FINANCIAL APPRAISAL OF AUTOMOBILE INDUSTRY IN INDIA
(A CASE STUDY OF HONDA SIEL CARS INDIA LIMITED)

(Summary)

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On the canvas of the Indian economy, automobile industry occupies a prominent place. This sector has witnessed tremendous growth during the last two decades. Due to its deep forward and backward linkages with several key segments of the economy; automobile industry has a strong multiplier effect and is capable of being the driver of economic growth. Automobile Industry was delicensed in July 1991 with the announcement of the New Industrial Policy. The passenger car industry was, however, delicensed in 1993. The industry contributes ~22% of India's manufacturing GDP (Gross Domestic Product) and ~7% of India's overall GDP. The Indian automobile industry provides direct employment to 1 million people and indirect employment to 18 million people in the country. The Indian automobile industry, comprising passenger cars, two-wheelers, three-wheelers and commercial vehicles, is the seventh-largest in the world with an annual production of 20.4 million vehicles, of which 2.9 million are exported. At present, there are 19 manufacturers of passenger vehicles, 16 manufacturers of commercial vehicles, 10 manufacturers of two wheelers and 7 manufacturers of three wheelers in India.

Two-wheelers, being the most popular means of personal transport, alone account for about 75% of the total automobile production in India, while passenger vehicles account for nearly 16% of the production. However, owing to their lower sales realisations, two wheelers account for only around 32% of the sales in terms of value while passenger vehicles account for around 62% of the same. Commercial vehicles are categorised into heavy, medium and light. They account for about 5% of the market. Three wheelers are categorised into passenger carriers and goods carriers. Three wheelers account for about 4% of the market in India. The passenger vehicles are further categorised into passenger cars, utility vehicles and multi-purpose vehicles. In the passenger car segment, India is mainly a small car market though mid size and big car sale is continuously rising in recent years.
The major companies present in the automobiles market in India include Tata Motors Limited, Maruti Suzuki India Limited, Mahindra & Mahindra Limited, Ashok Leyland Limited, Hero MotoCorp Limited, Bajaj Auto Limited, Echier Motors Limited and Force Motors Limited. Tata Motors is India’s largest automobile company; the company manufactures commercial and passenger vehicles, and is the world’s fourth-largest truck manufacturer and the second-largest bus manufacturer. Maruti Suzuki is India’s largest passenger car company, accounting for 45% share of the Indian car market. Hero MotoCorp is the world’s largest two-wheeler manufacturing company in the world. Its market share in the Indian two-wheeler segment is 41%. Bajaj Auto is the world’s fourth-largest two-wheeler and three-wheeler manufacturer. The largest Indian passenger car manufacturers include Tata Motors, Maruti Suzuki, Mahindra & Mahindra and Hindustan Motors. Presence of foreign players such as Mercedes-Benz, Fiat, General Motors and Toyota is also growing in this segment. Recently, the passenger car segment has also seen the entry of other global majors such as BMW, Audi, Volkswagen and Volvo. Maruti occupies 50% of the market share in the mini and compact cars and is maintaining its share despite the stiff competition from manufacturers like Hyundai and Tata Motors, occupies over 20% of the market share in the small and compact car segment.

The production, sales and export development of automobile industry during 2006-07 to 2010-11 was at a CAGR (Compound Annual Growth Rate) of 12.7%, 11.3% and 23.7% respectively. The domestic passenger vehicles industry has been on a relatively steady growth phase over most of the last decade and has registered a 10 years CAGR of 10.3% during the period. The Indian car industry is still in the growth and evolution stage and is depending on the domestic and regional market. Overall Indian Automobile Industry has shown 2.61% growth in 2012-13 compare to 2011-12. Production and Domestic sales has registered growth of 1.20% and 2.61%, however export is negative growth due to negative global environment and fluctuation.
The study also presents a brief review of related literatures on the subject by different authors like, Nagarajan and Burthwal, Jagan Mohan Rao, Agarwal, Rajeswari, Chandrasekaran and Vijayakumar and Venkatachalam etc. We study the various research studies that have been carried out on different aspects of financial appraisal by the researchers, economists and academicians in India and abroad. Jagan Mohan Rao (1993) in ‘Financial appraisal of Indian Automotive Tyre Industry’ studied the financial appraisal of Indian automotive tyre industry. Agarwal (1999) studied the profitability and growth in Indian Automobile manufacturing industry.

