

Indian Automobile Industry Battles **WORKING CAPITAL HEADWINDS**

Changes in regulatory norms, supply chain disruptions, and rising commodity prices are posing a significant cash flow challenge for automobile Micro, Small, and Medium Enterprises (MSMEs) in India

The automobile (auto) is an important sector of the Indian economy, with an overall Gross Domestic Product (GDP) contribution of 7.1% and a manufacturing GDP contribution of a whopping 49%. It is estimated that approximately 37 million jobs, directly and indirectly, are supported by this crucial industry in India. It currently manufactures 26 million vehicles, including passenger vehicles, commercial vehicles, three-wheelers, two-wheelers, and quadricycles (Financial Year (FY) 2020), of which 4.7 million* are exported.

A snapshot of the Indian Automobile Industry

Contributes
7.1% to
the GDP

Constitutes
49% of
manufacturing
GDP

Employs
37 million
people

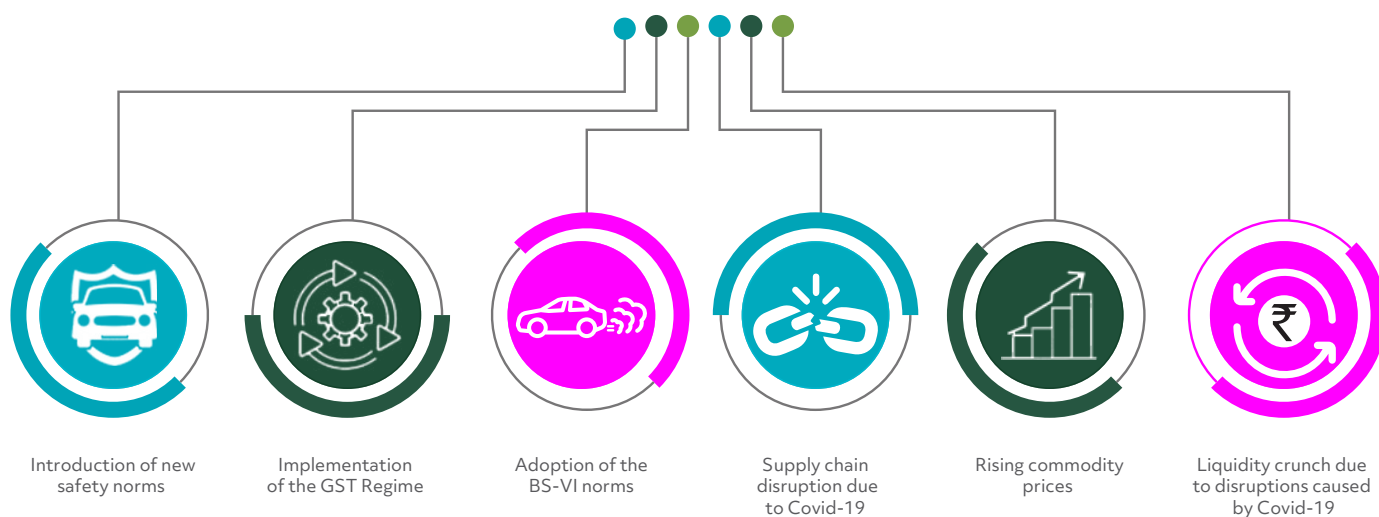
Manufactures
26 million vehicles,
annually, including
passenger and
commercial
vehicles and
quadricycles

Exports
4.7 million
vehicles



The auto industry, in general, has been in a state of stress for the past several years due to a combination of macro factors, technology shifts, and supply chain disruptions across various product segments. The industry was going through a deep structural slowdown even before the pandemic hit the world and particularly India. The stress of macro factors such as the application of new safety norms, Goods and Services Tax (GST) regime, and implementation of Bharat Stage (BS)-VI norms worsened supply chain disruptions, leading to production shortages. Changing consumer sentiment, new insurance norms, and continuing liquidity crunch from the Non-Banking Financial Companies (NBFCs) crisis also had a huge effect on the demand side.

Macro factors affecting the auto industry in the last few years



The auto industry was more severely affected by Covid-19 as compared to many other industries. As per the Auto Components Manufacturing Association (ACMA), the automobile industry in India witnessed two successive years of loss, 14.6% in FY20 and 13.6% in FY21. This level of deceleration in industry output and sales can be detrimental to the fortunes of several industry constituents but more so for Tier-2 and Tier-3 supply chains. Combine this, weak industry performance with other stress factors such as lack of financing alternatives, higher cost of financing, and then you have a case of several component manufacturers staring at imminent risk of lockdown or becoming insolvent in a short period.

