Report

Indian Commercial Vehicle Finance Market: Present and Prospects

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Introduction

With the changing landscape in the global automotive industry, India's automotive market has grown manifold in the last couple of decades. Delicensing of the auto sector in 1991 and opening of 100% FDI coupled with the increase in purchasing power over the years and growth of the Indian middle class has led to the levels of production of vehicles increase manifold over the years.

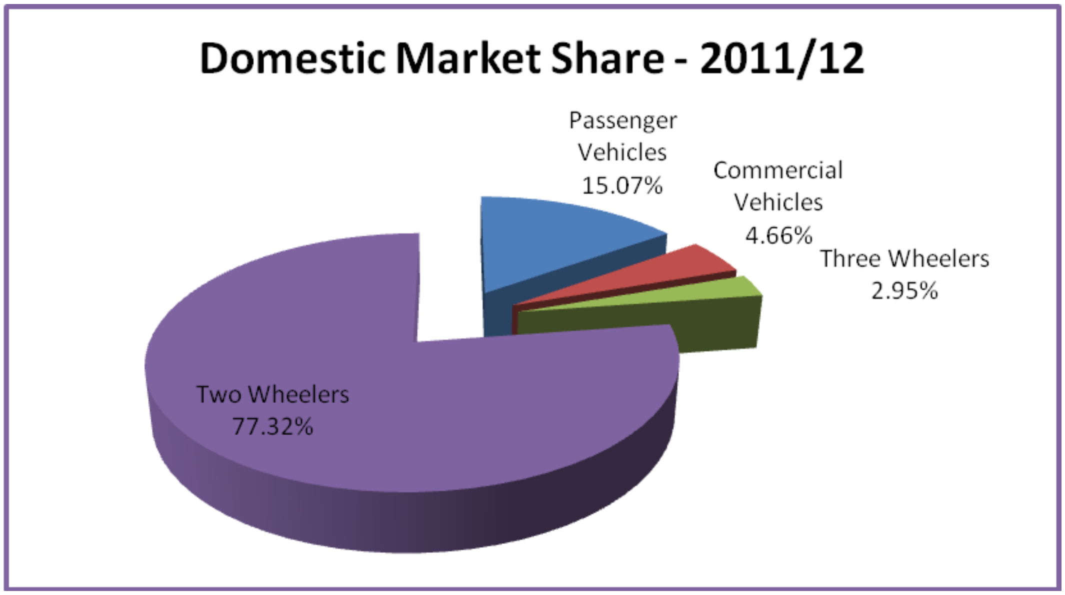
The relevance of the auto sector to the state of the Indian economy can also been seen by the FDI flows. The amount of cumulative FDI inflow into the Indian automobile industry during April 2000 to April 2013 was worth US$ 8.32 million, amounting to 4 per cent of the total FDI inflows (in terms of US$), as per data published by Department of Industrial Policy and Promotion, Ministry of Commerce.[1] FDI is only one indicator. The auto sector has a tremendous interconnectivity with several other core sectors, particularly the steel sector. There is a very strong correlation between the steel industry and the auto industry. In addition, the fate of the auto sector is also indicative of the state of urban economy – income and employment levels.

The auto segment itself is very vast area and has several fragmentations. In this report our focus has been on the Commercial Vehicle (CV) and CV finance industry and understanding of the potential, prospects, opportunities and challenges of CV finance market, presently & in the recent times to come.

