

INDIAN AUTOMOTIVE INDUSTRY

Expectation survey 2014



MAZARS IS AN INTERNATIONAL, INTEGRATED AND INDEPENDENT ORGANISATION SPECIALISED IN AUDIT, ADVISORY, ACCOUNTING, TAX AND LEGAL SERVICES. AS OF SEPTEMBER 1, 2013, THE GROUP OPERATES IN 72 COUNTRIES AND DRAWS ON THE EXPERTISE OF 13,800 PROFESSIONALS TO ASSIST MAJOR INTERNATIONAL GROUPS, SMES, PRIVATE INVESTORS AND PUBLIC BODIES AT EACH STAGE OF THEIR DEVELOPMENT.



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ABOUT THE SURVEY

A dedicated workforce from Mazars was identified to undertake research on specific aspects of India's automotive industry. The task of this special workforce was to dive deeply into the dynamics and key areas of concern of the automotive industry, which are pertinent to the current environment.

Brainstorming sessions were held with various industry experts to gain varied perspectives on the trends and challenges reigning over the automotive market. Matters relating to growth, expansion and profitability were identified as fundamental in determining the industry's growth.

Based on the above, each module of this survey was strategically designed with questions and focus areas, concentrating mainly on significant aspects of the automotive industry in India.

We reached out to more than 300 companies in the automotive sector in various verticals, such as suppliers, auto components, auto dealers and manufacturers.

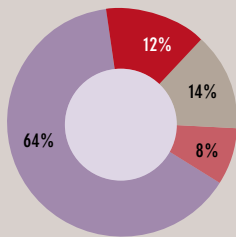
With 20 key focus areas encapsulated in this survey questionnaire, Mazars attempts to provide thought-provoking perspectives on various issues that have infested the automotive industry.

Responses from industry experts and professionals, including business heads, management and other key stakeholders have been analysed and collated to bring forward an exhaustive account of the automotive industry in India.

The adjacent charts represent the respondent profiles and the size of their organisation.

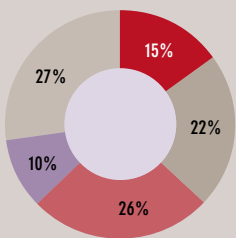
Nearly, two-third of the respondents are from the auto components vertical, approximately one-fourth are from the vehicles auto manufacturers' vertical, while 8% are from the two-wheeler manufacturers vertical. Others include professionals such as analysts and experts who know and understand the automobile industry.

Approximately half of the respondents are from companies which currently have an annual turnover of INR 200 crore to INR 1,000 crore, while 27% of the respondents are from companies which currently have an annual turnover in excess of INR 2,000.



Auto manufacturers:

- Passenger vehicles
- Commercial vehicles
- Two-wheelers
- Auto components



- Below 200 Crores
- 201 to 500 Crores
- 501 to 1,000 Crores
- 1,001 to 2,000 Crores
- Above 2,000 Crores

INTRODUCTION



ARVIND WALIA

Partner and Automotive Sector Expert, Mazars India

Welcome to our latest survey based report on the Indian automotive industry.

The automotive industry has been and will remain a vital element of the economy of industrialised countries across the globe. Today, this industry is not only viewed as an important driver of growth, income, employment and innovation, but also one which has increasingly been facilitating cross-border sharing of technologies and best practices.

In India too, the role of the automotive sector is substantial. This industry accounts for 7% of the nation's Gross Domestic Product ("GDP"), contributes more than one-fifth of the total excise duty collection and provides direct and indirect employment to over 13 million people. The automotive industry in India currently has 2 dedicated industry bodies - Society of Indian Automobile Manufacturers ("SIAM") and Automotive Component Manufacturers Association ("ACMA").

SIAM is the apex industry body representing 46 leading vehicle and vehicular engine

manufacturers in India. It is an important channel of communication for the automobile industry with the Government of India ("GoI"), as well as national and international automotive organisations. ACMA is the nodal agency for the Indian auto component industry that is represented on a number of panels, committees and councils of the GoI, through which it helps in the formulation of policies pertaining to the Indian automotive industry.

After possibly the longest and most difficult period of slump in India's automobile market, the Indian automotive industry has reasons to pin strong hopes on the new government which has assumed office in May of 2014.

There is now an underlying expectation of the fast track growth of this industry by pushing through reforms such as the Goods and Services Tax ("GST"), policies that boost infrastructure development and other initiatives which are focused on bringing back footfalls to automotive dealerships.

As a part of its ongoing focus on providing its automotive industry clients with opportunities

and platforms to voice their views and expectations, Mazars has timed this historic political development to undertake a focused survey. While structuring the survey questions and analysing the responses, Mazars has sought to gauge the current sentiment and outlook of the companies across all the verticals within India's automotive industry. Our endeavour has also been to provide thought-provoking perspectives on aspects which can position this vital industry back on track, while also identifying aspects which can potentially create road blocks.

We are deeply obligated to all the respondents for their participation. We are also grateful to the experts who have provided us with their worthy opinions and perspectives and hope that this publication will throw light on aspects that will catch the attention of the policy makers in the new government.

Have a good read!

EXECUTIVE SUMMARY

The automotive industry is a thrust sector for India. This industry is one of the key drivers of the national economic growth and is one of the largest auto markets globally. Demographically and economically, India's automotive industry is well-positioned for growth, servicing both domestic demands and export prospects.

88%

EXPECT THE AUTOMOTIVE INDUSTRY TO REVERT TO A DOUBLE-DIGIT GROWTH RATE IN THE MEDIUM TERM.

With the gradual liberalisation of the automobile sector since 1991, the number of manufacturing facilities in India has grown progressively. The favourable response from the industry to new progressive policies can be gauged from the large scale entry of automobile companies in the Indian market. Today, India has 9 significant manufacturers of commercial vehicles, 16 significant manufacturers of two and three wheelers and 5 significant manufacturers of engines.