Going by experts' analyses and macro trends, the industry is now rebounding and is poised to post cautious growth. This journey is not expected to be a smooth ride, given the high degree of uncertainty and volatility that has gripped the auto industry in general. One of the key implications of operating in such an environment is cash flow uncertainty. There are liquidity challenges not only for Tier I, II, and III segments but also for several Original Equipment Manufacturers (OEMs). Further many companies are either deciding to significantly scale down production or outrightly exit from businesses (Ford Motor Co.) The effect is much more visible and severe in several MSMEs that form the critical backbone of the auto industry supply chain. Unfortunately, several stories of stress and business closures at MSMEs in the auto industry have gone unnoticed.

Given C2FO's experience of working with thousands of auto industry suppliers across the country, the cash flow challenges and their effect on auto industry supply chains have been evaluated considering the following four key Industry drivers:

1- Demand Side

2- Supply Side

3- Technology Shifts

4- Regulatory changes

Demand Side – How customer sentiment and demand-side dynamics are affecting industry fortunes and driving supply chain challenges

Post pandemic, there has been a good uptick in demand in several segments of the auto industry, such as Passenger Vehicles (PVs). Coupled with this demand surge, there has been a significant change in consumer preferences, forcing automobile manufacturers to revisit their product and marketing strategies, all of which entail additional capital investments – not just on the OEM side but also deeper supply chains. Some of these shifts are shown below:



Traditional to Electric Vehicles (EVs) and hybrid vehicles

Given the government incentives, sustainability, and cost advantages in the long run



Shared mobility to personal mobility post covid

With consumers increasingly opting to own their vehicles to maintain social distancing



Premium to affordable vehicles

Owing to widespread salary cuts and job losses during the pandemic that has led to less disposable income in the hands of consumers



Sedans to Sport Utility Vehicles (SUVs)

With superior infotainment to meet the millennials' changing preferences



Physical to a digital (Phygital) car purchase journey

Powered by immersive Augmented Reality (AR)- Virtual Reality (VR) experiences

“To keep up with the evolving demands of the end customer, the auto companies and their supply chain partners require consistent investments and dynamic approaches to meet **unanticipated production imbalances**. This dynamic approach to managing finances requires the auto industry to consider nimble-footed and highly flexible FinTech solutions.”

Neha Tyagi

Sr. Director, Enterprise Sales C2FO India (Automotive Industry Lead)

Supply Side – Disruptions in supply chains require more collaboration and empathy toward business partners

The pandemic has led to widespread disruptions in automotive supply chains, which are globally integrated with a higher dependence on a few countries such as China. The bull run in the price of commodities, such as steel, copper, and aluminum, since the beginning of the pandemic, has had a cascading effect on both the cost and availability of key raw materials for the manufacturers of auto components. In addition, there is a severe shortage of semiconductor chips, which has added to the supply side pressures of the auto industry. Other concerns, including the shortage of shipping containers, import restrictions, and localization, continue to drive stress in auto industry supply chains. These concerns and one-off events like chip shortages have increased uncertainty for both auto OEMs as well as their component suppliers in India and around the globe.

Adding to the stress for the auto components suppliers is the change of OEMs from a "just in time" to an "always-on" inventory model. To ensure greater supply security of components, OEMs are going in for stockpiling. This new inventory model coupled with supply chain disruptions is driving **a greater need for short-term cash and the availability of on-tap financing for the suppliers**. The industry must think out-of-the-box and approach working capital requirements with a new mindset that can support frequent changes in the quantum and timing of financing for their business partners.

Key Fact to Consider: More than 85% of the Indian auto component industry comprises MSMEs¹, the majority of which are Tier-II and Tier-III suppliers that manufacture parts and sub-assemblies feeding the component manufacturers (usually Tier-I), the replacement market, and OEMs. Unfortunately, they've been the hardest hit financially during the pandemic.

Technology and Business Model Shifts – EVs and Vehicle electronics will continue to disrupt the status quo

The four megatrends, i.e., Connected, Autonomous, Electric, and Shared mobility, are leading the disruption trends in the auto industry in India and around the globe. Of these four trends, EV is emerging as a key disrupter. Also, the pace of EV disruption seems to have been accelerated in India due to factors such as the focus on reducing oil imports, a desire to strengthen energy security, the need to curb rising pollution, and international climate change commitments. Under the Paris Agreement, India has committed to cut greenhouse gas emissions intensity of GDP by 33% to 35% by 2030, increase non-fossil fuel power capacity to 40% from 28% in 2015 and substantially boost forest cover to reduce carbon dioxide.

