td>
</tr>
<tr>
<td>Immense scope for optimizations of costs</td>
<td>Will lead to national level competition for smaller companies which were protected earlier</td>
</tr>
</tbody>
</table>

*Source: Frost & Sullivan Research*

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**Preparedness of the Logistics Sector for Post GST Scenario**

While the GST regime is expected to be implemented by/before end of FY 2015-16, Frost & Sullivan has found that most of the logistics users and LSPs are not prepared to deal with the post GST scenario. On the whole, only about 15 percent of the LSPs are reported to have taken some initiative to deal with the situation. LSPs with national and multi-state operations mostly comprise those who have taken some initiative in this regard.
Among logistics users, about 23 percent reported to have taken some initiative to deal with the post GST scenario. In terms of user industries, FMCG, automotive, and pharmaceuticals mostly comprise those who have taken some initiative.

Exhibit 5: Preparedness of LSPs and Logistics Users to Deal with Post GST Scenario, 2015

The low level of preparedness of both logistics service providers and user industries could prove to be a challenge for adapting to the post implementation scenario. Therefore it is recommended that comprehensive planning on the desired optimal restructuring of respective operations be done by both segments at the earliest.
Mega Trend 2: Impact of Revised Land Acquisition Act on Logistics Infrastructure Growth

Land Acquisition – The Most Prominent Challenge for Logistics Infrastructure Projects in India

The primary reason for delay of most infrastructure projects (including those from logistics sector) in India has been the challenge of land acquisition.

A report presented by the Planning Commission to the Prime Minister during November 2014 stated that 83 percent of about 707 central sector projects have sustained delays of up to 12 years, with cost overruns of nearly INR 1,90,000 crore (~ US $3.17 billion). Among these delayed projects, 274 are from railways, 118 are from roadways, 26 are from ports and inland waterways, and a few more from other segments of the logistics sector. As a result of these delays, the Government was able to realize only about 10-15 percent of its actual targeted infrastructure development in these segments. Challenge in land acquisition, and the related relief and rehabilitation issues, including adverse law and order situations in some cases, was touted as the primary reason for delay.

The Center for Monitoring Indian Economy (CMIE) outlook of February 2015 on ongoing projects in the country stated that land acquisition problems led to stalling of 11 projects during December 2014 quarter, with an estimated investment of INR 265 billion (~ US $4.42 billion).

As per a research article published by Shri J.L. Narayan, Joint Adviser, Infrastructure and Project Monitoring Division of the Ministry of Statistics and Programme, primary reason for delay of road transport and highway projects in India is land acquisition, followed by realignment of public utilities like water supply, power supply line, etc. A number of projects have suffered due to lack of proper response or support from state government authorities in resolving the issue of land acquisition.

Revisions in Land Acquisition Act

On 30th December 2014, the Central Government introduced an ordinance to effect major changes in the existing Land Acquisition, Rehabilitation and Resettlement Act 2013. Among the multiple revisions made in the Act through this ordinance, the following key revision has significant implications for the logistics sector.

Removal of the consent clause and Social Impact Assessment for five more sectors, due to which assessment and mandatory consent of 80 percent land owners will not be required. Rural infrastructure and industrial corridors are among the five sectors. In addition, public private partnership (PPP) projects where ownership of land continues to be vested with the Government are also covered in the five sectors.
Omitting the social assessment part enables the Government to surpass a very important hurdle in such projects. As per the earlier law, the assessment was meant to find out how many people will be impacted. Hence, apart from the land owner, the social group (family, associates, employees, and all those who are dependent on the land) also needed to be compensated. But the new ordinance ensures that only land owners are compensated. In addition, the case of whether the land is fertile or not will not be taken into consideration while acquiring it for these five specific sectors. So even if the land is extremely fertile, as was the case in Tata’s Singur project, it can be acquired if it fits the criterion of these five sectors.

A uniform central policy of rehabilitation and resettlement for all types of projects covered under this Act is the other notable revision. This eliminates the variations and confusions in the form of different compensations applicable based on the type of project for which land is being acquired.

