



Bajaj Auto: Evaluating the Working Capital Requirements

“Companies operating in industries like FMCG and automobiles have been able to manage working capital efficiency and, thus, create value for shareholders by way of high ROCE.”¹

– Jigar Shah, Director, KR Choksey (Brokerage firm)

Over the past two decades, the Indian automobile industry has grown leaps and bounds, at a Compound Annual Growth Rate (CAGR) of 9%. At present, it is the second-largest two-wheeler and fourth-largest commercial vehicle manufacturer in the world. The automotive industry in India is intensely competitive and highly fragmented, with number of players operating in more than one segment of the industry. The nature of the industry accounts for high capital expenditures and may not generate high returns on the capital invested, but over the past few years, the players in this industry have been giving high returns to shareholders and operating on negative working capital. One such dominant player in the auto industry, Bajaj Auto is experiencing negative working capital for the past 5 years and giving high returns to its shareholders. However, since the impact of working capital fluctuations depends on the nature of the industry, for how long can Bajaj Auto continue to have negative working capital?

Indian Automobile Industry: An Overview

The automobile sector is a key driver of industrial growth in the global and Indian economy. According to the Organisation Internationale des Constructeurs d'Automobiles, 2006, annual turnover of the global auto industry is around \$5.09 trillion, which is equivalent to the sixth largest economy in the world.² Moreover, the industry is an indirect contributor to several other sectors of the economy and it

¹ “Investing in working capital management”, <http://www.financialexpress.com/news/investing-in-working-capital-management/152948/1>, April 2nd 2006

² Narayanan Badri G. and Vashisht Pankaj, “Determinants of Competitiveness of the Indian Auto Industry”, http://www.icrier.org/pdf/Working%20Paper%20201_final.pdf, January 2008

This case study was written by Sowjanya Mora under the direction of Fathima Reshma Taj H., IBSCDC. It is intended to be used as the basis for class discussion rather than to illustrate either effective or ineffective handling of a management situation. The case was compiled from published sources.

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is treated as a leading economic sector. The Indian automotive industry is distinguished as a key component and core driver of national economy. Over the decades, the industry has undergone rapid transformation, witnessed enormous prospects and emerged as most attractive markets in the world.

During 1980s, there were very few players in the Indian automotive sector with low volumes of production, old and substandard technologies. The industry took a new dimension when Indian government de-licensed and opened up the industry to Foreign Direct Investments (FDIs) in 1993 which encouraged many global players to enter the Indian auto industry. Further, economic liberalisation reforms contributed to the robust growth of the industry. At that time, a total of 17 new ventures came up which included General Motors, Ford, Toyota, Honda, Hyundai and Fiat, resulting in rapid expansion and growth of the industry.

The Indian auto industry constitutes two set of players – automobile component manufacturers (involved in manufacturing parts, components, bodies and chassis) and the vehicle manufacturers (engaged in assembling all the components into an automobile), which are also referred to as Original Equipment Manufacturers (OEMs). The Indian auto industry is highly competitive (Exhibit I) with large number of players in each segment of the industry manufacturing commercial vehicles, passenger vehicles, two-wheelers, three-wheelers and auto components. Most of the players are present in more than one segment of the industry (Annexure I). The industry is fragmented and is mainly dominated by small-scale and unorganised players. There are nearly 6,400 players, of which 6% belong to organised sector and the remaining belong to unorganised sector.³ However, in terms of value addition organised players represent nearly 77% of the output in the sector.⁴

Over the past years (2000–2001 to 2004–2005) the domestic auto industry has been growing at 14.2% CAGR.⁵ India holds the highest position in the three-wheeler market and occupies fifth largest commercial vehicle market in the world. India is one of the global giants in the two-wheeler industry manufacturing motorcycles, scooters and mopeds. In the last decade, two-wheeler industry in India grew at a CAGR of more than 10%. This growth was fuelled by shift in the demand mix, increasing income, rapid urbanisation and changing spending patterns.