Honda Siel Cars India Limited is a subsidiary of the Honda Motor Company Limited of Japan, for the production, marketing and export of passenger cars in India. It began operations in December 1995 as a joint venture between Honda Motor Company and Usha International of Siddharth Shriram Group. Honda Siel Cars India Limited is now known as Honda Cars India Limited. In August, 2012, the Company officially changed its name to Honda Cars India Limited and became a 100% subsidiary of Honda Motor Company. The company’s product range includes Honda Brio, Honda Jazz, Honda City, Honda Civic, Honda Accord and Honda Amaze which are produced at the Greater Noida facility. In 2011-12, the company had sold 54,427 units, and it witnessed a 35 per cent jump in sales at 73,483 units in 2012-13. During the year 2012-13, the Company has a market share of 2.74% in the overall passenger vehicle segment.

The various tools and techniques of financial appraisal are comparative financial statements, common size financial statements, trend analysis, funds flow analysis, cash flow analysis, cost volume profit analysis and ratio analysis. Ratio analysis has been found the most suitable tool of analysis and has been used in our study for the analysis. Ratio Analysis helps to ascertain the financial condition of the firm. Financial ratios help to summarise large quantities of financial data to make qualitative judgment about the firm’s financial performance. The ratios can be classified into four categories:
liquidity ratios, managerial efficiency ratios, leverage (long term solvency) ratios and profitability ratios.

Liquidity analysis attempts to analyses the companies’ ability to meet its short-term obligations. It is usually done through the calculation of current ratio and quick (liquid) ratio and absolute liquidity ratio. The company must attempt to maintain optimum (ideal) ratio which depends upon the type of manufacturing industry. If liquidity ratios of the company are higher than the ideal ratios, the company is said to be having idle investment. Likewise, if ratio is lesser to required one, the deficit will represent possible difficulties in the payment of current liabilities of firm and it is surely not a healthy sign for the company.

Managerial efficiency of the company lies in making optimum utilisation of the assets of the companies. Managerial efficiency ratios are classified as inventory turnover ratio, debtors’ turnover ratio, creditors’ turnover ratio, working capital turnover ratio, fixed assets turnover ratio and total assets turnover ratio of selected companies. Inventory turnover ratio depicts how long a company takes on an average to sale its stock and replaces its inventory. Higher inventory turnover is considered to be desirable as it usually implies strong sales. Debtors’ turnover ratio indicates the speed with which the amount is collected from debtors. The higher the debtors’ turnover ratio, the better it is, since it indicates that amount from debtors is being collected more quickly. Creditors’ turnover ratio indicates the speed with which the amount is being paid to creditors. The higher the creditors’ turnover ratio, the better it is, since it will indicate that the creditors are being paid more quickly which increases the creditworthiness of the company. Working capital turnover ratio reveals how efficiently working capital has been utilized in making sales. A high working capital turnover ratio shows efficient use of working capital and quick turnover of current assets like stock and debtors. Higher fixed assets ratio implies that company has invested lesser amount in fixed assets to generate sales revenue hence it depicts better ability of company to utilise the fixed assets. Total assets
turnover ratio shows how efficiently the total assets are being utilized in the business. Higher total assets turnover ratio indicates the higher efficiency in the utilization of the total assets.

