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Auto Track

Quarterly update

July - September 2017
Volume II

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Foreword

Auto Track is an initiative to keep our clients and customers abreast with the prevailing conditions and situation in the automotive sector; a major contributor to the country's manufacturing sector.

After the vital insights on the automotive sector in Auto Track I, we bring you the sequential guide Auto Track II. The quarterly publication envisages the outlook of the automobile industry with deep insights on its various verticals along with a summary of the major happenings in the industry including the comprehensive sales analysis and top stories covering different vehicle segments of the sector.

With its deep backward and forward (dealership retails , credit and financing, logistics, advertising, repair and maintenance, petroleum products, gas stations, insurance, service parts) linkages, the automotive sector has been recognised and identified at various platforms including Development Council of Automobile and Allied Industries, Planning Commission, National Manufacturing Competitiveness Council and Investment Commission as a sector with a very high potential to increase the share of manufacturing in GDP, exports and employment.

In recent years, the sector has rapidly increased its market share. The sector also helps in attaining two critical goals of the common minimum programme: increasing manufacturing output and employment creation.

Apart from meeting the domestic demand, Indian automakers are increasing their share in international markets too.

The business strategies recently adopted by automobile manufacturers have focused on small cars and fuel efficient cars with low on-road price to target a large part of the market. With such targets, the sector is expected to invest around INR 1 lakh crore for upgrading products to meet various upcoming regulations related to emissions, safety and fuel efficiency.

At the same time, the volatility in the automotive legislations of the country has made the market highly unpredictable as the industry awaits the passing of Motor Vehicle Amendment Bill 2017. The impact of GST on the used vehicle segment is yet to be seen. Further, there are difficulties related to proposed hike in the cess of large cars. In a nutshell, this is a time when industry can scale new heights with the right government scale.

In a fiercely competitive market, it is also important for automakers to be price sensitive and strengthen service quality to ensure customer loyalty. The Government of India and the automobile industry will have to together devise a two-way road map to encourage the next generation of opportunities.

This study encompasses a detailed understanding of prevalent issues and comprehensively covers the possible impact on one of the world's most important economic sectors by revenue.

Saket Mehra
Partner
Grant Thornton India LLP

Sector overview

Automotive industry, globally, as well in India, is one of the key sectors of the economy. In India, the auto sector is likely to contribute 12 per cent to the country's GDP over the next decade. The government is also working on the adoption of modern measures to encourage clean, safe, cheap and futuristic mobility services, which will also lead to job creation in the research, development and manufacturing sector.

The first three months of the FY 2018 have gone by in a flurry and it has been a rather implementation of the BS IV emission norms across the board and the ambiguous Goods and Services Tax or GST.

The majority of the auto industry saw a boost in the form of the GST, which led to many manufacturers dropping the prices of their models, especially in the premium segment even before the GST came into action, anticipating favourable consumer sentiment. Thus, the industry faces testing times and surrounds uncertainty on when sustainable growth and profitability would be a reality for the sector.

The concept of attaining competitiveness on the basis of cheap and abundant labour, favourable exchange rates, low interest rates and concessional duty structure is becoming outdated and unsustainable. In the light of above, it is felt that a greater emphasis is required on the development of the factors which can ensure long-term competitiveness.

The government recognises its role as a catalyst and facilitator to encourage the companies to move to a higher level of competitive performance. Hence, its policies are targeted at encouraging growth, promoting domestic competition and stimulating innovation.

As the auto industry would gun for competitiveness, better products and the move from BS IV to BS VI by 2020; government support will be indispensable.

First, there should be a focus on creating the right ecosystem which would include creation of high-quality R&D clusters for the auto industry. Few such clusters are in Haryana, Tamil Nadu, Maharashtra and one coming up in Sanand, Gujarat as well.

To supplement the same, the government needs to look at automotive-specific infrastructure; for instance, dedicated facilities for automobiles for auto exports at Indian ports.

There is a need to further focus on stable policies as frequent disruptions in policies push the companies to re-work their plans, which proves detrimental for the industry as a whole. The areas where the auto industry must frame policies on are:

The Indian economy has expanded 5.7 per cent year-on-year in the second quarter of 2017, below 6.1 per cent in the previous period and market expectations of 6.6 per cent. It remains the weakest growth rate since the first quarter of 2014 due to a slowdown in consumer spending and exports.

On the production side, manufacturing eased. GDP from Manufacturing decreased to 5131.39 INR billion in the second quarter of 2017 from 5331.94 INR billion in the first quarter of 2017

Courtesy- Economic Survey

environmental norms and safety regulations, inspection and certification regime and most importantly end-of-life regime.

Moreover, the industry needs to create an environment conducive to investment in future technologies. Currently, there is less focus on areas such as battery technologies, sensors, among others. The industry should request the government to refine trade policies which incorporate a long-term vision in it.

On the other hand, the government needs to rationalise the duty structure on raw materials and sub-assemblies.

The trade and tariff policies are to be kept stable and free of disruptions. The requisite for the government is to fulfil the

target of entering into free trade agreements (FTAs) with more countries, which would benefit the industry in the long run.

> The automotive industry, including component manufacturing, is estimated to grow to INR 16.16 - 18.18 lakh crore by 2026.
>
> - SIAM

Further, with product life cycles getting shorter, increasing number of product launches and expected variants across models; it is likely for the industry to witness increased production complexities and supply chain challenges, including forecasting, production planning and allocation. In this context, the products must evolve with a focus on increasing safety requirements, higher electronic content and a move towards more feature-rich and fuel-efficient vehicles.

Contrarily, there is a need for automotive industrialists to realign themselves as the market moves toward the next stage of evolution. Thus, automakers must re-evaluate their strategy in light of upcoming regulations.

Quarterly snapshot

Today, it's not just the sales and mobility options that are numerous, but the diversity of segments, models, and propulsion is equally vast.

Industry performance overview

The second quarter had brought a ray of hope for the industry, specifically post the implementation of GST on 1 July, 2017. After the initial apprehensions, market forces seem to be settling down.

In all aspects, the regulation of the new and integrated indirect tax regime has paved way for the automotive industry with not only benefits to the existing segments prevailing in the industry, but also for the upcoming launches of the vehicles inducing greener and cheaper vehicles for the consumers to reap benefits.

The genuine sentiment among consumers is quite positive and same is reflected in the jump of Q2 sales of passenger vehicle by 13.5 per cent.

Thus, the price cut euphoria following GST had brought increased footfalls to the sales outlets that translated into sales. This is clear in the domestic numbers, especially in the passenger vehicle segment. The commercial vehicle industry, which was in the red due to pre-buying blues on the eve of the enforcement of the BS-IV emission norms, emerged from its after effects. The medium and heavy commercial vehicle segment too in particular came on the road to recovery.

For better prospects, further push is required for the electric vehicles by the government. Though the impact of GST is on the higher side, to encourage adoption of electric vehicles by consumers, the government is leaving no stone unturned.

Moreover, the companies with growing interest in exploring the rural markets are further aiding the growth of the sector. The forecast of a good monsoon and a bountiful crop may give a further fillip to the market with the upbeat mood reaching out to the rural areas that would contribute a sizeable chunk of the total sales.

It's not just the sales and mobility options that are more numerous than ever, but the diversity of segments, models, and propulsion choices is equally impressive.

Quarterly comparison – Sales

July 2017 - September 2017

Date	Passenger Vehicles (PVs)	Commercial vehicles (CVs)	3 Wheelers (3Ws)	2 Wheelers (2 Ws)	Total Sales
Jul-17	298997	59000	41261	1679055	2078313
Jul-16	259720	51853	46397	1476332	1834302
y-o-y (%)	15.12	13.78	-11.07	13.73	13.3
Aug-17	294335	65310	51451	1891062	2302158
Aug-16	258737	53001	50193	1648871	2010802
y-o-y (%)	13.76	23.22	2.51	14.69	14.49
Sep-17	309955	77195	68916	2041024	2497090
Sep-16	278428	61622	56085	1871621	2267756
y-o-y (%)	11.32	25.27	22.88	9.05	10.11

Sales analysis: July 2017

July was an eventful month for the automotive industry.

Overall, there had been quite a few launches, but the biggest push for the industry was created by the implementation of GST. After the slowdown in sales in June'17 due to rationalisation of inventories by OEMs and at their dealerships before the advent of GST and expected reduction in vehicle prices post-GST, the July sales numbers were reassuring. Thus, vehicle sales grew at a robust pace in July and the automobile sector, one of the major beneficiaries due to reduced taxation in all vehicle categories other than hybrids, saw an uptick in demand.

July'17 recorded a YoY growth of healthy 15.12 per cent in domestic passenger vehicle sales. The spurt was primarily due to the upcoming festive season in August'17.

13.73 per cent YoY growth in the two-wheeler industry was mainly driven by 16.9 per cent YoY growth in motorcycles.

