

# EFFECT OF GOODS AND SERVICES TAX ON FMCG SECTOR

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## Abstract

GST is one of the most critical tax reforms in India implemented after a 17 year long journey. India is the hub of taxes where people pay many taxes which create confusion for them. At present, the taxation system in India is divided into two: direct taxes and indirect taxes. Goods and Services Tax is an umbrella term for all the indirect taxes in the country. The motto for GST is 'One Nation, One Market'. It is expected to remove the burden of existing indirect tax system and play an important role in the growth of our nation. Fast-moving consumer goods (FMCG) sector is the 4th largest sector in the Indian economy with Household and Personal Care accounting for 50 per cent of FMCG sales in India. Growing awareness, easier access and changing lifestyles have been the key growth drivers for the sector. The research paper tries to examine the effect of GST on the FMCG Sector. The FMCG sector is experiencing significant savings in logistics and distribution costs as the GST has eliminated the need for multiple sales depots.

**Keywords:** Goods and Services Tax, Fast Moving Consumer Goods, logistics.

## I. INTRODUCTION

GST is one of the most critical tax reforms in India implemented after a 17 year long journey. India is the hub of taxes where people pay many taxes which create confusion for them. At present, the taxation system in India is divided into two: direct taxes and indirect taxes. Goods and Services Tax is an umbrella term for all the indirect taxes in the country. GST is one of the most critical tax reforms in India which has been long awaiting decision. It is a comprehensive tax system that will subsume all indirect taxes of State and Central Governments and whole economy into seamless nation in national market. The motto for GST is 'One Nation, One Market'. It is expected to remove the burden of existing indirect tax system and play an important role in the growth of our nation. GST includes all indirect taxes which will help in growth of economy and proves to be more beneficial than the existing tax system. Fast moving consumer goods (FMCG) is the 4th largest sector in the Indian economy. There are three main segments in the sector – food and beverages which accounts for 19 per cent of the sector, healthcare which accounts for 31 per cent and household and personal care which accounts for the remaining 50 per cent.

The FMCG sector has grown from US\$31.6 billion in 2011 to US\$ 49 billion in 2016. The sector is further expected to grow at a Compound Annual Growth Rate (CAGR) of 20.6 per cent to reach US\$ 103.7 billion by 2020.

Accounting for a revenue share of around 60 per cent, urban segment is the largest contributor to the overall revenue generated by the FMCG sector in India and recorded a market size of around US\$ 29.4 billion in 2016-17. Semi-urban and rural segments are growing at a rapid pace and accounted for a revenue share of 40 per cent in the overall revenues recorded by FMCG sector in India. The rural FMCG market in India is expected to grow at a CAGR of 14.6 per cent from US\$ 29 billion in 2016 to US\$ 100 billion by 2020.

Growing awareness, easier access, and changing lifestyles are the key growth drivers for the consumer market. The Government of India's policies and regulatory frameworks such as relaxation of license rules and approval of 51 per cent Foreign Direct Investment (FDI) in multi-brand and 100 per cent in single-brand retail are some of the major growth drivers for the FMCG market.

## II. SCOPE OF THE STUDY

The Retail market in India is estimated to reach US\$ 1.1 trillion by 2020 from US\$ 672 billion in 2016, with modern trade expected to grow at 20 per cent - 25 per cent per annum, which is likely to boost revenues of FMCG companies. In 2016-17, revenue for FMCG sector have reached US\$ 49 billion and is expected to grow at 9-9.5 per cent in FY18 supported by expectations of the total consumption expenditure reaching nearly US\$ 3,600 billion by 2020 from US\$ 1,469 billion in 2015. Direct selling sector in India is expected to reach Rs 159.3 billion (US\$ 2.5 billion) by 2021, if provided with a conducive environment through reforms and regulation.

The government has allowed 100 per cent Foreign Direct Investment (FDI) in food processing and single-brand retail and 51 per cent in multi-brand retail. This would bolster employment and supply chains, and also provide high visibility for FMCG brands in organised retail markets, bolstering consumer spending and encouraging more product launches. The sector witnessed healthy FDI inflows of US\$ 12.60 billion, during April 2000 to September 2017. Some of the major initiatives taken by the government to promote the FMCG sector in India are as follows:

- In the Union Budget 2017-18, the Government of India has proposed to spend more on the rural side with an aim to double the farmer's income in five years; as well as the cut in income tax rate targeting mainly the small tax payers, focus on affordable housing and infrastructure development will provide multiple growth drivers for the consumer market industry.
- The Government of India's decision to allow 100 per cent Foreign Direct Investment (FDI) in online retail of goods and services through the automatic route has provided clarity on the existing businesses of e-commerce companies operating in India.