Background of the Automotive Sector

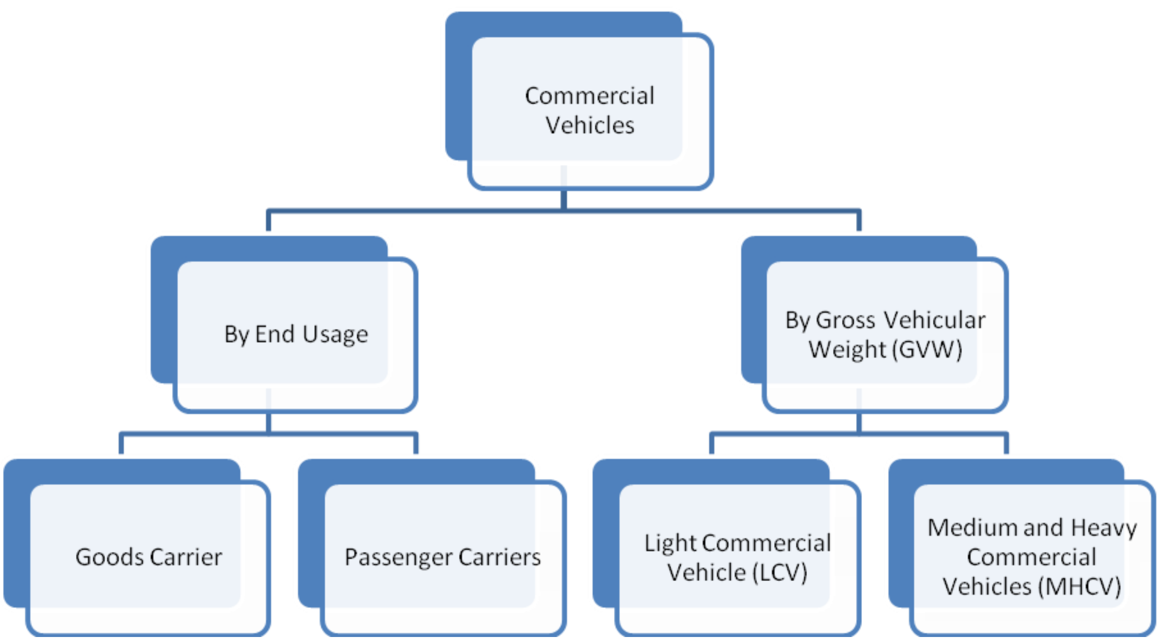
The automobile industry can be classified into a) passenger vehicles, b) commercial vehicles, c) three wheelers and d) two wheelers. The domestic market share of each of these in FY 2011-12 is presented below:

[1] http://www.ibef.org/industry/india-automobiles.aspx



Source: http://www.siamindia.com/scripts/market-share.aspx

Within the auto industry, the CV sector itself has several fragmentations. The CV market can be classified as follows:



CV classification is broadly on the basis of usage and weight and further on its utility between passenger or goods carrier. The goods carrier market presently dominates the CV sector, with an approx. share of 88% of the market volumes.[2]

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[2] http://www.indiacommercialvehiclesummit.com/

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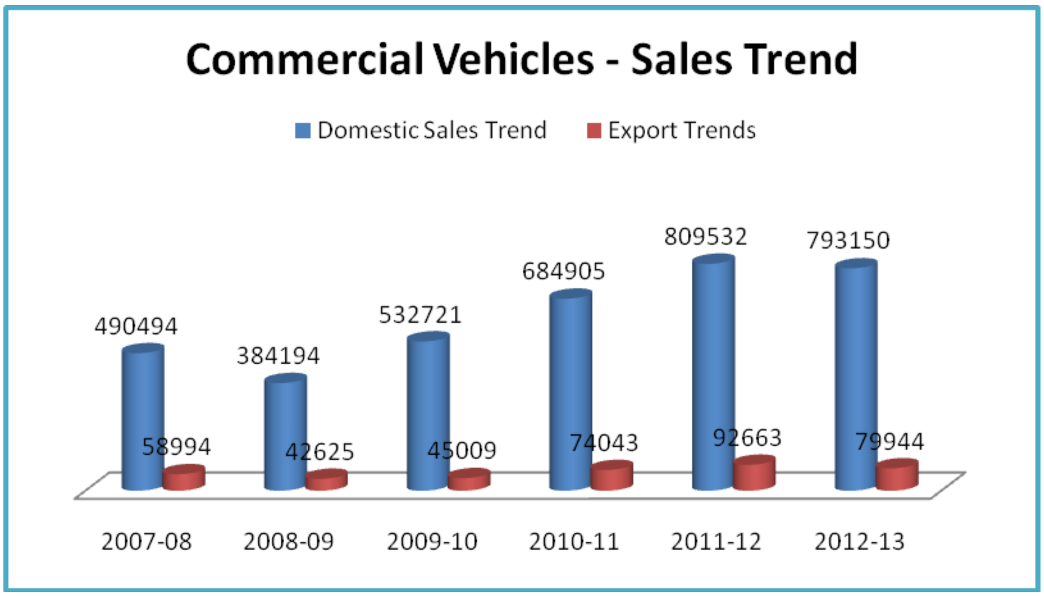
The sales volume of the CV sector, over the years, as indicated in the graph below, has been growing however there has been decline in the growth rate of the CV sector over the period. From the numbers below it can be deciphered that the domestic market forms the major chunk of the total CV market with share of exports being minimal. However, sale of commercial vehicles in the FY 2012/ 13 has recorded a year-on-year (Y-o-Y) decline of 2% and on the year-to-date basis there has been de-growth of 5.2% in the sale of commercial vehicles.



