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DISCOUNTING SYSTEM (TN TREDS):
A PROFIT MULTIPLIER FOR MICRO,
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(MSMES)

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TAMIL NADU TRADE RECEIVABLES DISCOUNTING SYSTEM (TN TREDS): A PROFIT MULTIPLIER FOR MICRO, SMALL & MEDIUM ENTERPRISES (MSMES)

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Abstract: *Tamil Nadu Trade Receivable Discounting System (TN TReDS) was an invoice discounting mechanism established by the State Government of Tamil Nadu in India to facilitate timely payment for supplies made by the Micro, Small and Medium Enterprises (MSMEs). This study is qualitative in nature and both primary data & secondary data were used. The study reveals that TN TReDS provides a collateral-free working capital, through competitive finance, to MSMEs. TN TReDS creates cost advantages to MSMEs which helps them to multiply their profit and improve the financial position. And the Reserve Bank's positive move will further strengthen this system.*

Keywords: TReDS, TN TReDS, Trade Receivables Discounting System, Tamil Nadu Trade Receivables Discounting System, Receivables Management, Invoice Discounting, e-Discounting, MSME

1. Introduction

When sales were made against cash then there are no receivables. On other hand if time is allowed to pay the amount due in future which results in receivables. Thus, trade receivables are unrealised sale proceeds which are arising on account of credit policy of the firms. Delay in payments is one of the biggest issues currently being faced by Micro, Small and Medium Enterprises (MSMEs) suppliers. Such delay locks up or blocks the working capital of MSMEs. To address this issue and expedite the process of receiving payment for their goods and services supplied to Tamil Nadu Government controlled entities the State Government of Tamil Nadu in India introduced an invoice discounting system for MSMEs called Tamil Nadu Trade Receivable Discounting System (TN TReDS).[1] It is, also, interchangeably called as Tamil Nadu Trade Receivable e-Discounting System (TN TReDS) as it is implemented through an electronic online platform.

2. Review of Literature

Akhilesh Kumar Sharma and Sushil K Rai in their study “Understanding the Impact of Covid-19 on MSMEs in India: Lessons for Resilient and Sustained Growth of Small Firms” surveyed 225 firms to investigate the impact of COVID-19 on MSMEs and found out the ways to enhance the resilience and promote its sustained growth in the presence of government supportive measures. In their study they observed that around 90 percent of surveyed firms realized decline in their turnover, which was mainly due to restriction in economic activities, decrease in demand, shortage of workers, and disruption in supply chains and reduction in employment. Smaller firms, in terms of both employment and investment, and younger firms have higher possibility to be affected by the external shocks. Support measures by the government during the pandemic were found to be insufficient and have limited relevance to the MSME sector in its revival. For enhancing resilience

and sustainability of MSMEs, the study suggested small firms should be encouraged for financial planning for business uncertainties and proposed financial security measures viz. Uncertainty Corpus Fund for Small Businesses and Small Business Insurance.[2]

The International Labour Organisation had, also, surveyed 1000 enterprises from 8 countries to assess the impact of Covid 19 on SMEs in India which includes the state of Tamil Nadu. In their study it was revealed that 70 per cent of SMEs had shut down their operations. Half of them were closed their business due to a reduction in orders. The causes for contraction of the Sector were found manifold. Prominent among them as per studies were: lower revenue, reduced demand for orders, shortage of cash flow, impact on labour force and prevailing uncertainties of the pandemic.[3]

H.N Pathak studied Small-Scale industries entitled “Small-Scale Industries in Luthiana” identified that interplay factors of favourable, timely and appropriate government policies and quick adaptability by the enterprises were responsible for the all-round growth of entrepreneurial talent.[4]

3. Objectives of the study

The following specific objectives are formed for the purpose of the study:

- To examine the TN TReDS salient features.
- To study impact of TN TReDS on the Credit Policy of MSMEs to maximise profit.
- To study impact of TN TReDS on the MSME’s Way Forward to maximise profit.

