Indian Automotive Industry – A Special Feature

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Content

India's Automotive Industry – An Overview

Automotive Industry is one of the key sectors of India's economy, accounting for nearly 4% of the country's GDP (2010). India is one of the few countries which registered a positive growth in passenger car sales even during the global crisis.

The Indian automotive industry is one of the largest manufacturing sectors in the country. It comprises around 50 major OEMs, providing direct or indirect employment for over 10 million people.

The industry structure has evolved over the past three decades, with 1983 marking the beginning of the transformation from the heavily regulated, closed market into increasingly deregulated, globalized and fast growing industry.

Table 1: Evolution of the Indian Automotive Industry

Heavy Regulation (Pre 1983)	Partial Liberalization (1983-1993)	Liberalization (1993-2000)	Globalization (2000-2012)
• Closed Market • Growth limited by supply side constraints • High duties and sales taxes	• Suzuki Motors and Government of India form a joint venture – Maruti Udyog • Similar joint ventures with companies in commercial vehicles and component forged	• Deregulation in 1993 • Global OEMs set-up assembly plants in India (GM, Ford, Honda, Hyundai, etc.) • Imports allowed from April 2001; alignment of duty on components and parts to ASEAN levels • Implementation of VAT • Automatic approval for up to 100% FDI investment • Boom in auto financing	• Foreign OEMs increase production capacities in India • Post 2008, a large number of inbound and outbound M&A deals take place • India becomes a hub for small and mid-sized fuel efficient cars

The Indian economy has grown at an average annual rate of nearly 7% in the five years ending 2011 and this growth rate is likely to be sustained in the medium term. Increasing industrial production and growing spending power of the middle-class households are expected to bring India to the top five markets for passenger and commercial vehicles by 2020.

By 2015 India is expected to become the seventh-largest automotive market in the world after China, the USA, Japan, Germany, Russia, and Brazil.

Two-Wheeler Segment Dominates the Automotive Sector

The automotive industry grew at a CAGR of 11.9% during 2005-2011. This growth was driven by a buoyant economy, new product launches and attractive finance schemes from automotive manufacturers and financial institutions.

In addition to domestic sales, growth from exports also contributed to the industry revenues; in 2010-2011, exports accounted for about 15% of total automotive sales in India.

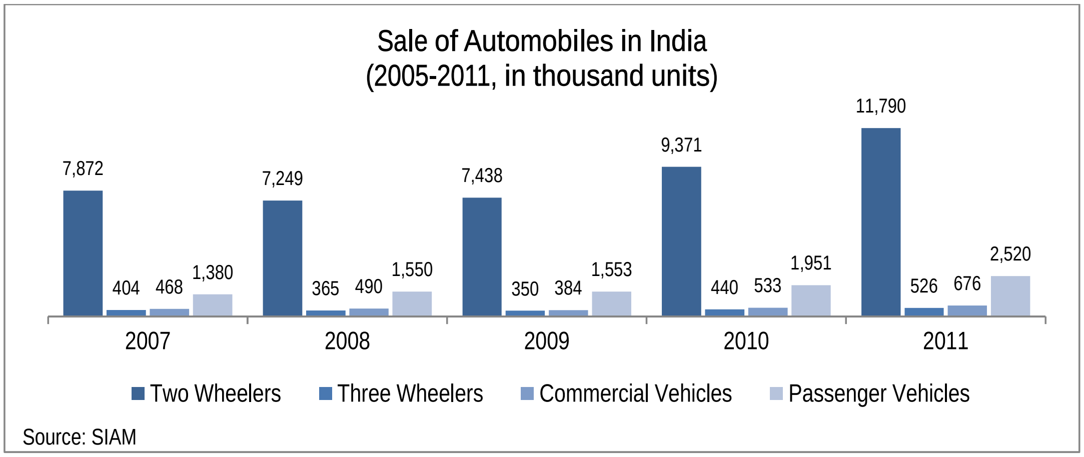
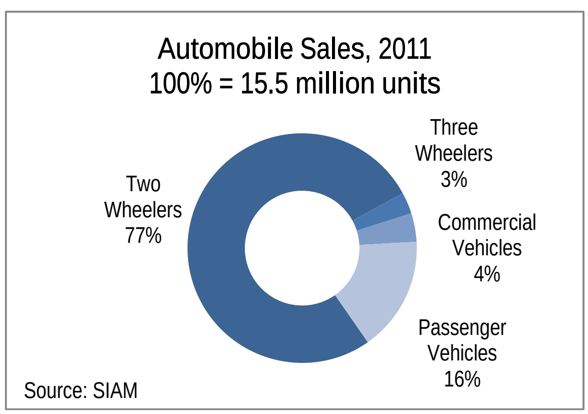


Table 2: Indian Automotive Industry at a Glance

Category	Domestic Sales in 2010-2011	CAGR (2004-2011)	Exports in Total Sales 2010-2011
Two Wheelers	11.7 million	11.3%	11.5%
Three Wheelers	526,000	9.3%	33.9%
Commercial Vehicles	676,000	13.4%	10.1%
Passenger Vehicles	2.5 million	15.5%	15.2%