**Impact of Revised Land Acquisition Act on Logistics Infrastructure**

Removal of the consent clause and Social Impact Assessment provides significant relief for developers of logistics infrastructure in rural areas, and also the developers of logistics infrastructure within industrial corridors. Further, investors participating in PPP projects would also be benefitted from this revision, and since most logistics (especially transportation) infrastructure projects are of PPP model, all the potential participants of such projects would be encouraged to take up new projects.

As a result of this revision in the Act, several delayed logistics infrastructure projects such as dedicated freight corridors, highways, private ports, and airports are expected to be completed quickly and new planned projects are expected to be launched. Other smaller logistics projects such as inland container depots, container freight stations, warehousing zones, and logistics parks are also expected to gain momentum.

A significant level of this momentum related to delayed project completion as well as new project launch is expected to be witnessed during 2015-16, thereby creating a Mega Trend for the logistics sector.
Mega Trend 3: Impact of Enhancing Regional Transport Links in South Asia

Evolution of South Asian Regional Economic Cooperation

The idea of specific regional cooperation in South Asia was first mooted in May 1980, and the formal economic and political cooperation organization in the name of the South Asian Association for Regional Cooperation (SAARC) was established on December 8, 1985. While SAARC’s key aims are to promote peace, trade, and development among its members, one of its major goals is to create a South Asian Economic Union by 2020. Establishment of the SAARC Preferential Trading Arrangement (SAPTA) in December 1995 and the South Asia Free Trade Agreement (SAFTA) framework in January 2006 have given new dynamism to the association and further stimulated intra-regional trade and integration.

Currently, the SAPTA covers over 5,000 commodities for tariff concessions within member countries. The exports within member countries, under the SAFTA have witnessed a considerable upward trend since the launch of the tariff liberalization program (TLP). As of 2014, the total value of intra-SAARC exports (in terms of freight on board) by member countries under the SAFTA has reached about US $3 billion. However, the intra-SAARC trade flows under the SAFTA are still far below the potential.
SAARC’s internal (intra-SAARC) trade as a share of its global trade is significantly low when compared to that of two other neighboring trade blocks – the Gulf Cooperation Council (GCC) and Association of South East Asian Nations (ASEAN).

Exhibit 7: Association’s Internal Trade as Share in Association’s Global Trade - Comparison between SAARC, the GCC and ASEAN, 2014

<table>
<thead>
<tr>
<th>Association</th>
<th>2014 Internal Trade Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>SAARC</td>
<td>9%</td>
</tr>
<tr>
<td>GCC</td>
<td>17%</td>
</tr>
<tr>
<td>ASEAN</td>
<td>48%</td>
</tr>
</tbody>
</table>

Source: WTO, Frost & Sullivan Research

Transportation Connectivity Issues within South Asia

South Asia’s economic integration is primarily being inhibited by the poor state of transport connectivity between member countries. Lack of cross border transport networks and constraints "at the border" and "behind the border" have tended to undermine the prospects of reaping the benefits accruing from closer economic cooperation. Despite actively pursuing regional economic integration through SAARC, almost all member countries focused only on development of the transport system in a national context, with little consideration given to cross-border issues of compatibility, uniformity of standards in infrastructure, and in acquisition of rolling stock and equipment.

Industry experts report that transit of consignments between neighboring countries that would take just 3-5 days if direct connectivity is available, currently takes about 3 to 4 weeks due to lack of such connectivity. To address this challenge, SAARC Secretariat conducted the Regional Multimodal Transport Study during 2006, to recommend ways to enhance transport connectivity among member countries through strengthened transportation, transit, and communication links across the region. The study recommended developing regional road corridors between India, Bangladesh, and Pakistan and development of modern border crossings to facilitate easy/uninterrupted movement of freight across borders.

The study also recommended developing regional rail corridors by standardizing technologies including track, rolling stock, and signaling and coordination. In addition, the study also recommended developing regional inland waterways between Bangladesh and India, which will be effective in the long term. A regional low-cost carrier connecting all key aviation hubs in member countries, primarily for cargo movement, was also recommended by the study.
The Asian Development Bank (ADB) has also been working closely with SAARC Secretariat and individual countries to promote regional transportation corridors.