Contrary to the first quarter of FY 2018, the CV segment witnessed recovery in sales with 13.73 per cent growth in July'17 on YoY basis driven by continued heavy demand for LCV. After reasonably tough Q1 (April-June 2017) when overall sales at 151,837 units were down 9.08 per cent YoY, the CV sector recorded a sharp recovery driven by an uptick in the critical medium and heavy commercial vehicle (M&HCV) segment. After the steep declines in April (-22.93 per cent) and May (-14.40 per cent), CV manufacturers saw green shoots of recovery and entered growth lane (+1.44 per cent).

It is vital to point out that the pace of decline in three-wheeler segment came down sequentially as the domestic sales continued to shrink but at a slower pace.

Sales analysis: August 2017

After slipping in June 2017, the automotive sector was back on track with a growth rate of 14.49 per cent in August 2017. Sales of passenger vehicles in the domestic market went up by a strong 13.76 per cent to 2,94,335 units last month as carmakers stocked dealerships ahead of the festive season. Sales of commercial vehicle grew by 2.51 per cent to 51,451 units during the month.

Good monsoons lifted consumer sentiments in rural areas buying two-wheeler sales. As many as 18,91,062 two-wheelers were sold in August'17. This is an increase. of 14.69 per cent over the year-ago period.

Sales analysis: September 2017

Consumers purchased newly-launched cars in September'17, a period that coincided with the festive season which is considered an auspicious time for buying. Thus, auto sales rose despite an increase in cess which was followed by a price hike on premium models, rising fuel prices and weak economic cues. Therefore, with the ongoing festival season, the consumer sentiment is expected to remain positive.

New models, SUVs drive the PV growth

In the passenger vehicle segment, most of the auto makers managed a double-digit growth with SUVs boosting sales. In addition, all OEMs that had recently launched new models fared better in the market compared to competition, a clear indication that consumers are looking for innovative features, new designs and styling their vehicles and are even willing to pay a wee bit more.

Compact cars of a leading auto maker of the country lead the sales charge with a growth of 44.7 per cent to 72,804 units (50,324 units). Utility vehicle sales rose 8 per cent to 19,900 units in September (18,423 units), with exports witnessed a de-growth of 1.3 per cent to 11,671 units for the automaker.

Overall, Commercial Vehicles were seen on the road to recovery and grew on the back of ramp-up in production and demand for new products. The major reasons of the increased sales of CVs have been new model launches in popular categories, GST benefits passed on to the customers and introduction of new technologies like Selective Catalytic Reduction (SCR) to meet emission norms.

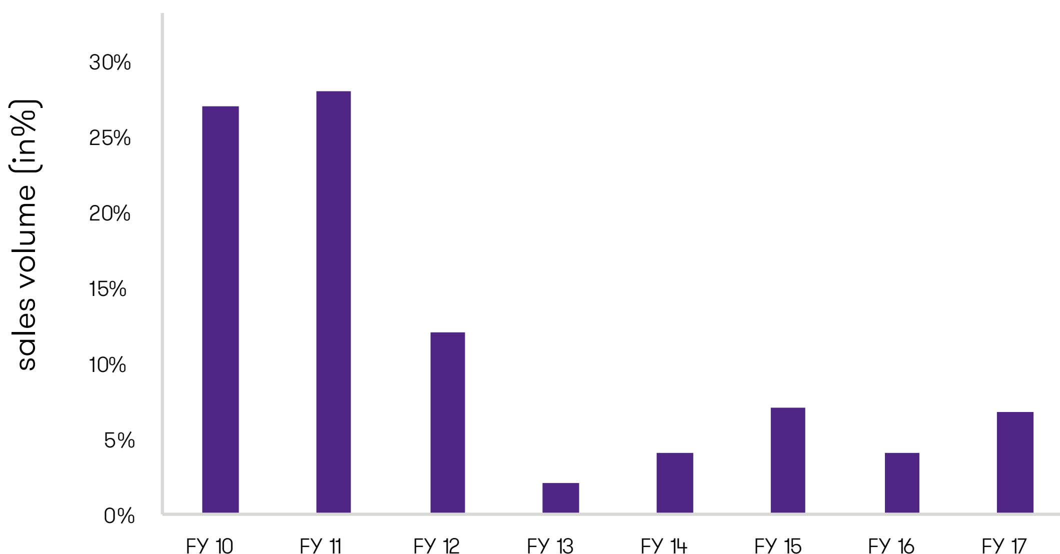
Moreover, to some extent, the re-stocking trend which took effect in August'17 after the implementation of the GST also led to higher despatches. Ahead of the implementation of GST, several firms had liquidated stocks; wherein a known fact is that automakers in India count despatches to dealerships as sales.

Investment scenario

Financial reforms in the past one decade, tighter monetary policies aimed at securing the Indian economy from the turbulent global market conditions have not just helped the Indian market to grow but have also helped in attracting investments from around the world.

The automotive Industry offers huge growth potential in terms of sales volume (including exports) and also immense employment opportunities. It is estimated that the automotive sector requires an incremental investment of INR 11,000 -12,000 crore per annum to realise its full growth potential. Out of this, the sector requires an incremental investment of INR 9,000-10,000 crore and the auto component sector requires INR 2000 crore.

Being a volume driven industry, a certain critical mass is a pre-requisite for attracting the much-needed investment in Research & Development and New Product Design and Development; whereas the employment opportunities would be in production line for both skilled and unskilled labourers. This would materialise only if the sector gets adequate attention in terms of investment.

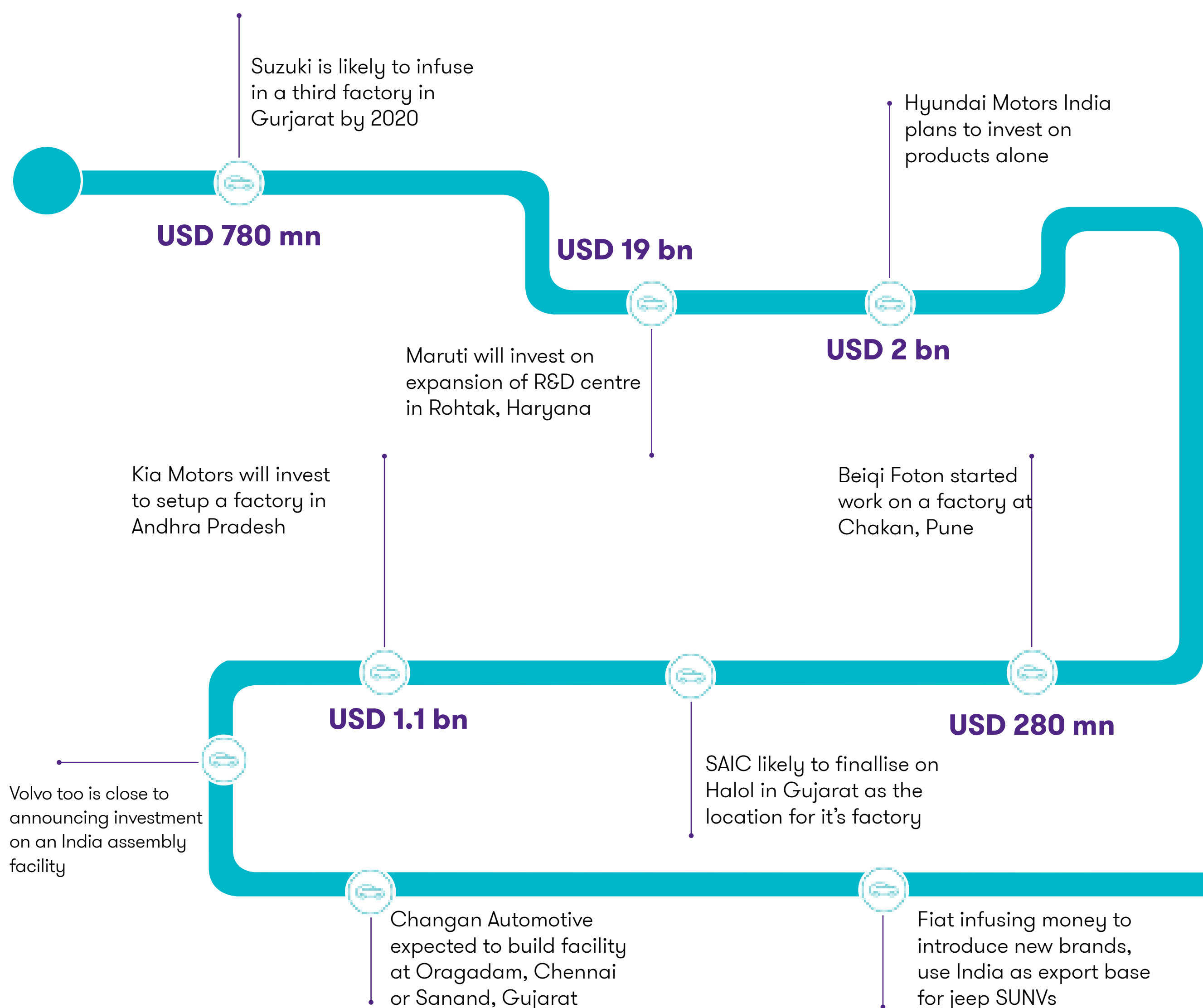


R&D investment is needed for innovations which is the lifeline for achieving and retaining the competitiveness in the industry. This competitiveness in turn depends on the capacity and the speed of the industry to innovate and upgrade. The most important indices of competitiveness are the productivity of both labour and capital.

