FACTORING- CREDIT OPPORTUNITIES IN ROMANIA

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Abstract

Capital is the main factor of production, business development becomes virtually impossible without taking into account the financial market and the resources it provides to businesses. Any business, regardless of its degree of development, is involving direct contact with financial markets, namely the institutions that mediate mobilization of capital and the services they provide. Understanding the functioning of the financial system, the specific financial mechanisms through which savings are allocated to support capital investments and the costs and risks involved is essential for the development of a solid base for business.

In this context, factoring operations can support economic agents, allowing a transfer of commercial receivables from their holder to a factor who commits to their recovery and guarantee such operations even if temporary or permanent insolvency of the debtor . Thus, factoring is a complex technique in at least two aspects, of the debt and the transfer of credit. **.** *Factoring is a means of financing business, especially export-import transactions, less known in Romania. Maybe because of poor business environment popularize the term is as little known as it was a few years ago the leasing.*

Present in Romanian legislation since 2002, 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.

The article is divided into three parts. In the first part we defined the concept of factoring and international factoring, then I presented the advantages and development of factoring in Romania, and the last part conclusions.

Keywords*: International Factors Group, factoring, product of financing, sale invoices, double sales, factoring contract , factor, financing technique, credit and payment instruments, costs, regulatory framework*

Introduction

Factoring overview

Factoring is a financial - trading activity which consists mainly of firm acquisition by a person named factor, from the producers of goods and services, the claims that they have on their customers. Factoring operation is essentially a transfer of trade receivables to a factor holder to commit to their recovery and guarantee such operations even if temporary or permanent insolvency of the debtor, retaining for this a commission. Results therefore that factoring is a complex technique consisting of at least two aspects: the credit and the transfer of debt, which is causing its financial and legal nature.

Factoring is a commercial credit agreement involving a specialized company (banking company or a specialized financial institution) in the collection of bills called ***Factor*** and a company providing products or services referred adherent **.** The adherent aims to charge invoices before their expiration term as the *Factor* seeks a benefit, usually a percentage of the invoices adherent he settled in advance. In factoring business is involved as well the customer/client of the which is notified that it will pay the bill at maturity to the *Factor*. By entering into a factoring agreement is not envisaged an isolated operation but is usually sought an exclusivity on a certain customer segment, region or country. The adherent is in a major advantage because it does not have to collect bills from a variety of customers but they receive the amount directly from the factoring company. The *Factor* accept invoices on its own risk and if the debtor does not pay cannot demand the payment from except that the adherent does not provide to its customer the services or goods covered by the adherent invoice).

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To assume the risk of non-payment of an invoice, the *Factor* must first agree that invoice, in other words it will only work with agreed clients and those that provide security. If it does not accept the invoice the *Factor* can cash it under a contract of mandate without taking the risk of default. The is adherent required to notify its customers that it yielded its claims to the *Factor*, so it must pay to the latter.

Factoring is a way of financing business - especially export-import transactions - less known in Romania. Maybe because of the poor promotion of the term in the business environment it is as little known as it was a few years ago at the "Lease". Meantime if we became familiar with leases, market trend will lead logically to modernization in trade financing. This involves as well adopting factoring as a means of funding, to the detriment of classic credit.

In a more common language factoring operation consists in selling by a bank or a specialized company receivables generated from commercial invoices. In the transaction, the bank (or factoring company) offers immediate financing. Thus upon presentation of the client's invoices for products or services purchased it's paid immediately a percentage of 85% of their value. After recovery of the invoices, the *Factor* will pay the difference of 15% from which retains the value of commission and interest. Specifically, factoring is the financing mechanism which quickly obtains cash by selling bills whose maturity is short (usually comprised between 180 and 360 days). Since *the Factor* is one that assumes the risk of default of the debtor, must take into account the seriousness of the foreign partners. In this regard, the bank (or factoring company) will require financial statements and reports concerning the importers loans so it can check the situation. The *Factor* take also into account the quality of the undertaken debt.

Factoring applies particularly in export-import operations where the need for fast cash and short time to recovery invested funds are in balance, hence the success of this financing mechanism.

Factoring benefits are primarily related to the ability to obtain financing in a very short time. Thus, banks and factoring companies provide financing on the day of producing the bills, of course after signing factoring agreement. Among the advantages we may indicate an improvement in the cash-flows due to much shorter time needed to obtain liquidity than for a loan. Moreover, unlike credit funds raised should not follow a particular destination as they can be invested according to the immediate needs of the client.

For traders who apply to 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 services only in case of shareholder partnership between adherent and debtor or if sales payments are conditioned, for advance or at delivery payment. Using factoring the companies engaged in commercial transactions also benefit that can focus on business development through the expansion of production and sales, while factor deals with tracking cashing and recording invoices conducted by factoring.

First worldwide important market that factoring has appeared was the United States', where until the 60s, most specialized firms were family companies. Since 1980, banks have seized the opportunity to promote such services and have launched a massive acquisition of factoring companies. The key to success is not the size of the market so the U.S. is inadequate reporting to into the context. It also does not matter much any knowledge of the concept of factoring. What matters is the proper organization of specialized companies and the awareness that factoring industry has its own culture. For example, the exchange of knowledge between members of factoring networks, such as "Factors Chain International", contributed to the growth of professionalism. Consequently, national companies in the sector have become able to operate internationally.

