

Creating Resilience

Shoring up Indian supply chains: Are we prepared for the future?

VIEWPOINT

World over, the COVID-19 pandemic has exposed the soft underbelly of global supply chains, causing corporates to take a sharp look at their procurement and manufacturing strategies.

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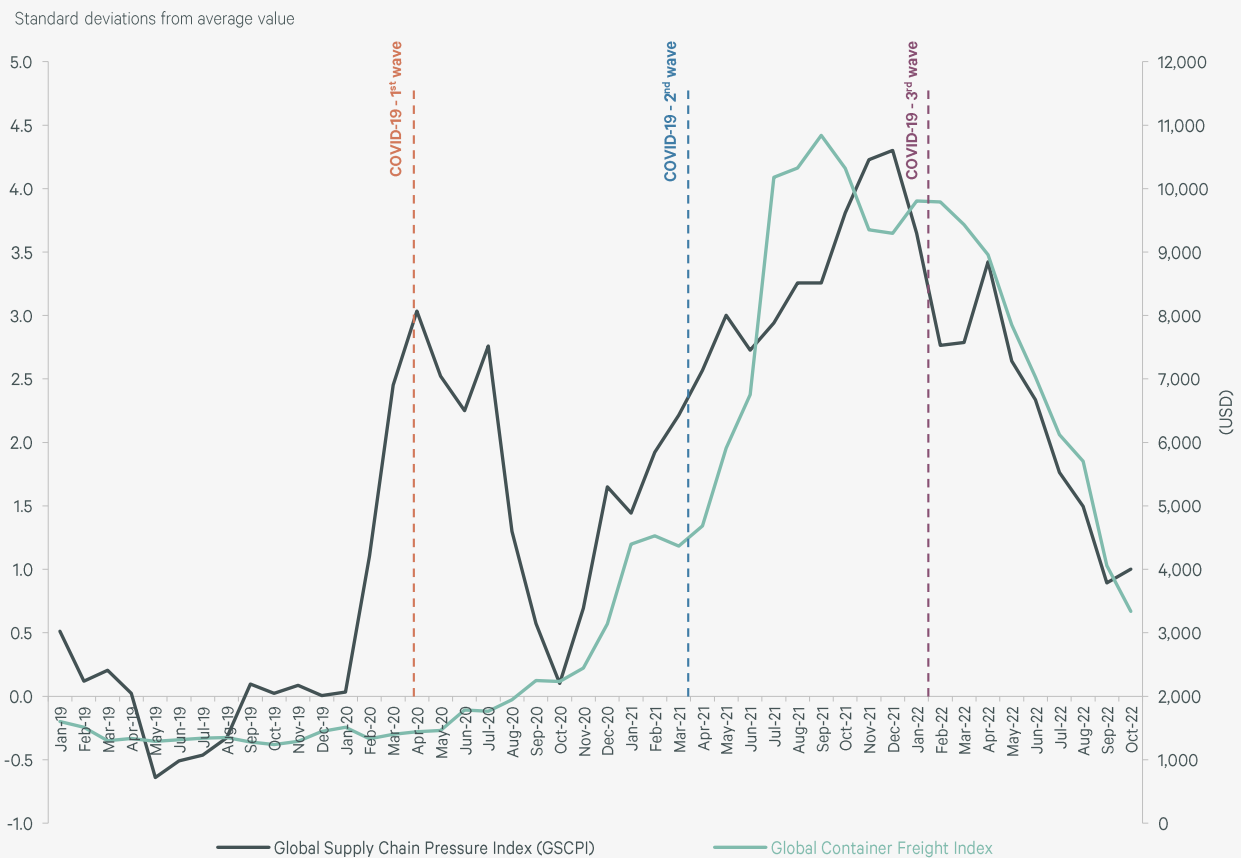


Supply chain disruptions were prevalent even before COVID-19, but the impact was either on demand or supply. Due to this, most corporates could continue implementing ‘just-in-time’ supply chain models to tide over any fluctuations.

