RESOURCE PAPER 34

INDO-JAPAN CHAMBER OF COMMERCE & INDUSTRY

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PREFACE

We, at the Indo-Japan Chamber of Commerce and Industry have immense pleasure in presenting the Resource Paper on the recent announcement by the Union Cabinet chaired by Prime Minister Shri Narendra Modi, has given its approval to introduce the Production-Linked Incentive (PLI) Scheme covering 10 key sectors for enhancing India's manufacturing capabilities and enhancing exports - 'Atmanirbhar Bharat' on 11th November 2020.

IJCCI has jointly thought through with Grant Thornton Bharat LLP to bring out a resource paper to understand the PLI automobile sector in India and how PLI scheme will benefit the industry at large. In this resource paper we will be discussing about the Automobile sector in India and how this scheme will benefit the Auto major including auto component manufacturers. A few words about the authors:

P.S. Krishnan : Partner in the Indirect Tax Practice with around 30 years of work experience, was previously associated with a global multinational consulting firm. He possesses 16+ years rich experience in the Departments of Enforcement Directorate & Customs and Central Excise under the Ministry of Finance Government of India. His work significantly comprises advisory and project implementation in the indirect tax space. He has successfully represented clients from across sectors before the Central Board of Indirect taxes Drawback Directorate GST Sectoral committees and the Directorate of Goods and Service Tax.

N. Mallikarjun : Associate Director with the Indirect Tax and Regulatory Practice. He possesses a decade of work experience in handling indirect taxes. Prior to this he was associated with a global multinational consulting firm. He has been associated extensively in erstwhile law and Customs, Foreign Trade Policy, SEZ, EOU, AEO, Bonded Warehouse and GST including PLI related matters.

Nemish Zaveri : Assistant Manager with the Indirect Tax and Regulatory practice of the firm, with over 4 years of work experience in handling indirect taxes. He has been associated in erstwhile VAT, Service Tax and currently he is involved in GST, FTP related matters.

This Resource Paper, we are confident will be a ready reckoner on PLI benefit for auto sector for the Indian and the international business community.

July 2021

Suguna Ramamoorthy
Secretary General

How PLI scheme announced by Indian Government will benefit the Automobile Sector to become globally competitive

The Indian Auto Industry- In top gear

Introduction

The India automobile industry sector is one sunrise sector which is witnessing tremendous growth and progress right from the era of liberalization (1991) till recent post covid / lockdown induced times.The key highlights as below of this sector would substantiate further the contribution and growth of the sector.

In a nutshell, the following statistics speak volumes of the auto industry sector in India.

- The automobile market in India is poised to grow to a US $ 512 billion industry by 2026 from US $ 222 billion which was seen in 2019. This represents a CAGR of 12.7% in the sector. The market includes new vehicles, used vehicles and associated services.
- India is the world's largest two-wheeler manufacturer and the world's 4th and 7th largest manufacturer of cars and commercial vehicles respectively.
- The above manufacturing capabilities have ensured that the sector contributes to 7% of India's GDP .

Expected substantial growth
Seen recent sign-off of projects

#1 - Largest two-wheeler
#4 - Largest manufacturer of cars
#7 - Largest commercial vehicle

Automobile manufacturing sector - with the PLI scheme the growth number are promising

Transitioning towards electric vehicle - various Govt. initiatives to foster to promote market

The aspects that have clearly worked in favor of the automobile industry in India are as follows:

- India has the world's largest rising middle class and young population and this complement increasing disposable income in the hands of its population and rapid urbanization.
- There exists transparency, synergy and ease of doing digital transactions which have positively contributed to the growth of the sector in India.
- Owing to a raging pandemic, there has been a higher preference for personal mobility in comparison to public modes of commuting which will propel and exponentially shoot up the demand for vehicles.
- Owing to a growth in the auto loan and insurance segment, there has been considerable growth in the auto services market.

Key market developments

The drivers for growth of this sector can be keenly attributed to a diverse demographic customer base and robust envisioned Government policies which focus on incentivizing manufacturers. The incentivization ranges from achieving economies of scale to adopting green/ alternate technology.

Ever-increasing domestic base

For every 1000 people in India, India has approximately 120 vehicles. This ratio is further expected to rise to 300 vehicles in the next 10 years.

Booming urbanization

By the end of 2025 the rate of urbanization is expected to reach 36.25% from the current rate of 33.2%. This would automatically warrant the need for more automobiles. It is estimated that by 2050, roughly 60% of Indians will live in cities and the cities of Delhi, Mumbai and Kolkata will be large metros with resident population exceeding 100 million.

