Value creation for Suppliers by Adopting Supply Chain Finance: Analysis in Automotive Product Company

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ABSTRACT

SMRC Automotive Products Pvt. Ltd. has come a long way since its creation in 1914 by Joseph Reydel. Over the years through several mergers and acquisitions, the organization has developed core competency in the field of automotive parts manufacturing such as instrument panels, door panels, bumper etc. for leading OEMs such as Tata Motors, BMW, Nisan etc. Lately the organization has experienced a slump in its annual sales majorly due to the impact of COVID 19 and the subsequent lockdown imposed by the Govt. of various nations. Due to the ongoing crisis and the uncertainty involved in situation coming back to normal, SMRC is actively looking forward to explore cost reduction opportunities in its purchasing operations. One such area is Supply Chain Finance which has largely been unexplored till now by SMRC. The adoption of reverse factoring can create significant reduction in financing cost for a major portion of the MSME suppliers which are strategic partners for the company's supply chain. Through this case an attempt has been made to determine the potential benefits SMRC can avail through better management of financial practises in its purchasing operations through Supply Chain Finance. A comparative analysis of the SCF products offered by various banks has been done to determine the most beneficial SCF programme/product for the company and its suppliers. This would result into a win-win situation for both the parties as the benefits would be experienced by both in the form of cost reduction in their finance operations.

Keywords

Supply Chain Finance (SCF); Reverse Factoring; Cost Savings; Working capital; Supply chain management
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Introduction

Financial Supply Chain Management can be characterized as the utilization of budgetary practices, instruments and innovations for advancing the administration of the liquidity and working capital tied up in supply chain with various stakeholders (Camerinelli, 2014). A supply chain financial management method involves effectively exploring firm-focussed practices concerned with cash-to-cash (C2C) cycles and weighted average cost of capital (WACC) as they manage their relationships with stakeholders (Randall, 2009).

Supply Chain Finance is a managerial practise which has time and again been mentioned in several literatures related to supply chain management but gained prominence majorly after the 2008 financial crisis and the disruption thus caused (Klapper, 2005).About 20 years back the focus of an organization was majorly upon improving the efficiency of its intra firm collaborations related to logistics and warehousing. The cost reduction opportunities were searched for in the domain of inventory management as well. The success which has been achieved by extending this management practise to the various trading partner in a supply chain has led to the development of Supply Chain Management (Lambert,2006). Conventionally supply chain management was considered as an integral domain of logistics, transportations, procurement and sales & marketing but lately the focus has shifted to other aspects as well such as risk management, sustainability, optimizing working capital etc. (Vousinas,2019).

In today's highly competitive global business scenarios, it becomes a really big challenge for the firms to cut costs from various head and at the same time optimize the working capital so as to not fall behind its competitors and lose its market share. The concept of SCF has its root back in 1980s in the automobile industry but it did not really emerge until the global economic crisis of 2008 (Vousinas,2019).

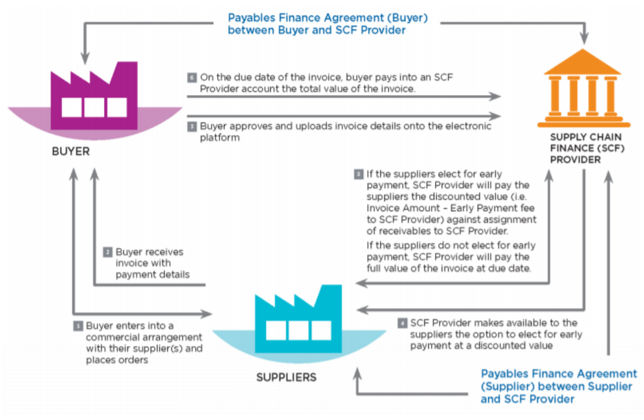
2.1 Objectives/KPIs related to SCF

The momentary targets of SCF are basically to expand profitability and decrease residing stock and process duration by means of successful working capital administration, while long haul destinations are to build piece of the overall industry and benefits for all individuals from the SC. The utilization of SCF measurements (for example Days Payables Outstanding – DPO and Days Sales Outstanding – DSO) alongside KPIs can fill in as an apparatus for assessing an association's financial conduct and execution after some time, a basic factor for the effective usage of SCF arrangements (Camerinelli,2014).