The auto industry has been performing well in both domestic and international markets. During 2005–2006, exports of the industry comprised about 5% of total exports from India, their total value was around INR 16,09,400, of which INR 7,97,400 were vehicle exports and INR 8,12,000 were auto component exports.⁶ According to the Society of Indian Automobile Manufacturers (SIAM), automobile sales (including passenger vehicles, commercial vehicles, two-wheelers and three-wheelers) in the overseas markets increased to 1.53 million units in 2008–09 from 1.23 million units in 2007–2008. In spite of the global slowdown, exports of Indian auto vehicles increased – export of passenger vehicles increased from 2,18,401 units in 2007–2008 to 3,35,739 units in 2008–2009. A total of 2,30,000 commercial vehicle (cars, vans, Sports Utility Vehicles and trucks) were exported between January and July 2009, resulting in a growth of 18%.

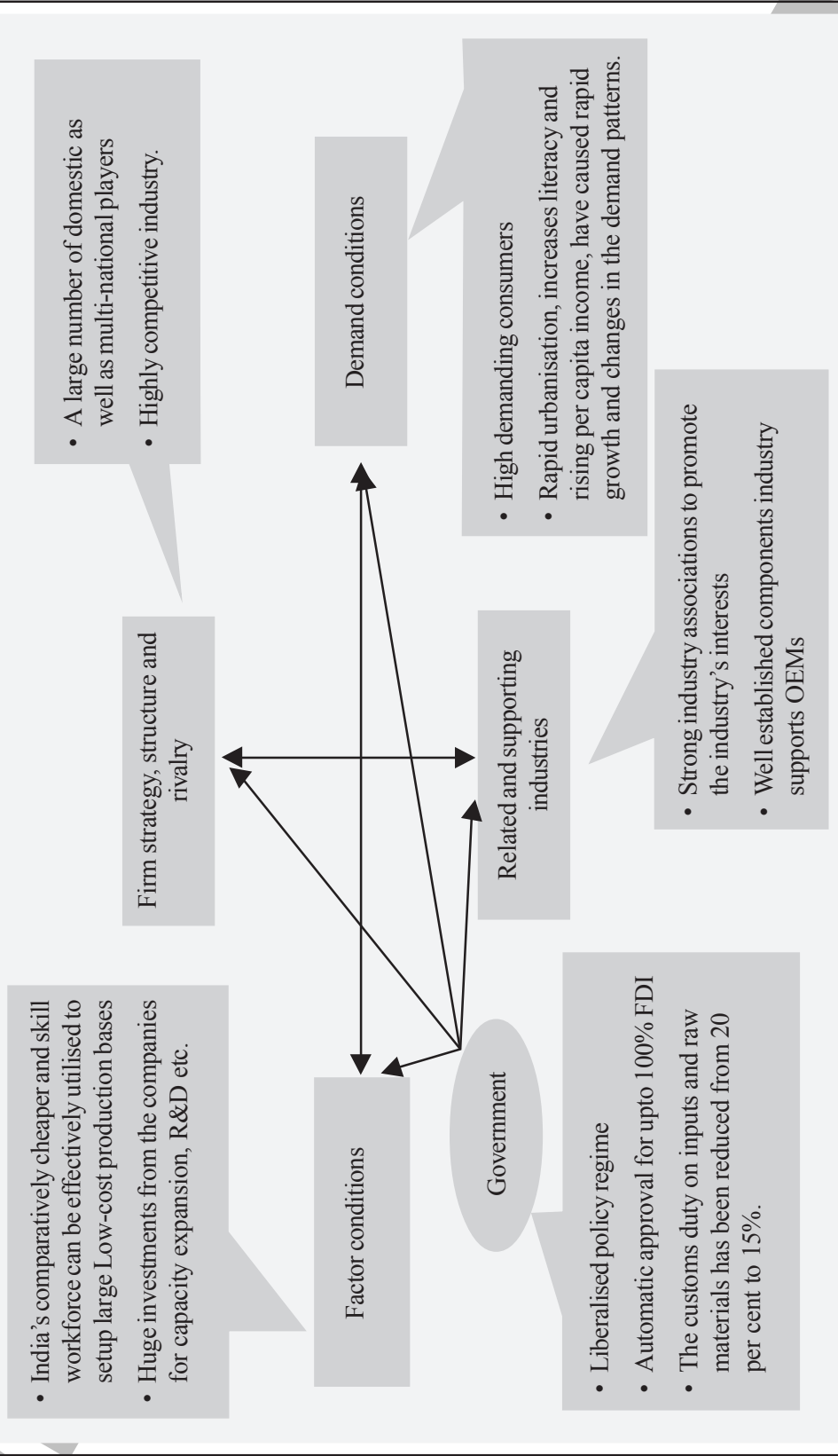
³ “Automotive”, http://ibef.org/download/Automotive_sectoral.pdf, January 25th–29th 2006

⁴ Ibid.

