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Whither Factoring in India ?

Abstract

Factoring has become well-established one in developing countries, particularly highly industrialized one. In various Asian countries, the growth of factoring has been dramatic while in Latin America, financial institutions continue to join the industry. Similar growth has occurred in Central Europe, the Baltic's and the Middle East. Today, almost every industry can profit from factoring. Textiles and clothing are the most popular but manufacturers of industrial and farm equipment, office equipment, electronics and processed food are increasingly turning to factoring. In fact, it has become a great source of finance for running the business very successfully. The present paper is a modest attempt to discuss the conceptual framework, international and Indian experience of Factoring along with the future of Factoring services in India.

Introduction

'Factor' has been derived from the Latin word 'Facere' which means 'to make or to do'. According to the Webster Dictionary 'Factor'[1] is an agent, as a banking or insurance company, engaged in financing the operations of certain companies or in financing wholesale or retail trade sales, through the purchase of account receivables. Therefore, factoring is nothing but financing through purchase of account receivables and a method of financing whereby a company sells its trade debts at a discount to a financial institution.

More specifically, factoring is a continuous arrangement between a financial institution (factor) and the client, which sells goods and services to trade customers on credit. As per this arrangement, the factor

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purchases the client's trade debts including accounts receivables either with or without recourse to the client, and exercises control over the credit extended to the customers and administers the sales ledger of the client. The client is immediately paid 80 percent of the trade debts taken over and when the trade customers repay their dues, the factor will make the remaining 20 percent payment.

Characteristics of Factoring

1. Usually the period for factoring is 90 to 150 days. Some factoring companies allow even more than 150 days.

2. Factoring is considered to be a costly source of finance compared to other sources of short-term borrowings.

3. Factoring receivables is an ideal financial solution for new and emerging firms without strong financials. This is because credit worthiness is evaluated based on the financial strength of the customer (debtor). Hence these companies can leverage on the financial strength of their customers.

4. Bad debts will not be considered for factoring.

5. Credit rating is not mandatory. But the factoring companies usually carry out credit risk analysis before entering into the agreement.

6. Factoring is a method of off balance sheet financing.

7. Cost of factoring[2] includes both finance cost and operating cost.

8. Indian firms offer factoring for invoices as low as Rs.1000.

9. For delayed payments beyond the approved credit period, penal charge of around 1-2% per month over and above the normal cost is charged (it varies like 1% for the first month and 2% afterwards).

Types of Factoring

Factoring can be broadly classified into Disclosed and Undisclosed, and Recourse and Non-recourse Factoring. In disclosed factoring client's customers are notified through factoring agreement, and this type can be either recourse or non-recourse one. Whereas, in undisclosed factoring, client's customers are not notified in the factoring arrangement, and the client himself undertakes sales ledger administration and collection of debts. Client has to pay the amount to the factor irrespective of whether customer has paid or not. But in disclosed type of factor client may or may not be responsible for the collection of debts depending on whether it is recourse or non-recourse.

Factoring v/s Bill Discounting

Factoring and Bill Discounting seems to be similar but differ a lot one to another. In addition to the rendering of factoring services, banks and financial institutions provide bills discounting facilities to finance the client needs. However, the following are found as the similarities and differences between the two services, they are:

1. *The factoring is considered as a financial option for the management of receivables, as it is the conversion of credit sales into cash.*

Similarities	
1. Both provide short-term finance. 2. Both get the account receivables discounted, which the client would have otherwise received, from the buyer at the end of credit period.	
Differences	
Bills Discounting	**Factoring**
1. It is a provision of finance against bills. 2. Advances are made against the bills. 3. The drawer undertakes the responsibility of collecting the bills and remitting the proceeds to financing agency. 4. Bills discounted may be rediscounted several times before the maturity. 5. Bill discounting is always with recourse, i.e. in case of default the client will have to make good the loss. 6. Bill financing is individual transaction oriented i.e. each bill is separately assessed on its merits and got discounted purchased. 7. Bill finance is always 'In Balance Sheet' financing i.e. both the amounts of receivables and bank credit are reflected in the balance sheet of the clients as current assets and current liabilities respectively. This is because of the 'with recourse' nature of the facility. 8. The drawee or the acceptor of the bills is in full knowledge of the bank's charge on the receivables arising from the sale of goods and services.	1. Factoring renders all services like maintenance of sales ledger, advisory services, etc in addition to the provision of finance. 2. Trade debts are purchased by assignment. 3. Factoring undertakes to collect the bills of the client. 4. Debts purchased for factoring cannot be rediscounted, they can only be refinanced. 5. Factoring may be with or without recourse. 6. In factoring, bulk is provided against several unpaid trade generated invoices in batches. It follows the principle of 'whole turnover' 7. In full factoring services facility is 'off balance sheet' arrangement, as the client company completes his double entry accounting by crediting the factor for consideration value. 8. Factoring services like 'undisclosed factoring' are confidential in nature i.e. the debtors are not aware of the arrangements.