Thus, in order to keep up with the growing demand, several automakers have started investing heavily in various segments of the industry which would most probably increase the production of passenger vehicles in India by 1.3-1.5 million units a year and generate employment for 20,000-25,000 people.

Global vehicle majors too have been ramping up investments to cater to growing domestic demand. These manufacturers plan to leverage country's competitive advantage to set up export-oriented production hubs.

On The Fast Track



Moreover, India has significant cost advantages as the auto firms save 10-25 per cent on operations vis-a-vis Europe and Latin America. Thus, an anticipation subsists that a large pool of skilled manpower and a growing technology base would induce greater investments in future.

Favoured with various benefits such as globally competitive auto ancillary industry; production of steel at lowest cost; inexpensive and high-skill manpower; entrenched testing and R&D centres etc., the industry provides immense investment and employment opportunities.

Foreign Direct Investment (FDI)

Foreign investments are considered crucial for the country which needs around USD 1 trillion for overhauling the infrastructure sector comprising ports, airports and highways to boost growth. A strong inflow of foreign investments is required to improve the country's balance of payments situation and strengthen the rupee value against other global currencies, especially the US dollar.

According to Department of Industrial Policy and Promotion (DIPP), the total FDI investments India received during April-June 2017 stood at USD 14.55 billion, indicating that government's effort to improve ease of doing business and relaxation in FDI norms to yield results.

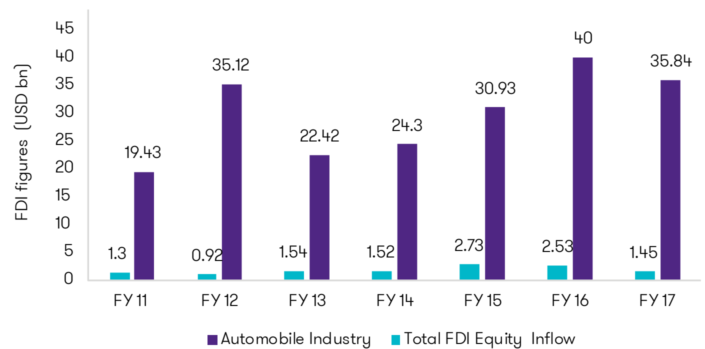
The government has announced several steps to attract foreign inflows. The measures include liberalisation of FDI policy and improvement in business climate. Thus, FDI into the country grew by 37 per cent to USD 10.4 billion during the first quarter of the current fiscal.

64%

To USD 110.12 billion in nine months during Oct to June 2017 from USD 67.26 billion in the same period last year due to the launch of 'Make in India' initiative.

In context to the automobile industry, which is a fully delicensed industry and where free imports of automotive components are allowed; the government encourages foreign investment in the sector and allows 100 per cent FDI under the automatic route. Moreover, the government has not laid down any minimum investment criteria for the industry and besides offering a liberal FDI regime, it has made successive policy changes that facilitate stronger growth in the automotive sector

FDI Trends over the past few years



FDI equity inflows in the automobile industry aggregated to USD 16.51 billion over FY 2010-16. Whereas in FY 17, FDI inflow accounted for 5.09 per cent of total FDI equity inflow for country's automobile industry.

Leading global players like Ford Motors, Honda, ISUZU Motors, Tata Motors and Suzuki Motors have already invested heavily in the manufacturing sector resulting in the establishment of new assembly lines, manufacturing, and greenfield units, thereby boosting the automotive manufacturing ecosystem in India.

Collaborations

If the industry has to insulate itself, there has to be collaboration. This is the overlying message to the industry as the uncertainty within is here to stay and the pace of change too is unpredictable. Thus, automotive dealers and manufacturers need to work in a collaborative environment to stay relevant during these challenging times.

Domestically, some consolidation or alliances are expected; driven by the need for access to better technology, manufacturing facilities, service and distribution networks. For instance: Mahindra Two Wheelers Limited (MTWL) acquired 51 per cent shares in France-based Peugeot Motorcycles (PMTC).

The components sector too is in a strong position to cash in on the country's cost effectiveness, profitability and globally recognised engineering capabilities. As the benefits of collaboration become more apparent, super specialists may emerge in which the automobile is treated as a system, with each specialist focusing on a sub system, akin to IT Industry. Though the approach is radical, but it may prove to be an important step in reducing the complexity and investment requirements, while promoting standardisation and meeting customer demands.

Large number of products are made available to consumers across various segments which has gathered pace with the entry of a number of foreign players.

Manufacturers seems to have planned for the future with early advocates of technological and distribution alliances expected to yield positive results, enabling domestic OEMs to access global technology and experience and permitting them to grow their ranges with fewer financial risks.

Thus, for the achievement of the goal to improve efficiency in capital outlays; a good place to start is with platform (or chassis) and powertrain investments.

New Financing Options

Carmakers such as BMW, Audi, Toyota, Skoda, Volkswagen & Mercedes-Benz have started providing customised finance to customers through NBFCs.

Major MNC & Indian corporate houses are moving towards taking cars on operating lease instead of buying them.

Deals scenario in India

India saw 22 main stream IPOs raising USD 2.5 billion in the YTD 2017. Key sectors were banking and financial services, healthcare and pharma, transport, education and IT & ITES.

India entered deals worth USD 47.8 billion in YTD 2017, 34 per cent higher than YTD 2016. In spite of ambiguity among PE investors on the impact of GST, the deal activity exhibited 74 per cent growth in YTD 2017 as compared to last year.

M&A vales recorded a promising 22 per cent growth as the country saw increasing domestic consolidation. There have been 11 Merger & Acquisition Deals from Jan-May 2017 in automotive sector, up by 170 per cent to USD 254.8 million as compared to the last year. PE investment rose 607 per cent to USD 90.2 million resulting from three deals in Auto Parts and Equipment. These included Piramal Finance's investment of USD 42.5 million in RSB Transmissions India and USD 44.9 million in IndoShell Mould. SAIF Partners India invested around USD 2.8 million in Fiem Industries.

Major Deals in second quarter of FY17 – 18

M&A

Mahindra & Mahindra ltd and Erkunt Traktor Sanayii A.S

Mahindra & Mahindra Ltd., the world's largest tractor company by volume and part of USD 19 billion announced its second acquisition in Turkey on 20th September 2017. After acquiring stake of 75.1 per cent in Hisarlar in January 2017, M&M agreed to acquire Erkunt Traktor Sanayii, the 4th largest tractor brand in Turkey, and an associate company for an enterprise value of USD 117 million. It will acquire 100 per cent of tractor making operations for USD 76 million and 80 per cent of foundry business which provides castings to machine services for USD 41 million.

This deal would not only allow M&M to tap the fourth largest tractor market in the world, but also to have a strong brand presence, wide portfolio of products and access to manufacturing capacity, dealer network and neighbouring markets such as Middle East, CIS, & North African markets.

M&A

IMC International Metalworking Companies BV and L&T Cutting Tools Ltd

On 16th August 2017, Larsen & Toubro Ltd (L&T) agreed to sell its entire stake in its unlisted unit L&T Cutting Tools Ltd to IMC International Metalworking Companies BV, owned by Warren Buffett-led Berkshire Hathaway Inc., for INR 174 crore. The sale is part of L&T's strategy to exit non-core businesses. L&T Cutting Tools, incorporated in 1952, manufactures fabricated metal products.

M&A

Bharat Forge Ltd and Analogic Controls India Ltd

Auto components maker Bharat Forge Ltd completed the acquisition of balance 40 per cent shares of Analogic Controls India (ACIL) on 21st September 2017 post which ACIL has become wholly owned subsidiary of Bharat Forge. Hyderabad-based Analogic's founders agreed to sell the stake as the company had a negative net worth of INR 7.88 crore as of March 2017. Bharat Forge acquired a 60 per cent stake in the company in 2013. Bharat Forge said Analogic is "strategically important" as it has the resources and technical capability to execute projects related to defence, aerospace and electronic components and sub-systems.

Partnership

Mahindra & Mahindra and Ford Motors

Mahindra & Mahindra has entered into a partnership with American car giant Ford Motors Company in September 2017. This association is expected to help Mahindra & Mahindra expand its global outreach, and help Ford Motor Company gain some more market in India, benefitting from the successful business model of its new partner. Besides helping each other get better markets within and outside India, the two car companies will cooperate in endeavours like mobility programmes, connected vehicle projects, and product development. One pivotal avenue in the partnership between Mahindra Group and Ford Group will be developing electric vehicles. This will be a crucial step forward in times when other auto companies are also looking to make a mark in the emerging electric vehicle segment.

