Inflationary Pressure On The Automobile Industry

** R. Amuthan*
*** Dr. A. Ramachandran*

"Spiraling inflation, dwindling economic growth and baffled stock market is the order of the day. There is consensus that controlling inflation is the need of the moment, even it requires sacrificing the growth a little bit".

INTRODUCTION

Inflation is the relentless phenomena for every country in the world. In the third week of July 2008, inflation climbed to 11.98%. It may not have crossed the significant mark of 12%. The R.B.I. hoped to contain inflation with a 5 – 5.5% band. However, given the current scenario, RBI aimed at achieving a figure 7% by March 2009. Stiff hikes in the repo rate and CRR go a long way in reducing inflation. (Reference**- Editorial Column, The Hindu dated Aug.5 2008).** However, rising inflation coupled with depreciating US$ cause tight liquidity conditions and a slowdown in the global economy is an unexpected challenge for the policy makers across the globe.

OBJECTIVE OF THE STUDY

To analyse how inflation impacts the outlook of the Automobile Industry in India.

SCOPE OF THE STUDY

- This study has linked the current economic scenario and the individual performance of Auto Companies in India.
- This study has touched upon the increasing condition of inflation in 2008 and the decreasing condition of inflation in 2009.
- As it has focused on the current scenario, it may not act as a model study in future.

BRIGHT MARKET POTENTIAL BUT BLEAK PROFIT POTENTIAL

- The Indian auto sector saw an 8.14% upswing in vehicle's sales in quarter-1 financial year 2009 to reach 24.60 lakh units against 22.75 lakh units. The pack leader was the passenger vehicles' segment which grew at 15.08% followed by commercial vehicles segment, which grew by 9.22%. The two wheelers sector grew at a comparatively slower pace at 7%. It is only the three wheeler segment whose growth declined by 0.84%.

Table -1: The Projected and Actual Sales for the June Quarter

S.No.	Name of the segment	Q1 FY09	Q1FY08	% Change
1	Passenger Vehicle	401495	348883	15.08
2	Commercial Vehicle	108889	99694	9.22
3	Three wheelers	84994	85718	-0.84
4	Two wheelers	1865337	1741257	7.13
	Total	2460715	2275552	8.14%

- The major concern for the auto –industry is the input costs which have increased by 30%. The price of steel, which forms around 40% of the cost incurred over raw materials, is likely to be increased by 25% in Q1 Financial year 2009. This is the only expenditure which has eroded the margins of the automobile companies. Maruti Suzuki's Q1 Financial year 2008 results are the best example. Due to the rising input cost and other expenses, the company's earning before interest and tax, deprecation and appropriation(EBIDA) margins fell by 3.6%. On account of this consequence, the profit per car for Maruti fell by 17.85% in the first quarter. Since Maruti has adopted a more aggressive policy on deprecation in the current fiscal, the profit per car has come down by 6.93%.

* *Assistant Professor,* Department of Management Studies & Research, Tamil Nadu College of Engineering, Coimbatore, Tamil Nadu. Email: ramuthanfinance75@yahoo.co.in
** *Director,* SNR Institute of Management Science, Coimbatore, Tamil Nadu. Email: ram1200@rediffmail.com

Bajaj Auto too saw its EBITDA margins decline by 19 basis points. There appears no respite for the auto companies in the near future, as some of the players are expecting steel prices to move up further as the moratorium period for steel companies ended on August 7, 2008. Though the government has already indicated that it might form a price band for steel; this will further erode the margin.

- Vehicle manufactures are not able to pass on the hike in cost to customers. Even finance cost is putting another speed breaker in the growth of sales as interest rate has increased due to the tightening of the monetary policy by RBI for taming inflation.

Following are the details of raw material and other operating expenses of various auto mobile companies in India. The financial data has been compared between quarter-2((April - JUNE -2008) and previous quarter-1 (January- MARCH 2008).