Leverage ratios assess the following two aspects of the long-term solvency of a firm i.e. ability to repay the principal amount when due; and the ability to pay the interest and dividend promptly and periodically as per the agreed terms and conditions. Leverage ratios are classified as capital gearing ratio, debt-equity ratio, total debt ratio, proprietary ratio, fixed assets to proprietors’ funds ratio, current assets to proprietors’ funds ratio and interest coverage ratio. Capital gearing ratio establishes the relationship between fixed interest bearing capital and shareholders’ funds and thus examines the capital structure of the company. The lower the capital gearing ratio, the better it is for the company because it shows that too much capital has not been raised by way of debentures as debenture holders do not share in business losses.

Debt equity ratio indicates the extent of funds provided by long-term lenders in comparison to the funds provided by the owners, i.e. shareholders. Usually, lower the debt-equity ratio, higher is the degree of protection enjoyed by the creditors. Total debt ratio depicts the proportion of firms’ total assets, financed by total debt. To the creditor, a low ratio would ensure greater security for extending credit to the firm. Proprietary ratio measures the proportion of the company’s assets that are provided or claimed by the owners. Higher proprietary ratio generally indicates secured position to creditors and a lower ratio indicates greater risk to creditors. Fixed assets to proprietors’ funds ratio measures the proportion in which owners’ funds are invested in fixed assets of the company. The lower this ratio, the better it is for the long term solvency of business because proprietors’ funds will be available for working capital needs also. Current assets to proprietors’ funds ratio indicates the extent to which shareholders’ funds have gone into the financing of the current assets. The lower this ratio, the better it is for the company because it implies that the current assets are mainly financed by the proprietors’ funds and less is the
dependency on external sources. Interest coverage ratio indicates how many times the interest charges are covered by the profits available to pay interest charges. The higher the interest coverage ratio ensures larger security for the creditors with respect to their periodical interest payments.

Profitability refers to the ability of a business to earn profit. It shows the efficiency of the business. These ratios measure the profit earning capacity or the operational efficiency of the company. Profitability ratios are classified as gross profit ratio, net profit ratio, operating ratio, operating profit ratio, expenses ratios, return on assets ratio, return on investment ratio and return on shareholders’ funds ratio. Gross profit ratio shows the profit made on sales before taking accounts of overheads. Higher gross profit ratio is always in the interest of the business. Increase in the gross profit ratio will mean reduction in cost or increase in selling price. Net profit ratio measures the efficiency of the firm in generating additional revenue over and above the total cost of operations. The higher the net profit ratio, the better it is as increase in the net profit shows better performance of the management in the business. Operating ratio establishes the relationship between the aggregate of cost of goods sold and other operating expenses on the one hand and the sales revenue on the other hand. The lesser is the operating ratio, the better it is because less operating ratio means higher net profits. The Operating profit ratio refers to the profit generated by the firm from operating activities. The higher the operating profit ratio, the better it is because increase in operating profit ratio determines the efficiency of the firm in the management of the business. Expenses ratios indicate the relationship between expenses and sales. The lower the expenses ratio, the greater will be the profitability and higher the ratio, lower will be the profitability.

Return on assets ratio measures the overall efficiency of the management in generating profits from the use of assets. The higher the return on assets ratio the better it is for the company. Return on investment ratio measures how efficiently the capital employed in the business is being used. The higher the
return on investment ratio, the better it is, for the company because this ratio is a barometer of the overall performance of the enterprise. The ratio can be used to judge the borrowing policy of the enterprise. Return on shareholders’ funds measures the profitability of the funds invested by the shareholders. The higher the return on shareholders’ funds ratio, the better it is, for the company because it shows that the proprietors’ funds have been profitably utilized by the company.

The financial appraisal of automobile industry in India is presented in the study. Financial appraisal is the process of determining the operating and financial characteristics of a firm from accounting and financial statements. The goals of such appraisal are to determine the efficiencies or performance of a firm’s management as reflected in the financial records and reports. The important areas of financial appraisal include production, cost trends and sales, profitability, financial strength, working capital, liquidity and productivity. The present study is undertaken to make a financial appraisal of the selected companies of the Indian automobile industry. The study analyses the growth of automobile industry after liberalization, its production trend, sales trend, exports trend, profitability analysis, financial structure and financial performance of the automobile industry.