4. Methodology

The research was qualitative in nature and both primary & secondary sources data collected were collected for the purpose of the study. Secondary data such as published and unpublished government and private sources were used. Documents such as Government Orders (GOs), training materials, policy notes, etc., were consulted for the purpose of the study. Discussions with officials and persons who were involved in the implementation of the discounting system were, also, made to have a clear understanding of the working principles of the TN TReDS. A fair use of AI tool ‘Assistant’ @poe was used in this study to define the term “Way Forward”. Assumptions made were stated in the relevant discussion area. Impact of TN TReDS on the Credit Policy of MSMEs to maximize profit and Impact of TN TReDS on the MSME’s Way Forward are explored through two different commonly faced business scenarios. The working capital cost (rate) used for the purpose of the study were generally available in text books of financial management and the TReDS discount rate was the rate used by the Nodal Department which implements the TN TReDS.

5. Results and Discussion

5.1 Tamil Nadu Trade Receivables Discounting System (TN TReDS) and its salient features

In 2021-22 the following announcement was made in the Legislative Assembly of Tamil Nadu, India: “To ensure that MSMEs have faster channels for realisation of their dues, all State Public Sector Undertakings, Statutory Boards, Municipal Corporations and Apex Co-operatives will be mandated to join the Trade Receivable Discounting System (TReDS)”[5].

Tamil Nadu Trade Receivables Discounting System (TN TReDS) is mechanism established for facilitating the financing / discounting of invoices of Micro, Small and Medium Enterprises through multiple financiers through an electronic online platform. These receivables can be due from other private businesses or from Government agencies, including Public Sector Undertakings. The seller, buyer and financier are the three participants in the Trade Receivables Discounting System platform.

TN TReDS was designed to facilitate very early payment to Micro, Small and Medium Enterprises for the goods and services supplied by them through bill discounting, enabling the smooth flow of working capital. The supplier need not necessary to wait for the end of the credit period, if any, accepted for payment. Once a seller uploads an invoice on the electronic platform, it goes to the buyer for acceptance. Once buyer accepts, the invoice (then called a factoring unit) goes to auction and financial institution can quote various discounting rates. Once the seller accepts the discount rate, which is acceptable to them, the amount will get credited to the seller on the next working day. The maximum discount period allowed by the financier is 180 days. The buyer settles the amount to the financier at the end of the credit period or earlier through Tamilnadu Industrial Cooperative Bank Ltd., popularly known as “TAICO Bank” which act as a principal agency for TReDS in Tamil Nadu as the sole operator of current account with flexi deposit and Over Draft facility for auto debit on behalf of Government of Tamil Nadu. As such there is no chances for bad debts and there is no administration costs associated with credit collection.

Trade Receivables Discounting System platform operators were authorized by RBI under the Payment and Settlement Systems Act, 2007. At present, there are three authorized operators.

Telengana Today said that “Nearly 13 lakh MSMEs in the state of Tamil Nadu will be benefitted with the adoption of a collateral-free working capital on TN TReDS platform, India’s first and leading Trade Receivable Discounting System (TReDS). As of October 31, 2022, TN TReDS facilitated with bill discounting of more than Rs 36,000 cr. to over 13,500 MSME suppliers spread across 1,200 towns from across the country. In Tamil Nadu about 1,097 MSME sellers have registered on the platform and received Rs 775 cr. against their invoices from August 2022 to October 2022 and a total of Rs 4,962.60 cr. has been financed up till 31st October 2022.”[6] 87 Public Sector Undertakings (PSUs) have been onboarded on the platform.[7]

At present, in TN TReDS, 90% of each invoice value of registered buyers was brought for auction in the platform and the balance 10% value is released at the end of the credit period. The State Government of Tamil Nadu have directed the following buyer agencies to mandatorily participate in the TN TReDS platform for settling the bills of their Micro, Small and Medium Enterprises Suppliers of goods and services.

- i. All State Public Sector Undertakings and Companies where the State Government exercise managerial control by appointing its Chief Executive Officer.
- ii. All Municipal Corporations.
- iii. Major Statutory boards like Chennai Metropolitan Water Supply and Sewerage Board, Tamil Nadu Water Supply and Drainage Board, Tamil Nadu Housing Board and Tamil Nadu Urban Habitat Development Board.
- iv. Major Apex Co-operatives like Aavin and Co-optex.