Investments

Suzuki Motor Corp and Maruti Suzuki

Suzuki Motor Corp, the Japanese parent of Maruti Suzuki announced that it would invest INR 1,150 crore for a new unit to produce lithium ion batteries in Gujarat. Suzuki along with two manufacturers Toshiba and Denso will also invest around INR 1,150 crore for a new unit to produce lithium ion batteries which will be operational by 2020.
Suzuki Motor has decided to make electric cars at its factory in Gujarat. Suzuki will also manufacture electric cars for international markets.

Story of the quarter

Higher Demand of Used Vehicles and post GST impact on the segment

Used car market is growing at a CAGR of 15 per cent over the last 10 years and has touched 3.87 million in FY'17 and is estimated to touch 5 million by the end of FY'18. Though economic slowdown has hit new car sales numbers, the used cars market has seen an uptrend, clearly indicating that used cars will continue to move forward.

The rise in purchasing power, rapid growth of economy and increased consumer demands are some of the reasons for such high demand. Further, due to technological advancements in recent times, used vehicle segment has shown an improved trend and hence longer life which in turn has made the used cars easier and better to maintain. Even a used car with 40,000 - 50,000 km on the odometer is much easier to maintain than a car with similar mileage 8-9 years ago. Also, with easy availability to high speed internet, more people are able to buy or sell cars on the web. Search costs have also come down, thereby reducing the dependency on word-of-mouth advertising. All such factors have led to the evolution, a subsequent shift and growth of the used car market.

Thus, consumer has woken up to the positive value equation of pre-owned cars because of higher flexibility and reach to prospective car owners, whether first-time buyers or repeat. Also, the price advantage they offer is clear.

Considering the growth prospects and to cater to the demands of consumers, some organised players have also started entering the market of used vehicle segment. With the organised players stepping in, the used cars market has benefited from fair deals, warranties, better retail network, credibility, transparency and easy availability of finances; thereby assuring both the buyer and seller of their investment.

10X

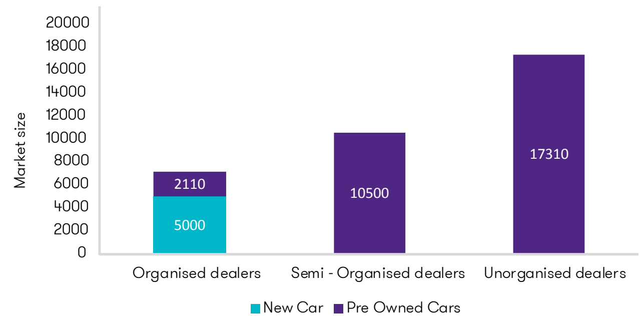
U.S. - a very mature pre-owned car market, is 10 times the size of India

+15%

However, the Indian pre-owned car market is amongst the fastest growing at 15% per year

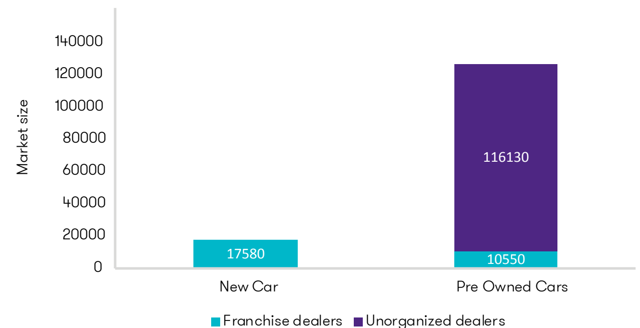
India

	Dealer Type	New car	Pre-Owned car
19%	account of organised dealers in total used car market	5000	2110
52%	contribution of semi-organised segment		10,500
29%	contribution of unorganised dealers		17,310



China

	Dealer Type	New car	Pre-Owned car
27%	franchisee dealers	17580	10550
73%	unorganised dealers		116130



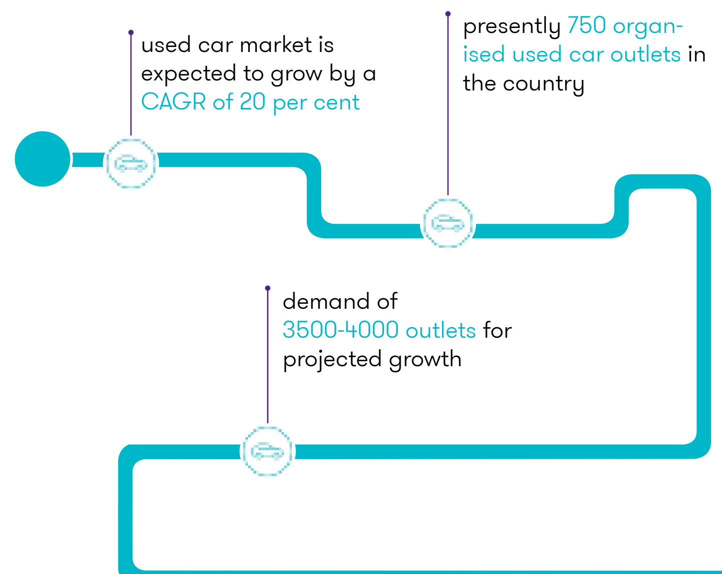
In India, organised dealers account for 19 per cent of the total used car market, with the semi-organised segment contributing 52 percent and unorganised dealers 29 per cent. Organised players in the country have made the whole process of buying and selling a lot simpler, easier, and transparent. In comparison, in China, the unorganised dealers are pegged at 73 percent and franchisee dealers at 27 percent.

Usually, the pre-owned car market grows at a higher pace when compared to the new car segment with the organised players contributing a major chunk to this growth. For instance, if new car sales report a 10-12 per cent growth, a 13-16 per cent uptick for the old car segment is expected.

With the inextricable linkage between the sale of old and new cars; it is estimated that about 27-28 per cent of new car sales accrue through exchange of old models. So, if new car sales are pegged at about 3 million, it is likely that about 8,40,000 used cars are exchanged for new ones at pre-owned outlets.

Most of the authorised dealerships conduct about 120-140 checks on each second hand vehicle before purchase, besides providing certification and warranty post sales. In a nutshell, the future of pre-owned car market is bright.

Future of used car market



Changes in the field of safety, emissions as well as connectivity trends are expected to further reduce the holding period of the used car going forward with only 1 in 3 used car customers considering a new car for purchase.

In the next five years, the used car market is expected to grow by a CAGR of 20 per cent with the organised sector playing a big role. At present, there are about 750 organised used car outlets in the country. In order to keep up with the projected growth, there is a demand for 3500-4000 outlets. Recognising the growth potential, many OEMs have opened used car showrooms for their own products.

Impact post-GST

The used car industry is a critical part of the automotive ecosystem and has to be dealt with as a major sector of utmost importance. A used vehicle might go through one or several wholesale transactions before it is retailed to a new consumer, and these wholesale transactions are extremely important to provide 'inventory liquidity' to the used car marketplace.

In the GST environment, the rate has been aligned with the new car rates, presumably under a broad umbrella of 'car sales'. Car purchase has come under the 28 per cent GST slab w.e.f. 1 July 2017, for both new and used cars. In the pre-GST era, dealers had to pay VAT, service tax, and cess at both state and central levels for sale/leasing of vehicles. Overall, the average VAT rate, pre-GST, worked out to be in the neighbourhood of 5-15 per cent on the sale of the car. Now the dealers have to pay tax of 28- 53 per cent (28 per cent + applicable cess) on the transaction value of the goods, probably the highest in the world for used car transactions. However, for dealers who are dealing in buying and selling of second hand goods i.e. used goods (or after such minor processing) and where no input tax has been availed on purchase of such cars are allowed to pay GST only on their gross margin. Value added by way of repair, refurbishing, reconditioning etc. would form part of the marginal value for discharging the GST liability.

It may be noted that no GST would be payable on intra-state supplies of second hand goods by unregistered person to the registered person, who deals in buying and selling of second hand goods and pays the outward CGST on the marginal value. Further, GST on inter-state supplies from unregistered person to a registered person has been deferred from 13 October 2017 till 31st March 2018.

Thus, the rate would make it four to five times the existing national average and twice the maximum VAT (which was very high). For instance, if a used car dealer sells 5 - 6 vehicles in a month at an average price of INR 2.5 lakhs each, generating

10 per cent gross margin, a tax rate of 28 per cent + cess on the margin (INR 7,000 GST + cess) would fundamentally make his business unviable and challenge his livelihood. Thus, GST seems to have a significant impact on the used car market and for taxation purposes it cannot be treated like the new car industry which is manufacturer driven. In order to give some relief, the Government has decreased the rate on sale of vehicle to 65 per cent of applicable GST + Cess. However, the same is subject to conditions such as the vehicle purchased before 1st July, 2017 and no ITC/CENVAT credit had been availed at the time of its purchase.

The growth and transformation of the used car market can be attributed to credible registered dealers and refurbished car marketplaces. The refurbished car market places provide high quality used cars along with on-road assistance and other post-sales services. In the short run, GST would imply a huge cost burden on the dealers as these dealerships will reduce the procurement price, as a result of which sellers will get less price for their cars. Ironically, they cannot increase the price of the cars as that would have an adverse impact on the sales as the new cars are going to cost less. The only possible solution available is to reduce the input cost by buying cars from sellers at a lower price. In the long run though, dealers can reduce the price of used cars as the prices would stabilise and the organised and credible players would be able to pass on input credits to the customers.

