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joneja bright steels: THE CASH discount decision

Surya Bhushan Kumar, Vinay Goyal, and Subrata Kumar Mitra wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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Sitting inside the office of his company’s headquarters in Faridabad, India, Ajai Joneja, joint managing director of Joneja Bright Steels Private Limited (JBS), was thinking about the current situation of the steel market in India. It was March 21, 2016, and Ajai was worried by the continuing decline in profitability and the firm’s stressed liquidity situation. Declines in sales concerned Ajai; he had expressed these and other, similar concerns at meetings where some of the top-level executives in the industry gathered. These executives seemed to be confronting many of the same business challenges. Accordingly, Ajai was creating a plan to improve the company’s profitability and liquidity position before competitors could surpass JBS’s position in the industry.

The proposal that Ajai considered was to offer a cash discount to the company’s customers. He believed that offering an incentive to customers in the form of a cash discount would encourage them to make early payments. His managers were not at ease with this proposal, believing that it might not have an impact and would not increase the company’s profitability. Historically, JBS had not offered this discount because of its business model, which was based on low business margins. But with its recent capacity expansion, the company had created unused capacity that could bring in extra profits. Based on his experience, Ajai believed that offering a discount to customers would improve the company’s overall credit collection period. However, he was uncertain about the impact that this type of discount would have on JBS’s overall profitability and stressed cash position.

Bright Steel Industry

In India, bright steel manufacturing was a growth industry due to its direct link to the automobile sector. Bright steel products are essentially products that are created from black steel with further processing of annealing, tempering, and/or rolling at room temperature (normally). These products have a superior surface finish and better tolerance, concentricity, and straightness. The overall growth rate for the industry was 11 per cent from fiscal year 2010/11 to fiscal year (FY) 2014/15, commensurate with the growth rate of the automobile industry.[[1]](#footnote-1) That growth was also expected to increase due to the higher number of global automobile giants conducting business in India.[[2]](#footnote-2) Daimler and Mercedes-Benz, Ford, Volkswagen, BMW, Hyundai, Nissan, and many other automobile manufacturers were establishing production facilities in the country. The Indian Government’s Ministry of Heavy Industries and Public Enterprises had developed a mission plan for the automotive sector in which it estimated that India would emerge as a preferred destination for designing and manufacturing automobiles and automotive components.[[3]](#footnote-3) The industry had the potential to generate up to US$145 billion,[[4]](#footnote-4) which would account for 10 per cent of the gross domestic product in India by 2016.[[5]](#footnote-5)

The state of the bright steels industry in India could be seen as competitive, with both large and small players. Jindal Steel and Power Limited and Bhushan Steel Limited were two of the larger, more reputable players. These companies operated in multiple steel product market segments; bright steel was just one part of their overall product portfolio. Many smaller players that produced bright steel products, located all across India, were among JBS’s competitors. Ajai considered C. Lal Alloys Pvt. Ltd., Gopalsons Steels Pvt. Ltd., and JBS to be among the more prominent smaller industry players (see Exhibits 1 to 3). These companies were relatively capital-intensive because the production equipment was expensive and the length of the production process ranged from one to three years, depending on capacity.

Automobile manufacturers and their ancillary companies were the major buyers of bright steel, but the product was used in other industries too. Construction companies, railways, textile machine manufacturing companies, accuracy-based fabrication manufacturers, and the defence sectors (for arms and ammunitions) were some of the industries that also used bright steel products.[[6]](#footnote-6)

steel and automotive industry trends

Bright steel was a ray of hope for the overall steel industry. Overall, the Indian steel industry was expected to be sluggish in the near future, and prices were expected to be low as a result of weak global demand (mainly due to the slowdown of the Chinese economy).[[7]](#footnote-7) The Centre for Monitoring Indian Economy Pvt. Ltd. (CMIE), an economic research organization, estimated that due to weak global demand, the price of steel was expected to remain stable in the near future (see Exhibit 4).[[8]](#footnote-8) However, the market dynamics of bright steel products were closely linked to the automobile sector, and trends in both industries (automobile manufacturing and bright steel manufacturing) were expected to be similar. India’s domestic economy was still healthy, and the domestic demand for automobile products was strong. According to the Society of Indian Automobile Manufacturers (SIAM), the automobile industry’s passenger vehicle segment grew 3.2 per cent in FY 2014/15 on a year-to-year basis. Sales of three-wheelers and two-wheelers also showed year-to-year growth of 12.5 per cent and 9.5 per cent, respectively.[[9]](#footnote-9) The future of Indian automobile manufacturers was looking promising. SIAM estimated that the passenger car segment would grow 6–8 per cent in FY 2015/16, and that the medium and heavy vehicle segments would experience a double-digit growth rate during the same time period.[[10]](#footnote-10)