Foreign Direct Investment Inflows

With the vision of making India the largest manufacturing hub for automobiles and to pivot India into a global automotive R&D hub, the Government has introduced effective labour laws, incentive schemes, a robust & progressive IP regime etc. to attract local and foreign investment between US $ 8000-10,000 million by 2023.

A spate of private foreign investment by large automobile manufacturers has been noted in recent times with the FDI inflow till March 2019 touching US $ 11.57 billion. From the period April 2019 till March 2021, the inflow increased and totaled to US $14.27 billion thereby recording a growth of 25.5%.

Some key announcements by state Governments and large automobile players

a. Amendments in Electric vehicle and storage policy promulgated by the Government of Karnataka, a leading industrial state in South India. The amendment provides for allotting a 15% capital subsidy to investors in the electric vehicle segment on the value of fixed assets employed.

b. A large multinational has committed and is currently working on setting up hyper charger network across the next 5 years. The network comprises of setting up 100,000 EV chargers across 400 cities in India.

c. A leading public sector bank in India has raised US $ 1 billion from a foreign public finance institution to extend loans to supply a chain of Japanese automobile industry in India.

d. Leading multinational corporations have set up subsidiaries in India to participate in the sector and set up their manufacturing units.

e. A leading ride hailing major has partnered with a global conglomerate to set up an EV manufacturing facility in Tamil Nadu, another leading industrial state in South India. The collaboration will see major technology transfer and will result in a facility built on Industry 4.0 principles.

Impact of the COVID-19 pandemic- Not a full stop

The Government of India announced a nation-wide complete lockdown in late March 2020 with the objective of arresting the spread of the virus. The result of the lockdown was immediately felt within the automobile industry which saw its operations freeze overnight.

From loss of working days to lack of availability of critical parts used for the manufacture of automobiles, the impact of the lockdown not only dented the ability to manufacture but also shaped consumer sentiment and spending. The pandemic has thus had a severe impact on the industry, with severe disruptions in the supply chain and manufacturing.

The steep impact has been gauged as follows:

- Passenger vehicle sales plummeted to sale of 33,546 units per month in May 2020 compared to 226,975 units sold in May 2019. The drop was also attributed to weak consumer sentiment and weak consumer spending.

- Economic slowdown saw sales for commercial vehicles dropping to 2711 units in May 2020 compared to 80,392 units in May 2019.
- Two-wheeler sales plummeted to 279,682 units in May 2020 from a peak of 17,25,204 units in May 2019 .

The current economic revival promulgated by the Government of India in response to pandemic has yielded significant positive results in the form of increase in sales on a year-on-year basis.

- The passenger vehicles segment recorded total sales of 276,554 units in January 2021. This is a seven-fold increase in sales from the all-time low sales figures of May 2020.
- Two wheeler sales also soared to a record of 1,429,928 units in January 2021 from the May 2020 levels of 279,682 units.

Outlook

The outlook for the automobile sector after factoring the impact of the loss caused by the pandemic, is bright. On the demand side, a rising middle class and young population will push towards stronger growth. Coupled with a change in preference and opting personal mobility in comparison to public mobility, the recovery and growth in the sector will be V- shaped.

With leading manufacturers increasing their digital footprint, customers are increasingly attracted towards automotive players who offer end to end digitization of sales, services, grievance redressal. Original equipment manufacturers and automobile manufacturers are also partnering with NBFC's and other banking partners to provide online financing options.

From the above statistics and change in consumer preferences, it can be predicted that the future for the automobile sector is very bright and India needs to bridge the gap between demand and supply by inviting and incentivizing manufacturers who achieve economies of scale. The pandemic has not been a full stop for the industry but is only a comma in realizing the true potential and market which India holds and poises.

Production Linked Incentive Scheme (PLI) - A glimpse into what's in store for the automobile sector

Introduction

The automobile industry is one of the key drivers of the Indian economy. The industry contributes to nearly 7.1% of India's GDP. The significant contribution of the industry has been majorly because of the gradual liberalization of the sector from 1991.

With a manufacturing capacity of 26 million vehicles (inclusive of passenger vehicles, commercial vehicles, two wheelers and three wheelers) during the period ending March 2020, the sector is easily poised to push India as the world's third largest automotive market by 2026.

Major global manufacturers (US, Germany, Japan, South Korea, UK, Europe and Italy based automotive players) have set up their base of manufacturing in India owing to a conducive business atmosphere and owing to the fact that many regional State Governments in India have rolled out various reforms/policies which are favourable for global manufacturers. This attracted the global auto components manufacturers to look for India as a supply chain solution to localize the components for a competitive market.

