BRACE FOR IMPACT: GST – THE NIELSEN VIEW

FMCG market recoups after demonetisation but GST shifts the goal post again

The Indian FMCG industry has been faced with black swan events in recent times, which might prove to be obstacles for some and opportunities for others. The demonetisation announcement of Nov 8th saw 86% of the currency exit the market overnight. However, resilient Indian consumers, manufacturers and trade in general adjusted rapidly, resulting in a timid impact of around 1.5% on overall FMCG sales in the months of November and December 2016. Cushioning the fall was the stock level in trade pipelines that continued to feed the robust consumer demand, despite the temporary drop in shipments.

Notwithstanding the constant flux, the FMCG industry has continued to grow well with manufacturers and retailers adapting to change with nimbleness. There has been widespread growth in the FMCG sector across all population strata. The macroeconomic trends also seem to be in the same direction with prediction of a good monsoon, low food inflation levels, the 7th Pay Commission announcement of a 23.5% (approx.) hike in Income for central government employees and pensioners and higher outlay commitments for MGNREGA.

GOODS AND SERVICES TAX

Economists and business strategists agree that the GST will increase compliance with tax regulations. The GST mechanism has a self-policing impact, so the entire value chain will be incentivised to be GST-compliant.

Of interest is the short-term impact, the medium-term (“settling-in” period) and the long-term steady state.

In the long-term, with uniform taxation for the whole country, inter-state movement of goods will be facilitated, resulting in a major change in sourcing and supply chain infrastructure and consequently, greater efficiencies.

The new regime is likely to improve efficiencies and lower cost of production for a majority of FMCG products. However, the unorganised market and the wholesale sector are likely to face challenges during the implementation in the short term.

ARE WE ALREADY WITNESSING A PRE-GST IMPACT?

With the GST rates announced for most FMCG products, manufacturers are now anxious to know the input tax credit norms. The possible loss of tax on the ‘stock in pipeline’ was a trade concern, which is leading to some destocking across multiple FMCG categories.

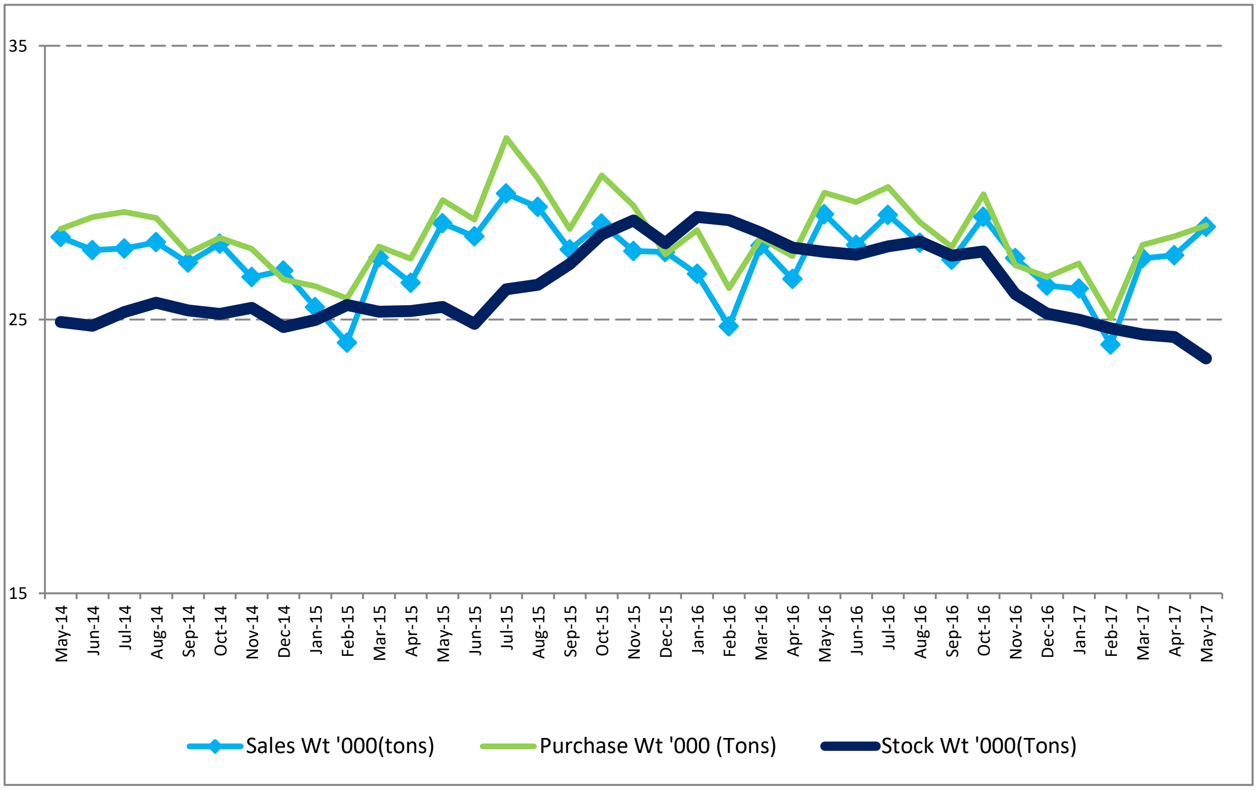
Nielsen Retail Measurement Services (RMS) has observed a lower average age of stock than a year ago, on retailers’ shelves in Q1 2017, calculating from the month of production to the current date. For instance, the indexed age of stock for laundry was at 81% of the category average.