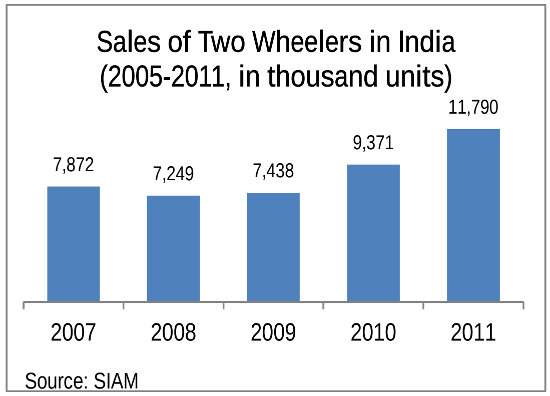
Unlike most developed and some of the developing markets, two-wheelers account for nearly three-quarters of automotive demand in India, owing to their affordability and ease of mobility. For 72% of India's rural population, two-wheelers are the most convenient mode of transport.

In spite of significant demand for two-wheelers, highest growth was witnessed by passenger vehicles, demand of which grew at a CAGR of 15.5% during 2005-2011. Three-wheelers and commercial vehicles also performed fairly well.



Double-Digit Growth of Two-wheelers Segment to Continue

In 2010, India ranked as the world's second largest two-wheeler market, only behind China. Nearly two out of every three automobiles sold in India are two wheelers. The Indian two-wheeler industry has reported strong volume growth over the last two years, having grown by 26% both in 2009-2010 and 2010-2011 to reach 11.8 million units.



A strong recovery in two-wheelers sales after the 2008-2009 slow down was driven growth in rural demand, increase in replacement demand, and rising proportion of cash sales.

Although India is the second largest two-wheeler market, two-wheelers household penetration is still much lower (at around 36%) compared with some of the other emerging markets such as Brazil, Indonesia, Thailand and Taiwan. Also, the penetration rates differ between the rural and urban areas, with the former under-penetrated by a factor of 1/3x compared with the latter.

Moderate penetration with an expected steady GDP growth, favorable demographic profile, underdeveloped public transport system are some of the factors that will contribute to continued growth of the two-wheelers segment (estimated to grow at a CAGR of 10-12% over the next five years to reach a size of ~21-23 million units by 2015-2016).

Competitive Landscape: Two-wheeler production in India is concentrated in the hands of a few large companies. Eight large producers accounted for over 90% of two-wheeler production in 2010-2011; by contrast, the Chinese market had around 10 large companies that accounted for 70% of production.

A concentrated but high growth sector, with the two largest producers, Hero Motors and Bajaj Auto, enjoying high profitability, indicates that the two-wheeler market has the room to accommodate new OEMs.

At the top-end of the motorcycles sub-segment, three global players: Harley Davidson, Hyosung and Ducati have recently entered the market; Mahindra & Mahindra, a local OEM, has also made an entry into the scooters sub-segment, the executive motorcycles sub-segment and the premium motorcycles sub-segment.

Key Trends

Demand Relatively Inelastic to Credit Supply

Till 2006-2007, about 50% of all two-wheelers purchased in India were financed by captive financiers, non banking finance companies and private banks. This share has declined sharply to about 25% by 2010-2011. The contraction in number of financed vehicles was a result of tightening supply of finance, attributed to a sharp rise in delinquencies during 2007-2009, prevailing high interest rates and resulting cut back of lending to this segment by some Indian banks.

Despite the shrinking finance availability, two-wheeler sales have remained buoyant. This underscores the trend where customers are shifting their dependence away from bank financed vehicles. The diminishing importance of finance availability as an influence on the customers' purchase decision has also partly been the result of increasing share of rural sales, where buyers rely less on organized finance options.

Production Capacity Addition Gaining Importance

Over the years, two-wheeler OEMs have systematically invested in capacity addition to meet the rise in demand. The installed capacity of the top three producers, Hero Honda, Bajaj Auto and TVS Motors increased from 8.4 million units in 2005-2006 to 12.9 million units in 2010-2011. These three producers incurred cumulative capital expenditure of about $22 billion during this period.

However, barring 2007-2008 and 2008-2009, despite additional investment, overall capacity utilization in the industry has remained high (75-80%). For the top three players, the utilization was around 87%. Running at such high capacity utilization, the buffer is shrinking fast. It is estimated that, in order to achieve industry volumes of 21-23 million units by 2015-2016 (domestic and export), OEMs will need to invest additional $20-30 billion to expand their production capacity.

