Working Capital Management at Toyota Motors Financial Services Corporation

Abhishek Mohanty
PGDM No. 13063
Student PGDM 2013-15, SDMIMD, Mysore
abhishek13063@sdmimd.ac.in

Ullas Rao
Associate Professor - Finance, SDMIMD Mysore.
ullasrao@sdmimd.ac.in

Comments by the Faculty

As a corollary to the increasing consumption of automobiles in India over the past couple of months; lending institutions acting as subsidiaries promoted by automobile companies have witnessed an exponential growth in business. These lending institutions operating as NBFC (non-banking financial company) provide credit to the buyers of automobiles at attractive rates of interest. While the lending rates are marginally higher than the rates charged by their commercial banking counterparts, it is the ease of faster clearance of documentation coupled with speedy disbursement of loan amount that makes them attractive.

It is in this backdrop that the author of this paper has sought to examine the operational aspects involving the credit disbursement process in a leading automobile financing company. The ideas reflected make up for an interesting discussion in the sense that the financial parameters employed by the lending company in assessing the credit worthiness of the franchises involved in selling automobile units play a pivotal role in determining the success of the business model. This is achieved by using a set of stringent financial ratios that are calculated for each of the franchisee units that determine the credit disbursement process on part of the lender.

With an expansive economy led by buoyancy in the automobile sector makes the study highly relevant and meaningful. The learnings gleaned out from this study would enable the readers to appreciate the intricate dimensions of credit disbursement process of the lending arms of automobile manufacturers functioning as a NBFC.

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Industry Profile

According to the Economic Survey 2010-11, it has been reported that NBFCs as a whole account for 11.2 per cent of assets of the total financial system. With the growing importance assigned to financial inclusion, NBFCs have come to be regarded as important financial intermediaries particularly for the small-scale and retail sectors. In the multi-tier financial system of India, importance of NBFCs in the Indian financial system is much discussed by various committees appointed by RBI in the past and RBI has been modifying its regulatory and supervising policies from time to time to keep pace with the changes in the system. NBFCs have turned out to be engines of growth and are integral part of the Indian financial system, enhancing competitiond and diversification in the financial sector, spreading risks specifically at times of financial distress and have been increasingly recognized as complementary of banking system at competitive prices. The Banking sector has always been highly regulated, however simplified sanction procedures, flexibility and timeliness in meeting the credit needs and low cost operations resulted in the NBFCs getting an edge over banks in providing funding. Since the 90s crisis the market has seen explosive growth, as per a Fitch Report1, the compounded annual growth rate of NBFCs was 40% in comparison to the CAGR of banks being 22% only. NBFCs have been pioneering at retail asset backed lending, lending against securities, microfinance etc and have been extending credit to retail customers in under-served areas and to unbanked customers.

Meaning and Types of NBFCs

Section 45I of the Reserve Bank of India Act, 1934 defines ''non-banking financial company'' as :

(i) a financial institution which is a company;

(ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;

(iii) such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify;

Hence in short an NBFC may be defined as a company registered under the Companies Act, 1956 and also registered under the provisions of Section 45-IA of the Reserve Bank of India Act, 1934 and which provides banking services without meeting the legal definition of bank such as holding a banking license. NBFCs are basically engaged in the business of loans and advances, acquisition of shares,stocks,bonds,

Debentures,securities issued by government or local authority or other securities of like marketable nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principle business is that of agricultural activity or any industrial activity or sale, purchase or construction of immovable property.

NBFCs vs. Conventional Banks

1. An NBFC cannot accept demand deposits, and therefore, cannot write a checking facility.
2. It is not a part of payment and settlement system which is precisely the reason why it cannot issue cheques to its customers.
3. Deposit insurance facility of DICGC is not available for NBFC depositors unlike incase of banks.
4. SARFAESI Act provisions have not currently been extended to NBFCs. Besides the above, NBFCs pretty much do everything that banks do.

Company Profile

Toyota Financial Services Corporation

Toyota Group started its financial services arm with an objective to provide customers with unique and innovative finance solutions to support Toyota sales worldwide .Headquartered in Nagoya Japan,Toyota Financial Services Corporation was established in 2000 as a holding company and has grown to be a company that currently 9,200 employees nationwide with assets of $150 billion .To meet the financing needs of Toyota customers, the company has expanded its global presence to cover over 33 countries across multiple regions.TFS now serves over 17 million customers.The first financial services operations commenced in Sydney,Australia in 1982 as Toyota Finance Australia Limited and were soon followed by operations in the USA,Canada,Europe,Asia and Oceania.With an experience of 30 years in the field of auto finance,the growth has expanded significantly both in terms of geographical reach and customer base.

