

TReDS: A Game changer for MSMEs.  
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### **An Introduction to TReDS**

Despite being called as the backbone of Indian economy, MSMEs often struggle with adequate cash flows. The government of India and RBI identified this long prevailing problem and came up with the concept of TReDS (Trade Receivable Discounting System).

RBI's Trade Receivables Discounting System (TReDS) is an interesting example of how digitisation is helping Micro Small and Medium Enterprises (MSMEs) get access to working capital, by auctioning their receivables. TReDS is an electronic platform that allows businesses to auction trade receivables such as invoices, and the platform serves as a transparent and quick medium for the small players to avail funds at cheaper rates, through banking and factoring companies. The benefits include quick turnaround, and lower finance cost owing to digitised information.

Accordingly, the RBI, in 2017, issued licence to three players:

- 1) Receivables Exchange of India Ltd (RXIL), a joint venture between Small Industries Development Bank of India (SIDBI) and National Stock Exchange of India Limited (NSE);
- 2) Invoicemart, promoted by A Treds Ltd (a joint venture of Axis Bank and mjunction services); and
- 3) M1Xchange, promoted by Mynd Solutions Private Limited.

As an automated system driven platform, TReDS facilitates auction of trade receivables at competitive market rates through transparent bidding process by multiple financiers. This helps in quick realisation of receivables, banks sharing the risk of receivables with MSME and appropriate price discovery.

In a recent development, Ministry of MSME issued a notification, stating that all companies (with a turnover of more than INR 500 Cr) registered under the Companies Act, 2013 including PSU companies, shall be mandatorily required to get themselves registered on the TReDS platform. This development has and in coming times will enable the Suppliers to use this discounting facility, as the corporate buyers and PSU's have started to register on the exchanges. This compliance will practically accelerate availability of working capital finance for MSME suppliers.

As the transactions on TReDS platform happen digitally; several risk-mitigating controls at various levels have been implemented.

- 1) KYC & AML checks on participants getting on board,

- 2) OCR technology comparing the invoice data with the data fed,
- 3) Suspicious Transaction & threshold breach alerts are implemented at various places to monitor the transaction behaviour vis-à-vis participant's profile and past transaction history.

At each stage, all participants are kept informed of a transaction through various notifications and online dashboards. To enhance the security, digital signature has been made mandatory by the government to initiate any transaction on the platform.

### **Participants in TReDS**

There are three direct participants involved in the activities of TReDS viz.

- i. MSME Sellers,
- ii. Corporate Buyers, and
- iii. Financiers.

The TReDS will provide the platform to bring these participants together for facilitating uploading, accepting, discounting, trading and settlement of the invoices / bills of MSMEs. The bankers of MSMEs and corporate buyers will be provided with access to the system, wherever necessary, for obtaining information on the portfolio of discounted invoices / bills of respective clients.

As the underlying entities are the same i.e. MSMEs and Corporate buyers, Public Sector Undertakings and Government Departments, the TReDS could deal with both receivables factoring as well as reverse factoring.