- With the demand for skilled labour growing among Indian industries, the government plans to train 500 million people by 2022 and is also encouraging private players and entrepreneurs to invest in the venture. Many governments, corporate and educational organisations are working towards providing training and education to create a skilled workforce.
- The Government of India has drafted a new Consumer Protection Bill with special emphasis on setting up an extensive mechanism to ensure simple, speedy, accessible, affordable and timely delivery of justice to consumers.
- The Goods and Services Tax (GST) is beneficial for the FMCG industry as many of the FMCG products such as Soap, Toothpaste and Hair oil now come under 18 per cent tax bracket against the previous 23-24 per cent rate.

### III. OBJECTIVES OF THE STUDY

The main objectives of the study include:

- To examine the growth of FMCG sector in India.
- To assess the effect of GST on FMCG sector.
- To recommend suggestions for the growth of FMCG sector.

### IV. METHODOLOGY OF THE STUDY

The research paper tries to examine the effect of GST on the FMCG Sector. The study is undertaken with the help of secondary sources. The data has been collected from various published sources, online databases etc.

### V. ANALYSIS

The data collected through various published sources is analysed. The analysis include the rate of taxes applicable on FMCG products, growth of FMCG Sector in India especially the rural FMCG market.

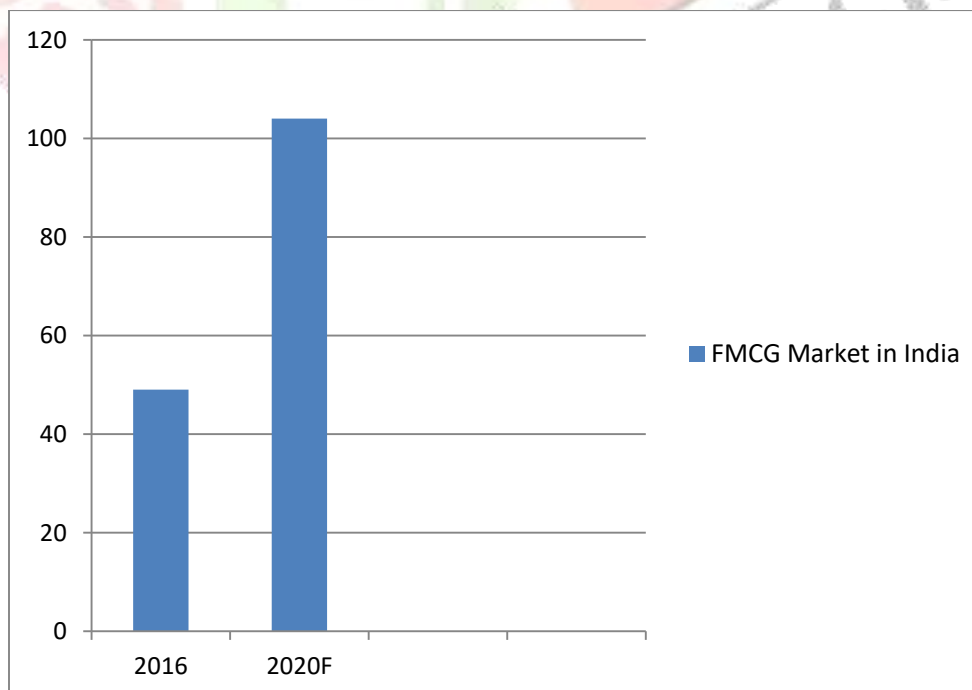
**Table no.1 showing the Rates of Tax for FMCG Products**

Product	Previously taxed at	Currently taxed at	Companies impacted
Detergents	23%	28%	HUL, P&G, Jyothy Laboratories
Shampoo	24-25%	28%	HUL, P&G, Dabur, Himalaya, Patanjali
Sanitary napkins	10-11%	18%	P&G Hygiene and Health Care