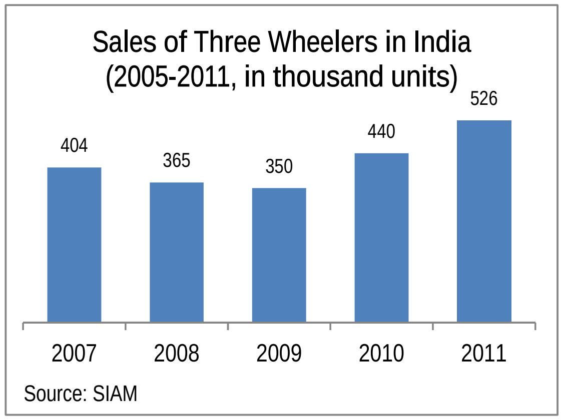
Distribution Network Strength Critical for Further Penetration

Two-wheeler OEMs continue to maintain their focus on expanding sales-cum-service outlets, especially in semi-urban and rural areas. Established dealers have helped OEMs scale up their networks by setting up satellite dealerships along with service facilities in neighboring smaller towns. As per estimates, the Indian rural market now accounts for around 45% of total domestic sales volumes, elevating their significance in the OEMs' distribution strategies.

To get the best returns from the distribution network, OEMs need to balance expansion in customer touch points, ensuring adequate dealer profitability and minimal channel conflict.

For smaller producers and the relatively new entrants, one of the key challenges is to scale up their distribution network. However, the inevitability of lower volumes in the initial periods dissuades new dealer additions. To incentivize, such OEMs will be required to compensate their dealers by offering higher margins, effectively leading to higher channel investments.

India’s Three-wheeler’s Market – The World’s Largest



India is the world’s largest three-wheeler market; it registered a CAGR of 9.3% during 2005-2011. The Indian three wheeler market comprises vehicles such as auto rickshaws and mini tempos.

The three-wheeler segment is broadly classified into two sub-categories: carriage and passenger vehicles. Since the former has a limited capacity to carry goods and is not preferred by many, most three wheeler manufacturers focus on the passenger vehicle sub-segment.

Three-wheelers form an important mode of transport in India; they cater to mobility needs of a vast majority of people not owning a private vehicle and inadequately served by public transport system. Three-wheeled scooter rickshaws are in some ways critical as alternate to public transport systems in most major Indian cities.

Three OEMs, Bajaj Auto, Mahindra & Mahindra and Piaggio, control bulk of the three-wheeler market in India.

Key Trends

Government Tightening Issue of New Permits

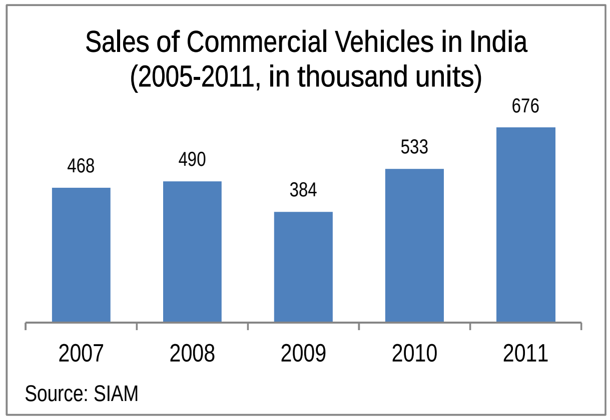
State governments regulate the plying of three-wheelers. In order to minimize pollution and encourage the use of alternate public mass transport systems, various state governments are controlling the issuance of new permits. A restriction on the issuance of permits is impacting sales. For example, TVS Motors reported a near 50% drop in sales in Tamil Nadu (a south Indian state) after the State Government reduced the number of new permits in 2010.

Growing Competition from Four-wheelers

In the passenger sub-segment, three-wheeler producers are gearing up for a structural shift to an “auto” on four-wheels from an “auto” on three-wheels. The paradigm shift is supported by the introduction of new four-wheelers that are designed to serve the same needs as a three-wheeler, albeit with enhanced functionality and higher perceived safety. Introduction of new four-wheeler models such as the RE60 by Bajaj Auto are a move in this direction. By being the first mover, the company is trying to capitalize on the slow, but steadily, growing opportunity for safe, environment-friendly and fuel-efficient means of public transport as an alternative to a car. Furthermore, in addition to Bajaj, other vehicles such as the Ace Magic and the Maxximo mini-van are also likely to step up the shift.

Commercial Vehicle Demand Follows GDP Growth

In 2010, the Indian commercial vehicles segment (Medium & Heavy and Light Commercial Vehicles) was ranked 8th globally, in terms of production. With more than 676, 000 units sold in 2011, this segment accounted for approximately 4.4% of all automotive sales in the country.



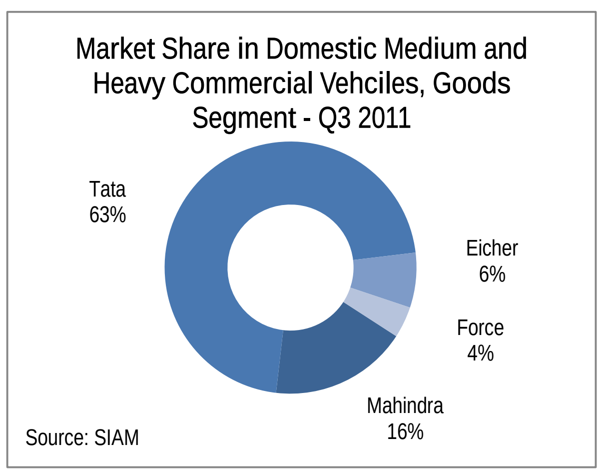
Commercial vehicles are sub-segmented into goods vehicles and passenger vehicles. Good vehicles used for transport include trucks, tempos, containers, trailers and tankers. In this sub-segment, medium and heavy commercial vehicles dominate the market. Passenger vehicles on the other hand, largely comprise buses; the segment has witnessed steady growth driven by growing domestic tourists, local passengers, and business travelers.

