Chapter 1

Introduction
1.1. INDIAN AUTOMOBILE INDUSTRY: AN OVERVIEW

The automobile industry in India is expected to be the world's third largest by 2016, with the country currently the world's second largest two-wheeler manufacturer. Two-wheeler production is projected to rise from 16.9 million in FY14 to 28.8 million by FY21. Furthermore, passenger vehicle production is expected to increase to 10 million in FY21 from 3.1 million in FY14.

Strong growth in demand due to rising income, growing middle class, and a young population is likely to propel India among the world's top five auto manufacturers by 2015. Automobile export volumes increased at a compound annual growth rate (CAGR) of 17.5 per cent during FY05-14, out of which two-wheelers accounted for the largest share in exports at 67 per cent in FY14.

The government aims to develop India as a global manufacturing as well as a research and development (R&D) hub. It has set up National Automotive Testing and R&D Infrastructure Project (NATRiP) centers as well as a National Automotive Board to act as facilitator between the government and the industry.

Alternative fuel has the potential to provide for the country's energy demand in the auto sector as the CNG distribution network in India is expected to rise to 250 cities in 2018. Also, the luxury car market could register high growth and is expected to reach 150,000 units by 2020.

Indian automotive Industry plays very vital role in overall growth and development of the economy. The automotive industry mainly consist of two main segment of this area i.e. Automobile Industry and Auto Component Industries. Apart from catering the need for direct demand for passenger car, commercial and personal vehicles, engine parts requirements, this industry also provide support for various industries like Capital Goods, Logistics, Paper, Cement, Steel, Non-Ferrous metals etc.

Indian Automotive Industry witnessed remarkable growth in last two decades. In 2-wheeler segment India is Second largest manufacturer and fifth largest in commercial vehicles segment. Today, India is world’s largest market for Automotive Industry. Chennai is known as ‘Detroit of Asia’ with 30-35% of total production of Indian Automotive Industry.
Automotive Sector can be classified into four segments. The First Segment as Two wheelers which consists of Mopeds/Scooty, Scooters, Motorcycles and electric two-wheelers etc. Secondly we can group as Passenger Vehicles which includes Passenger Cars, Utility vehicles and other Multi Purpose Vehicles. Thirdly we have Commercial Vehicles which subdivided into Light Commercial/Motor Vehicles and Medium or Heavy Commercial Vehicles and Lastly We have Three Wheelers which includes Passenger carriers and Goods carriers.

Figure 1.1: Segmentation of Indian Automobile Industry

<table>
<thead>
<tr>
<th>Segment</th>
<th>Domestic Market Share for 2014-15</th>
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<tbody>
<tr>
<td>Passenger Vehicles</td>
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<tr>
<td>Commercial Vehicles</td>
<td>3</td>
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<td>Three Wheelers</td>
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<td>Two Wheelers</td>
<td>81</td>
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<td><strong>Grand Total</strong></td>
<td><strong>100</strong></td>
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</table>
The Journey of Development of Indian Automotive sector was started in 1897, when Indian roads witnessed the first car and till 1930 we had only imported cars on Indian roads. In 1940s, Hindustan Ambassador was launched but due to the restriction under License raj, growth was very slow. India was a closed market with few players catering the needs of the overall market with their specified products.

In 90’s the first breakthrough took place when Suzuki collaborated with Indian government and formed Maruti Udyog which started its production in 1983. Eventually the Liberalization took place in India and opened the doors for New Entry in joint venture. Today, More than 35 market players are catering the needs of Indian Market. Automotive Mission Plan 2006 also facilitates the smooth functioning of Indian Market Players.

Today automotive sector is one of the main growing segments to boost the overall economy. With an annual production of 16.9 million Two-Wheelers this entire industry accounts for 22% of Country’s Manufacturing GDP. India stands as third largest producer in automobile sector and India’s share in global passenger market is expected to double by 2020. The surging demand in this sector is providing fuel to fire as the sales figures are growing with Compounded Annual Growth Rate of 18% p.a. Production of Passenger vehicles are also expected to surge from 3.1 Million in 2014 to 10 Million which is expected by 2020.
Figure 1.3: Production of Automobiles in India

Source: Tata Motors, Society of Indian Automobile Manufacturers (SIAM), Aranca Research
Figure 1.4: Evolution of the Indian Automotive Sector
Figure 1.5: Expected CAGR of Indian Automobile Industry
India is booming - and projected to maintain the trajectory