2.2 Reverse Factoring

In this arrangement a bank offers to pay the invoices of a company to its supplier in exchange for a certain amount of discount on the invoice amount. In this the supplier leverages the strong credit rating of its buyer to obtain financing at a lower cost than what it is currently being offered (Pfohl and Gomm, 2009).RF is an arrangement through which a buyer, with the help of its financier, offers a supplier credit against the credit rating of the buyer for the period of the payment term (Demica, 2007). The greater the difference between the credit rating of supplier and buyer, the more the supplier will be able to enjoy lower finance costs.

In simple terms, RF consists of a buyer, a supplier, a financial institution and a web platform for administration, often presented by the bank. In this process, the supplier first delivers the goods agreed upon with the buyer and after approval of receipt by the buyer, the electronic invoice thus generated gets uploaded on the web platform. Thus, the supplier gets right to ask for the value of the order before the maturity date from the bank in return for which the bank charges a small percentage as processing fee and interest cost of receiving goods before the invoice maturity date. After the maturity date the buyer is obliged to pay the full amount to the bank/Fintech (Vousinas, 2019).



Source: Global SCF Forum

Figure 1- Transactional flow in supply chain finance

The case study in this journal explores the cost saving opportunities in a reverse factoring product offered by three financial institutions (2 Banks & 1 Fintech) for the suppliers of an Automotive company.

Case Background

Joseph Reydel began the reydel company in 1914 which specialized in manufacturing rainwares and bicycle saddles in France. The company was bought by Jean Bourgois in 1935 and the company was moved to Paris where manufacturing continued till the start of the war.

2.1 Adaptation to modernism

The decision to move the manufacturing plant to Gondecourt, North of France post the war in 1948 in addition to the invention of moped turned out to be beneficial for Reydel as the activities got boosted tremendously as well as its business. Reydel products began to be produced from leather and plastic during this time. In the year 1956 the company focussed its production on moped majorly and by this time it had started to use cutting edge technology to produce products meeting customer requirements.

2.2 Entering the automotive market

In 1959 Reydel team invested more in acquiring new engineering skills and thus entered the automotive market by first producing plastic parts for an automaker. Reydel began manufacturing its first instrument panel for Renault 12 in 1969, then continued the R 10 and R 16. Reydel produced its first thermoformed instrument panel in 1974 and thus left a mark in the industry of its competency in the field. Reydel became an established automotive supplier in 1980 by venturing into divergence of products and activities thus opening firms in France and England. It received a quality award from fiat in 1994 for continuously adapting to changing demand of customers and the new norm of Just in Time always improving quality of its products.

2.3 Significant acquisition in the later years

In 1995, Reydel was acquired by Plastic Omnium and in 1999 it was bought by American group Viseton. Viseton boosted the technological advancement and competency development of Reydel thus improving its product range throughout. On 2nd August 2018, Samvardhana Motherson Group acquired Reydel and thus Reydel became Samvardhana Motherson Reydel Companies (SMRC).

2.4 Impact of COVID

SMRC used to procure raw material worth Rs. 120 Cr per annum until last year i.e. FY 2019. But the recent outbreak of COVID 19 created a havoc in the market conditions where the logistics and supply base got hugely disrupted due to the lockdown imposed by the governments of several nation. Moreover, a slump of 40% was also observed in the sales of the company. Due to this huge reduction in sales the projected purchase for the year FY 2020 were brought down to Rs 80 Cr. As a part of the handling the crisis cost efficiency improvement initiatives were identified as a major area to be worked upon. These initiatives would not only be helpful for a short period till the crisis prevails but would continue to give away benefits for years to come.

Supply chain finance was till now an unknown area for SMRC until the crisis struck and the organization started looking for cost cutting initiatives. Hence the company took a great deal of interest in this area and how could help in bringing down the cost of finance not only for the SMRC but even the supplier which would indeed help the entire supply chain through financial bullwhip if such practise is adopted by all the stakeholders. The financial distortions faced currently by the small and medium suppliers are majorly due to cost of financing and such issues rapidly shot up due to the COVID crisis owing to the lockdown imposed by the government. Supply chain finance product if adopted by SMRC and suppliers would save a huge sum of opportunity cost that the supplier would have to pay if any other means of financing has been adopted. It would help SMRC also as the savings created due to SCF adoption can be shared through early payment discounts negotiated thereafter.