⁵ Ibid.

⁶ “Determinants of Competitiveness of the Indian Auto Industry”, op.cit.

Exhibit I
Indian Automobile Industry



Source: "Automotive", http://ibef.org/download/Automotive_sectoral.pdf, January 25th-29th 2006

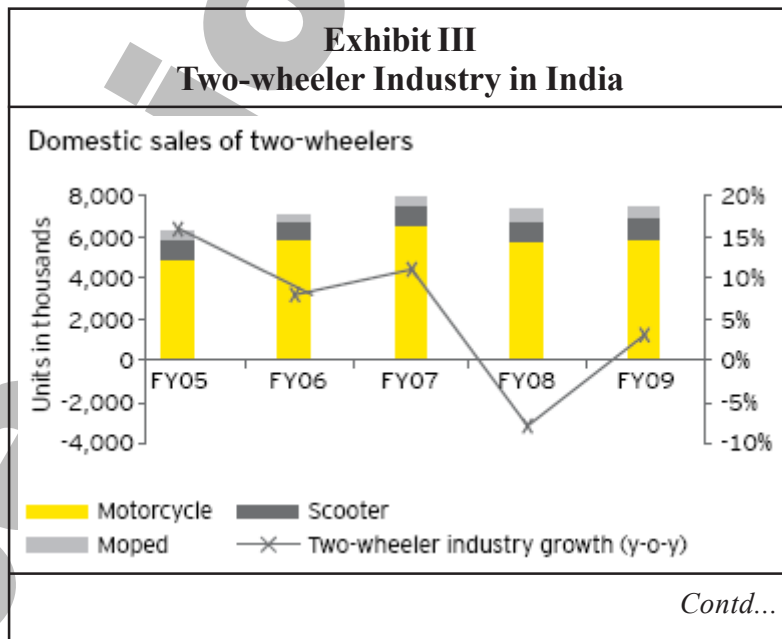
Despite the economic downturn during 2007–2009, overall production (passenger vehicles, commercial vehicles, two-wheelers and three-wheelers) increased from 10.85 million vehicles in 2007–2008 to 11.17 million vehicles in 2008–2009.⁷ Production of passenger vehicles increased from 1.77 million to 1.83 million while two-wheelers touched 8.41 million from 8.02 million.⁸ According to

Exhibit II Share of Each Segment of Indian Auto Industry		
Segment	Share in Total	CAGR
Two wheelers	74.1%	9.6%
Passenger vehicles	16.3%	19.5%
Three wheelers	4.6%	12.6%
Commercial vehicles	5.0%	21.8%
Source: “Automotive Industry”, http://www.ibef.org/download/Automotive_010709.pdf , December 2008		

an analyst at Ernst & Young, passenger vehicle sales in the country will grow at a CAGR of 12% to touch 3.75 million units by 2014 as against 1.89 million units at the end of 2008–2009.⁹ Similarly, as per CARE Research, a credit rating agency, domestic two-wheeler sales will grow at a CAGR of 8.8% by 2014 i.e., 11.3 million.

Two-wheelers, which account for a major share of industry volume has been growing at a CAGR of 9.6% (Exhibit II). Until late 1990s, two-wheeler market was dominated by scooters, contributing higher percentage of sales. However, with changing times, with the focus driven on better fuel efficiency and faster mobility, a structural shift towards motorcycle which constitutes 80% of the market.

