

Relevance of Factoring for Financing Small and Medium Enterprises (SMEs)

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CONCEPT AND MECHNICS OF DOMESTIC FACTORING

Working Capital Finance by Banks: Share of Number of Accounts by Size and Sector (%)

| Industry Size and Nature | 2016 (September) | | | | | 2017 (September) | | | | |
|--------------------------|------------------|-------|-------|-------|-----------|------------------|-------|-------|-------|-----------|
| | SOCBs | PCBs | SBs | FCBs | All Banks | SOCBs | PCBs | SBs | FCBs | All Banks |
| 1. Large | 6.50 | 4.59 | 1.72 | 76.89 | 4.86 | 10.90 | 12.72 | 3.03 | 77.31 | 12.85 |
| 2. Small and Medium | 87.08 | 41.46 | 54.63 | 13.67 | 42.62 | 71.90 | 71.09 | 45.72 | 16.44 | 70.23 |
| 3. Cottage | 2.87 | 40.58 | 43.00 | 0.18 | 39.63 | 2.38 | 2.99 | 47.28 | 0.00 | 3.91 |
| 4. Service | 3.55 | 13.38 | 0.64 | 9.26 | 12.89 | 14.82 | 13.20 | 3.97 | 6.24 | 13.01 |
| Total | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |

Source: Author's Calculation Based on *Scheduled Bank Statistics*, Bangladesh Bank.

Working Capital Finance by Banks: Growth of Number of Accounts by Size and Sector: 2016 -2017

| Size and Nature of Working Capital Financing | 2017 (September) | | | | |
|--|------------------|---------------|---------------|---------------|---------------|
| | SOCBs | PCBs | SBs | FCBs | All Banks |
| 1. Large | 24.46 | 38.93 | -1.04 | -20.42 | 34.51 |
| 2. Small and Medium | -38.73 | -14.06 | -53.04 | -4.84 | -16.15 |
| 3. Cottage | -38.46 | -96.31 | -38.31 | -100.00 | -94.98 |
| 4. Service | 209.76 | -50.56 | 247.22 | -46.67 | -48.67 |
| Total | -25.79 | -49.88 | -43.89 | -20.86 | -49.12 |

Source: Author's Calculation Based on *Scheduled Bank Statistics*, Bangladesh Bank

Industrial Term Loan by Banks: Share of Amount by Size and Sector of Each Group of Banks (%)

| Industry Size and Nature | 2016 (September) | | | | | 2017 (September) | | | | |
|--------------------------|------------------|-------|-------|-------|-----------|------------------|-------|-------|-------|-----------|
| | SOCBs | PCBs | SBs | FCBs | All Banks | SOCBs | PCBs | SBs | FCBs | All Banks |
| 1. Large | 45.26 | 63.45 | 69.00 | 78.10 | 58.45 | 40.36 | 64.75 | 47.57 | 73.09 | 57.27 |
| 2. Small and Medium | 37.31 | 20.79 | 30.31 | 5.44 | 25.41 | 45.26 | 18.63 | 28.55 | 7.22 | 26.72 |
| 3. Cottage | 3.84 | 0.23 | 0.69 | 0.74 | 1.30 | 0.50 | 0.13 | 4.61 | 0.42 | 0.27 |
| 4. Service | 13.59 | 15.53 | 0.00 | 15.72 | 14.85 | 13.89 | 16.49 | 19.27 | 19.27 | 15.74 |
| Total | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |

Source: Author's Calculation Based on Scheduled Bank Statistics, Bangladesh Bank

Industrial Term Loan by Banks : Growth of Amount by Size and Sector 2016 -2017

| Size and Nature of Industrial Credit | 2016 (September) | | | | | 2017 (September) | | | | |
|--------------------------------------|------------------|--------|-------|-------|-----------|------------------|--------|--------|-------|-----------|
| | SOCBs | PCBs | SBs | FCBs | All Banks | SOCBs | PCBs | SBs | FCBs | All Banks |
| 1. Large | 38.39 | 17.95 | 8.05 | 18.26 | 21.93 | NCBs | PCBs | SBs | FCBs | Total |
| 2. Small and Medium | -13.38 | 22.69 | 26.15 | 15.11 | 4.10 | 19.02 | 25.93 | -55.34 | 10.66 | 23.27 |
| 3. Cottage | 1084.12 | -48.26 | 89.22 | 0.00 | 212.55 | 61.87 | 10.54 | -38.98 | 57.07 | 32.28 |
| 4. Service | 9.64 | -0.94 | -100 | 18.54 | 1.52 | -82.77 | -27.88 | 332.47 | 0.00 | -73.99 |
| Total | 13.00 | 15.13 | 2.45 | 17.77 | 14.44 | 36.35 | 31.11 | 100.00 | 44.96 | 33.41 |

