# Factoring

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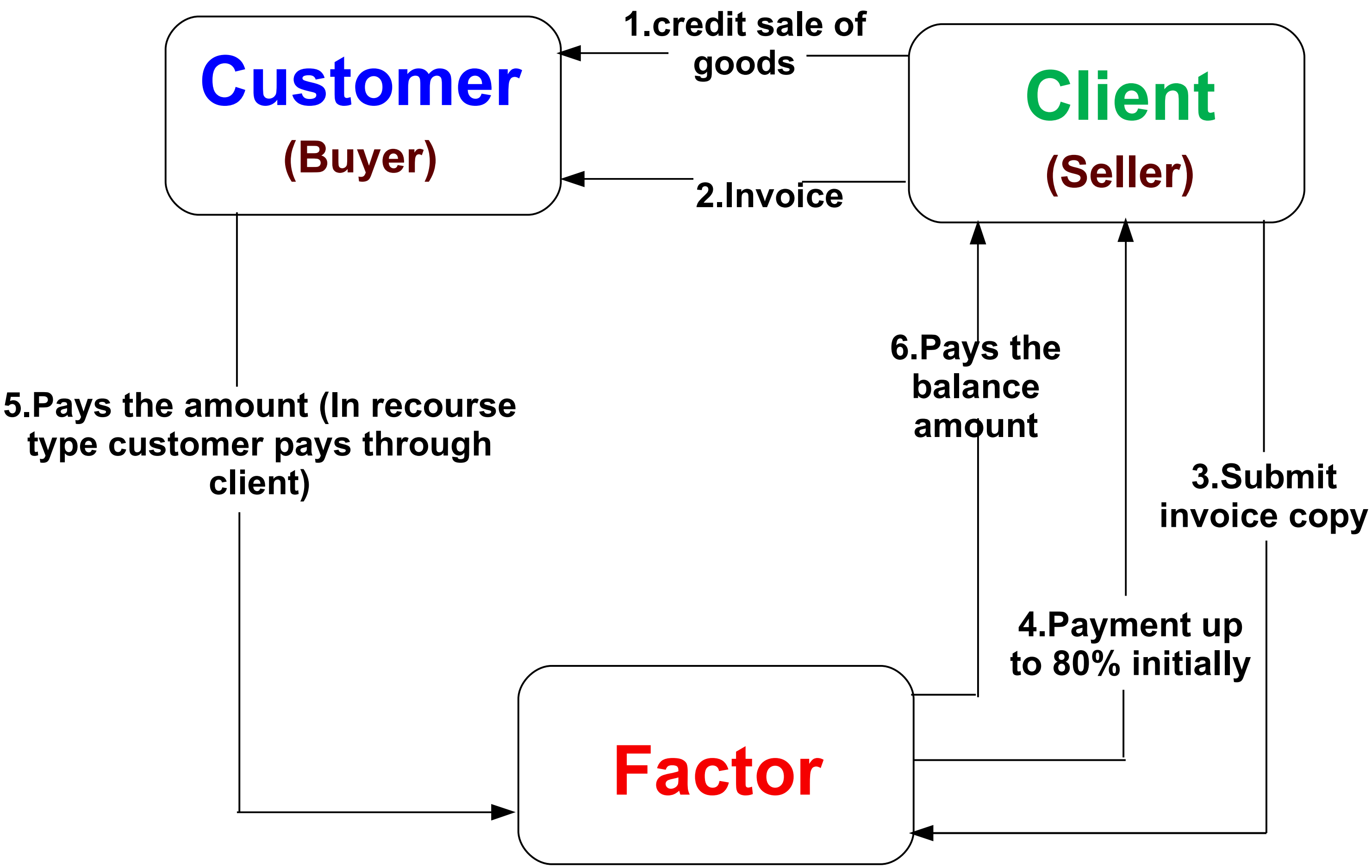
- "factoring is an arrangement under which a financial institution (called factor) undertakes the task of collecting the book debts of its client in return for a service charge in the form of discount or rebate."

# Mechanism of Factoring (After Agreement with factor)



- Functions of factoring
    - Purchase and collection of debt
    - Sales ledger management
    - Credit investigation and undertaking of credit risk
    - Provision of finance against debts
    - Rendering consulting services

# ADVANTAGES

1) Under the factoring arrangement the client receives prepayment up to 80-90 percent of the invoice value immediately and the balance amount after the maturity period. This helps the client to improve cash flow position which enables him to have better flexibility in managing working capital funds in an efficient and effective manner.