For most part of the last decade and until 2011, the Indian automotive industry had enjoyed a respectable growth at a compounded annual growth rate ("CAGR") of approximately 14%. The industry, which currently contributes nearly 7% of India's GDP and employs over 13 million people, is the largest in two-wheelers segment and the seventh largest in the passenger cars segment globally.

The Indian economy is currently going through a turbulent phase with its GDP growth slowing down to a decade low in 2013-14, with domestic as well as external aspects playing a significant role in this downfall. However, the slump has veiled many outstanding industry advancements. Standards of

quality and productivity have been raised without a corresponding increase in price. Cars are now safer, more fuel efficient and more technically advanced than ever. Automotive workplaces have evolved to be the hubs of high skills, advanced technologies and dynamic changes.

Even during the economic downturn, the two-wheeler and three-wheeler segments upheld the trend in some of the more significant indicators of progress. Though the weakness in the economic growth had resulted in a slowdown in the automotive sector in 2012-13 and 2013-14, India is expected to regain respectable growth trends from this year.

The survey conducted by Mazars was timed alongside a significant political change in the India. It not only captures the aftermath of the recent slowdown, but also encapsulates new hopes that have arisen with the formation of the new government in May of 2014.

While several automotive organisations are making investment budgets to suit the current economic scenario, a majority of the respondents expect a fuller utilisation of their plants and resources in the near to medium term.

82%

OF THE RESPONDENTS ARE GEARING UP FOR A GROWTH BETWEEN 4% AND 7% IN THE TWO-WHEELER SEGMENT, WHILE A MAJORITY IN THE VEHICLE SEGMENT EXPECT 2014-15 TO BE A YEAR OF CONSOLIDATION AT A GROWTH OF UPTO 4%.

Some mergers and alliances are more likely to take place domestically in this year itself. These are driven by the need for access to better technology, manufacturing facilities, service and distribution networks. The components segment is expected to benefit from India's cost-effectiveness, profitability and globally-recognised engineering capabilities.

83%

EXPECT THE TREND OF NEW MODEL LAUNCHES TO CONTINUE AND 50% EXPECT SUBSTANTIAL REVENUES (IN EXCESS OF 20%) AS AN OUTCOME OF NEW OFFERINGS.

The upbeat sentiment about the industry is echoed in the business plans that the organisations have made for the next 3 years. A clear growth pattern has emerged wherein the industry is optimistic while expecting consolidation and a turn-around trend in 2014-15, increasing to more than 7% growth year on year ("YoY") from 2015-16 onwards. An overwhelming majority expects the industry to regain its past glory with a double-digit growth within the next 5 to 7 years.

At the same time, the Indian automotive industry is facing challenges associated with the key automotive companies investing in innovations and novel technology concepts. An unprecedented new landscape appears to be emerging. Expectations from the new models that are being launched are high with these offerings facilitating a competitive edge for India in the larger global platform.

The road to growth, however, is not expected to be a smooth ride. Troubled by several challenges, it will take a while before the growth in the Indian automotive industry gains pace. The respondents have extended concern over basic success drivers like infrastructure, technology, government support and cost of raw materials.

Improvement in the quality of roads will also lead to an increase in the vehicle sales. Also, the industry needs to work towards upgrading technologies to meet global standards. The low-cost advantages related to the Indian auto component industry are anticipated to continue attracting new investors.

The implementation of some import trade restrictions on China can be a major step to propel substantial growth within the Indian automotive industry.

Majority of our respondents believe that the Automotive Mission Plan ("AMP") has significant potential to drive the industry towards progress. However, the current stagnancy in the AMP is a cause of great concern. The policies of the AMP need to be implemented effectively for the industry to grow.

With the growing Indian population and increasing earnings, the growth prospects of the automotive industry remain high. Availability of low cost finance in the market is a major assisting force for buyers.

Customer preference, while purchasing a new vehicle, is bent towards fuel efficient automobiles. Value for money and affordability play a vital role in the selection of vehicles, given the cost consciousness prevalent in the Indian consumer market.

The strategies that are likely to be adopted by the automotive companies will be aimed at meeting the major challenges faced today, particularly in the areas of rising fuel prices, automobile recycling, increasing environmental and safety concerns, cost-effectiveness and rising market competition.

The slow pace of the industry growth in the yesteryears is now changing gears. The ensuing years are expected to witness consolidation, introspection, integration and growth in India's automotive sector.

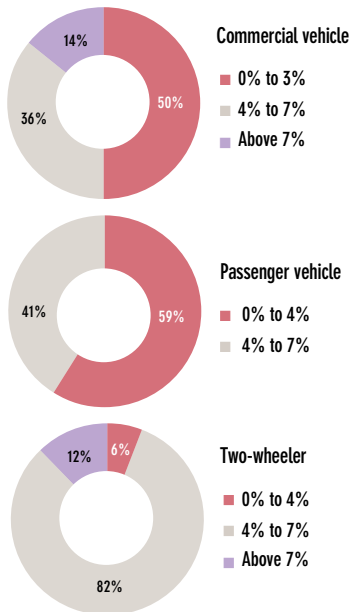
63%

RESPONDENTS ADVOCATE THAT THE IMPROVEMENT IN INFRASTRUCTURE WILL DRIVE THE AUTOMOTIVE INDUSTRY TO SUCCESS.