Headquarter	Nagoya Lucent Tower 15F,6-1 Ushijima-cho,Nishi-ku, Nagoya,451-6015,Japan
Shareholder	Toyota Motor Corporation (TMC) (100%)
Establishment	July 7,2000
Number of Associates	94(as of April 1,2013)
Business Activities	Holding Companies of Toyota's Sales finance companies
Brief History	1982-Toyota Finance Australia Ltd(TFA) 1988-ToyotaFinanceCorporation(TFC),Japan (established) 1996-Expansion to 10 countries/locations 2000-Toyota Financial Services Corporation(TFSC) established Expansion to 20 countries/locations 2005-Expansion to 30 countries/locations 2013-Expansion to 35 countries/locations

Directors	Yoshimasa Ishii (President & CEO,Executive) Eiji Hirano(Executive)Nobuyori KodairaTakuo SasakiMichael GroffYaduhisa Fujita

Toyota Financial Services India Limited

TFSIN is and Indian subsidiary of Toyota Financial Services Corporation (TFSC) which is a wholly-owned subsidiary of Toyota Motor Corporation (TMC) Japan .Toyota group has recognized the potential of the Indian automobile market and has identified it as a key market for global growth.Toyota Financial Services in India through its global expertise will offer unique products,pricing and service exclusively to Toyota customers.The company has been setup under the guidance of its MD & CEO Mr. Kazuki Ogura,who has put together a formidable team.Toyota Financial Services strives to provide an easy and comfortable experience during the Toyota purchase.TFSIN have several value added services which will cater to customers requirements throughout the vehicles life.Toyota Financial Services is registered with Reserve Bank of India as Non-Banking Finance Company vide its Registration No.:N-02.00253 having its registered office at Toyota Financial Services India Ltd,1ST Floor,Centropolis,No. 21,Langford Road, Richmond Town,Bangalore-560025 .

Headquarter	Toyota Financial Services India Ltd.1st Floor/Centropolis/ No. 21/Langford Road/Shanthi Nagar/Bangalore-560025
Shareholder's Equity	INR 2600 Million
Establishment	May 20th,2011
Number of Associates	71 (as of May 30th,2012)
Business Activities	Captive Finance Company for Toyota
Brief Milestones	August 19th,2011:Application for NBFC License(RBI Bangalore) May 2nd,2012:Certificate of Registration(RBI Bangalore) June 5th 2012:Start of Business Operations(Delhi & Bangalore)
Directors	Director(Executive):Kazuki Ogura Director:Hiroshi Nakagawa Director:Sandeep Singh Director:Mao Saka Director:Eiji Hirano Director:Yasuhiro Yomada

Values

Toyota Financial Services believes a car adds happiness to people's lives and as a company.It desires to ensure Toyota customers in India is provided with a happy car throughout their journey.TFSIN through its three pillars of Transparency,Fairness and Simplicity will strive to provide its customers with the best customized financial services support in the industry.Toyota Financial Services India's objective is to pleasantly exceed its customers' expectations and become their first preferred car finance partner.

HR Vision

"To strive to build a humanistic performance driven organization with the belied that people are the major assets and they will sustain the company as an institution with vitality and perpetuity."

Products/Services

TFSIN have designed a range of products from which the customers can choose the one that suits their requirements best and drive home their dream Toyota car .Unique finance schemes from Toyota Financial Services are based on our core philosophy of "customers for life". Toyota Financial Services give the following options for Toyota customers:

- 100% finance
- On Road Funding
- Loyalty Benefits
- Extended Tenure
- Customized Products
- Insurance Funding
- Low Margin Money
- NRI Funding

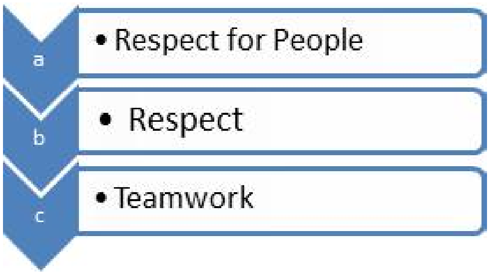
Products of TFSIN

Classic Finance	**Easy Finance**
Easy Monthly Installment	Plan based on your future income
Planned Outflow	Flexible EMI to go with your increasing Income Level
Flexi Finance	**Smart Finance**
Low Monthly Outflow	Affordable initial cash outflow
Pay more when you get more	Easy upgrade to your next Toyota

Future Growth and Prospects

As the world's second-largest car manufacturer,Toyota is committed to tackling environmental issues.Our approach is both long-term and holistic. The total life-cycle of the product, from design and use of Materials to end-of-life recycling,is examined for environmental impact-as seen in this report-as are Socio-economic aspects, such as the health and safety of our employees, and the communities in which Toyota operates.Toyota's response to the challenges of promoting environmental excellence involves Total commitment from management and employees. Toyota's managerial values, business methods, value and beliefs are collectively known as the Toyota Way.