Within the two-wheeler segment, motorcycles occupy 80.6% and their sales account for around 80% of total sales (Exhibit III). Cost, ownership and economies of scale are the key purchase criteria of this segment. Though the industry witnessed a slowdown in Financial Year (FY) 2008, it picked up in the subsequent year and grew by 2.6%. Ernst & Young analysts state that, “Though FY09 was a tough year for two-wheelers like it was for other automotive sectors, the variation in growth



with respect to the five-year CAGR was the lowest comparatively. Considering the demographics and income levels in the country, the purchase of two-wheelers for regular mobility is very high, thus

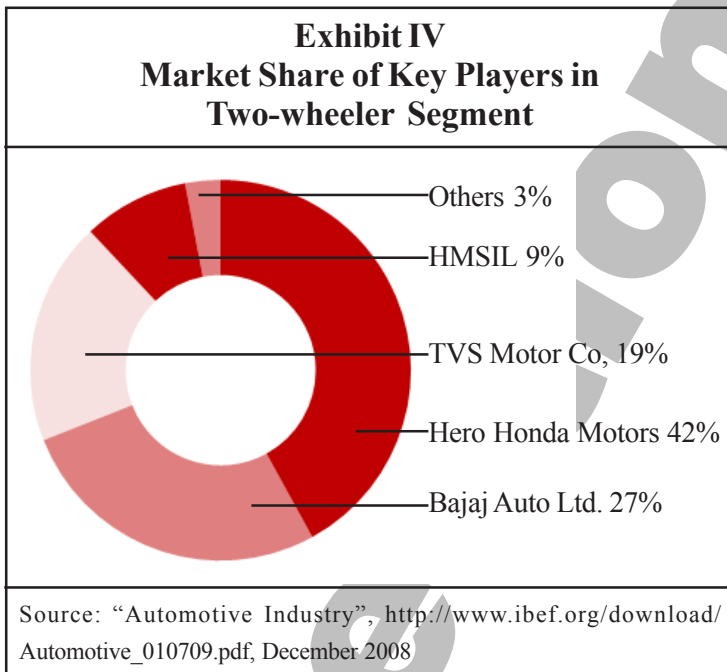
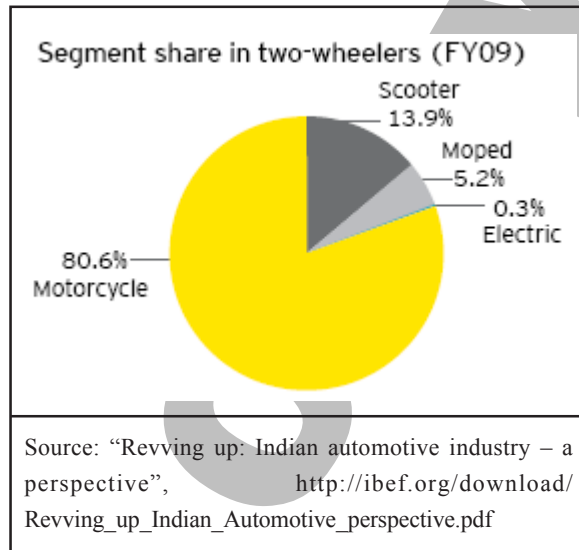
⁷ “Automobiles”, <http://www.ibef.org/industry/automobiles.aspx>, September 2009

⁸ Ibid.

⁹ Ibid.

the domestic potential needs no reaffirmation. We believe that focusing on rural potential will pay dividends for the domestic market and the export volume growth should remain intact.”¹⁰ The exports of this segment are moving at a CAGR of 31% in FY2005–2009, crossing the 1 million mark in FY2009.

Hero Honda is the market leader with a market share of 42% in Indian two-wheeler segment followed by Bajaj Auto, the second largest with 27% share. (Exhibit IV). There are only few established players in this segment and they pose tough competition to each other.