During 2005-2011, the sale of commercial vehicles grew at a CAGR of 13.3%. The market contracted only in 2009 (affected by global economic slowdown), only to post a strong recovery in 2010 and 2011. The growth of most commercial vehicles is directly correlated with industrial and manufacturing activity growth. Growth in road infrastructure along with strong economic growth has fuelled growth of goods and passenger carrier sub-segments over the years.

Outlook remains buoyant with growth in sales predicted at 10-12% in the medium term. However, a moderate slowdown in growth is likely, affected by rising interest rates, slowing industrial output, and substantial increase in vehicle prices coupled with high-base effect of previous years.

Competitive Landscape

The commercial vehicles segment in India is largely indigenous and is dominated by Tata Motors (market share of 63%). Other major players include Eicher Motor, Ashok Leyland (Force Motors), and Mahindra.



In late November 2011, Daimler announced an agreement with ICICI Bank (a major domestic financial institution) to provide financing packages for BharatBenz customers in India, in a bid to increase its share of the commercial vehicle market across India.

German truck manufacturer, MAN Group, announced plans to take over its Indian joint venture, MAN Force Trucks, with a view to increase its presence in the domestic market. The plans, announced in December 2011, however, are subject to regulatory approval.

Key Trends

Growth in the Share of Light Commercial Vehicles

The commercial vehicle segment is likely to experience significant structural changes with the emergence of hub-and-spoke model of transportation, driven by growth in organized retail. With increased road infrastructure development, commercial vehicle sales would be driven by focus on application-specific vehicles such as light commercial vehicles, typically sub-3.5 ton vehicles for short distances. Over the last three years, the ratio of light commercial vehicles to overall commercial vehicles has already increased to 1.27x compared with the average of 0.65x over the previous seven years. However, there is significant room for growth, considering that the current share of light commercial vehicles in overall commercial vehicles sales is 48% (2011), as compared with an average of 88% for emerging and developed countries.

Increasing Competition

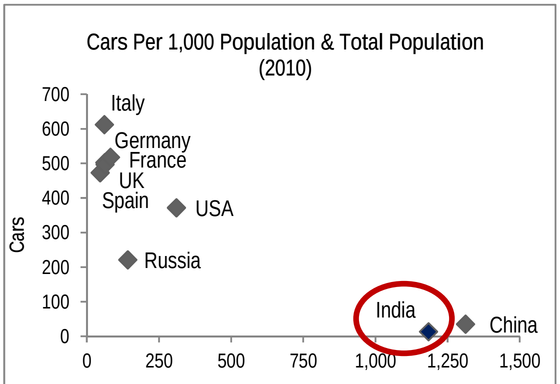
With the commercial vehicle segment attaining meaningful size and showing potential for stronger long to medium term growth, competitive pressures in the industry are likely to increase, especially given the entry of several international OEMs in the Indian market. Currently, international OEMs are following a two-pronged strategy in the emerging markets: (a) adapting premium products for local-markets, and (b) entering the low-cost segment through local engineering, sourcing, and production. In India, most of international players have entered into alliances with local partners through joint ventures, so as to gain a deeper understanding of the local market. These joint ventures are benefiting from the strong product, technology and design capabilities of the foreign partner, and from the in-depth understanding of the local market of the Indian collaborator. However, it is also believed that the established players, in defending their market position, would continue to draw significant strength from their established brand franchise, extensive distribution network and competitive cost structures.

Stable Freight Rates and High Input Costs Creating Margin Pressures

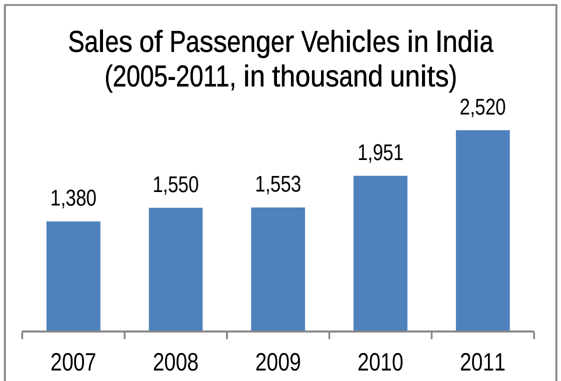
Freight rates on major routes have remained largely flat in 2011 and have not moved upwards in line with rising operating cost for fleet operators, thus indicating building pressure on fleet operator's viability. While freight rates are largely a function of overall economic activity, demand-supply mismatch in particular regions are impacting local freight rates. With major part of the road freight segment comprising unorganized players, pricing power remains limited and linked more to demand-supply scenario. Large fleet operators are, however, well placed on account of in-built escalation clauses in their long-term contracts with their customers for fuel and other expenses.

