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THE BUSINESS FINANCING THROUGH FACTORING

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Abstract

Cash flow is the key to the success of every business. As a company grows and needs to speed up cash flow, small businesses generally first turn to banks for financing. However, in the last years, banks can not always fully accommodate a firm's financing needs due to the tough credit standards. Given the circumstances, alternative financing options (such as accounts receivable factoring) can provide the working capital the companies need. Factoring – also known as debt factoring – is a business and also a financing method in which a factoring firm buys debts resulted from the supply of goods and services. In other words, factoring is the cash-management tool of choice for many businesses. Starting from these considerations, an important part of the paper will contain the most significant aspects regarding the evolution of factoring globally during 2007-2017, more precisely in Europe and abroad, as well as the evolution of the volume of factoring operations in Romania.

Keyword: financing, domestic financing, international financing.

JEL Classification: M41, M49, G20, G21

I. Introduction

The continuous development of society reflects an unprecedented evolution of everything that is trade relations and the financing of economic activities. Today, more than ever, trade finance is an important condition for business development and competitiveness.

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Factoring provides the cash needed in a simple and secure way, thus avoiding bank lending altogether, or reducing them to a minimum. The major difference from obtaining bank liquidity is that the factor looks at the company's client portfolio at the time of the debt purchase decision, while the bank offers bank credit financing on the collateral guarantees presented by the applicant.

Through this theme, I have attempted to change the perception of inferior product that persists over factoring, while trying to "advocate" for this form of business financing, both domestically and internationally. The lack of knowledge of the product, of the benefits that can be gained from its use, has led to this perception that factoring is the last variant of financing to which economic entities resort to when they are rejected by banks.

Based on these considerations, the present paper deals with a topic of high relevance that affects most economic entities. Thus, in the scientific approach of this paper, a brief presentation of the main theoretical aspects related to the origin and evolution of factoring operations, the identification of the main types of factoring, as well as the establishment of the most important functions of the factoring financing was considered.

Overall, this paper can be considered as a research of the most important theoretical and practical aspects of factoring activity through an international approach from past to present, while identifying future prospects in the development of the topic addressed.

II. Presentation of the factoring concept

Until the early 2000s, factoring was considered a niche product. Debt financing and non-defaulting insurers were not on the list of priorities of any manager, as market liquidity was more than sufficient.

Today, one of the main problems faced by indigenous SMEs is the late payment of invoices. This is a direct effect of the crisis, which has led to the promotion of special banking services, such as factoring.

In most cases, the factoring service involves the financing of two-stage invoices (Bărbută-Mișu, 2009: 174):

- Immediate financing (which also bears the name of available factoring) - represents approximately 80% of the value of each invoice;
- The remaining 20% of the value of each invoice will be paid when the factor collects the invoice (from this amount, the costs incurred by the factoring operation: commission, interest) are deducted.

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In essence, the role of factoring companies is to replace the adherent in operations not necessarily in the commercial field. Their activity is manifested in several directions, thus (Bărbută-Mișu, 2009: 179):

- releases the economic entity from the risk of non-payment of the bills by taking over the risk on them;
- ensures the enterprise with cash, immediately paying the ceded claims;
- can reduce the company's indebtedness in the short term by converting a term sale into a cash sale (indirect effect);
- performs ancillary services: informs clients about potential buyers, offers market information, verifies customer payment capacity, manages the factoring account, provides advice and assistance on commercial contracts, provides useful information about possible difficulties that may arise in a foreign country (foreign exchange risk, political risk).

Factoring is a relatively modern way of financing trade in the short term. By resorting to factoring, firms simultaneously benefit from at least two fundamental elements for the development of their business, namely: immediate financing by transforming receivables with immediate cash outflows into immediate liquidity, and protection against the default risk of borrowers, and this is increasingly aware of by the market companies and hence the growing interest in this product (Mihalciuc & Steclaru, 2017).

