



CENTRE : DDU KAUSHAL KENDRA

NAME OF THE PROGRAMME : B.VOC(LOGISTICS AND
SUPPLY CHAIN MANAGEMENT

PROGRAM CODE : 3UABVOC(LSCM)

COURSE CODE : 17LSCM202

NAME OF THE PAPER : CORPORATE FINANCE

SEMESTER : II

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DESIGNATION : GUEST FACULTY

TOPIC :FACTORING



Factoring

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Meaning:

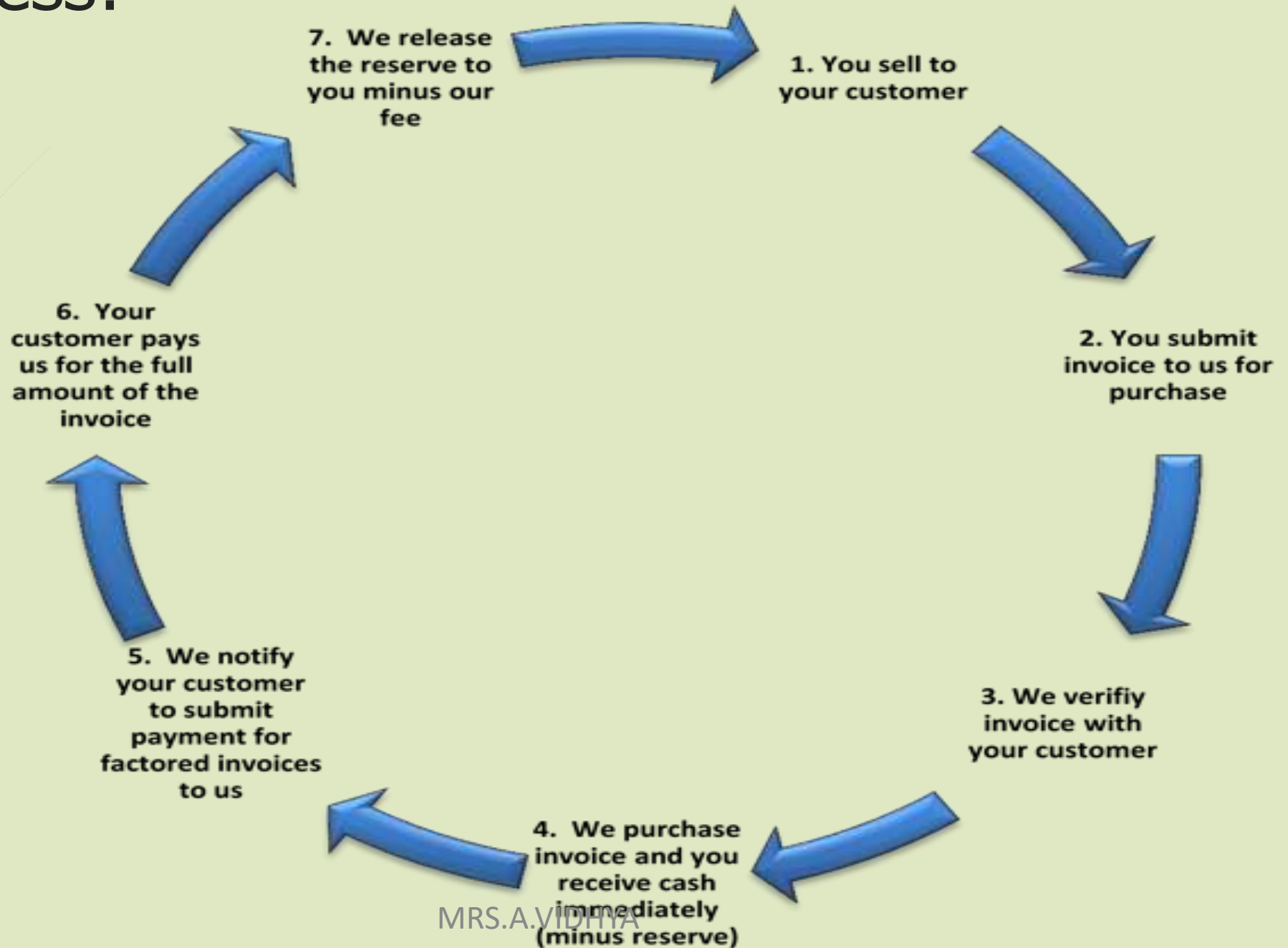
- It is a debt-collection service where the factor purchases book-debts of the client at a discount either with or without recourse.
- When there is a credit squeeze in the company, it has to debt upon the debt collection.
- In such situation factors render good service.