The study focuses on the financial appraisal of Honda Cars India Ltd. We also study the comparative financial appraisal of the three companies i.e. Honda Cars India Ltd., Maruti Suzuki India Ltd. and Tata Motors Ltd. The period of study is from financial year 2007-08 to 2011-12 and the study is mainly based on secondary data. Financial Appraisal of selected companies have been studied by Liquidity analysis, managerial efficiency analysis, leverage (long term solvency) analysis and profitability analysis. Liquidity ratios of selected companies reveal that liquidity position of Maruti Suzuki is better than that of Honda Cars and Tata Motors. Maruti Suzuki’s, proportion of current assets, liquid assets and absolute liquid assets is sufficient enough to meet its current liabilities. However, liquidity position of Honda Cars is not so healthy in comparison to Maruti Suzuki and Tata Motors. Thus, proportion of current
assets, liquid assets and absolute liquid assets of Honda Cars is not sufficient enough to meet its current liabilities.

The analysis of inventory turnover ratio shows that the stock of Maruti Suzuki is selling more quickly (followed by Tata Motors and Honda Cars). However, there is delay in the sale of stock of Honda Cars. The study of debtor’s turnover ratio indicates that Honda Cars is collecting the amount from its debtors more quickly (followed by Maruti Suzuki and Tata Motors). The more quickly the debtors pay, the less is the risk from bad debts. However, the analysis of creditors’ turnover ratio shows that Maruti Suzuki is paying its creditors more quickly (followed by Honda Cars and Tata Motors) which increases the creditworthiness of Maruti Suzuki. The analysis of working capital turnover ratio shows that Honda Cars has efficiently utilized its working capital (followed by Maruti Suzuki and Tata Motors). However, the study of fixed assets turnover ratio and total assets turnover ratio indicates that Maruti Suzuki has efficiently utilized its fixed assets as well as total assets (followed by Honda Cars and Tata Motors).

The analysis of capital gearing ratio of selected companies reveals that the capital structure of Maruti Suzuki is low geared (followed by Tata Motors and Honda Cars). In Honda Cars, the proportion of fixed interest bearing capital is more than the equity shareholders’ funds and thus the company is highly geared. The study of debt equity ratio shows that the long term creditors of Maruti Suzuki are more secured about the repayment of their debts by the company (followed by Honda Cars and Tata Motors). The study of total debt ratio shows the solvency of is much better (followed by Tata Motors and Honda Cars). However, there is threat to the solvency of Honda Cars as the company is carrying too much debt. The analysis of proprietary ratio indicates that the assets of Maruti Suzuki are mainly financed by its proprietors’ funds (followed by Honda Cars and Tata Motors) and thus lesser is the dependence on external funds. The study of fixed assets to proprietors’ funds and current assets to proprietors’ funds reveals that that the current assets and fixed assets
of Maruti Suzuki are mainly financed by the proprietors’ funds (followed by Tata Motors and Honda Cars) and less is the dependency on external sources. However the analysis of interest coverage ratio shows that the lenders of Maruti Suzuki are more secured with respect to their periodical interest payments (followed by Honda Cars and Tata Motors). This has a favourable impact on the credit worthiness of Maruti Suzuki (followed by Honda Cars and Tata Motors).

