



ISSN Print: 2394-7500
ISSN Online: 2394-5869
Impact Factor: 5.2
IJAR 2019; 5(5): 183-187
www.allresearchjournal.com
Received: 02-04-2019
Accepted: 27-04-2019

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A study of financial management practices of automobile industry in India

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Abstract

Automotive industry plays a very important role in the development of economy of a country as the development of many other sectors like iron, steel, rubber, glass, plastics etc. is linked with the growth and development of the automotive sector. After the introduction of liberalization measures in India in 1991, Indian Automotive Industry has been moving upwards on the growth track with large number of global auto manufactures setting up their manufacturing facilities in India, but still the industry has not developed fully. A well defined framework is required for the proper growth and development of automotive industry of India. A study on the financial aspect of corporate sector units is very valuable to the shareholders and investors to carry out investment analysis, further it helps the financial institutions, and lenders to understand the financial capability of the companies. Moreover, it also helps industry associations, Government to study the characteristics of the companies for conducting comparative analysis.

Keywords: Financial management, automotive, automobile, ratios, composite index, panel data regression

Introduction

Financial Management is changing rapidly; and changes are occurring not only in the theoretical background of the subject, but also in its use in the real-world setting. Conflicting interests of different stakeholders in a business firm demand globalization of finance, strategic alliances and large amount of financial information and a variety of other considerations which widen the horizons of financial management. Corporate Finance, also known as Financial Management, is concerned with the acquisition, and effective utilization of funds by a business firm. In other words, it can be said that financial management involves raising funds from most suitable sources, investing them in assets, and distributing the returns generated from assets to the shareholders of a company. Financial Management was a branch of Economics till late nineteenth century; and after that it emerged as an independent and separate discipline. Financial Management as a discipline is of great interest to academicians as the area is still developing and there are many aspects where controversies exist which need to be clarified. It is also useful for business managers as it helps them to take crucial decisions for the growth and development of their business. Financial management is one of those functional areas of management which is vital for the success of a business. Inefficiency in financial management along with uncertainties in the business environment can cause serious problems and hurdles in the functioning of a business enterprise.

History of Indian automobile industry

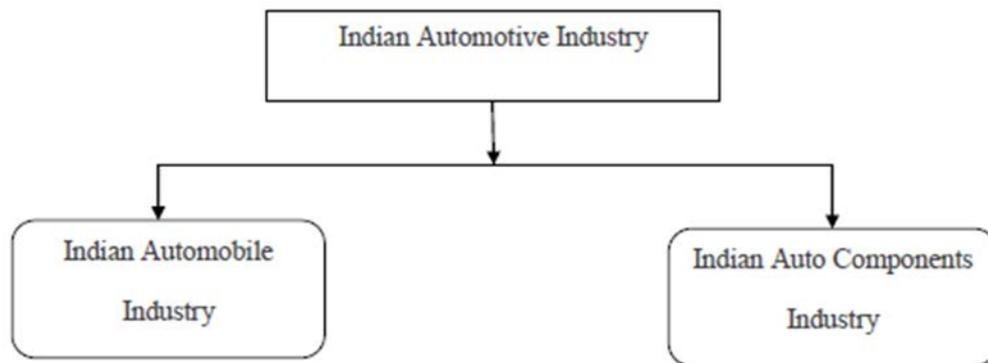
1. Pre-Liberalization Era before 1991: History of Indian Automobile Industry dates back to the beginning of 19th century when General Motors set up a plant in Bombay to assemble cars and trucks in 1928, followed by Ford Motors of India which set up a plant in Madras in 1930 and additional ones in Bombay and Calcutta in 1931. Then in 1942 Hindustan Motors was incorporated in Calcutta by Birla Group; and in 1944, Premier Automobiles Ltd. was incorporated in Bombay by Walchand Group. Tata Engineering and Locomotive Company, and Ashok Leyland were founded as manufacturer of commercial vehicles in 1945 and 1948 respectively.