Source: Global Insights Database, Business Week, Booz & Company analysis

Figure 1.6: Estimated GDP Growth of India
Figure 1.7: Contribution of Indian Industries in GDP
The above graph shows the increasing contribution of Indian Industries in GDP. Since Independence as a clear view of contribution of all three areas viz Agriculture, Industry and Services in Indian Economy is presented through this graph. The data is clearly showing the increasing contribution of Industry in the GDP. While at the time of independence it was only 14%, it was 36% during 90’s when the most awaited LPG introduced in India. As the Automotive mission plan was introduced in India in 2006 the country witnesses the contribution between 36 to 40 percent while it was expected to touch the mark of 42% at the time of 2020. If we looked closely the reason behind this we will find that in 1953 Indian Government permits only those projects in India which involved phased manufacturing programme. On one hand it restricts the major development and growth in this sector and resulting in exits of brand like GM and Ford on other.

It was the time when India had only three main player in the segment of passenger car viz. PAL, SMPI and HM. Hindustan Motors was the first manufacturer in India and its product profile includes the famous Ambassador, Hindustan 10, Hindustan 14 etc. Since there was very limited choice for the Indian customers with high pricing and low efficiency and mileage, it failed to attract prospect consumers. In between 60’s & 70’s some push up was felt in this sector when for the first time in India Government permitted Maruti Ltd. to set up its manufacturing plant. Although Maruti Udyog do not having any prior experience in this business but due to stake of government in this venture people of India having a ray of hope with this company.

The major turnaround in this sector was seen between 80’s and 90’s. It was the era when many key developments was taking place in the Indian Automobile Industry which let the development of this sector and reported by 36% contribution in the GDP. It was the period when government seriously made efforts to supplement public transport system in India, Starting with joining hands with foreign partners for technological development and low cost benefits. The Government also nationalized the Maruti Ltd and gave it a new birth as Maruti Suzuki India Ltd. which later on proved to be a boon for the entire nation. Government was seriously intended that time to provide low cost, fuel efficient and budgetary vehicles for countrymen. The joint venture of Maruti with Suzuki Motor of Japan led a new era in the history of
Indian Automobile Sector. Entry of Maruti with Suzuki helped this sector to produce low cost high efficient vehicle. The company launched Maruti 800 which was a great success and ruled the Indian market more than two decades. The company also added Gypsy, Omni like variations in its product line which served perfectly the need of Indian customer and that was the main reason behind its success and gained substantial market share in very short span of time.

Later in 1991 Government introduced economic reforms and New Industrial Policy in India which led the reduction in government control in this sector it also opened doors for private players and entrepreneurs to come up and take part to build India a powerful economy. Several measures were taken to promote the private players in Indian Industry viz. automatic approval, removal of license raj, FDI up to 51% etc. The favorable responses of new policy gave a new lifeline and about a dozen of players came forward to cater the demand of New India.

Source: Global Insight Database, Booz & Company analysis

**Figure 1.8:** Expected Automotive Sales by 2020
In the last decade several policy reforms have also taken place and visionary statement “Make in India”. The Automotive Mission Plan 2006-16 was also a milestone in this direction. Beside all such policy initiative many new initiatives take place to ensure the development of this industry. Resulting this, India’s share in World Car Production, which was just 1.72% in 2002 was grown and reported 5.2%
in 2012. Indian players are also come out from their shell and take part in world automotive market by taking their business globally. The reports of Global insight database also claimed that India is one of the key players in this growth story.

![Chart showing comparison of automotive sales between Western Europe and India]

Source: IHS, (National Electric Mobility Mission Plan) NEMMP 2020, ACMA, Aranca

**Figure 1.10:** India is much ahead of Western Europe in Automotive Sales

The recent report by Bostan Consultancy Group (BCG) claimed that China is losing its attractiveness of being traditionally cost advantage country. India’s world lowest labour cost country status can avail this opportunity of cost competitiveness. The automotive industry is contributing 3% in GDP on an average to the country’s economy. Its share is even higher and nearly 7% in economy of China and India. The Government policy related to FDI also brings new investment in this industry. As the
report of HIS expecting India’s growth story overpass many of the Europeans country’s sales figures before 2020. Meanwhile, the Government also taking serious steps to develop proper infrastructure, clear policy of GST, providing financial and technological support and target sustainability in overall economy.