Advantages and Disadvantages of Factoring

Firms resorting to factoring also have the added attraction of ready source of short-term funds. This form of finance improves the cash flow and is invaluable as it leads to a higher level of activity resulting in increased profitability. By offloading the sales accounting and administration, the management has more time for planning, running and improving the business, and exploiting opportunities, The

2. *Factoring cost vary according to the transaction size, financial strength of the customer etc. The cost of factoring varies from 1.5% to 3% per month depending upon the financial strength of the client's customer.*

reduction in overheads brought about by the factor's administration of the sales ledger and the improved cash flows because the quicker payments by the customers result in interest savings and contribute towards cost savings.

On the other hand, factoring could prove to be costlier to in-house management of receivables, especially for large firms, which have access to similar sources of funds as the factors themselves and which on account of their size have well organised credit, and receivable management. Factoring is perceived as an expensive form of financing and also as finance of the last resort. This tends to have a deleterious effect on the creditworthiness of the company in the market.

Costing and Pricing of Factoring Services

While pricing factoring services, the Factoring fees or Administrative charges and Discount charges should be taken into consideration. Factoring fees are charged mainly as administrative expenses for providing various services to the clients, sales ledger administration, credit control administration and Bad-debts administration. This fee is normally computed with reference to the projected sales turnover of the client during the next twelve months. It is always quoted as a percent of projected sales turnover. Generally, this charge varies between 1 and 2.5 percent of the projected turnover. Usually a minimum handling/administrative charge is stipulated to which a certain percent of the projected turnover is added. On the other hand, for providing instant credit to the client by way of prepayment, some charges have to be levied and they are called discount charges. This charge is normally linked with the base rate. Hence, cost-plus pricing strategy is adopted for fixing the price for factoring services. Therefore,

Factoring Charge = Cost + Profit

While arriving at the cost, one should take into account the fixed cost that remains fixed irrespective of volume of business and the variable cost that varies directly with the volume of business transacted. Again, the pricing strategy depends on the costing technique that is being adopted, i.e., either absorption costing or marginal costing. Absorption costing is based on the principle that the client would be required to pay for the entire fixed cost as well as the variable cost while in the case of marginal costing, the entire variable cost and a part of fixed cost only would be recovered. Normally, the factoring cost involves both direct cost as well as administrative cost as shown in Exhibit - 1.

Legal and Financial Aspects

The legal status of a factor is similar to an assignee. Once the factor purchases the receivables of a firm and notified to the customers, they would be under a legal obligation to make all remittances to the factor. A customer who by mistake remits the payments to the firm is not discharged from his obligations to the factor until and unless the firm remits the proceeds to the factor. The factoring agreement governs the legal relationship between a factor and the firm whose receivables are to be factored, and is so drawn as to suit the various needs specifying the period of validity of the contract and modalities of termination.

Factoring involves two types of costs: (a) factoring commission; and (b) interest on funds advances. Factoring commission represents the compensation to the factor for the administrative services provided and the credit risk borne. The commission charged is usually 2-4 per cent of the face value of the receivables factored, the rate depending upon the various forms of service and whether it is with or without recourse. The factor also charges interest on advances drawn by the firm against uncollected and non-due receivables. In the UK, it is the practice to advance up to 80 per cent of the value of such outstanding at a rate of interest which is 2-4 per cent above the base rate. This works out to near the interest rate for bank overdrafts. The cost of factoring varies, from 15.2 to

16.20 per cent (Singh, 1988), 15.6 to 16.0 percent (SBI Monthly Review, 1989), and the margins in which the factors will have to operate would be extremely narrow. The strategy of factors, therefore, must be to carve out a niche in the services segment namely, receivables management and generate revenues by way of commission rather than concentrate on lending and financing activities where the margins are low.

International Factoring

Factoring has become well-established in developing countries, particularly highly industrialized one. In various Asian countries, the growth of factoring has been dramatic while in Latin America, financial institutions continue to join the industry. Similar growth has occurred in Central Europe, the Baltics and the Middle East. Today, almost every industry can profit from factoring. Textiles and clothing are the most popular but manufacturers of industrial and farm equipment, office equipment, electronics and processed food are increasingly turning to factoring.

