Building a strategic and profitable auto finance portfolio in India
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The Indian auto finance market is one of the most matured in the world, with penetration levels of approximately 75% and the experience of multiple cycles. With significant innovation in areas of digital underwriting, collections and customer life cycle management being driven in the market by leading OEM captives, it has the potential to become a benchmark in auto financing.

Jens Diehlmann
EY Global Automotive Finance Leader

The Indian auto finance market has seen a significant transformation. Key value drivers for the business have increasingly changed to building a more holistic relationship with both car buyers and dealers, requiring car financiers to relook at their auto business strategy.

Fali J Hodiwalla
Partner, Financial Services Advisory
Ernst and Young LLP
The Indian auto finance market – at a crossroads
The auto finance market in India has gone through peaks and troughs, ...

The auto finance market is at the cusp of a high-growth period fuelled by economic growth, innovative products, improved credit collection processes and effective use of online channels. However, over the years, it has gone through several cycles of low-growth to high-intensity competition, to shrinkage, to stabilization and now at the cusp of rapid growth again.

- **1990s**: Auto finance market takes shape in late 1990s, as liquidity in the economy and strong growth in auto sales drove NBFCs to aggressively capture market share. Banks participated mainly through on-lending to NBFCs.
- **2000s**: Opportunity in the auto sector and improvement in risk management techniques (introduction of credit bureaus) led to the emergence of banks as the leading market players (approximately 65% share) in the early 2000s. Organized players begin focusing on used vehicle and refinance. Financiers resort to aggressive selling through subventions and interest rates cuts.
- **2007-08**: The recession of 2007 led to a period of economic slowdown and NPAs shot up. This created a period of low growth and reduced competition. This was a phase of high rates and low LTVs. Liquidity crunch and rising defaults force players to reduce auto loan exposure. Several leading banks and NBFCs left the market and sold portfolios.
- **2011-14**: Post 2011, even as the economy recovered, banks were still shy to lend aggressively. This opportunity was seized by OEMs who set up their own captives, offering customized product offerings in the loan and lease segments.
- **Present**: After a period of slow growth till 2014-15, the auto finance industry has started to grow rapidly. Increased presence of fleet taxis is opening up new segments.

These ups and downs of the auto and auto financing market have helped the market mature. It is currently a well-developed financing market with 74% finance penetration, and sub-1% NPAs. This puts it in a prime position to leverage the next cycle of consumerism and lending growth in the country.

Source: EY Analysis
The Asian market offers a good opportunity for lenders and captives to penetrate further and build high-growth portfolios.

- Addition of 100 million people into middle class every year — a potential to add over a million additional new entry-level cars each year
- Current low auto finance penetration rates
- Regulations to avoid auto finance bubble – minimum down payment rule

India has a healthy portfolio LTV, at par with developed countries.

![Bubble chart showing LV sales CAGR (2015-22) and auto finance market growth.]

Size of bubble indicates LV sales in 2015 and color denotes market maturity.

### Auto finance market maturity description

1. **High**
   - These markets are characterized by strong presence of captives, operating through advanced financing and leasing products.

2. **Moderate**
   - While strong finance penetration and considerable market share of captives characterize these markets, high potential to increase adoption of advanced financing and leasing products exists.

3. **Low**
   - These markets have limited finance penetration, with automotive finance landscape primarily governed by local banks and NBFCs through standard product offerings.

### Challenges
- Lack of credit history of first-time buyers
- Debt burdens relative to individual income are 30% higher as compared with the US
- Higher rate of loan defaults in some markets

### Opportunities
- 72% Light Vehicle (LV) sales CAGR (2015–22) in India has a healthy portfolio LTV, at par with developed countries.

Source: LMCA; EY Analysis
The period from 2010 to 2015 has been one of mixed recovery. The period witnessed increased participation from NBFCs and captives, resulting in intensified competition and product innovation. While in 2007–09, OEMs were primarily focused on developing and leveraging relationships with financiers to penetrate rural markets, during 2010–15, focus moved to leveraging finance for strengthening market position while improving dealer control and profitability.

