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Green Sill Capital Fiasco: A Recipe for Disaster & Deceit

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Abstract

An expert in the field of supply chain finance, Greensill Capital successfully brought out uninterrupted financial innovations to meet the demands of its large number of customers' need for financing. In the recent times, the company filed for bankruptcy. This news has put its essential and primary customers, namely, GFG Alliance and Liberty, the metals and trading groups, in danger. These companies have a high growth rate and hence need funds to support such growth. Large amount of funds can be consequentially obtained by converting factorized receivables into securitized package which is an example of financial innovation. To deploy such funds, Greensill needed to find new customers or finance the existing ones. The COVID-19 pandemic further delayed the process. This case throws light over many topics relating to financial strategy and financial instruments like reverse factoring, securitization, insurance, and the relationship with banks. This case also showcases the significance of business ethics. The data presented in this case study is secondary.

Keywords: Financial innovation, business failure, firm growth, working capital management, supply chain finance; securitization, business ethics

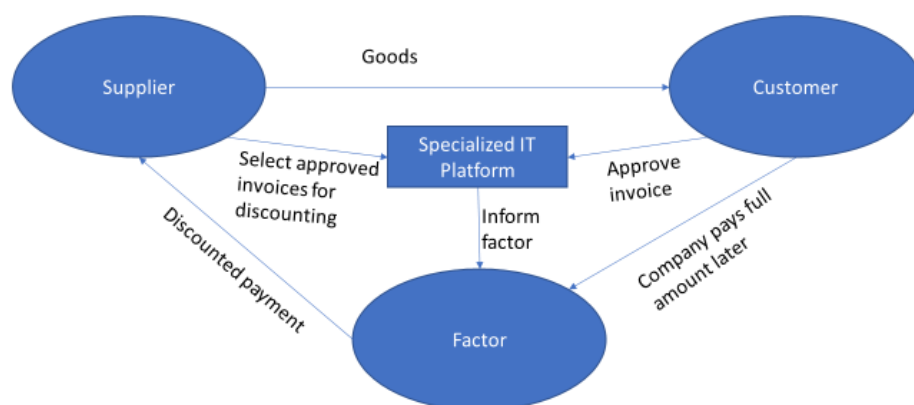
Usually in management studies, case studies of successful companies and organizations are used in educating students. However, it can also be informed by failures that show what should not be done. What is especially interesting are great failures that are often in the news because you learn how they succeeded and why they failed. In this paper, I narrate the story of the collapse of Greensill Capital in March 2021. The importance of this case study is not just because a fast-growing firm broke into bankruptcy. It is also because the report of its growth provides tremendous lessons in strategy, networking, and teaching Alternative Finance for business management students. The final failure highlights that cutting corners is not only unethical, it is also unhealthy for all the supply chain that it was financing.

1. A brief introduction to Alternative Financing

When usually a company starts, it starts with a small amount of capital and assets. As it grows, it requires huge amount of funds. Not only equity, the business also requires debt financing. Unless a substantial amount of collateral security is provided, banks are usually highly unwilling to give a big loan to businesses. Further, fixed assets are required for such collateral and even so, the loan is only provided on part amount of the value of the assets. For example, if a land of 10 lakh rupees is mortgaged, the bank would be willing to give somewhere around 5 to 7 lakhs. The proportion could be higher or lesser depending on how developed the country is. The interest rate on the same would also differ based on different parameters of the country. The availability of such credit funds also affects the working capital management of the organizations and specifically small organizations.

Thus, a financial bottleneck is created and companies which want to grow fast and want to borrow capital for their businesses have a dire need to find a different way of resourcing their finance. Such funding must also put more value to their collateral security. One of many such sources of alternative finance is known as bill discounting, and another by the name of factoring. In bill discounting, the company recovers the money from the costumers at a later date and pays off the bill discounter. In factoring, the factor collects the money. Such services are provided by banks and non-banking financial institutions. While bill discounting is risky free and cheap, on the other hand, factoring has a probability of risk and is expensive, which is because of the extra services provided with the same. It is apparent that if a firm is fast growing, it would require more financing and hence, the firm would even be willing to pay a higher rate