2) client need not have any administrative set up for sales ledger administration and collection from debtors. Naturally this will result into a substantial saving in time and cost of maintaining own sales ledger administration and collecting receivables from the customer. Thus, it will reduce administrative cost and time.

3) With cash available for credit sales, your liquidity will improve and therefore, your production cycle will be accelerated.

4) When without recourse factoring arrangement is made, the client can eliminate the losses on account of bad debts. This will help him to concentrate more on maximizing production and sales. Thus, it will result in increase in sales, increase in business and increase in profit.

5) The client can avail advisory services from the factor by virtue of his expertise and experience in the areas of finance and marketing. This will help the client to improve efficiency and productivity of his organization. Besides this, with the help of data base, the factor can readily provide information regarding product design/mix, prices, market conditions etc., to the client which could be useful to him for business decisions.

## Disadvantages of Factoring

1) Image of the client may suffer as engaging a factoring agency is not considered a good sign of efficient management.
2) Factoring may not be of much use where companies or agents have one time sales with the customers.
3) Factoring increases cost of finance and thus cost of running the business.
4) If the client has cheaper means of finance and credit (where goods are sold against advance payment), factoring may not be useful.

# Type of Factoring

- The factoring facility available worldwide can be broadly classified into four main group:
- Full service non-recourse
- Full service recourse factoring
- Non-notification factoring
- Domestic Factoring & Export Factoring

## Full service Non recourse factoring:

Under this method, book debts are purchased by the factor, assuming 100% credit risk. The full amount of invoices have to be paid to clients in the event of debt becoming bad.

→ The client prefers this type of factoring to obtain 100% cover under factoring rather than take insurance policy which provides only 70%-80% cover.

## Full service recourse factoring:

In this method of factoring, the clients is not protected against the risk of bad-debt. If the factor has advanced fund against book debts on which a customer subsequently defaults, the client will have to refund the money.

I. **Advance factoring** II. **Maturity factoring**

So, in the case of non-recourse advance factoring & recourse advance factoring Factor gives advance cash against book debt due to the client immediately.

In case of non-recourse advance factoring , payment is on maturity or when the book debts are collected, or on the insolvency of the customers. And in the case of recourse maturity factoring, the factor pays to the client when the books debts have been collected.

## Non-notification factoring

In this type of factoring, customers are not informed about the factoring agreement. It is through this company that the factor deals with the client's customers. This type of factoring is available in the UK to financially strong companies.

## Domestic Factoring

Domestic factoring provides funding against invoices raised on customers within India.

Three parties: 1.Customer 2.Client 3.Factor

## Export Factoring

Export factoring provides immediate financing against your export receivables. Financing can be availed in Rupees or in foreign currency.

Four parties: 1.Customer (importer) 2.Client (exporter) 3.Import factor 4. Export factor

- ✓ It's Also called 'Two-Factor System of Factoring'

## Cost & Benefits of Factoring

**Two** types of costs involved:

1. Factoring Commission 2. Interest charge on advance payment

# Difference between Factoring & Bills Discounting

- Bills discounting is always with recourse, and as such the client is not protected from bad-debts whereas Factoring can be either with recourse or without recourse.
- In bill discounting the drawer undertakes the responsibility of collecting the bills and remitting the proceeds to the financing agency, while the factor usually undertakes to collect the bills of the client.
- BD facility implies only provision of finance but a factor also provides other services like sales ledger maintenance and advisory services.
- So factoring is all of bill discounting plus much more.

# Impact of Factoring in balance sheet

1. Pre-factoring balance sheet

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1.