The analysis of gross profit ratio reveals that the Tata Motors is efficiently generating higher profits made on sales (followed by Maruti Suzuki and Honda Cars) before taking accounts of overheads. Deterioration in the gross profit of Honda Cars indicates decrease in selling price or increase in cost price or increase in raw material or increase in the direct expenses of the company and thus, it also implies that Honda Cars is not controlling its direct expenses efficiently. The study of net profit ratio indicates the sound operational efficiency and profitability position of Maruti Suzuki (followed by Tata Motors and Honda Cars) in generating additional revenue over and above the total cost of operations. Honda Cars has been even incurring net loss which reveals that Honda Cars has inefficiently controlled its operating and non-operating expenses and thus decreases its efficiency in generating net profit. The analysis of operating ratio shows that Maruti Suzuki has efficiently controlled its operating cost (Tata Motors and Honda Cars), and thus has a favourable impact on its profitability. It also shows that Honda Cars has been unable to control its operating cost which adversely affects the operating profit of the company and shows inefficiency of the Honda Cars in the management of the business.

The analysis of operating profit ratio indicates that Maruti Suzuki has efficiently controlled its cost of goods sold and operating expenses (followed by Tata Motors and Honda Cars) and thus has larger profits available after all operating costs have been met, to be distributed to shareholders and for the creation of reserves. This also shows that Honda Cars has been unable to control its cost of goods sold, operating expenses efficiently and thus has an
adverse affect on the profitability of the company. The study of direct material
cost ratio, selling and distribution expenses ratio and cost of goods sold ratio
reveals that Tata Motors has efficiently controlled its direct material cost,
selling and distribution expenses and cost of goods sold (followed by Maruti
Suzuki and Honda Cars) and thus has a favourable impact on the efficiency and
profitability of the company. This also implies the inefficiency of Honda Cars
in controlling its direct material cost, selling and distribution expenses and cost
of goods sold and thus reduces its profitability. However, the study of
administrative expenses ratio shows that Maruti Suzuki has efficiently
controlled its administrative expenses (followed by Honda Cars and Tata
Motors) and thus increases the profitability of the company.

The analysis of return on assets ratio and return on investment ratio indicates
the overall efficiency of the management of Maruti Suzuki (followed by Tata
Motors and Honda Cars) in generating profits from the use of assets and capital
employed in the business. This also shows that Honda Cars has been even
incurred negative returns from the use of assets and capital employed in the
business and thus has an adverse affect on the profitability of the company. The
study of return on shareholders’ funds reveals that the management of Maruti
Suzuki has profitably utilized the funds provided by the shareholders (followed
by Tata Motors and Honda Cars) and Maruti Suzuki was much efficiently able
to pay regular and higher dividend to its shareholders. This also shows that
Honda Cars has been incurring negative returns on shareholders’ funds because
Honda Cars has inefficiently utilized the funds provided by the shareholders in
the business and it adversely affects its profitability. Thus, Honda Cars will be
unable to provide fair return to its shareholders.

Maruti Suzuki found best in terms of liquidity among the companies selected
for the study. It is followed by Tata Motors and Honda Cars. However, the
liquidity position of Tata Motors and Honda Cars is almost the same. The
managerial efficiency of Maruti Suzuki is very sound (followed by Honda
Cars and Tata Motors). Honda Cars also has a satisfactory managerial
efficiency. The leverage position of Maruti Suzuki is very sound (followed by Tata Motors and Honda Cars). However, the leverage position of Tata Motors and Honda Cars is almost the same. In terms of profitability, Maruti Suzuki is very efficient (followed by Tata Motors and Honda Cars). However, the profitability position of Honda Cars is very inefficient. Further, here it is important to note that the pre-indicated ranks are not the sole indicator of business efficiency. As a matter of fact the interpretation of ratio depends upon number of factors. In the present study a general criteria for assessment of ratio has been used. According to which the company with higher profitability, higher liquidity ratios (not more than ideal ratio), lower debt-equity ratio (not less than ideal ratio), higher proprietary ratio (not more than ideal ratio) and higher turnover ratio is assumed to be more efficient.

Keeping in view the above observations relating to the study, the following measures are suggested which would go on a long way to improve the performance of Indian automobile industry.

1. It is suggested that there is a need for Indian automobile industry to adopt producing and selling wide range of products, to adopt better market strategy, by reducing cost and revising selling prices to enhance the value of turnover so as to go ahead in the era of competitions.