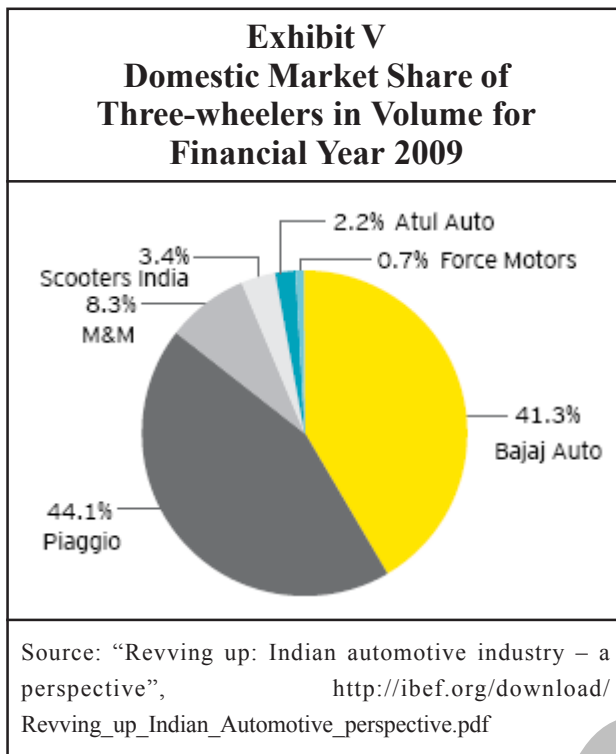
In an emerging economy like India, three-wheelers are a low cost means of transport in cities and towns. India is the largest three-wheeler market in the world. These vehicles are used as passenger vehicles (auto-rickshaws) as well as small capacity commercial vehicles (pick-up vehicles). It is a small but fast growing segment, with production increased from 2,03,234 vehicles in 2001 to 3,74,414 vehicles in 2005. Three-wheeler sales in India touched a new record of 0.36 million registering a growth of 10.5% CAGR over the last 6 years (2004–2009).¹¹ Ernst & Young viewed this growth as,

“Three-wheelers have played an important role in the last-mile connectivity both for passenger as well as commercial purposes. The existence of a large number of small-businesses promises a sustainable demand in the domestic market. Very little has been done in terms of product innovation and manufacturers will have to focus on it. Going forward, this segment will face competition from small commercial vehicles in the commercial space, for which the manufacturers have to rethink product positioning and marketing strategies.”¹²

¹⁰ “Revving up: Indian automotive industry – a perspective”, http://ibef.org/download/Revving_up_Indian_Automotive_perspective.pdf

¹¹ “Automotive Industry”, http://www.ibef.org/download/Automotive_010709.pdf, December 2008

¹² “Revving up: Indian automotive industry – a perspective”, op.cit.



Bajaj Auto is an established player in both two-wheeler and three-wheeler market segment. It is one of the leading players (41.3%) in the three-wheeler segment (Exhibit V). Total exports of the three-wheelers reached 141.24 thousand units, registering a growth of 44.5% CAGR over the last 6 years (2003–2009) with a large contribution i.e., 97% being accounted by Bajaj Auto.¹³

Bajaj Auto’s Working Capital Requirement: Is Negative Working Capital Positive?

Bajaj Auto is a flagship company of the Bajaj Group which is amongst the top 10 business houses in India. Bajaj Auto is ranked as the world’s fourth largest two and three-wheeler manufacturer and is well known

exporter (it exports to several countries – Latin America, Africa, Middle East, South and South East Asia). The history of the company dates back to 1965, when Rahul Bajaj (present chairman of the Group) took charge of the business and turned the company into new heights.

The predecessor of Bajaj Auto was formed on November 29th 1945 as M/s Bachraj Trading Ltd. In 1948, it started selling imported two- and three-wheelers and in the subsequent year, it became public limited company. After obtaining manufacturing license from the Indian government in early 1960s, the company started manufacturing its own two-wheelers and by 1970 it reached a mark of 10,000 vehicles. In the same year, it introduced new models of two-wheelers and launched three-wheeler vehicles. Based on the consumer categories and approximate price points, Bajaj Auto classifies motorcycles into three segments – Entry segment (these are typically 100 cc motorcycles at a price point of INR 35,000, Bajaj Auto is in this segment through the Platina), Executive segment (they comprise 100 cc to 135 cc motorcycles and priced between INR 40,000 to INR 50,000, it has two brands in this segment – XCD and Discover) and Performance segment (these are sleek and high performing motorcycles with price points in excess of INR 50,000 and Pulsar is the flagship brand in this segment).