2. Post-factoring balance sheet

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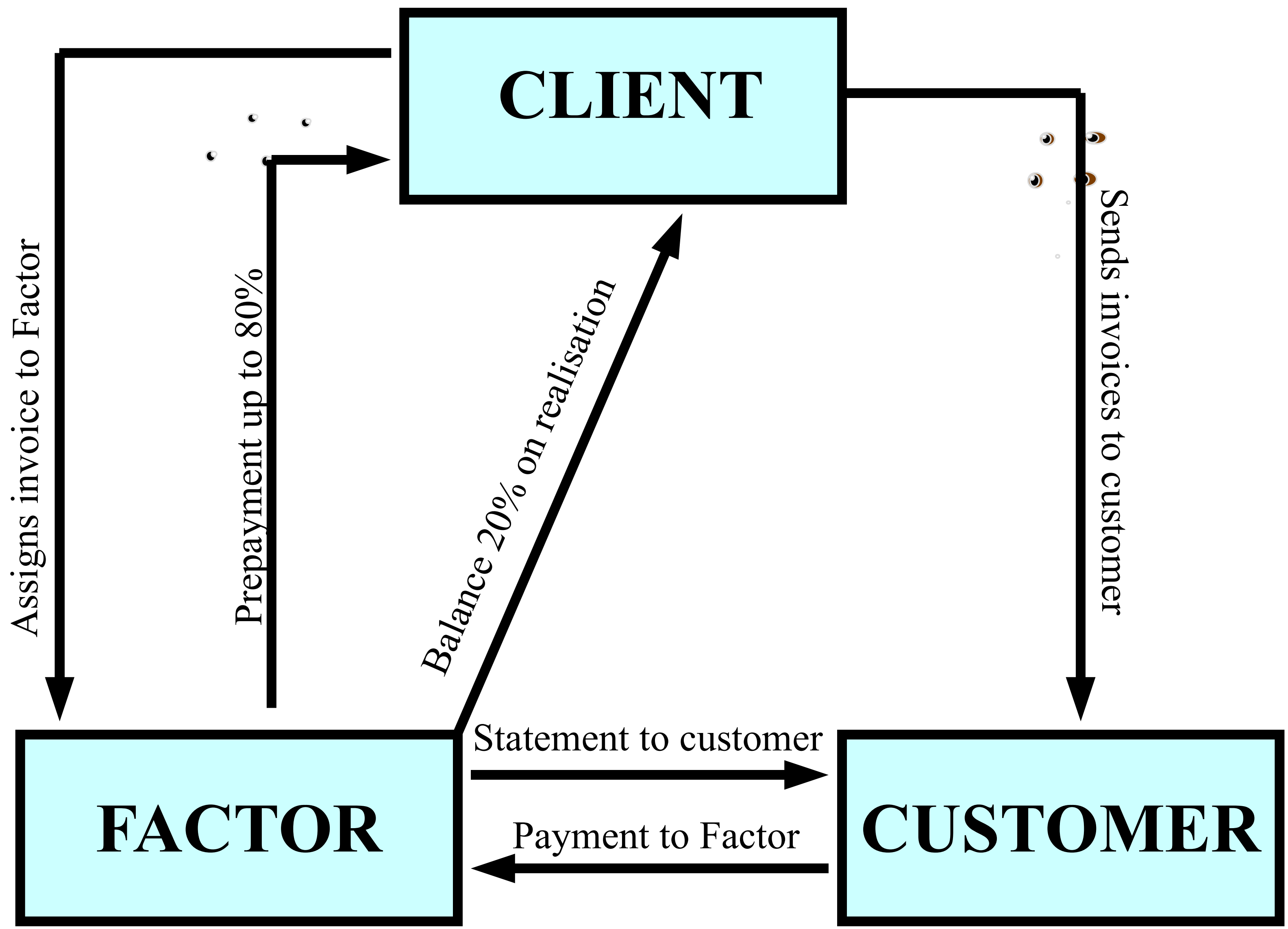
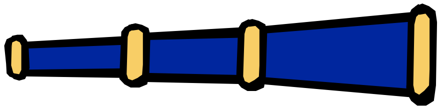
# Factoring companies in India

SBI Factors and Commercial Services Pvt. Ltd
HSBC Factoring Solutions
PNB Factoring : PNB Subsidiary Company
IFCI Ltd.
Small Industries Development Bank of India (SIDBI)
Standard Chartered Bank
The Hong kong and Shanghai Banking Corporation Ltd
Foremost Factors Limited
Global Trade Finance Limited
Export Credit Guarantee Corporation of India Ltd
Citibank, India

# MECHANISM OF FACTORING



# INDUSTRIES THAT CAN BE COVERED BY FACTORING



**Small Scale Industries with growth potentials**

**Medium Scale Industries**

**Service Industries**

## SBI Factors

**How it works?**

You invoke your customer in the usual way-only adding a notification that the invoice is assigned to and must be paid to SBI FACTORS.

