Consumer Markets

Union Budget 2016

Post-Budget sectoral point of view

#Budget2016 | #KPMGIndiaBudget

http://www.kpmg.com/IN/budget2016

Table of contents

Context

Where we are

The fundamentals of the Indian economy have remained positive in a subdued global economic environment. The International Monetary Fund (IMF) opines that India's GDP can grow by 7.3 per cent in FY2015-16, compared with 6.3 per cent for China and an average of 4.3 per cent for emerging markets.[1] Consumer inflation continues to remain below 6 per cent due to the decline in crude oil and commodity prices along with tighter monetary controls.[2]

However, despite these factors, FY2015-16 did not witness the much anticipated revival of demand in the consumer goods sector in India. A weak monsoon for the second year in a row along with untimely rains led to a slowdown in rural demand, especially in the second quarter of FY2015-16, which in turn impacted the top-line growth of companies in the consumer goods sectors. This was apparent especially among the Fast Moving Consumer Goods (FMCG) companies who depend on the rural market for about one-third of their sales.[3] This meant that for a second consecutive year, several FMCG companies saw a low growth in demand. On the other hand, low commodity prices have helped companies maintain and even improve their margins.

Over the past few months, the government has looked to address these challenges faced by the rural sector with the Pradhan Mantri Fasal Bima Yojana (PMFBY), announced in January 2016,[4] which is a move to de-risk farming. In retail, the government announced changes to the FDI policy in November 2015 with the exemption of the local sourcing clause in single-brand retail on a case-by-case basis, especially in case of high-tech products,[5] allowing single-brand retailers to conduct e-commerce transactions.[6]

Growth expectations

Renewed focus on agriculture and rural sectors by the government is expected to increase rural disposable income. In addition, the coming year is expected to have a normal monsoon,[5] which is a key factor governing the demand of FMCG products, especially for the rural markets. These factors are expected to help rural consumption recover by the beginning of FY2017-18. As a result, FMCG companies are expected to renew their focus on rural markets after the slump experienced this year.

The outlook for fuel prices for FY2017-18 is positive, with crude oil prices expected to stay below USD40 per barrel.[7] The continuing low fuel prices are expected to have a positive impact on the prices of commodities, as well as reduce manufacturing and logistics costs for FMCG companies, which are expected to help improve margins and keep costs under control. On the demand side, lower fuel prices are expected to help bring down inflation and, thereby, increase consumer spending.

The implementation of the Seventh Pay Commission's recommendations is also expected to propel consumer demand. It is estimated that the consumption boost to the economy could be as high as USD9 billion,[8] and could have a positive impact on the sales for the retail and FMCG sectors.

The revised Foreign Direct Investment (FDI) policy on single brand retail is expected to attract global brands in the consumer electronics category, as well as allow brands in other categories to expand their footprint through their own e-commerce retail operations. In addition, the relaxed sourcing are likely to make it easier for retailers to start their operations, and we could see some major retailers start their operations in FY2017-18. As a result, investments in the retail sector in FY2017-18 are expected to further pick up pace after slowing down in FY2016-17.

The premium and luxury consumer goods segment is expected to benefit from the revival in consumer demand. Many categories such as premium and luxury chocolates, fine wines and premium liquor, designer footwear and apparel are looking at increasing their penetration into tier-II and smaller cities through online and other channels to make up for the lack of quality retail space available. A weakening Chinese economy and the growing demand for these products in India is expected to result in more global premium and luxury brands entering the Indian market in 2016. Domestic companies are expected to respond by launching their own product lines in this segment, as was seen in the ice-cream segment earlier this year.[9]

In our view, despite the slowdown in the global economy, the growth story of the Indian consumer goods sector is expected to continue in 2016, with companies expanding distribution and using new channels for distribution, giving rise to newer products and category extensions.

1. IMF cuts global growth forecast as China slows, The Hindu, 19 January 2016
2. India continues to be a haven of macro economic stability: CEA, The Hindu Business Line, 05 February 2016
3. FMCG industry on recovery path; outlook remains positive, Livemint.com, 24 February 2016
4. NDA moves to derisk farming, Livemint.com, 14 January 2016
5. Major FDI policy reforms notified, KPMG in India, 27 November 2015
6. Despite El Nino, next monsoon will be normal, predicts IMD, The Times of India, 08 October 2015
7. Big Banks Cut Oil-Price Forecasts, The Wall Street Journal, 25 February 2016
8. Seventh Central Pay Commission recommendations won't put finances in a squeeze: Government, The Economic Times, 21 November 2015; KPMG in India's analysis, 2016; USD1 = INR66.81 as on 29 November 2015
9. KPMG in India analysis

Expectations (policy/fiscal/tax)

