CHAPTER IV

Impact of Public Policy on Automobile Industry

The industrial policies adopted in India since 1947 have had wider implications on the various categories of industries. They have been designed to promote economic development by giving emphasis to public sector units; private sector is also encouraged to fulfil the objectives of Five Year Plans. Licensing and control policies have been adopted to suit the requirements of a mixed economy. This scenario has changed after the adoption of new economic policy in 1991. The policies are intended to attract foreign collaboration, equity participation, partnership and foreign direct investment by the global players of the automobile industry. They aim at offering substantial employment to a large number of people in India and increasing the country's exports. The government policy has played an important role in determining the industrial structure, growth and performance of the motor vehicle industry in India. The policy instruments relate to capacity licensing and foreign exchange, restriction on foreign collaboration, price control, reservation of certain parts, spares and components for small scale industries and Foreign Exchange Regulation Act (FERA) and
Monopolies and Restrictive Trade Practices (MRTP) Act. These were operative at various points of time and their impact was different on different segments of the industry.

The Regulatory Policy Environment (1948-1980)

The Industrial Policy Resolution, 1948, classified automobiles and tractors as industries of importance which would be controlled and regulated by the Government. As a first step, imports of complete vehicles were severely restricted and to foster local manufacturing, it was decided to limit assembly of imported vehicles (in knocked down condition) only to those firms which had a programme of local manufacture. Automobile firms not having a manufacturing programme were not considered for foreign exchange allocation after 1950; subsequently this policy has been extended to the year 1952. As a result of these moves, many prominent American automobile manufacturers had to wind up their Indian operations.

The production of vehicles was licensed. Licensing capacity involved not only estimation of the total demand but also its distribution by: a) types of vehicles based on the nation’s priorities, b) number of manufacturers. Preference was given to commercial vehicles as passenger cars were identified as luxuries. Once a licensed capacity was granted to a manufacturer, he was strictly expected to stick to it
and his production should not exceed the licensed capacity. Individual firms that exceeded the production target against licensing capacity were also given permission based on installed capacity. Between 1975 and 1980, through the provision of 'regularisation of excess capacity' firms in the commercial vehicles, scooters, motor cycles, mopeds and ancillary segments were allowed to produce in excess of "licensed capacity" provided no additional investment in machinery was required. Firms were allowed to expand licensed capacity by 5 per cent a year up to a maximum of 25 per cent in 5 years since 1975. This was beyond the 25 per cent expansion in 5 years, permitted under the industrial licensing policy (Narayanan D., 1989). In 1965, components were demarcated into list A & B. List B was further sub-divided and between 60 and 80 components were reserved exclusively for SSI units. Items such as oil seals and radiator were allowed to be produced under SSI sector. These items were not allowed to be manufactured by medium and large scale units. This policy of protection did not exclude foreign collaboration. To meet the growing demand of the two wheelers, another 25 per cent of excess capacity was granted to automobile units. Thus, the policy curtailing the concentration of economic power was diluted (GOI, Fifth Five Year Plan Draft, 1979).
The Concept of 1980-1985 Industrial Policy

The new Industrial Policy Resolution was announced in 1980. Macro economic policies such as industrial policy, licensing policy, fiscal policy, exchange rate policy, export and import policy and monetary policy underwent perceptible changes manifesting a shift from a highly controlled economy to a liberalised economy. Hence this policy sought to scrap the undesirable restrictions, controls and licensing over investment, imports and production. The main ingredients of this policy are a) restoration of competition; b) progressive dismantling of industrial licensing system, c) liberalisation of trade regime and working in a new era of competitiveness in imports and exports, d) re-orientation of fiscal policy and e) necessary amendments in the MRTP Act.