The Toyota Way



Competitors' Information

All NBFC's are Competitors to Toyota Financial Services India

Some Meagre Competitors are:-

- Bajaj Financial Services
- Daimler Financial Services India Pvt Ltd.
- Ford Credit Kotak Mahindra Ltd

Inventory Funding

Inventory financing refers to a line of credit or short-term loan made to a company for purchasing products for sale. These products, or inventory, serve as collateral for the loan if the business is unable to sell and repay its loan. Inventory financing is useful, especially, for the businesses that must pay their suppliers in a shorter time period than what is taken in selling the inventory to customers. Moreover, it also provides a solution to seasonal fluctuations in cash flows in addition to helping a business reach a higher sales volume. Lenders might view inventory financing as a type of unsecured loan for if the business is unable to sell its inventory, the bank might not be able to either.

Inventory Funding Team of TFSIN

The **Inventory Funding team** of TFSIN is responsible for providing in-house financing to the dealers of Toyota who are approved by Toyota Kirloskar Motors, India .

Firstly,the dealers in India who sells Toyota Cars get approved from **Toyota Kirloskar MotorsI(TKM)** to start with the Toyota dealership business.

Secondly,The TKM approved dealers approach TFSIN for loan for Inventory Funding .The total process starting from commencing the loan-application process to the sanctioning of amount to the dealers is for 15 days.

The process for sanctioning the loans to the dealers are as follows-

1. TKM Approved Dealers Approach for Loan for Inventory Funding

The TKM approved dealers approach for loan for Inventory Funding from Toyota Financial Services India Limited .The loan is required for Inventory Financing relating to Toyota Cars on a Revolving Credit basis .Revolving Credit is a type of continuous credit to facilitate the smooth flow of operations relating to Wholesale Sales and Retail Sales of Cars and the cost of maintaining the inventory.

2. TFSIN Sends the Required Check-list of Documents to the Dealers

The Inventory Funding team of TFSIN acknowledge the TKM approved dealers and sends the required Check-list of documents to start the loan-application process as soon as possible.

The required check-list of pre-sanctioned documents are as follow

- Family-tree and Brief background of the promoters .
- Detailed Background of the Dealership Company and the Group Companies .
- Last 2 years Audited Financials of the dealership company and their respective Group Companies .
- Provisional Financials of the Dealership Company and the Group Companies .
- Last 2 years ITR(Income-tax Return) of the promoters
- Last 2 years ITR(Income-tax Return) of the dealership-company and the Group Companies.
- Latest Net-Worth Statement of the promoters .
- Memorandum of Association and Article of Association of the Dealership Companies and the Group Companies .
- Latest Copy of the dealership Agreement between the Dealership Company and the Toyota Kirloskar Motors .
- Infrastructure details of the dealership Company and the Group Companies .
- Photocopy of the latest property documents offered as a Collateral-Security .
- Details of PAN Card of the dealers and individuals required for CIBIL(Credit Information Bureau India Limited) Score .
- Details regarding the Passport of the promoters .

After sending the required Check-list of documents to the dealers, the dealers send the required documents needed to complete the loan-application process .

3. Checking the Documents Pending on Behalf of the Dealers

After the dealers send the documents, the next step is to check the list of received documents and pending documents by matching the documents received with the documents check-list and sending the list of pending documents to the dealers .The turn-around time is **1 day .**

4. Analyzing the Financials of the Dealers:-

The fourth step is to analyse the financials of the dealership company and the group company for the last 3 years starting from Financial Year 2010-11 and the Provisional Financials of the dealership and the Group Company .The important aspects of the Financial Analysis of the dealers are as follows –

a.Analyzing the Balance-Sheet

The Balance-Sheet and Profit and Loss Account of the dealership company and the group company is filled and analyzed in a format prepared by the **CFO** of the company Mr. Akihiko Sekiguchi.

The format of the Balance-Sheet is more precise and detailed-oriented as it provides a **brief break-up** of the following items along with a tabular format

Cash and Deposits

Particulars	2010-11 (INR Mn)	2011-12 (INR Mn)	2012-13 (INR Mn)	31/1/2014 (INR Mn)
Cash				
Bank Deposits Details:-				
1.Bank of Baroda FD				
2.HDFC Bank FD				

Receivables and Receivable(Group):

Receivables refer to the outside Debtors and Receivables(Group) refers to the Debtors of the Group Companies of the dealership.