Strengthening of PV finance market is expected to be driven by growth in both—loan disbursement volume and average loan value.

Promising future for the auto finance industry
The growth will be driven on the back of:

- **3%-5%** increase per annum in ticket size of cars
- **75%** LTV growth of 2%-3% from **72%** to **75%**
- **80%** Finance penetration growth from 74% to 80%

Source: CRISIL Research, EY Analysis, Insights gained from market interactions
India is a large automotive market, expected to grow at a CAGR of 13% by value during FY15-FY26 to reach US$300b.

After facing stagnation in FY12-FY15, the country is witnessing signs of sustained recovery.

FY09-FY12: strong PV growth
Introduction of new models by incumbents, new entrants in the industry, and a supportive financing environment

FY12-FY15: volatile times
Slowdown, primarily due to a sluggish economy, high interest rates and stalled infrastructure projects

FY15 onward: recovery in sight
Strong long-term fundamentals, reforms push by the new Government, further aided by numerous new launches and higher technology adoption

The country’s growth potential is helped by the existence of a large driving population, which is expected to aid growth in vehicle penetration.

By 2020, the country’s vehicle penetration is expected to increase by 50% albeit against a low base. With the population expected to hit 1.4 billion in 2020, and large majority of the population belonging to the driving age, the country provides for one of the world’s most attractive auto markets.

Vehicle penetration, per 1,000 driving population

Source: SIAM; LMCA; EY Analysis
... the country’s strong demographic and socioeconomic fundamentals ...

The long-term fundamentals for the market remain strong as the country evolves into the fastest-growing global economy. The country offers a strong growth potential to the industry, owing to its strong consumption, large youth population, and rise of the middle class and working population. Furthermore, favorable factors of production and a strong push by Government to improve manufacturing in the country are key enablers for OEMs looking to leverage local production to serve the country’s and nearby markets.

Source: Kotak Institutional Equities Research; United Nations; Department of Economic and Social Affairs, World Bank
The country’s strong fundamentals provide significant foundation to a market that is poised to more than double its current market size by FY20.

### Strong credit infrastructure
- India’s credit infrastructure is well-developed due to increased use of credit bureaus, internal scoring models and strong collections processes leading to low NPAs in this sector.
- Gross NPA levels in the industry have significantly improved to sub-1% levels for most of the leading players, from 3%-5% seen during the 2009 crisis.

### Regulations favoring NBFCs and captives
- Regulations related to flexible lending norms such as subvention schemes and lending below base rates are stricter for banks, providing significant expansion opportunities for NBFCs and captives.
- Captives-driven subvention schemes are highly effective in the Indian market.

### Used car financing
- Used PV disbursements of INR532b accounted for 41% of total disbursements and is expected to grow 1.9 times at a CAGR of approximately 13.5% during FY15-FY20 to reach INR1,003b.
- Organized finance is expected to comprise approximately 20% of this market in FY20, up from approximately 15% in FY15.

### Product variants and new segments
- PV retail financing in India is predominantly through vanilla loan products. However, captives have started to offer innovative products and subvention schemes, including product bundling.
- These products are relatively complex to sell due to limited sales capability at the point of sale and low customer awareness. However, the related multifaceted benefits are expected to drive the sale of such products.

Source: CRISIL Research; EY Analysis; Insights gained from market discussions
However, the challenge faced by auto financiers – portfolio profitability – still remains.

Historically, auto financing has been a low-profitability business, due to intense competition, restricted pricing power and high opex costs. While the cost of funds, especially for NBFCs has been going down, the ROAs continue to operate in the 1%-1.6% ranges.