During 1980s with the entry of Japanese and Italian scooter companies into the Indian market, domestic players like Bajaj Auto faced tough competition as the foreign companies adopted sophisticated technology while the latter used low-end technology. However, Bajaj Auto, with its strong brand image and other competency features maintained dominant position in the Indian auto industry. Soon, the company started investing in high-end technologies and focused on high-end

¹³ “Automotive Industry”, op.cit.

offering, particularly in high-powered motorcycles. Year-on-year the company increased its production size and attained economies of scale.

In fiscal year 1994–1995, it produced 1 million vehicles and became a well-established exporter to several countries. It is India's largest exporter of two- and three-wheelers. In 2006–2007, exports of Bajaj motorcycles grew by 82% to 3,00,656 units and three-wheelers by 87% to 1,40,645 vehicles.¹⁴ In the same financial year, over 1,50,000 two-wheelers and three-wheelers sales were made to Sri Lanka and also over 1,00,000 vehicles were sold to Latin America. Besides, establishing an assembly plant in Nigeria, Bajaj Auto in FY2006–2007 established a 95% owned joint venture in Indonesia which in coming years will play a key role in expanding the company's footprint in South-East Asia.¹⁵

The global turmoil and resultant low demand affected the Indian auto industry. Though the production volume increased, the third quarter of FY2008–2009 was particularly tough. Average monthly sales of motorcycles in India plunged by over 17% in the 3rd quarter of 2008–2009 with that of 2nd quarter – from an average of 5,24,939 units per month to 4,35,114 units. The sales and profits of Bajaj Auto tumbled – net sales and other operating income fell by 2.6% to INR 88.11 billion in 2008–2009. However, the company succeeded in maintaining double-digit operating Earning Before Interest, Tax, Depreciation and Amortisation (EBITDA) margin of 13.6% of net sales and other operating income for 2008–2009 rising to 15.2% margin for the fourth quarter (2008–2009). In addition, the robust exports of the company made some positive news. During 2008–2009, it exported an all-time high of 7,72,519 units of two and three-wheelers, representing a growth of 25% over the previous year (2007–2008).

However, since past 5 years, current liabilities of the company exceeded current assets resulting in a negative working capital (Annexures II (a) and II (b)). Nevertheless, Bajaj Auto is taking necessary measures to improve its working capital. But the company is not considering this as negative remark as the other players in the industry are also experiencing negative working capital. Experts viewed that the top Indian companies with high return on capital have operated on negative working capital.¹⁶ Interestingly, companies belonging to FMCG and auto industry are known for good returns to their shareholders (both in terms of dividends and capital gains) though they showed a negative working capital. In addition to Bajaj Auto, Hero Honda which is the market leader and TVS, the third largest in this segment are also operating on negative working capital but are giving high returns to their shareholders. Due to the improved inventory turnover ratio and better working capital management cycles, these companies are enjoying the wide gap between the days of cash receipts from their debtors to payment days to their creditors. In short, they are enjoying the time period between number of days the payment to creditors and their receivables. Since, the nature of the industry has a considerable influence in the working capital management, for how long can the nature of auto industry allow these companies to continue negative working capital? However, the big question is to what extent the nature of industry will determine the working capital requirement?

¹⁴ "Bajaj Auto's Sixty Second Annual Report: 2006–2007", http://www.bajajauto.com/report/AR_2006-07.pdf, 2006–2007

¹⁵ Ibid.

¹⁶ "Investing in working capital management", <http://www.financialexpress.com/news/investing-in-working-capital-management/152948/1>, April 2nd 2006