Passenger Vehicles – Underpenetrated Potential

With sales of nearly 2.5 million passenger vehicles in 2010-2011, India's passenger vehicle market ranked as world's seventh largest; larger than markets like the UK, France and Spain (in volume terms). Passenger vehicles accounted for nearly 16% of total automobile sales in 2011.



Source: EIU



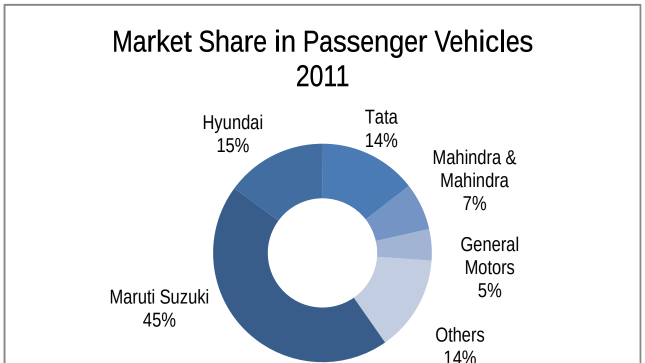
Source: SIAM

After averaging nearly 30% in 2010/11, passenger vehicle sales growth is expected to slow down significantly in 2012/13-2016/17. However, it will remain strong, at an average of 14% a year. Strong economic growth, rising disposable income, easy financing and relatively low car penetration have been driving the industry's growth.

In the past few years the Indian automotive industry has seen entry of many foreign OEM's. In order to beat the competition from new players local and established OEMs are offering low cost car manufacturing capabilities to the world.

Competitive Landscape

Nearly 75% of the passenger vehicle market is dominated by three OEMs: Maruti, Hyundai and Tata Motors.



Source: SIAM

The small-car market, which already accounts for two-thirds of domestic sales, offers the most promising prospects for sales growth as increasing affluence enables more Indians to trade up from motorcycles. This segment is also highly competitive. So far, most foreign car makers, barring Hyundai, had restricted themselves to the sedan and premium segment cars, but in the recent past some of these players have also made an entry with low priced models vying for a share of this lucrative segment. This is likely to lead to intense rivalry in the segment. Within the lower priced segment (mini/compact), the price band is widening, with higher priced but better value products achieving higher volumes than some of the lower priced models.

The price range may widen further depending on the success of the ‘Nano’ segment. The launch in 2009 of the Nano, manufactured by Tata, with a price tag of around US$3,000 has the potential to revolutionize the small-car market in India, although sales have so far failed by a wide margin to meet expectations.

Large established players in market derive strength from their low-cost manufacturing capabilities, strong brand recognition, and wide distribution and servicing reach. While this gives them a competitive advantage over new entrants, the advantage is likely to diminish as international players gain brand recognition and expand their product offerings.

Superior small-car portfolio, a wide distribution and service network and competitive pricing on the back of locally sourced auto components will be the key factors in determining the success of a foreign OEM in the Indian market.

It is estimated that the Indian passenger vehicle industry is likely to reach 4.85 million in annual sales by 2015-2016, representing a CAGR of 10.8% over the next five years.

Key Trends

Consumer Friendly Finance Schemes

Passenger vehicle financing penetration has risen steadily over past few years where over 65-70% of cars are financed. Except for few interest rate hikes, vehicle financing cost has declined in longer period of time. Easy financing availability, combined with increasing disposable income levels provides an ideal platform for strong growth in this segment.

Rise in Demand from Small Towns and Rural Areas

Rising disposable income in small towns and rural areas, improving road connectivity and higher number of earning members in a family has led to an increase in demand for passenger vehicles in recent years. Maruti Suzuki generated 19% sales from non-urban areas compared with 4-5% five years back.

India is Emerging as a Destination for Small Car Production

India is fast becoming a global production hub for small-cars. In 2009, it surpassed Japan by selling around 900,000 small-cars, compared with 700,000 in Japan. India has also become the second-largest exporter of small cars, and may soon overtake Japan. In 2010-2011, India shipped out nearly 450,000 vehicles, registering a CAGR of 26% during 2006-2010. Exports now form a considerable part of the automotive industry, accounting for 18.6% of total passenger vehicles sold in 2010-2011, compared with 7.3% in 2001-2002. Small cars comprise over 90% of total passenger car exports. India has become the largest export hub for Hyundai (outside Korea) with over 40% of its small car production contributing to export from India.

Key Challenges and Risks

The Indian automotive industry is faced with several challenges that pose a risk to the growth outlook for the industry. While a slowdown in the overall economic growth is likely to affect demand across all segments, specific challenges such as high interest rates, fuel costs, slowdown in industrial activity, flat fright rates and rising input costs are affecting demand and profitability in specific segments.