Consequently, at present, several used car dealers anticipate that high GST rate on second-hand car transactions will directly impact their sales and revenue. While the entire country looks forward to a uniform tax structure to bring in transparency and trust, the used vehicle segment would certainly wish for the government to rethink and revisit the GST rate, at least for this segment, and iron out the unintended anomalies.

Emerging opportunities and challenges

Effect of Higher allocation for farm credit in Budget 2018

Any loan in agriculture and allied sector (dairy, fishery, piggery, poultry, bee-keeping, etc.) to farmers is farm credit and is an important prerequisite for agricultural growth. Agricultural policies have been reviewed from time to time to provide adequate and timely availability of finance to this sector.

RBI has made it mandatory for all banks to lend at least 18 per cent of total loans to agriculture. If the banks fail to do so, they are penalised by locking the shortfall for five years in RID fund (Rural Infrastructure Development Fund) that returns 4-5 per cent a year. Banks see this as an inconvenient necessity, because not only are bad loans in the sector higher, but also the pricing of these loans is abnormally low. So, the banks indulge in indirect farm credit in which they provide loans to the companies that make farm inputs and to the non-banking finance companies (NBFCs) that then lend to the farmers. Thus, such Indirect farm credit are funds availed by fertilizer dealers, state corporations, FCI, warehouses etc

Allocation for farm credit in Budget 2018

The total agriculture loan target is increased by INR 1 lakh crore to a record level INR 10 lakh crore in the budget for 2017-18; an 11 per cent increase from 2016-17's target of INR 9 lakh crore. Further, INR 15,000 crore was set aside, as a special effort, to provide short term crop loans at subsidised interest rates to farmers to ensure adequate credit flow.

Government also raised budget allocation for Ministry of Agriculture & Farmers Welfare by 6 per cent to INR 51,026 crore for 2017-18 from INR 48,072 crore. The total allocation for agri and allied sectors is INR 58,663 crore, up from INR 52,821 crore. This large budget allocation would help farmers invest more and earn better profits in farm ventures.

Thus, the current budget provides more than 24 per cent allocation of INR 1.87 lakh crore towards rural, agricultural and allied sectors; whereas the reinforcement of the government commitment to double farm income over next five years bodes well for the farm community. There also stands approved extension of tenure of loans under Credit Linked Subsidy Scheme of the Pradhan Mantri Awas Yojana from 15 to 20 years.

To help farmers get better value for their produce, a model law on contract farming is also proposed to be circulated among states. Additionally, the government's earlier goal of bringing in more regulated agriculture markets on the electronic National Agriculture Market (e-NAM) platform was reiterated.

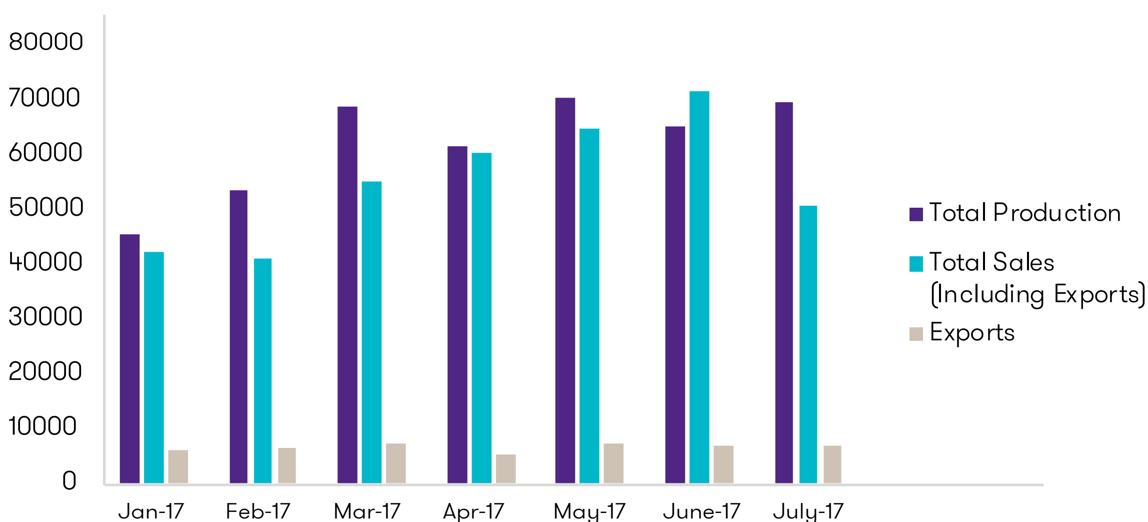
Boost demand for farm equipment and tractors segment

The agriculture sector has witnessed a considerable decline in the use of human and animal power for agricultural activities in recent years. This has paved way for a range of agricultural equipment that has been introduced in the market. A large number of these agricultural equipment is driven by tractors or diesel engines and therefore are swiftly transforming the traditional agricultural processes of the country into agriculture mechanisation with increased awareness among farmers for the need of farm mechanisation; which makes them keen to acquire tractor with the help of credit facilities from financial institutions. Consequently, tractors are an integral part of mechanisation and have a crucial role to play in increasing agricultural productivity.

In Agri business, farm equipment caters to requirements across the value chain. The size of the farm equipment sector is estimated at approximately USD 6.5 Billion. In FY 17, tractor makers sold 582,000 units, registering a growth of 18 per cent. Agriculture machinery market in the country is estimated to grow at a CAGR of over 10 per cent in five years' period till 2018; driven by factors such as increased agricultural credit, corporate involvement, focus on increasing the yield, etc.

With maximum mechanisation at initial value chain stage, the sector is dominated by tractors (at 84 per cent) with India being the largest tractor manufacturer in the world. By advancement in manufacturing of tractors there's possibility that could lead India to another green revolution. Moreover, the government's thrust on rural spending, infrastructure creation and irrigation spending in the budget is likely to further drive the demand for tractors. The attractive subsidies given by central and state governments also encourage farmers to buy farm equipment.

The farm equipment sector is yet to become a major market segment; the tractors remain a major sector of investment and the tractor industry is expected to record a volume growth of 9-10 percent in the current fiscal. Therefore, the focus of the government on rural development and farmer welfare would be positive for the tractor and the two-wheeler sector as the entry-level motorcycle sales also have a sizeable dependence on the rural segment.



Effect on Make in India plans with GST cess hike on cars

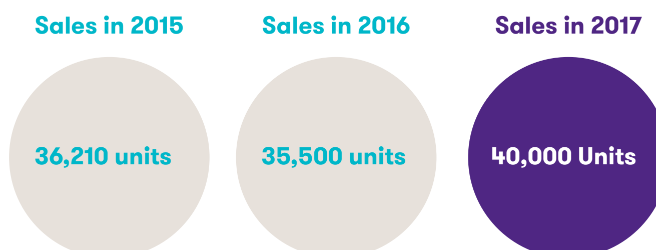
For large vehicles, the government had set levies under GST at a lower rate compared with the previous regime. To that effect, luxury car manufacturers had immediately cut prices to pass on the benefit to consumers, who had responded positively, pushing up demand.

However, country's luxury vehicles' market, bracing for double-digit growth, hit a roadblock as the government proposes to implement the decision to raise the cess on large vehicles. The GST Council decided to raise the cess on large cars and utility vehicles to 25 per cent from 15 per cent, taking the total tax incidence to 53 per cent (28 per cent GST plus 25 per cent cess).

CESS POST INCREASE

Small cars	1% (petrol, 4 metres, 1200CC) 1%
Small cars	3% (diesel less than 4 metres and below 1500CC)
Mid - size cars	25% (Over 4 metres and more than 1500CC)
SUV	25%

This has upset automakers who would have to increase prices leading to a double-digit drop in sales for second consecutive year in 2017; thereby affecting future investments and resulting in job losses. It is a shock for them as the proposal to levy cess comes only after a month of GST implementation and makes it hard for the large car manufacturers to understand the sudden alterations. Thus, all plans need to be reworked; specially for the luxury segment, as higher cess has thrown a spanner to their planning and pricing strategy and had left them scrambling for short-term measures, instead of planning for future market growth. It seems the manufacturers are going back to the drawing board and questioning the business case rather than reaping the anticipated expansions of dealerships, local manufacturing of products with a healthy sector spurring double digit growth with a positive business case.



Witnessing the entire scenario to be against the spirit of liberal market dynamics, it is believed that government needs to take a pragmatic decision on its proposal, as the move would slow down the growth in premium car market and the altered roll out would not only dampen the spirits of the industry across the entire value chain, but also would eventually lead to revenue loss for the government. Moreover, a constant shift in policy would make long-term planning for the market highly risky, and it would only have an adverse impact on country's financial ratings.

The current GST structure seems to be a good for the overall automotive industry which promises high revenue generation for the market. Thus, the policy regime needs to be predictable, consistent and clear. Manufacturers have requested the government to address their concerns and seriously consider the cess hike and exert themselves to keep the same at arm's length.