Parties in Factoring:

- There are 3 parties:
 - a) Factor: a person, an agent, or a firm which renders the services of factoring.
 - b) Client: the company or the firm to whom the factor renders his services of factoring.
 - c) Debtor/Customer: a person or a firm who is in debt to the client.

Process:





Features:

- ☐ Invoice amount
- ☐ Shifts Responsibility
- ☐ Responsibility of maintaining credit sales ledger
- ☐ Easy access
- ☐ Strengthening the financial position
- ☐ Service charges
- ☐ Allows the client to concentrate on business.
- ☐ Consultancy services

Mechanics of Factoring

- ❖ The Client (Seller) sells goods to the buyer and prepares invoice with a notation that debt due on account of this invoice is assigned to and must be paid to the Factor (Financial Intermediary).
- ❖ The Client (Seller) submits **invoice copy only** with Delivery Challan showing receipt of goods by buyer, to the Factor.
- ❖ The Factor, after scrutiny of these papers, allows payment (usually upto 80% of invoice value). The balance is retained as Retention Money (Margin Money). This is also called Factor Reserve.
- ❖ The drawing limit is adjusted on a continuous basis after taking into account the collection of Factored Debts.
- ❖ Once the invoice is honoured by the buyer on due date, the Retention Money credited to the Client's Account.
- ❖ Till the payment of bills, the Factor follows up the payment and sends regular statements to the Client.



Types of Factoring:

- ☐ Full Service Factoring
- ☐ Factoring with recourse
- ☐ Maturity Factoring
- ☐ Invoice Factoring
- ☐ Bulk Factoring
- ☐ Agency Factoring
- ☐ Undisclosed Factoring

1. *Full Service Factoring*: Factor provides various services in

- a) Finance
- b) maintaining sales collection
- c) undertakes credit collection
- d) offers protection against bad debts

2. *Factoring with Recourse*:

- a) Customers are given 90 days payment period
- b) If the customer fails to pay the debt amount, the factor charges the client for the due amount.
- c) Offers consultancy services



3. *Maturity Factoring:*

- a) Also called "collection Factoring".
- b) No finance is provided.
- c) Involves appointment of expert personnel.
- d) Deducts the service charges from amount collected.

4. *Invoice Factoring:*

- a) Involves selling of invoices to the factor.
- b) The business acts as a trustee to the factor.
- c) The factor first pays out 80% of the face value of the invoices.



5. *Bulk Factoring:*

- a) The responsibility of maintaining sales ledger, collection of credit and risk of bad debts rests with the client.
- b) The factor provides 80% of the face value of selected invoices as finance.

6. *Agency Factoring:*

- a) clearly defined risks and responsibilities.
- b) Clients maintains sales ledger and collects debts from the debtors.
- c) Factor provides pre-payment service and protects the client against bad debts.



7. *Undisclosed Factoring:*

- a) No direct sale to the customers.
- b) At the time of delivery, goods are sold to the factor for cash.
- c) The factor appoints the business as its agent to collect the debt.
- d) The factor has no recourse in the case of bad debts.



Advantages:

☐ *To the client*

- a)Competitive credit terms
- b)Accelerate the production cycle
- c)Free from tensions
- d)Efficient Working Capital Management
- e)Assessing quality of debtors
- f)Expansion of business



Advantages:

☐ To the buyer:

- a) Adequate credit facilities
- b) Getting periodical statement from the factor
- c) No affect on quality of goods, contractual obligations etc..

☐ To the Factor:

- a) improves the quality of advances of the banks
- b) It is not at all a threat
- c) It is a complementary to the banks



Disadvantages of Factoring

- ❑ Expensive
- ❑ Shrinks as Business Contract
- ❑ Affects the customer relationship
- ❑ Less control



Charges for Factoring Services:

- ❑ Factor charges Commission (as a flat percentage of value of Debts purchased) (0.50% to 1.50%)
- ❑ Commission is collected up-front.
- ❑ For making immediate part payment, interest charged. Interest is higher than rate of interest charged on Working Capital Finance by Banks.
- ❑ If interest is charged up-front, it is called discount.