But COVID-19 exposed supply chain vulnerability by inflicting simultaneous shocks to both supply and demand – such as trade curtailment on account of widespread lockdown measures and adverse impact on consumer sentiments for the latter.

The first half of 2020 was marked by widespread lockdowns and travel restrictions while recovery and recalibration of supply and demand was witnessed in the second half of the year - resulting in overall world merchandise trade contracting by 9%¹ in 2020 when compared to 2019. Maritime transport was also affected by the pandemic with sales contracting by nearly 4%¹ in 2020. This drop, however, was not as steep due to pent-up demand and the need to have enough inventory. Moreover, this pent-up demand led to container shortages and insufficient shipping capacities due to continued disruptions in mid-2020. Subsequent port congestions led to increased dwell time and skipped port calls, causing a hike in freight rates (refer fig 1).

Figure 1: Supply chain pressures causing global freight costs to soar



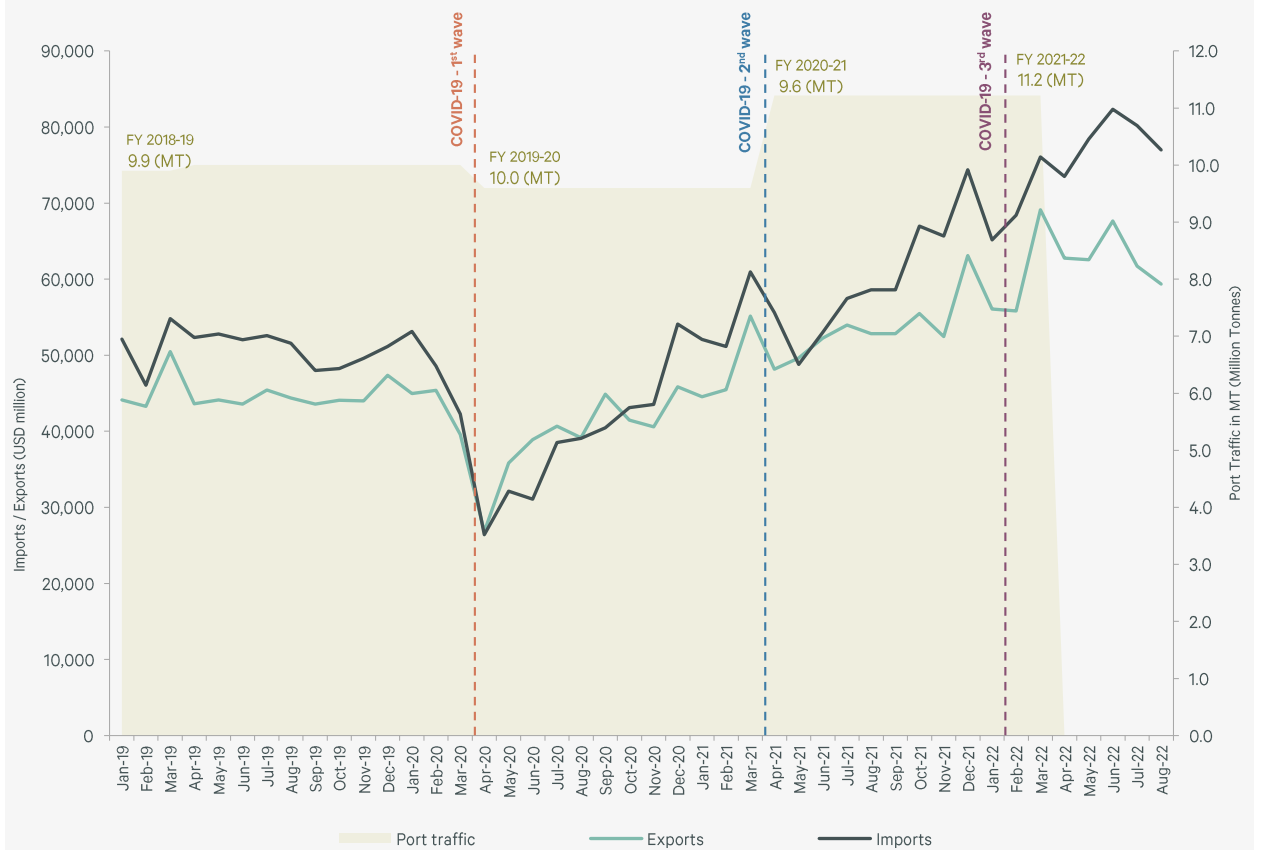
Source: Federal Reserve Bank of New York; Freightos, 2022; CBRE Research Q4 2022.

