

Profit from Knowledge Series – Auto Sector

Auto-components industry in India: Need to resolve two key issues

A Background Note

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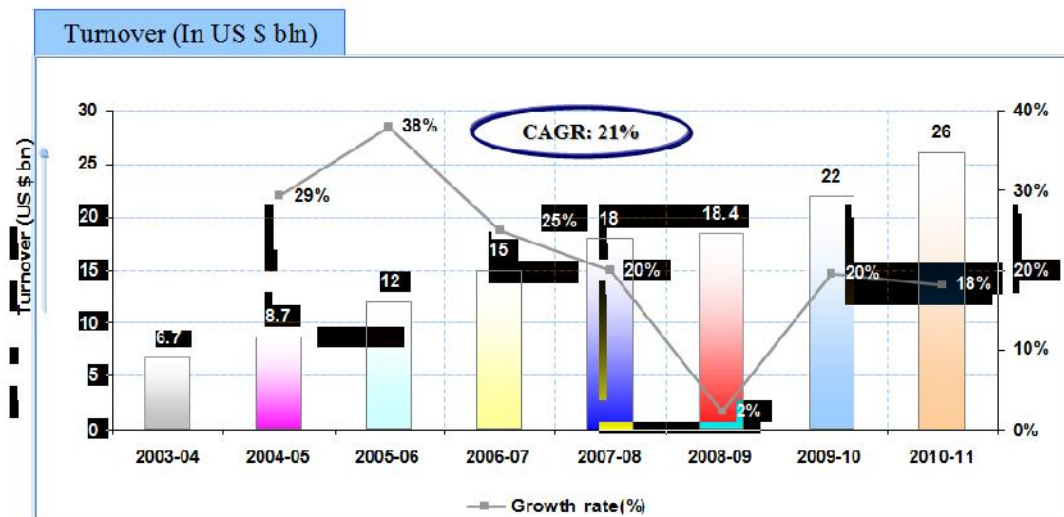
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Auto-components industry in India: Need to resolve two key issues

Introduction

The Indian automobile components industry has grown impressively over the last decade. From a \$6.7 billion industry in 2003-04 today it has become a \$26 billion industry.

