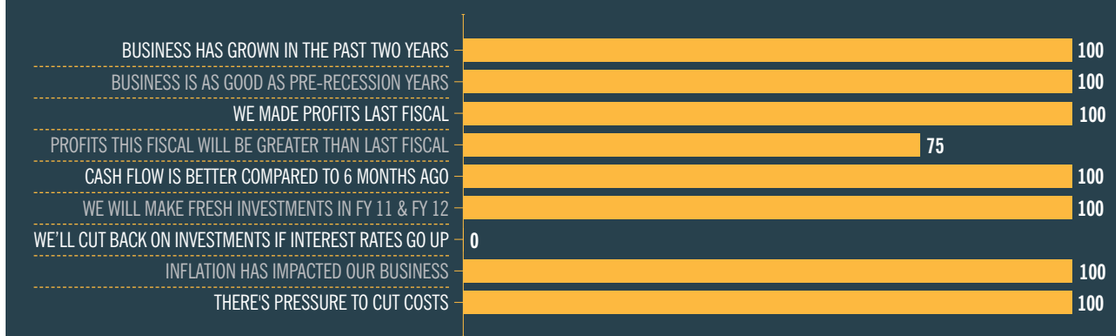
IN TOP GEAR

They're facing cost pressures on all counts. But Chakan's auto OEMs and parts companies aren't letting that get in the way.



FULL THROTTLE: The auto industry is expected to account for 10.4% of India's GDP by 2016.

PHOTOGRAPHS BY SANJIT KUNDU

Arundhati Ramanathan

WHEN VOLKSWAGEN OFFICIALS from Germany want to visit the company's plant in India, they just have to board one of Lufthansa's non-stop flights between Frankfurt and Pune. A smooth, half-hour drive later, they're in Chakan, home to the carmaker's massive plant, which has an annual production capacity of 110,000 units. The company is gung-ho on its prospects in India—the entire production from its Chakan plant is targeted at the domestic market. For Volkswagen, it's a long-term play, and from the looks of it, there could well be lots of its executives getting on that non-stop flight to Pune. There may, of course, be a few from Mercedes-Benz as well, considering that the luxury carmaker's plant—its numbers are far more modest—is also in Chakan.

The Chakan industrial area, developed in four phases, covers 2,765 hectares. It also hosts two major domestic auto OEMs (original equipment manufacturers): Mahindra & Mahindra and Bajaj. (In all, the Ranjangaon-Talegaon-Chakan industrial belt around Pune has about a dozen auto OEMs.) Supporting the automakers are hundreds of ancillary units. Thus, for all intents and purposes, Chakan, today, has a complete auto ecosystem. Though it is far younger than Pune's other auto clusters—Pimpri, Chinchwad and Ranjangaon—Chakan is growing at a phenomenal pace.

Mahindra & Mahindra has invested ₹5,000 crore on its plant in the cluster. Volkswagen has spent ₹3,800 crore and Mercedes Benz, ₹600 crore, while tyre-maker Bridgestone is investing ₹2,600 crore. An international exhibition centre, sprawling over 240 acres, is also coming up. Every turn has signposts of the big names of the auto world. Every plant stretches for three to four kilometers. Little wonder then, that the Maharashtra Industrial Development Corporation (MIDC) is struggling to find space to accommodate the 6,000 business proposals for Chakan pending before it.

Just what is driving this kind of investment? The answer, simply put, is the present and the future. People are flocking steadily to buy cars. In fact, some models, such as Maruti's Swift, Hyundai's i20 and Volkswagen's Polo have waiting periods running into months. Even luxury carmakers BMW, Mercedes, Audi and Porsche are unable to keep up with demand. As for the future, according to the government's Automotive Mission Plan 2006-2016, the auto industry will account for 10.4% of India's GDP by 2016, from 5% in 2010. Strong demand for cars and bikes will fuel this growth.