Table-2: Showing the Cost of Raw Material Components of Auto Companies

(Rs. In lakhs)

S.No.	Name of companies	Q 2FY2008	Q1 FY2008
1	Hero Honda Motors	206162	197974
2	TVS Motor Co.	60413	51940
3	Maruti Suzuki	347951	369428
4	Ashok Leyland	165183	166668
5	Eicher Motors	88690	43440
6	Swaraj Mazda	11760	10507
7	Tata Motors	502513	387560
8	Bajaj Auto	162315	157960
9	LML Ltd.	2138	1516
10	Escorts Ltd.	38402	33896
11	HMT	3922	2150
12	M&M	224630	195019
13	Punjab Tractors	22820	16519

Source: www.nseindia.com

INTERPRETATION

From the above table we can understand that except Maruti Suzuki, all the other companies have been heavily hit by the raw material price increase. The major component that forms the raw material is steel. Not only the above mentioned OMCs, but also the auto ancillary companies are no way spared by this steel price hike. Since April 2008, the availability of steel products remains beyond the reasonable price pattern. In the past one year, the prices of steel have gone up by nearly 15%. This unprecedented growth in inflation hits the total volume of trading. As a result, both sales and net profit were down in the quarter (Q2FY2008) from April to June 2008 as compared to previous quarter (Q1FY2008) from January to March 2008.

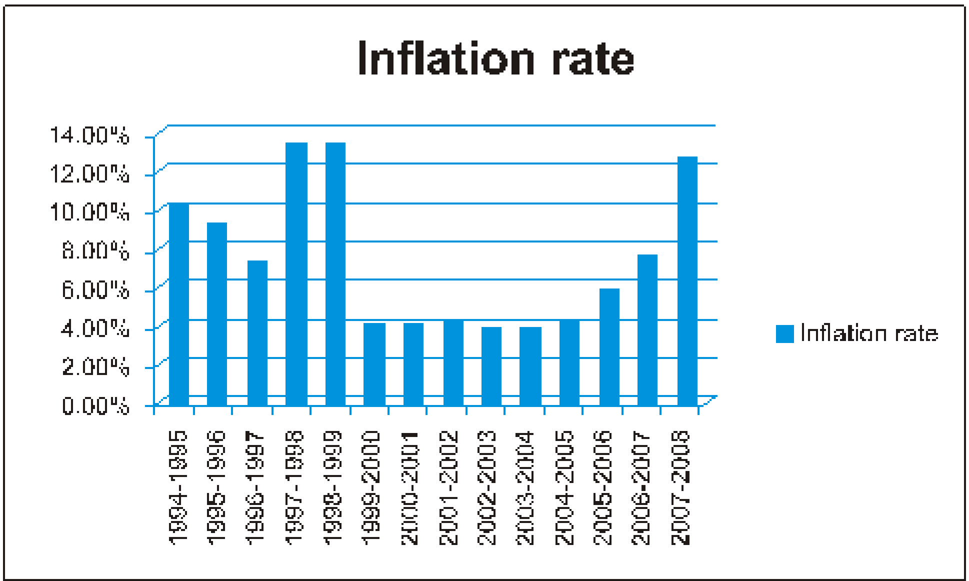
As per the survey report, out of four cars sold in the country, as many as three are sold through finance. Adding fuel to flames, the automobile industry will be affected by the credit crisis. Last year, as much as 85% vehicles were purchased through financing. Now it has come down to 67%. This situation will prove otherwise only when inflationary pressure reduces.

Cost of vehicle increase is only because of rising interest rates. According to banking sources, the average interest rates on auto loans now range from 12.5% to 13% which is expected to go up by 50 to 100 basis points. As far as Tata Motor is concerned, it increased the prices of its commercial vehicles twice in the last three months by 3.5% each time. It would normally take a 7% price increase in three years, but this time it did in three months.

This means the market can absorb price increases. Spiraling input costs will continue to strain operating margins, especially as raw materials constitute a major slice of the expenditure of vehicle makers. Inflation started hitting the Automobile industry in India only after January 2008. The following comparison between current and previous quarter sales and profit growth will make the adverse effect of inflation very clear.

Table 3 : Inflation Growth - Comparison Among Different Financial Years
Annual Inflation Rate

Years	Inflation rate
1994-1995	10.20%
1995-1996	9.20%
1996-1997	7.20%
1997-1998	13.20%
1998-1999	4.70%
1999-2000	4%
2000-2001	3.90%
2001-2002	4.10%
2002-2003	3.80%
2003-2004	3.80%
2004-2005	4.30%
2005-2006	5.80%
2006-2007	7.50%
2007-2008	12.63%
As on May 16, 2009	1.65%



Source: Labor Bureau- Government of India

INTERPRETATION

From this table and chart, it is quite obvious that inflation followed an increasing trend in the FY 2007-2008. Till 2008 (from 2003 onwards) it was consistently increasing. On account of this, the purchasing capacity of the people drastically came down (except for those who are belong to the IT Industry).