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2. Post-Liberalization Era after 1991: In the early 1990s, Indian economy faced a very serious economic downturn leading to a massive balance of payment crisis which was bailed out by International Monetary Fund; and the Government of India had to take a series of actions towards globalization and liberalization under the guidance of International Monetary Fund and World Bank. These globalization and liberalization measures introduced in 1991 resulted into the entry of Tata Engineering in the passenger car segment which at

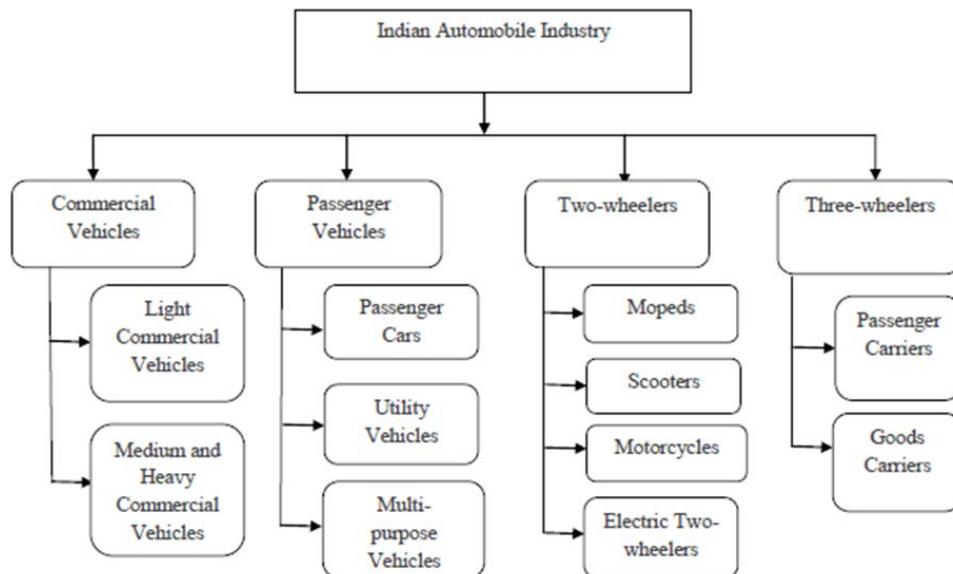
that time was manufacturing commercial vehicles only. Due to de-licensing of Indian passenger car segment in 1993, many other global manufacturers such as General Motors, Ford, Honda, Daimler-Chrysler, Fiat, Hyundai, Toyota Kirloskar, and Reva Electric entered the Indian passenger car and multi-utility vehicles market. Daimler-Chrysler and Reva Electric entered the Indian market in 1994, General Motors, Ford and Honda in 1995, Hyundai in 1996, and Toyota Kirloskar and Fiat in 1997.

Structure of Indian automobile industry



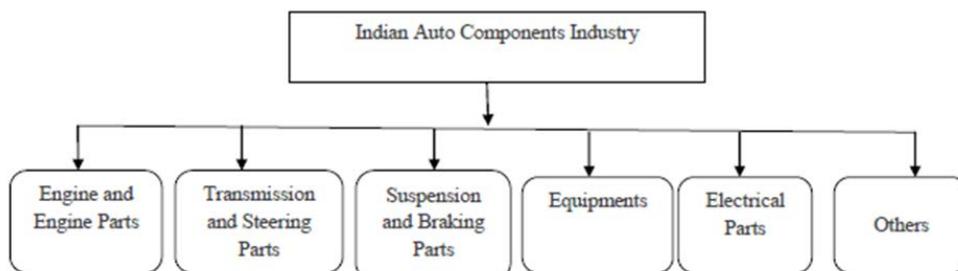
Source: Report of Indian Brand Equity Foundation, January 2019, retrieved from www.ibef.org

Fig 1: Categorization of Indian Automotive Industry



Source: Report of Indian Brand Equity Foundation, January 2019, retrieved from https://www.ibef.org/download/automobiles-jan-2019.pdf

Fig 2: Categorization of Indian Automobile Industry



Source: Report of Indian Brand Equity Foundation, retrieved from https://www.ibef.org/download/auto-components-jan-2019.pdf

Fig 3: Categorization of Indian Auto Components Industry

Review of Literature

Hamaguchi (1985) ^[10] studied the prospects of self-reliance and indigenization in automobile industry with particular reference to Maruti Suzuki India Limited. He concluded that the liberalization policy in respect of Indian automobile sector should be oriented more towards the development of the automobile ancillary industry in the long run and concessional import tariffs with respect to the ancillary items; and spares should not pose threat to the domestic automobile ancillary industries. It was suggested that the reservation policy of certain auto ancillary items to the small-scale sector should be designed on consideration of scale and technology.