<table>
<thead>
<tr>
<th>Percentage of average advances</th>
<th>Banks</th>
<th>NBFCs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal rate of return (IRR)</td>
<td>11.0%</td>
<td>14.5%</td>
</tr>
<tr>
<td>Processing fees and other income</td>
<td>0.2%</td>
<td>0.7%</td>
</tr>
<tr>
<td>Interest expense</td>
<td>6.0%</td>
<td>9.0%</td>
</tr>
<tr>
<td>Net interest margin</td>
<td>5.2%</td>
<td>6.2%</td>
</tr>
<tr>
<td>Operating cost</td>
<td>1.8%</td>
<td>2.3%</td>
</tr>
<tr>
<td>Dealer payout</td>
<td>1.0%</td>
<td>0.8%</td>
</tr>
<tr>
<td>Credit loss</td>
<td>0.5%</td>
<td>0.8%</td>
</tr>
<tr>
<td>Profit before tax</td>
<td>2.0%</td>
<td>2.3%</td>
</tr>
<tr>
<td>Tax</td>
<td>0.6%</td>
<td>0.7%</td>
</tr>
<tr>
<td>ROA</td>
<td>1.4%</td>
<td>1.6%</td>
</tr>
</tbody>
</table>

NBFCs have higher lending rates on account of riskier profiles they lend to.

NBFCs charge higher processing fees, particularly in the used segment.

NBFCs rely on expensive market instruments, driving up cost of funds.

NBFCs have higher opex, mainly on account of door-step collections and salesforce payouts.

Riskier target segment of NBFCs lead to higher credit losses.

Control on credit loss is very critical for a reasonable ROA of a NBFC.

The low ROAs on the auto finance portfolio have led to the withdrawal of several leading retail focused banks from the market, creating the opportunity for new players to come in.

Source: Annual reports; Analyst reports; EY Analysis
Emergence of captives
New kids on the block
The captives have emerged as key contenders in the Indian automotive finance landscape.

75%-80%
Finance penetration of foreign OEMs with captives has been higher than the rest of the market, primarily driven by innovative campaigns.

While multiple financiers exist in the market, the top 10 players account for approximately 80% of the new PV financing market.

1 The top three private sector banks dominate the market due to their wide customer base, competitive rates, customer service and cross-selling supported by aggressive marketing and wholesale financing tie-ups with dealers.

2 PSU banks have been losing market share, primarily due to relatively passive strategies in the face of increasing competition from NBFCs and captives, and tight credit environment. These banks predominantly compete on competitive pricing and low service costs.

3 NBFCs and captives have primarily leveraged non-metro and rural customer base to increase market share. While NBFCs have focused on high-risk customers, captives have looked to offer subvention-linked innovative products.

Source: Company annual reports, India Ratings and Research reports, EY analysis
Most foreign OEMs have adopted the captive route to improve finance penetration.

The financing approach of OEMs in India exhibits three major strategic approaches as depicted in the chart below.

**Foreign OEMs with captive financing setups**

These companies have leveraged captives to promote sales through differentiated financing products. Further, they have actively supported dealer funding requirements and enhanced dealer relationships.

**Financing through tie-ups: banks and NBFCs**

These companies offer standardized product offerings and primarily rely on cash discounts to increase sales momentum.

**Indian OEMs with captive financing setups**

While these companies offer a combination of standard and customized products, they have a low finance penetration due to higher focus in rural segments.

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Source: Company annual reports, India Ratings and Research reports, EY analysis
Captives have been successful as they added value to the entire ecosystem – OEM, dealers and customers, ...

Captives are playing a pivotal role across the customer and vehicle life cycle with an overarching objective to drive profitability based on higher sales and brand enhancement. Over the year, captive finance units have been able to drive multiple agendas for OEMs, such as enabling growth in dealer profitability, improving customer engagement and reducing the dependence on other financing channels.

Captives’ success in the retail market has been primarily driven by their potential to offer differentiated and innovative financing schemes with effective customization. Furthermore, captives provide lucrative dealer financing schemes with interest-free periods and subventions to aid inventory funding and drive dealer profitability.