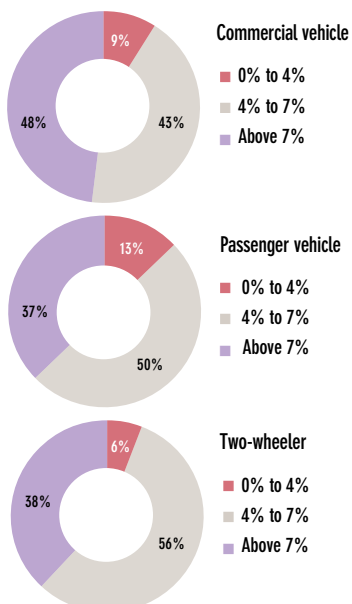
1. GROWTH



OVER 50% EXPECT CONSOLIDATION IN 2014-15 WITH A GROWTH OF UPTO 4% FOR FOUR-WHEELERS



91% EXPECT A GROWTH OF OVER 4% IN THE COMMERCIAL VEHICLE SEGMENT



Q.1.(a) What is the approximate industry growth that you have factored in for your organisation's annual planning for the year 2014-15?

The slowdown of the economy starting from 2012-13 has severely impacted the growth momentum of the industry. Overall, the industry grew by a shade under 5% in 2012-13. This was on the backdrop of a negative growth in the passenger cars and commercial vehicles segments and an unusually flat growth of 5% in the two-wheeler segment.

With a new government in the center, year 2014 has brought in a hope of revival in India's economic environment. The initial positive signals from the new government for a business-friendly policy framework and fast tracking of initiatives, particularly in the infrastructure projects, are a strong impetus to a feel good factor, essential for economic growth. However, 2014 is predominantly being looked at as a year of consolidation, where the direction of the policies and initiatives of the new government would be more evident.

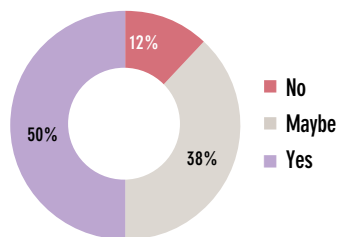
This view was supported by our survey where a majority of the respondents have planned for a maximum of upto 4% growth for the year 2014-15 for all four-wheelers. The mood in the two-wheeler segment is more upbeat with 82% planning for a YoY growth in the region of 4% to 7%.

Q.1.(b) What is your expectation in terms of growth for the subsequent 2 years i.e. 2015-16 and 2016-17?

While the vulnerability and depressed sentiment resulted in the market slowdown in 2012-13 and 2013-14, India is expected to strengthen the growth trends from 2014-15 onwards. The sector will move towards revival, but will take some time to match up with the incessant growth of the last decade.

Building on the consolidation in the year 2014-15, the economy in general and the automotive sector in particular, is expected to change gears and gather steam from the year 2015-16 onwards. The ever present twin phenomena of low car penetration and rising incomes, when combined with increasing affordability of cars, is expected to get the growth momentum on track.

There is a general optimism that the growth of the automotive industry in all its segments would accelerate to 7% or more from 2015-16.



88% EXPECT THE INDUSTRY TO RECORD A DOUBLE-DIGIT GROWTH RATE OVER THE ENSUING 5 TO 7 YEARS

“We expect to witness a more rapid double-digit growth in the two-wheeler segment with the new policies and improved buying sentiments of our end customers.”

SUNIL KANT MUNJAL, JOINT
MANAGING DIRECTOR,
HERO MOTOCORP

75% RATED ECONOMIC GROWTH AS THE MOST IMPORTANT DRIVER OF GROWTH

Q.2. What are the prospects over the medium term horizon of the Indian automotive industry to regain its lost growth momentum of the last decade (where the industry grew at 15%)?

Industry experts and companies appear to have largely converged in terms of their expectations of a CAGR exceeding 10% over the ensuing 5 to 7 years, with ACMA and SIAM endorsing these estimates.

The growth drivers which fuelled the industry in the last decade are expected to kick start the fast momentum over the ensuing 12 to 18 months. An improved policy framework, better vehicle affordability and improved infrastructure are expected to take the industry growth to double-digit levels, albeit over the medium to long term (i.e. 5 to 7 years). However, as discussed in the later part of this report, a caveat has to be added to the expected growth trajectory. To regain the momentum, the growth enablers would require the government's attention. Besides this, sensitive but much needed labour reforms are essential to achieve a double-digit growth.

Nearly 88% of the respondents believe that the automotive industry can revert to a double-digit growth rate, with about 50% strongly expressing this sentiment.

Q.3. What are the most important drivers of growth in the Indian automotive industry?

India is home to almost all the major global automobile brands, which together contribute more than three-fourths of the total production and domestic sales. The period of 2001-02 to 2011-12 was a remarkable one for the Indian automobile industry which made steady progress on all important fronts, i.e. production, domestic sales and exports. Yet, this growth story fell short of the growth trajectory seen in China.

For India, the critical enablers as per the industry feedback are the overall economic growth, government policies and interest rates. The popular impression that the fuel costs also significantly impact the industry growth is not sufficiently validated by the survey response, though the industry experts as well as the respondents have, in a later part of the survey, stated that fuel efficiency is the most important aspect in the selection of a specific model by the majority of the buyers.

Factors	Most important	Moderately important	Least important
Economic growth	75%	25%	0%
Government policies	64%	33%	3%
Interest rates	45%	45%	10%
Fuel costs	37%	53%	10%
General inflation	23%	43%	34%

Three-fourths of the respondents have identified economic growth, while nearly two-thirds of the respondents have identified government policies as the most important growth driver.

In the view of the high dependence on financing, where 70% sales of passenger cars and 90% commercial vehicles are financed, the industry's growth is also sensitive to the interest rates. Our survey has confirmed this aspect with 45% respondents assigning this as a significant factor for growth.

Q.4. What will be the impact on the future exports due to the withdrawal of incentives by the European Union and other global factors?