of interest. Many times, the banks provide the factoring services at a lower rate to such large firms for invoices or bills, specifically if such firms have frequent transactions with consumers using an online platform. Since the banks offer such services, they have extremely competitive terms on these services because they get last-mile data to lock customers. But for smaller companies with higher risks, a non-banking factor, like Greensil Capital, is needed. The insight that large customers are less risky has led to the development of reverse factoring, where the acceptance of bills by large customers provides immediate finance to suppliers. As we can see in the Figure 1, a centralized electronic platform provides all the suppliers with a reverse factoring facility. For discounting the bill, the supplier has to merely log in and select the bills that are approved. Immediate payment is assured to the supplier and this could also give them long term credit. Supply chain firms find this arrangement significantly profitable, and even more so if there are frequent transactions and a wider and greater network size since it reduces the transaction costs. It is also a factor in the growth of supply chain finance at double digit rates. Experts and researchers also say that supply chain management helps the firms to perform better and would further improve if a digital platform is used. This system also helps in reducing the bankruptcy in the market and helps to stabilize the supply chain. In fact, substantive amount of research now says that since supply chain financing decreases the cost of capital by keeping in mind the least risky firm in the chain, which is often times the buyer, it not only helps the individual firms but the whole supply chain group as well. For a firm to perform better, it should be more central to its supply chain but the relationship is an inverted U as returns decrease after an optimal centrality of the focal firm.



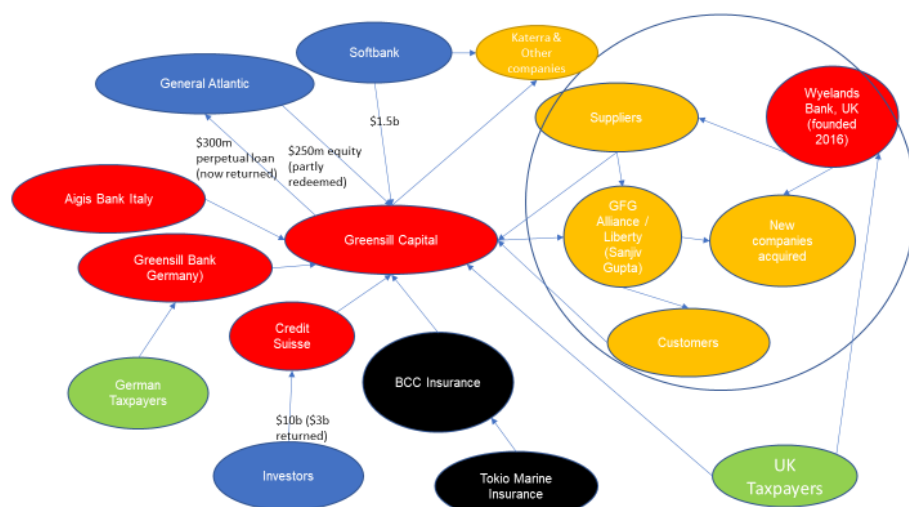
Source: Ashta, 2021, June 27th

Figure 1: Supply Chain Finance, Source: Author

Lower cost of capital of the buyer of the customer is the main factor in determining the use of factoring or reverse factoring. Sufficient research in supply chain finance states that if bankruptcy causes any disruption in the supply chain all the members' risk will increase. But more so if the supplier defaults. (Gibilario & Mattarocci, 2019). However, there is no research on the causes or effects of a failure of the factoring firm on the supply chain. The failure of Greensill provides an interesting case study in this research gap.

2. The Greensill – GFG case study

In Figure 2, we can see the relationships between the major actors of this case study, but latest news states that the repercussions wider. There are two major firms involved in the Greensill debacle. Greensill capital is the first amongst them and it is also the factor. It had many customers, Vodafone and AstraZeneca among them, but the important relation was with Liberty and GFG Alliance. The latter two were a part of Sanjeev Gupta's empire. Simply put, GFG was a customer of great significance and thus all of its suppliers were eligible for reverse factoring or supply chain finance services from Greensill. In short, the payables of GFG were managed by Greensill. And if GFG acquires other firms, their erstwhile suppliers will get an assured source of financing for their supplier payments. This availability of finance would then reduce their risk of insolvency and avoid disruptions in supply chains (Cavenaghi, 2013). To point out something amusing, the primary focus of GFG Alliance is on metals since Zhang et al. found that the industries that gain the most through supply chain finance are mining, manufacturing and transport. This also helps to reduce bankruptcy.