Kaur (1997) ^[11], in her doctoral research work, studied the determinants of corporate dividend policy in India by taking a sample of four industries, viz. chemical, metal and alloys, electrical, and engineering industry for a period of five years ranging from 1990 to 1995. For achieving the objectives of the study, three measures of dividend policy of companies, viz. DPS to face value of shares, yield ratio, and payout ratio were taken as dependent variables; and their relationship was studied with seventeen independent variables.

Antwi et al. (2012) ^[12] examined the relationship between capital structure and value of firm by taking a sample of all the thirty-four firms listed on the Ghana Stock Exchange for the year 2010. The study revealed that equity capital as a component of capital structure was relevant to a firm's value; and another component of capital structure, viz. long-term debt was also found to be relevant to the value of a firm in the case of selected companies. It was suggested that corporate financial decision-makers should use long-term debt financing more as compared to the equity financing because former had a greater impact on the value of a firm as compared to that of latter.

Shubita and Alsawalhah (2012) ^[13] studied the impact of capital structure on profitability of 39 companies listed on the Amman Stock Exchange over the period 2004 to 2009. A significant negative relationship was found between debt and profitability of the sample companies during the study period. The study suggested that the sample companies should consider designing of an optimal capital structure, and must carry out feasibility study before making investments in the new projects.

Ranti (2013) ^[14] examined the determinants of dividend policy of fifty firms listed on the Nigerian Stock Exchange

for the period 2006 to 2011. Dividend payout ratio was taken as a dependent variable, while independent variables included company's financial performance, size, financial leverage, and independence of board. It was observed that the factors such as financial performance of firms, firm size, and board independence had a significant positive relationship, while financial leverage had a significant negative relationship with the dividend payout decisions of the selected firms.

Regulatory framework of Indian automobile industry

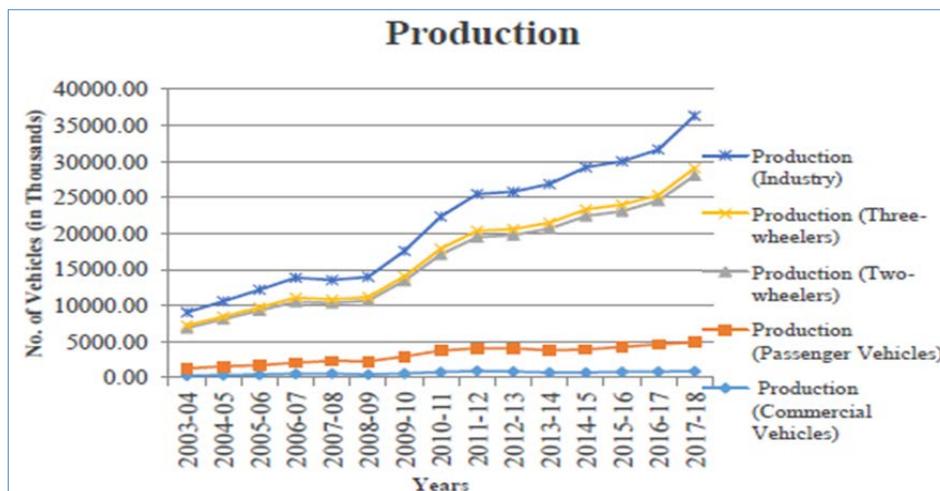
1. Technical Regulations

2. Policies and Plans Formulated by Government of India for Regulation of Indian Automobile Industry

- Auto Policy 2002
- Automotive Mission Plan 2006-16
- Report of the Working Group on Automotive Sector for the Twelfth Five-Year Plan (2012-17)
- National Auto Policy 2018
- National Electric Mobility Mission Plan (NEMMP) 2020
- Automotive Mission Plan 2016-26

Growth of Indian automobile industry

Indian Automobile Industry has become quite resilient; and at present, it produces a wide variety of passenger cars, multi-utility vehicles, light, medium and heavy commercial vehicles, two-wheelers, and three-wheelers. The Indian Automobile Industry has become most dynamic and growth oriented. According to the Annual Report, 2012 of Ministry of Heavy Industry and Public Enterprises, Indian Auto Industry employs 12.5 million people, directly and indirectly; and the sector is contributing 20 per cent to the kitty of indirect taxes of the government. According to the Report of Working Group on Automotive Sector for the 12th Five-Year Plan (2012-17), in the last ten years, the volumes, exports, and turnover have grown by 3.8, 19.6, and 6 times respectively. In the following subsections, the growth of Indian Automobile Industry has been analyzed by studying the trends (taking 2003-04 as the base year) and growth rate of production, domestic sales, and exports of various segments of the industry. Market share of various segments of the industry was also studied for the financial year 2017-18.



