

# **The Advantages of Using Factoring, as Financing Technique on International Transactions Market**

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## **Abstract**

*Factoring appears as a contract between one party (called adherent), providing goods or service and a banking company or a financial institution specialized (called factor), which the last one shall finance debts pursuing and preservation against credit risks and adherent gives factor by way of sale, debts arising from the sale of goods or services to third parties. Factoring is a means of financing business, especially export-import transactions, less known in Romani, but it is present in Romanian legislation since 2002.*

*In this article I defined the concept of factoring, then I presented the advantages of factoring the last part I approached development of factoring in Romania.*

**Key words:** adherent, factor, international trade

**JEL classification:** F10, G15

## **1. Introduction**

Factoring represents a contract between one part called adherent - provider of goods or services - and a banking society or a specialized financial institution, called factor, by means of which the latter ensures the

financing, the debt monitoring and the protection against credit risks, while the adherent assigns (sells) to the factor the debentures resulting from the selling of goods or the services provided to a third person. Factoring can be defined as a debentures mobilization instrument, the effect of which is the accomplishment of the payment by the contracting parts.

Present in Romanian legislation since 2002, factoring is a way of financing business, especially export-import transactions, less known, maybe because of poor business environment popularize.

## **2. The benefits offered by factoring operation**

*The benefits* of the factoring contract come from the inner advantages of this credit procedure, but also from the promising result obtained after comparing the positive aspects with disadvantages, the latter existing in a small proportion.

The *first advantage* comes from the *small number of the procedures* required for obtaining the credit facility. For the start, the seller and the buyer conclude a commercial contract. The seller fills a *standard printed form*, by means of which he requires financing from the factor through factoring; apart from some *general information* (solicitor, object of activity, debtor, sales, imports etc.), the contract also contains some *extra information* about each client (name of the client, address, contact person, the register number at the Commerce Register, the fiscal code, estimated sales etc.) *The factor analyzes and verifies the assigned debtors*, communicating the *preliminary amount*, the costs and the conditions of factoring operations to the import factor. The last stage is the *conclusion of the factoring contract* between the seller (as adherent) and the commercial bank (as factor).

Another aspect which should be mentioned is the fact that the *financing expenditure on the whole is exclusively in the charge of the debtor*, the latter having to support not only the financing cost (the

interest), but also the value of the commissions charged by the factor. This contractual clause is not so important in comparison with all the advantages obtained when benefiting from a factoring contract. The adherent enjoys current facilities of treasury, with the help of the factor, either through the credits that he receives, or through the feeding of the current account with liquidities necessary to the current payment operations, and at the same time benefits from specialized banking services. The factor becomes an *administrator* and a *consultant of the adherent* when it comes to selecting the customers according to their solvency and directing the adherent's commercial policy into a certain direction; yet, the adherent loses this way part of his financial-economic independence.

Another aspect is the fact that the mobilization of debentures reaching maturity at the due moment takes place with a quantum of at *most 80%* of the total value of debentures, so that the difference is discounted at the maturity from the value of the payment made by the adherent through the factor, after the deduction from the interest value and the owed commissions. By means of factoring, the adherent, by transmitting the debentures, performs an *immediate and irrevocable cashing* of nominal values (represented by bills) coming from the factor, the latter becoming the adherent's financing person, until the customer effectively pays all his bills. The customer has to deal with his monthly obligations towards the state budget, the renting expenditure, energy, water, salaries and also with the purchasing of considerable quantities of raw materials.

The documents required for obtaining the financing through factoring are not as many as those necessary for obtaining a credit. The adherent can resort to factoring only for the debentures payable on a short-term (usually less than 120 days and only exceptionally 180 days), while the operation can be carried out also with appeal against the seller.

Factoring allows the adherent to benefit from the necessary capital for continuing the commerce, to reduce the rotation cycle of the *fond de*

roulment by the immediate payment of bills by a single financing institution and not by the great number of customers, to focus his attention on the commerce itself and, last, to register a growth of the turnover and benefits. The period for obtaining liquidities is shorter than in the case of a credit, and also it is not necessary to maintain a certain destination for them.

Another strong point is that of *eliminating the risk of insolvency* potentially experienced by the commercial partner of the adherent, a risk like this being taken up by the factor.

Factoring contributes at simplifying the accounting evidence of the adherent and also of his functional system of financial and accounting monitoring, regarding the cashing of bills; coming in charge with the task called “customers” from the adherent’s accounting, and making use of the current account system, this way, the adherent can benefit from a reduction in the amount of the funds necessary for the current activity and from the possibility of using the financial means for other purposes. The factor carries out all the operations connected to the adherent’s bills, processes these bills by introducing them in his informational system, together with their cashing. The factor draws up a complex financial report regarding the operations performed at the end of every month.

The adherent can benefit from unlimited capital, factoring representing the only financing source through which financing grows together with the sales. The factor provides regular detailed reports, which allow a better administration of the cash-flow, and at the same time there are no geographic limits regarding factoring operations. The adherent takes a full advantage from the discounts received at the immediate payment (early payment discount) or for ordering large quantities of goods (volume discount). The involvement of the factor in the administration of his customer’s business – the adherent – is accompanied by a large spectrum of services, but also by some aspects connected to the modern methods of administration and accounting, by studies analyzing the foreign market or juridical services; all these are meant to make the

adherent more operational, to strengthen his safety and to expand the market, by establishing relations with partners with a certain solvency. As the turnover increases, amounts of money become available for meeting the surging demand for financing.