Source: Author's Calculation Based on Scheduled Bank Statistics, Bangladesh Bank

Working Capital Finance by Banks: Share of Amount by Size and Sector of Each Group of Banks (%)

| Industry Size and Nature | 2016 (September) | | | | | 2017 (September) | | | | |
|--------------------------|------------------|-------|-------|-------|-----------|------------------|-------|-------|-------|-----------|
| | SOCBs | PCBs | SBs | FCBs | All Banks | SOCBs | PCBs | SBs | FCBs | All Banks |
| 1. Large | 49.33 | 52.92 | 64.93 | 67.23 | 53.68 | 61.05 | 52.55 | 3.03 | 82.18 | 55.34 |
| 2. Small and Medium | 43.10 | 29.16 | 27.16 | 3.57 | 28.72 | 35.88 | 30.01 | 45.72 | 3.17 | 28.84 |
| 3. Cottage | 1.20 | 1.10 | 7.60 | 0.00 | 1.07 | 0.18 | 0.44 | 47.28 | 0.00 | 0.40 |
| 4. Service | 6.37 | 16.82 | 0.31 | 29.20 | 16.54 | 2.89 | 17.01 | 3.97 | 14.65 | 15.43 |
| Total | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |

Source: Author's Calculation based on Bangladesh Bank, *Scheduled Bank Statistics*

Working Capital Finance by Banks: Growth of Amount by Size and Sector

| Industry Size and Nature | 2017 (September) | | | | |
|--------------------------|------------------|--------|--------|---------|-----------|
| | SOCBs | PCBs | SBs | FCBs | All Banks |
| 1. Large | 39.02 | 29.10 | -99.60 | 36.35 | 30.56 |
| 2. Small and Medium | -6.49 | 33.77 | -85.68 | -1.02 | 27.17 |
| 3. Cottage | -83.03 | -48.00 | -47.05 | -100.00 | -52.40 |
| 4. Service | -49.05 | 31.45 | 7.76 | -44.01 | 18.13 |
| Total | 12.33 | 30.01 | -91.49 | 11.55 | 26.64 |

Source: Author's Calculation Based on *Scheduled Bank Statistics*, Bangladesh Bank

SMEs suffer liquidity shortage because of:

- (a) Most of the SMEs sale their products on a credit basis but a substantial part of their purchase is on cash basis**
- (b) delayed payment of their receivables by large and medium sized firms as well as public sector enterprise and government departments**
- (c) lack of expertise in financial management, in general, and credit management, in particular.**

Banks are unwilling to lend due to

(a) Inability of SMEs to provide sufficient security, (2) Higher operating costs for lending small amount of loan,

© Absence of proper accounting system in SMEs, (d) Incidence of high bad debt in SMEs, and

(e) Lackening efforts of collecting book- debts after financing book debts by banks.

Factoring- What It Means?



Is a contract between **'the Supplier'** and **'the Factor'** wherein:

the Supplier assigns receivables to the Factor

Notice of Assignment of receivables is given in writing to the debtors.

the Factor performs atleast two of the following services:

- **Financing** by way of prepayments against invoices
- **Sales Ledger Maintenance**
- **Collection** of Receivables
- **Credit Protection** against Bad Debts

Bill Discounting vs. Factoring

- **Financing of Receivables of Clients (Borrower) against BOEs and LC.**
- **Lending Against Strength of Balance Sheet .**
- **Credit Risk on Client (Borrower) and Client repays Credit .**
- **Serviced by Consolidated Cash Flow of the Client .**
- **Security / Collateral Driven .**
- **Only Finance**
- **Limits Linked Security/ Collateral.**
- **Financing against Clients' (Sellers) invoices in Open Account Trade.**
- **Lending Against Strength of Transactions.**
- **Performance Risk on Clients (Borrower) and Credit/ Payment Risk on Debtor. Repayment Comes from Debtors not Clients.**
- **Serviced by Invoiced Backed Dedicated Cash Flow from Debtors.**
- **Cash Flow and portfolio Driven**
- **Finance and Value Added Services (Sales Ledger Management and Collection)**
- **Limits Linked To Growth .**