III. Classification of factoring operations

In international practice, several types of factoring are recognized, depending on the services offered by each package. Factoring operations are classified according to several criteria, as can be seen from Table 1:

Table 1- Classification of factoring operations

No. Crt.	Classification criteria	Categories of factoring	The characteristics of each category
I.	Depending on the time of payment of receivables purchased from the adherent (including the additional services offered to it)	*I.1. Tradițional factoring* (or conventional factoring, old line factoring)	The factor makes the payment in the amount of 80-90% at the time when it receives and accepts the receivables ceded by the adhering, the remaining 10-20% will be paid when the receivables are fully recovered. The factor undertakes to finance and manage the receivables, while assuming the risk that the invoices he has taken will never be paid by the disposable debtors.

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Table 1-*Cont.*

No. Crt.	**Classification criteria**	**Categories of factoring**	**The characteristics of each category**
		I.2 *Factoring on maturity, it is part of the new factoring formula* (new line factoring).	Payment of the billed invoices takes place at the time of their maturity, and the factor takes over the risk of default when invoices are accepted.
		I.3 *Agency factoring, it is part of the new factoring formula*.	The factor buys the debtor's debts, pays them in advance, but the debtor's management remains in charge of the adherent, who will collect the invoices at maturity, and the sums received from the debtors will immediately remit the factor. In this type of operation, the adherent behaves as an intermediary / agent of the factor, the risk of default by borrowers being taken over by the latter.
II.	Depending on the confidentiality of the factoring operation	II.1 *Closed factoring* (also known as confidential invoicing)	The client has the possibility to keep secret that he has turned to the services of a factor;
		II.2 *Open factoring*	In this type of operation, the adhering gives the factor all the receivables, notifying the debtors about this.
III.	Depending on the sphere of coverage, the way of taking over and administering the receivables	III.1 *Partial factoring*	Not all bills are accepted for purchase, they are subject to a process of selection by the factor, which does not take over the administration of the bills, the obligation to collect them is the adherent's.
		III.2 *Total factoring*	The factor assumes the following obligations: takes all the bills of the adherger, ensures the function of their management and financing, collects them from the debtor and covers the credit risk.
IV.	Taking into account the short-term loan character, the	IV.1 *Non-recourse factoring*	In the case of non-payment of bills by borrowers, the risk of default (up to the agreed level) rests with the factor, and he has no right of recourse against the adhering for the amounts that he has

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Table 1- *Cont.*

No. Crt.	**Classification criteria**	**Categories of factoring**	**The characteristics of each category**
	guarantee of which is the claims accepted by the lender		not received. However, factoring institutions can protect themselves against the risk of non-collection of bills by calling on the services of an insurance company. In this case, the factor may be set at most against the insurance company.
		IV.2. Factoring with recourse	the factor does not assume the risk of not collecting the bills, but only finances the activity of the adherent in the proportion of 80-90%. If the clients become insolvent, or if the debtors fail to pay the debts, whatever the cause, the factor will recover the amounts not collected from the adhering by exercising the right of regression.
V.	From the point of view of the participants in the factoring operation	*V.1. Domestic factoring*	is the most common type of factoring, where one factor occurs and the basis of this operation is a commercial contract (deliveries of goods, works, services) within which all the participants, the adhering, the debtor and the factor, are residents of the same state.
		V.2. International factoring	it presupposes the existence of an international commercial contract. In this type of factoring there are often two factors: the import factor (located in the country of the debtor / buyer) and the export factor (located in the country of the exporter).
		V.3. Factoring inverse	the factor finances a debtor's debts to a supplier
		V.4. Back-to-back factoring	is a special factoring operation that is specific to companies that have little capital and insufficient administrative resources as they rely only on the financial support of the parent company that plays the role of factor

Source: Hațegan (2011: 116-117); Bostan (2010: 60-61); Rentrop & Straton (2014); Popa (2008: 309)