Joneja Bright Steels

JBS was one of the largest manufacturers of bright steel products in Faridabad,[[11]](#footnote-11) a part of the New Delhi National Capital Region in India. It was a major supplier of bright steel products and served many renowned automobile manufacturers across India. By 2016, JBS had emerged as a one-stop shop that enabled automobile manufacturers to meet all their requirements for bright steel. In Northern India, almost every automobile manufacturer was on JBS’s client list, including the largest passenger car manufacturer, Maruti Suzuki India Limited, located in Gurgaon.

During FY 2014/15, the company’s annual turnover was ₹1,357 million (approximately $19.8 million),[[12]](#footnote-12) in comparison to ₹1,284 million in FY 2013/14. This represented an annual growth of 5.69 per cent. The major source of JBS’s income (approximately 96 per cent) was from the sale of bright steel products. Some minor income was generated through the sale of services and from financing activities.

JBS was founded in 2002 by two young brothers, Gurnam Singh Joneja and Ajai Joneja, in Ballabhgarh, a small town near Faridabad in the state of Haryana, India. Their entrepreneurial journey started from humble origins—a small steel scrap trading company created by their late father, Sher Singh Joneja. The company was initially known as Joneja Iron and Alloy Steel Company, but changed its name to Joneja Bright Steels in 2002. The brothers’ vision, reflecting their belief that customers deserved only the very best, was to create a brand name in processed steel by offering products of the highest quality with timely delivery. Gurnam, the elder of the two brothers, was technically very efficient and managed the administrative part of the company. Ajai, the younger brother, was very people-oriented. Using his strong business acumen, Ajai was responsible for the commercial aspects of the business.

The automotive industry boom in India, starting in 2000, led to an accompanying meteoric rise in demand for JBS’s products. JBS had grown from having only one unit for manufacturing steel bars, acquired by the brothers’ father in 1987, to adding another unit in 2002 to manufacture cold heading quality wires. In 2003, the brothers visited Japan—a visit that helped transform them into technology-savvy manufacturers and effective leaders in the processed steel industry. By 2004, they had added a third plant to JBS for manufacturing bar products. The existence of all three plants greatly increased JBS’s strength in terms of product variability and the overall product portfolio. JBS’s capabilities extended from bright wires to bright bars, with diameter ranges varying from 1.40 millimetres (mm) to 40 mm for wires, and from 3 mm to 80 mm for bar products. As a result, the company was able to launch two new projects, one for automobile components (in 2006) and another for high carbon and fine wires (in 2010).

The company’s focus on quality was a differentiating factor for major buyers of its products. Those major buyers included original equipment manufacturers (OEMs) that supplied their final products to automobile manufacturers. In order to ensure high quality standards, JBS established its own steel testing laboratory, which was approved by the National Accreditation Board for Testing and Calibration Laboratories. The company’s international practices brought dividends in the form of an ISO/TS-16949 certification, the first of its kind for any bright steel bar manufacturer in India.[[13]](#footnote-13) When awarded this certification, Gurnam said, “We were the first company in the field of bright steel bar manufacturing to get an ISO/TS-16949. We are dedicated to operating with integrity and providing value-added services to all our customers with the best quality products on time, every time.”

Company Growth

The company’s net profit had decreased to ₹5.4 million in FY 2014/15 (see Exhibit 5). In the past, the cost of goods sold had ranged from approximately 76–80 per cent of the company’s annual income (see Exhibit 5). But the company expected its other operating expenses to increase by 2–3 per cent in FY 2015/16. Thus, in keeping with prior experience, JBS expected that profit levels would not increase unless the company took some steps to increase revenue. Furthermore, the financial strength of the company had increased considerably during the past five years (see Exhibit 6).