Types of Factoring

Domestic Factoring

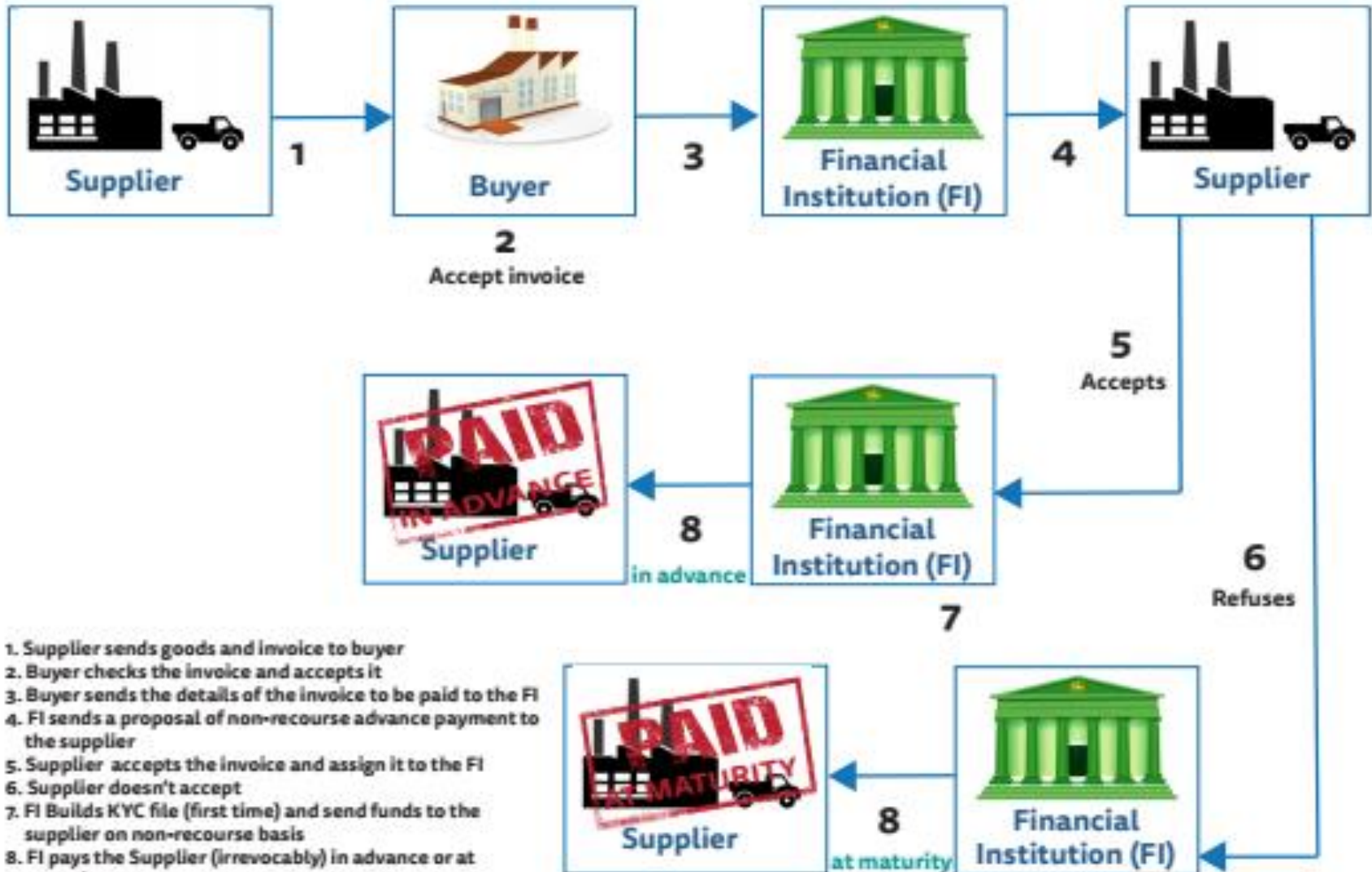
Export Factoring

For Inland sales on a “With Recourse basis”