- You submit copies of invoices to SBI FACTORS, accompanied by the receipted delivery challan or any other valid proof of dispatch.
- SBI FACTORS will provide pre-payment up to 80% of the invoice value.
- Follows up with the customer for realization of payment due.
- Balance payment made immediately on realization.
- To keep you informed of the factored invoices, SBI FACTORS will send you monthly statement of account.

**SBI Factor offers:**

· Instant Cash
· Follow up and Speedy Collection
· MIS Services
· Sales Ledger Administration.
· Credit Protection.

# CASE STUDY OF SUNLIGHT INDUSTRIES LTD

(Rs. Crore)

| | |
|---|---|
| ***(A) In house Management :*** | |
| Cash discount(Rs 800 croreX0.40X0.02) | **Rs 6.4** |
| Bad debts (Rs 800 croreX0.015) | **12.0** |
| Opportunity Cost (Forgone contribution on lost sales) [Rs 75 croreX0.205 net of bad debts] | **15.4** |
| Avoidable administrative and selling expenses | **9.0** |
| Cost of investment in receivables © | **14.4** |
| Total Cost | **57.2** |
| © Avg. collection period (0.40X10days)+(0.60X75days)=49 days | |
| Investment in debtors : Rs 800 croreX49/360=Rs 108.9 crore | |
| Investment in debtors: (Rs108.9X0.60X0.12)+ (Rs108.9X0.40X0.15)= Rs 14.4 crore | |

| ***(B) Canbank factors Proposal:*** | **With recourse** | **Without recourse** |
|---|---|---|
| Factoring Commission (Rs 875 croreX0.025) | **21.9** | **-** |
| (Rs 875 croreX0.045) | **-** | **39.4** |
| Discount charge(Rs 750.7*croreX.21X30/360) | **13.1** | **-** |
| (Rs 701.9**croreX.22X30/360) | **-** | **12.9** |
| Cost of long term funds invested in debtors: | | |
| [(Rs 875 crore-Rs750.7 crore)X0.15X30/360] | **1.6** | **-** |
| [(Rs 875 crore-Rs701.9 crore)X0.15X30/360] | **-** | **2.2** |
| | **36.6** | **54.5** |

*Amount of Advance=0.88X(Rs 875crore – Rs 21.9 crore)= Rs 750.7crore

**Amount of Advance=0.84X(Rs 875crore – Rs 39.4 crore)= Rs 701.9crore

| ***(C) Indbank Factor Proposal*** | ***With recourse*** | ***Without recourse*** |
|---|---|---|
| Factoring Commission (Rs 875 croreX0.018) | **15.7** | - |
| (Rs 875 croreX0.036) | - | **31.5** |
| Discount charge(Rs 721.8£croreX.20X30/360) | **12.0** | - |
| (Rs 674.8££ croreX.21X30/360) | - | **11.8** |
| Cost of long term funds invested in debtors: | | |
| [(Rs 875 crore-Rs721.8 crore)X0.15X30/360] | **1.9** | - |
| [(Rs 875 crore-Rs674.8 crore)X0.15X30/360] | - | **2.5** |
| | **29.6** | **45.8** |

£ Amount of Advance=0.84X(Rs 875crore – Rs 15.7 crore)= Rs 721.8crore

££Amount of Advance=0.80X(Rs 875crore – Rs 31.5 crore)= Rs 674.8crore

| ***Decision Analysis: Recourse Factoring*** | | (Rs. Crore) |
|---|---|---|
| ***Particulars*** | ***Canbank*** | ***Indbank*** |
| Benefits (Rs 57.2-Rs 12 Bad debts to be born by company) | **45.2** | **45.2** |
| Costs | **36.6** | **29.6** |
| Net Benefits | **8.6** | **15.6** |

| ***Decision Analysis: Non-Recourse Factoring*** | | (Rs. Crore) |
|---|---|---|
| ***Particulars*** | ***Canbank*** | ***Indbank*** |
| Benefits (Rs 57.2+Rs 1.1Bad debts to be borne by factor) | **58.3** | **58.3** |
| Costs | **54.5** | **45.8** |
| Net Benefits | **3.8** | **12.5** |