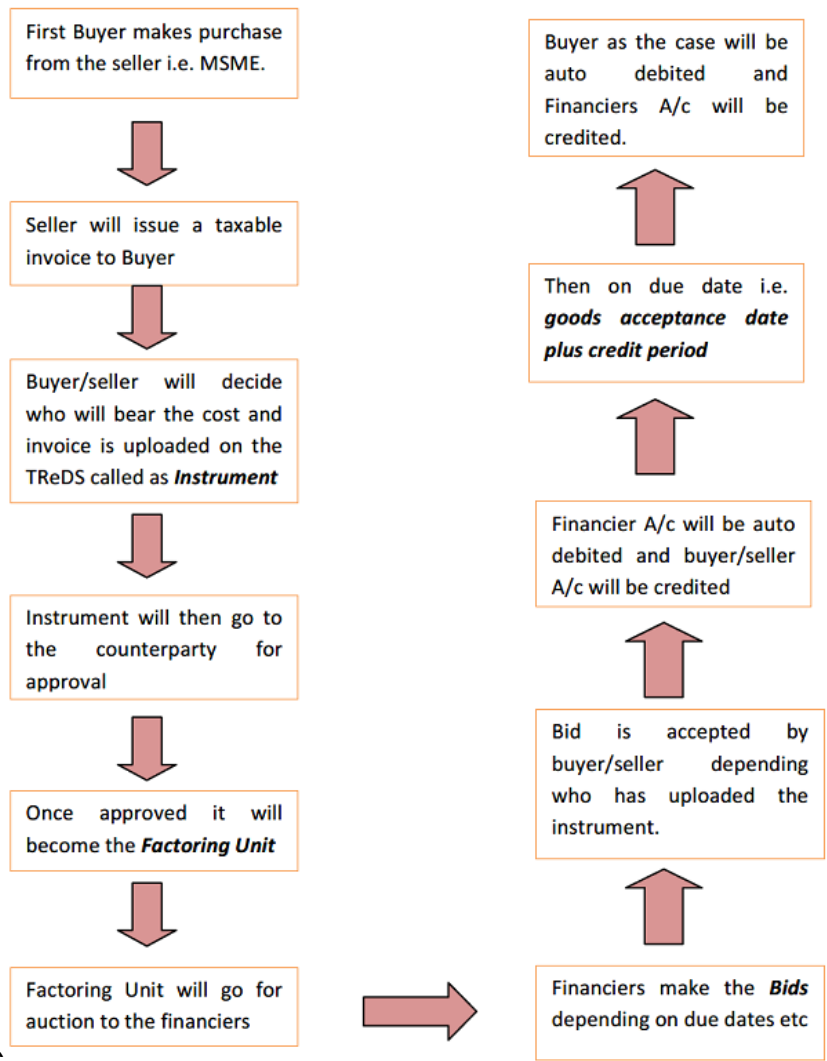
### **Factoring and reverse factoring**

Factoring refers to a financial transaction where a supplier sells his invoices (book debts/receivables) to a third party at a discount. The third party (financier) who discounts the invoice is called factor.

The MSME trade receivables discounted by banks and other financial institutions on TReDS are essentially in the form of a reverse factoring system. In reverse factoring, the seller (supplier) trades his duly converted factoring units of invoices/bills of exchange, to the financier at the behest of the buyer corporate. The financier (bank or Non-banking financial institution) who buys these factoring units, steps into the shoes of the supplier to receive payment from the corporate buyer on due date. Once the invoice/bills of exchange is discounted by the financier, the onus of collecting payment from corporate buyer rests with the financier **without recourse to the seller** (supplier who sold the invoices/bills of

exchange to the financier is discharged from liabilities to the financier on account of discounted invoice). Another advantage to the supplier is that the rate of interest decided by the financier while discounting the invoice (factoring units) is based on the rating of buyer corporate and not on the rating of the seller. He therefore gets the better pricing in the competitive bidding due to good credit rating of his clients.

**How TReDS Works:**



**Advantages:**

1. Reduced operational cost - The cost of business between MSME seller and corporate buyer is reduced as there is an interest cost saving of at least 4-5% annualised.

2. No collateral required: This adds to savings as there is always an opportunity cost attached to providing collateral.
3. One-time documentation with the exchange: No separate documentation for availing discounting facility with multiple banks and for multiple corporate buyers.
4. Borrowings are not increased for MSMEs – Cash is realised as soon as the bid is accepted by the supplier, thus making it early income realisation instead of a borrowing in the books.
5. No reflection of borrowing in books of Corporate Buyer as the transaction is initiated between MSME supplier and financing bank. For corporate buyer, the payables is reflected on as-is basis.
6. Security of digital platform for confidentiality of information
7. Minimises the duplicate payments and other operational risks
8. Can be integrated with ERP systems and avoid manual processes

#### Loans Vs TReDS

Working capital credit/ Bank Loan	TReDS
Collateral and Bank guarantor required	No collateral/ Bank Guarantor required
Issue is based on Past years performance	Past performances not considered
Heavy Documentation for each loan	One-time documentation+ KYC formalities
High Interest rates	Low rates of interest
Heavy turnaround time	Credit within T+1 days

This system introduced is definitely a boon to the MSME industries allowing easy access to working capital funds, hassle free and secure digital platforms. This system enables faster growth opportunities to the businesses and growth towards large scale industries is faster.