For many companies, selling in an international market place is the ultimate challenge. While the rewards can be substantial, success can also bring its share of problems. Different customs, currency systems, laws and languages still create barriers to trade in a world where sophisticated computer technology allows orders abroad to be placed within seconds. One of the greatest problems facing exporters is the increasing insistence by importers that trade be conducted on open account terms. This often means that payment is received many weeks or even months after delivery. Unsurprisingly, many organisations find that giving buyers credit in this way can cause severe cash flow problems. Further problems can arise if the importer delays payment beyond originally agreed terms or makes no payment at all because of financial failure.

International factoring provides a simple solution regardless of whether the exporter is a small organisation or a major corporation. The role of the factor is to collect money owed from abroad by approaching importers in their own country, in their own language and in the locally accepted manner. As a result, distances and cultural differences cease to be a problem.

A factor can also provide exporters with 100% protection against the importer's inability to pay. The advantages of export factoring have proved to be very attractive to international traders. It is now seen as an excellent alternative to other forms of trade finance and the role of the letter of credit is gradually diminishing as a consequence. This means that the prospects for international factoring can be seen as favourable in all countries including those are still developing. In the future though, the real challenge for factoring companies will be to maintain their flexibility, they should react quickly to changing market circumstances.

International Factoring is used by exporters who sell on open account or documents against acceptance terms. International factoring eases much of the credit and collection burden created by international sales. By outsourcing the credit function, exporters can convert the high fixed cost of operating an international credit department into a variable expense. Commissions paid to the factor are based on sales volume so costs fluctuates with actual sales. In addition to relieving exporters of the time-consuming administrative burden of approving credit and collecting export sales, international factoring lets exporters safely offer their foreign customers competitive open account terms. Financing is provided by means of advances against outstanding accounts receivable. In summary, international factoring provides the following benefits to exporters:

- Increased sales in foreign markets by offering competitive terms of sale
- Protection against credit losses on foreign customers
- Accelerated cash flow through faster collections

- Lower costs than the aggregate charges for L/C transactions
- Liquidity to boost working capital
- Enhanced borrowing potential and an opportunity to make use of supplier discounts

Obviously, there are also advantages for importers. Until quite recently the Letter of Credit (L/C) was the most universally accepted method to control international trade, in the sense of assuring that the exporter would ship in accordance with the sales contract or the purchase order and that the importer would honor his financial obligations. Yet, while this method (or 'term of sale') had considerable merit when goods were moving slowly and at irregular intervals along shipping lanes, the L/C places a financial burden on importers, which in most cases is no longer tolerated. Hence, international factoring provides the following benefits to importers:

- Purchase on convenient 'open account' terms
- No need to open L/C's
- Expanded purchasing power without blocking existing lines of credit
- Orders can be placed swiftly without incurring delays, L/C opening charges, negotiation charges, etc.

International Factoring

There is nothing complex about factoring. It is simply a unique package of services designed to ease the traditional problems of selling on open account. Typical services include investigating the creditworthiness of buyers, assuming credit risk and giving 100% protection against write-offs, collection and management of receivables and provision of finance through immediate cash advances against outstanding receivables. When members of Factors Chain International (FCI) carry out export factoring, the service involves a five or six stage operation.

I. The exporter signs a factoring contract assigning all agreed receivables to an export factor. The factor then becomes responsible for all aspects of the factoring operation.

II. The export factor chooses an FCI correspondent to serve as an import factor in the country where goods are to be shipped. The receivables are then reassigned to the import factor.

III. At the same time, the import factor investigates the credit standing of the buyer of the exporter's goods and establishes lines of credit. This allows the buyer to place an order on open account terms without opening letters of credit.

IV. Once the goods have been shipped, the export factor may advance up to 80% of the invoice value to the exporter.

V. Once the sale has taken place, the import factor collects the full invoice value at maturity and is responsible for the swift transmission of funds to the export factor who then pays the exporter the outstanding balance.

VI. If after 90 days past due date an approved invoice remains unpaid, the import factor will pay 100% of the invoice value under guarantee.

Not only is each stage designed to ensure risk-free export sales, it lets the exporter offer more attractive terms to overseas customers. Both the exporter and the customer also benefit by spending less time and money on administration and documentation. In all cases, exporters are assured of the best deal in each country. This is because export factors never appoint an import factor solely because the company is a fellow member of FCI. Import factors are invited to compete for business and those with superior services are selected. In some situations, FCI members handle their client's business without involving another factor. This is becoming more common in the European Union where national boundaries are disappearing. However FCI members conduct their business, with the aim of selling in the complex world of international trade, dealing with local customers.