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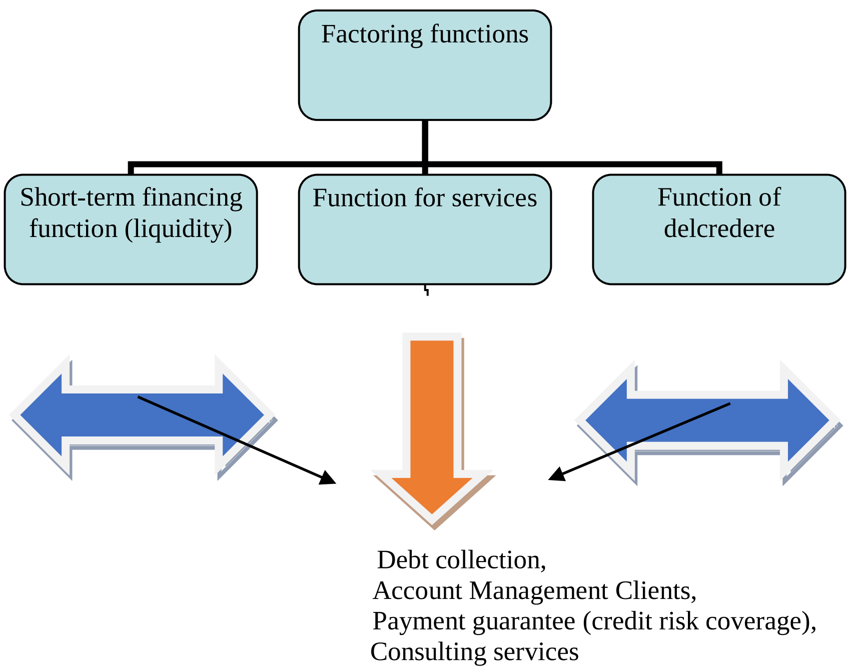
IV. Factoring functions

Besides the main activity - financing - factoring involves the provision of ancillary services in favor of the adhering, including: accounting and administration of invoices, management support, market information, customer creditworthiness, debtor monitoring, invoicing to customers, collecting their value, etc. (Oprean, 2015).

The use on a growing scale of factoring is due to several functions that it has and which are presented schematically in Figure 1.:

Figure 1- Factoring functions



Source: Processing after: Bărbuță-Mișu (2009: 177-179)

Of the three functions of factoring (financing function, service function, trust function), factoring companies have a well-defined role and a significant importance for the good functioning of an economy (Popescu, 2016).

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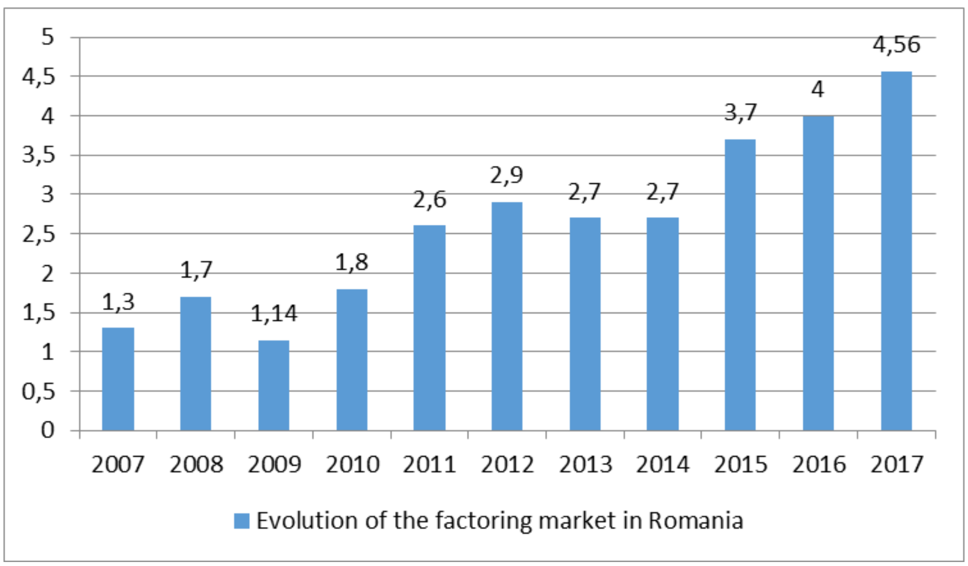
V. Factoring at national and global level

At national level, the Romanian legislation includes several normative acts regarding the notion of factoring (Law No. 246 of 30 June 2009, Legislation issued by the NBR), but the basic regulation was the Government Emergency Ordinance no. 10/1997, now abrogated, which refers to the reduction of the financial bottleneck and the losses in the economy.