International factoring

The first form of factoring has been funded in the U.S. in 1808, after which, under its own regulations the activities promoted by a number of U.S. states, factoring quickly spread throughout the United States. In 1923, in the U.S. was adopted the world's first law of factoring.

In Europe, the first factoring company appeared in England in 1960. At present in all European countries there are factoring companies, most of which belong to international groups such as the U.S. International Factors, Walter Heller & Co., International Factors France etc. Also, it was enacted detailed legislation in this area, in each of the Western European countries.

If we look at international factoring several important factors are to be noticed and considered such as:

- the Factor is a bank, usually a wide known one, fact which on the one hand brings credibility and on the other hand allows it, through Factor correspondents in the importer's country, to acknowledge the latter financial situation so making able the best decision to take concerning the takeover of the claim or not;

- the activities tracking debt collection and credit control are taken from adherent and are made with a higher efficiency due to Factor capabilities:

- payment of invoice amount is guaranteed to the adherent;

- the Factor charge a fee of between 0.5% and 2% of the total debt (depending on volume of activities performed, the existing risks and bills).

- the interest charged by the Factor for its financing is usually higher more than 3% than the market rate.

Finally should be mentioned that factoring apply to transactions with short term credit payment (generally up to 180 days), which usually refers to goods with a low degree of processing, consumer goods and industrial products series, whose sales are repeatable so that collection facilities can be provided on an ongoing basis.

International Factoring (bills negotiation) is first and foremost a financial banking transaction with commercial support, which, based on a contractual agreement, the Factor, a specialized banking institution undertakes to ensure recovery of claims that Adherent (the exporter) has at its customers (the importers) and perform other services for the Adherent.

The Factor take over the bills representing receivable from Adherent and agree to pay them to it, either after full payment of their fee or, most often, paying some bills (between 70% and 80% of their value) immediately and rest when invoices are received in full. The Factor charges a fee for its services that covers all expenses and is earning him a profit.

The Factor take over as well all collection activity tracking the invoices and credit control including accounting operations, as well as sending statements and letters. This allows the Adherent to employ its staff for other activities, leading also to a relaxation of pressure on cash-flow and increased competitiveness of the Adherent.

In international factoring operations may come up to four parts: Adherent (the exporter), Export-Factor (a bank in the exporter's country), Import-Factor (a bank in the importer's country) and Foreign Customers (the importers).

Schematically, the mechanism of a comprehensive international factoring transaction is as follows:

- factoring transaction begins when Adherent submit the Factor its claims on third party importers as invoices with different maturities, from exports performed by the Adherent;

- comes up factor subrogation to the Adherent rights in claims mobilization ;

- payment of bills nominal fee less the Factor fee, either immediately - before the maturity of debt (old line factoring), which requires payment before maturity and thus adding to the cost of factoring an appropriate interest rate, or at maturity (maturity factoring).

In case of payment on maturity, the Export- Factor hands over the claims to the Import - Factor that recovers their value from importers making settlements with Export-Factor, which then pays the exporter.

Export- Factor can pay the Adherent at delivery a certain amount of bills and afterwards the difference will be adjusted after recovery of loans. At debt maturity the Import-Factor receives from the third party borrowers their value by showing the payment and settlement documents with the

Export-Factor. In the case of immediate payment factoring, The Export- Factor, as noted above, advances funds to the Adherent paying the bills at face value from which deducts the interest and fee. Export-Factor can grant also loans to the Adherent for development of export production. By factoring operations, the Adherent transfers on Factor the insolvency risk of its customers, the risk of collection (payment cancellation) and currency risk (devaluation of the currency in contract). In addition to taking these risks, the Factor ensures to Adherent, as mentioned above, other services too, such as sales accounting, tracking receivables from foreign customers, developing short term studies on foreign markets as well as on the Adherent customers, specialized banking services as granting and guaranteeing loans or as economic efficiency analysis for Adherent export activity. By resorting to factoring Adherent may increase its export products competitiveness.

Factoring activity in Romania

In Romania factoring has substantially grown recently. With all substantial advantages offered by factoring, Romanian companies have resorted to a greater extent to this category of product until 2001. Only then transactions exceeded 100 million Euros. Meanwhile, in Poland transaction volume measures 3 billion Euros and the Czech Republic, Hungary and the Baltic countries recorded higher volumes. The reasons for this discrepancy account both to macroeconomic conditions and the banking offer system. Lack of bank offer was a brake on expand factoring, but the current trend is on a high increase. The rapid growth of banks' revenues from factoring operations (approximately ten times in the last six years) indicate an increase in trade exchanges and need for cash of the economic agents, faced with increased tougher competition. Now the domestic bank factoring services market is divided between BRD(27%), BCR(23%), Raiffeisen(19%), UniCredit(19%) and ABN Amro(12%).