Table 1.2: Automobile Production Trends of India

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<thead>
<tr>
<th>Category</th>
<th>Passenger Vehicles</th>
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<th>Three Wheelers</th>
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Table 1.3: Indian Automobile Domestic Sales Trends

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Table 1.4: Automobile Exports Trends of India

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Figure 1.11: Automobile Exports Trends of India

Figure 1.12: Gross Turnover of Indian Automobile Industry
1.2. DIVIDEND: AN OVERVIEW

Dividend is an integral part of area of Finance. The area of financial management usually deals with financing, allocation and proper management of funds and through this activity its aims to generate value for their shareholders. Financial management is mainly concern with three activities viz, Financing Decision, Investing Decision and Dividend Decision. Among all three dividend decision are most strategic in nature. Dividend in the normal use of words refers to that portion of the net earning which is distributed by the company among its shareholders. The shareholders, as investors, are interested in maximizing their returns at a given level of risk or minimizing their risk at a given level of returns, are interested in maximizing their returns, and together want to maximize returns with minimizing risk and thereby to maximize their wealth. This is the essence of desirability of dividends from the investor’s point of view.

On the other hand, a company needs to provide funds to finance its long-term growth. If a company pays out most of the profit it earns, then for business requirements and further expansions, it will have to depend upon outside sources such as issues of debts or new equity shares. So, dividends in a firm are paid according to the policies and decisions of the management regarding the retained earnings of the firm.

As the development takes place, the concept pertaining to area of finance and dividend decision also changed to a great extent. With changes of time, new terminology also introduced in the field of finance and its area became very vast. Today, the decision regarding distribution of dividend involves several concerns. Dividend is profit available for shareholder which is actually a portion of Net Profit earned by the company in a particular accounting period though its normal course of action of the business. A company usually prefers to retain some portion of the total profit for future investment proposal which is normally comes under retained earnings. This activity is known as ploughing back of profits. In case company does not have sufficient profitable investment Proposal Company may offer to distribute entire profit to the investors. Apart from this there are many issues involve regarding the dividend policy of a firm.
1.3. ISSUES INVOLVED IN DIVIDEND POLICY OF THE FIRM

1. Cost of Capital
2. Realization of Business Objectives
3. Expectation of Shareholders
4. Liquidity Position of Firm
5. Managerial Control
6. Legal Constraints

1. Cost of Capital

Cost of capital is the main issue while making the decision regarding the dividend policy of the firm. It actually direct the decision of the finance manager to decide whether to distribute dividend or not and if yes up to which extent. Usually this decision is based on the ratio of rupee profit on investment which is normally understood as rate of return. This ratio is calculated as: \( \frac{RE}{RA} \)

Where, RE is the Expected Rate of return from shareholder and, RA is Profit expected to earn by Business activity.

This provides a quick test for a financial manager to take the judgment regarding the decision on dividend policy. If this ratio is greater than 1 it implies that business having the ample opportunity to reinvest and generate more profit for shareholders. So the finance manager is prefer to retain earning and discontinued the distribution of dividend. On the other hand, if the value is less than 1 it implies that the business is not generating more profit compared to expectation of shareholders so the manager should prefer to distribute the entire profit to the shareholders. In case it is 1 then it is upto the prudence of the manager or the policy maker to take the judgment.

2. Realization of Business Objectives

Dividend policy is always formulated keeping in view the core objective of business. A financial manager always tries to maximize the return from operation of business and to earn profit for their shareholder to achieve the ultimate goal of wealth maximization.
3. Expectation of Shareholders

The expectation of shareholders’ group also affects the policy formulation regarding the dividend to a great extent. If a company practicing low payout policy, it may adversely affect the perception and motivation of shareholder to take position in that company and sooner or later the shareholder redirect their investment to the security of other firms which offer better returns. On the other hand, very high payout policy also creates a liquidity crunch in the company itself.

4. Liquidity Position of the Firm

The liquidity position of the firm is also a concern for deciding the dividend payout. Dividend payout involves outflow of cash which may cause the cash crunch into the firm. So a manager needs to ensure the availability of cash in the firm so that it does not affect the working capital of the firm.

5. Managerial Control

Managerial Control includes the perception and attitude of the board members regarding the dividend payout policy of the firm. If management is having the conservative approach they prefer to distribute the dividend among the shareholders on the contrary if they believe in aggressive policy they prefer to retain earnings up to a great extent and reinvest in the investment proposal available with the company.