TN TReDS is not only providing quick finance but also eliminates the bad debt by a guaranteed payment through TAICO Bank’s auto debit provision. This guaranteed payment avoids the associated credit administration cost too. The cost of invoice discounting at TN TReDS consist of

two components, namely Discount / Interest cost and Platform charges. Both are expressed as a percentage on the value. The nodal department, which implement the TN TReDS, uses the discount rate 8.5% and platform charge 0.35%. Thus, the discounted cost in TN TReDS is in single digit only.

As per MSME SAMADHAAN- Delayed Payment Monitoring System under Micro, Small and Medium Enterprise Development (MSMED) Act, 2006, 692 cases were filed by MSMEs for Rs.224.95 cr. against State Govt. of Tamil Nadu for delayed payment and only 123 cases for a claim of Rs.102.75 cr. is still pending. Of which 114 cases, against a claim of Rs. 53 cr., were pending for more than 6 months. Since TN TReDS expedites the process of receiving payment for goods and services supplied by MSMEs to Tamil Nadu Government controlled entities in future such as cases will be avoided by the TN TReDS.[8]

5.2 Impact of TN TReDS on the Credit Policy of MSMEs to maximize profit

The Receivable Management Costs determines the credit policy of the firm. Generally, the benefit from credit sales is expected to be more than the credit costs to allow a credit sale. Credit costs consist of two components namely: carrying costs and defaulting costs. The carrying costs includes the interest on the receivable and administration cost associated with credit collection while defaulting cost is associated with bad debts.

Scenario: An MSME is selling its product on credit basis for 2 months and its customers are associated with 5% credit risk (ie) bad debt. While the administration costs of credit were 2% on credit sale. Its annual turnover is expected at Rs.10,00,000 if credit extended and no credit is given sale would be at 60% there on and the cost of sale is 75%. Interest rate is 18% p.a. The profitability in this situation as follows:

(i) Profitability with credit sales		Rs.
Credit sale		10,00,000
Less:		
Cost of credit:		
Default risk	(Rs.10,00,000 x 5%)	50,000
Interest cost 2 months	(Rs.10,00,000 x 18%)	30,000
Credit administration costs	(Rs.10,00,000 x 2%)	20,000
		9,00,000
Less:		
Cost of Sale (75% of sale value)		7,50,000
Net Profit		1,50,000
(ii) Profitability on cash sales		Rs.
Cash sales	(Rs.10,00,000 x 60%)	6,00,000
Less: Cost of Sales (75% on sales)		4,50,000
Net Profit		1,50,000

It can be observed from the above that net result were same under both the options. A risk averse firm would prefer to sell on cash basis only, even though turnover is lower, with no risk. However, if the buyer entity is TN TReDS on boarded customer in such a condition the default risk and administrative cost are eliminated.

Assuming a discount rate at 10% the profitability in the above situation as follows:

(iii) Profitability with TReDS		Rs.
Credit Sale		10,00,000
Less:		

Cost of credit		
Default risk	(Nil)	Nil
Discount cost 180 days	(Rs.10,00,000 x 10%)	49,315
Administration costs	(Nil)	Nil
		9,50,685
Less:		
Cost of Sale (75% of sale value)		7,50,000
Net Profit		2,00,685

Thus, the profit is creased to the extent of eliminated cost 70,000 in the form of bad debts and administration costs and decreased by difference in interest cost 19,315. Further, TN TReDS is leaving a chance for reduction in the discount cost, if the entity pays due earlier than due date.

5.3 Impact of TN TReDS on the MSME’s Way Forward to maximize profit

Assistant, a General-purpose assistant bot in @Poe AI tool defines the phrase "way forward" as “a plan or strategy for progress or improvement in a particular situation or context. It implies finding a path or approach that allows individuals or groups to move ahead, typically after facing challenges or obstacles. It can be used in various settings, such as business, politics, or personal development, to discuss future actions, solutions, or directions that can lead to positive outcomes”.[9]

Scenario: An MSME is currently facing financial constraint and having only Rs.10,000 as cash in hand. It has two business opportunities: a private firm order that requires an investment of Rs.1,00,000 with a profit margin of 30% and another private firm order that requires an investment of Rs.1,20,000 with 40% profit margin. However, the MSMEs was able to get Rs.1,00,000 only from bank as working capital assistant at a cost of 18%.