JBS had from its beginnings competed with industry stalwarts, and Gurnam had successfully kept the company afloat through many market fluctuations. Through private logistics facilities and highly customized products, JBS had received a substantial amount of business from automobile manufacturers. These measures helped JBS to harness the benefits of a solid just-in-time inventory system. In FY 2012/13, JBS increased its production capacities for bright steel products.

The company’s revenue was primarily dependent on orders from OEMs. With the existing orders from OEMs, approximately 20 per cent of the company’s capacity was unused. JBS was selling its products to OEMs on a 45-day credit period throughout the year. The company had taken its working capital loan from a commercial bank at a fixed interest rate of 18 per cent per annum.

The Manager’s Dilemma

Recent capacity expansion had provided JBS with an extra avenue for earning income. In FY 2014/15, 20 per cent of the company’s capacity was not utilized. In previous years, the company had experienced some decline in its revenue due to the sudden drop in demand for its products; however, the increase in demand for automobiles in India was encouraging. The important point to decide was pricing.

The company’s current revenue was declining as a result of pricing pressure. Ajai knew that if he priced his product effectively, the company’s revenue would definitely increase. At the same time, he was aware that he needed to ensure that his cash flow and profit were not affected by a change in pricing. The best solution he could think of in the present circumstances was to make a change in the discount policy. Traditionally, JBS followed a conservative credit policy and had not offered a cash discount for reducing the company’s standard credit period of 45 days to make payment in full (net 45 days).[[14]](#footnote-14) Ajai was now considering a change in that policy, proposing to keep the credit period of 45 days, but offer a 2 per cent discount if the customer paid within 10 days (2/10 net 45 days).[[15]](#footnote-15)

Ajai discussed the issue of a discount with his field sales managers. They predicted that approximately 50 per cent of JBS’s customers would take advantage of the cash discount proposal. Ajai concluded that the company’s revenue could be increased by 8 per cent by 2016/17 if the cash discounts were offered to customers. This would be 2 per cent less than an earlier estimation of 10 per cent growth but would benefit JBS by decreasing its commitment to working capital. The existing opportunity cost of investing funds in the market was usually estimated at 18 per cent per annum (consider as total interest charges to be paid in case of raising any further working capital loan from the market).

Ajai was conflicted. He thought that trying the discount might be a good way to increase the company’s market share, but he was skeptical about the impact that such a discount would have on JBS’s profitability. He wanted more information before making his decision. He asked the head of the finance department to provide information about the firm’s liquidity and financials: What was the status of the working capital in his company? How did the company’s working capital compare to the working capital of its competitors? How profitable would the company be if the cash discount proposal turned out to be positive in the future?

EXHIBIT 1: KEY FINANCIAL INFORMATION FOR JBS’S COMPETITORS

Fiscal Year 2014/15, in ₹ millions

|  |  |  |  |
| --- | --- | --- | --- |
| **Name** | **Revenue** | **Net Profit** | **Total Assets** |
| Omega Bright Steel Pvt. Ltd. | 141.00 | 5.64 | 127.97 |
| Gopalsons Steels Pvt. Ltd. | 48.82 | 0.37 | 29.26 |
| C. Lal Alloys Pvt. Ltd. | 52.17 | 0.05 | 30.87 |

Source: Annual reports of Indian private limited companies were provided by MCA Services, Ministry of Corporate Affairs, Government of India, accessed March 24, 2016, www.mca.gov.in/mcafoportal/login.do.

Exhibit 2: Income Statements for JBS’s Competitors

Fiscal Year 2014/15, in ₹ millions

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Omega Bright Steel Pvt. Ltd.** | **Gopalsons Steels**  **Pvt. Ltd.** | **C. Lal Alloys Pvt. Ltd.** |
| Revenue | 1,410.00 | 488.20 | 521.70 |
| Cost of goods sold (COGS) | 1,170.00 | 386.20 | 396.50 |
| Operating expenses | 144.50 | 461.10 | 102.50 |
| Interest expenses | 9.40 | 23.20 | 22.70 |
| **Profit before taxes** | **86.10** | **5.20** | **0.70** |
| Income tax | 29.70 | 1.50 | 0.30 |
| **Net profit** | **56.40** | **3.70** | **0.50** |
| Purchases during the year | 1,156.20 | 380.80 | 417.36 |

Source: Annual reports of Indian private limited companies were provided by MCA Services, Ministry of Corporate Affairs, Government of India, accessed March 24, 2016, www.mca.gov.in/mcafoportal/login.do.