Automotive exports during 2012-13 remained static at 0.55 million units while two-wheelers at approximately 2 million units grew by 5% over the previous year. With Europe having decided to withdraw a concessional tariff regime for India and some other developing nations with effect from January of 2014, the export of vehicles is likely to be adversely affected. The Commerce Ministry in India is considering fresh incentives to help these sectors retain their competitiveness.

Notwithstanding these factors, experts believe that exports from India would grow at a moderately satisfactory rate. This view was also endorsed by 72%, who felt that exports from India would have a modest growth.

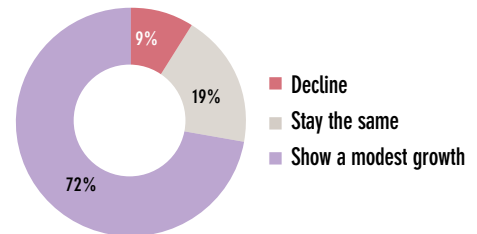
Q.5. Do you see Africa emerging as a major destination for automotive exports in the next five years?

Africa is the third fastest growing economic region in the world. Its rate of urbanisation is higher than India and lower than China. It is widely estimated that from 1 million vehicles at present, the annual automotive sales would grow to 6 million vehicles in the near future. With this, global automotive companies are focusing on Africa notwithstanding the current challenges.

In line with the overall sentiment, 91% of the respondents agree that Africa may well be a major destination for automotive exports in the next five years.

Intensive efforts are required by the industry to understand the challenges relating to delays on the ports, procedures for customs validation, non-tariff barriers and documentation requirements (which are relatively excessive) in some African countries. The Indian government too is taking strong measures to promote exports to Africa and is conducting a joint study on the free-trade agreement.

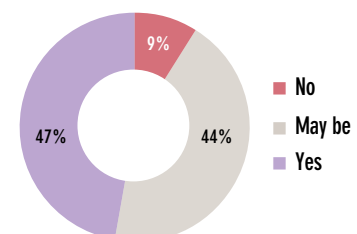
72% EXPECT EXPORTS TO SHOW A MODEST GROWTH DESPITE WITHDRAWAL OF INCENTIVES



“In the midst of an unpredictable economic condition, exports will enhance the GDP growth of India. India is fast becoming a major procurement center for global automobile companies and is set to mark its league into the top five vehicle producing nations worldwide.”

DAVID CHAUDAT, PARTNER AND LEADER, AUTOMOTIVE, MAZARS

91% ARE TARGETING AFRICA AS A MARKET FOR EXPORTS



2. EXPANSION



Q.6. Will the introduction of new models follow the same trend as it has in the year 2013-14?

New model offerings as a strategy is not a strategy to gain a competitive edge any longer, rather a necessity for remaining competitive. This trend is expected to continue for the next 5 to 7 years. In the last 2 years, around 90 vehicle models were introduced, which included those on totally new platforms, as well as variants of existing platforms.

As the competition grows, launching new models in short intervals will be of vital importance. However, this poses large challenges for automotive manufacturers. The integration of all the segments of the manufacturing process; and coordination between the design team, production line, suppliers and distributors, are paramount to successful product launches. The time lag between the design and rollout of vehicles has gone down considerably, i.e. from 24 months in the 1980s to 12 months presently. Automotive companies have internalised the process for continuously innovating on technology, styling comfort and safety while developing new models.

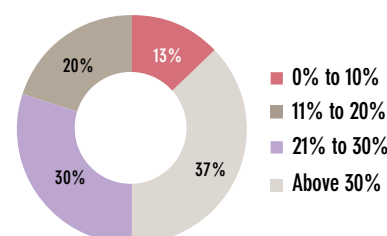
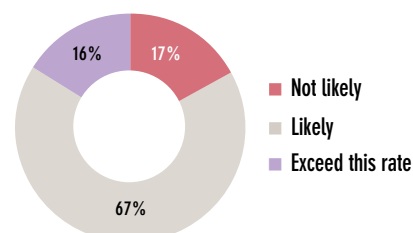
This has significantly shortened the life span of any given model, while burdening high development costs across the entire supply chain.

Q.7. What is the expected growth from the new offerings i.e. the percentage of total revenue coming from the new models?

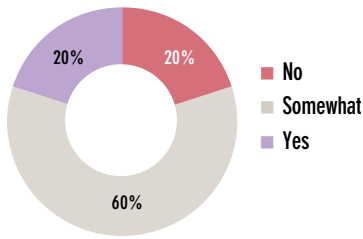
The launch of several new models in the market has helped Original Equipment Manufacturers ("OEMs") like Maruti, Hyundai, Honda, Toyota and Ford attain relative success. Some of the remaining companies have struggled with no comparable exciting offerings. The industry has looked positive on the strength of the rising demand for Accent, Grand and Santa Fe, the new Honda City and the Amaze compact sedan. Ford has reported a 51% YoY jump in its sales in May 2014 due to the demand for Ecosport. The trend is clear and accepted by the 'OEMs' and industry experts. Almost all the automakers are focusing on efforts to make gains, using tried-and-true methods, i.e. by unleashing new models.

The overall commitment to the introduction of new models as a strategy to remain competitive was evident as nearly 37% of the respondents expected new products to contribute between 11% and 20% of the revenue, while approximately 50% expected the share of new models to be in excess of 20%.

83% FEEL THAT THE NEW MODELS WILL CONTINUE TO BE LAUNCHED



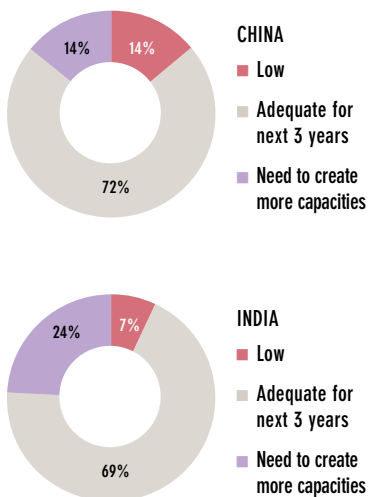
50% EXPECT OVER 20% OF THEIR REVENUE TO COME FROM NEW MODELS



80% HAVE FACTORED IN THE ADDITIONAL COST BURDEN OF LAUNCHING NEW MODELS

Q.8. Is the automotive industry throughout the supply chain geared to absorb the additional cost burden arising from introduction of new models?