### Key stakeholders

- **Customer engagement**
  - Ability to develop a customer database, use analytics and leverage for resell and cross-sell
  - Potential to improve customer relationship by offering “one stop solution” through bundled products
  - Ability to independently conduct creative marketing campaigns

- **Dependency on existing financing channels**
  - Ability to bridge existing credit gaps and increase sales

- **Dealer profitability and control**
  - Potential to offer differentiated finance schemes with subventions to increase sales in urban areas
  - Potential to improve dealer relationship and control by providing inventory and other fund requirement

### Objective of captive

- Potential to offer differentiated finance schemes with subventions to increase sales in urban areas
- Offer product, customer segment and geography-specific schemes
- Potential to enhance residual and resale value and increase used car sales
- Improved profitability due to incremental sales and increased in-house finance penetration
- Potential to improve aftersales revenue by offering bundled products
- Potential to improve customer loyalty
- Opportunity to improve customer loyalty

### Car life cycle

- **Pre-sales**
- **Sale**
- **Post-sale**
- **Repurchase**

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Source: EY analysis
Differentiated products and subvention-based schemes have provided a strong opportunity for captives to garner market share, as they enhance the overall value proposition for the customer.

Approximately 80% of customers would consider buying a car higher than their budget, if attractive financing schemes are available.

58% of dealers believe differentiated finance products can lead to a more than 10% increase in sales.

However, the market is witnessing a growing trend where OEMs with captives are able to provide alternative financing products including leasing, step-up or step-down, and bullet or balloon payments. These products have enabled captives to attract the premium customer segments and enhance overall customer value proposition.

Meanwhile, banks are offering high LTVs and longer loan repayment tenures to customers, leveraging their large customer bases while also waiving processing or foreclosure fee in order to stay competitive in a market where regulations limit their ability to customize financing products.

Vanilla loans continue to dominate the Indian market landscape with approximately 95% market share, as their ease of availability and simple structure attracts majority of customers, while alternative financing products have had low popularity due to multiple challenges:

1. Complexity to sell due to sales capability at the point of sale
2. Customers’ fear of being duped
3. Low customer awareness

Captives have also leveraged the dealer channel well to drive their growth

Dealer networks and direct channels (through branch walk-ins) are critical to drive new PV sales.

DSAs have lost importance except in select semi-urban and rural areas.

Source: Market Research Survey; EY Analysis; Insights gained from market discussions

Building a strategic and profitable auto finance portfolio in India
While it’s a high-growth market, the restricted profitability on the book, even during good credit cycles, is not driving enough banking and NBFC focus on this segment. In this section, we look at a few key drivers to the auto financing strategy, which can significantly enhance the portfolio profitability, even making it the most lucrative product on a retail financier’s book.
Choose the right segments and target them with the right customer value propositions.

The Indian market is witnessing new segments emerge with rise in level of income across tiers and strata. The rise of consumerism and the onset of the digital age have fuelled the aspirations and requirements of the millennials, which auto financiers need to gear up to meet. Hence it is critical for any financier to identify and target their segments and geographies well, and thereon build customized value propositions. Financiers would need new operating models to reach out to customers and establish credit worthiness to make the most of the opportunity. It must be noted that the customers today will benchmark the players to their best e-commerce app and not the best bank.

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<th>Rapid-growth segments</th>
<th>Segment characteristics</th>
<th>Segment’s financing needs</th>
<th>A financier’s value proposition</th>
</tr>
</thead>
<tbody>
<tr>
<td>First-time buyers</td>
<td>Growth in youth population, favorable income and rising aspirations are fuelling rapid increase of first-time buyers.</td>
<td>Need for affordable financing options with high LTVs and a great customer experience</td>
<td>Engaging early in life cycle through affordable financing – subventions and high LTV schemes</td>
</tr>
<tr>
<td>Fleet and taxi segment</td>
<td>Fleet and taxi segment accounts for approximately 10% of the Indian PV sales. The emergence of high-growth taxi aggregator platforms is expected to further drive the segment’s volume, as more drivers look to own cars to integrate with these platforms.</td>
<td>Need for affordable financing with high LTVs, longer tenures, flexible documentation and income surrogates</td>
<td>Repayment flexibility, bundled maintenance, high LTVs, long tenure schemes backed by risk-based pricing</td>
</tr>
<tr>
<td>Self-employed</td>
<td>A fast-growing segment which continues to be the key target for NBFCs, and generally facing the issue of unavailability of traditional income proofs, this segment is a driver of growth and profitability for NBFCs.</td>
<td>Fast turnarounds, need for financing options relying on surrogates for income and with ease of documentation</td>
<td>Bundled schemes backed by risk-based pricing and with used car, top-up or refinance options</td>
</tr>
</tbody>
</table>

**Opportunity to benefit from the increased disposable income of the semi-urban, rural and aggregator taxi segment**

70% of the compact car owners are under 35 years of age.

