CHAPTER - II

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INTRODUCTION

Factoring is a powerful financial instrument, specially designed to meet the post sales working capital requirements of the industrial trade and service sectors. Factoring is a method for companies to convert account receivable to cash by selling them to a factoring institution. With the adoption of liberalisation policy in India, the requirements of the industries also changed. Out of many innovations to meet such demands of business community factoring services seem to be the most feasible solution since it is a tried and true form of financing throughout the developed world.

Having determined the research problem and its worthiness, the researcher decided to make an empirical study of the problem. The study of various aspects of performance of factoring institutions remained one of the widely researched areas in the field of finance. There has been a continuous research in the field of performance evaluation and clients’
satisfaction towards factoring services. Such studies proved to be very useful to the researcher in getting an insight into the main objectives of the study and finalizing the methodology. A brief account of important studies pertaining to the factoring services are presented in this chapter.

These studies are presented under three heads such as studies related to performance of factoring institutions, clients’ satisfaction and factoring as a financing option.

**Review of studies related to Financial Performance of factoring institutions is presented here**

Latha, T., (2001) in her study on “Performance Evaluation of SBI Factors”, focused on the solvency position, leverage and profitability of SBI Factors. The debt management of SBI Factors was effective as a result of following a good credit policy and the non-performing assets could be controlled as per this study. The results of the study indicated satisfactory operational efficiency and financial viability of SBI Factors and Commercial Services Private Limited.¹

Sangeetha, V.M., (2002) in her research study, “Performance Evaluation of Canbank Factors Limited” identified various growth indicators and analysed their impact. The researcher has identified the
indicators of the NPA’s like excess holding of cash balances, mounting overdues and sticky loans, bad and doubtful debts and deteriorating productivity of employees. She concluded that Canbank Factors Limited had taken proactive actions and brought down the net NPA to nil during the year 2001-02 and Canbank Factors could accelerate its profits with effective control over the expenses.²

“Evaluating the financial performance of Canbank Factors Limited” a study conducted by Jailakshmi N (2003) highlighted the profitability and financial performance of Canbank Factors during the study period 1997-2002 through ratios. However, the researcher has failed to analyse the NPA’s role and its impact on profitability but she suggested some measures for improving profitability through conscious efforts and careful planning in the factoring services.³

Siva Shankari, L., (2003) in her research work, “A study on factoring services and business performance with special reference to SBI Factors Coimbatore” made an attempt to study the concept of factoring and business performance of SBI Factors and Commercial Services Private Limited. The study examined the various aspects of
factoring services and concluded that the financial performance of SBI Factors was good.4

“A study on the financial and service performance analysis of SBI Factors Commercial Services Private Limited” a research study conducted by Trishla (2003) highlighted the financial position of the company and probed the avenues of business development in and around Coimbatore. This study failed to make an indepth analysis into the factors determining the funds position of the factoring institution.5

Rajarajeshwari, J., (2004) in her study entitled “Performance Analysis of SBI Factors Limited Coimbatore branch” made a year-wise analysis to assess the trends in the levels of business performance of the branch. Growth rates, percentages and ratios were used for the analysis. This study failed to analyse the funds position of SBI Factors.6

Balwinder Singh and Arvinder Singh (2004) in their paper, “Factoring Services in India: Progress, Problems and Prospects” made an attempt to compare the SBI Factors and Canbank Factors regarding growth of factoring turnover through compounded annual growth rate for 10 years. However, this study could not throw light on the operational efficiency on the select factoring institutions.7
Reddy, Y.V., and Santhosh Patkar, (2004) in their article entitled, “Working Capital and Liquidity Management in Factoring,” examined the relationship between liquidity and profitability of factoring companies. They found that liquidity and profitability were inversely related to each other in both factoring companies, SBI Factors and Canbank Factors. They suggested that investment in current assets should be reduced and the level of sundry debtors should be decreased by giving more stress on increased recovery. They concluded that the delay recovery increased the amount lacked up in working capital which resulted in additional cost through increase in borrowing.