In the current economic situation it can be said that the development of factoring in Romania has some limitations caused mainly by the following facts:

- Technical issues related to nature and natural limits of factoring
- Economic situation
- Financial regulations
- The level of understanding and knowledge of the involved factors
- The need to making up specific legislation

Evolution of factoring market in Romania during the period of 2009 – 2011

In Romania factoring market is controlled in proportion of about 75% of companies in the banks. The main players are BCR, BRD, Raiffeisen and Unicredit Tiriac, which work on the factoring market through 'inhouse' departments while lending institutions such as ING and BT are on the market through specialized divisions, namely the Commercial Finance and Factoring Company. *Next Capital Factoring* Company, with totaling 5 million grants last year, is one of the leading independent players in the market. Recently, the British private equity fund North Bridge took over 29% of its share capital, the value of transaction amounting to 4 million. Most customers of the *Next Capital* are SMEs and entrepreneurship.

Factoring market in Romania increased in 2011 by 10-15% compared to 2010, when it fell by 27.8%, to € 1.3 billion, compared to 2009, in the context of marked reduction in the number of borrowers accepted by specialised companies. One of the most important players on the Romanian market is *Capital Factoring* company which finances up to 80% of the assigned customer invoices within 24 hours from the date of signing the contract, even if SMEs do not meet the necessary conditions to get a traditional bank loan. Financing that meet the necessary conditions are guaranteed by the National Credit Guarantee Fund for SMEs.

Factoring market in 2010 was 1.3 billion Euros, a contraction of 28% over the previous year when factoring market reached a total of 1.8 billion euro, an increase of 63% over 2008. Factoring market in Romania has continued to develop and in 2012, according to representatives of companies in the domain. Moreover, since 2011 new specialized companies emerged, which shows the interest in the business. According to experts Romania is interesting to investors because of the market size, even if in this period is little hope for growth.

According to the data, Romania ranks last in the region in terms of factoring volume transactions related to gross domestic product (GDP), at a level of 0.52% compared to 0.67% of GDP in Bulgaria. The low penetration of factoring in the GDP shows that this sector has a significant potential for growth. Factoring which is a financing product implies the assignment of payment of bills on time in order to get quick cash, but funding does not include collaterals (deposit, mortgage), being strictly based on customer invoices.

For the development of factoring industry in our country I think there is a need to diversify the range of services offered by factoring companies, such as:

- the bookkeeping of sales, inventory, cash management, representatives a.s.o for the adherent;
- providing adherent information on the economic-financial situation of buyers;
- informing with statistical data on key customers, products and market sales volumes etc.

Thus adherent will find at the factoring company a source of commercial informations, a source of credit and services of banking, insurance, accounting, statistics etc.. The only concern to the adherent will be to make and sell quality and competitive goods.

Nevertheless a question arises: ***has factoring a future in Romania?***

There are many factors to be considered in order to give a positive answer to this question. But what we can say with certainty is that the success of this funding technique depends on its acceptance by customers, consisting primarily of small and medium enterprises, as well as on the behavior of the *Factors* in satisfying users requirements. Has factoring been able to meet only temporary needs due to fortuitous circumstances or needs arising from the development of the Romanian economy, only time will give us an answer.

Conclusions

At the end it can be concluded that for Romania is necessary that factoring become the subject to a legal status similar to that met in the U.S. and known as the Factor Acts, harmonized as much as possible with European Union legislation.

It must however be taken into account that the evolution of the legal nature of factoring leads to a vicious circle: to develop factoring needs a status that can not be attained but only when it is highly developed, so it is that factoring will have to be developed on the move.

It is also necessary that financial institutions which monitor factoring give to it every chance up agianst other financing techniques. We bear in mind primarily the National Bank and the commercial banks which must expand use of credit and payment instruments.Exporters that will need to mobilize their client accounts and which will not have sufficient financial coverage to obtain credit by mobilizing trade receivables will have to resort to factoring.

In terms of economic and financial obstacles, first will have to be reduced factoring costs by lowering *Factor* costs. Romanian *Factors* which appeared since a real short period may consider to improve their work efficiency. Increasing the number (and quality) of bills covered by B/E will bring to bear in that direction - that as posibilities to internal cost reduction. On the outside it is envisaged endowing with high performance equipment for data processing and communication, as well as competition and specialization of factors in different fields.

Another obstacle related to factoring costs can be deemed the relative ignorance of the prospective users to the offered services.

Candidates to factoring may only consider the importance of financial advantages of this technique, not knowing or minimizing the importance of some other advantages. Or, factoring is not reduced only to the immediate and final settlement of bills. If a company interested in this technique takes into account only financial benefits, risks to give up its use due to its high apparent costs. It should be a shift from apparent cost to actual cost, ie know all services obtained for this cost. It depends on the promotional activity carried out by *Factors* and is a matter of educating customers on sale domain.

Factoring activity requires a single regulatory framework, given that it has potential to grow more than seven times the amount of 1.6 to 1.8 billion, reached already last year. Currently, factoring market is dominated by banks, which run internally such operations but independent players begin to force their way in as well.

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