36% of the premium cars owners have bought their cars exchanging their old ones.

Source: Market Research survey; EY Analysis
Leverage used car financing – to reduce product life cycle, drive new car sales, enhance brand value and improve yields.

Used car financing offers multiple benefits for OEMs and dealers

01 New source of profit and high yield: Used car sales, supported by attractive financing, acts as an additional source of profit for the dealer. Furthermore, its high yield helps drive the profitability for the financier.

02 Product lifecycle: Used car financing schemes can enable buyback options making it easier for customers to change vehicles frequently, driving down the average age of a product.

03 Brand and residual value: Easier buyback and existence of OEM’s warranty, driven by the financing schemes, help drive growth in the residual value. This further helps establish strong brand identity.

04 New car sales: Buyback schemes and reduced product life cycle will drive new car sales at the dealership.

Imperative: Offer buyback guarantee before the end of the product life cycle to achieve higher residual value.

Certified inventory of used cars supported by attractive financing options enables building of brand and residual value, while providing a new source of profitability with high yield. Furthermore, attractive buyback schemes help reduce the product life cycle as customers find it easier to graduate to better models, thereby further driving new car sales.

Approximately 40% of customers change cars within four to six years, followed by approximately 30%, who do so in two to four years.

Approximately 40% of the used car buyers are below 30 years of age.

Source: Market Research survey; EY Analysis
Refinance existing customers, cross-sell and bundle.

Auto finance can provide a base of asset-tested customers who can be cross-sold a multitude of financial products. The options include:

1. Refinancing of existing auto loans
2. Higher risk auto finance product variants such as high tenor, high LTV, balloon, interest only and step-up
3. Bundling of automotive accessories, services warranties and insurance
4. Unsecured loans based upon repayment performance on existing loan

2.5% ROA of a leading NBFC, that started out as auto finance captive and was able to diversify into unsecured lending and other adjacent business lines, using the captive asset-tested customer base.

Source: Company annual report; EY Analysis
Innovate dealer financing to drive retail volumes by leveraging the wholesale-retail linkage.

Dealers are a key part of the auto finance value chain and one of the most important levers for driving growth by helping them overcome their financial challenges. Dealers’ financial needs are focused around multiple aspects such as capex funding to expand their business, working capital to sustain operations and inventory funding. Lenders need to play a significant role in ensuring support to dealers by providing flexibility in their offerings.

Driving incremental sales...

...through captives’ customized products enables cross and up selling of the products. Attractive financing also helps with the sales of slow moving model inventory.

Furthermore, captives’ product bundling can drive dealers to secure additional revenues through participation in aftermarket.

The lenders are well-positioned to develop and maintain an exhaustive customer database, enabling dealers in lead generation.

Driving down dealer costs, while providing business support

Captives’ inventory funding schemes, backed by flexibilities such as credit-free periods, staggered payments and case-specific relaxation of penal interest charges help drive down dealer costs, especially against cyclical demand.

Furthermore, captives provide capex support through term loans, while also financing current assets including part purchases, receivables etc. through working capital limit.

Imperative

Inventory funding is over 70% of a typical dealer’s funding requirement, making it the focal point of captive-dealer relationship.

Source: Market research survey; EY Analysis
While leasing companies have been present in India for a couple of decades, the market has remained limited owing to both supply-side limitations and demand dynamics. The leasing market has been largely dominated by Indian subsidiaries of global leasing companies, with Indian leasing companies and captives gaining market share in recent years.

Captives can leverage the existing OEM-dealer relationships to offer a better value proposition, better service quality and, importantly, manage the residual value risk better thus leading to a gain in market share. Leasing is prevalent in car price segments of more than INR500,000 in mid-size, UV and luxury car segment. While the total cars under leasing are at approximately 70,000, the current leasing penetration of corporate sales is minimal at approximately 10%.

