

**Corporate Financial Planning and Budgeting in an Automobile firm- Premier Automobiles Ltd.**

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## **INTRODUCTION**

VESPA Group is one of the leading business conglomerates from Maharashtra, India which is headed by Mr. Sudhakaran, Group Chairman, VESPA Group. Operations of the group are spread over from pharmaceuticals to chemicals, from alcohol to automobile, heavy engineering and construction. Premier Automobiles Ltd. is one of the group company, which is located at Jejuri Industrial Area, which is 60 kilometers away from Pune, Maharashtra. The company is operational in the manufacturing of Three Wheeler LCV (Light Cargo Vehicle). In early February, 2012 Mr. Rajan (CEO) & Mr. Rushikesh (CFO) of Premier Automobiles Ltd. received a mail from Group Corporate Office. The message was loud and clear. The mail was stating the current economic conditions, the country is passing through and the GDP growth has slowed down and expected to further come down in the near future. At this turmoil times of recession, delivering the consistent financial performance with holding the investors confidence through consistent dividend and better and steady market valuation was the top priority. The role of CEO & CFO was highlighted in the mail as the pioneer responsible entities for the organisational performance. Both of them are bestowed with necessary authorities and responsibilities as they are the 'Key Decision-makers' with regard to financial and non-financial performance of the respective company. VESPA Group is following a decentralised approach where each of the company is operating as an individual 'Profit Centre'. In the first week of April, 2012 Mr. Sudhakaran, Group Chairman, VESPA Group conveyed 'Annual Review & Budget Meeting'. Financial Performance of all group companies was reviewed. All the group company CEO's and CFO's participated in that meeting. Several Group companies faced the pinch of economic slowdown; the same was revealed by Mr. Sudhakaran, Group Chairman, VESPA Group. Premier Automobiles Ltd. got special appreciation for their performance during the financial year 2011-12. Companies share capital is 20,000 Crores and Companies market share in terms of Sales in Three Wheeler LCV segment is 60 percent.

## MARKET

India surpassed every other country in 2011, including China, in sales of commercial vehicles, repeating its feat as the world's fastest growing truck and bus market for the second successive year in a row. Sales of commercial vehicles, mainly trucks, buses and lighter cargo vehicles grew 22% in 2011 year-on-year, higher than its global arch rival China which posted a 10% dip for the same year. While US, once the world's largest CV market bounced back into the positive territory in 2011 posting a 13% growth year-on-year signaling some revival of the global automotive market. **(The Economic Times of India, dated 30<sup>th</sup> March, 2012)** Although year 2011 was the year of growth, but lot of external developments took place at the end of 2012. The dark side of global economic recession is getting darker day by day and also there has been increase in the 'Excise Duty' announced off late in India.

Apart from the above mentioned threats, one major threat is knocking Indian Light & Heavy commercial vehicles sector i.e. External competition. Indian market is seen as the ideal destination for commercial vehicle manufacturing companies. Commercial vehicle sales are seen as a barometer of economic activity and the interest in the higher growth from a steady GDP has led to entry of many international players in recent years. Already a slew of foreign players such as world's largest commercial vehicles maker Daimler AG, Volvo, Scania, MAN, Navistar, Kamaz Vectra and Hino Motors have set up beachheads in India in the past few years. While Chinese players like Sinotruk International, Shandong Shifeng and Beiqi Foton Motor, the largest Chinese truck maker by volume, are all set to introduce their product in the Indian market in coming months.

Premier Automobile Ltd. is currently enjoying a dominant position in the market in the segment of 'Light Commercial Vehicle' which has emerged in India in 2001 and there on in a meaningful way. There is one important reason for the sound position of the company in the market that one of the major automobile group has specifically not entered in to 'Light Commercial Vehicle (3 Wheeler) segment at all.

Currently Premier Automobiles Ltd. is one of the five major companies producing Light Weight Commercial Vehicles (LCV) with 1 tone and 1.5 tone loading capacity in India. Normally the companies with wider service and distribution network enjoy the major chunk of market share. But in the present context one of the major group in automobile is away from manufacturing of three wheeler LCV in India and other three manufacturers are although reputed and widely distributed barring that, the products of Premier Automobiles Ltd are very strong and technically sound that it is currently outperforming the competition with a market share just above 60 percent. Currently Premier Automobiles Ltd has 760 dealers and service centers throughout India.