Fresh statistics indicate that the total volume for factoring increased in 2007 by almost 15%, against to 12% in 2006. The world total stands now at ●1,299,127 million, although the figures shown in Exhibit I and II indicate that the factoring industry continues to enjoy double-digit yearly growth, even more impressive are the growth figures for international factoring, in excess of 40%, a consistent pattern for the past years. The percentage for 2007 is particularly high as it has been decided to include now the figures for export invoice discounting.[1] But even without the inclusion of export invoice discounting, the results illustrate that exporters and importers, around the world, are becoming more and more familiar with the advantages to be derived from a factoring arrangement: working capital, credit risk protection and collection service for the exporter, while the importer benefits from buying on open account terms without the need to open letters of credit or to accept other payment conditions with a similar restrictive character.

It can be realized through the world trends that FCI itself grew to a membership of 231 members, located in 63 countries. The joint membership now has a world volume share of 58 %, and even 82 % when looking specifically at cross-border factoring, making the network the undisputed leader in this field of trade finance. It can be too realized that the forgoing growth percentages would have been even more impressive if the statistics were read in US dollars but with Europe being the largest regional market for factoring, the euro is probably the most relevant choice.

Three-hundred-thousand companies in 60 countries currently use factoring as a means of credit, amounting to a global business of over Rs 52,20,000 crore (E900 billion). In fact, the Asia-Pacific region only accounts for 16 per cent of this value, according to FCI. Perhaps more important is the potential between China and India. The Chinese began factoring in 1987, and currently their industry stands at $12 billion. Today, Indo-Chinese trade is valued at $19 billion. This is predicted to grow to $50 billion by 2020. According to Jiang Xu, manager (factoring), Bank of China, most of this growth will be in the SME sector. Thus, the potential for Indo-Chinese factoring appears huge. However, much of the export factoring business is generated in Greater China and in Turkey, two regions where FCI's representation is second to none, with the USA and Western Europe as the major import factoring markets. In that perspective China has become the largest generator of export factoring business, with continued growth potential not seen anywhere else in the world (see Exhibit II and III to know more about Factoring Turnover and Volume by Countries). It is also evident from the table II and III that the growth of the factoring in entire Europe, America, Africa and Asia is found with some growth in terms of business volume, but that growth was not very significant. It is due to the lengthy and laborious legal procedure of the factoring as well as least consideration of factoring as a financial service in the eyes of users. Not only that, even legal charges of the factoring is also a problem in this regard.

Factoring in India – A View

In India, the idea of providing factoring services was first thought of by the Vaghul Working Group. It had recommended that banks and private non-banking financial companies should be encouraged to provide factoring services with a view to helping the industrialists and traders to tide over their financial crunch arising out of delays in the realization of their book debts. The RBI subsequently constituted a study group in January 1988 under the chairmanship of

Mr.C.S.Kalyanasundaram, former Managing Director of the SBI, to examine the feasibility of starting factoring services. On the recommendation of the committee, the Banking Regulations Act was amended in July 1990 with a view to enabling commercial banks to take up factoring services by forming separate subsidiaries. In the public interest and in the interest of banking policy, the RBI is of the view that:

(i) The banks should not directly undertake the business of factoring.

(ii) The banks may set-up separate subsidiaries or invest in factoring companies jointly with other banks.

(iii) A factoring subsidiary or a joint venture factoring company may undertake the factoring business. But, they should not finance other factoring companies.

(iv) The banks can invest in the shares of factoring companies not exceeding 10% of the paid up capital and reserve of the banks concerned.

But, in February 1994, the RBI permitted all banks to enter into factoring business departmentally. Since factoring requires special skills and infrastructure, the RBI has further stipulated that:

(i) Factoring activities should be treated at par with loans and advances and should accordingly be given risk weight of 100 percent for calculation of capital to risk asset ratio.

(ii) A bank's exposure shall not exceed 25% of the bank's capital funding to an individual borrower and 50% to a group of borrowers. Factoring would also be covered within the above exposure ceiling along with equipment leasing and hire purchase finance.

(iii) Factoring services should be provided only in respect of those invoices that represent genuine trade transactions.

In India, the State Bank of India in association with the Small Industries Development Bank of India, Union Bank of India, State Bank of Sourashtra and State Bank of Indore first started the factoring service. The pioneering factoring company founded by the SBI is called "SBI-Factors and Commercial Services Pvt. Ltd (SBI FACS)". It was started in July 1991 with a subscribed capital of Rs. 25 crores. It has been allotted the Western Zone comprising of Maharashtra, Gujarat, Goa, Madhya Pradesh, The Union Territories of Dadra, Nagar haveli, Daman and Diu. Similarly, the RBI has allotted the Southern Region to the Canara Bank, the Northern Region to the Punjab National Bank and the Eastern Region to the Allahabad Bank for providing necessary factoring services to the clients of those regions. The RBI has removed this zonal restriction in 1993. In South, Canara Bank has already established 'Can Factors Ltd.' Now, these two factoring companies can operate in the centres outside their given zones. Besides the above, some non-banking companies also have made a bid for entering into factoring services. Thus factoring service has got a very bright future in India due to its superiority over other forms of financing.