High Financing and Fuel Costs Affecting Passenger Car Sales Growth

After reporting 15-20% growth in 2010 and 2011, passenger vehicle sales growth is expected to slow down in 2012 and beyond. The slowdown is likely to be driven by rising finance costs and continuous increase in fuel prices.

In order to control prevailing high inflation, Indian central bank tightened the monetary policy and hiked interest rates (reverse repo rates) from 3.25% in 2010 to 7.50% in 2011. As a result, the interest rates on passenger car finance rose by more than 250 basis points in 2010-2011 to 11.5%. Rising interest rates have already started dampening buyer sentiments and it is perceived to have an adverse impact on the passenger car demand outlook for 2011-2012.

Similarly, despite partial deregulation and a tempered hike of petrol prices in India, rise in fuel prices has affected passenger car sales. A sharp surge of 20% in petrol prices during 2010-2011 led to a slowdown in passenger car sales in the second half of 2010-2011. Further increase in petrol prices is speculated, which may lead to increased pressure on passenger car sales growth.

Slowdown in Industrial Output and Flat Freight Rates Dampen Commercial Vehicle Sales

The Index of Industrial Production (IIP) in India has been highly volatile and has been down from record highs of 18-20% reported in 2006-2007 to average 5-10% in 2010-2011. The IIP trend points to a slowdown in economic activity, which in turn indicates a potential slowdown in demand for medium and heavy commercial vehicles. Long haulage vehicles are expected to be especially vulnerable to demand slowdown given their strong linkage to industrial freight availability.

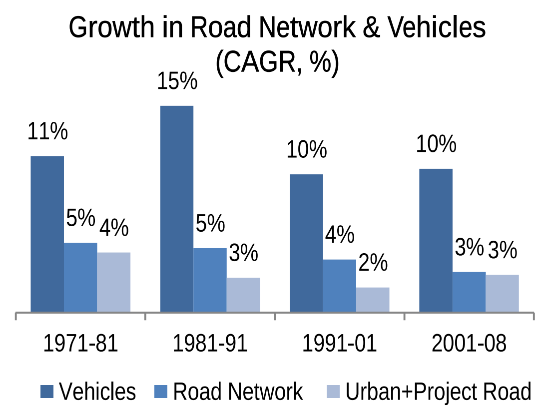
On the other hand, freight rates on major routes have remained largely flat over 2010-2011 and have not moved upwards in line with rising operating cost for fleet operators, thus indicating building pressure on fleet operator’s viability and their interest in expanding their fleet.

Increase in Raw Material Prices Affecting OEM Margins

Prices of key raw materials have been increasing (Steel +28%, Aluminum +23% and Rubber +85% in 2011), and this uptrend is expected to continue in 2011-2012. New, higher-priced raw material supply contracts started for most OEMs in April 2011 and the cost pressures are likely to further increase. Margin contraction may occur more for OEMs, such as for Maruti and Hyundai Motors, operating in the price sensitive segments in the passenger car market.

Infrastructure growth has lagged vehicular traffic growth creating severe infrastructure problems

Good physical connectivity in the form of road network and availability of adequate parking is essential to grow new automobile sales, especially those of four-wheeler passenger vehicles.



Source: Ministry Of Road Transport & Highways, GOI

Since the early 1990s, India's growing economy has witnessed a rise in demand for transport infrastructure and services. However, growth in road infrastructure has not been able to keep pace with rising demand and is proving to be a drag on the economy. Over the last four decades, the growth in road network has lagged the growth in net vehicle addition by a factor of 1/3x. Urban road network growth situation has been worse.

The ever compounding traffic and parking problems are forcing the Indian federal and local governments to implement punitive measures that may adversely affect the growth of automotive industry in the long run. The National Urban Transport Policy that was cleared by the Indian central government in 2006, encourages integrated land use and transport planning in cities, and focuses on greater use of public transport and non-motorised modes by offering central financial assistance. At various levels, the local governments are regulating parking availability. For example, in Aizwal, the capital of North Indian state of Mizoram, the owner of any type of motor vehicle including two wheelers must have a garage within their own residential or business premise or in some other place, or a garage hired from any other person, for parking the vehicle The prospective owner will have obtain a certificate from the transport department to show as a proof. Similarly, the parking policy of Bangalore (an Indian metropolitan) has included travel demand management principles. Other Indian cities such as Chennai and Pune have begun to take steps to discipline and manage the on-street parking through proper demarcation etc. Similarly New Delhi government has introduced variable parking rates while Kolkata has revised and rationalized public parking rates.

Unavailability of adequate parking and dissuasive parking measures are compelling customers to defer their purchases, especially those of large and medium sized four-wheelers in the urban areas.

Growing incidence of labour unrest in the industry

OEMs in India employ a significant number of casual labour to keep costs low and rationalise overheads in case of industry slowdown. The presence of such labour has increasingly become a recurring problems at various automotive production belts in India such as those in the northern hub of Gurgaon-Manesar or in southern hub of Tamil Nadu and the Western hub of Maharashtra and Gujarat. There is a growing dissatisfaction among the automotive industry casual workers, that their wage hike has not been commensurate with steep inflation. Political support from local parties and unionization of such labour has made the retrenchment of striking workers difficult.