Competitive positioning

Indian captives primarily cater to individual customers of luxury and premium vehicles. This segment is mostly ignored by other leasing companies owing to high risk perception of customers. Furthermore, there is a need for high sales and education efforts to drive the segment.

Majority of leasing companies in India focus on the corporate segment, due to low-risk customers, existing product awareness and tax benefits to customers. While being the most attractive, high intensity of competition exists in the segment.

An attractive segment but will take time to realize benefits

Can be an immediate focus segment – leverage existing corporate relationships

Key drivers for auto leasing in India

1. Growing passenger vehicle market with widening product portfolio, increasing sales of luxury cars and geographic penetration

2. Increased disposable income and aspirations, leading to increased vehicle replacement trends

3. Corporates increasingly looking for better expense management, helped by tax leverage; impending arrival of GST regulations

4. Increasing awareness of tax benefits in corporate employees, opening up new customer segments owing to entry of cab aggregators into leasing business to grow fleet sales

INR1m

Average leasing ticket size as compared with average PV loan disbursement of INR380,000

10%-15%

Projected growth in PV leasing till FY20

10%-15%

Net benefit to customers of lease over loans and expected to increase post GST implementation

Source: EY analysis; CRISIL, Leasing co. Annual reports, Market interviews
Deploy templatized and micro market model-based application scorecards to drive risk-based pricing.

There exist multiple challenges in the credit underwriting process, which if addressed well, can drive significant value creation for lenders. Customers are faced with a need to undertake multiple dealer visits for provision of documents and experience delay in car purchase due to high turnaround time. There is a strong need to improve TATs through instant decisioning. Financiers also need to accommodate the lack of documented income especially for self-employed customer segments and monitor regional variations in credit behavior, building these back into their profiling and pricing frameworks.

**Templatized underwriting process and “expert judgment” scorecards**
Lenders should enable template-driven underwriting through expert judgment-based scorecards that classify customers into score bands, which can then define the loan amount multiples, LTVs, documentation and pricing.

<table>
<thead>
<tr>
<th>Why is it needed?</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Templatization enables better TATs and customer experience.</td>
</tr>
<tr>
<td>2. Bureau credit scores in India are not yet as predictive as global scoring models.</td>
</tr>
<tr>
<td>3. Income disclosures are relatively low, especially in case of self-employed customer segments.</td>
</tr>
</tbody>
</table>

**Micro market attractiveness models**
Lenders can develop a micro market attractiveness index using demographic, socioeconomic, catchment and portfolio performance data.

<table>
<thead>
<tr>
<th>Why is it needed?</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. These models are critical to account for the regional variances in consumer credit behaviour in India.</td>
</tr>
<tr>
<td>2. They can help leverage portfolio performance and other micromarket data to underwrite risk appropriately.</td>
</tr>
</tbody>
</table>

**Risk-based pricing**
Interest rate – one of the most critical success criteria for a auto finance lender – can be easily determined through risk-based pricing, facilitating better overall portfolio profitability.

<table>
<thead>
<tr>
<th>Why is it needed?</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. More creditworthy customers can be sourced by offering lower pricing.</td>
</tr>
<tr>
<td>2. Appropriate risk pricing can help retain the “not-so-good” customers.</td>
</tr>
</tbody>
</table>

Source: EY Analysis
Auto finance is central to the car buying process and, with automakers’ heightened focus on minimizing the time spent in the car buying process, the need for efficient and hassle-free auto finance approvals become pertinent. Since the approval and disbursement process is core to the auto finance value chain, getting it right can ensure that the customer is delighted and becomes a source of long-term value.

Financiers need to focus on leveraging digital and analytical tools to reduce the complexity of loan approval and documentation. Market leaders have attained that position today by providing 30-minute approvals at the dealership.

Create a best-in-class customer experience by enabling instant approvals.