Table-4: Showing Bleak Performance In Sales and Profit Growth- Comparison Between Current (CQ1- APRIL-JUNE 2008) and Previous (PQ1-JANUARY-MARCH 2008) Quarter of 2008.

(Rs. In Lakhs)

S.No.	Name of Companies	Sales CQ1	Sales PQ1	Profit CQ1	Profit PQ1	Inflation impact
1	Hero Honda Motors	284353	278865	27287	29870	Yes
2	TVS Motor Co.	91107	87502	702.29	583	No
3	Maruti Suzuki	475358	478388	46585	29768	No
4	Ashok Leyland	188386	256200	5056	18056	Yes
5	Eicher Motors	55403	65335	527	1946	Yes
6	Swaraj Mazda	16270	17492	610	670	Yes
7	Tata Motors	692844	780490	32611	44690	Yes
8	Bajaj Auto	233837	267840	16226	18240	Yes
9	LML Ltd.	2474	2991	-1518	-1331	Yes
10	Escorts Ltd.	54280	53147	930	968	Yes
11	HMT	2634	3250	-1095	-530	Yes
12	M&M	329344	314816	15930	22110	Yes

Source: www.nseindia.com

INTERPRETATION

From the Table-4, it is quite obvious that except TVS Motor Company and Maruti Suzuki, all the companies are seriously reeling under sales growth reduction or profit growth reduction or both. Here, **Yes** means inflation impact but **No** means Nil inflation impact. In case of TVS Motor company, the sales increased from Rs.87502 lakhs to Rs.91107 lakhs. So it increased by 4.11% and similarly, profit increased by 20.46%. In case of Maruti Suzuki, the sales decreased by 0.63% but profit growth increased by 57% in the current quarter as compared to the previous quarter which happened because of the good performance of the company. In case of all the other companies, either in sales or profit or in both sales and profit growth, only reduction has taken place **due to inflation impact.**

POSITIVE INFLATION TREND AND THE POSITIVE PERFORMANCE OF AUTO COMPANIES IN 2008-09.

After December 2008, the inflation started decreasing massively. The whole sale price index nearly went to zero percent level. It was because of the impact on the announcement of stimulus package for the worth of Rs.60 crore by Central Government on February 16^{th} 2009. As a result of this, 4% CENVAT was abolished for steel and iron rod items, customs duty was relaxed and 100% FDI (Foreign Direct Investment) was welcome in Steel and Textile sectors. More than anything else, petrol and diesel prices were decreased by the central government on account of the reduction in international crude oil price. These above said changes in the economy made the whole sale price index to decrease significantly. This decreasing trend has helped the Indian Automobile industry to enjoy a big reduction in its cost of raw material consumption.

Table-5 : Showing The Trend of Cost of Raw Material Consumption

Raw Material Consumption	2008 (Q4) Rs in lakhs	2009 (Q1) Rs in lakhs
Hero Honda	234793	194916
TVS Motor	75709.93	65684.71
Maruti Suzuki	345123	473849

Ashok Leyland	56746.50	57796.03
Eicher Motors	5093	5357
Swaraj Mazda	8300	6174
Tata Motors	433970	297209
LML	2699.56	1305.53
BAJAJ Auto	141720	124013
Escorts	33729.60	29113.51
HMT	2396	1948
M&M	232504	142019.15

INTERPRETATION

From Table-5, it is quite obvious that all the auto companies had witnessed a positive trend in cost of raw material except in the case of Maruti Suzuki and Eicher Motors. This case of declining trend was clearly due to market performance but not due to industry and economic changes.

Table-6: Showing Good Performance In Sales and Profit Growth- Comparison Between Current (CQ1- March 2009) Quarter of 2009 and Previous(PQ1-Dec.2008) Quarter of 2008.