An August 2010 report by the Automotive Component Manufacturers' Association, the nodal body for the parts industry, supports the government's projection. It states that the Indian auto component industry is expected to grow over four-fold to $113 billion by 2020. Total passenger car production is pegged to quadruple to 9 million cars, with exports accounting for 35%. In addition, says the report, two- and three-wheeler production will double to 2.2 crore units by 2015 and reach 3 crore units by 2020. Commercial vehicle production is seen going past the 22 lakh-unit mark in the same period. Consequently, the report concludes, the Indian component industry is projected to invest $35 billion over the next decade. It is also expected to add a million jobs in that time.

Chakan will play a big part in driving this growth. An obscure village a decade ago, it today stands testament to the automotive sector's, indeed, the country's, growth. Drive down its well-laid roads and you will see an endless fleet of shiny cars dotting this once-barren land.

"We are seeing continuous growth month-on-month. Chakan is becoming a small-car hub, exporting to the world," says a beaming M Radhakrishnan, co-founder and joint MD, Autoline Industries. The company epitomises the cluster's tremendous growth. It was launched as a sheet-metal supplier in 1995 by Radhakrishnan and three others with an initial investment of ₹3 lakh. Today, it has diversified into design, engineering and manufacturing, has seven plants and expects to end the fiscal year with a turnover of ₹650 crore. And, it's listed.

Manufacturers and suppliers shrug inflation off as problem that is cyclical in nature. They don't expect another slowdown very soon.

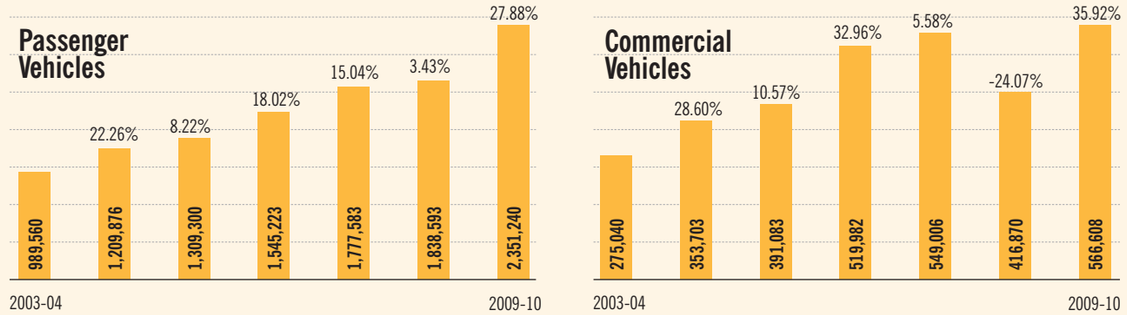
Immediate Woes

Rosy as the future is, companies in the Chakan cluster still face some serious difficulties today. The biggest problem, by far, is inflation. "While medium-term growth will remain robust, the immediate concern is how the market will react to inflation, higher interest rates and higher EMIs," says Claude D'Gama Rose, Managing Director, Continental Automotive India, which supplies brake systems among others.

With steel prices climbing, input costs have shot up dramatically. However, SMEs are finding it next to impossible to raise their prices. "They (OEMs) resist price increases very strongly. If it is a 10% increase in price, they would, at most, concede to a 5% increase," says Vijay Pusalkar, Chairman and MD of Indo Schottle Auto Parts. "OEMs may find a way to increase prices and pass costs to the consumer but the same principle is not applied for the vendors," he adds. Ratan Kumar, General Manager of Mask Polymer, which supplies rubber components, agrees. "While prices rise every month, OEMs compensate only quarter to quarter," he says.

SMEs depend on volumes to fuel growth and enjoy better profits. But even if volumes are high, cost increases can put

Automobile Production Trends



Source: Society of Indian Automobile Manufacturers

their margins under pressure. Besides, says, Pusalkar, the parts industry's margins haven't really improved on higher volumes as OEMs demand discounts on larger orders. And there is always the "China threat"—cheap parts.