The profitability under the financial constraint as follows:

Initial cash position as follows:

	Rs.
Cahs in hand	10,000
Bank Loan	90,000
Total cash available	1,00,000

Operating result as follows:

	Rs.
Cost of Goods Sold	1,00,000
Sales	1,30,000
Gross Profit	30,000
Bank Interest (90,000x18%)	16,200
Net Profit	13.800

Closing cash position will be:

	Rs.
Opening cash in hand	10,000
Add:	
Net Profit	13,800
Total	23,800

However, if the buyer is an TN TReDS onboarded entity it provides new opportunity to MSME to get discounted the invoices. If there is no other constraint in accepting the high profit margin order it may, also, considered for investment. In such a case the net result will be as follows:

Initial cash position is as follows:

	Rs.
Cash in hand	10,000
Bank Loan	1,00,000
Total cash available	1,10,000

Operating result as follows:

	TN TReDS	Further Order	At the end
	Rs.	Rs.	Rs.
Cost of Goods Sold	1,00,000	1,20,000	2,20,00
Sales	1,30,000	1,68,000	2,98,000
Gross Profit	30,000	48,000	78,000
Bank Interest	18,000	--	18,000
TN TReDS Discounted costs#	--	5,770	5,770
Net Profit	12,000	42,230	54,230

Change in cash position as follows:

	TN TReDS	Further Order	At the end
	Rs.	Rs.	Rs.
Inflow:			
Opening cash in hand	10,000	10,000	1230
Bank Loan	1,00,000	--	--
TN TReDS Discount Receipts#	--	1,11,230	--
Sales Proceeds / Receivable	--	--	1,68,000
TN TReDS 10% Margin receipts	--	--	13,000
Total	1,10,000	1,21,230	1,82,230
Outflow:			
Purchases	1,00,000	1,20,000	--
Bank Loan:			
Repayment	--	--	1,00,000
Interest	--	--	18,000
Closing cash in hand	10,000	1,230	64,230
Total	1,10,000	1,21,230	1,82,230

#(90% on the sales value of 1,30,000 discounted is Rs1,17,000. Less: 10% discount cost thereon for 180 days, Rs.5,770)

From the above it is clear that the profit is increased from Rs.13,800 to Rs.54,230 (i.e. increase in profit is 3.93 times). Moreover, the financial condition in the form of cash in hand, also, improved from Rs.23,800 to Rs.64,230.

6. Findings and recommendation

From the above it is clear that TN TReDS offers competitive finance, which is a collateral-free working capital, within a quick span of time for the Micro, Small and Medium Enterprises suppliers of goods and services to the TN TReDS onboarded entities. Further, TN TReDS eliminate the bad debts and credit administration costs. As such having significant influence in determining the credit policy and way forward strategies of an MSME through its cost advantages. Apart from improved financial conditions, the positive influence multiplies the profit of the MSME either by increasing its turnovers or volume of profit. Further, it is expected that there will be a substantial reduction in the cases for delayed payment to MSMEs under Micro, Small and Medium Enterprise Development (MSMED) Act, 2006 in future in respect of the State.

The Reserve Bank of India mandates the commercial banks to have minimum investment in government securities. Since, the payment in TN Trends was backed by the Government of Tamil Nadu with guaranteed payment through TAICO Bank, the inclusion of TN TReDS financing may help further reduction in the discount rate by increased banks participation which in turn attract more MSMEs towards the portal.

7. Conclusion

TN TReDS is not only helps for early collection of invoice values at an offordable cost but also relieves the MSME from the credit collection process. Thereby it helps the MSMEs to focus on their core business activities for effective utilization of resources and to get maximum return.

Thus, the government have provided a timely and favourable mechanism through appropriate policies and its success and benefiting from the TN TReDS are largely depended on the quick adoptability by the enterprises. The adoption of the suggestions provided above may further improve the active participation by the stakeholders.

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