Source: http://www.siamindia.com/scripts

The growth in LCV and MHCV market in India has been erratic over the period of the time. The market volumes and growth of LCV and MHCV has been illustrated below.

	Domestic Market Volume (No. of vehicles)					
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
LCVs	2,15,912	2,00,699	2,87,777	3,61,846	4,60,831	5,23,043
M&HCVs	2,74,582	1,83,495	2,44,944	3,23,059	3,48,701	3,15,226

Growth (%) YoY						
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
LCV	-12.60%	-7.00%	43.40%	25.70%	27.40%	13.50%
M&HCVs	-0.40%	-33.20%	33.50%	31.90%	7.90%	-9.60%

As the graph indicates, there has been a de-growth in both the LCV and M&HCV market in the last few years. Several macro-economic factors are attributable to the decline in the volumes and profitability in the commercial vehicles segment, few being high ownership costs (driven by higher fuel costs, high interest rates, excise duty hikes, road tax etc.), stringent lending norms, higher inflation, fluctuations in foreign currency and slow rural income growth. Despite the bleak situation prevailing in the CV market, the growth forecasted for FY 2013-14 is at 7-9%[3].

Auto Finance Overview

In the CV market availability of credit is a very important factor on which its performance depends. The penetration of finance in this sector is around 90%.

In the 1980s, concept of auto finance was restricted to only the rich and the affluent. However with the liberalization of the Indian economy, entry of several foreign investors and banks has changed the scenario around. Catapulted by the growing economy, the purchasing power of Indian middle class, gave way to a surge in the demand for automobiles. This gave way to the role of the banks and other financial institutions, which harnessed the growth of the auto mobile industry by offering auto loans at competitive prices. The Indian auto segment in general became the eye candy for the financiers due to its consistent growth.

The automobile loans offered by banks and other financial institutions have proliferated the rise of the automobile sector in India by conduit of affordable schemes at competitive rates of interest. The availability of various schemes and features and the fact that the financing can cater to the requirements of the customer and needs has made auto financing products viable option in India.

Categories of Auto financiers

Entry in the auto financing segment has been relatively easy and hence the gap between existing players and new entrants is not much. Auto financing market typically remains competitive. Some of the players in the market are:

Banks

Banks, both public and private, cover a huge portion of the auto finance market since they are among the most established lending institutions around. They are in a position to offer competitive rates as compared to other financers with better access to credit histories. Customers are used to working with their local bank for a variety of day-to-day needs. Turning to them for car financing seems like the natural next step. The CASA advantage that banks have gives them an edge over other financiers.

Non Banking Finance Companies (NBFCs)

Acting as an aide-de-camp to banks, NBFCs occupy a significant position in financial intermediation. NBFCs cover a signification portion of the total auto finance market in

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[3] http://www.siamindia.com/upload/SIAM-Forecasts.pdf
Forecasted growth for FY 2013-14 for LCV goods is 10%-12%, MHCV goods is 1%-3% and passenger buses is 6%-8%.

India. Though banks have low cost of funds, NBFCs have certain advantages and lesser stringent regulatory requirements as compared to banks. NBFCs are not bound by priority sector lending requirements, not required to maintain CRR, can customize products, have wider reach to customers. These differences have resulted in NBFCs having a significant role playing with banks on the lending front. Also, banks have concentrated more on the car loan segment whereas NBFCs are more focussed on providing finance to the commercial vehicle segment.

Rental Operators

Several companies provide equipment on rental for periods ranging from few weeks to years to the end customers. Short term renting of commercial vehicles for construction and infrastructure space are popular in India as well.

Captive leasing and Financing Arms of leading manufacturers

The captives of some major international manufacturers only recently entered the Indian market. The captives initially only supported the expansion of the OEM's dealer network, through floorplan and working capital financing. It is only in the last two to three years that captives have started to introduce more sophisticated products, such as insurance and service packages.