OEMs are forced to shorten the product lifecycles in order to react to the expectations of individual and fast-changing consumer demands with innovative products. In the past, an average product lifecycle in the automotive industry was 8 years. Today, the lifecycles are much shorter, or at least the product's design is often modified after 2 or 3 years in the market. With development costs for a new model remaining on the same level or even increasing, this concurrently means shortening of the amortisation time for the OEM and the entire supply chain and potentially, lower profits (in the absence of a corresponding increase in prices for a flow-through). This aspect is not a deterrent for the strategy of 'new model introduction' and the industry is assessing the impact of the additional cost impact in their pricing and economic model.



69% BELIEVE THAT INDIA HAS ADEQUATE CAPACITIES FOR THE NEXT 3 YEARS

Q.9. Are the capacities in India and China, in relation to the demand potential, adequate for the next 3 years?

The estimated utilisation of the global capacity in 2012-13 was 70% as against the historical average of 80%. Most of the underutilisation was reported from Europe and Brazil, Russia, India and China ("BRIC") regions. Due to the brutal restructuring of their automotive industry post 2008, USA was relatively better placed in terms of capacity utilisation. The capacity utilisation in 2012 and 2013 were 64% in China, 83% in USA, and 71% in India.

Projections of vehicle sales suggest that the growth will mostly take place in emerging markets. The growth rate until 2020 is projected at an average 3% per year for the Organisation for Economic Cooperation and Development ("OECD") countries and 9% per year for the BRIC countries.

A comparison of the projected production levels in 2020 (between 125 and 130 million cars worldwide) with the actual capacity in 2012-13 indicates that the additional production capacity of around 35 to 40 million cars needs to be built over the next 8 years. The countries with the largest projections that need to expand capacity in the medium term are India and China. For the next few years, existing capacities are expected to be able to meet the expected demand, albeit after considering technological improvements.

Our respondents have stated that the current capacities in China and India are adequate for at least next 3 years, 72% in case of China and 69% in case of India.

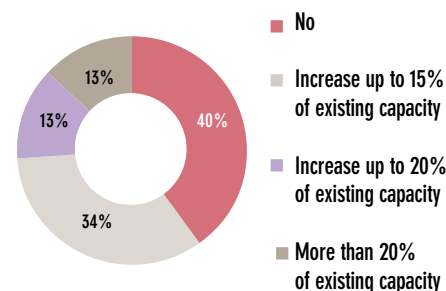
Accordingly, most organisations have restricted their plans for investments in capacities for the ensuing 2 years.

Q.10. Do you plan to increase your organisation's capacity over the next 3 years?

The automotive industry had invested in capacities earlier to cope with the expected sales growth of around 8-10% per annum.

Last year, investments to the tune of INR 20,000 crore were made in the Indian automotive industry. The slowdown in the industry over the last 2 years has resulted in several organisations having excess capacities. Consequently, fresh investments in capacity building are unlikely in the near to medium term. However, the investments in developing new products, refreshes and research and development is an ongoing exercise, which is expected to continue.

In tandem with the perception about the industry capacity, respondents were conservative in relation to the expansion in a 3 year time frame. 40% firmly believed that no expansion was required, while 34% felt a marginal expansion of 15% may take place in the ensuing 3 years in their organisation.



74% ARE NOT LOOKING TO INCREASE CAPACITY SIGNIFICANTLY

“All of the car manufacturers have capacity problems – all of them.”

CARLOS GHOSN,
HEAD, NISSAN-RENAULT

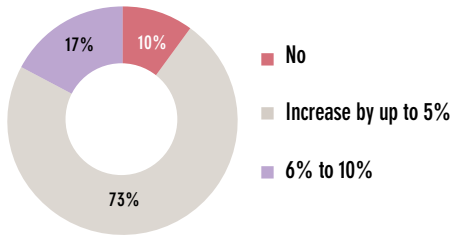
Q.11. What would be your preferred areas of investment over the next 3 years?

With the investment in capacity building not being a high priority area, the Indian automotive industry has an opportunity to focus its investments on innovation, productivity and quality. While the leading global auto suppliers typically spend 5% to 10% of their revenues on Research and Development (“R&D”) for innovation and quality, it is currently and cumulatively less than 1% in the case of Indian manufacturers.

The automotive industry has always had an impact on upstream and downstream industries. For example, the steel, aluminium, plastics and glass industries invest in R&D and innovation to come up with high-strength, lightweight composites to improve the quality and offer “green solutions” for sustainable automobiles. Downstream, the finance and insurance industries become more innovative to facilitate greater affordability in tier 2 cities and rural areas. Consequently, investing in innovation, productivity and quality would not only accelerate the growth of the industry but also create positive impulses for other coupled industries. Our respondents strongly identified preferred areas for investment in the next 3 years as productivity, quality and innovation.

	Most preferred area of investment	Medium preferred areas	Least preferred areas
Productivity increase	84%	10%	6%
Quality initiatives	81%	10%	9%
Innovation	74%	20%	6%
Green technology	50%	40%	10%
Marketing and brand building	50%	39%	11%
Acquisitions	40%	44%	16%
Capacity increase	31%	24%	45%
Land and building	20%	31%	49%

84% RATED PRODUCTIVITY INCREASE AS THE MOST PREFERRED AREA FOR INVESTMENT



73% FEEL THAT CONTINUATION OF THE EXCISE BUDGET REDUCTION MADE IN THE FEBRUARY 2014 BUDGET WILL HAVE A POSITIVE IMPACT ON THE DEMAND

Q.12. Do you think the reduction in the central excise duty as announced in the February 2014 budget would improve the consumer sentiment and possibly revive the demand for vehicles and therefore, should be continued after June 2014 as well?