“ Coupled with soaring commodity prices, there is a severe shortage of semiconductor chips, which has added to the supply-side pressures of the auto Industry. Other concerns, including the shortage of shipping containers, import restrictions, and localization, continue to drive stress in auto industry supply chains. ”

Ravi Tanniru

SVP & Head Enterprise Sales C2FO India

Four Megatrends in the auto industry



Another impetus is the decreasing cost differential of owning EV vs other variants. Although the price of EVs is still higher than that of traditional vehicles, the difference is decreasing (with evolving tech and incentives), and there is growing evidence that in terms of the total cost, running an electric vehicle is far cheaper, partly due to the price differential between electricity and petrol/diesel/Compressed Natural Gas (CNG), along with low maintenance.

Many states in India have so far rolled out an EV policy to offer additional subsidies and promote the adoption of electric mobility. However, a critical factor to drive the adoption of EVs is the support infrastructure (charging/repairs), which also needs to be developed in tandem. With the infrastructure comes the confidence and the aspiration to own and drive the vehicle of the future.

Such shifts in technology and business models, coupled with governmental push, continue to put the **onus on the OEMs and their supply chains to invest in building the right product, component, and infrastructure mix**. As business models continue to evolve, striking a balance between managing existing business requirements and preparing for the industry's future requirements poses a challenge, especially for suppliers. Across the industry, the board needs to invest in newer technologies, talent, and infrastructure to build new capacities, requiring incremental capital both for working capital and Capex requirements.

Regulatory and Compliance Norms – Necessary changes to benefit long term interests of the auto industry

The Government of India (GOI) has rolled out multiple regulations concerning vehicle safety features such as emission and fuel efficiency. In the past three years, features such as the anti-lock braking system and dual airbags were made mandatory in vehicles. The auto industry also leapfrogged to BS-VI emission norms from BS-IV norms in just 3 years. In the coming years, India will adopt a stricter form of Corporate Fuel Efficiency norms, which is also expected to further push vehicle prices. The regulations are primarily driven by the motives of reducing carbon emissions and improving the safety of passengers. Policies around the Vehicle Scrappage and Green Taxes are also devised to give a significant boost to the demand for new vehicles.

While regulatory policies are giving the much-needed push to consumer demand on one side, they are also exerting cost pressures on OEMs and auto component suppliers, which must stay in compliance with the changing norms and standards. This will require a continuous flow of investment into technology, infrastructure, and resources. Given the price sensitivities in the Indian market, there is limited scope for these costs to be passed on to the end consumer in a short period. Hence, the industry must withstand the cost and capital pressures for both the OEMs and suppliers to keep pace with its needs.



Conclusion:

The auto industry is wary of the pandemic's third wave but is also excited about the green shoots in demand revival with the hope of growth in the long run. The interesting trends in each of the drivers discussed in the paper point toward new opportunities for this strategically crucial sector for the Indian economy. Furthermore, India is being considered for expansion and new capacities by multinational auto companies. GOI's INR 26000 crores Production Linked Incentive (PLI) plan is expected to put India in a sweet spot to capitalize on the global trends.

However, a lot will depend on the preparedness of OEMs and associated suppliers to keep up with the uncertain yet promising future that lies ahead. The ability for auto companies to manage their working capital efficiently will be a critical factor for them to cash in on opportunities and withstand the emerging challenges.

- ▶ OEMs and suppliers across all tiers need to collaborate and work closely to plan for scenarios of uncertainties around maintaining demand vs production balance, addressing supply chain constraints, leveraging new business opportunities, and keeping pace with the regulatory changes. With supply chains being more integrated, the onus is on each node of the auto network to not only keep their house in order but also support their business partners. Utilizing the strength of technology and data, OEMs and component suppliers need to create deeper visibility into the health of the sub-tier (IIs and IIIs) and ensure adequate mechanisms are in place to support their working capital needs effectively.
- ▶ A balanced and focused approach is required when addressing the technology and business-model-related opportunities to ensure the right decisions are taken with clear cost-benefit as well as risk-analysis frameworks. Suppliers need a clear vision about their role in the future automotive world - a concrete action plan on how to adapt in terms of resources, especially the capital, talent, infrastructure, and technology. An intelligent and thought-through estimate on the level of financing that is required, along with access to cost-effective alternatives, will be the focus of every auto company's Chief Financial Officer (CFO).
- ▶ Prudent working capital management will support recovery in credit profiles of automotive-component suppliers, which are commonly heavily loaded with debts. The MSMEs that constitute a significant part of the supply chain are heavily dependent on regular cash inflows, as they lack cash reserves to withstand these headwinds. Alternative sources of financing, such as technology- and platform-enabled supplier financing, will prove extremely beneficial for suppliers, opening a plethora of easy and cost-effective options. C2FO is India's leading technology and business partner for several auto OEMs. C2FO provides highly customized, technology-led, and dynamic financing solutions that support supply chain health and sustainability for the auto industry.

Source

* [Invest India](#)

¹ [ET Auto.com](#)