Performance of automakers in China and India: an empirical investigation using ratio analysis

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Abstract
Automakers in China and India are continually increasing their shares of the automobile market by adopting cost leadership strategy. In this study, we examine the operational and financial performance of automobile firms in China and India through a range of accounting ratios. This analysis provides a snapshot of operating and financial performance of Chinese automakers in comparison to one of their main competitors, India. The results of the analysis suggest that despite the public view that Indian automakers are posing serious challenge to Chinese automaker in recent years on the cost competitiveness, Chinese automakers have shown continuous improvement in their performance and out-performed Indian automakers in operational areas. This study identifies some critical factors that Indian automobile manufactures need to pay attention to improve their performance and compete with other automakers who have adopted similar business strategy.

Keywords
investigation, ratio, performance, analysis, india, china, automakers, empirical

Disciplines
Business

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Performance of Automakers in China and India: An Empirical Investigation using Ratio Analysis

Ying Deng*, Anura De Zoysa and Shyam Bhati

Automakers in China and India are continually increasing their shares of the automobile market by adopting cost leadership strategy. In this study, we examine the operational and financial performance of automobile firms in China and India through a range of accounting ratios. This analysis provides a snapshot of operating and financial performance of Chinese automakers in comparison to one of their main competitors, India. The results of the analysis suggest that despite the public view that Indian automakers are posing serious challenge to Chinese automaker in recent years on the cost competitiveness, Chinese automakers have shown continuous improvement in their performance and out-performed Indian automakers in operational areas. This study identifies some critical factors that Indian automobile manufacturers need to pay attention to improve their performance and compete with other automakers who have adopted similar business strategy.

JEL Codes: M40 and M41c

1. Introduction

The landscape in the world auto industry has changed significantly over the last decade with the rapid expansion of this industry in emerging markets such as Korea, China and India on the back of government incentives and cost leadership strategy. As a result, many leading automakers in developed markets have relocated their production facilities to emerging markets with a view to reduce their production cost and to be cost competitive (Mahidhar et al. 2009). Not surprisingly, with huge demand for automobiles from the growing middle class and massive government support, China has become a major manufacturer of automobiles among the emerging markets in the last decade. The number of units produced by Chinese automakers has increased from 2 million units in late 1990s to 9.5 million units in 2008. With this rapid development, Chinese automobile industry is now considered as the fastest growing automobile industry in the world (Tang, 2009). It is believed that product diversification and low-cost manufacturing base in China have made Chinese automakers competitive in the global market (Haas 1987; Dent 1996; Chery 2013). Another country that has expanded its auto industry in the last decade is India. Along with China, it is pursuing a cost leadership strategy which is aimed to become as cost competitive as other emerging automakers, including Chinese automakers (Tang 2009). In recent years, India has become the formidable adversary to China as both being an auto manufacturer and a location for production in the Asian region. The fact that India’s annual production volume for automobiles has increased from 0.9 million units in 2002 to 2.3 million units in 2008 is a clear indication of the rapid expansion of this industry in India (Tang, 2009). As per the latest Industry performance report, the number of vehicles produced by Indian auto manufactures from 2011 to 2012 exceeded over 20 million units, showing an impressive annual sales growth rate of over 10% (Industry statistics 2013).

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Given the rapid development of an Auto Industry in both China and India in recent years, it is interesting to know how the major automakers in these two countries have performed in terms of managing their operating costs and assets in their quest to outperform competitors and to increase their market share. Therefore, the main objective of this paper is to examine the performance of the top automakers in China and India with a view to identify the emerging trends in the cost and assets management of the automakers of these two countries. The remainder of the paper is organized as follows. Section 2 provides an overview of the relevant literature with regards to the background of Chinese and Indian production conditions. This is followed by Sections 3 and 4 that describe the research design and the study’s findings respectively. Section 5 provides a summary and conclusions.