¹UNCTAD's Handbook of Statistics for 2021



The year 2021 witnessed renewed COVID-19 waves, which led to port closures / impeded port efficiencies across the world. Global supply chains, especially of electronics, auto & auto ancillaries and toy sectors, were also thrown out of gear following a semiconductor shortage. This situation was further compounded by the geopolitical crisis in Europe in 2022 which drove up energy prices. This volatility of global energy markets also added to supply chain disruptions. As of today, while container prices are softening, supply chain challenges have continued owing to delays on account of port congestion and China’s zero-COVID-19 policy.

Figure 2: Sailing in turbulent waters: COVID-19 and its impact on India’s international trade



Source: Ministry of Ports, Shipping and Waterways, Ministry of Commerce and Industry, Government of India (GoI), 2022; CBRE Research Q4 2022.

The below section highlights pandemic-led disruptions and the impact on the Indian export-import (EXIM) landscape:

Table 1: Sailing in turbulent waters: A timeline of supply chain disruptions in India

COVID-19 1st wave (Mar-Jun 20)	COVID-19 2nd wave (Mar-May 21)	COVID-19 3rd wave (Jan-Mar 22)
<ul style="list-style-type: none"> • Demand shock witnessed across regions • Supply chain restricted to only essentials • Prolonged lockdown led to exodus of manpower • Railway network utilised to transport essentials and mobilise the supply chain • Emergence of hyperlocal and last-mile deliveries • National Rail Plan (NRP) 2030 unveiled to increase railway dependence • PLI scheme introduced to boost various industries 	<ul style="list-style-type: none"> • Restrictions on the movement of goods and services eased • Global lockdowns curtailed imports / exports • Week-long Suez Canal blockage led to further delays in ships headed to Europe • PLI scheme expanded to IT hardware, telecom & networking products and drone & drone components and white goods • Launch of INR 76,000-crore India Semiconductor Mission to turn India into a hub for semiconductors • PM Gati Shakti National Master Plan unveiled to boost infrastructure • Hyperlocal and last-mile deliveries became mainstream • Raw material and semiconductor shortage flared up due to shifting consumption patterns and high demand 	<ul style="list-style-type: none"> • China’s strict zero-COVID-19 policy and localized infection spurts led to closure of key ports • The Russia-Ukraine crisis enhanced volatility in global energy markets; led to shortage of key raw materials such as steel, gasoline, etc. • Elevated container shipping costs • Continued congestion at global ports • INR 20,000 crore grant to PM GatiShakti Master Plan and development of 100 cargo terminals • Additional allocation of INR 19,500 crore under the PLI scheme for high-efficiency solar modules

Source: CBRE Research Q4 2022.





In the wake of changing dynamics due to COVID-19 waves and geopolitical risks, Industrial & Logistics (I&L) stakeholders had to optimise supply chains to improve efficiencies. The below table highlights the impact felt by stakeholders across the I&L spectrum and the measures they adopted:

Table 2: Impact of the disruptions on I&L stakeholders

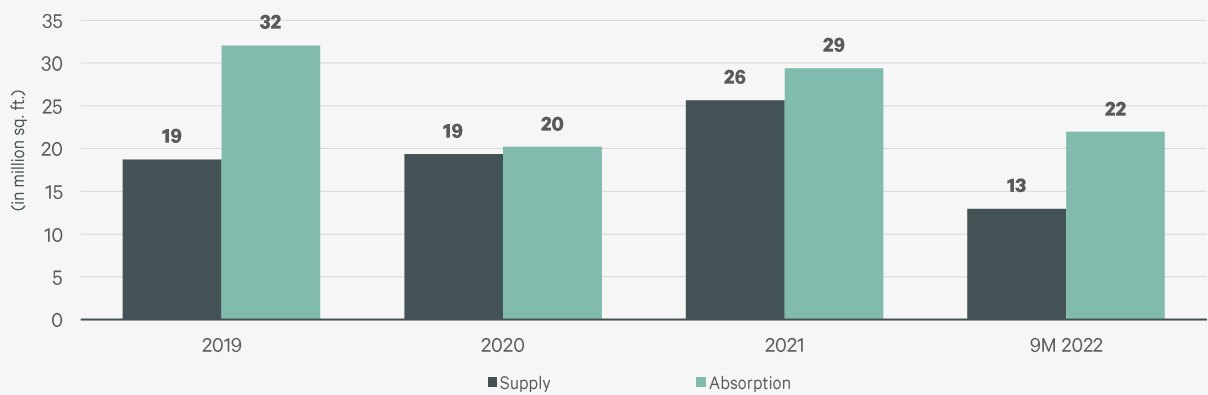
Occupier impact	<ul style="list-style-type: none"> • During the 1st wave of the pandemic, flaws in linear supply chain models were discovered as occupiers could not cater to the increasing e-commerce and consumer demand • Subsequently, during the 2nd wave, occupiers realigned their supply chains to become tech-enabled and ‘networked’, thus insulating themselves from external shocks • Occupiers moved from ‘just-in-time’ to ‘just-in-case’ strategies and ‘nearshoring’ of manufacturing gained traction
Developer impact	<ul style="list-style-type: none"> • Developers witnessed construction delays due to shortage of labour and raw materials; focus on short-term leases and subletting of ‘white-spaces’ was prevalent during the 1st wave • As mobility restrictions eased, occupiers expanded in tier II and III locations with a continued focus on first- and last-mile warehouses • Construction costs started to inch up post the 2nd wave due to a shortage of raw materials amidst geopolitical tensions
Investor impact	<ul style="list-style-type: none"> • While the I&L sector emerged as the most preferred real estate option, investors remained cautious during the 1st wave of the pandemic • Post the 2nd wave of the pandemic, as occupier demand increased, large-sized institutional deal closures were witnessed • This was followed by investors launching I&L-focused funds and platforms

Source: CBRE Research Q4 2022.

How was I&L real estate in India impacted?

Along with the ongoing COVID-19 concerns, global events such as increasing costs due to inflation, the war in Ukraine, etc., compounded supply chain disruptions during 2022. These disruptions adversely impacted occupier decision-making as well as slowed project completions, leading to slackened I&L leasing. Project completions dropped by about 23% Y-o-Y to nearly 13 million sq. ft. in 9M 2022. Leasing activity remained almost stable on a Y-o-Y basis to touch 22.0 million sq. ft. during the same time period. We now expect the overall leasing activity in 2022 to remain range-bound at about 28-32 million sq. ft., a growth of up to 5% on an annual basis.

Figure 3: Supply-demand trends in the I&L sector (2019 - 9M 2022)



Source: CBRE Research Q4 2022.