Receivables and Receivable GroupDetails	2010-11 (INR Mn)	2011-12 (INR Mn)	2012-13 (INR Mn)	31/1/2014 (INR Mn)
Outstanding <6 months				
Outstanding >6 months				

Details of other Current Assets

The details of other Current Assets is also bifurcated to get a better picture

Details of Other Current Assets	2010-11 (INR Mn)	2011-12 (INR Mn)	2012-13 (INR Mn)	31/1/2014 (INR Mn)

Similarly, the break-up of Other Current-Liabilities, Long-term borrowings and Short-term borrowings is also done to facilitate the analysis in a detailed manner .

b.Important Aspects of the Balance-Sheet of the Dealers

The Balance-Sheet of the dealers is analysed from the following point of view

Inventory Funding Structure of the Dealers (Operating Aspect)

The Inventory Funding Structure of the dealers is compared on Year-to Year basis to see whether the Inventory Funding Requirements of the dealers is increasing on YOY (Year to Year basis) versus the increase in Sales. This is an important aspect of analysis because if the Inventory Funding requirements of the dealership company is not increasing, it means that the Sales of the car is not showing an upward trend. It also facilitates in the calculation of the **Operating cycle (in terms of number of days)** which is the sum of **Inventory Turnover Ratio** and **Receivables Ratio** as per the financials. **Operating cycle** is an important aspect of calculation which is used while calculating the **Sanctioned Limit Amount** to the dealers.

• Working Capital (Operating Aspect)

Working Capital Requirements is simply calculated by adding the **Receivables** and **Inventory** and subtracting the **Payables**. If it is in surplus, it means that the dealership company has a sound liquidity position to meet the Short-term requirements of the business.

• Remaining Room for Loan(Investing and Financing Aspect)

The remaining room for Loan is calculated by adding the major Fixed Assets which is in the form of **Land and Building** and subtracting the **Long-term Borrowings**. If the amount is in surplus, it means that the credit-worthiness of the dealer is good in the long-run to meet the requirements of the long-term loan.

c. Analyzing the Profit and Loss Account

The Profit and Loss Account is also prepared in a detailed format .It also provides a brief break-up of Expenses and Other Income.The major component of the expenses of the dealer is Selling and General Administrative Expenses(SGA) which is bifurcated in the following manner:-

- Employee-benefit Expenses
- Selling and Advertisement Expenses
- Rent

The other Expenses is classified in the following manner-

- Finance Cost(Interest)
- Depreciation and Amortization Expenses

The other Income is classified in the following manner-

- Interest Income
- Dividend Income
- Income from Others

Alongwith the Profit and Loss Account, A Common-Sized Statement is prepared stating each-item in the Profit and Loss Account as a percentage of **Sales Turnover**. Secondly, a **Trend** Analysis is also done which states the increase or decrease in terms of percentage of each particular item in a Profit and Loss Account .

d. Preparing a Ratio Analysis Table

The Ratio Analysis table is prepared based on the preparation of Balance-Sheet and Profit and Loss Account .It is classified in the following manner-

- Liquidity Ratios which include Current Ratio, Receivables Ratio, Payables Ratio, Inventory Turnover Ratio as a major component .
- Profitability Ratios which includes Gross-Profit Margin, Operating Profit Margin, Interest-Coverage Ratios and Dealers Efficiency Ratio .

Note:- Dealers Efficiency Ratio states the ratio of SGA Expenses to Gross Profit .

5. Preparing a Dealer Summary Sheet.

After analysing the financials of the dealers, the next step is to prepare the Dealer Summary Sheet which shows the qualitative details of the dealers in the form of the background of the dealers which includes:

- Name of the Dealership Company
- Details of the Family Tree and Family Background

- Details of the Outlets of the dealers in terms of Location and Facility. The dealership facility comprises 4S-

1. Sales
2. Service
3. Spares
4. Security

- A brief Summary of the financials of the dealers and the Consolidated Summary also which is taken from the Consolidated Balance-Sheet .

Note:- A Consolidated Balance Sheet is prepared by merging the Balance-Sheet of the Dealership Company and the Group Company.