(Rs. In Lakhs)

S.No.	Name of Companies	Sales CQ1	Sales PQ1	Profit CQ1	Profit PQ1	Inflation impact
1	Hero Honda Motors	287404	341184	30042	40217	No
2	TVS Motor Co.	85282.01	101507	-95.86	1040.12	No
3	Maruti Suzuki	453712	633437	29247	34873	No
4	Ashok Leyland	100084.83	121812	1853.48	3236.50	No
5	Eicher Motors	7804	8895	1165	616	No
6	Swaraj Mazda	4190	13415	-1050	309	No
7	Tata Motors	702933	471363	34699	-26326	Mar.per
8	Bajaj Auto	178754	225899	13021	29349	No
9	LML Ltd.	1771.62	4045.44	-3008	-727	No
10	Escorts Ltd.	49526	48164	-34.12	782.37	No
11	HMT	2970	5286	-1755	-1725	No
12	M&M	250625	361918	119.66	41807	No

Source: www.nseindia.com

INTERPRETATION

Table -6 was showing increasing trend in sales as well as profit track. It was squarely because of the declining trend in the cost of Raw material Consumption. From analyzing the table, it is found that the grave effect of inflation was not felt. Except in the case of Tata Motors, all the other companies did not feel the impact of inflation. In case of Tata motors, the decline in profit and sales was because of market performance (Mar. per) but not because of inflation impact.

FUNDING CRUNCH

More than the hardening of interest rates, vehicle makers are concerned over the shrinking availability of finances. Lack of finance availability from banks' side is another concern for Auto companies in India. Some companies like Tata Motors and Mahindra, have got their own finance companies to fund the ventures.

The financing model of ICICI BANK has got changed. It has come as a rude shock to the automobile sector. As per the new financing model, the two wheeler finance service will not be offered at the dealer point itself. It will be from ICICI BANK's existing branch network only. This situation may make two wheeler vehicles selling more difficult. With a hardening of interest regime round the corner and a debilitating squeeze on availability of finance, vehicle makers may find it extremely difficult to stick to their targeted growth in sales volumes.

On the whole, things are not looking fine for the industry. As inflation number increases, the entire industry is likely to reel under pressure even further. So we cannot expect automobile industry to move ahead.

MITIGATING BUSINESS STRATEGIES

- This inflationary trend is likely to continue in the coming months, which have prompted auto companies to step up their cost reduction efforts. In order to deal with tightening credit situation, reduction in transaction cost and increased participation of manufacturers and dealers will help control the finance cost.
- Attractive Finance options to the customer and launching new models in all vehicle segments will help to avoid the tight situation. Maruti and TVS could be the appropriate example in getting success in launching new models.

Table-7 : The Sales Figures of Maruti Vehicles For August 2008 and August 2007 Are Given Below

Segment	Models	August			Till August			April'07-March'08
		2008	2007	% Change	2008-09	2007-08	% Change	
A1	M800	3717	5480	-32.2%	25319	29444	-14.0%	69553
C	Omni, Versa	6540	7889	-17.1%	33554	35734	-3.0%	89729
A2	Alto, Wagon-R, Zen, Swift	41736	37667	9.7%	197889	186886	5.9%	499280
A3	SX4, Swift Dzire, Esteem	5427	4839	12.2%	27376	20289	34.9%	49335

Source: www.maruti.co.in

INTERPRETATION

From this table, it is well known that only new models are driving the growth of Maruti. All the old versions namely M800, Omni are showing negative growth.

In line with Maruti Motor company, TVS Motor Company also had not suffered from inflationary impact. However, it had suffered a lot more from the lack of financing facility. The Company achieved annual two wheeler sales of 1.28 million units, against 1.53 million units numbers sold in the previous year. The turnover declined from Rs. 3,921 crores to Rs. 3,310 crores.The profit before tax of Rs. 35 crores for the year was substantially lower than the previous year's PBT of Rs. 91 crores due to lower sales and consequent reduction in gross margins. The current year 2008-09 will continue to be a challenging year. Continued restricted availability of retail finance is likely to affect growth of two wheelers. However, the Company is now in a better position to leverage on its complete portfolio with the launch of TVS Flame and reverse the declining trend in sales. The Company further plans to launch more new products and partially neutralize the rise in costs by implementing aggressive cost reduction programmes in the current year.

During the year 2007-08, the motorcycle category of the two wheeler industry registered a decline of 8%. The economy segment which has been the driver of growth in the past suffered a maximum decline of 19% because of non- availability of retail finance and stringent credit norms imposed by the financiers especially in small towns and rural markets. During the year, the motorcycle portfolio was largely dependent on StaR brand of motorcycles, which is a significant player in the economy segment, dependent upon availability of retail credit. Despite the slowdown, keeping in mind specific requirements of customers, **the Company launched a powerful 110 cc variant of StaR City and a new StaR Sport which delivers best in class mileage**.