Thus, in anticipation of ensuring that their voices are heard, the manufacturers expect that all this might change as the GST Council may change the rates for high-end vehicles; but it remains to be seen. In addition, the high rates on hybrid and electric vehicles haven't quite sat well with the industry, when the government would want to have a fully electric fleet by 2030. There are problems for sure, but one can always be hopeful.

Indian Auto Components Aftermarkets

Emerging trends post disruptions of GST and demonetisation

Recent trends seem to suggest that the Auto Components Aftermarket has emerged as a silver lining for the auto component industry with turnover growing by 14 per cent despite demonetisation and uncertainties over the implementation of the industry. India is all set to become the third largest auto components market in the world by 2025. Globalisation of the sector has created opportunities for auto component makers in the aftermarket segment not only in India, but also globally, as they can now offer quality products at competitive costs.

Under the Automotive Mission Plan (AMP) 2026, the auto component aftermarket is estimated to reach a size of INR 1.79-2 lakh crore. A report by Automotive Component Manufacturers Association of India (ACMA), the apex body of the auto component industry, said the segment stood at INR 56,098 crore (USD 8.4 billion) in 2016-17 and is expected to grow at 10.5 per cent and reach INR 75,705 crore (USD 13 billion) by 2019-20. As per a latest study genuine OE (original equipment) spares accounted for around 40 per cent of the total component consumption in the passenger vehicle segment. The remaining 60 per cent is split evenly between IAM (Independent Aftermarket) branded parts and U-parts (parts from unorganised segment).

Currently, the way the Auto Components Aftermarket segment is structured, there exists some amount of cash transactions and some amount of transactions at tax rates which are significantly lower than the GST enacted rate of 28 per cent.

Interestingly, post demonetisation, the segment which was expected to have the most challenging times ahead actually reported a positive impact. The industry did report periods of reduced sales that was mostly the case with any business post demonetisation. Industry experts, representing the organised sector, expressed that demonetisation was a blessing which helped them grow their business, made business more transparent, reduced the spurious market and was a step towards digitalization. The move also helped in reorganizing their business and build strong relationships with their distribution channel.

The enacted GST rate is 28 per cent on spare parts (other than tractor component) as against the prevailing rate of 12 per cent (VAT). The industry is definitely feeling the pressure and has still not figured out how GST, the biggest possible tax reform in India, would impact business in the medium and long term. Auto components aftermarket experts however believe that GST is good for the industry and would positively impact business and definitely benefit the end customer.

The timing of GST implementation can be questioned since industry, especially the distribution channel in some ways, was still preparing for GST when it got implemented. The immediate trend pre-implementation of GST saw distributors reducing stock levels to avoid facing non-compliance issues in the new regime since their backup systems were not ready and they were not willing to increase their tax liability. The stock levels which were mostly within the 3-4 months level were reduced to 15 days to a month. This trend impacted the business in May/ June 2017.

Post GST implementation, the end customer has not faced any issue. The vehicles moved and as part of wear and tear, parts were needed to be replaced which helped the business gain rounds.

The idea of GST has sunk in and the industry today along with its distribution channel has slowly started adopting and developing systems to adopt to the new way of doing business. The industry reported initial hiccups largely from retailers who were not willing to stock, but things have moved since then. The manufacturers introduced interesting incentive schemes to mitigate the problem which worked in pockets. The one clear trend that has emerged from this is that stock levels has definitely reduced at the distributors and retailers level for good and will never possibly move back to the 3-4

stock levels which is a thing of the past. The manufacturers and organised players are realigning their logistics strategy including questioning the need for centralisation and removing multiple depots which seemed like a tax efficient answer from GST perspective. The industry has reported reduced time of delivery from manufacturer locations. The stock levels are being kept at optimal levels whereas fast moving and some medium moving stocks are being kept at depots and slow moving stocks are being centralised. The industry experts also expect consolidation to happen at distributor levels to handle the situation.

The spurious market continues but at reduced levels today. Post implementation, the stockists who have more physical stock compared to the book stock could manipulate the system and sell at reduced prices. This phenomenon is slowly changing as there is an increased awareness among stakeholders and a fear today of non-compliance which in erring people from following malpractices.

Today, it is clear that business will grow and disruptions such as demonetisation and GST will happen and will only help in making business more transparent and cleaner. Hence, in the coming years, while the organised sector will grow and the U-parts/unorganised sector will either fall in line or perish. The growth of the segment by 14 per cent is reflective of the segment's maturity and resilience.

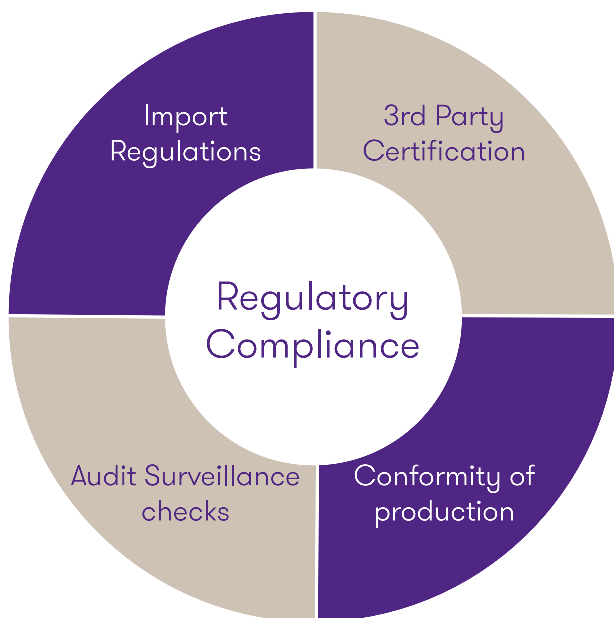
Anamitra Das
Chartered Accountant

Regulatory updates

Indian automotive standards - Leading or Lagging?

Though a comprehensive process exists for formulation of safety and emission regulations for the auto industry, the liability and enforcement regime seems to be lacking, as there is no specific statute catering to product liability and recalls in India

The Automotive Industry Standards (AIS) are the technical specifications of the automotive sector of the country. They are based on the norms of United Nations Economic Commission for Europe (UNECE). The standards are well-established and regulated under the Ministry of Road Transport & Highways (MoRT&H), the nodal ministry for regulation of the automotive sector.



Specifically, the industry has kept its standards for both Safety & Emission regulations at par with International Standards to sustain the growth of the Industry and to enable the receipt of global acknowledgement of its environmental issues.

An understanding of the laws on automobile safety and automotive regulations is pertinent, as they lay down guidelines and industry standards to be adhered to.

To ensure participation of industry stakeholders in formulation of regulations, the Ministry of Road Transport, Highways & Shipping (MoRTH&S) consists of two committees i.e. Central Motor Vehicles Rules-Technical Standing Committee (CMVR-TSC) and Standing Committee on Implementation of Emission Legislation (SCOE), which advise the Ministry on automotive safety and emission regulations respectively.

The AIS are published by the Automotive Research Association of India (ARAI) on behalf of the Automotive Industry Standards Committee (AISC). The AISC and the Bureau of Indian Standards (BIS) assist the CMVR-TSC in drafting and implementation of standards on automotive safety, which have to be complied with by the automobile manufacturers.

Chapter V of the CMVR specifically deals with construction, equipment and maintenance of vehicles. Under the rule, various test agencies are established to test and certify the vehicles based on the safety standards and emission norms prescribed by the MoRT&H. Similarly, Rule 126 of the CMVR requires every vehicle manufacturer to submit a prototype of its vehicle to be subjected to tests by the testing agencies, which are mentioned under the Rule. The agency, upon satisfactory testing, grants a compliance certificate to the manufacturer.

For safety standards, the CMVR relies on BIS standards, such as use commercial fuel as per BIS specification (IS 1460-2000), mentions general specifications on overall dimensions of the vehicle, and requires compliance with the AIS. BIS also formulates mandatory standards for the auto industry, for example specifications for tubes for pneumatic tyres.

The WHO has identified 7 safety standard specifications for vehicle design, or minimum safety standards. India meets just 2 of these 7 standards. In comparison, Russia meets all seven, Brazil meets five, while China and South Africa meet four each. The absence of five norms in India which includes electronic stability control, frontal and side crash impact standard, pedestrian protection and child restraint systems also means the country fails the international benchmark for all these standards currently. However, crash testing has become compulsory for cars in India as crash tests have come into regulation from 1 October, 2017 through the Central Motor

Vehicles Regulations. This is a welcome initiative because the crash test certification would regularise and improve both quality of the car and its safety function.

Recently, there were news reports of defective airbags which resulted in a recall of around 16 million cars globally. Auto manufacturers have not been historically subjected to as many recalls in the Indian market. However, leading car manufacturers have “voluntarily” recalled cars in India, on account of defective airbags or on failure of NCAP crash tests.

Although the Act allows complaints only by the Central Government or by the BIS itself or a consumer recognised by these entities for such purpose, non-compliance with such mandatory standards still attracts serious penalties including fine or imprisonment, or both.