2. Background

Existing manufacturing literature acknowledges that the global differences must be addressed in order to understand the changing global strategy climate especially with reference to the Asia Pacific region (Olds 1999). There is limited literature on the global differences in automobile manufacturing and how such differences of automobile firms influence technology, operational performance and cost performance. Many variables are influential due to the global differences, such as downtime, materials costs, scrap rates etc. These variables often reflect the changes when production line switches from one country to another. This highlights the importance of the emerging markets and the Asian countries where serious attempts have been made to attract the developed nation to outsource their production lines to their regions on the ground of cost effectiveness. However, different countries have varied production characteristics, production costs and target markets. The comparative studies are necessary to examine and compare the production conditions and evaluate the differences of cost levels and operational performance across countries. There has been empirical evidence on such comparative studies in various industries. For instance, the comparative study conducted for the investigation on mobility in the American and Japanese industry (Cole 1980); examines the quality practices for the United States of America (the U.S.A), China and India (Raghunathan et al. 1997). Another study examines the cross-sectional comparative study of new product development processes in Japan and the U.S.A (Song and Parry 1997). However, the comparative studies on cost performance of automobile industry are limited. This provides the background for this study which compares the status of Chinese automobile industry with that of India.

The Chinese automakers have experienced large-scale and low-cost production and increasing advanced technology is being used for manufacturing. As widely known, the Chinese automobile industry is heavily influenced by the government policies and institutional structures (Harwit 1995). In 2009, on the strength of government stimulus measures, China had overtaken the United States to become the world’s top auto maker and market (Liu 2010). India has also taken a similar path in developing its automobile industry. As in the case of China, heavy influence from government policies, structural change, foreign investments and technology has changed the competition of the automobile industry in India (Dangayach and Deshmukh 2001; Upadhayay and Kanavi 1999). India is the fourth largest car market.
in Asia and provide great amount of cost saving in labour compared to the auto
giants such as the U.S., Japan, and Germany (ACMA 2006-2007).

The automakers in China and India have both been through significant
transformation and modernisation over the years. Prior to the production of first
vehicle, the Chinese car market mainly relied on the imported vehicles. In 1949, the
construction policy of Communist Chinese Government accelerated the need for
homemade vehicles in order to revive the economy laggard by the transportation of
resources required for agricultural development (Harwit 1995). Since 1970s, the
Chinese auto makers started to rationalize and modernize the production process
and equipment. Efficiency became the major criterion to assess the performance of
auto producers (Zhao and Xiong 1981). The realization of effective production and
need for developed technology to advance the auto industry lead to the growth of the
car manufacturing in China (Harwit 1995). However, during 1990s, the mass
production strategy was criticized by Zhou (1989 cited in Harwit 1995) on the ground
that the large -scale manufacturing have created inefficiencies in the local industry.
Post 2000, the local automakers are facing new challenges due to increasing
manufacturing costs.

The local automobile industry in India was established in 1940s with the production
of the Morris Model (Lee and Anderson 2006). In the 1960s, there were 800 Maruti
cars produced by the joint venture between Japan’s Suzuki and Indian carmaker
Maruti (Basu 2003). According to Choudhury (2006), Premier automobile Ltd in India,
with the increased production capacity gained from its joint venture with Fiat, now
has the capacity to produce 60,000 cars a year. According to industry sources, in
2005 approximately 208 million people in India could afford a new car with a value
between $2,500 and $5,000 and this number is predicted to be doubled to 439
million households in 2020, suggesting huge growth potential for Indian automobile
automakers in the next decade (Mayer and Pleines 2008).

However, the automakers in both countries are now facing many challenges. Many
economists have doubted that the manufacturing industry in China could maintain its
cost competitiveness with the soaring Chinese wages (The economist 2012). Indian
auto industry also faces similar challenges. As argued by Dangayach and
Deshmukn (2001), India will face a tough competition in terms of reduced cost,
 Improved quality, products with higher performance, and a wider range of products
and better service. Given the business environment in both countries, in which
production costs and competition are increasing, it interesting to see how
automakers in China and India are performing to achieve their operational and
financial objectives.

3. Research Design

In order to achieve the objectives of this study, performance of major automakers in
India and China are assessed using a number of accounting ratios. The data for this
study was obtained from Bureau Van Dijk’s OSIRIS database (OSIRIS) which
provides the financial information on automakers under industry categories based on
the classification provided by the Global Industry Classification Standard. All 4 Indian
automobile automakers listed on this database and the top four largest automakers
in China, measured in terms of the amount of sales formed the sample for this study. Accordingly, the data used in the study consisted of financial data of 8 public companies, four from each country, for the period 2007–2012.

This study employed a financial ratio analysis to conduct the research as it is considered an important tool for performance of automakers with previous years as well as with other automakers in the same industry (Chen and Shimerda 1981). Many studies have used financial ratios to investigate efficiency and effectiveness of firm’s business operations. For example, D’souza and Megginson (1999) used financial ratios to compare companies’ performance at the stage of the pre- and post-privatization from 1990 to 1996. Altman (1968) also used financial ratios in combination with discriminant statistical method to investigate the bankruptcy prediction of firms.