This policy shift was considered to be an ultra in the Industrial policy. The most significant provision of this policy regarding automobile industry was, regularisation of unauthorised excess capacity installed in the private sector. For instance, while regularising installed capacity in excess of the "licensed capacities", FERA and MRTP companies were also to be considered. The normal permissible capacity expansion of upto 25 per cent of the (authorised) licensed capacity would become automatically available to the overall installed capacity, including the regularised excess capacity. The liberalisation
policies encouraged the growth of industry. However, the appearance of Maruti Udyog Ltd., in 1983 had changed the market conditions in the four wheeler sector.

The Industrial Policy of 1980 was further liberalised in 1982 to permit industrial units to claim an endorsement for higher capacity to the extent of one-third of the highest production achieved during the year ending 1981-82. Industrial undertakings were allowed to seek re-endorsed higher capacity on the basis of best production in the 5 years ending 1982-83 or 1983-84.

**Development in Industrial Policy - 1985 to 1990**: A major policy statement was made in 1985 which paved way for further liberalisation in the Indian economy. This policy introduced deregulation and led to the transformation in the two-wheeler industry. It initiated modernisation programme and setting up of new units in the automobile industry and access to imported technology. Several restrictions on MRTP and FERA companies were removed. Delicensing was introduced later in several segments of the automobile industry and the system of product-specific capacity licensing (broad banding as it was called) was also relaxed.

*Liberalisation of licensed capacity in the name of economies of scale and modernisation*: This policy envisaged the need for the
industry to grow at a rapid pace, achieve economies of scale and undertake modernisation which signified the introduction of the latest technology. The scheme of endorsement of capacity was liberalised and automatic increase was granted to units wanting to achieve economies of scale and a 49 per cent rise in capacity for modernisation was allowed.

Broad banding: Along with the liberalised entry into the automobile industry, the government announced a policy of 'broad banding' in 1985 to allow manufacturers to utilise installed machinery most flexibly. The broad banding procedure gave vast scope to manufacturers to produce a wide variety of products in broad product groups, such as, two wheelers, which included all motorized two wheelers. Such broad banding was also permitted in component manufactures. This flexibility was provided to enable the manufacturers to adjust their product mix depending on the market demand. It included a large number of items such as machine tools, motorized two wheelers and motorized four wheelers.

The government exempted the automobile industry from the provisions of Sec. 21 and 22 of the MRTP Act especially with a view to permit automobile companies to grow in line with international trends. And to buttress the indigenization efforts for new generation
vehicles, the ancillary industry was completely delicensed. The government also introduced a scheme of minimum economies of scale of production in the entire automobile sector to have higher production through better utilisation of capacity viability of the units (Motorindia, 2000).

**Industrial Policy of 1990**

India refused to get the help of IMF and World Bank to honour its multinational financial commitments. The World Bank - IMF policy package had been accepted by India. Full-Scale liberalisation and Privatisation measures had been introduced in India. It is quite natural that these policy measures had been appropriately reflected in the Industrial Policy of 1990. Automobile industry was further liberalised with the following features. Indian economy witnessed a downward trend in 1990. The agricultural and industrial sector faced a sluggish rate of growth leading to balance of payments crisis. The Gulf war crisis had further worsened the economic conditions. There was all-round deterioration in the finance of the Government of India. The salient features of the Industrial Policy of 1990, which were of immediate relevance to the automobile industry are given below.

- **Delicensing**: All new units up to an investment of Rs. 25 crore in fixed assets in non-backward areas and Rs. 75 crore in
centrally notified backward areas were exempted from the requirement of obtaining a licence.

- **Import of Capital Goods**: For the import of capital goods, the entrepreneur would have entitlement to import up to a landed value of 30 per cent of the total value of plant and machinery required for his unit.

- **Import of raw materials and components**: For import of raw materials and components, imports were permitted up to a value of 30 per cent of the ex-factory value of annual production. The ex-factory value of production would exclude the excise duty on the item of production. Raw materials and components on open general licence would not be included within this 30 per cent limit.