In Romania, the volume of factoring operations has been increasing since 2007 and so far. In 2017, the local factoring market was 4.56 billion euros, the highest value so far, as we can see in the Figure 2.

Figure 2- Evolution of the factoring market in Romania in billions euro



Source: processing after FCI Annual Review 2017, Retrieved from: https://www.fci.nl/downloads/annual_review_2017.pdf

The Romanian legislation (Law 246 of 30 June 2009 repealing Law No 469 of 9 July 2002 on measures to strengthen contractual discipline) also regulates factoring as "the contract between a party, referred to as an adherent supplier of goods or services, and a banking corporation or a specialized financial institution, referred to as a factor by which the latter secures the financing, the pursuit of claims and the preservation against

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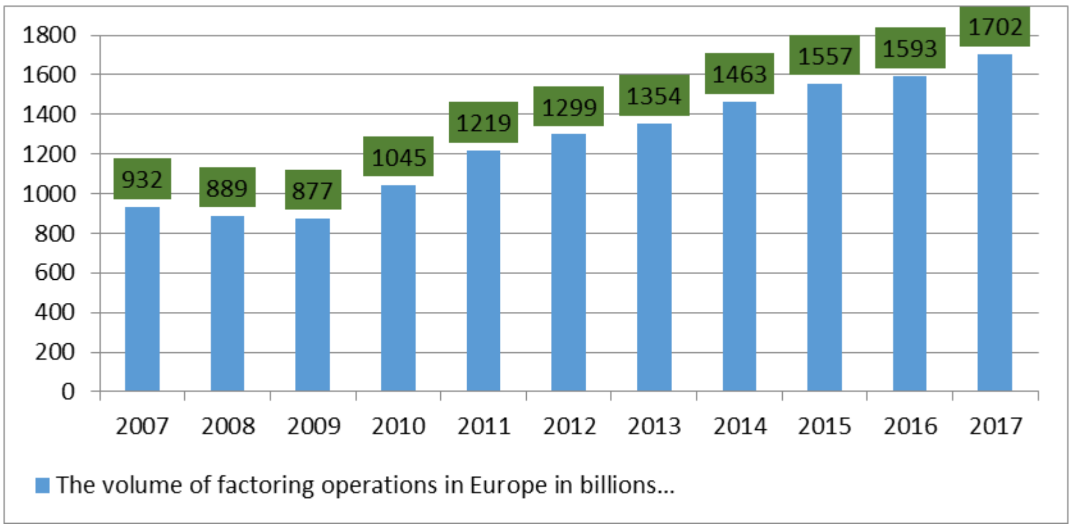
credit risks, and the adhering gives up the factor, by way of sale, to the debts arising from sale of goods or provision of services to third parties." (Popa, 2008: 306).

Worldwide, the idea is that factoring financing is optimal for the financial needs of companies of all sizes, but especially small and medium-sized enterprises.

Europe, the world's largest factoring market, was the strongest growing region in 2017, as the volume of operations rose to 1,702 billion euros in 2017 (Figure 3). This is the highest growth rate for the European market since 2011. The increase was mainly driven by the attention that the banking sector has begun to give to this industry. In Europe, the commercial banking sector controls about 90% of the total factoring volume.

Figure 3. The volume of factoring operations in Europe during 2007-2017



Source: processing after FCI Annual Review 2017, https://www.fci.nl/downloads/annual_review_2017.pdf

As can be seen from the above graph, the beginning of the financial crisis in 2008 recorded for the factoring industry somewhat similar values, the decrease, in 2009 compared to 2008, of only 12 billion, or 1.3%. Between 2010 and 2017, the volume of factoring increases significantly due to the fact that the world in full recession is trying to find advantageous financing solutions for their activities. Over time, it has turned out that almost every industry can take advantage of the benefits of factoring, the textile and consumer electronics sectors being among the most popular. However, in the last few

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years, factoring institutions have begun to focus their attention on other industries, such as the industrial and office equipment industry, the food processing industry, and so on.