In this study, financial ratios are used to investigate four main areas of company performance—profitability, inventory management, liquidity and solvency. More specifically, return on assets (ROA), profit margin ratio (PM), asset turnover ratio (AT) and expenses to sales ratios are used to evaluate the profitability of automakers while the stock turnover ratio (ST) is used for assessing the efficiency with inventory management. The liquidity position of the automakers is assessed using the current ratio (CR) while the level of solvency is assessed using gearing ratio. Although all ratios are calculated separately for all four automakers in each country, the analysis presented in this paper is based on the overall average ratio calculated for each country. When calculating this overall average ratio, individual ratios are weighted by the sales mix to arrive at a more realistic annual average ratio for each country.

4. Results and Analysis

The ratios calculated for each country in relation to profitability, inventory management, liquidity and solvency of automakers are shown in the Appendix. The following sections will provide an analysis on the comparison of the performance of Chinese and Indian automakers in these four areas.

Profitability

The profitability of automakers is measured in terms of return on assets (ROA), which is a ratio of total earnings to total assets. Basically, ROA indicates how much income each dollar of assets generates. Figure 1 below shows the ROA for both the Chinese and Indian automakers over the period from 2007 to 2012.
As shown in Figure 1 above, the profitability of Chinese automakers have increased from 6.5% in 2007 to 11.8% in 2012. This shows that overall profitability of these automakers have increased 80% over this period. By contrast, the profitability of Indian automakers has declined from 14.2% in 2007 to 8.1% in 2012, showing almost 60% decrease in profitability over this period. The above graph also shows that China had a profitability slump in 2008 which resulted in its profitability dropping from 6.5% to 3.2% while India also had a profitability slump in 2009 which resulted in its profitability to drop from 11.9% in 2008 to 1.6% in 2009. This abnormal decrease in profitability in 2008-09 periods may have been due to the economic impact of GFC. In order to identify the possible reasons for the significant change in the pattern of profitability in two countries, the profitability of automakers in each country is further analysed using DuPont analysis which disaggregates the ROA ratio into profit margin (PM) and asset turnover ratios (AT). DuPont analysis “recognises the two basic ingredients in profit-making: increasing income for dollar of revenues and using assets to generate more revenues” (Horngren, 2006, p.794). For this purpose, profit margin (%) is calculated from the operating profit or loss before income taxes divided by operating revenues whilst asset turnover ratio is calculated dividing the operating revenue by total assets. The PM and AT of Chinese and Indian automakers for the 2007-12 period are shown in Figure 2 below.

An examination of the trends in PM and AT shown in Figure 2 above provides some explanations as to why profitability gap between the two countries is widening. First, the trends of AT shows that since 2009 there have been an increasing gap between the two countries in relation to the use of assets to generate income. While the Chinese automakers have increased the efficiency with which assets are used to generate income by about 30% over this period, Indian automakers were unable to generate any additional income from their assets. This increased efficiency with assets utilization by Chinese automakers has partly contributed to their increased profitability. Second, the trends of PM shows that over the period from 2007 to 2012, Chinese automakers have steadily increased their profit margin from 6.5% in 2007 to 8.9% in 2012 while the Indian automakers have dropped their profit margin from 12.6% in 2007 to 7.2% in 2012. From this result, it is clear that the increased profitability of Chinese automakers is largely due to the increase in their PM and AT ratios. On the contrary, the decline in profitability of Indian automakers is due to the continuous drop of their PM ratio. Considering the fact that the PM gap between the two
countries has widened considerably, the following section further analyses the PM ratio with a view to identify the factors that contribute to this trend between two countries.

Cost of Goods Sold to sales ratio (COGS ratio) gives picture of how well the firms manage the manufacturing costs in relation to sales. Obviously, automakers prefer to have the lowest possible COGS ratio as it provides them a higher gross profit margin to recover all other costs and to contribute to their profit. The increase in this ratio may be due to the increase in sales prices or decrease in manufacturing costs as a result of efficiencies with costs of materials, direct labour and overhead costs. The trends of GP ratio and the COGS ratio of the two countries are depicted in Figure 3 below.

