

## CASE STUDY 2

Let us take the case where the SME avails of finance from a Factor for and purchase of raw material, manufacture of goods and getting paid after delivery<sup>1</sup> of goods to a buyer. The interest component is charged to the SME and Buyer depending who is availing the credit.

Players:

1. SME: Best Inc (BI)
2. Raw Material Supplier: Best Aluminium Works (BAW)
3. Buyer: Material Supply Co. (MSC)
4. SME's Bank: Acme
5. Raw Material Seller's Bank: Widget
6. Buyer's Bank: Pinnacle **Commodity**:

BI manufactures **Soft Drinks** and supplies it to its buyer MSC. BI buys **Aluminium Cans** from BAW.

**Transactions:**

1. SME and Buyer enter into a contract where the SME will sell the finished product and the buyer will buy the same.
2. The SME and Raw Material Seller enter into a contract where the raw material seller will sell raw materials and the SME will buy the same.
3. The buyer sends the SME a Purchase Order.

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<sup>1</sup> In some cases the factor may insist the buyer to accept documents before payment is made

4. Against this purchase order the SME opens a Back to Back purchase order on the raw material seller
5. The raw material seller sends the raw materials to the SME and submits documents to his bank
6. The raw material seller's bank sends the documents for acceptance to the SME's bank
7. The SME's bank intimates the SME for acceptance of documents.
8. The SME accepts the Bill of Exchange and takes the docs to release his goods.
9. The SME receives the goods
10. The SME's bank intimates the raw material seller's bank on acceptance
11. The SME's bank forwards the payment to the raw material seller's bank the full invoice value.
12. The raw material seller's bank credits the raw material seller's account.
13. The SME processes the goods to finished product and sends the goods to the buyer
14. The SME then gives the documents to his bank.
15. The bank sends the documents for acceptance to the buyer's bank
16. The buyer's bank intimates the buyer for acceptance of documents.
17. The buyer accepts the Bill of Exchange and takes the docs to release his goods.
18. The buyer receives the goods
19. The buyer's bank sends the SME's bank the Bill of Exchange.
20. The SME's bank pays the SME 75% of invoice value less its costs
21. The buyer pays his bank on due date.
22. The buyer's bank forwards payment to SME's Bank

23. The bank intimates the SME of receipt of funds and pays the balance 25% to the SME less its costs

24. Transaction Ends

**Costs: Let us assume an invoice for Rs.100 for 30 Days (SME & RAW MATERIAL SUPPLIER)**

***Payments 1<sup>st</sup> Leg***

<u>S.No.</u>	<u>Particulars</u>	<u>Amount (₹)</u>
1.	<b>Bank funds 100% of invoice value</b>	<b>100.00</b>

***Receipts***

<u>S.No.</u>	<u>Particulars</u>	<u>Amount (₹)</u>
1.	Bank charges interest @ PLR+1% on 100% of Invoice Value $((15/100) \times 100) / 365 \times 30$	1.23
2.	Bank Charges 1% Flat Fee of Invoice Value as Processing Fee	1.00
3.	Bank Charges 0.25% for Document Handling – Flat Rate	0.25
<b>TOTAL</b>		<b>2.48</b>

**Net Payment By Bank:**

<u>S.No.</u>	<u>Particulars</u>	<u>Amount (₹)</u>
1.	Payments by Bank	100.00
2.	Receipts by Bank	2.48
<b>NET PAYMENT by BANK</b>		<b>97.52</b>

**Note:**

1. The Receipts under Leg 1 are Notional as they are yet to be received and are deducted upfront
2. The bank pays the Raw Material Supplier Rs. 100 as it charges Rs. 2.48 to the SME

Let us assume an invoice for Rs. 200 for 180 Days (SME & BUYER)

***Payments 1<sup>st</sup> Leg***

S.No.	Particulars	Amount (₹)
1.	Bank funds 75% of invoice value	150.00

***Receipts 1<sup>st</sup> Leg***

S.No.	Particulars	Amount (₹)
1.	Bank charges interest @ PLR+1% on 75% of Invoice Value	
	+Rs.2.48 (((15/100))x152.48)/365)x180	11.30
<b>TOTAL</b>		<b>11.30</b>

**Net Payment by Bank:**

S.No.	Particulars	Amount (₹)
1.	75% of Invoice Value to Buyer	150.00
2.	Less Receipts by Bank	11.30
3.	Less 100 % of Invoice Value to Raw Material Seller	100.00
<b>NET PAYMENT by BANK</b>		<b>38.70</b>

**Receipts 2<sup>nd</sup> Leg**

S.No.	Particulars	Amount (₹)
1.	Buyer pays Bank 100% of Invoice Value	200.00
2.	Bank charges document handling fees @ 0.25% Flat on 25% of Invoice Value	0.13
<b>TOTAL</b>		<b>200.13</b>