The Indian factoring market, according to Factors Chain International (FCI), a Netherlands-based association of factoring companies, has in five years grown from Rs 1,980 crore ($450 million) in 2002-03 to Rs 11,000 crore ($2.5 billion) today. That number will go up to Rs 44,000 crore ($10 billion) by end-2007, however, India is lagging behind a little.

Yet the impact of factoring on India is visible. The finance ministry states that during the 2002 global recession, about the time factoring became popular, only SMEs stood firm as the sector's exports in the sector went up by 7.5 per cent, and it was found that SMEs were responsible for 34 per cent of India's exports, where we see factors playing a major role in financing SMEs in quick time, in continuing the tempo of their growth.

A comparison of the exports of 154 listed SMEs, especially those with a turnover between Rs 50 crore and Rs 500 crore, shows that exports had gone up from a paltry 1.40 per cent in 2004 to 7.2 per cent by the end of 2006. These companies have also seen an 8 per cent rise in exports in 2006 when compared to 2005. Although this may not be due to the rise of the factoring market, it highlights the potential for growth. Only 3,000 SMEs have access to factoring, just 0.025 per cent of the 12 million in the country that need credit financing. It is the balance that factoring companies are out to get. If they succeed, this innovative finance method is set to explode.

Factoring is yet to make it to the big time, because 95 per cent of the domestic bills of exchange industry, worth a whopping $334 billion, is still using letters of credit (LCs). The problem with factoring domestically is that, unlike international factoring, no due diligence is performed on the buyer, and no default insurance is provided. If a domestic buyer delays payment on the date of bill maturity, the SME is required to pay off the accumulating debt. A factor gives the SME a 30-day grace period and charges a penal interest rate of 2-3 per cent after this period. Currently only seven companies offer factoring, with four majors dominating banks, they are: CanBank Factors and State Bank of India Factors (with a combined clientele of 2,000 SMEs), GTFL (over 360) and HSBC Bank (120). See Table – I to know about factoring turnover of various players in India in the course of 2002 to 2006.

TABLE - I
Factoring Turnover of Indian Factoring Pioneers

Factor Company	2002	2003	2004	2005	2006*
GFTL	355.4	728.2	1485.5	2330.2	6029.5
HSBC	NO	NO	4357.6	2703.1	5825.6
Canbank Factors	1386.5	1497.2	1887.5	2621.5	2510.8
SBI Factors	NA	NA	NA	3512.8	3361.4
Foremost Factors	238.8	262.2	221.4	256.3	238.8
ECGC	NO	NO	308.8	180.6	NA
Citibank	NO	2.2	17.5	23.3	NA

Figures show factoring turnover till 2006 in Rs. crore
*Estimates; NA: Data not available for the period; NO: not operational
Source: Factors Chain International year 2007

Bank Finance to Factoring Companies

Reserve Bank of India in its notification dated 12th February 2008, has permitted banks to extend financial assistance to support the factoring business of Factoring Companies that should comply with the following criteria :

a) The companies carry out all the components of a standard factoring activity,viz.,financing of receivables,

3. *According to the UNIDROIT definition of international factoring, export invoice discounting is not export "factoring" as only one service element is provided, namely finance. However, as more and more national factoring associations are including export invoice discounting in their international factoring figures, FCI has somewhat reluctantly decided to follow suit so that the FCI statistics for those countries match the statistics used locally.*

sale-ledger management and collection of receivables.

b) They derive at least 80 per cent of their income from factoring activity.

c) The receivables purchased/ financed, irrespective of whether on 'with recourse' or 'without recourse' basis, form at least 80 per cent of the assets of the Factoring Company.

d) The assets/income referred to above would not include the assets/ income relating to any bill discounting facility extended by the Factoring Company.

e) The financial assistance extended by the Factoring Companies is secured by hypothecation or assignment of receivables in their favour.

As per the existing guidelines, bills discounted / rediscounted by NBFCs and those arising from sale of certain types of vehicles, are not eligible for bank finance. Further, the unsecured loans extended by the NBFCs to other companies are also ineligible for bank finance.

In the Indian context, factoring is being viewed as a source of short-term finance. The estimated aggregate potential demand for factoring (finance) would be about Rs 4,000 crores (SBI Monthly Review, 1989). There seems to be a tendency to view factoring primarily as a financing function - a source of funds to fill the void of bank financing of receivables for small-scale industries and others. This attitude is fraught with dangers and could lead to a "catch 22" situation. In launching factoring service, the thrust should be in the twin areas of receivables management, and credit appraisal; factoring agencies should be viewed as vehicles of development of these skills. Since the small-scale sector lacks these sophisticated skills, factors should be able to fill the gap. Giving priority to financing function would be self-defeating, as receivable management would be given the back seat. It is for the factors to generate the necessary surpluses to mop up the additional resources and then embark on financing function.