Annexure I	
Presence of Automotive Players in More than One Segment	
Manufacturer	Segments
Ashok Leyland	LCVs, M&HCVs, Buses
Asian Motor Works	M&HCVs
Atul Auto	Three wheelers
Bajaj Auto	Two and three wheelers
BMW India	Cars and MUVs
Daimler Chrysler India	Cars
Eicher Motors	LCVs, M&HCVs, Buses
Electrotherm India	Electric two wheelers
Fiat India	Cars
Force Motors	Three wheelers, MUVs and LCVs
Ford India	Cars and MUVs
General Motors India	Cars & MUVs
Hero Honda Motors	Two Wheelers
Hindustan Motors	Cars, MUVs and LCVs
Honda	Two wheelers, Cars and MUVS
Hyundai Motors	Cars and MUVs
Kinetic Motor	Two wheelers
Mahindra & Mahindra	Three wheelers, Cars, MUVs, LCVs
Majestic Auto	Three wheelers
Maruti Suzuki	Cars, MUVs, MPVs
Piaggio	Three wheelers, LCVS
Reva Electric Car Co.	Electric cars
Royal Enfield Motors	Two wheelers
Scooters India	Three wheelers
SkodaAuto India	Cars
Suzuki Motoreycles	Two wheelers
<i>Contd...</i>	

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Swaraj Mazda Ltd.	LCVs, M&HCVSs, Buses
Tata Motors	Cars, MUVs, LCVs,M&HCVs, Buses
Tatra Vectra Motors	M&HCVs
Toyota Kirloskar	Cars, MUVs
TVS Motor Co.	Two wheelers
Volvo India	M&HCVs, Buses
Yamaha Motor India	Two wheelers
Source: "Automotive Industry", http://www.ibef.org/download/Automotive_010709.pdf , December 2008	

Annexure II (a)					
Profit and Loss Account of Bajaj Auto for the FY 2005–2009					
Year ended March 31 st			(INR 000's)		
	2009	2008	2007	2006	2005
Income					
Sales including Excise Duty	90,587.5	96,925.8	105,997.5	85,555.40	65,492.9
Less: Excise Duty	6,127.2	10,266.6	13,141.6	10,813.2	8,187.7
Net Sales	84,460.3	8,6659.2	92,855.9	74,742.2	57,305.2
Wind Power Generated, mainly Captively Consumed	-	-	330.5	199.5	249.4
Other Income	4,906.8	4,908.8	8,201.4	6,535.8	5,942.7
Operating Result from Insurance Business	-	-	739.9	645.4	643
Amount transferred from the policyholder's A/c	-	-	31.3	-	-
Contribution to the Policyholder Fund	-	-	(972.3)	(1,085.5)	(451.2)
	89,367.1	91,568	10,1186.7	81,037.4	63,689.1
Expenditure					
Materials	64,615.7	66,192.9	68,990.5	53,281.5	40,946.8
Other Expenses	12,433.5	11,912.4	12,487.8	10,155	9,335.7
Interest	218.9	51.6	55.4	3.4	6.7
Depreciation and Write Downs	1,306.2	1,746.1	1,905.9	1,912.8	1,856.6
	78,574.3	79,903	83,439.6	65,352.7	52,145.8
Less: Expenses, included in above items, Capitalised	144.2	230.4	320.5	248.1	198.4
	78,430.1	79,672.6	83,119.1	65,104.6	5,1947.4
Operating Profit before Taxation and Exceptional Items	10,937	11,967.4	-	-	-
<i>Contd...</i>					

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Exceptional Items					
Expenditure incurred for Voluntary Retirement	1,833	1,023.6	-	227.8	493.3
Valuation Losses of Derivation Hedging Instruments	218	-	-	-	-
Export Incentives Accrued in Previous Year Written Off	-	-	103.9	-	-
	2,051	1,023.6	83,608.7	65,332.4	52,440.7
Profit for the Year before Income from Associates and Taxation	8,886	10,943.8	17,578	15,705	11,248.4
Income from Associate of Subsidiary	(622.94)	231.2	203.9	93.1	258.2
Profit for the Year before Taxation	8,263.6	11,175	17,781.9	15,798.1	11,506.6
Taxation					
Current Tax	3,009	3,927.5	5,449.6	5,395.6	3,719.9
Deferred Tax	(195.2)	(276.8)	(220.4)	(366.2)	(226.7)
Fringe Benefit Tax	75	33.5	50.3	64.3	-
	2,888.8	3,684.2	5,279.5	5,093.7	3,493.2
Profit for the Year	5,374.8	7,490.8	12,502.4	10,704.4	8,013.4
Tax credits/ (debits) Pertaining to Earlier Years	-	-	4.9	228.2	(2.6)
Prior Period Expenses	21.4	1.7	8.6	8.7	18.5
	5,353.4	7,489.1	12,498.7	10,923.9	7,992.3
Minority Interest	(4.5)	(6.5)	5.2	(122.1)	26.9
Net profit	5,348.9	7,482.6	12,493.5	11,046	7,965.4
Compiled by the author from the Annual Reports of the Company					