**Exhibit 8: Major Regional Transport Connectivity Corridors being Promoted by SAARC**

The United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) has been working with South Asian nations over a master plan to strengthen transport connectivity within the region and also link the region to West Asia.

A two-day conference titled “Regional Policy Dialogue on Strengthening Transport Connectivity in Southern Asia” was jointly organized in November 2014, by the ESCAP and the Asian Institute of Transport Development. Policy makers and other key stakeholders from each of SAARC members participated in the conference. Their deliberations reiterated that the major cause for the current low level of trade in Southern Asia was the high cost associated with poor cross border transport connections, as well as complex and inefficient cross-border transport policies.
They also noted that poorly developed land transport infrastructure and facilitation were significant barriers to exploiting the potential of regional economic integration in Southern Asia as high transport costs were denying benefits of geographical proximity and efforts to boost intraregional trade. Poor surface transport links and lack of transit arrangements have prevented formation of regional production networks and prevented the region from leveraging its strategic location at the crossroads of Asia.

Policy makers and other stakeholders at the conference called for urgent measures to boost intraregional transport connectivity, which could greatly contribute to its overall economic growth and reduce poverty.

**Efforts to Improve Cross-Border Transportation in South Asia**

Multiple initiatives to strengthen transport connectivity under different overlapping subregional frameworks of SAARC, Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC), and South Asia Subregional Economic Cooperation (SASEC) among others are in the process. However, there is need for coordination between transport corridors being promoted by these different bodies to maximize network integration and provide a major boost to economic activity, especially in the landlocked countries of the region. For this, a comprehensive master plan on transport connectivity in Southern Asia is recommended. Such a master plan could be developed in consultation with government agencies, regional and subregional organizations, multilateral development banks, and other key stakeholders.

**Exhibit 9: Major Regional Transport Projects Initiated by SAARC Secretariat during 2010-2014**

<table>
<thead>
<tr>
<th>Major Benefits</th>
<th>Project Name</th>
<th>Sector</th>
<th>Year of Approval</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh</td>
<td>SASEC Railway Connectivity: Akhaura-Laksam Double Track Project</td>
<td>Transport/Rail</td>
<td>2014</td>
</tr>
<tr>
<td>Bhutan</td>
<td>SASEC Road Connectivity Project</td>
<td>Transport/Road</td>
<td>2014</td>
</tr>
<tr>
<td>India</td>
<td>SASEC Road Connectivity Investment Program: Project 1</td>
<td>Transport/Road</td>
<td>2014</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>SASEC Railway Connectivity Investment Program</td>
<td>Transport/Rail</td>
<td>2013</td>
</tr>
<tr>
<td>Nepal</td>
<td>SASEC Road Connectivity Project</td>
<td>Transport/Road</td>
<td>2013</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>SASEC Road Connectivity Project</td>
<td>Transport/Road</td>
<td>2012</td>
</tr>
<tr>
<td>Regional</td>
<td>SASEC Transport Logistics and Trade Facilitation Project</td>
<td>Transport/Road</td>
<td>2011</td>
</tr>
<tr>
<td>Regional</td>
<td>Regional Transport Development in South Asia</td>
<td>Transport</td>
<td>2010</td>
</tr>
<tr>
<td>Nepal</td>
<td>Subregional Transport Enhancement Project</td>
<td>Transport/Road</td>
<td>2010</td>
</tr>
</tbody>
</table>

*Source: SAARC Secretariat*
Efforts are being made by member countries to develop cross-border transport and integrated border management including development of the integrated check posts (ICPs), authorized economic operator programs, customs automation and use of ICT, entering into bilateral and subregional transport arrangements, and accession to international conventions. Development of a South Asian regional railway network is gaining importance, as one of the most economical and environmentally sound modes for domestic and regional transit.

Findings of preliminary assessments found that inland connectivity through railway corridors could help to substantially reduce time and costs of intra-regional trade. For example, extending the Istanbul-Tehran-Islamabad container train corridor to other parts of Southern Asia could reduce freight costs between South and West Asia by up to 44 percent and reduce the time taken for shipments by almost half.