To provide relief to the automobile industry, the GoI had reduced the excise duty by 4% to 6% for the period up to June 30, 2014. After initially passing off this discount to consumers, most manufacturers increased the prices soon after to compensate for the rising input costs. Consequently, the expected impact of the increased sales did not come about. In most cases, the vehicle manufacturers had to absorb the burden of higher duty already paid on unsold inventories. However, the industry welcomed the duty reduction and strongly felt that it would help in stirring up the demand.

73% of the respondents feel that the demand will positively be affected up to 5%, due to the cut in the excise duty, thus strongly advocating the continuation of this reduction and not limiting it to June 30, 2014.

Mazars has been advocating the need for the extension of the excise duty cut, and is delighted that the new government has extended the validity of concessional excise duty regime provided for the capital goods, automobiles and consumer durables sectors by six months, i.e. till 31 December, 2014.

3. PROFITABILITY



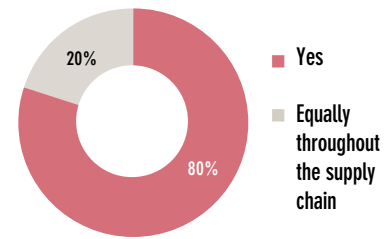
Q.13. Do you agree that the overall profitability of the industry (as a whole) in India is under pressure and the maximum pressure gets passed on to the tier 1 and tier 2 suppliers?

The overall profitability of the automotive industry in India is under pressure and the maximum pressure gets passed on to the tier 1 and tier 2 suppliers. Small companies, with revenues under INR 100 crores, operate at a very low profitability and have a relatively lower return on capital employed ("ROCE"). With significantly lower margins, these companies are more prone to risks associated with any fall in the demand.

Inevitably profit pressures in the industry are passed down throughout the supply chain, with relatively disproportionate pressures being borne by the tier 2 suppliers, thus curtailing their ability to invest in tandem with the OEMs and tier 1 suppliers.

Consequently, this segment represents the soft underbelly of the industry, leading to stress on the entire supply chain.

There was a strong agreement amongst the respondents that margin pressures are borne disproportionately by the supply chain, particularly by the tier 2 suppliers.



80% FEEL THAT DISPROPORTIONATE PRESSURES ARE BEING ABSORBED BY THE TIER 2 SUPPLIERS

“Tier 1 and tier 2 suppliers are under intense pressure to reduce their overall cost structure. This pressure is rooted in a number of factors, including the demands for price cuts from the OEMs. These demands are the result of the growing price pressures that the OEMs themselves are facing in the competitive automotive market.”

*SUNANDAN KAPUR,
VICE CHAIRMAN,
KRISHNA GROUP*

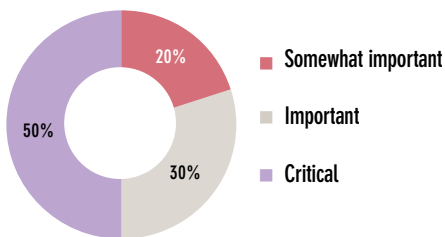
4. CHALLENGES



63% BELIEVE THAT INFRASTRUCTURE DEFICIT IS THE KEY CHALLENGE FOR THE INDUSTRY

“The automotive sector in India has the potential (as it has done in the past) of generating more jobs than most of the other industries in the organized manufacturing sector. However, this sector has possibly seen the most amount of industrial conflict. The bane of this lies in India’s archaic labour laws and the consequent high utilisation of contractual labour.”

MONISH CHATRATH, PARTNER AND LEADER, CONSULTING AND MARKETS, MAZARS INDIA



80% WANT LABOUR LAW REFORMS

Q.14. What are the major challenges faced by the Indian automotive industry today?

The government should allocate increased funds towards infrastructure development for the automotive sector. With the improved roads, ports and power facilities, there will be a considerable growth in the sales of vehicles.

	Major challenges	Moderate challenges	Minor challenges
Availability of cost effective capital	70%	23%	7%
Access to world class technology & quality practices	63%	34%	3%
Infrastructure deficit	63%	27%	10%
Talent crunch	52%	31%	17%
Trade policy	43%	30%	27%

63% respondents agreed that the Indian automotive industry urgently needs advanced technologies to produce fuel efficient, environmental friendly, lighter, safer, and cost-competitive engines and vehicles.

As compared to most of the other countries, the interest rates on finance of vehicles are much higher in India. According to experts, the availability of cost-effective capital will enable India to attain a competitive position globally.

Q.15. To what extent are the necessary reforms in labour laws important to the industry?

Contract workers, who are paid relatively lesser benefits, constitute 70% to 80% of the workforce in the industry. The underlying tension caused by the clash between the workforce’s aspirations, automotive companies’ cost considerations and outdated labour laws result in significant pressure. The insecurities of the casual labour have the potential of derailing India’s automotive ambitions. Consequently, labour market reform is necessary to retain the competitiveness of the automotive companies.

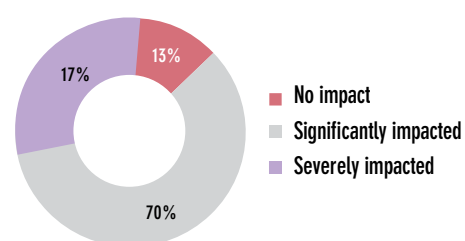
4 out of every 5 respondents have stressed that the need for labour reforms is either critical or very important. 50% felt that such reforms are critical for the automotive industry’s growth.