6. Legal Constraints

The company also take into the consideration the legal provisions and norms before formulating their dividend policy. A company has to take into account the provisions of Companies Act, Income Tax Act etc while formulating their dividend decision.

1.4. DETERMINANTS OF DIVIDEND POLICY

There are many crucial involves while deciding the determinacy of dividend policy. Dividend decision is directly affect the wealth of shareholders. Any changes in dividend decisions, is a policy matter which is taken by the management itself. There are several issues involves in this decision. In this section, the researcher would like to take an attempt to explore and explain the importance of those factors which affect dividend policy.
Chapter 1

These determinants are as follows:

1. **Dividend Payout Ratio**

Among all the corporate financial decisions few are as strategically important as dividend decision. Corporate dividend policy plays an important role and affects the capital structure as well future dividends. Form the micro concept, as long as there are investment projects with returns exceeding those that are required (in general, mostly, Weighted Average Cost of Capital) it will use retained earnings and the amount of senior serenities will support to finance these projects. If the firm has retained earnings left over after financing all acceptable investment opportunities these earnings then will be distributed to the shareholders in the form of cash dividends. If otherwise there won’t be any dividends. The treatment of dividend policy as a passive residual determined solely by the availability of acceptable investment proposals implies that the dividends are immaterial and irrelevant; the investors are rather indifferent between dividends and retention by the firm.

Forms the macro standpoint, dividend decisions have implications not only at the level of individual firms, but at the macroeconomic level as well. At the individual firm level, dividend is the first, if not the only indicator of the firm’s performance. Indeed, the objective of modern Joint Stock Company is to generate a steady stream of dividends to its shareholders. Higher and regular dividend payments are sure to enhance the market value of the firm and the reputation of its management.

On the other hand, such a policy may mean less availability of internal funds and more dependence on external resources for reinvestment and expansion purpose. Thus while determining dividend payments; a prudent management strikes a balance between shareholders preference and the firm’s long-term interest, safeguarding the firm’s control.

Again from the macroeconomic point of view, dividend policies of individual firms when combined together play a significant role in determining overall rates of saving and investment as well as patterns of flow of funds in the economy. Further, dividend policies also level other social economic implication. If shareholders are concentrated
only in a few economic brackets, these changes in the dividend income will affect the overall income distribution as well as factor shares. Exceptionally high dividend payments or abnormally low dividend payments under such conditions might lead to less efficient resource allocation in the economy as a result of changed consumption patterns.

Recognizing the importance of dividend policies of corporations and their bearing on resource allocation and income distribution in the economy, this project attempts to explore the possible factors that determine the dividend behaviour in the Indian corporate sector.

2. Stability of Dividend

Another important dimension for determining the dividend policy is the Stability of Dividend. An investor always examines the stability of dividend pattern prevailing in the company. He always examines the regularity or stability of dividend pattern followed by the company over the period of time. This stability also further classified into:

a) Constant Dividend Payout Ratio
b) Steady Dividend Per Share
c) Steady plus Extra Dividend Payout policy

3. Nature of Industry

Dividend Policy is also greatly influenced by the nature of the firms. The company engaged in capital goods usually having larger operating cycle which in turn required maintenance of proper level of working capital in the firm for smooth functioning of the business. In the same way, the company which having stable earning may usually formulate a stable dividend payout practices in comparison to those who are having session based business. Companies engaged in public utility product or services are in better position to opt relatively stable nature of dividend practice in comparison to other firms.
4. **Business Cycle**

Business cycle also plays a very important role in determining the dividend policy for a firm. Many of a time business oscillations determine the dividend practices opted by the firms at large. During the time of prosperity or boom in economy a prudent management would like to save reserve for future requirement and that time they preferably follow the conservative practices regarding the dividend distribution. Small firm owners on the same time would prefer to save the fund as reserves because they usually face lots of problem while raising the fund for external source of finance. Moreover, companies offering higher rate of dividend may having lack of profitable project to invest. On the other hand, some firms used this as a powerful tool for marketing the security in depressed market.

5. **Taxation Policy**

High taxation rate reduces the corporate earning and resulting companies would prefer to lower down the rate of dividend for shareholders at large. Many of a times government also imposed dividend tax for pre-specified income level class or based on the tax rate offered by the company. These policies affect the capital formulation to a great extent and also play an important role while determining the dividend payout policies for a Company.