Finalization of SAARC Railways and Motor Vehicles Agreements and their likely endorsement is expected in 2015-16 after the reaffirmed need at the 2014 SAARC Summit. This could provide a huge boost for the competitiveness of intraregional trade. In addition to these, in the year 2013, the Indian and Bangladeshi governments launched another new rail link between the two countries from Agartala (Tripura, India) to Akhaura (Bangladesh). This would provide rail connectivity between India’s North Eastern states and Bangladesh, and is expected to be significantly helpful in cargo transportation.

The initiatives for enhanced regional economic cooperation and cross-border transportation networks in South Asia are expected to gain further momentum in 2015 and thereby, compel the logistics sector to develop infrastructure and operations to tap opportunities from regional services.

**Impact of India’s South Asian Regional Trade on its Logistics Sector**

Key products / commodities traded by India with its neighbors include agricultural produce, food products, textiles and garments, consumer goods, electronics, automotive, and engineering goods. Average logistics cost for all these products is estimated to be in the range of 11-12 percent of their sales value. Accordingly, the value of logistics market opportunity from India’s South Asian regional trade as of 2014 was about US $2.3 billion. This involved facilitating the movement of goods across borders and earning revenues from the services of transportation, warehousing, freight forwarding, and value-added services related to this goods movement.

The largest share of this opportunity is in terms of transportation (especially road transportation) combined with freight forwarding since India has road links with Pakistan, Bangladesh, Nepal, and Bhutan. With Sri Lanka and Maldives, the transportation is primarily by sea and a small share by air. Ongoing efforts to add alternate modes such as inland water transport and coastal shipping with Bangladesh are expected to open up more opportunities
in goods transportation. In addition, enhanced use of railways with Bangladesh and Pakistan can also open up additional opportunities in transportation.

Warehousing service opportunities exist mainly in the form of bonded warehousing at ports as well as container freight stations serving the country’s trade with SAARC members. Value-added services represent a very small share as of now. However, both warehousing and value-added logistics services are likely to witness significant opportunities if the targeted economic union is realized.

Enhanced trade and cultural ties and facilitation of a conducive business environment that provides market access to a neighboring country’s logistics service providers by SAARC members, can open immense opportunities for the logistics sector within the region. Such initiatives can lead to regional tie-ups among logistics companies in member countries or even industry consolidation, thereby creating large logistics service companies in South Asia.

At the current growth rate, the logistics market opportunity from India’s South Asian trade is likely to reach about US $5.18 billion by 2020. However, if economic ties are improved by efforts of the new Government, the logistics market opportunity from the country’s South Asian regional trade is likely to reach around US $6.5 billion.
Mega Trend 4: Impact of e-commerce on Logistics Sector

Rise of e-commerce in the Indian Retail Sector

The Indian retail sector size in FY 2014 was about US $450 billion. Traditional retailing still occupies around 93 percent of the total organized retail sector in India. Online retailing currently occupies just around 7 percent of the pie, however, this sector is witnessing a strong growth and receiving heavy investments.

Urbanization is leading to expansion of cities creating the need for a wider retail footprint around the country, and consumers are increasingly moving from just shopping for needs, to looking for an experience while they shop. This will also push for growth of organized retail formats around the country, consequently occupying a share of around 20 percent of the total retail pie by 2020, from the current 7.5 percent.

Online retailing is the current hotbed in the Indian retail landscape, gaining significant limelight during the past few months with large scale investments and promotional activities to capture the consumer attention as well as the shopping revenues. The growth with planned investments upwards of US $3 billion this year. While online retailers are competing on prices on the one hand, on the other, they are competing on shorter delivery cycles and service coverage.

Exhibit 10: Share of Organized Sector and Online Retailing, 2014

Logistics market for the retail sector was about US $27 billion as of 2014. Transportation contributed the largest share of this market followed by warehousing.
Logistics Practices of the e-commerce Industry

The logistics practices of the e-commerce industry are significantly different from the traditional business channels. The value chain itself is significantly shorter than traditional business channels and the logistics dynamics playing on this industry are primarily driven / triggered by a customer’s purchase / transaction on the e-commerce website. In that context, this is a pull based value chain unlike the push based value chain employed in traditional business channels.