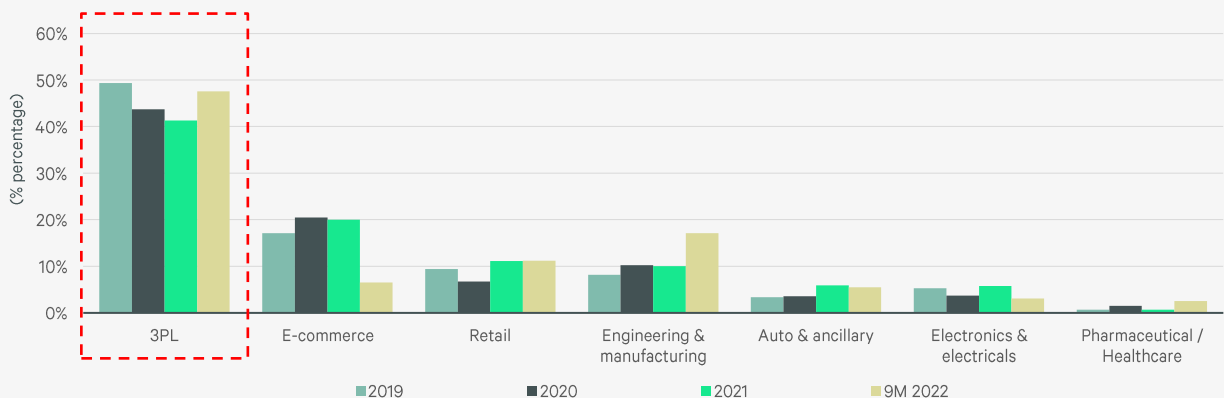
Below is a lowdown of how the real estate dynamics of the I&L sector panned out against the backdrop of these disruptions.



Renewed dominion of 3PL players

Between 2019 and 2021, the share of 3PL players had been on a steady decline, driven by growing demand from e-commerce and engineering & manufacturing firms. However, leasing activity by these players increased during 9M 2022 driven by demand from interlinked stakeholders across the supply chain (refer to fig 4). These included wholesalers, retailers and e-commerce players who would need to hold a higher level of 'safety stock'.

Figure 4: Variance in the share of key sectors in I&L leasing activity (2019 - 9M 2022)



Source: CBRE Research Q4 2022.



Capitalising on robust e-commerce growth

Lockdowns and other mobility-related restrictions acted as a catalyst to the already robust e-commerce sector. During 2021, the Indian e-commerce market added 40-50² million new shoppers - an increase of about 35% Y-o-Y. This addition of new users and subsequent sales growth led to improved space take up from e-commerce players during 2020-2021. However, in 2022, reopening of offline stores led to a short-term drop in appetite for new space from e-commerce players. We expect their leasing sentiments to continue to be driven by the festive / year-end demand.



Policy sustenance bolstering the engineering & manufacturing sector

Buoyed by the PLI scheme and the government's intent to improve India's global manufacturing position led to engineering & manufacturing players posting a sustained leasing performance during the pandemic. The PLI scheme alone attracted over INR 2.4 lakh crore³ investments in the manufacturing sector over the last two years. Further, the recently launched National Logistics Policy, which aims to reduce the logistics costs as a % of GDP from about 14%⁴ to single digits and improve the overall efficiency of the sector through the Comprehensive Logistics Action Plan (CLAP), is anticipated to drive investments. Moreover, the National Industrial Policy when released would also add to the regularisation of the sector.



Overhaul of inventory models

For over two years now, manufacturers, omni-channel retailers and logistics companies have been shifting from a 'just-in-time' inventory approach to a 'just-in-case' model. The latter requires them to keep large volumes of stock on hand to serve as a buffer in case of potential disruptions. As supply chains normalise, occupiers are seeking to achieve a balance between these two models while focusing on inventory control and stabilisation.



Continued investor interest

The above events and the immediate bounce back of I&L demand displayed the sector's resilience, which in turn led to an increase in investor interest. The year 2021 recorded an investment peak of more than USD 1.3 billion as compared to USD 0.08 billion in 2020. These investments were led by mostly global players' greenfield and brownfield acquisitions. In 9M 2022, the sector attracted about USD 144 million across greenfield and brownfield assets from both global and domestic players.



Rise in construction costs

Supply-demand imbalances owing to port congestions, especially during Q2 – Q4 2021, resulted in I&L greenfield construction costs⁵ to grow by nearly 3% Q-o-Q in major cities. Another spike of 2-3% Q-o-Q in construction costs was recorded in Q3 2022, on account of the Russia-Ukraine geopolitical crisis. When looked at from a Y-o-Y perspective, this rise jumped to 5-6% in Q3 2022.