Source: Ashta, 2021, June 27th

Figure 2: A panoramic view of the actors involved in the Greensill Capital case study.

To facilitate its growth, GFG had an external growth strategy through which it acquired other firms. This acquisition strategy was based on figuring out and finding firms with good health but no access to finance. Thus the targets and the targets' suppliers obtain more liquidity by acquiring them and providing them access to Greensill Capital. For example, 0057hyalla steelworks, a failing firm in Australia, was bought by Sanjeev Gupta for A\$700m. The firm paid late and told its suppliers to take financing from Greensill Capital at a 8% discount (Smyth, 2021).

As research had pointed out, the operating performance of the central firm in a supply chain improves till an optimal point is reached (Carnovale & Yenyurt, 2015). In its network, GFG was the focal firm. Thus, the network relationship between Greensill, GFG, and its future acquisitions was an essential part of the strategic relationship.

3. Lowering risk? Private equity, private placements and network externalities

Because Greensill wanted to take advantage of GFG and all its customers, it itself needed finance as well. Partly, it wanted equity since it does not have to be repaid in case of bankruptcy and is therefore considered lower risk. It took this equity funding through private placement, another alternative finance arrangement that avoids disclosing information to the market. The technology and high-growth-oriented private equity firm General Atlantic provided Greensill Capital with \$250 million in equity in 2018 (Smith, Wiggins, & O'Murchu, 2021). Based on this increase in equity, Greensill itself could take more debt. Simultaneously, General Atlantic was happy because a year later, in 2019, General Atlantic took a perpetual debt of \$300 million from Greensill (routed through a chain of companies).

Moreover, for Greensill, this led to another dynamic advantage. Since General Atlantic had invested in Greensill, other investors felt that the due diligence performed on Greensill was adequate, and therefore, in 2019, Softbank's Vision Fund invested \$1.5 billion into Greensill (Smith, Wiggins, & O'Murchu, 2021). Moreover, by joining Softbank's network, Greensill could get introduced to all the large firms that Softbank had invested in and could factor their invoices (Jenkins, 2021). Moreover, Softbank was willing to invest in Greensill to indirectly bail out its own target acquisitions that were having trouble, such as Kattera (Inagaki, 2021).

4. Financial leverage to increase returns

However, equity capital, such as the founders and the private equity funds, wants to have the financial leverage to increase their returns. For this, Greensill Capital needed to get refinancing from a bank or some alternative finance sources. Partly, it was able to get some refinancing from Greensill Bank AG, a local bank in Germany that Greensill had acquired, for its fixed assets such as private aircraft. It turned to Credit Suisse and GAM for much larger refinancing, and they decided to find investors who would lend money. For this, they needed to create a securitization-type fund for Greensill receivables that investors could buy into (Jenkins, 2021).

5. Insurance for risk mitigation

Investors like low risk. Since Greensill's business with GFG was risky, it was important for Greensill to find insurance for the bills that they were discounting. This insurance was essential if Greensill wanted to get refinanced by securitizing the customer bills and packaging them, and selling the package to investors. If the package proposed by Credit Suisse on Greensill receivables were insured, the investors would be willing to invest in such structured funds because their own risk would reduce. In our case, the insurance was provided by BCC insurance, certified by one of this insurance company's brokers in Australia. The outcome of this financing from Credit Suisse meant that suddenly Greenfield was flushed with the availability of funds to on-lend and could grow immediately if it could find customers. This meant that Greensill required its customers, such as GFG, to grow quickly to access the suppliers of all their acquired companies. Since GFG wanted to grow also, it became a convenient partnership. Moreover, the insurer would also grow if the size of the portfolio it insured grew. Another win-win-win situation. By 2021, the Greensill linked funds were about \$10 billion (I. Smith, 2021).