Auto-component Industry – Size



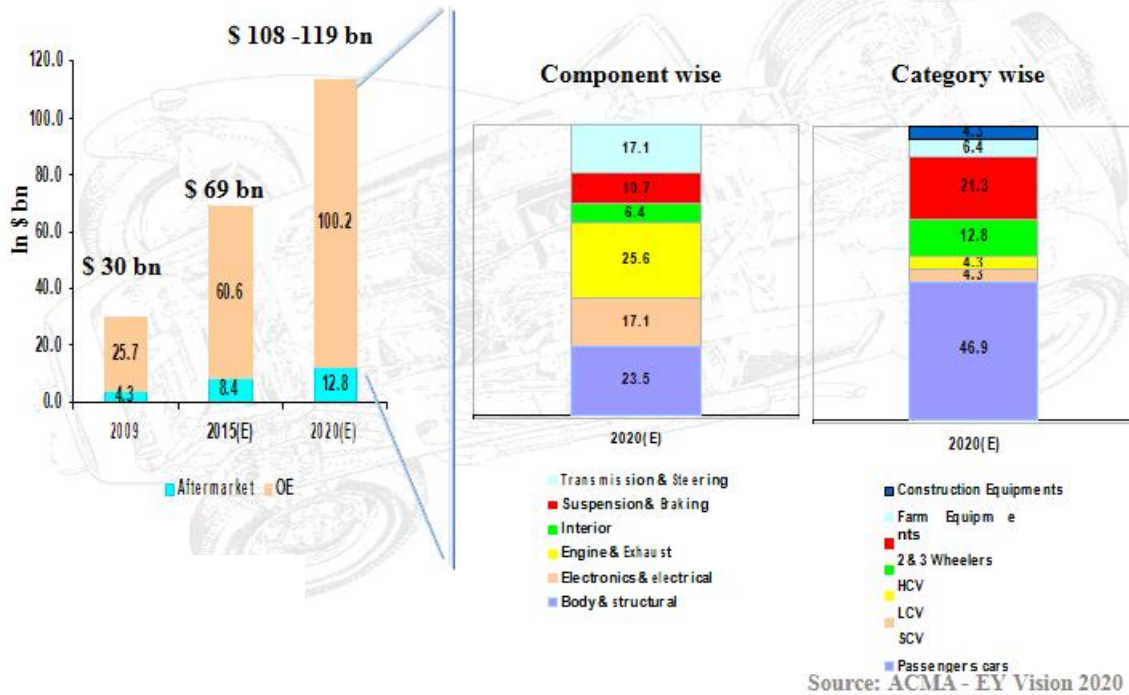
Source: ACMA - EY Vision 2020

The growth is a reflection of the emergence of India as a global automobile hub with almost all global auto makers having set up plants in India to cater mainly to the domestic market as also the export market. The Indian auto component industry has kept pace with technological developments and is today catering not only to OEM and Tier I auto makers in India but abroad as well. Many Indian auto part makers have today also succeeded in emerging as the supplier of choice to global auto majors.

Prospects

According to a Vision 2020 Document prepared by the Automotive Components Manufacturer's Association, the overall domestic demand for automobile components is likely to increase from about \$30 billion in 2009 to as much as \$119 billion by 2020.

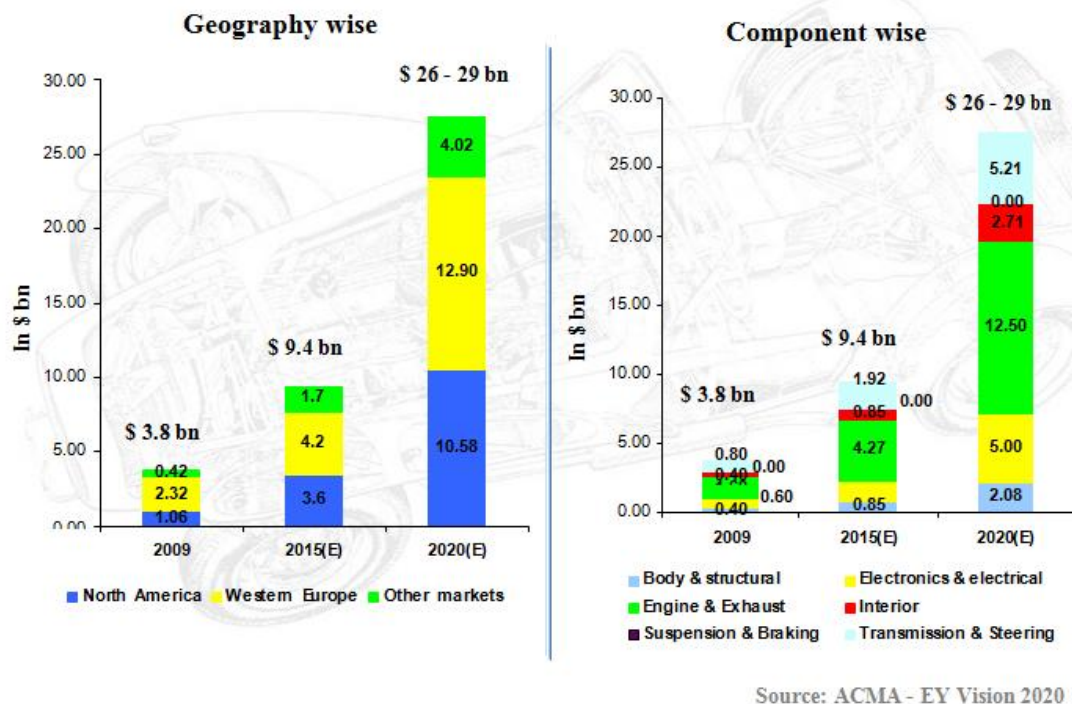
Vision 2020: Auto-component domestic demand



Of this, the share of domestic auto parts producers would go up from about \$22 billion to \$84 billion.