Source: Constructed on the basis of data given in Table 1.1

Chart 1: Trend of Production of Segments of Indian Automobile Industry for the Period 2003-04 to 2017-18

Future of Indian automobile industry

The Indian Automobile Industry has made great strides over the past two decades at the international level and has become a major manufacturing hub. According to Automotive Mission Plan 2016-26, in terms of global rankings in manufacturing output, Indian Automobile Industry is the second largest in two-wheelers, eighth largest in commercial vehicles, sixth largest in passenger cars, and the largest in tractors. In order to keep up with the growing demand, several auto-makers have started investing heavily in various segments of the industry during the last few months. The industry attracted Foreign Direct Investment (FDI) worth US\$ 17.40 billion during the period April 2000 to June 2017, according to data released by Department of Industrial Policy and Promotion (DIPP). Several automobile manufacturers, from global majors such as Audi to Indian companies such as Maruti Suzuki and Mahindra & Mahindra, are exploring the possibilities of introducing driverless self-driven cars for India. The Government of India is encouraging foreign investment in the automobile sector, and has allowed 100 per cent FDI under the automatic route.

Need for the study

Infrastructure development of any country is based on its urban, rural, and industrial development, but the proper infrastructure development can be made only by connecting the various regions which is possible through the automotive industry. Automotive industry plays a very important role in the development of any economy as the growth of many other sectors like iron, steel, etc. is not possible without it. After the introduction of liberalization measures in India in 1991, Indian Automotive Industry has progressed tremendously with a large number of global auto manufacturers setting up their manufacturing facilities in India, but still there is enough scope for its further development. A well-defined framework is required for the proper growth and development of this industry.

Objectives of the study

- To examine the structure, growth, and regulation of automobile industry in India.
- To study the financial structure of the selected Indian automobile companies.
- To study the working capital management of the selected automobile companies.
- To analyze the profitability and to identify the determinants of profitability of the selected companies.
- To evaluate the dividend policy of the selected automobile companies.
- Finally, to make suggestions for successful survival in competitive business world.

Research methodology

The present study intends to evaluate the financial management practices of Indian Automobile Industry by taking a sample of all the companies listed on Bombay Stock Exchange covering the major segments of this industry, *viz.* commercial vehicles, three-wheelers, two-wheelers, and passenger vehicles. Therefore, the study focuses only on the automobile manufacturing companies of the Indian origin. The present study is based on secondary data collected from annual reports of the selected automobile companies, reports of various organizations, *viz.*

Society of Indian Automobile Manufacturers (SIAM), Automotives Components Manufacturers Association (ACMA), Ministry of Heavy Industries and Public Enterprises, Prowess Database of Centre for Monitoring Indian Economy, and Ace Equity Database of Accord Fintech Pvt. Limited. The other sources include various books, journals, newspapers, websites relating to the Indian Automobile Industry, and Bombay Stock Exchange. Further, the various publications of the Department of Heavy Industry, Ministry of Heavy Industries and Public Enterprises, Government of India, and reports of Reserve Bank of India have also been accessed for the purpose.

Period of the study

The study covers the data relating to the period 2003-04 to 2016-17. The year 2003-04 was selected as the starting financial year of the study because major changes took place in the automobile industry of India with the introduction of Auto Policy 2002. It was the first comprehensive policy formulated by the Government of India for the growth and development of the automotive industry in the country. During this period, many new reforms were introduced by the government for the development of this sector after this policy.

Conclusion

The present study is a modest effort to comprehensively examine the structure, growth, regulation, and financial management practices of Indian Automobile Industry. It covers all the aspects of financial management, *viz.* financial structure, working capital management, profitability, and dividend decision. The study mainly focuses on Original Equipment Manufacturers (OEMs) of Indian origin and does not extend to the automobile manufacturers operating in India which are of non-Indian origin. The Indian Automobile Industry is one of the major sectors contributing significantly to the growth and development of the economy. The industry has bright future prospects due to which Government of India is also making plans and policies for its further development. The overall annual production, domestic sales and exports of the industry showed a tremendous increase over the study period; and two-wheelers segment excelled all the segments of the industry on all these growth parameters.

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