Skincare	24-25%	28%	HUL, Dabur, Himalaya, Patanjali
Hair dyes	23-28%	28%	Godrej Consumer Products
Ayurvedic medicine	7-10%	12%	Dabur, Emami
Toothpastes, soaps, hair oil	22-24%	18%	Colgate-Palmolive, HUL, P&G
Paints	25-26%	28%	Asian Paints, Berger Paints, Nerolac
Branded paneer	3-4%	5%	Nestle, Mother Dairy
Butter, ghee, cheese	4-5%	12%	Amul, Nestle, Mother Dairy

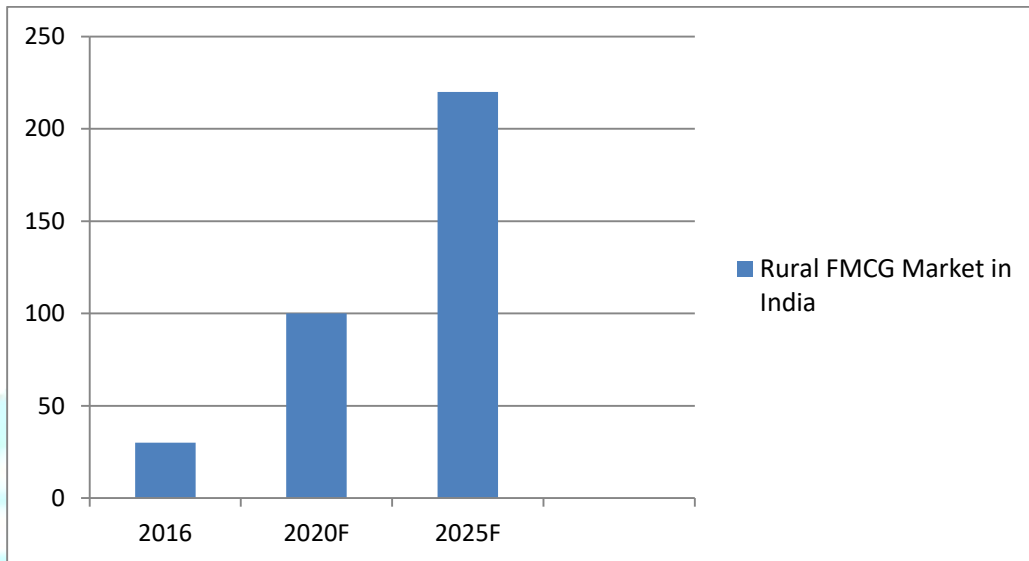
The above table shows the various rates of taxes prevailed for commodities in the FMCG sector and the revised rates applicable after the implementation of GST. The total current tax rate for the FMCG industry is around 22-24 percent. Under GST, the tax rate comes to an average of 18-20 percent.

**Table no. 2 showing the growth of FMCG Market in India**



FMCG market in India is expected to grow at a CAGR of 20.6 percent and is expected to reach US\$ 103.78 billion by 2020 from US\$ 49 billion in 2016. The favorable demographics and rise in income level will definitely boost FMCG market.

**Table no. 3 showing the Rural FMCG Market in India**



The rural FMCG market in India is expected to grow to US\$ 220 billion by 2025 from US\$ 29.4 billion in 2016. A Rise in rural consumption will drive the FMCG market

**Figure no. 1 showing the Rural FMCG Market in India**



The figure depicts the growth of rural FMCG market in India and is expected to reach US\$ 100 billion in the year 2020.

VI. **FINDINGS:** The major findings based on the objectives of the study are-

1. FMCG market in India is expected to grow at a CAGR of 20.6 percent and is expected to reach US\$ 103.78 billion by 2020 from US\$ 49 billion in 2016. The favorable demographics and rise in income level will definitely boost FMCG market.
2. GST has tremendous effect on the FMCG sector. The major highlights in the FMCG sector after the implementation of GST are:-

- **Reduction in logistics costs:** The FMCG sector will benefit from GST by saving a considerable amount of expenses on logistics. Distribution costs for the FMCG sector currently amount to 2-7 percent of the total cost, but are expected to drop to 1.5 percent after implementation of GST software. Due to the smoother supply chain management in regards to paying tax, claiming input credit, and removing CST under the GST regime, there will be a cost reduction in terms of transportation and storage of goods. The reduction in taxes and distribution costs should enable companies to lower prices on consumer goods.
- **Increase in effective tax rates:** Aerated beverages have been placed in the highest tax slab of 28 percent and will now attract an additional tax of 12 percent. Beverage companies have said the effective tax rate of 40 percent on sweetened aerated water and flavored water under GST is against the stated policy of maintaining parity with the existing weighted average tax, which is significantly below 40 percent. "This increase will have a negative ripple effect and hurt the entire ecosystem of farmers, retailers, distributors, and bottlers in India. This increase in tax will further limit the growth of the beverage industry," said the Indian Beverage Association (IBA) in a statement.