CV Financing: Segregation by vehicle type

Since the CV sector in itself is quite large, there are several categories/ classes of CVs which can be considered for financing. Each category in itself is a huge market.

Lower-end – Upper-end

The main difference between the lower-end and upper-end vehicles lies in the facilities provided by them and their prices on the assets being standard assets in the market with a ready secondary market. The upper-end vehicles have the following advantages over the lower-end vehicles.

1. High quality equipments.
2. Better performance.
3. More precise construction.
4. High design.
5. Technologically Innovative.

The lower-end vehicles in India are much cheaper than the upper-end vehicles due to their low cost of production.

Light – Heavy

The Light CVs refers to those commercial vehicles whose weight does not exceed 3.5 tones whereas the Medium & heavy CVs refers to those whose weight exceeds 3.5 tones.

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Earlier the demand for used vehicles was restricted to MCVs and HCVs but now the list also includes smaller vehicles like LCVs and small commercial vehicles, this is because of the huge sales of these kinds of vehicles in the past 5years. The demand for the used vehicles stands good even in the rural areas, semi-urban areas and the Tier III cities.

In case of the new vehicles the market is dominated by the Small Commercial Vehicles i.e. less than 5 tones. The demand for the bigger vehicles has slipped down because the industrial production has come down and due to the lack new investments.

Large Fleet Operators – Small Fleet Operators

The market for the fleet operators has been deteriorating since 2011. The sharp rise in the overall cost of ownership combined with considerable rise in the operating costs and the constant excessive pressure on the fleet operators. The small fleet operators are running out of cash to purchase the vehicles and service their debt, whereas the large fleet operators are under pressure to maintain high cash reserve to maintain their working capital.

Auto financing products

There are several variants of financing options available to customers in the auto segment. Some of the popular products are:

a. Vanilla loan
b. Hire purchase
c. Leasing including financial lease and operating lease
d. Conditional sale
e. Asset renting

Financing of Commercial Vehicles

The financial products offered by financiers in the CV space are mostly leasing (both operating and financial) and loans.

CV Loan in India

Commercial vehicle loans are usually taken by individual, partnership firms, proprietorship firms, HUF (Hindu Undivided Family), trusts, societies, self-employed, businessmen and private and public limited companies for their financing needs for owning and running commercial vehicles. Commercial vehicle loan options are available for buses, tippers, transit mixers or any other heavy, light or small commercial vehicle. A commercial vehicle loan can be taken for a variety of commercial vehicles, which may be used at different locations. While loans are sanctioned for the purchase of a new commercial vehicle, banks also offer loans for pre-owned vehicles. Borrowers can also avail of a top up on existing loans subject to conditions.

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The interest rates range from 10% to 15% depending on the customer and vehicle segment. The rate depends on a lot of factors such as the number of vehicles owned by the borrower, his business turnover, repayment track record from other financiers (if any), etc. The financial institutions are able to confirm the rate of interest once they have studied the documents. The interest rate may be fixed or variable. Processing charges include processing fee, stamp duty and vehicle valuation charges. The processing fee depends on the loan amount. It usually ranges from 2%-4%.

CV leasing in India

Globally there is a clear domination of lease over loan. In auto financing segment over 60% of US market and 40% of European market follows the lease route for an auto purchase. The auto-leasing sector in India has recently picked up pace, although the market is still in its nascent stage.

The scope of growth of leases in this sector is very high owing to the large number of infrastructural projects in the pipeline which will result in the demand for commercial vehicles to grow combined with the rising cost of manufacturing these vehicles, users are forced to look at lease options more actively than ever before.

On the flip side, the deterrents to growth of leasing as a financial product, which may be more generic to the product than specific to the sector, are multiplicity of taxes. For instance, in a chassis, the combination of the chassis and the body is treated as a new asset for indirect tax purposes and accordingly, the chassis suffers local taxes whereas the body of the vehicle is subject to works contract. From leasing point of view sales tax in form of VAT/ CST are applicable on lease rentals. Then, at the end of the lease if there is any transfer of ownership, sale tax is applicable on the sale consideration. Further there may be issues of input tax credit being disallowed, adding to the costs of the transaction, making it completely unviable.