The effect of recent strikes has been adverse on both OEMs as well as auto component producers. India’s leading passenger car producer, Maruti Suzuki India, suffered a total of 60 days of production losses due to three instances of labour unrest at its Manesar plant, which mainly produces the Swift, in 2011. Similarly, some workers at a General Motors factory in the western state of Gujarat went on strike for nearly three months. While specific OEMs were affected in the wave of strikes in 2011, resurgence of strikes in 2012 can severely dent the industry supply capacity.

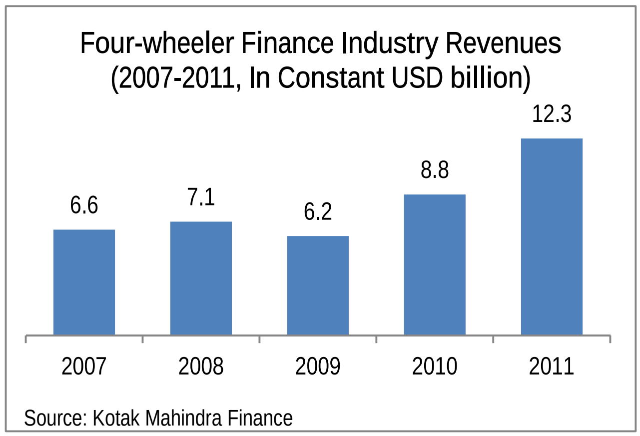
Auto Finance – Sustained Growth in Four-Wheeler Segment

Automotive Finance market in India comprises lenders such as commercial banks, co-operative credit institutions (urban and rural), Non-Bank Financial Companies, financial institution and captive finance companies of leading OEMs.

The penetration of auto finance in the four-wheeler segment is higher compared with the two-wheelers segment.

Four-wheeler Finance Segment

The four-wheeler auto finance segment was estimated to have generated USD 12.3 billion in revenues during FY2011. During 2006-2011, this segment grew at annual average rate of 13%, nearly half the rate of growth in car sales during the same period. Except in 2009, finance penetration remained steady at around 70% of car sales. By comparison, the corresponding penetration in China was around 12-15%.



Two factors have contributed the most to the recent growth of four-wheeler auto finance in India: high proportion of youth amongst the four-wheeler customers and improved availability of customer credit scores from credit bureaus.

A high proportion of youth that are not averse to loans are taking auto finance loans early in their working lives. This segment typically has growing cash flows and has therefore shown increased inclination towards finance. Additionally, the emergence and improved services of credit bureaus have allowed financers to take improved credit decisions and lower credit losses. With better availability of credit data, financiers have been offering higher-loan-to-value, which have brought even more borrowers into the financing net.

Other important factors that have contributed to the growth of auto finance include: geographical expansion and better distribution by both manufacturers and financiers (which has opened up new markets), launch of new models in untapped segments which has reduced ownership period to 36-40 months and has increased finance velocity, etc.

While the long term secular growth is strong, adverse macro economic variables have dented the auto finance industry in the recent past. Four-wheeler finance has been adversely impacted in 2011 by poor sentiment due to high inflation (constraining disposable incomes), higher fuel prices, weak property prices and poor capital markets. In the last 10 months of 2011, interest rates rose by 200-225 basis points which eroded finance penetration by 5-10% and auto finance remained flat.

The four-wheeler auto finance industry in India is fairly competitive. Banks, specialized financial institutes as well as OEM captives participate in the market. The supplier market has consolidated over the past few years as some firms exited the industry and the largest company slowed down post the financial crisis of 2008.

On the other hand, new captives have entered the market in the past two years. BMW Financial Services, Volkswagen Financial Services, Daimler Financial Services and Toyota Financial Services have commenced operations in India. With the arrival of the captives, competition has amplified and new products have been launched.

Two-wheeler Finance Segment

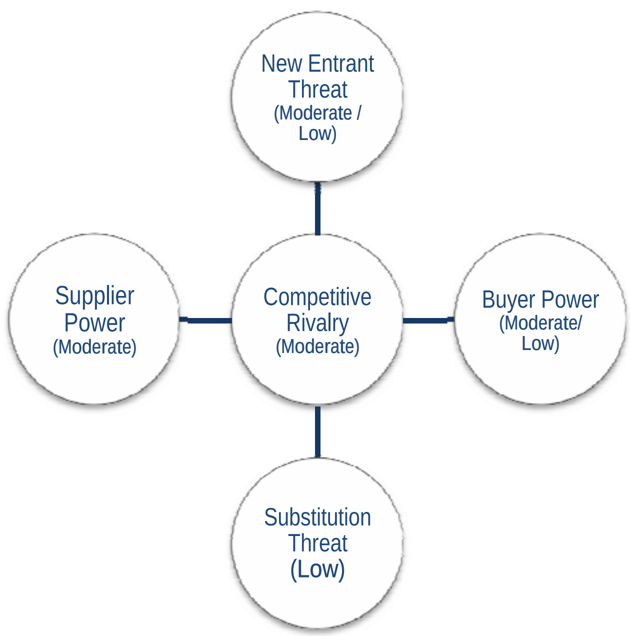
The penetration of two-wheeler finance in India is relatively low at around 25% of the total two-wheeler sales in 2010-2011. Penetration of two-wheeler finance steadily declined between 2006-2007 and 2010-2011. It was estimated that while every second two-wheeler was financed in 2006-2007, the penetration slid down to one in four by 2010-2011.