This has resulted in the formation of multiple automobile clusters within India (Andhra Pradesh-Tamil Nadu cluster, Gujarat-Madhya Pradesh cluster, Karnataka-Maharashtra cluster).

Despite a slump is the sector during FY 2020-21 owing to the COVID-19 pandemic, the sector managed to impress observers by registering an overall growth of 56.5% export of automobiles in March 2021.

Indo-Japanese relations

At the recently concluded 13th India-Japan Foreign Ministers' Strategic Dialogue in October 2020, the Indian and the Japanese External Affairs Ministers Dr. Jaishanker and H.E. Mr. Motegi, reiterated and reaffirmed the mutual trust shared between India and Japan. The delegation reviewed and discussed on the following aspects:

a. Reviewed the progress made in India-Japan Special Strategic and Global Partnership.

b. Emphasized the importance of a free, open, and inclusive Indo-Pacific region that draws its premise from diversified and resilient supply chains.

Taking cue from relations maintained by the nations, the industry community also collaborated and have come together to invest in India and ramp up production. Recently, major automobile manufacturers have partnered to capture the growing EV car segment in India by executing an agreement for capital alliance to establish and promote long-term cooperation in new fields ranging from electric vehicle technology to autonomous driving.

Investment Promotion Reforms - need and approach

The current Government recognized the importance of Investment Promotion and has taken numerous steps to boost investments in India since 2014. These include Make in India, Ease of Doing Business, Start-up India, Production Linked Incentives (PLI) Schemes for various sectors etc.

Production Linked Incentive schemes

With the objective of providing a major boost to manufacturing and making Indian manufacturers globally competitive, the Government of India has proposed Production-Linked Incentive (PLI) Schemes for [1]13 sectors-3 sectors in March 2020 and 10 sectors in November 2020 with an outlay of US $ 26,300 million over the next five years.

The incentives are offered to the manufacturers in each of the sectors as per specified annual increases in their production/sales to achieve economies of scale. We have encapsulated the contours of the PLI scheme for the automobile sector in the subsequent paragraphs.

1 Automobiles and Auto Components, Pharmaceuticals Drugs, Specialty Steel, Telecom & Networking Products, Electronic/Technology Products, White Goods (ACs and LEDs), Food Products, Textile Products: MMF segment and technical textiles, High efficiency solar PV modules, Advanced Chemistry Cell (ACC) Battery, Medical devices, Large scale electronics manufacturing including mobile phones &Critical Key Starting materials /Drug intermediaries and API.

Production Linked Incentive scheme - Automobile and Auto components sector

The Production-Linked Incentive Scheme in the Automobile and Auto Components sector (managed and implemented by the Department of Heavy Industries) comes with an outlay of approximately US $ 7600 Million(highest outlay of all the PLI schemes) spread over a five-year period.

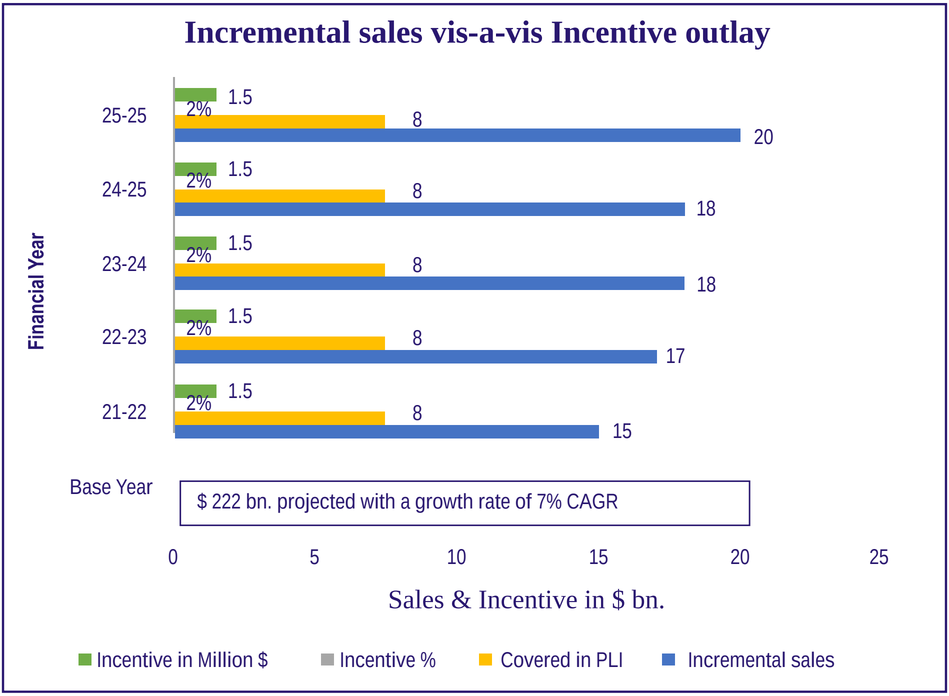
The commitment to introduce the PLI scheme reiterates India's vision of boosting India's manufacturing capabilities and enhancing exports. Under the scheme, there are three broad plans for the automotive sector- Global sourcing Scheme, Vehicle/Component Champion Scheme and Production Linked Incentive Scheme. While the fine details of the scheme are yet to be notified, one can expect a high turnover, investment, turnover criterion to be eligible for the scheme. For instance, the criterion for auto original equipment manufacturers to be eligible to participate in the scheme is set as follows:

- Global group revenue: Exceeds US $ 1300 Million
- Global Investment in Fixed Assets: US $ 500 Million

The turnover and investment criterion for auto component manufacturers is set at 1/10th that of auto original equipment manufacturers.

The schemes are explained as follows:

	Component Champion scheme	Production Linked Incentive scheme	Global Sourcing scheme
Incentive	Between 4% - 7% of sales value available as cash back.	Between 0.5% - 4% of sales value as cash back.	Between 2% - 12% of sales value on incremental sourcing from India.
Objective and conditions	• To boost exports. • Maximum turnover eligible for incentives = 125% of incremental export turnover or incremental turnover, whichever is lower.	• To reduce high logistic costs by rewarding the distance travelled for exports. • Incentive is as follows: • 2001-3000km= 0.5% • 3001 km to 5000km= 2.5% • Greater than 5000km= 4% • An additional incentive of 8% (year-on-year) is also awarded on incremental sales.	Incentive is awarded as follows: • Incremental domestic sales revenue > INR 75 Crores = 2% till 10% up to INR 1000 Crores.



Contours of the PLI Scheme

a. The objective of the scheme is to attract mega investments from OEM's to set up their plants in India and gradually establish the production to distribution eco-system in India. With the propensity to spend higher in India, the manufacturers will benefit largely by availing the scheme and ramping up production to cater to the large consumption market in India.

b. The scheme is also attractive to large manufacturers who rely on a Just-in-time inventory system. Various initiatives and schemes promulgated by the Indian Customs agency, such as the AEO programme (Authorized Economic Operator) also facilitate and incentivize manufacturing and investing in India. Leading automobile manufacturers (South Korean and US based automobile company) have obtained AEO T2 licenses in India. India AEO is a mutual recognition scheme in the international markets through joint action plan between countries.

c. The PLI scheme may be able to compensate exporters by offering a higher incentive even for exports in comparison to RoDTEP scheme (where the reward rate may not exceed 1.5%) and the MEIS scheme (where the reward rate may not exceed 5%).

d. Dedicated automobile clusters have emerged across India owing to multiple reasons ranging from favorable state industrial policies to availability of adequate support infrastructure (power, water, land, rail and port transport).

Interplay of PLI Schemes - Automobile sector and Advanced Chemistry Cell (ACC) Battery

The PLI scheme for ACC Battery storage and the auto sector is interlinked. With the objective of gradually phasing out Petrol and Diesel automobiles and the deployment of E-vehicles, the notification of the PLI scheme for ACC battery storage production comes at the apt time.

The commitment of the government to boost the manufacturing of E-vehicles through its flagship FAME policy (Faster Adoption and manufacturing of electric vehicles in India), incentives under the ACC battery PLI scheme accompanied with the PLI scheme on auto sector will reduce the cost of manufacturing electric vehicles and thus, make it affordable for a large segment of the market.

This will be seen as a twin benefit for large scale manufacturers to invest and manufacture E-vehicles.

Blue Sky

The PLI scheme provides an opportunity for large automobile conglomerates to manufacture in India and source from India and set up their end to end eco system within India and will be a roaring success.

The scheme will provide manufacturers with the necessary time (over 5 years) to ramp up production and break-even in their operations and profitability. Ancillary regional government policies and favorable tax program's (namely AEO) will enhance international supply chain security and facilitate movement of legitimate goods thereby ensuring ease of business in India.

The scheme, from all aspects, is a win-win for the Government of India and the manufacturer as the manufacturer is aptly incentivized for ramping up production and catering to an ever growing domestic automobile market, which is poised to grow and attain the position of the world's third largest market. With the constant improvement in ease of doing business with new benefit schemes creates an attractive environment for automobile and components manufacturers.

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