Methodology

3.1 Estimation of cost savings in Supply Chain Finance for SMRC

A survey was carried out upon on the major supply chain finance providers in the market for their product specifications. These consists of banks as well as fintechs providing SCF solutions to companies.

The following banks and fintechs was contacted to understand their SCF product features-

Banks	Fintechs
1. State Bank of India	1. Vayana Networks
2. Bank of India	2. Capital Float
3. ICICI	
4. Kotak Mahindra	
5. HDFC	
6. Citibank	

Relevant information regarding the products could be received only from three institutions since banks were majorly concerned in speaking to the finance department as the final call for the project implementation resides with finance department.

The distinguishable features for the SCF Products provided by each institution can be categorized into the following-

1. **Rate of Interest** – Interest charged upon the financeable amount is deducted from the invoice amount while paying the supplier.
2. **Tenor**- Time period of invoice maturity i.e the period till which the payment term was originally decided which is the same as the repayment period decided by the bank.
3. **Credit Limit** – The limit of the financeable amount decided by the bank per supplier based on past purchase history of the buyer.
4. **Mode of supplier onboarding** – The mode of onboarding a supplier for this program can be either virtual or manual. Virtual process gets completed withing a day whereas manual process may take upto a week since it requires manual submission of original documents and clearance which is

cumbersome and time taking compared to virtual process which is just

5. **Processing amount** – The percentage of the total invoice amount that shall be financed for each purchase depends upon the T&C of banks
6. **Processing Days** – No. of days required by banks to transfer the financeable amount to supplier's account.

Table 1 – SCF Product comparision of Three providers

Banks/ Fintechs	Rate of Interest	Credit Limit	Tenor	Virtual Onboarding
SBI	7.05	Flexible	90 Days	No
ICICI	8.75	Flexible	90 Days	Yes
VAYANA	12.25	Flexible	90 Days	Yes

3.2 Supplier Spend Analysis

The credit limit given to each supplier under SCF depends upon the average monthly spend/purchase that the buyer (SMRC) does on each supplier. As mentioned above this credit limit is extended for three months i.e. 90 days.
Hence credit limit – **Average monthly purchase from supplier x 3.**
This can be analysed from the past purchase data. The projected purchase data for the year 2020 was collected and analysed to find out the suppliers with the highest purchase amount. Currently SMRC Pune plant consists of 78 suppliers, out of which 30 suppliers are listed suppliers and the remaining are non-listed suppliers.
The objective was to analyse the cost of capital being incurred by these suppliers to run their operations at present. To attain at accuracy in the cost savings calculations, only the non-listed suppliers were considered for the analysis with the assumption that the non-listed MSME firms would be incurring a high cost of capital at present compared to the listed ones. Hence, they would more readily agree for this scheme compared to the bigger firms.
A further analysis of the top 10 non listed MSME firms according to spend gave the following results-

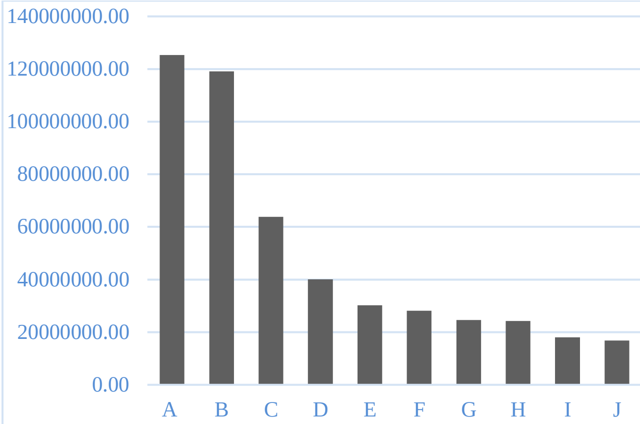


Figure 2 – Projected annual spend of spend wise top 10 suppliers

Note - The net amount of purchase for these 10 suppliers will be only considered for the cost savings estimation from SCF product adoption.