![Figure 3: Gross Profit Margin and COGS](image)

The trends of the GP ratio and the COGS ratio in Figure 3 show a surprising result. Contrary to the expectation that Chinese automakers have a higher GP ratio and lower cost of sales due to their higher profit margin, the result show that the cost of sales of Chinese automakers are considerably higher than that of Indian automakers resulting a much lower GP ratio in comparison to that of Indian companies. As depicted in Figure 3, the cost of sales of Chinese automakers is 9% higher than that of Indian automakers in 2007 and by 2012 this gap has widened to almost 12 percent. This indicates that the low profitability of Indian automakers is not due to their manufacturing costs management but due to their poor management of other expenses, including operating costs and non-financial costs. The analysis of the costs of items adjusted to gross profit to arrive at net profit used for PM calculation shows a massive gap between the two countries in relation to these cost items. More specifically, the ratio of other expenses to sales in Chinese automakers has reduced from about 12% to 9% in the period from 2007 to 2012, indicating about 25% drop in these costs. In contrast, the costs of these items for Indian automakers have increased from about 15 percent in 2007 to 23% in 2012, showing about 51% increase over this period. To analyse this aspect further, the operating costs and the other non-operating costs to sales ratios are calculated for the period 2007-12 and the results of this analysis is shown in Figure 4 below.

As shown in Figure 4, the operating costs to sales ratio of Chinese automakers steady decreased from 13% in 2007 to 11% in 2012 with an annual average cost of
12%. In contrast, operating costs to sales ratio of Indian automakers have changed from 21% in 2007 to 20% in 2012. For some reason, the operating costs in 2009 jumped to abnormally high level at 28%. The average operating cost of Indian automakers in this period, excluding cost in 2009, was about 21% which is about 9% higher than that of Chinese companies. This higher level of operating costs of Indian automakers seems to have had a significant impact on the low profitability of Indian companies.

![Operating Costs to Sales and Other non-Operating/Financial Costs](image)

**Figure 4: Operating Costs to Sales and Other non-Operating/Financial Items**

The other non-operating/financial items include the total amount of unusual/exceptional items and other non-operating/financial items. As shown in Figure 4, Chinese automakers have been able to set off all their non-operating and financial costs from the non-operating income and contribute to the income about 2% additionally. Indian companies, on the other hand, had no additional revenue to cover these expenses and their income is affected by this expense item.

**Inventory Management**

Stock turnover ratio is useful in analysing a firm’s working capital management. It indicates how many dollars of sales a firm is able to generate for each dollar spent on stock. The stock level is determined by the production needs and the optimal level of stock that is necessary to run firms’ normal operations. Therefore, stock turnover ratio is used to investigate the management of working capital of the automakers of two countries. It is calculated as operating revenue divided by total stocks which includes raw materials, work in process, finished goods, inventory payments and other related inventory adjustments. Thus, higher stock turnover may indicate a better inventory utilisation. As stock turnover is combined with inventory management at different stages, the ratio explains how well the firms control and manage their inventory levels. The impacts from inventory control may create additional costs to the firms and reduce the reported profits. Alternatively it may also create savings to the operation if inventory management is efficient. Figure 5 below shows how the stock turnover ratio of the two countries has behaved from 2007 to 2012 period.
As indicated in Figure 5, the stock turnover of Chinese automakers has gradually increased from 5% in 2007 to 7% in 2011 and it has jumped from 7% to 15% in 2012. From the above Figure, it is apparent that Chinese automakers are generally having a higher stock turnover ratio. The stock turnover ratio of Indian automakers was higher than that of Chinese automakers until 2011. In 2007, Indian automakers had stock turnover ratio of 14% which is more than double of the Chinese stock turnover ratio. However, in recent years this rate has deteriorated to about 11% in 2012 which is well below the 15% rate that Chinese automakers had in the same year. The main reason for the improved turnover ratio of Chinese automakers is that their level of sales has increased at a higher rate than the increase in their level of stocks. On the other hand, the stocks level of Indian automakers have increased at a higher rate than the rate of increase of their sales. The observed ratio also matches the general production conditions in the local Chinese environment. Expansion of domestic economy, recovering from the shocks of global recession has lead to the increased demand for cars in China since 2010. Consequently, the scale of production has also increased to cater for the increased demand.

