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THE PRIORITY DIRECTIONS OF NATIONAL ECONOMY DEVELOPMENT

FACTORING – THE MODERN WAY OF COMPANY FINANCING

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Abstract: *Every enterprise, regardless its business activities, is faced with the issue of financial resources. Nowadays, a huge pressure is exerted on entrepreneurs from two directions. On the one hand, in order to keep pace in competitive fight, they have to offer variety of benefits to consumers, such as deferred payment. On the other hand, there is often the lack of operating capital because of provided supplier credit, which prevents flexibility, new investments and thus prevents the further growth of the company. The enterprise is under such pressure forced to request a loan and risks the failure of complying payment deadlines to its own suppliers. In these problematic situations, the factoring emerges as a convenient alternative way financing.*

Keywords*: factoring, overdraft, instruments of financing, sources of funding.*

1. Introduction

The current era is a time of rapid changes and uncertainty that rate is increasing. Such situation is caused by various factors, including continuously increasing pace of scientific and technological development, growing competition as well as increasing demands of customers. It is an objective phenomenon of modern market economy and a company, in order to be successful, must be able to adapt to these changes to sustain development and competitiveness. Ensuring stability and strengthening the market position is not an easy task. This requires the acceptance of risk, correct prediction of changes, which may drastically affect the company functioning and the associated profit. The export orientation of enterprises, enhanced by the entry of Slovakia into the European Union, has brought an increased interest in the use of non-traditional alternative forms of financing.

This article was based on domestic and foreign theoretical sources, with excerption of knowledge from domestic and foreign literature. The aim of the paper is to

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increase awareness about the possibilities of using factoring as an instrument of financing receivables, which will positively affect the financial aspect of the company.

This article was processed with help of scientific publications and magazines as well as the internet resources. Standard scientific methods, such as abstraction, comparison, inductive and deductive methods were used to achieve the main goal.

2. Factoring

In the scientific literature multiple definitions can be found that explain factoring as a possibility of alternative financing. Factoring represents a "redemption of short-term receivables by the bank at the initiative of owners or creditors of receivables without recourse" (Tkáčová, 1995).

Another definition of factoring is: "Factoring represents the sale of company receivables to specialized factoring companies. Factoring company provides following major services: administration of individual receivables (0.5-2 % of the receivable value), protection of credit by customer assessment and provision of finances (usually around 80% of the receivable value)" (Majková, 2008).

Following definition describes factoring as a contractually agreed summary of operations and relations between receivable owner and factoring company. The owner/seller by forwarding the receivable sells the short-term receivable resulting from the sale of goods. New creditor, which is factoring company, purchases and administrates the receivables under factoring agreement (Vejačka, Vincová, 2008). Purchased can be only the receivables that meet following conditions (Dvořák, 1997):

- Maturity period of receivable cannot exceed 180 days,
- Receivable based on unsecured supplier credit,
- Receivable must not associate rights of other parties,
- It must be possible to forward the receivables,
- Receivable is acceptable by factoring company in terms of country of origin and creditworthiness.

2.1. Subjects of factoring

From the foregoing definitions is obvious that factoring is conducted among several parties. Usually there are three following parties/subjects involved in the factoring process:

- The creditor (supplier) – provides goods or services to customer for set price.
- The debtor (customer) – purchase goods or services from supplier with commitment, that he pays properly in agreed time. Within factoring operations, the financial execution is forwarded to a third party – the factoring company.
- Factoring company (in many resources referred as the "factor") – is an intermediary in dealing with relations between suppliers and customer. The factor

offers its clients not only the access to funds before the maturity of receivable and risk transfer, but other services such as consulting as well.