6. The problem: Overexposure was the key risk

The problem was that GFG was a big part of Greensill's portfolio and as both grew, the percentage part of the Gupta empire in Greensill became about 70% by 2019 (Smith, Wiggins, & O'Murchu, 2021). By March 2021, GFG had borrowed about \$5 billion from Greensill (Smith, Barnes, Hammond, Smyth, & Pooler, 2021). Moreover, COVID-19 had deeply affected the metals business since all the downstream customers were affected, thus fragilizing the GFG alliance and its suppliers and increasing their need for financing. At the same time, COVID-19 had reduced bank financing and therefore the supply chain was even more

dependent on the funding from Greensill. Greensill could behave in a risk neutral or risk seeking manner, since it had insured the portfolio of discounted bills, thus exploiting a situation of moral hazard (Stiglitz, 1983).

Since Sanjeev Gupta's financing for his external growth was quite opaque, it meant that Greensill funds' portfolio seemed increasingly risky to outsiders. The BCC insurance company was fearful but still interested because its own growth depended on the development of the network. However, when another insurance company, Tokio Marine, acquired the BCC insurance company in April 2019, the acquiring company examined the entire portfolio of BCC Insurance. Notably, it felt that BCC's exposure to the Greensill fund was too high and that Greensill's exposure to GFG was too high, and that GFG was too opaque to determine risk. Moreover, a part of the package pertained to future expected bills of GFG which were therefore risky. Tokio Marine, therefore, stopped the insurance cover for the Greensill fund (I. Smith, 2021).

7. Bankruptcy

When the insurance stopped, the investors realized that the risk had gone up, and they asked to get their money back unless a new insurance company could be found. However, no insurance company was willing to take the risk primarily because they felt that Greensill Capital was too risky and because the GFG empire was also too foggy. Notably, when a firm is dealing with closely held companies, they can raise invoices on each other purely to get supply chain financing from different factoring firms (Smith, O'murchu, & Pooler, 2021). As a result of the lack of insurance, investors wanted their money back, and Credit Suisse, in turn, had to ask Greensill to pay back. This reimbursement required all the GFG suppliers to pay back, which they could not do. GFG itself had used the money to buy fixed assets (that is, companies), and therefore, it was not possible to divest them quickly enough. Moreover, the COVID crisis had reduced the sale of metals and had impacted Sanjiv Gupta's business adversely, and he had already defaulted on payments of about \$1 billion (Smith, Barnes, et al., 2021). Public subsidized loans from the UK government went through Greensill to GFG.

The result was a liquidity crisis that caused Greensill Capital to file for bankruptcy administration on March 8. This bankruptcy then impacts investors and Credit Suisse upstream, GFG, and its suppliers downstream. As noted earlier, the manufacturing, mining and transport industries are found to be more dependent on supply chain financing for the survival of the chain members (Zhang et al., 2019) and therefore the closing of the finance impacts the whole

supply chain of GFG. In Germany, the Greensill Bank was also asked by German regulators to reduce their exposure to GFG Alliance (R. Smith, 2021). In Italy, Aegis bank also suffered from the failure of Greensill and has failed (Smith, Wiggins, & Borrelli, 2021).

It also affects its shareholders, such as General Atlantic and Softbank. General Atlantic had redeemed some of its share capital when Softbank invested and was therefore much less exposed. To reduce its reputation damage, it has repaid the \$300 million perpetual loan so that the downstream investors and banks reduce their losses. The investors have been able to get back \$3 billion of the \$10 billion invested in the Greensill fund.

GFG Alliance is therefore left without financing and a number of downstream financiers, such as Credit Suisse are asking it to reimburse them. GFG has also been unable to make its tax payment to the government (Pooler, Robert Smith, and, & Pickard, 2021). German taxpayers are affected since the German court has also started examining the winding up of Greensill Bank, since it had lent to GFG also, and the State would have to repay the retail depositors upto €100,000 each.

8. Conclusion

The Greensill case serves as a contemporary teaching platform to examine how modern firms increasingly compete, grow, and fail through financial design rather than through products alone. Its pedagogical strength lies in integrating finance, strategy, and ethics into a single narrative of organizational rise and collapse. For management scholars, the case opens pathways to theorizing financial fragility as an organizational outcome. For managers, it underscores that the durability of any business model ultimately depends less on innovation itself than on the transparency, discipline, and integrity with which innovation is governed.

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