### **BACKGROUDN OF PREMIER AUTOMOBILIES LTD**

Premier Automobiles Ltd. is a 'Market Leader' in the Three Wheeler LCV segment in India. There are three vehicles manufactured by the automobile unit of the group namely Ape, Bulleto & Caliber in the above mentioned segment. All the above three products have occupied 60 % of the market share of the respective segment. At the same time individual market share of the above mentioned three products is also given below **(See Exhibit No. I )** The details relating to Share Capital, Existing Reserves & Surplus and other liabilities of the Automobile Company are also given below **(See Exhibit No. II )**

Premier Automobile Ltd. Of the VESPA Group is exceedingly performing well with the track record of year on year increased profits for last consecutive five years and most importantly the Company has successfully declared and distributed the dividend at constant rate of 20 % every year since last five years. VESPA group strongly believes in decentralization and each group company is positioned as 'Profit Centre'. Each such 'Profit Centre' is headed by CEO of the respective company who is regarded as the overall responsible for strategizing and both financial and non-financial performance of his company along with CFO who is specifically responsible for the financial performance. The hierarchy of the group starts with 'Group Chairman' at the top and CEO & CFO at the lateral level, followed by the Senior-middle level management team. **(See Exhibit No. IV)** The performance of top management of individual company is monitored by 'Group Chairman' primarily through two parameters, which are residual income and dividend distributed. The shareholders of Premier Automobiles Ltd. are very happy with the foray and the march of the company towards the financial excellence which is very evident form the rate at which they are constantly getting the dividends.

The reason for such cash-rich position of the company can be attributed to a sole reason that company is having unique products in its portfolio. The technical features and mileage of all the three vehicles is far superior than competing Brands **(See Exhibit III)**

Although the clouds of recession getting darker in Asia following series of economic ups and downs in Europe and America, CEO of Premier Automobiles Ltd. Mr. Rajan was communicated by Mr. Sudhakaran Aiyar, Group Chairman, VESPA Group that as per economic survey of 2012, there will be an increase in the light commercial vehicle segment by 20%. (Existing Market size of the same segment is 40,000Crores). This message from Group Chairman really filled in different energy and confidence among the top-middle level management of the company. But this would also clearly mean that if company fails to catch this opportunity in the recessionary times, it may end up losing investors confidence and loss of significant market valuation and market share. Mr. Rajan & Mr. Rushikesh decided that they would take this opportunity in a manner of controlled growth rather than volcano blast, which later on both of them might not be able to handle and sustain with the

increased expectations of the investors and the other stakeholders. Above situation cast their mind to their business school days of MBA that they read about corporate financial planning through corporate budgeting.

#### **CURRENT FINANCIAL POSITION, FACTS & CHALLENGES**

As a professional organization Premier Automobiles Ltd. should closely monitor its financial results, financial reports and budgets. After having a brainstorming corporate budget meeting and benchmarking of financial targets for next financial year both Mr. Rajan & Mr. Rushikesh decided to look for more closely integrated and feasible approach towards corporate budgeting as well as product level budgeting.

Mr. Rushikesh asked all its subordinates to update the business processes, minimize the manual tasks and to come out with corporate budget with the help of Industry standards and various ratios of the organisation. Current financial position could be very well be understood from the following financial information and ratios.

Premier Automobiles Ltd. Is working at 5 percent of Net Profit if compared to the Net Sales of the company. Competitive pressures are mounting and the gross margin with which company is operating is getting reduced year on year as there are acute labour problems in the present industrial scenario. There is acute shortage of skilled and unskilled industrial labour in Maharashtra (The Economic Report of Maharashtra 2010-11) The materials and production department of the company is almost 40 percent of the Net Sales. Corporate office is delivering best of they have with almost 95 percent of top-middle level management professional are working with Premier Automobiles Ltd. Since last seven years which resulted into state of art organisational environment and stringent control over administrative costs and selling & distribution overheads of the company. The cumulative impact of the two could be understood with the operating profit to sales ratio is 40 percent. Premier Automobiles Ltd. had gone for debt capital options with Debentures at 16 percent and accepted Public Deposits at the same rate. Total debt capital borrowed is 12500 crores.

Dividend Rate- 20% (Consistent since last five years)

Reserves and Surplus- 1320 Crores.

#### Important Ratios

1. Net profit to sales ratio- 5%
2. Gross Profit ratio- 60%
3. Operating Profit ratio- 40%
4. Fixed interest liability is 2000 Crores
5. Tax rate- 30%

Poor Stock Performance is the primary reason that 'Board of Directors' fire the Chief Executive Officers and other top executives of the organisations. This many times tempts CEO's and CFO's to boost the stock price through marginally adding few rupees to Earning Per Share (EPS). This is historically regarded as a mistake on their part, rather they should eye to create measurable long term value for shareholders. The same could be achieved through 'Corporate Budgeting'. As mentioned above it is the joint responsibility of Mr.Rajan (CEO) and Mr. Rushikesh (CFO) of Premier Automobiles Ltd.