Shortage of skilled labour is another problem. With so many factories in the cluster, employees frequently change jobs in search of better pay. Lack of skill has compounded the problem for the entire industry, making labour costly. Consequently, SME wage bills have shot up 40-60% since 2008. Workers are reportedly demanding pay hikes of up to 110%.

The labour scarcity has made some OEMs recruit fresh faces right out of school. The rationale is simple: an experienced person would need a higher wage and have to unlearn old techniques and learn new ones. The OEMs find it easier to train young minds. And that's brought the average age on the shop-floor down to 24. Mithesh Karkare is one such recruit. After finishing his twelfth standard, he joined Mahindra and has been on the firm's rolls for the past seven months. Karkare's job is to fit tail lamps along with three other parts. "I love working here as it gives me a great opportunity to learn and spend time with what I love best: automobiles," gushes the 19-year old.

Tough Times

But the problems today aren't nearly as bad as those that beset the industry during the economic slowdown. The Indian automotive sector responds to the pulse of the country. And quite naturally, the slowdown saw demand for automobiles diminish, particularly for commercial vehicles. Chakan, too, saw demand dwindle. Fortunately, domestic demand still generated sufficient numbers for most enterprises to stay above water. However, export-oriented suppliers were hit.

The SMEs strewn around Chakan bore the brunt of the deceleration, as order books shrank. "We lost 35-40% of our business mainly because we export 60% of what we produce. Our exports took an 80% beating. Wages had to be cut and 150 people had to be laid off from a workforce of 375," recalls Pusalkar.

The government's stimulus package provided a big boost to the sector, improving demand, and putting it back on an even keel. Everyone—OEMs and their suppliers—has bounced back now. OEMs ended FY10 with 23-24% growth. Suppliers are now seeing 40-50% growth in production since 2008 owing to rising demand for both passenger cars and commercial vehicles. As for Indo Schottle, its headcount has now risen to 550. The company clocked a turnover of ₹150 crore in 2010 (₹70 crore in 2008).

There were some positives during the slowdown. Companies that had invested in the future during the boom phase reaped the rewards. For instance, Mahindra and Mahindra, which had acquired 692 acres of land in Chakan in 2008 to build a plant, benefited greatly from rock-bottom prices. "We were able to negotiate prices with the equipment suppliers because they wanted to recover costs to keep their setups running," says LP Pereira, CEO, Mahindra Vehicle Manufacturers. Equipment prices have now shot up 25 -30%, adds Pereira.

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Co-founder and joint MD, Autoline Industries

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The Road Ahead

Though rising costs are a constant challenge for the sector, both manufacturers and suppliers shrug inflation off as a problem that is cyclical in nature. They don't expect another slowdown in the near future. At the top of the pyramid, OEMs like Volkswagen are thinking only of ramping up. The German carmaker plans to ramp up capacity by another 20,000 units in 2011. "The market is projected to grow at 18-20% over the next few years. We keep the growing numbers in mind and try to follow this trend," says Holger Nestler, the group's Executive Director (technical).

The company is looking to increase the degree of localisation in its cars to tide over currency fluctuations, says John Chacko, Volkswagen Group India President and MD. Currently, 40% of the Polo's parts (including the engine) are imported while 60% is locally made. "We would like to manufacture engines, depending on the volumes we produce—upwards of 200,000 engines a year qualifies for having your own factory," says Chacko.

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CEO, Mahindra Vehicle Manufacturers

Mahindra's Pereira, too, is upbeat in his forecast for the group. "Our annual production capacity is pegged at 320,000 for the first phase of production. We should be able to achieve 50% of this in 2012." He expects the plant to achieve full capacity by 2014. And, over the following two years, Pereira says the company "should be thinking of getting into phase two of capacity expansion, to 540,000 units".

Even the SMEs, despite their grouses, admit that business has never been better. Pusalkar, who has been in the business for 26 years, explains just how much better: "As long as there is a 4-6 month waiting period for vehicles, there is no slowing down!"

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