Customer interest in financing waned with the rise in interest rates and lenders remained wary of aggressive lending due to high delinquencies reported during the economic crisis. Overall, there was a contraction in the two-wheeler financing segment. .

Conclusion

The Indian automotive manufacturing industry has attracted the interest of both domestic and international OEMs vying for a share of the growth. Despite intensifying competition and an impending moderation in growth, the overall attractiveness of the industry remains moderate to high as reflected in high profitability of current participants.

Buyer power in the hands of automotive dealers is weakened by the high switching costs faced by dealerships and customer loyalty with respect to dominating brands. On the other hand, **supplier power** of commodities' providers (e.g. metals and rubber) remains high due to their large size, consolidation of the industry and the fact that automotive manufacturers account for only a small proportion of their supplier's revenues. For the **new entrants**, setting up a production facility involves large capital outlay thus constituting a significant entry barrier and high fixed cost. Furthermore, the global tightening of emission standards is additionally ramping up the costs. **Substitutes** present a moderate threat in the form of used vehicles and other modes of transport. Across all segments, **competitive rivalry** is boosted by the presence of large, international OEMs



Porter's Five Forces Analysis

Buyer Power: MODERATE - LOW

The main buyers within the Indian automotive industry are automotive dealers. However, end-user pull-through from end customers is very important.

Dealerships tend to have exclusive contractual agreements with manufacturers and as such switching costs for the automotive dealers are very high. At the same time, Indian automotive industry is dominated by large OEMs such as Hyundai and Suzuki implying dealers having a low level of OEM choice.

On the other hand, OEMs rarely sell directly to end consumers and tend to use a dealership to reach the end market. This somewhat strengthens the buyer as manufacturers are reliant on dealerships.

Overall, the buyer power in the hands of channel partners is moderate to low.

Supplier Power: MODERATE

Key input providers to the Indian automotive industry are a mix of large multinationals with a strong presence within global markets and small local component suppliers. On one hand, to ensure timely delivery of critical materials such as steel and rubber, large suppliers such as Tata Steels often bind OEMs into supply contracts thus strengthening their own power. Furthermore, with fairly low differentiation of raw materials, the switching costs for the OEMs are relatively low, which reduces the supplier power.

On the other hand, there are more than 600 small and medium sized component suppliers that form majority of the auto component output in the organized sector. These suppliers are highly dependent upon one or two OEMs for the entire off-take of their produce. The power of such suppliers is therefore weakened by their high dependence on OEMs and low differentiation in their products.

Overall, the supplier power in the Indian automotive industry remains moderate.

Threat of New Entrants: MODERATE-LOW

Brand strength and reputation are highly important in the Indian automotive industry, and it is therefore quite difficult for new players to directly enter the market. Furthermore, setting up a production facility involves large capital outlay thus constituting a significant entry barrier and resulting in high fixed costs. Additionally, leading automotive brands such as Hyundai and Suzuki enjoy an exceptionally high level of brand recognition, which is reflected in their high sales volumes and market dominance.

However, absence of FDI restriction, buoyant capital markets and growing demand offer good prospects for international OEMs to enter the market. This has been reflective in the entry of the luxury car and motorcycle manufacturers in the country during 2010-2011.

Overall, the threat of new entrants in the industry remains moderate to low.

Threat of Substitutes: LOW

India does not have a robust public transportation system. Most Indians rely on their own transportation fueling the demand for automobiles. Similarly, the demand for freight transportation faces competition only from Indian Railways, which has its weakness in non-bulk cargo transportation and network coverage. The only potential substitution threat the Indian automotive industry faces, is from the sale of used vehicles. Overall, the threat of substitutes to the industry is very low.

Intensity of Rivalry: MODERATE

The automotive manufacturing market consists of a relatively small number of large-scale companies. The market is fairly consolidated, as some companies attempted to increase their market share in the face of limited growth in large but mature markets. Rivalry is somewhat reduced due to a degree of differentiation, with several different segments within the industry (including 'luxury' vehicles and 'budget' vehicles).

Exiting the industry requires substantial divestment of highly specific assets, thus is associated with high exit barriers. Companies utilize a high level of design and marketing to promote their products. Some companies occupy more than one segment by utilizing different brands, for example Fiat (Fiat and Ferrari) and BMW (BMW and Mini).

The automotive industry in India has continued to grow at a strong rate in recent years. This helps in alleviating rivalry, reducing the level to moderate overall.