Though leasing is becoming attractive as a more popular product, the add-on costs in the form of taxes are acting as a deterrent and add to the complexities. Nevertheless this untapped sector provides huge opportunities to financial institutions due to its inherent benefits pertaining to risk removal and cash flow restructuring.

Leasing has been a widely accepted product in the passenger vehicle segment owing to the tax free perquisite benefit availed by the employees. In the current market scenario the penetration rate of leasing in passenger vehicle segment is 25% vis-à-vis the penetration rate of leasing being 3%-4%. CV financing and CV industry in particular is posed to several challenges in the recent times than opportunities clearly explaining the traction in volumes and numbers.

Opportunities

In total, India has more than 35 financial institutions that provide financing.[4] Banks have an advantage over other financiers in the auto finance market because of the high degree of confidence by customers. They offer lower rates, have better access to credit histories and possess the ability to process loan approvals more quickly. [5]

While banks have to cater to multiple products and services, some NBFCs are more sector focused. Banks were taking the easier route of lending to NBFCs and also fulfilling their priority target—lending to agriculture and allied activities. However, with the change in regulations and the recommendations of the Nair committee on priority sector lending, private banks have realized that they would have to boost their priority sector lending.

Leasing and additional service offerings are rare with NBFCs. Even captives typically do not offer additional services, other than insurance broking. But with more Indians owning cars, maintenance, warranty and insurance packages have become more attractive and international captives have begun to respond with a variety of product bundles. As additional vehicle services are not very common, this sector offers great opportunities for captives to differentiate themselves from competing consumer banks. In particular, customized and sophisticated products, like maintenance or insurance packages, could help captives to raise customer awareness. As the service business promises high profitability, there is huge potential to realize additional revenues.

Challenges

The current challenges on the other hand to the growth of the auto finance industry are several. The CV industry, since the start of 2013, has entered into a downward cycle following the closure of many iron ore mines, coupled with industrial slowdown and weak investor sentiment across sectors, which have held back new projects. Input costs for the medium and heavy CV transport operators have gone up significantly due to substantial increase in diesel prices, driver salaries and toll charges. At the macro-level slowing of the economy and regulatory imbalances impacted the CV financing industry. Rise in lending rates resulting in higher cost of funds and constantly tightening lending norms and fleet operators/ borrowers struggling to repay debt and soaring NPA levels have led to the stunting of auto finance market as credit evaluation and collection efforts have become more stringent.

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4. *Top Auto Finance Companies in India,* Business map of India, July 2012.
5.(Source:http://www.rupeetimes.com/news/car_loans/psu_banks_dominate_the_auto_loan_market_2139_P2.html)

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According to a report by ICRA [6], the short term outlook for the CV finance industry is "subdued as delinquency levels in the commercial vehicle loan portfolio of various originators have been on an upward trend over the past 12 months or so." For 2012, 3.38% of loans disbursed have not been repaid for more than 90 days and such loans have only repaid or amortized by 34% of the amount disbursed so far. On an average across the 2011 origination vintage, loans which have not repaid for more than 90 days have not increased in the last 12 months and has stabilized to 2.15% of the loans disbursed. [7] This can be attributed to the loan servicing efforts of non-banking finance companies which have been party successful in controlling delinquencies.

Prospects

According to a report by Ernst and Young, Indian commercial vehicle (CV) sales were expected to grow at a CAGR of 15% in the next five years - from 0.8 million in 2011-12 to reach 1.6 million units by 2016-17.[8] The improving road infrastructure in rural and semi-urban areas will be one of the main drivers of this development.

The growth of commercial vehicle industry has been linked to the country's industrial activities and the overall GDP. In the short term the CV volumes and financing has got impacted due to the macro factors, but considering the huge infrastructural demand in the country and the strong fundamentals, we are bullish on the long term prospects of the CV industry in general and higher penetration for CV financing in particular.

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6. http://www.icra.in/Files/ticker/SH-2013-Q1-1-ICRA-Commercial%20Vehicles.pdf
7.http://timesofindia.indiatimes.com/business/india-business/CV-financing-to-see-rise-in-defaults-report/articleshow/19637152.cms
8. http://www.ey.com/IN/en/Newsroom/News-releases/Press-Release_Indian-Commercial-Vehicle-sales-to-hit