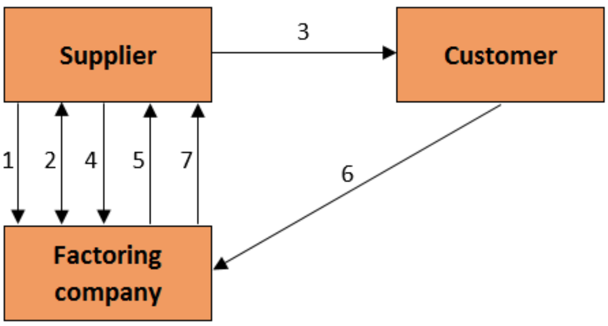
2.2. The procedure of factoring

In case that business entity detects the lack of financial sources and decides to use the services of factoring company, it is obliged to submit required documents. The documents serve to evaluation of potential client creditworthiness and following decision of refinancing amount and amount of individual charges. The most important required documents are (Vejačka, Vincová, 2008):

- request for factoring of receivables;
- financial statements of business entity for last two completed accounting period and quarter of the year concerned;
- contract between supplier and customer (in case such contract does not exist, it is necessary to provide copy of the confirmed order);
- summary of all open receivables against customers;
- brief description of the company, its history, market position and management;
- In case that receivables are insured, it is necessary to provide the copy of insurance contract and copy of approved insurance limits.

When the business entity decides to use the services of factoring company, the entire process from application to payment of receivables consists of several steps, that are shown on following figure (Puchá, Kyseľová, 2011)

The process of factoring operation



Source: Puchá, Kyseľová, 2011

Description of individual steps of factoring operation (Puchá, Kyseľová, 2011):

1. The business entity address request for cooperation to factoring company. It fills the necessary forms for particular factoring company, containing the basic information about the own company and its customer. Then the factoring company sends and indicative offer for cooperation.

2. If the positive response from factoring company is sent, both parties sign factoring agreement with credit limit, which has a revolving nature. The factoring agreement is concluded in accordance with Commercial and Civil Code as well as international private and procedural law. Under the contract, the factoring company is committed to fulfill all or selected factoring activities.
3. In this step, the supplier delivers goods/provides services and issues invoice. The invoice will serve as an accounting document signed by either a written signature or an electronic signature.
4. The receivable is then forwarded, which involves the change of the creditor. When forwarding the receivable, the original creditor loses the rights to dispose of this receivable. Such rights are transferred to a third party – the assignee, who acts as a creditor to the debtor.
5. After the receivable is sold, the factoring company will submit the advance funding. Usually it is 80-95 % of the receivable value to the account of the supplier.
6. In the specified maturity date the debtor (customer) reimburses his liability to the factoring company account.
7. The final step is payment of the receivable residual value from factoring company to the account of the supplier.

2.3. The history of factoring

Factoring transactions are not new products of commercial banks as it seemed at first glance. As a matter of fact, they have been used already the period after World War II. in the USA. The penetration into Europe occurred in early sixties. (Tkáčová, 1995)

Factoring transactions were initiated by suppliers of goods. The impulse of factoring was development of science and technology and the related internationalization of economy as well as emergence of new forms of international trade. The customers increasingly got into problems due to the lack of financial resources, which forced them to request loans from suppliers. (Tkáčová,1995)

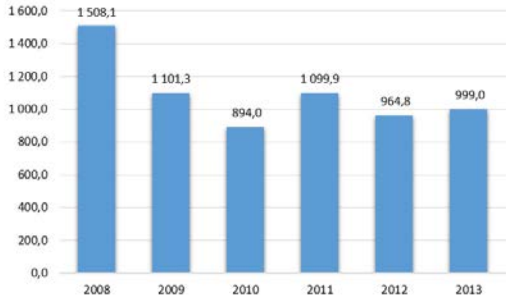
First they started to use traditional payment instruments, such as letter of credit, direct debit or bank guarantee. However, purchasers (customers) were not always willing to accept complex administrative burden or restrict own capital resources, etc. Suppliers were forced to seek new effective solutions to retain customers by implementing lending. The result of the search process was factoring. (Tkáčová, 1995)

2.4. Current factoring market in Slovakia

Factoring companies established the Association of factoring companies in 2003 in order to support and promote the interests of factoring companies in Slovakia. Factoring turnover was gradually increasing from year to year. The most progressive development occurred in 2006 when approximately 1.5 billion Euros were refinanced through factoring.

