

Health or Wealth? An Automotive Dilemma

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The debate on ‘environment vs development’ is undying and in spite of various polarized views on this debate, the world is always looking for a sustainable trade-off. Gradual change of climate, especially global warming, is a continuous threat towards the society. Hence, committed efforts from all stakeholders across countries are highly desired to achieve that trade-off. Further, phenomenal increase of air pollution caused by the vehicular emission has compounded the problem. India, in last few decades, has experienced a massive growth in automobile industry¹ and thus gets acutely affected by the menace of air pollution. As a controlling measure, the regulatory authorities have mandated vehicles to adhere to the certain standard norms of emission.

These standard norms have been evolved since enactment of ‘Bharat’ Stage (BS), the set of emission standards established by the Government of India to curb emission from motor vehicles. BS I and II were introduced long back in 1999-2000. Afterwards, mass-emission standards BS-III and BS-IV had been laid down in 2009. Each such progression denotes stricter norms of emission. Although India had been following BS-III regime from 2010, it had to take a shift to BS-IV regime by April 1, 2017. The progress of India in this regard is still lagging behind than its western counterparts as the developed nations had moved onto Euro 4 (January, 2005), Euro 5 (September, 2009) and Euro 6 (September, 2014). In view of this, on March 29, 2017, the Supreme Court of India took a significant step by placing a ban on registration and sale of BS-IV non-compliant vehicles on and after April 1, 2017. However, the issue of whether the accumulated inventory of BS-III compliant motor vehicles manufactured on or before March 31, 2017 can be sold from April 1, 2017 onwards had been raised before the Supreme Court. The arguments in favor of such demand cited ‘weak market forces’ and ‘demonetization’ as potential barriers for clearance of stock. Moreover, the past two instances², where industry was allowed to offload accumulated stock even after the timeline, had brought into notice. However, this argument was refuted by the Supreme Court and the ban on sale of BS-III compliant vehicles has been sustained.

Immediate reactions:

¹ The automobile sector alone contributed 7.1% of India’s overall GDP, 4.3% of overall exports and was accounted for 8% of India’s entire R&D expenditure in 2014 (GOI, 2016)

² After the cut-off date of April 1, 2005 BS-I and BS-II compliant vehicles and after the cut-off date of April 1, 2010 BS-III compliant vehicles were permitted to be sold, until the stock had been exhausted

The apex court's order to ban BS-III vehicles appeared as a 'shock' for the automotive industry. It created an initial panic and some uncertainty over inventory of vehicles, their registrations and piling up stocks at the Original Equipment Maker's (OEM's) stockyards. Mahindra and Mahindra released a statement stating that the 'unexpected ruling will have a one-time material impact.' Tata Motors, the largest commercial vehicles manufacturer in the country said in a statement:

"The Supreme Court order banning sale of all BS-III vehicles from April 1 is an unexpected and unprecedented move that will have a material impact on the entire automotive industry, OEMs' and dealer networks and is a penalty to the entire automotive industry..."

This sudden decision had left industry with two choices: either to export the existing BS-III vehicles after offloading maximum in three days (29 March, 2017 – 31 March, 2017) while providing heavy discounts to the customers or to upgrade the entire lot of BS-III into BS-IV compliant vehicles. The issue with the second option, i.e. to upgrade the vehicles to meet newer norms, was that it required huge time and resources to modify the engines and also there was lack of availability of BS-IV compliant fuel.

President of Society of Indian Automobile Manufacturers (SIAM) and MD of Ashok Leyland, Mr. Vinod Dasari commented: *"While no one pushed for BS4 fuel availability for 7 years to change over faster, this sudden decision – just a few days before the changeover - is rather unfortunate as it causes undue stress on the entire industry, and causes loss of jobs. Auto Industry, anywhere in the world, requires a stable and predictable policy which allows for long term planning and investments"*.

Another statement released by the industry representing body, SIAM, stated:

"Auto Industry is law abiding and is in full compliance with the emission norms set by Government that stipulates date of "Manufacturing". The historical implementation of emission norms also reinforces the current law that stipulates "manufacturing". Auto Industry has had the capability of making BS4 vehicles since 2010, but lack of proper BS4 fuel prevented it from selling such vehicles, nationwide. Running a BS4 vehicle with BS3 fuel can cause severe problems to some vehicles."

Despite such reactions from the market players, few players had been found to be proactive in this respect. For example: Toyota had implemented BS-IV technology a year back and was least affected by such ban. Few auto companies even welcomed this decision. Chairman, MD & CEO of Hero MotoCorp, India's largest two-wheeler manufacturer, Mr. Pawan Munjal said:

"I welcome this move by Supreme Court in the interest of public health. Hero MotoCorp, recognizing the need of the hour, carefully planned a proactive move to switch from BS III to BS IV compliant products across all our range well in time and have been producing only BS IV compliant products since one month before the given deadline. We have reduced our BS III inventory significantly in the past few months with the aim to minimize our stakeholder losses."