“The need of the hour is flexible labour reforms. An atmosphere of fear in the minds of the workforce is not healthy for the comprehensive growth of the industry. The stringency of labour laws is making companies outsource labour. This has increased the overall cost for the automobile companies in India.”

ARVIND WALLA, PARTNER, MAZARS INDIA

Q.16. How is your organisation impacted by the prevailing labour laws and situation of a high number of contractual labour?

All the companies struggle with rigid labour laws, thus innovating their HR practices to manage the consequent challenges. Most companies have a presence of large number of contractual workforces where adherence with the plethora of applicable laws poses practical difficulties. Several companies have the coexistence of a unionised workforce with differing productivity standards and wage levels compared to the contractual workers. Further, the permanency of a unionised worker compared to the temporary status of a contractual worker creates an uneasy work environment. The use of contractual employment may have been a convenient tool to curtail the power of labour unions. However, this strategy has reached its limits. Labour market reform is essential if automotive companies are to retain their competitiveness; in some instances, to simply survive the dynamics of the global business.



87% ARE ADVERSELY IMPACTED BY THE CURRENT LABOUR LAWS SITUATION

5. GOVERNMENT POLICIES



17. Do you think that the Indian auto component industry is likely to be impacted by the imports from China?

The production costs in China are significantly lower than India. The difference ranges up to 20% and contrary to the common belief, the Chinese automotive industry has greatly improved on the quality parameters. China's advantage is its scale of operations, cheaper raw materials, lower capital costs, simplicity of tariffs and cost of doing business.

Many OEMs like Tata, Bajaj Auto, M&M, TVS Motors, Ford Motors etc. are directly sourcing components from China. According to a recent report by Crisil, China more than tripled its share of the Indian automobile part imports to 21% in 2012, from 6% in 2006.

From the overall industry perspective, the negative fallout of low cost imports on the component suppliers is balanced out by the advantage to OEMs and some tier 1 suppliers. However, in spite of the successes of component industry in exporting to Europe and North America, India has become the net importer of auto components. For many experts, this trend is of serious concern.

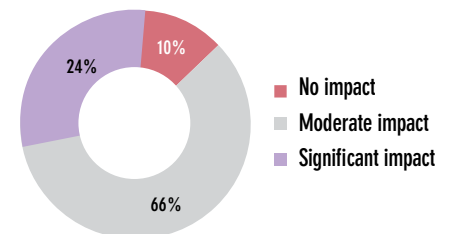
However, notwithstanding the growing imports and threat perceived by many affected suppliers, two-thirds of the respondents categorise the impact of imports as 'moderate' on the industry, while nearly one-fourth of the respondents consider this to be significant.

Q.18. Should the Gov institute some import trade restrictions from China?

In 2000, the China-India trade was worth just US \$2.9 billion, which grew to US \$80 billion in 2012. India is currently running a hefty trade deficit with China (over US \$25 billion), which it is struggling to manage. In fact, the current situation makes out a strong case of putting some restraining mechanisms on one-way import of auto components.

62% feel that the Gov should institute import trade restrictions vis-a-vis China, to address the cost disparity and virtual one-way trade for component manufacturers.

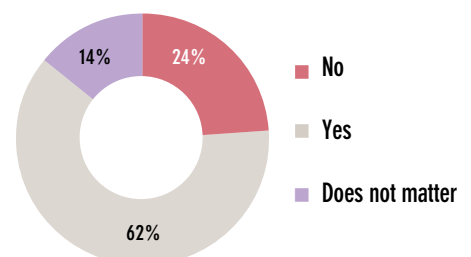
66% FELT THAT THE IMPORTS FROM CHINA WILL HAVE ONLY A MODERATE IMPACT ON THE COMPONENT INDUSTRY



“I must be honest that there is a great deal of concern in our industry, given the large and growing deficit in our trade with China. When conditions are more propitious and trade is more even, we will find it more feasible to discuss Regional Trade Agreement or Free Trade Agreement between our countries.”

*DR. MANMOHAN SINGH,
FORMER HONOURABLE PRIME
MINISTER*

62% WANT THE GOVERNMENT TO INSTITUTE IMPORT RESTRICTIONS FROM CHINA



55% WANT THE GOVERNMENT TO INVEST IN INFRASTRUCTURE AS A PRIORITY

“There should be clarity on diesel pricing and continuation of subsidies, lowering of interest rates and the reigning in of inflation, continuation of excise duty cuts as the OEMs have not really been able to capitalise on the cuts so far and imposition of GST to ensure that there is a fair pan-India tax structure.”

JANESHWAR SEN,

Sr. VP (MARKETING), HONDA CARS INDIA

Q.19. What are the measures taken or likely to be taken by the GoI for boosting the automotive industry’s growth?

The medium to long-term growth prospects of the automotive industry are bright. There is also a consensus on a desirable intervention by the GoI.

As per the new budget of June 2014, the excise rate cut, previously introduced in the interim budget, will continue till 31 December, 2014. To bring forth larger benefits, the interest rates need to be brought down to make vehicle financing attractive, long-pending introduction of GST has to be introduced (this single reform has the potential to revolutionise the entire manufacturing sector by eliminating the cascading effect of taxation and can overnight make 'made in India' products cost-competitive) and the infrastructure deficit needs to be addressed to ensure uninterrupted and reliable power supply to major automotive clusters. An improved infrastructure will ensure the smooth functioning of India's automotive sector. This apart, implementation of the plans for building highways need to be accelerated.

The long-term pending labour laws reforms are becoming an absolute necessity, since reform and stability of policy on fuel pricing, have a considerable impact on the industry.

The views of the industry have been echoed by the respondents in their responses which have been tabulated for priority listing as below.