The following figure illustrates the development of factoring transactions in period 2008-2013. Since 2006 the development started to gradually slow down and increased only slowly. The turnover in 2008 was only 8 million Euros higher than in 2006. Due to the economic crisis, in 2009 the turnover decreased by 400 million. Factoring companies have been recovering out of the crisis for a long time as the turnover in 2010 continued to decrease to the amount of 894 million Euros. The situation slightly changed in 2011, when turnover increased by 200 million, but in 2012 it decreased again to 964.8 million. The turnover somewhat increased in 2013, but the future will show the further development.

The development of factoring transactions in Slovakia (in million EUR)



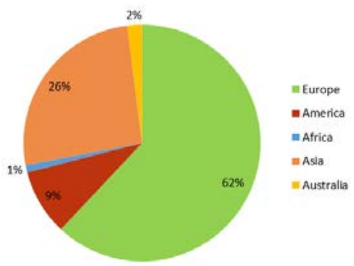
Source: FCI-Factors chain international. www.fci.nl (02.06.2016)

2.5. International factoring market

Almost all factoring companies worldwide are associated by Factors Chain International (FCI), which is the global representative body for factoring and financing at domestic and international markets. FCI associates more than 400 member companies in 90 countries and provides a unique network for cooperation in cross-border factoring. (FCI, 2016)

FCI was founded 1968 as an organization to associate independent factoring companies worldwide. At the time of establishment, domestic factoring was available only in North America and a few European countries. The founding members recognized the potential in international factoring, but first they realized the need to implement factoring in countries where it was not available. Then was necessary to create framework for international factoring, which enabled factories to closely cooperate in the countries of exporters and importers. (FCI, 2016)

Share of individual continents on global factoring turnover in 2014

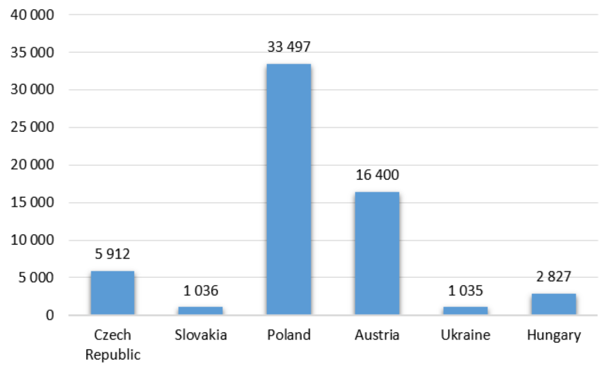


Source: FCI-Factors chain international. www.fci.nl (02.06.2016)

The latest available data from 2014 shows on following figure, how involved in the total turnover were the individual continents. The largest share holds Europe, up to 62 %. Based on this fact we can say that factoring market in Europe is well developed. The second largest share belongs to Asia, up to 26%. America and Australia contributes with a low share. The lowest share holds Africa. It is only 1% of total turnover, which evolves this continent as least developed factoring market.

On following picture, we can compare the situation of factoring in Slovakia and other selected countries. For comparison we chose the neighboring countries with direct border with Slovak republic. Those countries are Poland, Czech Republic, Austria, Hungary and Ukraine. Slovakia import and export goods right through these countries. According to information from the Slovak Ministry of Finance website, most goods from Slovakia go to European markets. The quarter of export is intended for Germany; another quarter goes to other Eurozone countries. Another quarter is exported to Hungary, Poland or Austria, half of this quarter is exported to Czech Republic. Part of goods is also exported to Ukraine. Although not directly, the goods are also exported to other countries, such as Russian Federation, USA, China and others. Based on the chart on following picture we can observe, that factoring is most developed in Poland, where its annual turnover reached up to 33.5 billion. The second highest factoring turnover out of compared countries has the Austria, 16.4 billion. Third rank has the Czech Republic, with turnover was almost 6 billion. Half of it is in Hungary, only 3 billion. Slovakia has comparable factoring turnover with Ukraine, where value for both countries slightly exceeds one billion which is the lowest value of selected countries.