However, for policy reasons, should these go hand in hand, then the accent should be on receivable management otherwise, these agencies would end up as financing bodies. From the firm's point of view, factoring arrangements offer certain financial benefits in the form of savings in collection costs, reduction in bad debt losses, and reduction in interest cost of investment in receivables. On the other hand, the firm incurs certain costs, in the form of commissions and interest on advances. Therefore, to assess the financial desirability of factoring as an alternative to in-house management of receivables, the firm must assess the net benefit of this option, using the profit criterion approach. The factors have to establish their credibility in offering better management of receivables and financing at competitive rates to the clients.

Conclusion and Suggestions

Factoring is a complete financial package that combines working capital financing, credit risk protection, accounts receivable bookkeeping and collection services. It is offered under an agreement between the factor and a seller. Under the agreement, the factor purchases the seller's account receivable, normally without recourse, and assumes the responsibility for the debtor's financial ability to pay. If the debtor goes bankrupt or is unable to pay it's debts for credit reasons, the factor will pay the seller. When the seller and the buyer are located in different countries the service is called international factoring. A growing number of companies offer factoring services and many of these works internationally. Most factors are either owned by, or associated with, well-known international banking or other financial institutions as well as insurance companies or industrial organizations.

Factoring is now universally accepted as vital to the financial needs of small and medium-sized businesses. It has the support of government bodies and central banks throughout the world. As international trade continues to increase, the opportunities for the factoring industry are also expected very high at a significant growth. International factoring works in a similar way to domestic factoring, exporters have realized that it can help them to become more competitive in complex world markets. Many businesses that turn to factoring companies are reassured to know that the industry is closely associated with the banking sector. Although factoring companies remain highly specialized institutions, nearly all-major banks now have factoring subsidiaries. This has enabled the industry to promote its services with great success and to work for businesses of every size. For factoring to develop, it is imperative that an enabling legal environment is created and the Factoring Bill is passed in Parliament. It is also essential to enable weak companies that are tided over their liquidity problems, by accepting receivables through the factoring companies.

Factoring is a recent but rapidly growing phenomenon in India. It is getting higher and penetrating into the Indian trade finance sphere, since its introduction by the RBI in the early 1990s on the recommendation of the Kalyanasundaram Committee, with the primary objective of providing adequate and timely finance to the financially constrained SMEs that were going through sluggish expansion.

According to a World Bank's report, India's factoring activity grew by over 800 per cent between 1998 and 2003. That clearly shows the growing demand of factoring finance in India. According to the Factors Chain International, Indian factoring grew by 176 per cent during 2002 to 2006. Nevertheless, the factoring sector is lagging behind a little. While 3 lakh companies in 60 countries across the globe currently use factoring as a means of credit, there are only eight active factoring companies operating in India with as small as 0.32 per cent share of the total global factoring business. Apart from this, it has been observed that out of 12 million SMEs, only around 3,000 SMEs have access to factoring. This reflects that Indian factoring industry is growing far below its real potential. Finally, if we compare its growth (that is 800 per cent) with that of China and Taiwan, that increased by as high as 23,900 per cent and 1,500 per cent respectively during 1998-2003, we realize that we have to go a long way before catching up with global countries.

The growth potential for factoring products is staggeringly high. At present, in the light of continuous appreciation of the rupee and rising inflationary pressure, engendering an uncertainty over credit availability and cost of bank credit, factoring could play the role of a saviour for Indian traders to remain competitive in the global arena, both in the short run and the long run. This will help accelerate the wheel of foreign trade and add considerable momentum to the process of globalization. Hence, the Government agencies should give adequate attention to the spread and use of factoring. Not only that, the Government must frame appropriate policies to provide stimulus to factoring activities in the country as Factoring is a sunrise industry in India.

Finally, it can be asserted that, factoring would become a good and great financial source for business enterprises in the present critical and complex economic environment of the world and a viable and profitable lending activity to banking sector in their business portfolio. So the banks and financial institutions should make a fruitful attempt to bring-up the business of factoring for the benefit of corporate world.

Notes

- In factoring, a financial institution (factor) buys the accounts receivable of a company (Client) and pays up to 80%(rarely up to 90%) of the amount immediately on agreement.

- Factoring company pays the remaining amount (Balance 20%-finance cost-operating cost) to the client when the customer pays the debt. Collection of debt from the customer is done either by the factor or the client depending upon the type of factoring.