3.3 Identified cost savings opportunities

1. **Supplier Savings** – Suppliers with a higher cost of capital and cost of financing can leverage upon the better credit rating of its buyer to obtain financing for its working capital. This way the constricted access to trade financing can be eased out. The supplier can hence use this arbitrage opportunity to ease out its cash flow problems and at the same time ensure a less risky supply base for its buyer.
2. **Buyers Savings** – Based upon the savings realized by the suppliers on adoption of SCF Product, an early payment discount can be negotiated with the supplier which will result into a reduction in COGS for the buyer (Sadlovska,2006).

Result

4.1 Assumptions taken for the Cost Savings estimations

1. Average purchase to be financed every 60 days= Rs 4.22 Cr
2. SBI rate of interest 7.05% is considered for SCF
3. Average cost of capital for the suppliers considered to be 13.5%
4. Average difference between supplier's current cost of capital and cost of factoring in SCF = 13.5 – 7.05 = 6.45 %
5. DPO with all the supplier in present scenario = 60 days

6. Average discount in early payment considered to be 0.5 %
7. Total No. of Suppliers = 10.

4.2 Cost Saving Calculations (Sadlovska,2006)

1. Supplier Savings

Savings = Average difference between supplier's current cost of capital and cost of factoring in SCF X 16.66% X Amount Borrowed

= 6.45% X 16.66 % X 4.08 Cr (60 days = 16.66 % of a year)

= **Rs. 4,39,169/-** (60 days savings)

Annual Savings = Rs 26,35,014/-

2. SMRC's Savings

Savings achieved due to an early payment discount

= Rs 4.08 Cr X 0.5%

= **Rs 2,04,000/-**

Annual Savings = Rs 12,24,000/-

Net Savings for suppliers = Rs 14,11,014/-

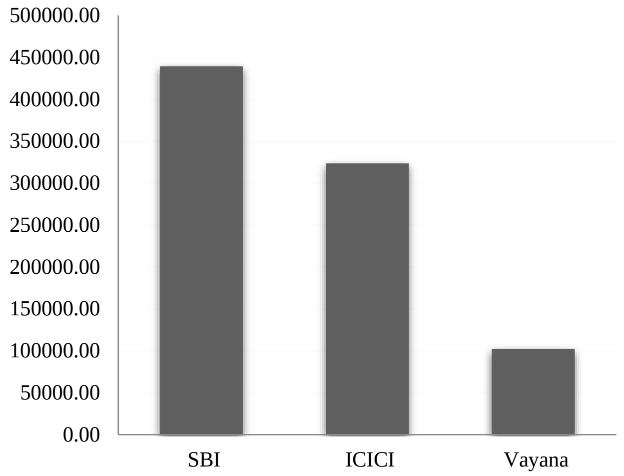


Figure 3 – Comparison of Supplier Savings per purchase cycle in Three products

Conclusion

- The maximum savings can be achieved in the SCF product offered by State Bank of India for the suppliers.
- The most important point of differentiation between the products is the rate of interest (RoI). SBI has the lowest rate of interest.
- The net supplier savings will be what is left from the savings after an early payment discount has been negotiated. In the example above the early payment discount has been considered to be 0.5%. This can vary from supplier to supplier as some supplier may agree for a higher margin for SMRC and some other supplier may only agree for a lower margin or discount rate.
- The supplier saving is calculated for all the suppliers combined and the separate bifurcation for each supplier will vary from one another.
- It has to be negotiated between the supplier and the buyer that who will be bearing the interest on finance. In our example we have assumed that it is the supplier who will be bearing the interest since supplier gets an early payment and hence an early access to its working capital. But this may not be the case always as some suppliers may not want to increase debts figure on their balance sheet.
- If interest is paid by SMRC, then the finance department needs to compare the interest incurred by it in making payments through the current mode. If significant savings is being earned in the practise, then only the scheme will turn out to be profitable.

Apart from the tangible benefits, certain intangible benefits can also be earned through SCF such as long-term healthy relationship with supplier. It may also be turned into a vendor development program to help out the MSME firms which are strategically important to the company's supply base.

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