<table>
<thead>
<tr>
<th>Application</th>
<th>Underwriting</th>
<th>Disbursement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Awareness or knowledge</strong></td>
<td><strong>Select and apply</strong></td>
<td><strong>Loan processing (soft approval)</strong></td>
</tr>
<tr>
<td>1.1 Customer is informed about auto finance product by the DSE*.</td>
<td>2.1 Customer provides basic information for pre-qualification.</td>
<td>3.1 Hygiene checks are performed at the bank processing unit.</td>
</tr>
<tr>
<td>Customer receives targeted marketing offers for auto loan products.</td>
<td>2.2 DSE suggests financing product or provider as per customer profile.</td>
<td>3.2 Basic eligibility criteria are verified (e.g., income, CIBIL, de-dupe, ITR checks) and sample RCU.</td>
</tr>
<tr>
<td>Customer visits the financier’s branch, website or mobile banking app to obtain information.</td>
<td>2.3 Customer provides initial documentation to the DSE.</td>
<td>3.3 Soft approval communicated to dealers and customers.</td>
</tr>
<tr>
<td>Customer compares financier products through TPT websites.</td>
<td>2.4 FE* logs in the customer application and uploads scanned copy.</td>
<td>3.4 Customer decides to proceed or refer alternative financiers for better offer.</td>
</tr>
<tr>
<td></td>
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</tbody>
</table>

Customer receives pre-approved loan offer basis existing relationship with financier.

Dealer is given a portal access integrated with the financier’s systems.

Customer tracks application status through net banking or phone banking.

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57% of the surveyed dealers recommend financing on the basis of the customer profile and TAT of loan processing.

Source: EY Analysis; Market interviews
While leveraging a right mix of short-term and long-term funds to drive down the costs of funding, lenders also need to strategically leverage parent credit ratings and support (where relevant) to gain access to cheaper funds.

**Sources of funds**
Include CPs and NCDs by driving toward profitability in the first two years. Alternatively, depending on pricing and availability, ICLs and rupee-denominated bonds can also be considered.

**Parent support**
Letter of comfort, corporate guarantee from global parents (where relevant) can improve credit rating and has a positive impact on borrowing costs.

**Asset liability management (ALM)**
Approximately 20%-50% of outstanding book is typically short-term in nature. Most entities have an ALM mismatch in the initial years; diverse funding sources available in the later years reduce the ALM mismatch.

**Rating and security**
Issuing NCDs requires a minimum credit rating of “A2” and issuing CPs requires a credit rating of “A3.” Furthermore, all NCDs, including short-term NCDs, should be fully secured.

**Cost of funds**
While the equity component varies, the cost of funds ranges between 8.5%-11% for majority of finance companies.

**CPs and NCDs**
CPs and NCDs require captives to enter into credit rating exercise early in their life cycle to reduce the cost of borrowing. Audited financial statements are required for borrowing from these instruments.

**Base rate of foreign banks**
Base rate of foreign banks is lower than private sector banks by 0.5%-0.75%. CPs and NCDs are cheaper by close to 0.5%-0.75% than short-term and long-term bank borrowing respectively.

**Initial focus on dealer financing**
Initial focus on dealer financing can help ensure that short-term borrowings and CPs are able to meet the requirements, keeping cost of funds low.

**Parent support compensates**
Parent support compensates for lack of track records and can help save close to 50-100 bps.

**Lenders need strong ALM**
Lenders need strong ALM to mitigate liquidity and interest rate risk in the initial years, especially through CPs.

Source: EY analysis
The historically low-ROA auto financing business can drive ROA improvements with the help of several peripheral revenue and cost drivers, making it a highly risk-free yet profitable and therefore attractive business line in a retail portfolio.

An illustrative example for NBFCs

<table>
<thead>
<tr>
<th>Percentage of average advances</th>
<th>NBFC conventional</th>
<th>NBFC transformed</th>
</tr>
</thead>
<tbody>
<tr>
<td>IRR</td>
<td>14.5%</td>
<td>15.4%</td>
</tr>
<tr>
<td>Processing fees and other income</td>
<td>0.7%</td>
<td>0.8%</td>
</tr>
<tr>
<td>Interest expense</td>
<td>9.0%</td>
<td>8.8%</td>
</tr>
<tr>
<td>Net interest margin</td>
<td>6.2%</td>
<td>7.4%</td>
</tr>
<tr>
<td>Operating cost</td>
<td>2.3%</td>
<td>2.0%</td>
</tr>
<tr>
<td>Dealer payout</td>
<td>0.8%</td>
<td>0.6%</td>
</tr>
<tr>
<td>Credit loss</td>
<td>0.8%</td>
<td>0.7%</td>
</tr>
<tr>
<td>Profit before tax</td>
<td>2.3%</td>
<td>4.2%</td>
</tr>
<tr>
<td>Tax</td>
<td>0.7%</td>
<td>1.3%</td>
</tr>
<tr>
<td>ROA</td>
<td>1.6%</td>
<td>2.9%</td>
</tr>
</tbody>
</table>