In terms of the global market, the Vision document estimates that exports by Indian auto component makers would go up from about \$3.8 billion in 2009 to about \$29 billion by 2020.

Vision 2020: India's Export Potential



This growth is predicated on the basis of the growth of the Indian automobile industry, the major demand source for auto component makers as more than 95 per cent of their sales are to the OEM sector and the rest is accounted for by aftermarket sales. The automobile sector, which has been growing at around 26 per cent for the last two years, is expected to double in size by 2016 according to the *Society of Indian Automobile Manufacturers (SIAM)*.

Thus, ACMA projects that the Indian auto component industry is likely to continue growing at or around the CAGR of 21 per cent that the industry has achieved over the last 7 years.

Problems

The industry is currently facing two critical short-term challenges apart from some of the longer-term challenges depicted below:

Challenges India is committed to address

- **Infrastructure Deficit**
- **Talent Crunch**
- **Scaling-Up the industry**
- **Access to World-class Technology and Quality Practices**
- **Remaining cost competitive**
- **Access to and availability of cost-effective capital**
- **Trade Policy**

These challenges are:

A. A slowing down of investment in the OEM auto sector, and

B. A sharp rise in imports, mainly from ASEAN countries.

A. Investment Slowdown

According to a Business Today report (August, 2011), the Indian automobile industry is currently feeling a bit hobbled due to several factors. The industry talks of six Ms that determine investments in the automobile sector. These are men (labour), money (capital), material (inputs), matter (energy, water), mandarin (policies) and market (domestic and global).

According to auto makers, India scores well only in two of these 6 Ms: Men and Market. The current problem, however, is that there are problems in these two areas as well. First, when it comes to Men (labour), there two issues: lack of skilled workers and increasing militancy in the last few years

which has even led to the death of a chief executive of an auto component maker in Greater Noida and of course, the strike at Maruti's Manesar plant.

With regard to the market again there are two issues: the slowdown in North American and European markets and a demand slump in the short run because of a sharp switch in customer preference for diesel engines due to an equally sharp rise in fuel costs.

Apart from these two detrimental factors, the recent increase in interest rates has further skewed the picture against India as an investment destination when it comes to another critical M - Money (capital).

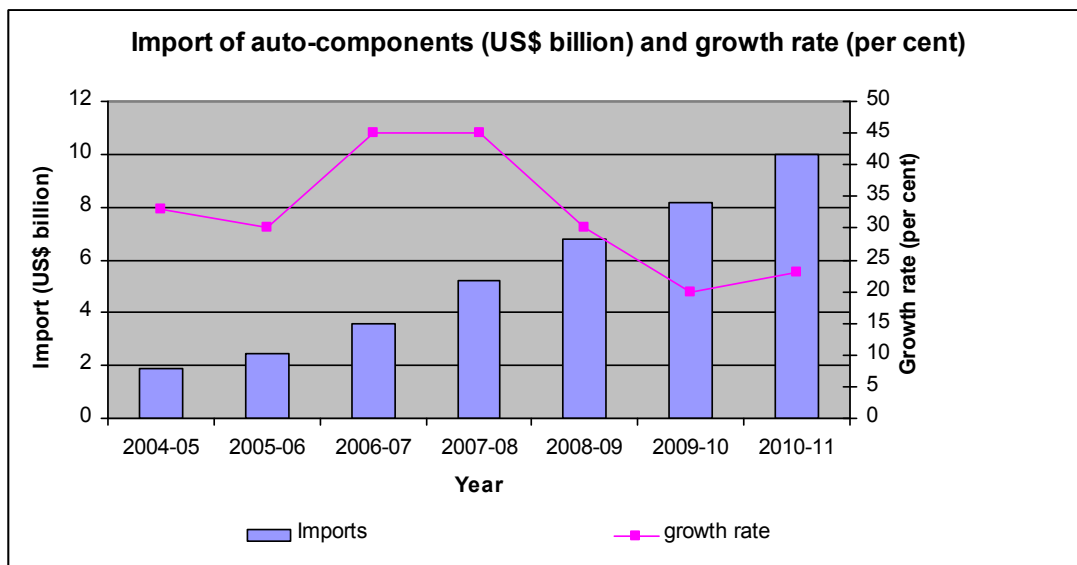
As a consequence of these issues, automobile manufacturers have either put on hold their investment plans or are going slow on them. As of now, as much as Rs 15,648 crore of investment by auto majors are in the pipeline.

