INDIAN FINANCIAL SYSTEM

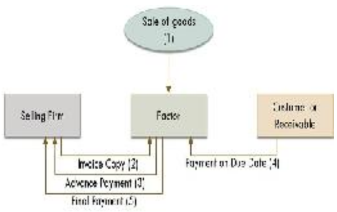
M.COM SEMESTER II

FACTORING

Dr. Geetika T. Kapoor
Department of Commerce

FACTORING

- Factoring is defined as a method of managing book debt, in which a business receives advances against the accounts receivables, from a bank or financial institution (called as a factor)
- There are three parties to factoring i.e. debtor (buyer of goods), the client (seller of goods) and the factor (financier)
- Factoring is financial service provided by an intermediary known as a factor who purchases receivables from the client.
- Factoring, receivables factoring or debtor financing, is when a company buys a debt or invoice from another company.
- It is a form of invoice discounting in many markets .
- In it accounts receivables are discounted in order to allow the buyer to make a profit upon the settlement of the debt.
- It can also be said that there is a transfer of ownership of accounts to another party who then chases up the debt.



FUNCTIONS OF FACTORS

- CREDIT MANAGEMENT FOR THE CLIENT
- PROVISION OF PRE-PAYMENT OF FUNDS AGAINST RECIEVABLE DEBTS
- ARRANGEMENT OF COLLECTION OF FUNDS
- ADMINISTRATION OF SALES LEDGER

FORMS OF FACTORING

Recourse Factoring

The factor purchases the receivables on the condition that the loss arising on account of irrecoverable receivables will be borne by the client. For example, assume that a factor has advanced an amount of Rs.2.4 lakh against a receivable of Rs.3 lakh which turns out to be irrecoverable. Under a recourse factoring arrangement, the factor can recover the sum of Rs.2.4 lakh from the client.

Non-Recourse Factoring

Here the factor has no recourse to the client if the debt purchased turns out to be irrecoverable. Since the factor bears the losses arising on account of irrecoverable debts (receivables), the factor charges a higher commission (the additional commission is called the del credere commission). Also, the factor participates actively in the credit-granting process and decides/approves the credit lines extended to the customers of the client. While non-recourse factoring is the most common form of factoring in countries like the USA and the UK, in the Indian context, factoring is done with recourse to the client

Maturity Factoring

Under this type of factoring arrangement, the factor does not make any advance payment. The factor pays the client either on a guaranteed payment date or on the date of collection. The guaranteed payment date is usually fixed taking into account the previous ledger experience of the client and a period for slow collection after the due date of the invoice.

Advance Factoring

Under this arrangement, the factor provides an advance varying between 75-85 percent of the value of receivables factored. The balance is paid upon collection or on the guaranteed payment date. As we have already seen, the factor charges interest from the date on which advance payment is made to the date of actual collection or the guaranteed payment date. The rate of interest is usually determined depending upon (i) the prevailing short-term rate of interest; and (ii) the client's financial standing and (iii) volume of turnover.

Invoice Discounting

Under this arrangement, the factor provides a pre-payment to the client against the purchase of book debts and charges interest for the period spanning the date of pre-payment to the date of collection. The sales-ledger administration and collection are carried out by the client.

Full Factoring

A factoring arrangement which combines the features of non-recourse and advance factoring arrangements is called Full Factoring or Old-Line Factoring. Put differently, full factoring provides the entire spectrum of services – collection, credit protection, sales-ledger administration and short-term finance.

Bank Participation Factoring

This arrangement can be viewed as an extension of advance factoring. Under this arrangement, a commercial bank participates in the transaction by providing an advance to the client against the reserves maintained by the factor. For example, assume that a factor has advanced 80 percent of the value of factored receivables and the commercial bank provides an advance limited to 50 percent of the factor reserves. The client is required to fund only 10 percent of the investment in receivables, the balance 90 percent being provided by the factor and the commercial bank.

Supplier Guarantee Factoring

This arrangement was developed by the American factors primarily to help their importers/distributors involved in executing import orders on behalf of their customers.

Cross-border Factoring

The mechanics of Cross-border Factoring (also referred to as an international factoring or export factoring) is similar to domestic factoring except that there are usually four parties to the transaction – exporter, export factor, import factor and importer.

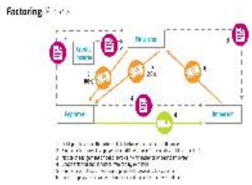
PROCESS OF CROSS BORDER FACTORING

- The customer places an import order with the distributor.
- The distributor seeks the approval of the factor for extending credit to the customer.
- On receiving the credit approval from the factor, the distributor makes arrangements for shipping the supplies directly to the customer.
- The factor guarantees payment to the foreign supplier in respect of the specific shipment. Upon shipment, he credits the account of the distributor and debits the account of the customer for an amount equal to the invoice value of the goods shipped plus distributor's commission.

PROCESS CONTD…

- Instead of making an advance payment to the distributor against the customer's account that has been factored, the factor pays the supplier directly for the invoice value of the goods shipped.
- The factor follows up with the customer, collects the amount due and makes the final payment to the distributor after deducting his commission and guarantee charges.

Thus, apart from offering the usual services, the factor guarantees payment to the supplier on behalf of his client (the distributor) thereby engendering greater confidence in supplier-distributor dealings.



BENEFITS OF FACTORING

TO THE CLIENTS

- Raise short term finance
- Free from botheration of credit management
- Comprehensive Credit Control System
- Free to explore new markets or new businessess
- Can offer competitive credit terms to their customers
- Reduction in overhead expenses on follow –up
- Interplay of various working capital components

BENEFITS CONTD…

TO THE BUYERS

- Attractive Credit Terms
- Lesser Documentation as compared to financing by Banks
- Saving on Bank charges
- Periodical Statements received from the Factor

TO THE BANKS

- Factoring services are complementary to Banking Services
- Provide Necessary Liquidity to the clients
- Improved quality of Advances

Examples of Factoring Companies in India

Regional Office	Name of the Company
Bengaluru	Canbank Factors Limited
New Delhi	IFCI Factors Ltd.
	Bibby Financial Services (India) Pvt. Ltd.
Mumbai	SBI Global Factors Ltd. [Formerly: Global Trade Finance Limited]
	India Factoring & Finance Solutions Pvt Ltd
	Siemens Factoring Private Limited
Patna	Pinnacle Capital Solutions Private Limited

THANK YOU