(Contd. on page 42)

- The development of capital market is a necessary step before indulging in any event of disinvestment. It includes international capital market, which allows PSEs to have access to GDR route and external commercial borrowing.
- The Government of India should give a broader look to existing legal issues involved in disinvestment and should discuss it with the stakeholder to arrive at some appropriate legal framework.
- Disinvestment proceeds should not be considered only to reduce fiscal deficit but it should be used for R and D initiating diversification. All this together, with fixed timeframe, would make disinvestment a worthy exercise to perform.
- Disinvestment need not and should not be regarded as a case of selling family silver. The original investments were made by the government out of its receipts. If some parts of these investments have to be sold and realized for the purpose of expanding the activities of the state in certain other areas which are considered to be urgent now, it should not be regarded as some thing which is undesirable. Disinvestment, even where it does not lead to transfer of ownership, can have a salutary effect on management. There will be a new sense of accountability, which goes beyond being responsible only to the government.

BIBLIOGRAPHY

1. Datt, Ruddar,(2007), "Economic Reforms in India From First to Second Generation and Beyond" Deep and Deep Publications Pvt. Ltd., New Delhi.
2. Dhar,P.K.,(2004) "Indian Economy its Growing Dimension", Kalyani Publishers, New Delhi.
3. Suresh, N.D., " Privatisation of PSUs" in edited book Business Environment and policy by J. Gowda, Deep and Deep Publications, New Delhi.
4. Datta Ruddar, Sundram K.P.M.,(2003) "Indian Economy" 54th edition Schand and sons, New Delhi.
5. Mishra Girish, (2005) "On Disinvestment in India" www.Znet.Activism.com.
6. Bhushan Prashant, (2006) "Privatisation: from the Guru himself",www.countercurrent.org
7. Mukherjee Dipankar, (2007) "The Ugly Face Of BALCO Privatisation", People's Democracy, vol XXXI.
8. Keswani Aneel and Shackleton Mark B., (*2007*) "How Real Option Disinvestment Flexibility Augments" European Journal of Operations Research, Forthcoming.
9. Suzuki Yui, and Suzuki Yukari, (*2007*) "The Effects of Interprovincial Migration on Human Capital Formation in China", School of Diplomacy and International Relations; University of Michigan.
10. Ghosh A.,(2004) "The Nation's Economic Dilemmas", Business Line.
11. Bhushan, Prashant, "Privatisation: from the Guru itself", www.countercurrents.org (2002).
12. Sethuraman S., "Disinvestment in India's Public Sector", Government of India, Press Information Bureau (2001).

(Contd. from page 32)

T.V.S.'S EXPANSION IN THREE WHEELER SEGMENT

The Company also entered the three wheeler segment in March 2008. Another important milestone crossed during the year was the commencement of commercial production from its state-of the-art plant located at Karawang near Jakarta, Indonesia and successful launch of TVS Neo, the Bebek, exclusively developed for the Indonesian market by its subsidiary PT TVS Motor Company, Indonesia.

GOVERNMENT OF INDIA INITIATIVE FOR CONTROLLING PRICE RISE

To ensure adequate supply of steel, the GOI has imposed additional export duty of 15% on primary steel and HR coils, 10% duty on exports of CR coils, Pipes & Tubes, 5% export duty on export of galvanized steel. The government also abolished customs duty on imports of Pig iron, sponge iron, semi finished products, HR coils, CR coils, bars & rods, Ferro alloys and zinc.

RBI'S INITIATIVE FOR CONTROLLING PRICE RISE

RBI has increased the case reserve ratio to 8.25% from the earlier 7.5%. It will perhaps minimize the credit off take of companies. The loan interest rate will increase. This will cut down the free flow money in the country.

CONCLUSION

Financial Success is the result of decreasing cost and increasing revenue. From above mentioned facts and figures, it is all the more true that automobile companies in India failed to reduce the cost. Nor do they have the capacity to increase the revenue. From Maruti's case, it is well understood that offering flexible **financing facilities** and **launching new models** will help automobile companies to sustain and ensure profitability particularly **at times of negative inflation effect.**

BIBLIOGRAPHY

1. www.nseindia.com
2. Business Line dated 21st July 2008
3. Business Line dated August 7th 2008
4. Editorial " The Hindu " dated August 5th 2008
5. The Hindu 27th August 2008
6. Karvy the Finapolis, Volume 2, issue 2, June 2008.
7. Google.co.in
8. Maruti and Tvs company websites.