Domestic Factoring Process

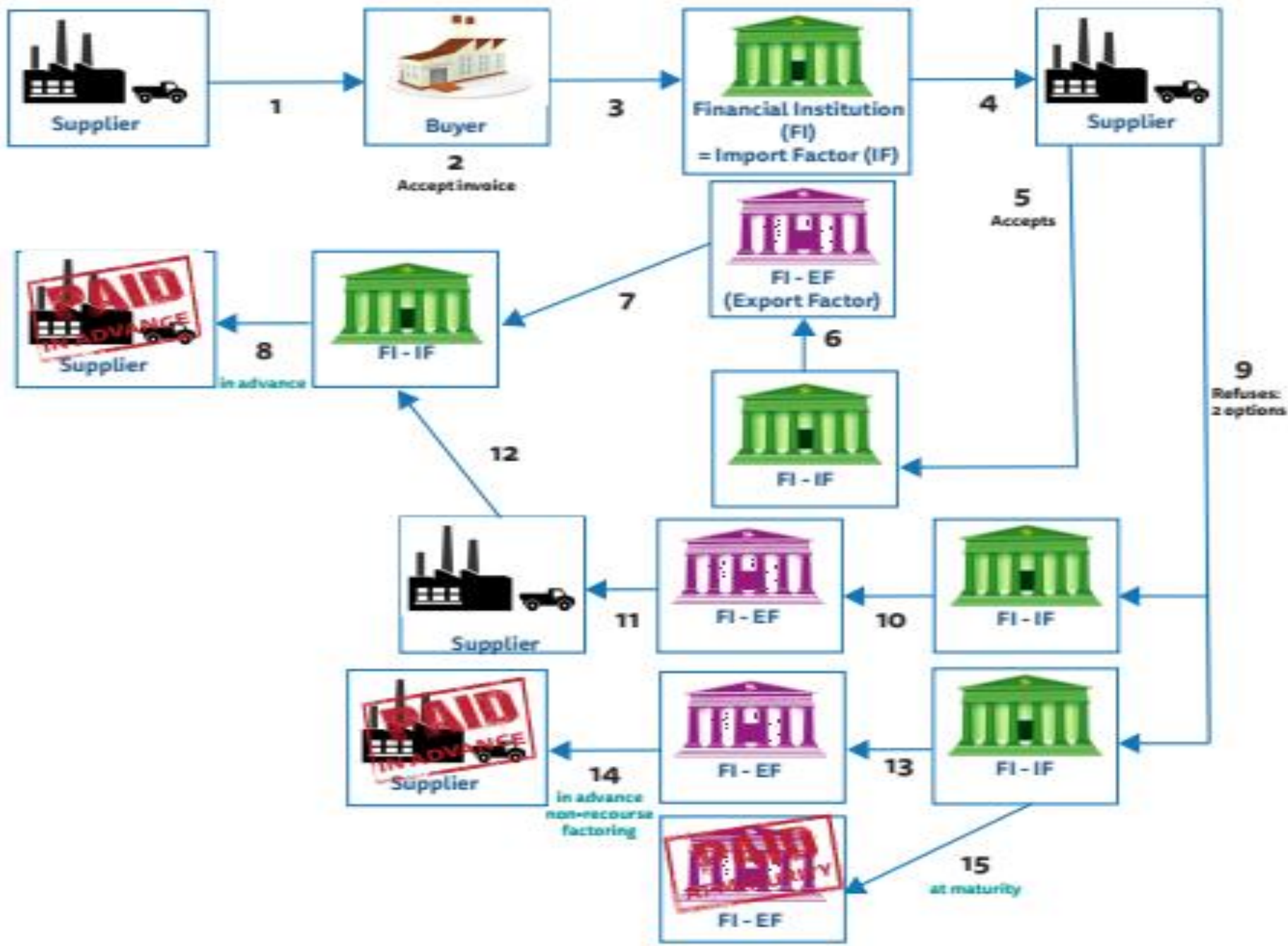


Reverse Factoring Process



1. Supplier sends goods and invoice to buyer
2. Buyer checks the invoice and accepts it
3. Buyer sends the details of the invoice to be paid to the FI
4. FI sends a proposal of non-recourse advance payment to the supplier
5. Supplier accepts the invoice and assign it to the FI
6. Supplier doesn't accept
7. FI Builds KYC file (first time) and send funds to the supplier on non-recourse basis
8. FI pays the Supplier (irrevocably) in advance or at maturity

4 Corners Model (in the case of a far country)



Sellers Advantage



- ☺ **Can sell on Open Account Terms**
- ☺ **Immediate and Flexible Finance Supports growth**
- ☺ **Not Collateral Linked**
- ☺ **Collection and Follow ups**
- ☺ **MIS**
- ☺ **Credit Management**
- ☺ **Credit Protection**

Sells More

Buyer's Advantage



- ☺ **Can buy on open account – substitute LC's**
- ☺ **Automatic revolving line**
- ☺ **Sellers credentials established**
- ☺ **See the goods before payment**
- ☺ **Commercial Issues – Debit Notes/ Credit Notes/
Replacements accepted**

Buys More

TYPES OF RISK IN FACTORING

- **Performance risk of client / seller**
- **Credit risk of debtor / buyer**
- **Credit Risk of Client (Seller) in the
Eventuality of Recourse**

Performance Risk

- Years of Relationship Between Buyer and Seller.
- All Instance of Delayed Payments Must be Examined.
- The Extent and Reasons for Dilution Should be Highlighted.
- Defaults of Any Nature are to be Highlighted With Complete Detail.
- Two Way Trade Must be Checked .

Credit / Payment Risk of Debtors

- **Management and Experience**
- **Competitive Position and Market**
- **Types of Industry**
- **Trade References**
- **Financial Assessment**
- **Cash Flow Assessment**
- **Debtor Payment Practice**

Documentation in Factoring

- **Factoring Agreement**
- **BOE/Undertaking /Debtor Introductory Letter**
- **Personal / Corporate Guarantee**
- **Demand Promissory Note**
- **Post Dated Cheques**
- **Accepted Bill of Exchange, Where Feasible**
- **Limits Set on Individual Debtor- Total Exposure Within the Set Limits**
- **Set Off Clause Between Debtors and Between Group Companies**
- **Whole Turnover Clause**

Thank you