- In recourse factoring, client undertakes to collect the debts from the customer. If the customer doesn't pay the amount on maturity, factor will recover the amount from the client. This is the most common type of factoring. Recourse factoring is offered at a lower interest rate since the risk by the factor is low. Balance amount is paid to client when the customer pays the factor.

- In non recourse factoring, factor undertakes to collect the debts from the customer. Balance amount is paid to client at the end of the credit period or when the customer pays the factor whichever comes first. The advantage of non recourse factoring is that continuous factoring will eliminate the need for credit and collection departments in the organization.

- The first factoring company was started by the SBI in 1991 namely Factors and Commercial Ltd. (SBI FACS) followed by Canara Bank and PNB, setting the subsidiaries for the purpose. While the SBI would provide such services in the Western region, the RBI has permitted the Canara Bank and PNB to concentrate on the Southern and Northern regions of the country, for providing such services for the customers. The major players since 1991 are Canbank Factors, SBI Factors and later Foremost Factors. The new entrants in the market include ICICI, HSBC and Global Trade Finance. Canbank Factors leads in the domestic market with about .65%-70%of the share. The Vaghul Committee Report on Money Market Reforms has stressed on the need for factoring services to be developed in India as part of the money market instruments. Many new instruments had already been introduced like Commercial Paper (CP), Pm1icipation Certificates (PC), Certificates of Deposits etc. but the factoring service has not developed to any significant extent in India.

- The eighties in India was witness to a virtual deregulation of capital market a number of innovative financial instruments and schemes were born. The policy of the power- that - be also helped in the development of money market. The capital market mutatis mutandis tried to transplant some of the successful schemes of the west. The working group (1987) on the money market, headed by

Vaghul, observed: "Despite various measures taken over the years to enable the small-scale sector to recover its dues from the medium and large industries (and in particular the public sector) the small-scale units face a liquidity bind because of their inability to collect the dues". Since the earlier efforts to popularise a bill market in India did not have the desired results an alternative had to be found. Available data reveal that funds locked up in book debts have been increasing at a faster rate than growth in sales turnover or build-up in inventories (Anantha Krishnan, 1990). Thus, factoring as a remedy became a fait accompli. A committee was constituted under the chairmanship of Kalyana Sundaram (1988) to examine the feasibility of factoring services in India and suggest operational modalities of launching such a service.

Exhibit - 1: Cost Sheet for Factoring Service

(A) Direct Cost	Rs.	
Per invoice amount	....	
Per active account	....	
Per debtor account	....	
Per client	....	% of turnover
Bad debt provision	....	% of turnover
Total Direct Cost	________	
(B) Administrative Cost	....	% of turnover
(C) Total Factoring Cost	= A + B	
(D) Profit	=	% of turnover

(E) Required Factoring Charge $= \dfrac{C + D}{\text{Total Turnover}} \times 100$

= % of turnover

Exhibit - II
Factoring Turnover by Country
Factoring Turnover by Country in 2007 (in Millions of EUR)

No. of Companies	Continent/Country	Domestic	International	Total
EUROPE				
8	Czech Republic	3,840	940	4,780
9	Denmark	5,574	2,900	8,474
26	France	107,040	14,620	121,660
50	Germany	65,000	24,000	89,000
10	Greece	6,500	920	7,420
27	Hungary	2,940	160	3,100
40	Italy	112,820	9,980	122,800
8	Lithuania	1,870	820	2,690
7	Norway	15,000	2,000	17,000
20	Poland	7,150	750	7,900
10	Portugal	15,582	1,306	16,888
9	Romania	1,000	300	1,300
15	Russia	12,850	250	13,100
9	Slovakia	900	480	1,380
23	Spain	78,618	5,081	83,699
50	Sweden	18,000	3,700	21,700
90	Turkey	16,930	2,695	19,625
38	Ukraine	850	40	890
107	United Kingdom	274,530	11,966	286,496
556	Total	746,994	82,908	829,902
AMERICAS				
662	Brazil	21,000	60	21,060
59	Canada	3,000	1,270	4,270
70	Chile	13,550	1,070	14,620
20	Mexico	9,000	200	9,200
8	Panama	473	10	483
110	U,S,A,	90,000	7,000	97,000
929	Total	137,023	9,610	146,633
AFRICA				
2	Egypt	0	20	20
3	Morocco	500	160	660
9	South Africa	9,700	80	9,780
3	Tunisia	205	40	245
17	Total	10405	300	10705
ASIA				
15	China	16,650	16,326	32,976
10	Hong Kong	3,600	4,100	7,700
7	India	4,715	340	5,055
8	Israel	600	200	800
13	Japan	76,662	1,059	77,721
6	Malaysia	455	13	468
10	Singapore	2,760	510	3,270
25	Taiwan	29,000	13,500	42,500
20	Thailand	2,200	40	2,240
114	Total	136,642	36,088	172,730
AUSTRALASIA				
20	Australia	33,000	80	33,080
7	New Zealand	670	30	700
27	Total	33,670	110	33,780
1643	TOTAL	1,064,734	129,016	1,193,750
125	OTHERS	88,397	16,980	105,377
1768	TOTAL WORLD	1,153,131	145,996	1,299,127