Exhibit 3: Balance Sheets for JBS’s Competitors Fiscal Year 2014/15, in ₹ millions

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Omega Bright Steel Pvt. Ltd.** | **Gopalsons Steels**  **Pvt. Ltd.** | **C. Lal Alloys Pvt. Ltd.** |
| **Assets** |  |  |  |
| Cash | 354.80 | 0.80 | 0.60 |
| Accounts receivable | 377.90 | 134.80 | 110.00 |
| Inventory | 133.90 | 66.90 | 45.40 |
| Short-term loans and advances | 11.90 | 2.60 | 5.50 |
| Other current assets | 2.00 | 10.90 | − |
| Non-current assets | 399.00 | 76.50 | 147.20 |
| Total assets | 1,279.70 | 292.50 | 308.70 |
| **Liabilities** |  |  |  |
| Current liabilities |  |  |  |
| Accounts payable | 103.00 | 99.90 | 15.20 |
| Short-term borrowing | 60.70 | 86.00 | 119.20 |
| Short-term provisions | 5.20 | 0.30 | 0.20 |
| Other current liabilities | 36.90 | 17.80 | 14.00 |
| Non-current liabilities | 45.60 | 28.20 | 59.50 |
| Shareholders’ capital | 194.20 | 18.00 | 14.00 |
| Reserves and surplus | 824.80 | 42.30 | 86.60 |
| Total liabilities and shareholders’ equity | 1,279.70 | 292.50 | 308.70 |

Source: Annual reports of Indian private limited companies were provided by MCA Services, Ministry of Corporate Affairs, Government of India, accessed March 24, 2016, www.mca.gov.in/mcafoportal/login.do.

Exhibit 4: Forecasted Production (in tonnes) and Average Prices (₹ THOUSANDS per Tonne) of Finished Steel in India

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Fiscal Year** | **Consumption** | **Production** | **Imports** | **Exports** | **Prices** |
| 2015/16 | 99,230.00 | 93,664.00 | 11,171.90 | 11,171.90 | 39,016.90 |
| 2016/17 | 106,154.00 | 99,000.00 | 9,250.00 | 9,250.00 | 40,575.00 |
| 2017/18 | 113,725.00 | 106,400.00 | 8,450.00 | 8,450.00 | 43,250.00 |
| 2018/19 | 122,850.00 | 114,700.00 | 8,560.00 | 8,560.00 | 45,250.00 |
| 2019/20 | 132,800.00 | 124,600.00 | 8,725.00 | 8,725.00 | 47,250.00 |

Source: “Steel Data: Production, Imports, Exports, Consumption and Prices of Finished Steel,” CMIE Industry Outlook, accessed March 24, 2016.

Exhibit 5: Summary of JBS Income Statements, 2010–2015 (in ₹ millions)

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Fiscal Year** | **2010/11** | **2011/12** | **2012/13** | **2013/14** | **2014/15** |
| Revenue | 1,079.00 | 1,269.40 | 1,343.30 | 1,284.00 | 1,357.00 |
| Cost of goods sold (COGS) | 820.00 | 990.00 | 1,070.00 | 1,029.30 | 1,069.50 |
| Operating expenses (including depreciation) | 148.20 | 165.60 | 188.50 | 209.70 | 248.50 |
| Interest expenses | 12.40 | 12.90 | 19.70 | 19.80 | 30.10 |
| **Profit before taxes** | **98.40** | **100.90** | **65.10** | **25.20** | **8.90** |
| Income tax | 32.50 | 32.70 | 24.40 | 5.70 | 3.50 |
| **Net profit** | **65.90** | **68.20** | **40.70** | **19.50** | **5.40** |
| Purchases during the fiscal year | 863.80 | 984.34 | 1,078.32 | 1,051.11 | 1,072.55 |

Source: Company documents.