3. New Goods and Service Tax (GST) would simplify tax structure. It will be reflected in the following aspects:

**a. SUPPLY CHAIN STRUCTURE**

- Introduction of GST as a unified tax regime will lead to a re-evaluation of procurement and distribution arrangements.
- Removal of excise duty on products would result in cash flow improvements.
- The rate of GST on services is likely to be 16 per cent and on goods to be 20 percent.

**b. CASH FLOW**

- Tax refunds on goods purchased for resale implies a significant reduction in the inventory cost of distribution.
- Distributors are also expected to experience cash flow from collection of GST in their sales, before remitting it to the government at the end of the tax filing period.

### c. PRICING and PROFITABILITY

- Elimination of tax cascading is expected to lower input costs and improve profitability.
- Application of tax at all points of supply chain is likely to require adjustments to profit margins, especially for distributors and retailers.

### d. SYSTEM CHANGES AND TRANSITION MANAGEMENT

- Changes need to be made to accounting and IT systems in order to record transactions in line with GST requirements and appropriate measures need to be taken to ensure smooth transition to the GST.
- It is estimated that India will gain US\$ 15 billion a year by implementing the Goods and Services Tax.

## GROWTH OPPORTUNITIES IN THE INDIAN FMCG INDUSTRY

- 1. Rural Markets** - Leading players of consumer products have a strong distribution network in rural India; they also stand to gain from the contribution of technological advances like internet and e-commerce to better logistics.
  - ♣ Rural FMCG market size is expected to touch US \$220 billion by 2025
- 2. Innovative products** - Indian consumers are highly adaptable to new and innovative products. For instance there has been an easy acceptance of men's fairness creams, flavoured yoghurt, cuppa mania noodles, gel based facial bleach, drinking yogurt, sugar free Chyawanprash.
- 3. Premium Products** - With the rise in disposable incomes, mid and high income consumers in urban areas have shifted their purchase trend from essential to premium products.
  - ♣ Premium brands are manufacturing smaller packs of premium products.
- 4. Sourcing base** - Indian and multinational FMCG players can leverage India as a strategic sourcing hub for cost-competitive product development and manufacturing to cater to international markets.
- 5. Penetration** - Low penetration levels offer room for growth across consumption categories
  - ♣ Major players are focusing on rural markets to increase their penetration in those areas
- 6. Online FMCG** - It is estimated that 40 percent of all FMCG purchases in India will be online by 2020, thereby making it a US\$ 5-6 billion business opportunity.

## VII. Conclusion

Rural consumption has increased, led by a combination of increasing incomes and higher aspiration levels; there is an increased demand for branded products in rural India. On the other hand, with the share of unorganized market in the FMCG sector falling, the organized sector growth is expected to rise with increased level of brand consciousness, also augmented by the growth in modern retail. Another major factor propelling

the demand for food services in India is the growing youth population, primarily in the country's urban regions. India has a large base of young consumers who form the majority of the workforce and, due to time constraints, barely get time for cooking. Online portals are expected to play a key role for companies trying to enter the hinterlands. The Internet has contributed in a big way, facilitating a cheaper and more convenient means to increase a company's reach. There are some instances where the tax rate under GST is higher than the present tax rates, and in such cases, several dealers could increase their stock levels in the run up to GST. On the other hand, in those cases where the GST rate is lower than the current tax rates, dealers would try to keep minimum stock and dispose of non-moving stock before the onset of GST.

Since different products are taxed at different rates, on a macro level, the average tax and the final prices that the end customer ends up paying will average out, with some products becoming more expensive and others becoming cheaper. Ultimately GST impacts the FMCG sector by readjusting tax brackets and reducing distribution costs for various companies. Some companies will "gain" with lower taxes and distribution costs, and thus may respond by increasing product volume and lowering prices, while others may "lose" with higher taxes, and thus need to compensate by increasing prices. The FMCG sector is experiencing significant savings in logistics and distribution costs as the GST has eliminated the need for multiple sales depots.

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