In order to at least maintain existing financial performance and keeping the investors' confidence intact and maintaining the existing market valuation, the CFO of the company Mr. Rushikesh is expected to come out with financial budgeting and Individual departmental budget. (Departmental budgeting will be required for HR dept, Sales and Marketing dept, Operations and materials dept.) Everything should result in to consistent distribution of equity dividend at 20 percent for next financial year and organic growth in Reserves and surplus on year to year basis.

**Questions for Discussion.**

1. How should Mr. Rushikesh achieve the dual target of consistent dividends and organic growth in 'Reserves & Surplus'
2. Is it possible to evaluate the above case from EVA (Economic Value Added) approach.

**Exhibit I - Company Products & Individual Market Share.**

Vehicle	Cost of vehicle	Market share
Ape	2,50,000	50%
Bulleto	3,00,000	30%
Caliber	2,00,000	20%

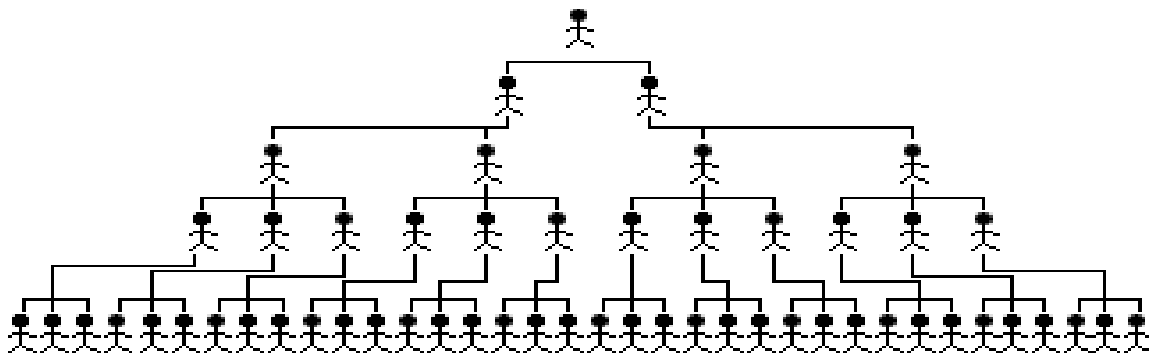
**Exhibit II- Liabilities as on 31.03.2012 (Rs. In Crores)**

LIABILITIES	Rs.
Share Capital	20,000
Reserves & Surplus	1,320
16 % Debentures	6,500
Public Deposits @ 16 % p.a.	6,000

**Exhibit III Technical Features & other highlights – A Comparison of Premier Vehicles with next ‘Best Competing Brand’**

Features & Other Highlights	Ape	Competing Brand	Bulleto	Competing Brand	Caliber	Competing Brand
Type	Single Cylinder 4 stroke	Single Cylinder 4 stroke	Single Cylinder 4 stroke	Single Cylinder 4 stroke	2 Cylinder 4 Stoke	2 Cylinder 4 Stoke
Displacement	395 cc	405 cc	395 cc	405 cc	870 cc	702 cc
Maximum Power Kw@rpm	7.38 bhp@3600 rpm	7.30 bhp @ 3500 rpm	8.0 bhp@ 3600 rpm	7.5 bhp@ 3500rpm	12.67kw @3600 rpm	16 hp@3200 rpm
Maximum Torque N.m.@rpm	16.7nm @ 2500 rpm	16.0 nm @ 2500 rpm	16.7nm @ 2500 rpm	16.0 nm @ 2500 rpm	43.5 nm	3.8mkg@2000 rpm
Compression ratio	18:1	18:1	18:1	18:1	-----	-----
Mileage	36+4	28+4	36+4	28+4	22+4	18+4
Special. Engine oil (Drain Period)	10000 km	5000 km.	10000 km	5000 km.	10000 km	10000 km
Wheel Base	2100 mm	2000 mm	2100 mm	2000 mm	1750 mm	1750 mm

**Exhibit IV Managerial Hierarchy of Premier Automobiles Ltd.**



The managerial hierarchy of Premier Automobiles Ltd is divided in four layers and it is a 'Tall Hierarchy' where Group Chairman is at top, and he is reported by CEO (Chief Executive Officer) and CFO (Chief Finance Officer). The General Manager (Manufacturing & Materials) and the General Manager (HR & Administration) reports to CEO, whereas the General Manager (Finance & Budgetary Control) and the General Manager (Marketing) reports to CFO of Premier Automobiles Ltd. Each General Manager is reported by three functional Assistant General Managers (AGM). Each Assistant General Manager is reported by Manager of the respective functional Area.