Order of importance	1	2	3	4
Improve infrastructure	55%	14%	21%	10%
Tax incentives	32%	32%	22%	14%
Low interest rates	28%	38%	21%	13%
Effective labour laws	26%	30%	22%	22%

Q.20. (a) Please rate the governments’ performance on the parameters which the GoI had to fulfil as per the AMP.

The AMP 2006-2016 is the first and largest initiatives taken by the GoI with the vision for India to “emerge as the destination of choice in Asia for the design and manufacture of automobiles and automotive components. The output of India’s automotive sector to be US \$145 billion, contributing to more than 10% of India’s GDP and providing employment to 25 million persons additionally by 2016”. To achieve the objectives laid down in the AMP, intervention at 2 levels for the industry and GoI was decided for execution.

The output from the automotive sector is currently contributing 7% of the GDP and engaging 14 million people. All the aspects are short of the AMP goals targeted for 2016. As per SIAM, the AMP’s targets may be missed by 20% to 25% at the current growth rate levels.

AMP envisaged government led initiatives need greater momentum in the areas of development of infrastructure, tax incentives to the automotive industry, exemption of export profits and development of capabilities by the creation of centralised R&D laboratories.

The respondents feel that on most of the parameters, the government's performance has been below satisfactory. Infrastructure creation and promotion of the country's capabilities are the two areas where the GoI has performed significantly low.

	Below satisfactory	Satisfactory	Good
Facilitate infrastructure creation	73%	24%	3%
Promote the country's capabilities	76%	21%	3%
Create a favourable business environment	69%	28%	3%
Attract investment	60%	30%	10%
Promote R&D	37%	53%	10%

Q.20. (b) As part of the AMP, the industry was to contribute towards the following parameters. Please rate the industry's performance.

	Below satisfactory	Satisfactory	Good
Design and manufacture products of world class quality standards	21%	69%	10%
Cost competitiveness	27%	50%	23%
Improving productivity of both labour and capital	50%	40%	10%
Achieving scale and R&D capabilities	54%	39%	7%
Showcasing India's products in potential markets	31%	52%	17%

69% feel that the industry has performed satisfactorily in designing and manufacturing products of world class quality standards and cost competitiveness. However, it has performed less than satisfactory levels in the areas of improving productivity of both labour and capital and on achieving scale and R&D capabilities. The respondents feel that the industry has performed satisfactorily in terms of showcasing Indian products in potential markets.

AN OVERWHELMING MAJORITY (60% TO 70%) IS DISSATISFIED BY THE GOI'S PERFORMANCE ON THE IMPLEMENTATION OF MOST PARTS OF THE AMP

MAJORITY FEEL THAT THE INDUSTRY'S PERFORMANCE ON MOST PARTS OF THE AMP (IN TERMS OF IMPLEMENTATION) IS EITHER SATISFACTORY OR GOOD

6. CONSUMER TRENDS



Q.21. What are the important purchase criteria for an Indian consumer in the decision making process for buying a new vehicle?

Buying a vehicle is an important decision for an Indian customer based on a wide range of factors such as affordability, need, social context and lifestyle preferences.

The price-value point and brand are the overarching criteria for buyers. The brand itself, however, represents a bundle of attributes for potential customers who evaluate the choices in the market before concluding the buying decision. It is, therefore, of no surprise that all the respondents have stated that the spiralling high fuel prices have made 'fuel efficiency' the most important criteria for evaluating the vehicle which needs to be purchased.

Our analysis has also shown that life styling preferences make 'styling' as the second most important aspect in the choice of a vehicle. The respondents believe that the user base in India is not yet sensitive and well-informed about environmental issues. Consequently, this aspect does not have a significant impact in the decision-making process for a vehicle.

	Most important	Moderately important	Least important
Fuel efficiency	100%	0%	0%
Vehicle styling	81%	15%	4%
Extended warranties	66%	15%	19%
Enhanced vehicle lifespan	60%	36%	4%
Safety innovations	50%	42%	8%
Use of alternative fuel technology	40%	20%	40%
Environmental friendliness	29%	24%	47%

FUEL EFFICIENCY IS CURRENTLY THE MOST IMPORTANT CRITERIA FOR BUYING VEHICLES IN INDIA

“The current consumer market is bloating with cost-conscious customers who also pay a great attention to the fuel efficiency of the vehicle. We are presently in the changing face of luxury in India.”

*ANIL KULKARNI, PARTNER,
MAZARS INDIA*

“An Indian buyer has various reasons to buy a vehicle – prestige, the need of the family, space, or upgrading to a higher quality or segment. Once the need for a vehicle is established, the buyer considers a brand that can provide quality, utility, reliability, styling and a reasonable re-sale value.”

*RAVI TALWAR,
CHAIRMAN, T & T MOTORS*

ABOUT MAZARS

Mazars is an international, integrated and independent organisation specialising in audit, consulting, accounting, tax and legal services. Directly present in 72 countries, Mazars unites the skills of 13,800 professionals. Through correspondence and the offices of representation agreements, Mazars also serves its clients in 21 additional countries, with teams of professionals who are at the forefront of technical and ethical standards.

In India, Mazars has an ambitious growth plan. We have a national presence with offices located in Bangalore, Gurgaon, Mumbai, New Delhi and Pune, as well as arrangements to serve our clients in all major cities in India. We serve an impressive portfolio of clients in various sectors like Automotive, BFSI, Energy, Manufacturing, Real Estate, Retail, Technology and Telecom.

Mazars in India, with over 600 highly skilled professionals, focuses on qualitative delivery for its clients in each engagement. Working in close-cooperation as a globally integrated and flexible team, our global partnership enables our clients to receive and maintain continuing support and benefit from our connection with our offices across the world.

Our approach consists of using international best practices whilst taking into consideration the applicable national standards and operational realities, as well as the requirements described by the client.

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