The adherent no longer offers discounts for the immediate payment by using factoring. As long as the sellers immediately cash their debentures, they will no longer have to offer discounts for the immediate payment. By making these savings and taking advantage from the discounts received for the immediate payment, the adherent is capable of compensating the factoring cost. Factoring operations are less expensive than building an own department for monitoring and collecting debentures.

### **3. Development of factoring in Romania**

According to the statistic data, the amount of factoring operations performed in Romania in 2006 rose to 710 millions of euro, that is a growth of 29% respect to the previous year and of 36,36% respect to 1996 (19 millions of Euro). This aspect clearly proves that the Romanian factoring market is going through continuous changes. The share of internal factoring operations, estimated for the first semester of 2007, is about 54.5%<sup>26</sup> that is about 300 millions of euro. The development registered by this type of credit becomes even more obvious if thinking about the figures registered last year on the same period. In comparison with the first semester of 2006, there has been a growth of 71% of the value of internal credit contracts. The activity domains considered to be fit for factoring operations and taken into account by Romanian banking societies when selecting their customers are the following: forestry operations, glass, china, pottery, ready- made clothes, textiles, leather, footwear, furs, electronics, electrotechnics, household appliances, food industry, wood, cellulose, paper; there might also be included other fields as well.

Currently, the local market of factoring services is divided between the Romanian Development Bank (29%), the Romanian Commercial Bank (25%), UniCredit Tiriac, Raiffeisen(10%), ABN Amro (12%) and other societies. Taking into account the total value of factoring contracts at an European level, Romania has registered a growth of 21%, from 0.076% to 0.092%, so that its share of European credits remains, as it can clearly be noticed, at an extremely low level. The particular development potential that Romania has when it comes to factoring, is proved not only by its constant evolution in the last years, but also by its participation percentage at the total amount of factoring credits at the European level, similar to that of the countries from East and Central Europe.

BRD factoring activity experienced a significant increase of 53% in 2011 compared to 2010 and reached a turnover of 900 million euros, corresponding to a market share of 35% and market leadership, according to a press release bank. BRD ranked second place with an "excellent" qualification among the best export and import factors within the organization Factors Chain International (FCI). "Evolution factoring operations both in the BRD and the factoring market in Romania, indicate interest in this product and its ability to meet customer needs in an economic environment affected by the crisis. BRD was, in 1993, the first bank in Romania to introduce in its products and services offer the factoring operations, the same year affiliation to Factors Chain International (FCI). During 2004, the bank became a full member of the FCI, and since 2011 is a founding member Factoring the Romanian Association and a member of its Board of Directors" according to a press release (<http://www.business24.ro/articole/piata+factoring>).

In the current economic situation it can be said that the development of factoring in Romania face some obstacles. In this category can be included, except technical obstacles related to the nature of factoring and it's natural limits; legal, economic, financial, psychological and physical obstacles.

In the current situation of Romania factoring should be promoted and supported with priority by governmental means and National Bank of

Romania to provide financial resources for development and growth. Widespread use of factoring could contribute to fluidization of payments between economic agents and, in this way, to limit financial blockade. In Romania is recorded annual increase over global average in terms of factoring operations. Despite these numbers, factoring financing remains still insufficiently exploited branch in relation to the actual financing needs of the economy.

According to the official statement made by the Romanian subsidiary of the most important company in the world dealing exclusively with factoring - Factoring Chain International – factoring contracts have reached a quantum of 1 milliard euro in 2006, followed by one of 1.3 milliards euro one in 2007 (Official statement made by the president of the Factoring Company, Factoring Chain International, the Romanian subsidiary, Valentin Chirca, November 2006).

Among the benefits of factoring we can mention: immediate cash, competitive commissions, flexible approach, customized products, and using financial discounts from suppliers.

## **Conclusions**

Among the advantages are also found an improvement in "cash-flow", due to time needed to obtain liquidity much shorter than for a loan. Moreover, unlike credit, funds raised should not follow a particular destination can be invested according to the immediate needs of the client. For traders who seek factoring facilities are complemented by the fact that the number of documents to be submitted to the bank or factoring company is much lower than for a credit application. After analyzing the documentation, the factor may refuse to grant services only in case of shareholder link between adherent and debtor or in case of conditioning payments sales, advance payment or delivery. The adherent takes a full advantage form the discounts received at the immediate payment (early payment discount) or for ordering large quantities of goods (volume discount).

Factoring is a commercial- financial activity which consists mainly of strong acquisition by a legal person named factor, from producers of goods and services, the receivables that they have on their customers.

Factoring operation is essentially a transfer of commercial receivables from a holder to a factor to commit to recovery them and guarantee such operations even if temporary or permanent insolvency of the debtor, retaining for this a commission. Therefore, factoring is a complex technique consisting of at least two aspects: the transfer of credit and receivables, causing financial and legal nature.

Factoring is a commercial credit contract, involving a specialized company (banking company or a financial institution specialized) in the collection of bills called factor and a company providing products or services called adherent.

With factoring, companies engaged in commercial transactions also benefits that can focus on business development through the expansion of production and sales, while factor deals with tracking cash and evidence conducted by factoring invoices.

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