Increased share of used car, rural and taxi segment, refinance and top-up loans
Through bundled product offerings
Optimal funding strategy
Reduced sales support cost through digital, enhanced productivity through Trade advance, enhanced scale through refinance or top-up
Increased direct sales through cross-sell and digital
Enhanced application scorecards, predictive analytics and larger share of cross-sell
Fully leveraging the improvement initiatives can significantly enhance the ROA

Therefore, it is imperative that NBFCs and banks look at auto financing as an anchor product on their portfolios and build scale, through the right OEM partnerships.

Source: EY Analysis
Our Global Automotive Center brings together 13,855 professionals around the globe to help clients achieve their potential – a team with technical experience in providing assurance, tax, transaction and advisory services.

EY’s areas of concentration touch all sub-sectors of the industry, including light vehicle manufacturers, component suppliers – original equipment and aftermarket, CV manufacturers, retailers and dealers, electric vehicle or advanced mobility, and automotive finance.

How EY can help

How EY can help you in automotive?

<table>
<thead>
<tr>
<th>What we deliver</th>
<th>What we deliver</th>
<th>Transaction Advisory Services (TAS)</th>
<th>Assurance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Advisory</strong></td>
<td><strong>Tax</strong></td>
<td><strong>Capital Transformation</strong></td>
<td><strong>Accounting Compliance and Reporting</strong></td>
</tr>
<tr>
<td>Performance Improvement</td>
<td>Business Tax Services</td>
<td>Transaction Support</td>
<td>Climate Change and Sustainability Services</td>
</tr>
<tr>
<td>Risk</td>
<td>Global Compliance and Reporting</td>
<td>Transaction Tax</td>
<td>External Audit Services</td>
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<tr>
<td>Technology</td>
<td>Human Capital</td>
<td></td>
<td>Financial Accounting Advisory Services</td>
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<tr>
<td>Retail Advisory</td>
<td>Indirect Tax</td>
<td></td>
<td>Fraud Investigation and Dispute Services</td>
</tr>
<tr>
<td>Dealer Operations</td>
<td>International Tax Services</td>
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<tr>
<td>Dealer Risk Management</td>
<td>Law</td>
<td></td>
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<tr>
<td>Dealer Performance</td>
<td>Transaction tax</td>
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<tr>
<td>Financial Advisory</td>
<td></td>
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<td></td>
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<tr>
<td>People and Organizational Change</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Dealer System, Process Integration</td>
<td></td>
<td></td>
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<tr>
<td>Mobility Strategy</td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

What we deliver

- Higher margin
- Higher customer loyalty
- Sustainable results
EY contacts

Randall J. Miller  
EY Global Automotive and Transportation Leader  
+1 313 628 8642  
randall.miller@ey.com

Rakesh Batra  
Partner and India Automotive Sector Leader, Ernst and Young LLP  
+91 124 671 4532  
rakesh.batra@in.ey.com

Jens Diehlmann  
EY Global Automotive Finance Leader  
+49 6196 996 24797  
jens.diehlmann@de.ey.com

Fali J Hodiwalla  
Partner, Financial Services Advisory Ernst and Young LLP  
+91 98201 39302  
fali.hodiwalla@in.ey.com

Regan Grant  
EY Global Automotive and Transportation Marketing Leader  
+1 313 628 8974  
regan.grant@ey.com

Som Kapoor  
India Automotive Retail Leader Ernst and Young LLP  
+91 98100 24855  
som.kapoor@in.ey.com

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EY contacts

About EY
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