This lower age of stock indicates that distributors and retailers are holding leaner supply as the front end awaits clarity on the impact of GST on pricing, and its implementation at the ground level, the latter being key to avoiding major disruptions to trade.

Consumer demand did not drop significantly during demonetisation. Leading to the lesson that manufacturers and trade should continue to build supply to meet the demand and steal share.

During this time, manufacturers should keep in mind that GST-compliance for wholesalers might be more challenging than direct trade, making it important to support them to ensure that the trade pipeline remains at healthy levels. Similarly, organised trade channels like ecommerce and modern trade should continue to be backed. Learning from demonetisation suggests derisking the total Channel play by planning for higher throughput through direct distribution and MT.

GRADUAL DECLINE IN STOCK LEVELS FROM JAN 2017, WHILE SALES REMAIN STRONG.



Representative category illustration
Source: Nielsen

Here are Nielsen's points of view on likely scenarios in pre-GST and post-GST implementation:

IMPACT POST-GST IMPLEMENTATION: NIELSEN VIEW

PRE GST IMPLICATIONS	SHORT-TERM	MEDIUM-TERM	LONG-TERM
LOWER TRADE PURCHASES	**STOCK AVAILABILITY CHALLENGES**	**DEMAND SIDE/ (PULL) VOLUME DRIVEN GROWTH**	**SUPPLY SIDE(PUSH)**
Lower pipeline Stock in anticipation of lower prices post GST	Possible distribution issues as supply chain constraints happen	Lower prices should induce a growth in consumption	**Increased Marketing Spends**
	Lower prices (may be through high promotions for relevant categories)	"Commodity to branding move", to accelerate branded foods segment	Reduced tax outlay getting reinvested in marketing and innovation. Additional investment in Trade marketing.
	Manufacturers are likely to pass on benefits of favourable GST to Consumers	Established Players will have a level playing field due to better tax compliance among local/ regional Players	**More Efficient Channel Management**
			Consolidated logistics spends because of fewer intermediaries reinvested in trade schemes. Likely fewer intermediaries as well lower age of stock in urban markets.

CATEGORY PRICE SENSITIVITY CAN PROVIDE A GLIMPSE OF WHAT TO EXPECT

Using meta-analysis on price elasticity across various FMCG categories and pairing it with the net tax change due to new GST rates we draw out scenarios below.