2. Inventory is the most crucial asset for a manufacturing organisation. Particularly with reference to inventory turnover ratio, the cost of materials in Indian automobile industry is the major component in production cost and its share is increasing (Narayanan and Vashishth 2008). The managerial efficiency to keep an optimum level of asset lies in maintaining an adequate ratio of assets to turnover.

3. Cost accounting and cost audit should be made mandatory in automobile industry and they should be called to prepare cost sheet along with their annual financial statements.

4. A systematic, prompt and regular flow of information and its analysis is important for improving productivity, efficiency and profitability. A
suitable management information system needs to be evolved which will take care of the data requirement of administrative officers as well as other units like factory etc., for internal management and control. Appropriate organisational arrangements should be made for the successful implementation of management information system in Indian automobile industry.

5. At present, in India the financial statements are presented on historical cost basis. As such these statements do not exhibit the correct realizable value of the assets on the date of the balance sheet. Thus, the true profitability cannot be ascertained on the basis of the figures given in the balance sheet on historical cost basis. It is, therefore, suggested that a supplementary statement should be included in the annual report showing the figures of assets and liabilities on the basis of current values.

6. At present, the profit and loss account of multi-product concern is disclosed in a consolidated form which cannot measure and judge the performance and profitability of each activity. Hence, the profit and loss accounts should be prepared on departmental activity basis by each multi product concern.

7. The policy of borrowed financing in automobile industry is not proper. So, the company should use wisely the borrowed funds and should try to reduce the fixed charges burden gradually by decreasing borrowed funds and by enhancing in owners fund.

8. The automobile industry is impeded by power and the state of road infrastructure in the country. Because of the road condition the penetration level of automobile in India is very low compared to other developing countries. Therefore, it is suggested that mass road building project should be seriously implemented in the next fifteen years are imperative.

9. Method of production by the Indian automobile industry is based on the assembly of different components in a knock down condition. The
MNC’s have not been improving the quality of produce in India rather they have been in a sense “importing” high quality products into the country. This is actually providing in India. Cost of fuel is important and at the same this fuel quality needs to be improved in terms of gumming tendency, and dust contamination.

10. The inverted duty structure of customs duty on raw materials components and finished goods needs to be corrected. The government should grant certain funds to leading Indian automobiles companies for research and development so that Indian vehicles can really become world class in five years time. Vehicles with 100 per cent local content should be given a concessional excise duty of 50 per cent of the normal rate. Further, all local constraints like the outdated industrial disputes act, factories act and the like, which make local manufacturing far more difficult, should be modified without further delay.

11. Liquidity position of Honda Cars India Ltd. is not sound as compared to Maruti Suzuki India Ltd and Tata Motors Ltd. Honda Cars India Ltd. should efficiently control its current assets and liquid assets to pay its current liabilities so that the creditors of the company feel secured about the repayment of their amounts by the company. This will enhance the creditworthiness and also the short term solvency of the company.

12. Honda Cars India Ltd. should also improve its managerial efficiency by effectively controlling its inventory, fixed assets and total assets. The company should also make payment to its creditors quickly as this will increase the creditworthiness of the company.

13. Leverage position of Honda Cars India Ltd. is not sound as compared to Maruti Suzuki and Tata Motors. Honda Cars should not raise too much capital by way of fixed interest bearing capital because company has to pay fixed obligation in the form of interest irrespective of the volume of the profit. The company should increase the proportion of proprietors’ funds in the business. This will improve the long term solvency position of the company.
14. Profitability position of Honda Cars India Ltd. is not sound as compared to Maruti Suzuki India Ltd and Tata Motors Ltd. Honda Cars should efficiently control its direct material cost, cost of goods sold, administrative expenses and selling and distribution expenses. Honda Cars should also efficiently utilize the assets, proprietors’ funds and capital employed in the business.