Investment in the auto components industry is also likely to be affected if auto majors continue to defer their investment plans.

A. Threat from Cheap Imports

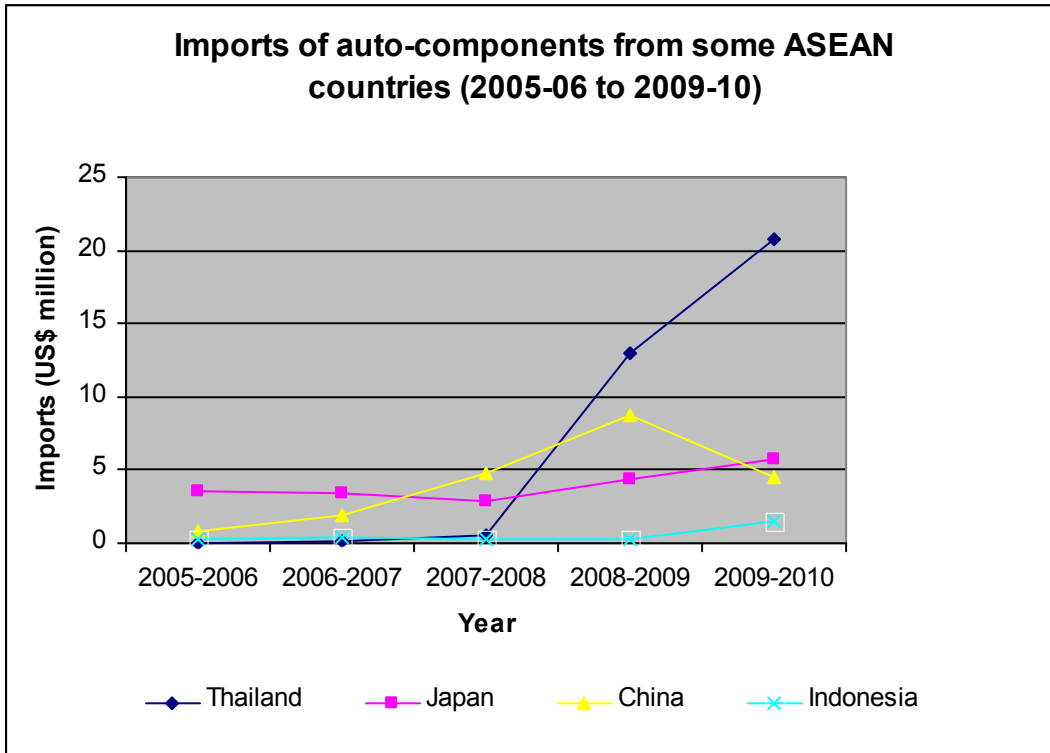
The second major issue that auto component makers are facing is with regard to sharply rising imports of auto components from ASEAN countries following the coming into effect of the Free Trade Agreement between India and ASEAN in January, 2010.

Rising Imports



While imports as a whole from all countries have also risen, the increase in imports from ASEAN countries such as Thailand, China and Japan, is proving to be worrisome for Indian component makers.

Sharply Rising Imports from ASEAN



Conclusion

Given the current scenario, there is an urgent need to look at:

- How to ensure a better investment climate for automobile majors, and
- Whether the tariff regime for auto components should be reviewed given that the auto component companies provide employment to nearly 1 million people and is likely to create an additional employment of another 1-1.2 million people over the next decade.

A stable and growing auto component industry, which has thousands of producers in the unorganised sector as well, is critical for the overall health of the economy. Hence, it is suggested that the Government of India review the above two issues on an urgent basis.