Categories with net tax increase

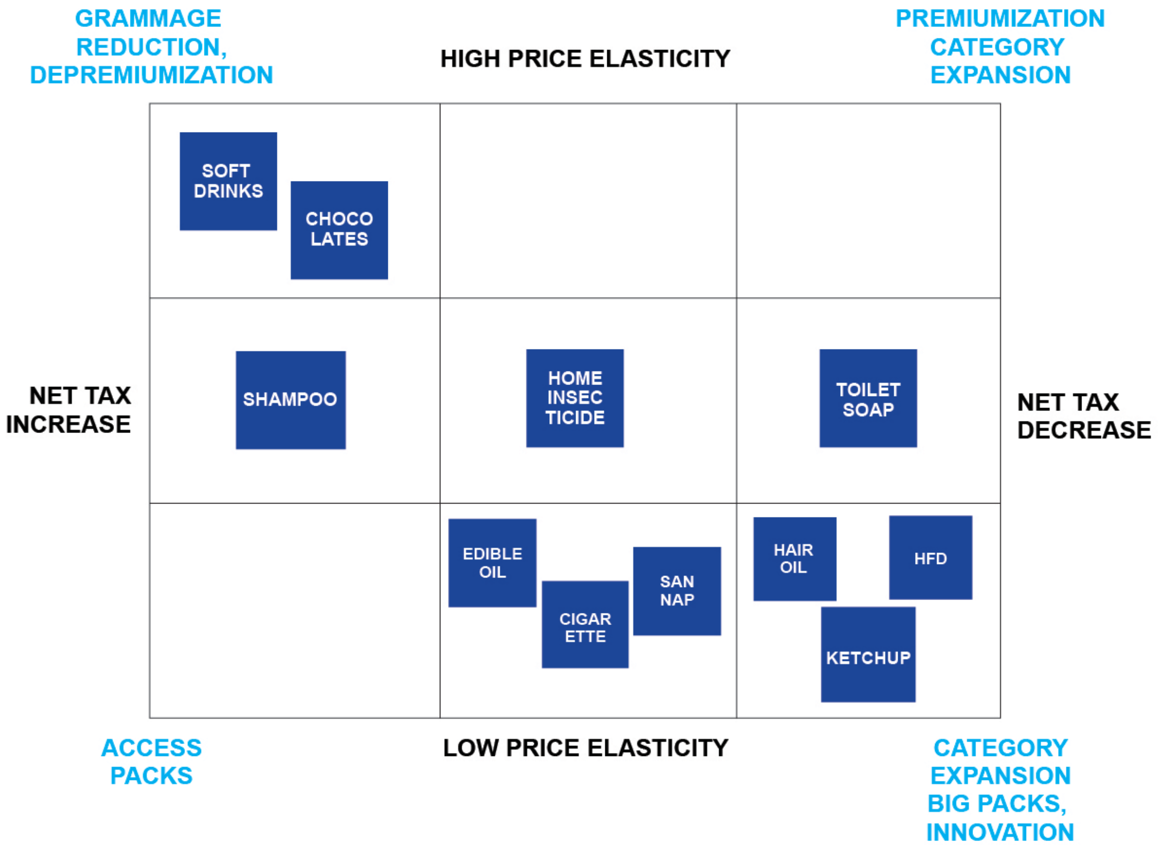
For price-sensitive categories like Soft Drinks and Chocolate, which face a net tax increase, manufacturers would need to work with consumption occasions, grammage or access pack innovations. At the same time, there could be a shift within the price tiers resulting in the squeezing of the top tier.

Categories with net tax decrease

- Categories with some price elasticity like Toilet soaps might see an opportunity for premiumisation and packaging innovations, including multi-packs, while keeping within the standard pack guidelines.
- Categories with relatively low price elasticity like the Hair Oils could witness category upgradation. In this category, consumers frequently use unbranded oils, and the drop in taxes could result in consumers moving to branded oil as the price-gap reduces.

While categories will play out differently depending on their particular dynamics, manufacturers should mindful of anti-profiteering clauses and standard pack norms, while changing gears.

PRICE ELASTICITY VS. NET TAX CHANGE



On X Axis: Net tax Change: Net tax decrease is where the taxes in GST regime are less than previous total taxes applied, whereas net tax Increase is where the tax in GST regime is more than before.
On Y Axis: Price Elasticity - this indicates how sensitive the consumers are to changing prices in this category. Low elasticity is low price sensitivity.
Source: Nielsen

These are our measured hypotheses based on the likelihood of various scenarios in different categories, price points and operational efficiencies. Success would lie in assessing the situation quickly and adapting swiftly to gain that crucial early competitive advantage.

ABOUT NIELSEN

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