Exhibit 11: Traditional Business Channels’ Value Chain
– Primarily Push Based System

Exhibit 12: E-commerce Value Chain – Primarily Pull Based System

Source: Frost & Sullivan Research
Unlike a traditional or off-line retail distribution chain of a product in which the customer can purchase only a limited number of products that are already physically present in the sale point, the online customer can seek to purchase a product listed by a vendor from any location across the country/world. And the purchased product has to be delivered within the committed period that calls for efficient routing of the consignment from seller to customer and optimal mix of multiple transport modes to ensure the timely delivery. Further, the off-line customer purchases the product only after seeing/experiencing the product so there is very little scope for returns or exchange, unlike in case of online customers. This calls for having an extremely efficient reverse logistics network and capability with both the e-retailers and their logistics service providers.

Both the e-retailers and their logistics service providers need to have a very well integrated (seamless) communication system and technology infrastructure along with the physical logistics infrastructure to deal with this dynamic nature of the business. Express transportation and time definite transportation services are a default need of this industry. Lean warehousing with a high efficiency of inventory holding and turnover is also a default expectation of logistics service users of this industry. In addition, usage of value added logistics services such as packaging, labeling, bundling, etc. is significantly higher than traditional channels. Further, premium logistics service features such as continuous consignment visibility, flexible delivery times, end-to-end reverse logistics flow, are also considered as basic services by industry participants.

This calls for engaging large scale logistics service providers with nation-wide (and if possible world-wide) operational network and capabilities to handle diverse product range and shipment sizes. Organized LSP usage is reported to be relatively high at about 45 percent in this industry, almost three times the level reported to be used in the overall retail industry. Some of the unique infrastructure needs for LSPs for this segment include a fleet of mixed vehicles ranging from two wheelers to light commercial vehicles, well positioned warehouses in close proximity to consumer clusters, and, technology enabled visibility. This visibility is to be made available to all participants in the value chain, including the consumers.

**Outlook for e-commerce and Impact on Logistics Sector**

Organized retail companies are looking to improve in areas relating to supply chain efficiencies and inventory management. This will open doors for LSPs to support in creation of new and innovative logistics and supply chain models. Considering the dynamic and high technology dependent operations, the online retail segment needs to make supply chain management models much more efficient and advanced than those of organized retailers.

The e-commerce segment is poised for strong growth in India, with online retailers competing not only on product price, but also on shorter delivery times, creating opportunities for bespoke express logistics services and a host of value added services.
Some of the key characteristics of the logistics services for e-commerce sector are network reach, timely express delivery, efficient sourcing, standard packaging practices to facilitate easy and secure shipping, ability to service a high number of stock keeping units (SKUs) and multiple modes of payment collection. The versatility and agility of this sector presents unique opportunities for innovative value-added services that can be offered at various echelons of the logistics delivery value chain.

Exhibit 13: Key Parameters of LSP Performance for Organized and Online Retail Segments in India, 2014

One the key attributes of an LSP serving this sector is competent representation of the manufacturer and online retailer, both at the B2B and B2C end. This is critical in this industry, owing to the fact that the LSP is ultimately the only physical point of contact with the customer in what is otherwise a purely virtual transaction. Furthermore, it is critical for LSPs working for this segment to be well funded with access to reasonable resources of working capital.

Frost & Sullivan opines that given the typical consignment sizes, volumes, and demanding delivery schedules, LSPs need to leverage internal business intelligence and modern technology based analytics initiatives to optimize the use of their resources and consequently offer better services.
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Frost & Sullivan (I) Pvt Ltd.,
ASV Hansa, No. 53
Greens Road, Thousand Lights
Chennai - 600 006
(INDIA)
P: +91 44 61606666
F: +91 44 42300369
www.frost.com

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For information regarding Frost & Sullivan’s whitepaper, please write to:
Srinath Manda
Program Manager - Transportation & Logistics Practice, Frost & Sullivan
M: +91-9884872788 | P: +91-44-66814443 | E: srinathm@frost.com

Priya George
Corporate Communications - Frost & Sullivan
P: +91-44-66814414 | E: priyag@frost.com

CII Institute of Logistics Contacts
K V Mahidhar
Head – CII Institute of Logistics
P: +91-44-42928900 | E: k.v.mahidhar@cii.in

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