- Details of the Assets of the Dealership Company and the Group Company and the percentage of assets of the dealership company in total assets .
- Infrastructure Details of the Dealers
- Net-Worth Statement of the promoters .
- Shareholding Pattern of the Promoters in the Dealership Company as well as in the Group Companies .
- Details of the **CIBIL Score** which is in the range of **300 to 900** .300 is the lowest score and 900 is the highest score. A score of 600 and above is good for the promoter .The scores are calculated after taking into consideration the details of the **Standard Account** of the dealers and the **Overdue Account** of the dealers .
- Finally, the Dealer Summary Sheet consists of the Brief Analysis of the Inventory Funding team of TFSIN in terms of Strengths and Considerations.
- Lastly, After analysing the dealer Summary Sheet, the **Credit Conditions** is laid down based on which the amount will be funded to the dealers .

6. Preparation of Credit-Memo

A Credit Memo is the the fourth step of preparation of document of Risk Appraisal process under Inventory Funding and it includes the following important components:

Main Component

a. Credit Memo 1

It contains information about the Applicant, Dealer Principal Name, Summary of Application which includes Sanction of New Limit, Renewal of Credit Limit, Increase and Condition Charge. The other important information are Types of Facility to be provided, Amount to be sanctioned, Review Timeline, Repayment option which is made on Revolving Credit Basis, Details of Collateral, Total Inventory Limit ,Pre-approved Adhoc Limit, Total Document Limit and the details of the Guarantors.

b. Credit Memo 2:

It contains the details of the Background of the dealers and the details of the Group Companies, Rationale of the Calculation of the Credit Limit, Operating Cycle Justification and the Limit Justification which briefly tells about how the limit is calculated. This component is very important because it forms the basis of making decision regarding the amount to be funded to the dealers of Toyota Cars .

c. Credit Memo 3

After the Credit Limit is determined and Limit Justification is decided, Another important component of Credit Memo is prepared which contains a Snapshot of the Financials of the dealership, Recommendation, Approval and Credit Conditions .

d. Credit Memo 4

This is the final component of Credit Memo which is prepared on the basis of other Components of Credit Memo. It contains Remarks on the Summary of the Financials by Senior Risk Analyst, Head-Operations and Risk, CFO and CEO.

Supporting Component

The supporting Component of Credit Memo forms the basis of preparation of Main Component of Credit Memo which includes the following-

Sales Data

It contains the details of the Consolidated Sales Data and Regionwise Sales Data of the sale of the Toyota Cars for Financial Year 2013-14 .The sales data is according to each Toyota Car for the last 12 months. The Toyota Cars are Etios, Liva, Innova,Fortuner,Corolla,Camry,Prado, Prius and Land Cruiser .After recording the Sales Data from the Monthly Dealer-Wise Sales Data,The average Sales of each Toyota Cars and Total Sales is calculated which forms the basis of the Calculation of Operating Cycle.

Operating Cycle Calculation

Operating Cycle is calculated based on the following steps:-

- Firstly,The Opening Stock is for the month of April which is calculated by dividing the Closing Stock for the FY 12-13 by the Overall Average Price for each Toyota Car which is Rs 9 lakhs.
- Secondly,The Closing Stock for each month is calculated by Adding Opening Stock to the Wholesale Purchase by the dealers and Subtracting it by the Retail Sales.

- Thirdly,The Inventory Turnover Ratio for each month is calculated based on the Closing Stock for each month and Retail Sales for each month.

- Lastly, After calculating the Inventory Turnover Ratio,the fourth step is to calculate the Average Inventory Turnover Ratio and add it to the Receivables Ratio to Calculate the Operating Cycle in terms of the number of times.

- The Operating Cycle is multiplied with 30 to convert it in terms of the number of days.

Brief Snapshot

Credit Limit					
Model	**Actual Avg sales p. m.**	**Prokected Avg sales p.m. for next 6 months**	**Operating Cycle (42.3 days)**	**Avg Ticket size**	**Limits in Rs. Mn**
Liva					
Etios					
Innova					
Fortuner					
Corolla					
OTHER					
Total					

a. Actual Average Sales for each Car is calculated which is mentioned in the Sales Data as a supporting component of the Credit Memo .

b. Projected Average Sales for each car is calculated based on the estimate of the increase in Sales of Car for the next 6 months and it is decided by the Senior Risk Analyst.

c. Operating Cycle is calculated in the Credit Memo after taking into consideration the Opening Stock,Wholesale Sales and Retail Sales of the car.The Average Inventory Turnover Ratio is determined and it is added to Receivables Ratio to compute the Operating Cycle.

d. Average Ticket Size is the overall average price of the Toyota Cars

e. Limits in Rs Mn is calculated in the following manner- Projected Sales*Operating Cycle (number of times)*Average Ticket Size