Actual impact:

Impact from Discount Offered:

The commercial vehicle segment produced large inventory and continued manufacturing BS-III vehicles till March with the expectation of higher sales in April given the expected price increase of 8 - 10% on BS-IV vehicles. As per the CRISIL report, the cost of heavy discounts and incentives for commercial vehicle manufacturers amounted to INR 1,200 crore (approx) till March 31, 2017. In addition, INR 1,300 crore had been incurred as a cost of disposal of the unsold inventory (including exports). Although, the commercial vehicle segment experienced an impact of 12% value on inventory, pure player like Ashok Leyland was most affected. Others like Tata Motors or Eicher had been cushioned by their other product offerings.

The impact on two-wheeler segment and passenger car segment were quite insignificant. Two wheelers, such as BS-III bikes and scooters were sold with discounts up to 30%. ICRA estimated the loss faced by this segment due to discounts to be around INR 600 crore. On the other hand, the passenger car segment stayed largely unaffected as it had mostly shifted to BS-IV regime from beginning of last year. But 10-30% discounts and freebies assisted the dealers to clear most of the stocks in last three days of March.

Impact on Inventory:

According to the CRISIL report, the impact of ban on the level of inventory was comparatively low for the companies like Bajaj Auto, Yamaha and Eicher as they had already upgraded their inventory to BS-IV from January 2017. Even market leader Hero Moto Corp, and two others, namely Honda and TVS Motors, had upgraded most of their models before the ban set in. The report mentioned that 25% of the banned vehicles are expected to go to exports. At the time when the ruling came, the two-wheeler segment was holding an inventory of 6,70,000 BS-III models amounting to INR 3,800 crore which is approximately half of monthly sales of the automobile industry.

Impact on Estimated Profit:

To address the challenge of placing unsold inventories, the companies started exploring export markets and converting the vehicles to BS-IV. The cost of the vehicles increases by 8-10% in the process of conversion. According to the research firm Nomura, the Net Profit margins of the automobile firms had been impacted by this ban and the estimations are as shown below in Table-1:

Table 1: Net Profit Impact (as estimated)

Inventory (Units)	Total Cost (Cr)*	Name of Company	Net Profit (estimated) FY 18 (Cr)	Net Profit impact (%)
18,000	281	Ashok Leyland	1,435	19.6
11,300	149	Eicher	2,274	6.6
20,015	162	Mahindra & Mahindra	3,722	4.4
300,000	163	Hero MotoCorp	3,844	4.2
75,000	381	Tata Motors	14,249	2.7
65,000	9	Bajaj Auto	4,469	0.2
* Net impact after exports, retrofitting, discounts and inventory carrying cost				

Source: Nomura Research

Impact on Stock Market:

On the date of announcement of the ban, the automobile market reacted negatively as expected. Although BSE Sensex and NSE Nifty were up by 73.96 points and 25.55 points respectively on that day, S&P BSE Auto sector and S&P Nifty Auto were down by 186.89 points and 42.05 points respectively. More specifically, those automobile manufacturers who had large amount of unsold BS-III vehicles in their inventory experienced a major blow. Table 2 lists down the stocks which had been significantly affected by the decision.

Table 2: Changes in Stock Prices

Company	% Change
Hero MotoCorp	-3.67%
Ashok Leyland	-2.66%
Bharat Forge	-1.13%
Eicher	-1.08%
Tata Motors	-0.95%
Maruti Suzuki	-0.65%
Mahindra & Mahindra	-0.61%

Source: www.zeebiz.com

Overall, it has been found that the shareholders of automobile industry had suffered an erosion of INR 88,390 million (approximately) in their wealth on the day of announcement of ban on BS-III vehicles. These results clearly indicate that the investors penalized the industry for its 'wait-and-watch' approach and lack of proactivity.

Challenges ahead:

When the debate on 'environment vs development' turns into a debate on 'health vs wealth', it is quite imperative that the stakeholders would give preference to 'planet over profit'. On this particular event of banning BS-III compliant vehicles, the decision taken by Supreme Court of India shows the long term vision and priority of the apex court in achieving health of India. According to the experts and environmental bodies, moving from BS-III to BS-IV regime would

significantly reduce overall pollution in the cities which have become notorious toxic chambers of vehicular emissions. Apart from demonstrating nobility, the decision carries significant managerial implications for the automotive industry. The quote from Ms Anumita Roy Chowdhury, Executive Director of Centre for Science and Environment (CSE), on ban of BS-III was as follows:

"This is a significant step forward as this gives the message and the lesson that the automobile industry will have to walk the extra mile to address the expansive concern around public health and not weigh down the transition by taking a very narrow technical view."

At this juncture, such comment is more relevant as India has already decided to move to BS-VI compliant regime by 2020 while skipping BS-V. Expectedly, this will lead India achieving emission standard as par developed countries. However, the path is not so smooth. The automobile industry of India should now shift gears and need to be more proactive in adopting state-of-the-art green technology to manufacture BS-VI compliant vehicles. If such up gradation can be treated as an investment for a healthy future, then only a giant leap towards sustainable development can be possibly attained.