- Efforts should be made to pass the Goods and Service Tax Bill (GST) in the Budget session to ensure it is implemented in FY2017-18. This is likely to have a major impact in the ease of doing business through uniform indirect taxes between states, making it easier for consumer goods companies to transport goods across states.
- Policy measures are required for the creation of an efficient supply chain and logistics infrastructure for FMCG and agri sector companies, enabling fewer and larger stock points across the country
- Tax incentives for start-ups, especially in the e-commerce sector
- Phasing out of deductions and exemptions in upcoming years
- Rationalisation of withholding tax provisions
- Increase in threshold limit for presumptive taxation scheme (Section 44AD of the Income-tax Act, 1961) for persons having income from business
- Provisions to improve the ease of doing business, especially for small retailers
- Permission for 100 per cent FDI in certain multi-brand retail segments such as food, electronics and luxury, which enable investments in supply chains and allow a larger number of global brands access to the Indian market
- Clear and definite FDI policy on e-commerce retail to help investors finalise their strategies for investing in India.

Recent government initiatives

- Creation of a uniform agricultural market has been an important focus area for the government, and parallel to GST, the government has proposed an electronic National Agricultural Market (NAM), a step beyond Agricultural Produce Market Committee (APMC) reforms
- The government plans to set up 42 mega food parks across the country in the next three to four years. In addition to the changes in the mega food park policy, the government has allocated INR20 billion to National Bank for Agriculture and Rural Development (NABARD) for affordable credit to agro-processing units being designated as food parks.

Key policies/fiscal and tax proposals

Key announcements[1]

Non-tax

Agriculture and allied sectors

- The Union Budget 2016-17 mentioned agriculture and farmers welfare as one of the nine key pillars, and aims to double the income of farmers by 2020. A total of INR359.8 billion for agriculture and farmers' welfare was allocated for the FY2017-18
- A dedicated irrigation fund worth INR200 billion has been announced to be set-up under National Bank for Agriculture and Rural Development (NABARD) to strengthen micro-irrigation and watershed development
- INR170 billion has been allocated to fast track the implementation of 89 stalled irrigation projects under the Accelerated Irrigation Benefits Programme (AIBP)
- Three key initiatives have been announced to ensure that the benefit of Minimum Support Price (MSP) reaches all farmers. These initiatives focus on encouraging decentralised procurement, creation of an online procurement system and improving the procurement process for pulses
- The Soil Health Card scheme has been expanded and it now targets to cover all 140 million farm holdings by March 2017
- The government aims to promote organic farming through 'Parmparagat Krishi Vikas Yojana' and 'Organic Value Chain Development in North East Region', with a target of bringing 0.5 million acres of land under organic farming scheme in the next three years
- A target of INR9 trillion for rural credit has been set by the government. In order to reduce the burden of loan repayment on farmers, a provision of INR150 billion has been made in the FY2017-18 towards interest subvention
- A unified agriculture marketing e-platform, aimed to provide a common online marketplace for the selected 585 regulated wholesale markets, is to be launched on 14 April 2016
- INR5 billion has been allocated as incentive for production of pulses under National Food Security Mission
- A target spend of INR8.5 billion on animal husbandry, cattle and livestock breeding has been announced
- Allocation of INR55 billion has been made towards the implementation of Crop Insurance Scheme, for FY2017-18.

FMCG and retail sectors

- To further boost retail trade, the Budget has proposed that small shops should be given the choice to remain open on all seven days of the week on voluntary basis. It also proposed to circulate a Model Shops and Establishments Bill which is expected to create uniformity in retail operations across the country
- Hundred per cent FDI through the Foreign Investment Promotion Board (FIPB) route in the marketing of food products that are produced and manufactured in India has been permitted. This is expected to bring in more investments into the food processing sector, especially the downstream supply chain, as well as allow foreign multi-brand retailers to set-up food-only retail stores.

Tax

Agriculture and allied sectors

- The services provided by National Centre for Cold Chain Development, by way of knowledge dissemination, have been exempted from service tax
- The excise duty on electric motor, shafts, sleeve, chamber, impeller, washer required for the manufacture of centrifugal pump has been reduced from 12.5 per cent to 6 per cent. More than 50 per cent of such pumps are used in agriculture
- The 5 per cent concessional Basic Customs Duty (BCD), as presently available under project imports for cold storage, cold room (including for farm level pre-cooling) has been extended for cold chain including pre-cooling unit, pack houses, sorting and grading lines and ripening chambers
- The BCD on refrigerated containers has been reduced from 10 per cent to 5 per cent. The excise duty on such containers has been reduced from 12.5 per cent to 6 per cent
- The excise duty on micronutrients covered under S. No. 1(f) of Schedule 1 Part (A) of the Fertilizer Control Order, 1985, has been reduced from 12.5 per cent to 6 per cent.