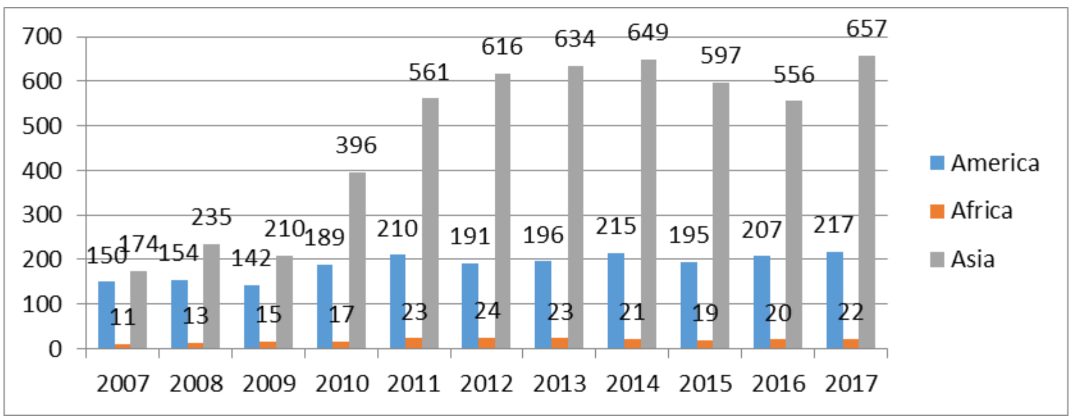
At present, factoring is becoming increasingly popular not only in industrialized countries but also in developing countries. In some Asian countries, but also in Latin America, financial institutions continue to join the industry. Similar growth is also seen in Eastern Europe, the Middle East or North Africa.

A new region with potential for factoring funding is Sub-Saharan Africa, where the FCI now counts only two members (https://fci.nl/en/about-fci-new_public/about-fci).

Since the beginning of the 2008-2009 financial crisis, factoring funding has begun to take root in developing countries, particularly in Latin America, the Middle East or North Africa.

In 2017, the volume of factoring operations in Asia amounted to 657 billion euros, in America the volume of factoring operations reached 217 billion euros, and in Africa, the region where the factoring industry is relatively underdeveloped, shows modest operations values of around 21-22 billion euros. Thus, in Figure 4, I have tried to synthesize a view of the evolution trend in the factoring industry on all continents except Europe.

Figure 4- The volume of factoring operations in Europe during 2007-2017



Source: processing after FCI Annual Review 2017. Retrived from: https://www.fci.nl/downloads/annual_review_2017.pdf

For the next period, Factors Chain International specialists predict that the global factoring market will grow, reaching an annual growth rate of 11.03% by 2020.

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Factors Chain International was founded in 1968 in Stockholm, Sweden, at the initiative of only six companies in Northern Europe and the U.S., to represent the interests of factoring companies around the world.

Today, based in Amsterdam and member companies that provide domestic and international factoring services in countries across all five continents, FCI is by far the largest factoring network in the world. Transactions of its members represent almost 80% of all factoring transactions in the world.

VI. Conclusion

Over the past ten years, the volume of factoring operations has increased significantly due to the fact that the company, which is in full economic recession, is trying to find advantageous financing solutions for its activities.

At the moment, the factoring industry aims to explore new horizons, both functionally and geographically. An extremely important role in this process lies with the FCI (Factors Chain International, an association that combines factoring independent companies with its headquarters in Amsterdam), whose mission is to introduce the concept of factoring in more and more markets by expanding the range of services usually offered by its members (http://www.asociatiadefactoring.ro/noutati).

Factoring is a complex financial product, a short-term financing instrument whereby receivables resulting from sales of goods and services are converted into liquidity. In this way, the factor plays the role of sponsor for adherence.

In addition to the main business activity, factoring companies provide several ancillary services, including: managing and managing customer invoices, protecting against the default risk of borrowers, is a non-warranty financing technique.

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