Though a comprehensive process exists for formulation of safety and emission regulations for the auto industry, the liability and enforcement regime seem to be lacking, as there is no specific statute catering to product liability and recalls in India.

The year 2020 will mark an important chapter in India's 67-year-old auto industry. That's when automakers will take a giant leap forward and switch to far stricter emission standards that are on par with those in the U.S., Japan and the European Union.

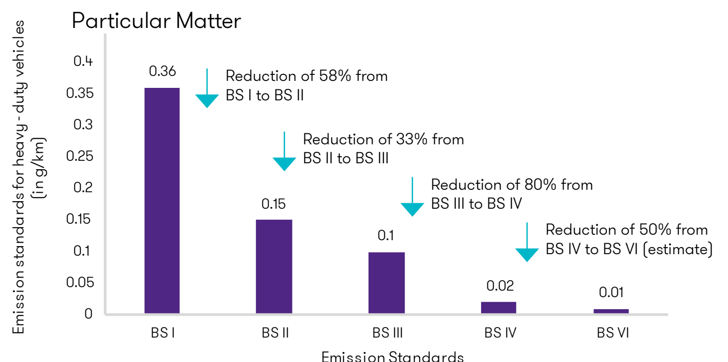
As new safety, emission and rating norms will come into effect, the next three years will be an exciting period in terms of innovation and R&D. It's set to change the very DNA of auto companies, making them accountable for each unit of particulate matter and emission exhaled by automobiles. For car buyers, it would mean driving cleaner vehicles with advanced technology, albeit at a higher price.

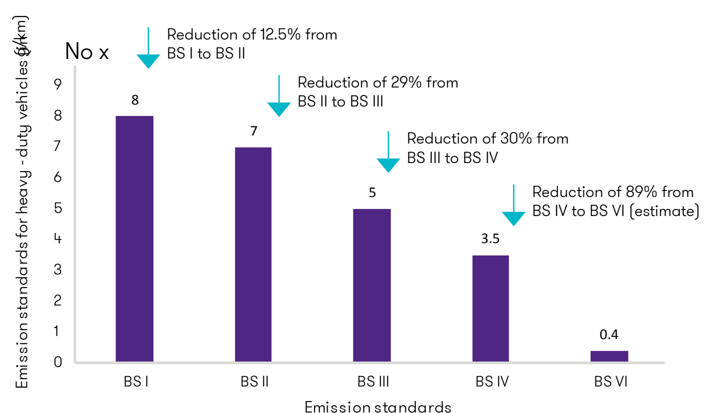
There are challenges but certainly the industry seems to be managing well. Country's vehicle technology would be at par with the international benchmarks and it is a matter of pride for us that within a period of three years, the industry would graduate to the expected level as against the 10-12 years of time span taken by other countries in the world.

As BS VI technology is an advanced one, it is not possible for the country to develop the same in-house. So the base technology might come from Europe and it has to be made suitable for the domestic market through domestic innovation. Unlike the local arms of the global automakers that have parent companies to fall back on, companies in the country will have to develop solutions with the help of global firms, specialising in emission control technologies. Early introduction of technology would also require support from the oil companies for the BS VI fuel availability. Thus, the companies would have to develop the requisite technologies and capabilities locally as against importing them because of much bigger scale.

Further, it is important to note that BS VI norms will address one of the inherent flaws in the European emission standards which permits diesel cars to emit more particulate matter and nitrogen oxide (NOx). In diesel cars, the jump to BS VI norms will result in reduction of nitrogen oxide emission by 68 per cent and particulate matter, which has a damaging effect on air quality and human health, by 82 per cent. Similarly, in heavy duty vehicles like trucks, the shift to BS VI norms would result in reduction of nitrogen oxide emissions by 87 per cent and particulate matter by 67 per cent.

Thus, India has for long lagged behind its western counterparts in checking vehicular emission at the source. Most developed countries have stringent factory checks in place to ensure vehicles meet the tight norms already in place. The gap though may soon be closing.





In summary, while some of the concerns of automakers are indeed legitimate, it is mostly agreed that decision to skip BS V and implement BS VI by 2020 is far nobler and puts people first. This will go a long way in putting the country at par with emission standards in place elsewhere and would ensure the standards to lead in comparison with the global technology.

Saket Mehra
Partner,
Grant Thornton India LLP

Anti - dumping duty on import of tyres from China

BACKGROUND/KEY HIGHLIGHTS

Over the years, growing imports of cheap tyres from China has posed a threat to the Indian tyre industry. Chinese tyres are cheaper on account of higher employee productivity, lower production costs and lower cost of finance. In addition, the Indian replacement market for truck and bus radial (TBR) tyre segment is very price sensitive and China because of its massive overcapacity has led to flooding of imports into the Indian market.

TBRs have increased 64 per cent from a year earlier in the fiscal year ended 31 March, 2016. According to the Automotive Tyre Manufacturers Association (ATMA), average imports in the past year (i.e fiscal 2016) were well over one lakh units a month, compared with a little over 65,000 in fiscal 2015 and about 41,000 the year before.

The growing trend of sale of Chinese tyres has significantly impacted the volumes/ returns of the Indian tyre manufactures who have been making significant investment in building up capacities in TBR segment. Indian tyre producers, have therefore, been demanding higher duties on imported tyres for some time.

IMPACT OVERVIEW

In December 2015, the Indian government had ruled out putting immediate restrictions to curb the import of tyres from China, saying it is too early for such a step as imports increased only in May-June 2015. Most of the domestic producers were expecting the government to take some steps in the Union Budget 2016-17 to impose an anti-dumping duty of about USD 25 per tyre or raise the import duty from 10 to 30 per cent.

ATMA had asked the Ministry of Commerce & Industry for early imposition of anti-dumping duty on import of TBR from China, which accounted 92 per cent of TBR's import into India. In India, anti-dumping and anti-subsidy investigations are conducted by Directorate General of Anti-Dumping and Allied duty (DGAD), which is a separate department under Ministry of Commerce.

ATMA had alleged that most of the TBR's import from China were being dumped into India as TBR export prices from China were significantly lower than the prices of such tyres in Chinese domestic market and also prices of similar exports originating from countries such as Thailand and South Korea. The per unit import price from China is even less than the cost of raw materials that go into the making of the tyres. According to ATMA, India's position as a target country by China has become further vulnerable with US imposing severe anti-dumping duties against Chinese imports into the USA. Slowdown of the domestic Chinese economy is feared to cause further dumping of tyres in India since the country offers a ready and growing market with very low import duties for finished rubber products, such as tyres.

ATMA had filed an application on behalf of the domestic producers namely Apollo Tyres Ltd., J. K. Tyre Industries Ltd. and Ceat Ltd., before DGAD for initiation of anti-dumping investigation and imposition of anti-dumping duty on the imports of "New/Unused pneumatic radial tyres with or without tubes and/or flap of rubber (including tubeless tyres), having nominal rim dia code above 16" used in buses and lorries/ trucks". ATMA had furnished evidence regarding the injury having taken place as a result of the alleged dumping in the form of increased volume of dumped imports in absolute terms and in relation to production and consumption in India. It had also claimed threat of material injury to the domestic industry.

DGAD issued a notification dated 3 May, 2016, initiating anti-dumping investigation concerning imports of the subject goods. It held an oral hearing on 24 March 2017 to provide an opportunity to the interested parties to present relevant information. Later, DGAD provided extension of time for completion of investigation up to 2 August 2017.

Finally, on 18 September 2017, the Ministry of Finance imposed definitive anti-dumping duty on new Chinese radial tyres (including tubeless) used in buses and lorries/trucks. This anti-dumping duty, unless revoked earlier, will be valid for a period of five years. Based on the recommendations of the Designated Authority in the Commerce Ministry, the revenue department imposed definitive anti-dumping duty that ranged from USD 245.35 per tonne to USD 452.33 per tonne, depending on the producer and exporter from China.

The imposition of anti-dumping duty has come as breather for the Indian tyre manufacturing industry at a time where the profits of tyre companies are impacted due to increased rubber prices. This will be in line with the most sought after 'Make in India' campaign and would highly encourage domestic production.

Arun Tondon
Chartered Accountant

Non-compete restrictions in the automobile landscape

Mergers and Acquisitions (M&A) have played a significant role in the growth of the automobile industry of India; being one of the largest industry in the world accounting for 7.1 per cent of the country's GDP. Being mindful of the increase in cross-border trade and an enhanced competitive climate in India, confidentiality, non-compete and non-solicitation agreements are becoming significant considerations for companies going through an M&A deal. The year 2016 saw many such M&A transactions, the most prominent being the merger of Ashok Leyland with Hinduja Foundries, acquisition of Cavendish Industries by JK Tyres, the acquisition of BSA by Mahindra and Mahindra, etc.

Restrictions with respect to non-compete are common in M&A transactions in the auto industry as they facilitate smooth implementation of a proposed combination including acquisition of control, shares, voting rights, etc. Through non-compete restrictions, purchaser strives to achieve complete benefit from the transferred assets (tangible/ intangible assets such as goodwill and know-how). Whereas, in the case of joint venture transactions, non-compete restrictions restrain the shareholders from competing to the disadvantage of the interests of such joint venture.