—
1. Union Budget 2016-17, http://indiabudget.nic.in/glance.asp, 29 February 2016

FMCG and retail sectors

- The excise duty for tobacco and tobacco products (excluding beedis) has been increased by 10 to 15 per cent.
- There was a marginal increase of Countervailing Duties (CVD) by 0.75 per cent and excise duty by 0.5 per cent on refined gold and silver bars. The excise duty exemption on jewellery (excluding silver-only jewellery) articles has been withdrawn.
- With the aim to promote the 'Make in India' programme, the customs duty on specific fibres and yarns has been halved to 2.5 per cent.
- The excise duty for branded readymade garments of retail sales price of more than INR1,000 has been increased to 2 per cent without Input Tax Credit (ITC) or 12.5 per cent with ITC. The tariff value for excise/CVD purposes has been increased from 30 per cent to 60 per cent.
- The abatement rate for footwear has been increased from 25 per cent to 30 per cent. The excise duty for rubber sheets for soles has been reduced from 12.5 per cent to 6 per cent.
- Basic customs duty, CVD, Special Additional Duty (SAD) and excise duty have been removed for parts and components of network devices such as modems, routers, IP cameras and set top boxes.

Direct tax

- Corporate tax rates have been proposed to be reduced over next few years from 30 per cent to 25 per cent with corresponding phasing out of exemptions and deductions
- To address the challenges created by digital economy, the Finance Bill proposes to levy an 'equalisation levy' at a rate of 6 per cent of the amount of consideration paid for specified services related to online advertisements that have been received or are receivable by a non-resident not having Permanent Establishment (PE) in India, from a resident or from a non-resident having permanent establishment in India. This tax has been limited to B2B transactions
- To facilitate the growth of start-ups in the initial phase of their business, deduction of 100 per cent of the profits (three out of five years for start-ups set up between April 2016 and March 2019) from a business involving innovation development, deployment or commercialisation of new products, processes or services driven by technology or intellectual property has been permitted. However, Minimum Alternate Tax (MAT) shall be applicable in such cases. Further, any capital gains arising to investors shall not be taxed in case proceeds are invested in notified startups
- The rates for withholding taxes on the payments for commission or brokerage (i.e. payments falling under the purview of section 194H) has been revised from 10 per cent to 2 per cent. Also, the threshold limit for withholding taxes on these payments been also been increased from INR5,000 to INR15,000
- Under the presumptive taxation scheme, an assesse has an option to be taxed at a flat rate of 8 per cent in case total turnover or gross receipts of business does not exceed defined threshold. It has now been proposed to increase the threshold limit from INR1 crore to INR2 crore.

Impact

The provisions for this year's Budget are expected to revive rural consumption, which has been subdued for the past two years, primarily due to a poor monsoon season.

The move to create a unified agricultural market e-platform could benefit food-based FMCG companies, as this is expected to make procurement processes easier and more transparent. In addition, the permission for 100 per cent FDI in the marketing of food products is expected to bring in more investments into the food processing sector.

With almost INR2,18,000 crore allocated for both roads and railways in FY2017-18, physical linkages are expected to improve significantly, and transit losses due to poor connectivity are expected to come down significantly.

The tax benefits to start-ups is likely to spur growth in the e-commerce retail sector. Reduction in the withholding tax rate can lower compliance burden for consumer goods companies (especially in case of e-commerce companies), as they typically operate through dealers, distributors and agents. For small retailers, the increase in the threshold limit for presumptive taxation is expected to reduce the compliance burden of the small businesses and facilitate the ease of doing business.

The additional excise duty on unmanufactured tobacco and cigarettes is expected to negatively impact the organised tobacco industry further. Additional duties on jewellery and branded apparel is expected to increase the price of such articles.

The removal of duties from parts and components of network devices is expected to promote companies manufacturing such devices to start assembly in India.

Our point of view

The Union Budget for FY2017-18 is a pro-agriculture, pro-rural sector Budget. The Finance Minister mentioned agriculture and rural sectors as two of the nine pillars of this year's Union Budget. The provisions recommended this year are expected to shift the focus of consumer goods companies again towards the rural market. In the long-term, the budgetary provisions that aim at insulating the agri and rural sector from the monsoon-related variations can help ensure that consumer goods companies have access to a more stable rural market.

Unfinished agenda

What is expected going forward

While the Union Budget 2016–17 envisages a long-term economic growth path for the agriculture and rural sectors, real benefits would only accrue if the initiatives announced are implemented in a timely and efficient manner. State governments also need to ensure high involvement in these initiatives to ensure effective implementation.

The passage of the GST Bill in the Parliament with non-inflationary tax rates is expected to benefit both urban and rural consumers and boost consumption, and improve the ease of doing business significantly.

In the retail sector, a more liberal and clearer FDI policy on both single and multi-brand retailing can boost foreign investments in the sector.

KPMG in India contacts:

Nitin Atroley
Partner and Head
Sales and Markets
T: +91 124 307 4887
E: nitinatroley@kpmg.com

Rajat Wahi
Partner and Head
Consumer Markets
T: +91 124 307 5052
E: rajatwahi@kpmg.com

Follow us on:
kpmg.com/in/socialmedia

Download the KPMG in India apps:

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

This document is meant for e-communication only.