² Bain & Company's 'How India Shops Online', October 2022

³ Media articles; Ministry of Commerce and Industry, GoI, 2022

⁴ Reimagining India's Supply Chain, Arthur D Little, 2020

⁵ Involves pre-engineered building structure with heavy-duty flooring with minimal mechanical, electrical and plumbing works

A roadmap for navigating future challenges

Redrawing inventory strategies



Most corporates are now following a mix of ‘just-in-time’ and ‘just-in-case’ strategies as larger safety stocks continue to be vital for supply chain resilience



At the same time, corporates are now looking at smarter strategies to keep inventory costs under control which include dual sourcing of raw materials and regionalising supply chains

Nearshoring / ‘friend-’shoring

Localisation of supply chains is steadily gaining fervour as corporates move operations closer to end-user markets as a way of hedging against any future exogenous shocks



However, as onshoring is not always possible, several corporates are reorchestrating critical supply chains by replacing risky foreign suppliers with close / safe allies i.e. ‘friend-’shoring



Technological enhancement



Digital tools have become critical for improving supply chain resilience and planning. Further, the focus of digital investments is shifting steadily from supply chain visibility to demand and supply planning



According to a McKinsey survey⁶, about 67% of supply chain leaders across the globe have implemented dashboards for end-to-end supply chain visibility, while 74% are now planning to invest in digital technologies for demand planning

Multisourcing strategies

The disruption of traditional supply routes has highlighted the need for sourcing flexibility. Therefore, it is imperative that corporates activate alternative supply sources. At the same time, keeping an eye on cost movements owing to these strategies is a must



Diversify logistics planning



Logistics challenges such as port congestion, container shortages, long lead times have led occupiers to relook at the traditional supply routes, thus highlighting the need for logistics flexibility



Many are, therefore, diversifying their logistics planning to include more 3PL players, drawing up alternative routing plans or diversifying their modal mix

⁶McKinsey’s Survey of Global Supply Chain Leaders, March 28-April 19, 2022

Leveraging the Indian opportunity



Sustain the policy push

The PLI scheme has an outlay of INR 1.94 lakh crore; infrastructure spending expected to go up from 4.6% of the GDP in 2020 to 7-7.5% by 2031⁷ to attract more investments



Balance the logistics mix

Increase the modal share of railways from 30% currently to 45%⁹ in freight traffic by 2024, in addition to identifying new dedicated freight corridors to ease logistics costs



Investing in skilling and upskilling the labour pool

About 75%⁸ of the workforce in the construction industry is unskilled but 66%⁸ of construction companies plan to prioritise digitization, which would require workers to enhance their skills



Bolster the manufacturing capabilities

India's share of manufacturing in GDP is likely to grow from 15.6% currently to 21% in 2031, implying that the manufacturing value would rise from USD 447 billion to USD 1,490 billion during the same period⁷

What can supply chain resilience mean for the Indian I&L space by 2030?



Traction in warehousing demand

due to continued focus on 'just-in-case' buffer stocks. Demand centres would see stronger leasing as several occupiers prefer to locate their warehouses closer to consumption hubs to cut down on transport costs. Therefore we expect the I&L stock to double by 2030 to cross 700 million sq. ft.



Share of grade A developments

in the overall I&L stock is anticipated to rise from the current 35% to more than 50% of the overall stock by the end of 2030, primarily driven by occupier interest in adding buffer stock and 'flight-to-quality' sentiment



Tier II and III cities to drive next phase of I&L growth

as supply chain disruptions boosted e-commerce consumption, leading to growth in demand for storage spaces and logistics service providers in these locations



Investments in manufacturing and logistics real estate to grow

in line with India's rising importance in the global value chain; more than USD 20 billion would be required to develop additional I&L spaces by 2030

Source: CBRE Research Q4 2022.



⁷ Morgan Stanley's 'Why This is India's Decade', November 2022

⁸ KPMG; Autodesk; Construction Skill Development Council of India's 'Skilling India: Construction Sector Demand and Supply', September 2022

⁹ National Rail Plan, 2021

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