Exhibit - III
Total Factoring Volume by Country
Total Factoring Volume by Country in the last 7 years (in Millions of EUR)

Continent/Country	2001	2002	2003	2004	2005	2006	2007
EUROPE							
Czech Republic	1,230	1,681	1,880	2,620	2,885	4,025	4,780
Denmark	5,488	5,200	5,570	6,780	7,775	7,685	8,474
France	67,660	67,398	73,200	81,600	89,020	100,009	121,660
Germany	29,373	30,156	35,082	45,000	55,110	72,000	89,000
Greece	2,050	2,694	3,680	4,430	4,510	5,230	7,420
Hungary	546	580	1,142	1,375	1,820	2,880	3,100
Italy	124,823	134,804	132,510	121,000	111,175	120,435	122,800
Lithuania	Shown	with Estonia	until 2003	1,040	1,640	1,896	2,690
Norway	5,700	7,030	7,625	8,620	9,615	11,465	17,000
Poland	3,330	2,500	2,580	3,540	3,700	4,425	7,900
Portugal	10,189	11,343	12,181	14,700	16,965	16,886	16,888
Romania	98	141	225	420	550	750	1,300
Russia	0	168	485	1,130	2,540	8,555	13,100
Slovakia	240	240	384	665	830	1,311	1,380
Spain	23,600	31,567	37,486	45,376	55,515	66,772	83,699
Sweden	5,250	10,229	10,950	14,500	19,800	21,700	21,700
Ukraine	0	0	0	0	333	620	890
United Kingdom	136,080	156,706	160,770	184,520	237,205	248,769	286,496
Total Europe	**415,657**	**462,437**	**485,750**	**537,316**	**620,988**	**695,413**	**810,277**
AMERICAS							
Brazil	11,020	11,030	12,040	15,500	20,050	20,054	21,060
Canada	2,699	3,100	3,161	3,157	3,820	3,386	4,270
Chile	3,123	3,130	3,500	4,200	9,500	11,300	14,620
Mexico	6,890	6,340	4,535	4,600	7,100	8,150	9,200
Panama	220	0	160	201	240	607	483
U.S.A.	101,744	91,143	80,696	81,860	94,160	96,000	97,000
Total Americas	**125,696**	**114,743**	**104,092**	**109,518**	**134,870**	**139,497**	**146,633**
AFRICA							
Egypt	0	0	0	1	1	3	20
Morocco	50	190	160	300	430	440	660
South Africa	5,580	5,860	5,470	7,100	5,580	7,800	9,780
Tunisia	171	153	210	185	226	270	245
Total Africa	**5801**	**6203**	**5840**	**7586**	**6237**	**8513**	**10705**
ASIA							
China	1,234	2,077	2,640	4,315	5,830	14,300	32,976
Hong Kong	2,690	3,029	3,250	4,800	7,700	9,710	7,700
India	690	1,290	1,615	1,625	1,990	3,560	5,055
Israel	429	354	190	155	325	375	800
Japan	61,566	50,380	60,550	72,535	77,220	74,530	77,721
Malaysia	842	610	718	730	532	480	468
Singapore	2,480	2,600	2,435	2,600	2,880	2,955	3,270
Taiwan	4,511	7,919	16,000	23,000	36,000	40,000	42,500
Thailand	1,240	1,274	1,425	1,500	1,640	1,925	2,240
Total Asia	**75,682**	**69,533**	**88,823**	**111,260**	**134,117**	**147,835**	**172,730**
AUSTRALASIA							
Australia	7,910	9,527	13,716	18,181	23,130	27,573	33,080
New Zealand	410	465	263	236	250	280	700
Total Australasia	**8,320**	**9,992**	**13,979**	**18,417**	**23,380**	**27,853**	**33,780**
TOTAL	**631,156**	**662,908**	**698,484**	**784,097**	**919,592**	1,019,111	**1,174,125**
OTHERS	**54,526**	**61,289**	**61,908**	**76,118**	**96,955**	**115,177**	**125,002**
TOTAL WORLD	**685,682**	**724,197**	**760,392**	**860,215**	1,016,547	1,134,288	**1,299,127**

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