Annexure II (b)					
Balance Sheet of Bajaj Auto as on March 31st 2005–March 31st 2009					
(INR million)					
	2009	2008	2007	2006	2005
I. Sources of Funds					
1. Shareholders' Funds					
a) Share Capital	1,446.8	1,446.8	1,011.8	1,011.8	1,011.8
b) Reserves & Surplus	16,681.1	14,788.9	60,436.0	50,926.8	42,537.1
Fair Value Change Account	-	-	60.5	71.4	28.1
	18,127.9	16,235.7	61,508.3	52,010.0	43,577.0
2. Policy Liabilities	-	-	6,728.3	4,056.7	2,137.8
3. Provision for Linked Liabilities	-	-	51,868.4	25,693.2	5,535.0
4. Funds for Future Appropriation in Policyholders'	-	-	2,029.8	682.3	64.1
5. Minority Interest	-	4.2	2,197.0	1,487.9	894.6
6. Loan Funds					
a) Secured Loans	-	69.5	224.6	1.5	0.8
b) Unsecured Loans	15,953.6	13,394.3	16,029.7	14,692.9	12,290.9
	15,953.6	13,463.8	16,254.3	14,694.4	12,291.7
7. Deferred Tax liability (net)	41.9	109.8	741.7	875.8	1,399.0
Total	34,123.4	29,813.5	141,327.8	99,500.3	65,899.2
II. Application of Funds					
1. Fixed Assets					
a) Gross Block	33,395.1	29,895.8	33,811.1	30,397.0	28,568.2
b) Less: Depreciation and Write Downs	18,093.9	17,267.9	20,307.1	18,516.9	16,778.2
c) Net Block	15,301.2	12,627.9	13,504.0	11,880.1	11,790.0
<i>Contd...</i>					

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d) Lease Adjustment A/c Plant & Machinery	-	-	175.0	175.0	175.0
d) Capital Work in Progress, Expenditure to Date	220.6	347.4	384.7	252.6	91.4
	15,521.8	12,975.3	14,063.7	12,307.7	12,056.4
2. Goodwill on Investments in Associate of Subsidiary	3,672.3	3,117.2	985.4	259.8	-
3. Technical Know-how	162.6	105.3	41.3	13.4	40.6
4. Investments	14,231.9	15,632.6	82,524.6	68,654.3	52,738.3
5. Policyholders' Investment	-	-	9,050.8	4,766.1	2,201.8
6. Assets held to cover linked liabilities	-	-	51,868.4	25,693.2	5,535.0
7. Deferred Tax Assets (Net)	263.6	140.9	138.6	64.3	92.0
8. Current Assets, Loans and Advances					
a) Inventories	3,717.6	3,661.3	3,173.7	2,744.7	2,247.0
b) Sundry Debtors	2,809.4	2,528.5	5,275.5	3,025.4	1,769.7
c) Cash and Bank Balances	1,426.4	712.4	7,554.5	4,764.8	2,668.8
d) Other Current Assets	1,256.8	799.5	1,704.8	2,606.9	1,225.3
e) Loans and Advances	13,809.0	8,978.8	29,399.4	21,899.5	20,428.7
	23,019.2	16,680.5	47,107.9	35,041.3	28,339.5
Less: Current Liabilities and Provisions					
a) Liabilities	12,339.5	10,497.0	30,175.7	20,355.5	12,292.1
b) Provisions	12,241.5	8,341.3	34,277.2	26,944.3	22,817.4
	24,581.0	18,838.3	64,452.9	47,299.8	35,109.5
7. Miscellaneous Expenditure Not Written-Off Voluntary Retirement Compensation	1,833.0	-	-	-	5.1
Total	34,123.4	29,813.5	141,327.8	99,500.3	65,899.2
Compiled by the author from the Annual Reports of the Company					