REVIEW ARTICLE

Factoring Industry in India –An Overview

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ABSTRACT

Factoring is a global industry with a large turnover. It provides a number of benefits, including predictable cash flow, lower administrative costs, decreased credit risks, and more time for the core business. Domestic and international factoring are gaining popularity at a rapid rate in every corner of the globe. During the industrialization period, the relevance of factoring has grown not just in developed countries but also in developing countries. The world factoring statistics indicates that the Factoring and Receivables Finance Industry volume witnessed retraction due to Covid-19, showing negative trends in most regions. Compared with the previous year's 2,917 billion euro, the 2020 volume of 2,726 billion euro represents a decline of 6.5%. The last time the industry experienced a decline was in 2009 during the financial crisis, when the industry lost 3% in global volume. This decrease in global volume in 2020 follows a solid three-year growth spurt from 2017-2019, when the industry grew by 6%, 9%, and 5%, respectively. However, 2020 marks an unprecedented reduction stemming from the effects of the virus, resulting in a significant reduction in global GDP and Trade that had a substantial impact. (FCI Annual Report 2021). A more consistent policy environment for factoring services is needed, one that supports and promotes increased involvement by all nations in various country groups and within each country group. The factoring services entered in India in the year 1991. Since then, a good number of factoring companies namely Canbank Factors, SBI Global Factors, HSBC Bank, IFCI Factors, India Factoring and Finance Solutions, DBS, Citibank, SIDBI, Standard Charted, Foremost Factors and Export Credit Guarantee Corporation of India have been offering factoring services in India.

Keywords: *Factoring industry; India; Global perspective*

INTRODUCTION

Factoring is a financial solution for receivables management. It is the process of converting credit sales into cash. A financial institution (factor) buys a company's accounts receivable (Client) and pays up to 80% (occasionally up to 90%) of the amount immediately after signing an agreement. When the consumer settles the debt, the factoring business pays the leftover money (balance 20% - financing cost-operating cost) to the client. Depending on the kind of factoring, the customer's debt is collected by either the factor or the client. In factoring, the account receivable might be for a product or a service. Examples are factoring against purchased products, factoring for construction services (typically for government contracts when the government entity is capable of repaying the loan during the factoring period). Contractors submit bills to receive immediate payment), factoring medical insurance *etc*.

Factoring Industry – A Global Perspective

Factoring as an industry has grown steadily across the countries. In Europe, the industry is well established and the growth in the Asian countries is also considerably high. Growing volumes of international trade have opened up many opportunities for the factoring industry. Agencies like FCI, which has a large network of factoring agencies in different countries, have contributed to the growth of factoring business. The performance of the factoring services industry can be analyzed with the help of data from FCI. Table1 shows the statistics of turnover of factoring business in various continents for the year 2020.

Globally, there are 4,155 factoring companies generating a total volume of business of 2,726,728 million Euros as of 2020 (*FCI Academy, Global Industry Activity Report* (*GIAR*) *2020*). Europe has the largest share in the total factoring volume. Asia has performance better than that of America's total factoring volume.

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The total volume of factoring includes domestic factoring and international factoring. Domestic factoring business consisted of reverse, recourse, non-recourse, invoice Discounting, collection and new type Islamic factoring was introduced during 2019 which accounted Worldwide Factoring Turnover around 81 millions of EUR in 2020. Export factoring, import factoring, and export invoice discounting constituted the total international factoring. Business volume from domestic factoring was greater in proportion of about 81% compared to International factoring of about 19%.Factoring business activities in 2020 have systematically decrease according to global GDP outcomes, to approximately – 6.5%.

Table 1. Factoring Turnover in Various Continents (2020) in millions of EUR

Continent	Domestic Factoring	International Factoring	Total	No. of companies
Africa	24,888	354	25,242	184
Asia Pacific	5,45,670	1,51,423	6,97,093	2,197
Europe	14,83,307	3,61,414	18,44,721	572
Middle East	7,146	2,370	9,516	23
North America	64,458	2,140	66,598	323
South America	80,531	3,028	83,559	856
Grand Total	22,06,000	5,20,728	27,26,728	4,155

Source: FCI, Annual Review 2021

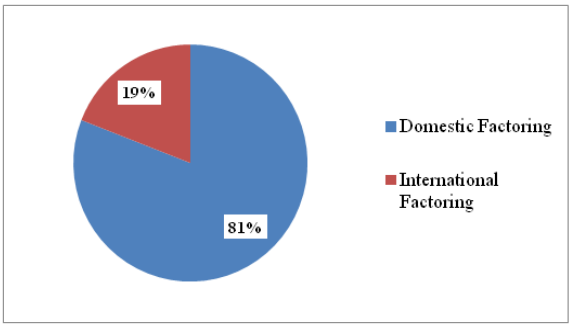

Figure 1. Proportion of domestic and international factoring in the world (2020)

Factoring in India

Factoring is viewed as a supplement to bank financing, enables the availability of much-needed working capital finance for small and medium-sized businesses, particularly those with high-quality receivables but who may be unable to obtain sufficient bank financing due to a lack of collateral or a poor credit profile. Small traders, industries, and exporters that maintain a long-term business connection with factoring firms benefit from improved cash flow and liquidity, as well as the ability to access auxiliary services such as sales ledger accounting, receivables collection, and credit protection. Factoring allows them to free up resources and have a one-stop shop for all of their company needs, allowing them to run their firm smoothly.