The Competition Commission of India (CCI), a statutory body of the GoI, regulates competition in the country, so as to ensure a level playing field for everyone. The objectives of CCI include prevention of practices which causes or likely to cause an appreciable adverse effect on competition, promotion and sustaining competition in markets, protecting freedom of consumers and ensuring freedom of trade.

CCI's approach towards non-compete restrictions has evolved gradually on a case-to-case basis, unlike the other jurisdictions where competition agencies have issued detailed guidelines on the subject. For instance, the European Commission has issued a notice (EU Ancillary Notice) on restrictions directly related and necessary to concentrations (In EU's context, concentration arises where a change of control on a lasting basis results from merger, or acquisition by way of purchase of securities / assets) which provides guidance on the treatment of non-compete restrictions. The Ancillary Notice details out when a non-compete restriction can be considered to be directly related and necessary for the implementation of the concentration.

CCI's take on recent non-compete restrictions in the auto industry

- SAIC Motor HK, part of China's SAIC Motor Corp, received the Competition Commission's approval to acquire certain assets of General Motors India in January 2017. In this case, CCI observed that there were no existing vertical overlaps between the parties. Also, considering minimal market share of General Motors India (GMI) in the market and various competitive constraints, the commission was of the opinion that any potential vertical relationship emanating from the proposed combination will not have any appreciable adverse effect on competition.
- The Competition Commission approved the proposed acquisition of a minority stake in TVS Logistics Services by CDPQ Private Equity Asia Ltd., part of North America's leading fund manager CDPQ. As per the deal entered into by the companies in October 2016, CDPQ will invest over INR 1,000 crore in acquiring a sizeable minority stake in TVS LSL, a privately-held subsidiary of the TVS Group. CCI, which keeps a tab on unfair business ways, has cleared the proposed acquisition, CCI was of the view that where the non-compete restrictions were proposed to be in operation till the term of the Share Holding Agreement (SHA), it shall remain binding as it shall not have any appreciable adverse effect to competition.
- In the case of Mahindra and Mahindra Ltd. and Ors., CCI observed that a restriction such as non-compete clause is a standard business practice followed by automobile manufacturers and cannot be said to be contrary to Section 3 of Competition Act, 2002 covering statute on anti-competitive agreements.

Other notable decisions

- In the case of Orchid Chemicals Hospira Healthcare , CCI was of the view that "non-compete obligations, if deemed necessary to be incorporated, should be reasonable particularly in respect of (a) the duration over which such restraint is enforceable; and (b) the business activities, geographical areas and person(s) subject to such restraint, so as to ensure that such obligations do not result in an appreciable adverse effect on competition."
- On 2nd June 2016, CCI received a notice filed by Power and Energy International (Mauritius) Ltd ("PIL" or "Acquirer") under sub-section (2) of Section 6 of the Competition Act, 2002 ("Act"). The notice was filed pursuant to the Subscription Agreement ("SA") and Share Holder Agreement ("SHA"), each dated 9th May 2016 between PIL, GMR Energy Limited ("GEL" / "Target"), GMR Infrastructure Limited ("GIL"), GMR Renewable Energy Limited ("GREL"), GMR Energy Projects (Mauritius) Limited ("GEPL") and Tenaga Nasional Berhad ("TNB"). The proposed acquisition related to acquisition of 30 per cent of equity shares of GEL by pursuant to the execution of SA and the SHA on 9th May 2016. It is stated in the notice that PIL will also acquire certain affirmative rights in GEL which will amount to control over GEL. Further, TNB and PIL do not have any direct or indirect activities in India and thus the Commission observes there is no possibility of any vertical foreclosure post combination in India.

CCI's Guidance Note on Non-Compete Agreements

The CCI released a Guidance Note on non-compete restrictions in end of June 2017. In the introductory statement to the Guidance Note, CCI has clarified that Guidance Note is not binding on the parties to a combination, but it is intended to be an important tool in drafting non-compete clauses. CCI has stated that principles enshrined in the Guidance Note would not be applied as a mechanical rule, but upon unique and specific circumstances of each case.

The general principles set out in the Guidance Note are briefly highlighted below:

- Non-compete restrictions should be directly related and necessary to the combination;
- Parties must choose the least restrictive alternative for attaining their objective;
- Due regard must be had to the nature of the business in determining the duration (in case of transfer of both goodwill and know-how - 3 years; In case of transfer of only goodwill - 2 years), subject matter and geographic field of application.

Conclusion

The vertical agreements in the automobile sector in an era of competition, has definitely raised some questions and debatable issues. However, it remains to be seen that how the automobile R&D will be affected in the country by the decision and the floodgates of complaints open before the CCI regarding similar anti-competitive practices operating in the aftermarkets of other industries (for e.g. electronic industry, mobile industry etc.).

The CCI is determined to bring the companies engaged in anti-competitive agreements to task, which is a positive development for the competition law regime in the country. The Guidance Note issued by the CCI encapsulates the international best practices laid down under the EU Ancillary Notice. Though, it provides much-needed clarity on the very scope and ambit of the non-compete restrictions in Merger & Acquisitions transactions, there still remains a sort of an ambiguity as to whether the non-compete clauses which deviate from the principles laid down by the Guidance Note constitute an ancillary restraint or not. In this context, it should be primarily noted that the EU Ancillary Notice recognises that exceptional circumstances may exist which may justify departing from the principles laid down by the Notice.

Therefore, it remains to be seen as to whether the CCI has also left some scope for such flexibility in the lines with its advanced counterparts (viz. European Commission). Further, the Ancillary Notice provides for the self-assessment of the validity of the non-compete restrictions based on the principles laid down by the Ancillary Notice. While the Guidance Note seems to be silent on this aspect, it does outline norms for non-compete restrictions. Therefore, stakeholders in the auto sector should be mindful of this note while negotiating and finalising any non-compete clause as adherence to the standards provided by CCI ensures a greater probability of receiving approval of the CCI for proposed Mergers and Acquisitions.

Radhika Jain
Partner,
Grant Thornton India LLP

Key Headlines

JSW Energy to set up INR 4k-cr electric car manufacturing plant in Gujarat

Business Standard 27 September 2017

JSW Energy, part of the Sajjan Jindal-led Jindal Group, signed a memorandum of understanding (MoU) with the Gujarat government to set up a Rs 4,000-crore electric vehicle-manufacturing facility in the state.

Utility vehicle sales grew 30% to 7.61 lakh units, Siam data showed.

Tata Motors to fuel business with Rs 4,000-crore investment

Business Standard: 22 August 2017

Saddled with losses in its domestic commercial and passenger vehicle business, home-grown auto major Tata Motors reiterated its turnaround plan focused on cost reduction, new products, and bringing in efficiencies in the supply chain. The company said it would invest Rs 4,000 crore this year. Of that Rs 2,500 crore will go to the passenger vehicle business. Calling the commercial vehicle (CV) its 'backbone', the company said it would invest Rs 1,500 crore in the business over the next few years

Union Minister for road transport & highways pushes for large-scale introduction of biofuel vehicles

Livemint: 02 August 2017

Government is looking at a large-scale introduction of biofuel vehicles for road and water transportation.

To prepare a roadmap for this, the minister held a high-level meeting and directed government and its think tank to study automobile standards developed by China for various methanol-powered vessels like cars and ships, and prepare a report.

China's SAIC to commence India operations in 2019

Livemint: 28 June 2017

SAIC Motor Corp., China's largest automaker, plans to enter the Indian automobile market and commence operations in 2019 through a fully-owned car manufacturing facility in the country. SAIC will be the first Chinese auto firm to enter India from the world's biggest auto market by volume.

Conclusion

India is becoming one of the fastest growing automobile markets in the world and many reports suggest that India will surpass China in the average Passenger Vehicle Segment by 2025.

There is tremendous potential in automobile industry and the recent growth figures by all the automobile majors prove that industry is back on track. Now the competition will not be limited to just the existing players in the market. It will now be much higher with all the auto majors lining up for entry into the country, either to market cars or to manufacture. Not only quantitative but qualitative change too is expected in the market wherein automotive sales are destined to resonate with global economic shift. India is certainly the place to be for global OEMs.

Moreover, the automobile industry is poised at the start of an exciting phase of growth at which point not all may derive from manufacturing conventional fuel-based vehicles. Various possibilities ranging from developing vehicles based on alternate fuels to collaborating with some-time rivals, have the potential to open fresh avenues for growth. On the contrary, the automobile industry of the country has an enormous growth with creation of huge interest among the analyst, policy makers and researchers too. The factors that has led and would further lead to the growth of automobile industry is its favorable government policy and the role played by supporting industries.

Thus, it can be positioned as one of the world's most attractive automotive markets for both manufacturers and consumers and its benefits which provides support to economy, employment and stability in the automotive industry.

Going forward, the country would be a key pillar of global automotive market; wherein policy, actions and strategies of players will have a fundamental impact on the global auto landscape.

India might result to be an anchor of future growth in the auto industry.

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