The turnover of factoring companies in selected countries in 2014 (in million EUR)



Source: FCI-Factors chain international. www.fci.nl (02.06.2016)

2.6. Financing of factoring and bank loan in practice

The use of factoring services for corporate financing has a growing trend lately. As every financing instrument, it is not always ideal, because it brings not only benefits but the often disadvantages as well. For a more objective evaluation of such advantages and disadvantages is necessary the comparison with other financing options.

2.7. Comparison of factoring with bank loan

Factoring and short-term loan as forms of financing are very similar. Both serve to momentarily cover the lack of financial resources. This sub-chapter is focused on comparison of factoring and short-term overdraft loan from selected commercial bank.

Table 1. Comparison of factoring and short-term bank loan in Slovakia

Financing instrument	Factoring	Shot-term loan (overdraft)
Interest rate	1 month EURIBOR + Bank risk margin	3.0 % p.a.
Minimum height	150 000 €	70 000 €
Maximum height	not fixed	not fixed
Payment term	180 days	1 year
Cost structure	Neither change nor increase based on the agreement with factoring company	Besides costs interest other fees, such as overdraft fee, administration fees, various sanction fines
Liability	Not needed	Needed
Documents needed for application	Financial statements, application, contract with customer	Financial statements, tax returns, questionnaire for interim financial statements and security
Availability period	Receivables are provided to factoring company according to client's request	Obtaining loan is a quite lengthy process
Additional services	In addition to financing, it provides comprehensive management of receivables and insurance	No additional services

Source: Authors

Based on foregoing table we can conclude that financing through factoring is less complex then financing through short-term bank loan. Factoring offers less complicated administration for approval than bank loan. The advantage of factoring is, that the maximum value of invoices is not set. However, the minimum invoice value is 150 000 to be possibly financed through factoring. Lower receivables must be financed through bank loan. The additional services represent another advantage of factoring. Factoring companies offer, besides financing, a comprehensive management of receivable as well as assuming the risk. Unlike a loan, which does not provide any additional services.

3. Conclusion

Answer to a question how much finances company needs to maintain smooth operation depends on type of business and the size of the company. Nevertheless, it is important to have sufficient amount of funds. The lack of money is often and business entities are forced to finance the needs of society through foreign sources. Many times, the companies resort to use external sources only to bridge the time gap between invoice issue and its maturity date. The enterprises need to carefully consider which financing instrument they will use. Both factoring and short-term loan can serve to bridge such time gap.

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FAKTORING - SAVREMENI NAČIN FINANSIRANJA KOMPANIJE

Apstrakt: Svako preduzeće, bez obzira na svoje poslovne aktivnosti, se suočava sa pitanjem finansijskih sredstava. Danas, veliki pritisak je izvršen na privrednike iz dva pravca. S jedne strane, kako bi se održao korak u konkurentskoj borbi, oni moraju da ponude različite pogodnosti za potrošače, kao što je odloženo plaćanje. S druge strane, često postoji nedostatak obrtnog kapitala zbog pruženog kredita dobavljača, čime se sprečava fleksibilnost, nove investicije i na taj način sprečava dalji rast kompanije. Preduzeće je pod takvim pritiskom primorano da zatraži kredit i rizikuje neuspeh zbog rokova plaćanja svojim dobavljačima. U ovim problematičnim situacijama, faktoring se pojavljuje kao pogodan alternativni način finansiranja.

Ključne reči: faktoring, overdraft, instrumenti finansiranja, izvori finansiranja