The Kalyanasundaram Study Group set up by the Reserve Bank of India in 1988 to examine the possibility and mechanics of starting factoring organisations in the country showed the way for the provision of domestic factoring services in India. Factoring was included in the Banking Regulation Act of 1949 as a type of activity that banks may engage in. The Reserve Bank of India announced rules allowing banks to form independent subsidiaries or jointly participate in factoring firms. However, it was widely believed that the lack of a factoring law was one of the primary barriers to the country's factoring business's expansion, along with high stamp duty on assignment deeds, ambiguity in Factors' legal rights in respect of receivables, and so on.

The Factoring Act, 2011, was passed by the Indian government to provide a much-needed legal framework for the factoring industry in the nation. The words factoring, factor, receivables, and assignment have been defined. The Act further stipulates that any firm doing factoring business must register with the RBI as an NBFC, whereas banks, government businesses, and corporations created under an Act of Parliament are excluded from the need of registering with the RBI to conduct factoring business. As a result, the Act clarified the activity of assigning receivables and exempted papers performed for the purpose of assigning receivables in favor of Factors from stamp duty, making the company more feasible. To decrease the risk of fraud and enhance the due diligence process for customers, the Act also requires that all receivables assignment transactions be recorded with the Central Registry created under the SARFAESI Act, 2002.

The Reserve Bank has authority under the Factoring Regulation Act, 2011 to set criteria for a Factor's "primary business," as well as to provide directives and collect information from them. Following the Act's passage, the Reserve Bank established a new type of NBFCs called NBFC-Factors and set regulations for them. The prudential standards that apply to NBFCs in the loan industry have been applied to NBFC-Factors as well. The RBI also oversees bank lending to factoring businesses and the factoring industry that banks engage in.

Depending on the demands of its clients, factoring companies in India offer a number of services, including recourse and non-recourse factoring, local and international factoring, and disclosed and hidden factoring. Because the factoring business and the bank are unable to cover the buyer's credit risk, most sales in India are done through the corporation. This is owing to the fact that factoring is not authorized in India due to the lack of credit insurance. As a result, a strong institutional infrastructure is needed to not only conduct an efficient and cost-effective factoring and reverse factoring process, but also to ensure that sufficient liquidity is available to all parties through an active secondary market.

India Factoring and Finance Solutions Pvt. Ltd. top Export Factoring performer as per FCI annual turnover statistics for three consecutive years and stands as first position in India for export factoring. SBI Global factors are market leader of factoring, Canbank factors have the highest rating of ‘A1’+ by CRISIL for the short-term debt programme.

Factoring Regulation Act, 2011

The Factoring Regulation Act 2011, which took effect in February 2012, governs the factoring industry in India and provides the country with a valid framework for factoring. The Assembly’s goal in enacting this Act was to develop the concept of factoring by making it more visible and coordinated, as well as providing clarity on the job cycle, rights, and commitments of groupings to contract for receivables. The following are some of the most notable features of the Factoring Act of 2011:

a) The Indian Stamp Act 1899 was amended by inserting Section 8D, which exempts any arrangements for the work of receivables for a factor from the stamp duty. The Act considerably reduced transaction costs for factoring courses of action that were previously vulnerable to high stamp requirement rates.

b) Every factor to enlist the characteristics of each transaction of the receivables task in support of it with a focal vault, which was established under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002. (*SARFAESI Act*). A gathered data base was aimed toward reducing fakes and encouraging elements to validate whether a particular receivables arrangement had recently been designated for an outsider.

Future trends

Steps have recently been taken to address the issues plaguing the factoring industry and to broaden the reach of factoring across the country. The Factoring Regulation Act of 2011 was passed to regulate receivables assignment in favor of factors and to define the rights and responsibilities of parties to receivables assignment. The Act includes measures such as stamp duty exemption for factoring debts, legal recognition of debt assignments, and the requirement of assignment notice.

In addition to TReDS, the RBI has suggested factors as a new form of non-banking financial business (NBFC). The main business eligibility criteria have also been simplified: the NBFC Factor must ensure that financial assets in the factoring business account for at least 50% of its total assets, and that income derived from factoring business accounts for at least 50% of its gross income, as opposed to 75% previously. Factors can now obtain credit information from credit bureaus thanks to RBI decisions.

To assist MSMEs with factoring activities, the government has approved the creation of a Credit Guarantee Fund For Factoring (CGFF) with a budget of Rs. 500 crore. The factoring credit guarantee fund has the benefit of encouraging factors to extend their lending to MSMEs against factored loans by sharing part of their risk, resulting in an increase in actual credit availability for MSMEs.

These initiatives, along with better economic environment, should assist to propel the growth of the factoring sector and transform the face of traditional working capital financing in the country. With more promotional conference, trainings, greater advocacy work should be done in developing countries like India.

CONCLUSION

For factoring business to grow, several business environment issues such as lack of awareness among clients, slowturn around time, regulatory factors that can catalyse the growth of factoring in India. Factoring is a widely used technique of receivables financing that is governed by a set of strict rules and processes. In the lack of laws, factoring was not a common or mainstream financial service at first. However, with the passage of the Factoring Regulation Act in 2011, the essential legal framework for the growth of factoring volumes has been established. However, corporate and PSU buyers reluctance to accept assignment of receivables in favor of factors, as well as difficulties with the legal system and banking’s control, have stifled expansion. Given the RBI’s and other organizations’ efforts to raise knowledge of factoring and its excellence as a receivable management service, a rise in volume is predicted.

Ethics statement

No specific permits were required for the described field studies because no human or animal subjects were involved in this research.

Originality and plagiarism

We ensure that we have written and submitted only entirely original works, and if we have used the work and/or words of others, that has been appropriately cited.

Consent for publication

All the authors agreed to publish the content.

Competing interests

There were no conflict of interest in the publication of this content

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