- **Foreign collaborations**: In respect of transfer of technology, if import of technology is considered necessary by the entrepreneur, he can conclude an agreement with the collaborator, without obtaining any clearance from the Government provided that royalty payment did not exceed 5 per cent on domestic sales and 8 per cent on exports. If, however, a lumpsum payment is involved in the import of technology, the proposal will require government clearance, but a decision of the government will be communicated to the entrepreneur within a period of 30 days.

- **Foreign Investment**: Keeping in view the need to attract effective inflow of technology, investment upto 40 per cent of equity will be allowed on an automatic basis; in such proposals also, the landed value of imported capital goods shall not exceed 30 per cent of the value of plant and machinery.
Broad Banding Scheme: The existing broad banding scheme (as under the previous industrial policy) was to continue to be in force. In addition, if no extra investment was required, no clearance from the Government would be necessary for production and sale of new items by existing units. (However, this would not include those items which were reserved for the small scale sector).

New Industrial Policy of 1991

The industrial policy of 1991 was a part of the macro economic policy and broad structural adjustment programme introduced in India in June 1991. The new policy was designed with a declared objective of transforming the basic nature of the functioning of the economy in lieu of planned economic development over the period from 1951 to 1991. The Indian automobile manufacturing industry has undergone a sea change after the liberalisation policies were announced in 1991. From a tiny sector dominated by a handful of manufacturers till 1980s, the auto industry in India suddenly witnessed the entry of scores of world auto majors in the market. The Indian auto industry saw the completion of one full circle from being a net importer of vehicles to exporter of vehicles made in India.

In India, the auto Industry was a key test of government's commitment to liberalisation, and a number of companies were allowed to set up operations. FDI was, at first, regulated by the Director-
General of Foreign Trade. Confidential "Memoranda of Understanding" (MoUs) were negotiated on a case-by-case basis with the auto companies. In November 1997, the cabinet approved clear and transparent rules applicable to all companies:

1. New projects should have a minimum foreign equity of US $ 50 million in the first three years of operation;

2. Commitment to localisation of production: The targets for local production were at 50 per cent in three years and 70 per cent by the fifth year; and

3. Specified levels of exports beginning from the third year of production must be maintained.

The result of this policy was to allow many more firms into the industry than the market could possibly sustain (John Humphry 2002). With the revival of the economy, every segment of the automobile industry, be it scooters, motor cycles, cars or trucks, showed positive signs of growth. Compared to other segments, car segment showed a major change during the liberalisation period.

**Changing Appearance of the Car Industry**

The car manufacturing sector was delicensed in June 1993. The government does not stipulate a minimum indigenous content. But
gradually, indigenisable components like tyres, wheels, glasses, lamps, upholstery etc. are locally sourced subject to volume.

The new policy encouraged both Indian and foreign companies to enter the market. This has led to introduction of over 30 new models in less than ten years. After a decade of Maruti's launch in India, the first of the players, General motors, Dawoo motors of South Korea and Ford motor company cautiously announced their plans to enter the Indian market. For GM and Ford, it was a kind of a re-entry after almost four decades. There was an enthusiastic show of confidence in the Indian auto market. The announcements by the top two global auto giants were followed by a series of joint venture announcements as foreign investments could only be in the form of minority stake in joint ventures. At present car industry was dominated by 12 major manufacturers. vis-a-vis that of hardly three to four Indian companies in the 1980s, two companies in early 1970s (The Hindu Industrial Survey, 2003).

Liberalisation in the 1990s

Till mid 1980s, supply was regulated by the manufacturers for their own benefit, artificial shortages were created in the market by the
collusion of the manufacturers and the distributors. The service to the customer was at its lowest level and at the mercy of the suppliers.

However, with the elimination of licensing system in 1993-94, the immediate post-liberalisation period witnessed a large increase in the supply of auto industry. This continued till the pent-up-demand, which was created earlier by the domestic manufacturers themselves was fulfilled.