Factoring is not Suitable in the following cases.

- a) where large volume of cash sales take place.
- b) Engaged in speculative business.
- c) selling highly specialized capital equipments or made-to-order goods.
- d) where credit period offered to the buyers is more than 180 days.
- e) where there is Consignment Sale or 'Sale or Return arrangements'.
- f) where sales are to the sister / associated companies .
- g) where sales are to the public at large, etc.



OVERTRADING

- Overtrading is a term in financial statement analysis. Overtrading often occurs when companies expand their own operations too quickly .Overtraded companies enter a negative cycle, where an increase in interest expenses negatively impacts the net profit, which leads to lesser working capital, and that leads to increased borrowings, which in turn leads to interest expenses and the cycle continues. Overtraded companies eventually face liquidity problems and/or run out of working capital.

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- ❑ *Excessive buying and selling of stocks by a broker on an investor's behalf in order to increase the commission the broker collects.*
 - ❑ *This situation has been known to arise when brokers are pressured to place a newly issued security underwritten by a firm's investment banking arm.*
 - ❑ *Also known as "churning".*
 - ❑ *A situation in which a company is growing its sales faster than it can finance them. This usually leads to enormous accounts payable or accounts receivable and a lack of working capital to finance operations.*



UNDER TRADING

- Under-trading is the reverse of over-trading. It means keeping funds idle and not using them properly. This is due to the under employment of assets of the business, leading to the fall of sales and results in financial crises. This makes the business unable to meet its commitments and ultimately leads to forced liquidation. The symptoms in this case would be a very high current ratio and very low turnover ratio. Under-trading is an aspect of over-capitalization and leads to low profit.

CASE STUDY ON CBC



- Factoring, or accounts receivable financing, provides companies with advances and credit guarantees through the sale of their receivables.
- CBC has worked with companies big and small, from start-ups to public companies, to provide liquidity and to help manage their accounts receivable bookkeeping and collection process on a with, or without, notice basis to their customers.
- The various commercial service programs offered by CBC are:
 - **Full Service Factoring**
 - **Non-Notification Factoring**
 - **Accounts Receivable Management**
 - **Credit Services**
 - **Letters of Credit**



□ Full Service Factoring:

With the full service factoring program, CBC purchases the invoices as they arise in the normal course of business. In addition, CBC administers and collects receivables from your customers. CBC provides regular and detailed documentation outlining:

- Receipt of your invoices
- Advances
- Customer payments
- Other reports relating to sales ledger activity

□ Non-Notification Factoring:

CBC offers non-notification factoring, which provides you with privacy and confidentiality. Through non-notification factoring, you will not be required to tell your customers (the debtor) that their invoices have been purchased.

□ *Accounts Receivable*

Management:

CBC's Accounts Receivable Management program handles your entire accounts receivable process for maximum efficiency and transparency. Our program covers the complete accounting and administration process, from credit protection and collection services to cash application, bookkeeping and reporting. Our professional accounts receivable managers give you the outsourcing support that keeps overhead low, sales high and margins up.

□ *Credit Services:*

CBC allows you to outsource your credit services to enable you to concentrate on running your business effectively, with the peace of mind knowing that your customers are credit-worthy and pose no risk.

Through our Credit and Collection service, CBC:

- Screens your customers for credit worthiness
- Assumes full credit risk on approved sales
- Performs bookkeeping and collection work

With decades of experience and entrepreneurial spirit, CBC goes beyond most factors and often is able to guarantee your customers' financial ability to pay when others will not.

□ *Letters of credit:*

A Letter of Credit can be the safest and fastest method toward obtaining goods. Today many exporters require Letters of Credit prior to agreeing to a transaction. CBC will work with its bank partners to issue Letters of Credit on behalf of the importer (buyer) that guarantee payment to the exporter (seller) upon the satisfaction of documentary requirements of the Letter of Credit.

□ *Forfaiting Service:*

- In trade finance, forfaiting involves the purchasing of receivables from exporters
- The forfaiter will take on all the risks involved with the receivables
- It is different from the factoring operation in the sense that it is a transaction based operation while factoring is a firm based operation
- Meaning, in factoring a firm sells all its receivables while in forfaiting, the firm sells one of its transactions



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