**FINANCIAL SERVICES**

III B com (BM)

**UNIT-V**

**FACTORING**

**Definition** :- Factoring implies a financial arrangements between the factor and client in which the firm get advances in return for receivables from financial institution .it is financing technique in which these Is an outright selling of trade debts by a firm to a third party ie factor of at discounted prices.

**MEANING:**- Factoring is an financial alternative in financing and management of account receivable .It states terms and condition of the sale in the factoring agreement.

**Concept**:-In finer terms factoring is a relationship between the factor and the client in which the factor purchases the client account receivables and pay upto 80% of the sum immediately a the time of entering into the agreement. factor pays the balance sum 20% of the amount which includes finance cost and operating cost to the client pays the obligation

**Types of factoring**:-

1. Resources and no resource factoring

2. Disclosed and undisclosed factoring

3. Domestic and export factoring

4. Advance and maturity factoring

**1. RESOURCES AND NON RESOURCES FACTORING**

 In this type of arrangement the financial institution can resort to the firm when the debts are not recoverable, so the credit risk associated with the trade debts are not assumed by the factor. On the other hand in non resource factoring the factor cannot resource to the firm in case the debt turnout to be irrecoverable.

**2. DICLOSED AND UNDISCLOSED FACTORING**

 The factoring in which the factor name is indicated in the invoice by the supplier of the goods or services asking the purchasers to pay the factor is called disclosed factoring .The form of factoring in which the name of the factor is not mentioned in the invoice issued by the manufacturer. In such a case the factor maintains sales ledger of the client and the debt is realized in the name of the firm. However, the control is in the hands of the factor.

**3. DOMESTIC AND EXPORT FACTORING**

 When the three part is to factoring that is the customer, client and factor reside in the same country, then this is called a domestic factoring. Export factoring or otherwise known as cross border factoring is one in which there are four parties that is exporter, importer, export factor and import factor. This is also termed as the two factor system.

**4. ADVANCE AND MATURITY FACTORING**

 In advance factoring the factor gives an advance to the client, against the uncollected receivables. In maturity factoring the factoring agency does not provide any advance to the firm. Instead the bank collects the sum from the customer and pays to the firm, either on the date on which the amount is collected from the customers or on a guaranted payment date.

**PROCESS OF FACTORING**

1. Borrowing company or the client cells the book debts to the lending institutions (factor)

2. Factor acquires the receivables and extend money against the receivables after deducting and retaining the following sum that is an adequate margin, factors commission and interest on advance.

3. Collection from the customer is forwarded by the client to the factor and in this way the advance is settled.

4. Other services are also provided by the factor which includes

* Finances
* Collection of debts
* Maintenance of debts
* Protection of credit risk
* Maintenance of debtors ledger
* Debtors follow-up
* Advisory services

 **FACTORING Vs BILL DISCOUNTING**

 The key difference between bill discounting and factoring lies in the fact that while bill discounting is the amount which the client pays before the due date with a discount less than the actual rate on the other hand factoring means the client gives his book debts to the financial institution or bank with a discount

 Bill discounting includes parties like payee, drawee, drawer where as factoring involves client, debtor and factor. Bills discounting and factoring both help entrepreneurs to use short term credit. When a business man takes a decision for factoring or account receivable financing, he needs to sell the account receivables or due invoice to factor.

**FACTORING IN INDIA**

 Factoring services in India is of recent origin. It owes its genesis to the recommendation of the Kalyanasundharam study group appointed by the RBI in 1989. The RBI issued guide lines for factoring services in 1990. The first factoring company-SBI factors and commercial ltd started operation in April 1991.

 The main recommendation of the committee are listed as follows

* Taking all the relevant facts into the account there is sufficient scope for introduction factoring services in India which would be complementary to the services provided by the banks
* The introduction of export factoring services would provide additional facilities to exporters.
* While quantification of the demand for factoring services has not been possible, it is assessed that it would grow sufficiently so as to make factoring business a commercially viable proposition with in the period of two years on the export front there would be a fairly good availment of various services offered by export factors.
* With a view to attaining a balanced dispersal of risk, factors should offer their to al Industries and all sectors in the economy
* The pricing of various services by factors would essentially depend upon the cost of funds.
* The RBI could consider allowing factoring organization to raise funds from the discount and finance house of India ltd as also from other approved financial institutions
* Factoring activities could perhaps be taken up by the small industries development bank of India, preferably in association with one or more commercial banks.
* The business communities must be educated through bank branches about the nature and scope of the services and the benefits occurring there from .

**FORFAITING**

Forfaiting is the means of financing that enables exporters to receive immediate cash by selling their medium and long term receivables-the amount an importer owes the exporter-at a discount to an intermediary.

Forfaiting is a form of export financing in which the exporter sells the claim of trade receivables to the forfaiter and gets an immediate cash payment.

**DIFFERENCE BETWEEN FORFAITING ANG EXPORT FACTORING**

Forfaiting is similar to cross border factoring to the extent both have common features of non recourse and advance payment but they differ in several important respects.

* A forfaiter discounts the entire value of bill. The implication is that forfaiting is 100% financing arrangement of receivable finance. But the extent of advance receivables financing with a factoring arrangement is only partial ranging between 75-85% the balance is retained by the factor as a factor reverse which is paid after maturity
* The availing bank which provides an unconditional and irrevocable guarantee is a critical element in the forfaiting arrangements on the other hand, in a factoring deal particularly non recourse type, the export factor bases his credit decision on the credit standards of the exporters and participates in the credit extension and credit protection process
* Forfaiting is a pure financing arrangement while factoring also includes ledger administration, collection and so on
* Factoring is essentially a short term financing deal forfeiting financiers notes arising out of differed credit transaction spread over three to five years
* A factor does not guard against exchange rate fluctuations; a forfeiter charges a premium for such risk.

**PROBLES OF FORFAITING**

The following are some of the drawbacks of forfaiting

* Forfaiting is not available for differed payments especially while export capita goods for which payment will be made on a differed basis by he importer.
* There is discrimination between western countries and he countries in the southern hemisphere which are mostly under developed
* There is no international credit agency which can guarantee for forfaiting companies which affects ong term forfaiting.
* Only selected currencies are taken for forfeiting as they alone enjoy international liquidity.