During this time, there was a smooth transition of the automobile market from its earlier 'mass market' type to the 'product variety' market type. It may be mentioned that till late 1980's the market was dominated by only a handful of models and they were not upto the customers expectations. In tractor market, there were four or five basic models. Same was the situation for cars, LCVs, trucks and buses. In the early 1990s, there was a total change in the market. A variety of products and their various variants inundated the market. But even then the customer specific expectation or usage had remained a distant strategy objective. The models rolled out during this time were produced mainly depending on manufacturer's technical ability and convenience rather than from any real feedback.

By and large, till mid 1990s, the market was governed from supply side. And the focus was basically on quantity augmentation and
supplying single basic model for each price segment with some minor changes in product features.

The trend continued till mid 1990s. At the end of this era, we witnessed the emergence of 'quality' as the primary determining factor to attain leadership in the market. Most of the manufacturers in the automobile industry during this time had gone for quality certification like ISO 9000 and QS 9000. (Tapas piplai: 200.)

During the 1990s, in the first half, the focus of the industry was on increasing the volume of production and in the second half, the accent was on quality.

In late 1990s, we witnessed another transition in the market which was directed towards further cost reduction—this time, by way of value engineering, re-engineering, and also through effective tackling of different cost drivers such as distribution-cost, direct material cost or conversion cost. During this period, we see the first sign of making the product based on customer specific need.

Moreover, emergence of price war is clearly visible in passenger car segment wherein within a price range of Rs.3.40 lakh and Rs.3.85 lakh ie within Rs.40,000 band, more than five different
models of cars are presently available with 20 variants, contrary to the earlier scenario where only one basic model was available within this price differential. This necessitates clarity in the positioning of the product as per customer's perceived benefit.

Changes in procurement strategy

Relationship between supplier and assemblers in the auto industry changed considerably in 1990s. The earlier procurement strategy was based on handling more than 500 vendors directly by each of the vehicle manufacturers. It became immediately outdated for burgeoning handling cost involved, together with high management control cost. In turn, the concept of system supplier came into being, (systems, sub-assembler of modules) rather than individual components. A first-tier supplier becomes responsible not only for the assembly of parts into complete units (dash boards, brake axle - suspension, seats, cockpit assemblies and so on), but also for the management of the second-tier suppliers. The assembler would previously have put these modules or systems in-house, using parts supplied by many different component companies.

Assemblers tried to standardise their platforms across their constituent companies and across market. This was to reduce
development costs and increase economies of scale. This policy had a radical impact on emerging markets. It also gave an additional advantage of 'flexibility' in the production for the vehicle manufacturers. And for multi-product manufacturers, switching over to different product models as per the fluctuating market demand became easy. Thus reacting to changing market requirement became very fast. The entire procurement and manufacturing activity started working as a total value chain instead of having fragmented activity as in the past.

Taking advantage of new economic policy, a number of foreign companies (mostly world majors) set up their manufacturing plants with high capacity in India. Simultaneously, Indian companies also augmented their production capacities lest they lose to the competitors; all these factors made the supply side very strong and overshot the demand potential within a very short span of time. As a result, the market became fiercely competitive; to lure the customer and to develop a strong brand equity, quality war and price war started among the manufacturers pushing the investment expenditure and selling costs to a further high level. This resulted in fall in profitability of the industry to an almost unviable point; seeing no other alternative and to stay competitive in the market, old Indian companies started cutting down the expenditure. The cost cutting exercise commenced
with reduction in process cost, direct material cost and finally employee cost. This has resulted in large-scale retrenchment, lay-off, VRS and further destabilised the economy which in turn again arrested the growth of consumption market because of the multiplier effect; the Indian companies taking advantage of this cost positioning started shifting their corporate focus on commercial vehicle segments like taxi, goods carrier etc. which are essentially price sensitive. The MNCs started following the "differentiation" strategy with the help of their uniqueness of design, technology, features, customer services, dealer network etc.
CHAPTER V

IMPACT OF LIBERALISATION ON INDIAN AUTOMOBILE INDUSTRY