**Liquidity**

In this section, the liquidity of automobile automakers in two countries is examined using current ratio, which is the ratio of current assets to current liabilities. This ratio indicates a company's ability to pay its short-term debts. A current ratio of greater than one is usually a minimum because anything less than one means the company has more current liabilities than current assets. However, higher current ratio may also indicate low level of liabilities employed by the companies. Figure 6 below shows the trend of the current ratio of automakers of China and India for the period from 2007 to 2012.
As per Figure 6 above, the liquidity of both Chinese and Indian automakers was relatively low as both countries have maintained a lower than one current ratio most of period from 2007 to 2012. Despite the fact that current liabilities of Chinese automakers were higher than their current assets, their current ratio has consistently remained around 0.5 throughout the observed period. In contrast, Indian automakers had a current ratio of 1.2 in 2007 but it has deteriorated continually to about 0.6 in 2012.

**Solvency**

Solvency indicates financial stability because it measure a company's debt relative to its assets and equity. Gearing ratio is one of the commonly used measures of solvency. It is a degree to which a firm's activities are funded by non-current liabilities and loans versus shareholders' funds. As Mascarenhas (2012) points out, higher the gearing ratio, higher the financial leverage of the company and the debts to be serviced by the company. The gearing ratio of two countries for the period 2007 to 2012 is depicted in Figure 7 below.

As shown in Figure 7 above, financial leverage of Indian automakers is much higher than that of Chinese companies. More specifically, the gearing ratio of Chinese
automakers has varied from 45% to 65% over the observed period with an average gearing ratio of 56%. In contrast to this, the gearing ratio of Indian automakers has varied from 97% to 430% with an average gearing ratio of 206%. Moreover, towards the end of the observed period, the debt level of Indian automakers was about 1.5 times of equity while the debt level of Chinese automakers was only 0.5 times of their equity. Although, prior studies have identified a positive relationship between the financial leverage and financial performance (for example, Akhtar et al. 2012), the high use of debts has not translated into higher profit for Indian companies. As shown in figure 1, ROA of Indian automakers is lower than that of Chinese automakers despite the fact that Indian automakers have maintained higher level of financial leverage throughout the period from 2007 to 2012. In fact, Indian automakers recorded their lowest ROA of 1.6% when they had highest gearing ratio of 431% in 2009.

5. Summary and Conclusions

The main objective of this study is to assess the performance of Chinese automakers in comparison to the performance of Indian automakers. The study is motivated by the general perception that Indian auto manufactures with their massive growth in sales in recent years are now seriously challenging the cost competitiveness of Chinese manufactures. However, the results of this study show that contrary to public perception, the performance of Chinese automakers measured in terms of their profitability, inventory management, liquidity and solvency, has improved in the period from 2007 to 2012 while that of Indian automakers has continually declined over this period.

The main conclusions of this study are: (1) profitability of Chinese auto manufactures is higher than that of Indian auto manufactures and is stable in recent years while the profitability of Indian automakers is on the decline, (2) the increased profitability of Chinese automakers is largely due to the increase in their profit margin and assets turnover while the decline in profitability of Indian automakers is due to the continuous drop of their profit margin ratio and their inability to increase the level of efficiency in relation to their asset utilisation (3) despite having higher profit margin, Chinese automakers had a considerably higher level of cost of sales than that of Indian companies, resulting in a much lower gross profit ratio relative to that of Indian companies, (4) relatively high level of operating costs of Indian automakers seem to have a significant impact on the low profitability of Indian companies, (5) the profitability of Indian automakers has been further eroded by their higher level of non-operating and financial costs, (6) Chinese automakers have been steadily improving their inventory management by converting their inventories into sales at a higher rate than that of Indian companies, (7) the liquidity level of both Chinese and Indian automakers has remained at relatively low level as both countries have maintained a lower than one current asset ratio most of period from 2007 to 2012, and (8) financial leverage of Indian automakers is much higher than that of Chinese companies. However, the high use of debts has not translated into higher profit for Indian companies.

Overall, despite intense competition and increased cost pressures in recent years, Chinese automakers have continued to perform well. Interestingly, the global
financial crisis has not had a significant impact on these automakers mainly due to increasing demand of cars in China. Such unique supply and demand relations have given the Chinese automakers a stable environment to manufacture and sell. India, on the other hand is in a similar situation but seems to be struggling in getting their costs controlled to compete with Chinese automakers on the cost leadership strategy.

This study has a number of limitations. First, although the sample includes all India automakers, it only consists of the top 4 Chinese automakers. Second, some important factors such as the trade policies of China and India that make a significant impact on the performance of auto industry are not considered in this study. Third, the data used for this analysis is limited to the period from 2007 to 2012.

References:


## Appendix: FINANCIAL RATIOS

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