Exhibit 6: Summary of JBS’s Balance Sheets, 2010–2015 (in ₹ millions)

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Fiscal Year** | **2010/11** | **2011/12** | **2012/13** | **2013/14** | **2014/15** |
| Current assets |  |  |  |  |  |
| Cash | 7.29 | 17.16 | 7.55 | 7.27 | 8.52 |
| Accounts receivable | 235.69 | 294.54 | 314.77 | 297.18 | 271.25 |
| Inventory | 116.36 | 102.99 | 109.85 | 131.64 | 134.71 |
| Short-term loans and advances | 54.33 | 52.69 | 138.92 | 71.23 | 70.28 |
| Non-current assets | 176.15 | 252.82 | 181.40 | 283.71 | 283.03 |
| **Total assets** | **589.82** | **720.21** | **752.48** | **791.03** | **767.79** |
| Current liabilities |  |  |  |  |  |
| Accounts payable | 84.76 | 136.22 | 89.48 | 64.35 | 47.13 |
| Short-term borrowing | 34.46 | 100.85 | 152.38 | 167.87 | 176.64 |
| Short-term provisions | 34.46 | 38.33 | 21.00 | 13.22 | 7.05 |
| Non-current liabilities | 165.55 | 105.99 | 434.04 | 146.54 | 108.77 |
| Shareholders’ capital | 19.59 | 19.59 | 19.59 | 19.59 | 20.59 |
| **Reserves and surplus** | **251.00** | **319.22** | **36.00** | **379.46** | **407.61** |
| **Total liabilities and shareholders’ equity** | **589.82** | **720.21** | **752.48** | **791.03** | **767.79** |

Source: Company documents.

1. India Brand Equity Foundation, *Automobiles* (TechSci Research, August 2015), accessed March 24, 2016, www.ibef.org/download/Automobile-August-2015.pdf. [↑](#footnote-ref-1)
2. Ibid. [↑](#footnote-ref-2)
3. Ministry of Heavy Industries & Public Enterprises, *Automotive Mission Plan 2006–2016: A Mission for Development of Indian Automotive Industry* (New Delhi: Government of India, 2006), accessed March 24, 2016, www.siamindia.com/uploads/filemanager/20AMP-2006-16.pdf. [↑](#footnote-ref-3)
4. All dollar amounts are in US$ unless otherwise specified. [↑](#footnote-ref-4)
5. Ministry of Heavy Industries & Public Enterprises, op. cit. [↑](#footnote-ref-5)
6. “Bright Bar Applications,” Prakash Steel Products Private Limited, accessed March 24, 2016, www.prakashsteel.com/brightbarapplications.html. [↑](#footnote-ref-6)
7. Tata Steel Limited, “Chairman’s Statement,” *Tata Steel 108th Annual Report 2014–2015: Responding to Challenges. Creating Long-Term Value*, 2–3, accessed March 24, 2016, www.tatasteel.com/investors/annual-report-2014-15/annual-report-2014-15.pdf. [↑](#footnote-ref-7)
8. “Steel Data: Production, Imports, Exports, Consumption and Prices of Finished Steel,” CMIE Industry Outlook, accessed March 24, 2016. [↑](#footnote-ref-8)
9. India Brand Equity Foundation, op. cit. [↑](#footnote-ref-9)
10. Nabeel A. Khan, “Passenger Vehicle Sales May Grow 6–8% in FY 2015–16: SIAM,” *Economic Times*, October 10, 2015, accessed March 24, 2016, http://economictimes.indiatimes.com/industry/auto/news/industry/passenger-vehicle-sales-may-grow-6-8-in-fy-2015-16-siam/articleshow/49294937.cms. [↑](#footnote-ref-10)
11. Faridabad was the manufacturing hub in the state of Haryana, India. Many small, medium, and large steel industries had their manufacturing units there. [↑](#footnote-ref-11)
12. ₹ = INR = Indian rupee; US$1 = ₹66.47 on March 21, 2016. [↑](#footnote-ref-12)
13. ISO/TS16949 was a quality-management certification jointly developed by the International Automotive Task Force and the International Organization for Standardization. The certification attested to a manufacturer’s continual improvement, defect prevention, and reduction of variation and waste in the automotive industry supply chain. [↑](#footnote-ref-13)
14. Buyers were paying JBS within 45 days without incurring any penalty. [↑](#footnote-ref-14)
15. Customers would receive no discount if they paid at any time from the 11th to the 45th day after the date of purchase. [↑](#footnote-ref-15)