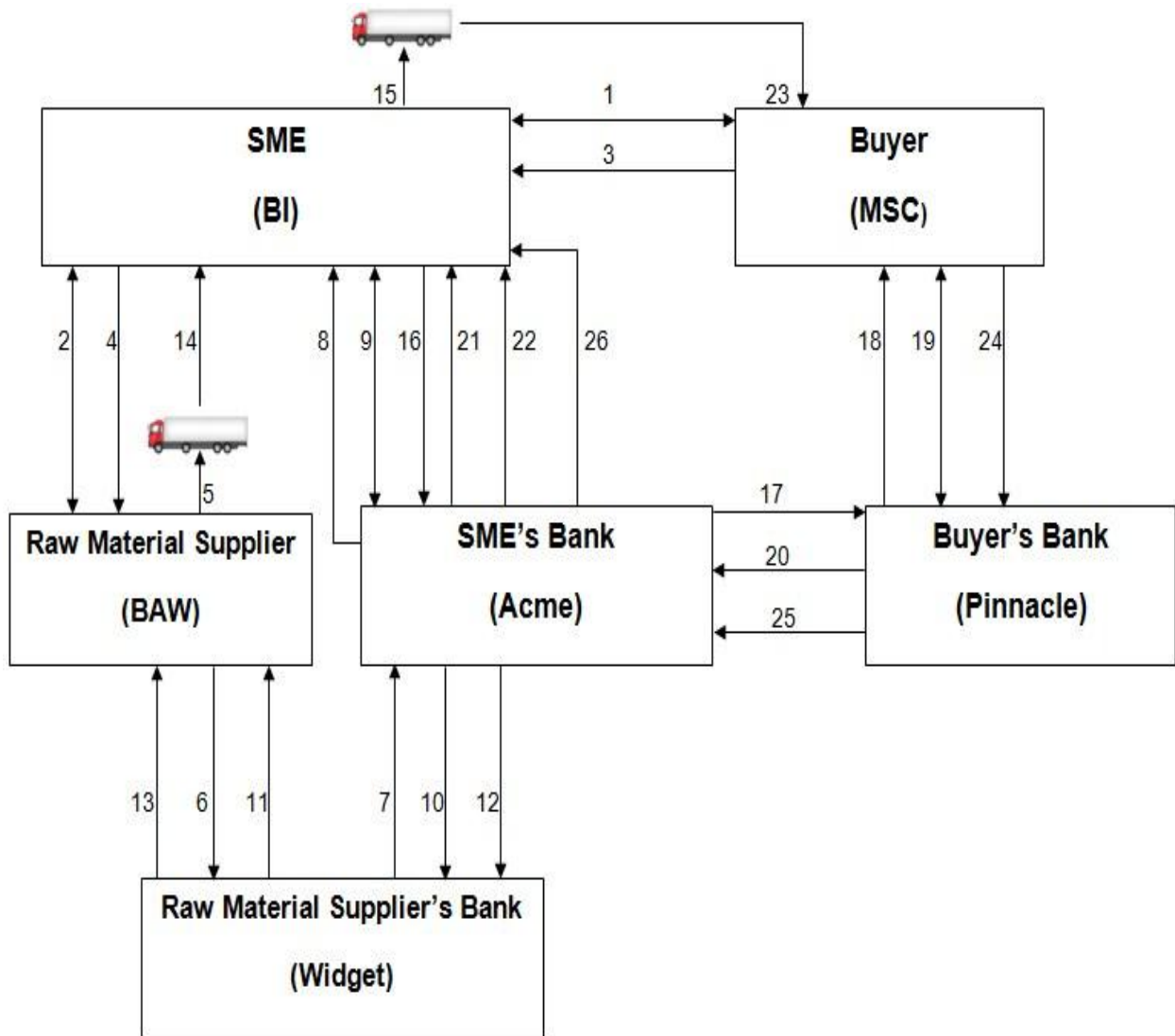
**Payments 2<sup>nd</sup> Leg**

S.No.	Particulars	Amount (₹)
1.	Bank pays Supplier the Balance 25% of invoice value	50.00
2.	Bank pays Interest on Fixed Deposit of Rs. 50 @ 5% per annum	1.23
<b>TOTAL</b>		<b>51.23</b>

**Net Receipt By Bank:**

<u>S.No.</u>	<u>Particulars</u>	<u>Amount (₹)</u>
1.	Receipts by Bank	200.13
2.	Payments by Bank	51.23
<b>NET RECEIPT by BANK</b>		<b>148.90</b>

# PROCESS FLOW



### Event Table

<u>STEP NO.</u>	<u>DAY NO.</u>	<u>EVENT</u>
1.	1	Contract between BI and MSC
2.	2	Contract between BI and BAW
3.	3	MSC sends purchase order to BI
4.	4	BI sends a Back-to-Back order to BAW
5.	30	BAW sends goods to BI
6.	30	BAW presents documents to WIDGET
7.	31	WIDGET sends documents to ACME for acceptance by BI
8.	34	ACME intimates BI about receipt of documents
9.	34	BI accepts bill of exchange and takes the documents
10.	34	ACME intimates WIDGET about acceptance of the bill of exchange by BI
11.	34	WIDGET intimates MSC about acceptance of the bill of exchange by BI
12.	35	ACME forwards payment to WIDGET for 100% of invoice value
13.	36	WIDGET credits BAW's Account
14.	37	BI receives goods
15.	50	BI processes goods and sends it to
16.	50	MSC BI presents documents to ACME
17.	51	ACME sends documents to PINNACLE for acceptance by MSC
18.	54	PINNACLE intimates MSC about receipt of documents
19.	54	MSC accepts documents and takes the documents to release his goods
20.	54	PINNACLE sends ACME the bill of exchange by BI
21.	54	ACME intimates BI about acceptance of the bill of exchange by MSC
22.	55	ACME credits BI's A/C with 75% of invoice value and debits MSC with 100% of invoice value
23.	56	MSC receives goods
24.	230	MSC pays PINNACLE for payment to BI
25.	231	PINNACLE forwards payment to ACME
26.	232	ACME credits BI's A/c less their charges
	232	TRANSACTION ENDS



**Note:**

1. By giving 30 days credit given to BAW, BI ensures that MSC pays it before paying BAW. Here Banks discount the invoices and pay BI
  
2. The tenor in step 22 is taken from Bill of Lading, which is Day 50. So we get effective Credit Period of  $50+180=230$  Days.