Bakker Marie, H.R., Udell Gregory, F., and Klapper Leora, F., (2004) in their study “Financing Small and Medium size Enterprises with Factoring: Global Growth and its Potential in Eastern Europe” examined the advantages of factoring over other types of lending for firms in developing economies. The authors also investigated the role of factoring in the Eight Eastern European countries, the Czech Republic, Estonia, Hungary Latvia, Lithuania, Poland, the Slovak republic and Slovenia. They concluded that factoring offered key advantages over other lending products and was likely to become more important in those countries.
Hemalatha, E., (2005) in her research work, “Evaluating the performance of SBI Factors and Commercial Services Private Limited” made an attempt to analyse the financial performance of the factors through Comparative statements of Balance sheet. Ratios like solvency ratio, stability ratio, liquidity ratio, turnover ratio and profitability ratio were computed. The Growth of SBI Factors was analysed through various growth indicators by calculating Annual Compound Growth Rate and suggested a tight Credit Policy to minimize the loss due to irrecoverable debts, a fair amount of investment in cash and bank balance to enjoy better liquidity position.10

Kiruthiga, M., (2005) conducted a study on “Factoring services and risk management with special reference to SBI Factors”. The results of the study revealed that SBI Factors had taken proactive action to bring down the net non performing assets.11

Veena K. Arora (2005), in her research study entitled “Factoring and forfeiting services in India : An appraisal” observed that as a financial service, factoring had several positive features from the point of view of the firm such as off-balance sheet finance, reduction of current liabilities, improvement in current ratio, management of accounts
receivable, reducing overhead costs, improved efficiency, protection against bad debts, etc. She concluded that factoring was a powerful tool for a small or medium sized companies hindered by lack of bank ability or other sources of funding.12

Aadarsh Aiyyar (2006) conducted a study entitled, “Factoring service as a global phenomenon with special reference to SBI factors and Commercial Services Pvt. Ltd.,” which focused on the financial appraisal of SBI Factors and Commercial Services Private Limited. The researcher appraised the financial performance of SBI Factors through comparative income statements and balance sheet. According to the study, factoring could be one of the viable tools for trade finance for the industrial sector. However, this study failed to indicate the funds position of the factoring institution.13

Studies related to clients’ satisfaction towards factoring services are reviewed here.

Factors and clients concluded that increase in the number of clients contributed significantly to the effective management of their receivables and clients’ satisfaction with the services provided by SBI Factors.¹⁴

Dr. Srividya, V., (2005) in her study on “The client perception of services offered by SBI Factoring services”, compared the factoring service offered by SBI Factors with other receivable finances offered by commercial Banks. The study revealed that the clientele portfolio of SBI Factors, Coimbatore consisted of 55 per cent of small-scale industrial units as against 45 per cent medium and large-scale industrial units. Satisfaction level was ascertained in respect of interest charges, processing fees, service charges, response time, adequacy and retention margin of factoring services offered by SBI Factors as compared with other receivable finances offered by client’s working capital banker. The results of the analysis made in the study indicated that majority of the clients were satisfied as to the adequacy of the advances given by SBI Factors.¹⁵

Gayathri, N., (2005) in her research work entitled “A study on small and medium enterprises: SME’s satisfaction with SBI Factors” analysed the satisfaction and expectation level of small and medium
enterprises from SBI Factors. The study showed the expectations of customers regarding reduction in interest rates and simplification of appraisal formats.\textsuperscript{16}

Anitha Prabha, R., (2006) conducted a study on “Factoring services with special reference to SBI Factors and Commercial Services Private Limited, Coimbatore”. In her study she made an attempt to analyse the short term financing techniques of business units and the impact of factoring on short term resources mobilization and clients’ attitude towards SBI Factors. The researcher concluded that the satisfaction level for various attributes of SBI Factors were high for services like response time and adequacy of funds. The clients were found to be dissatisfied with the higher financial charges, interest and service charges levied by the factor.\textsuperscript{17}

Shalini, P., (2007) in his study entitled “Customer satisfaction of SBI’s factoring services with references to Small and Medium Enterprises” analysed the factors that made the clients take up factoring service with SBI Factors. The study covered various aspects of customer satisfaction about the various factoring products and the difficulties faced by the customers in the matter of processing time, High handling charges,
Various fees, Penal interest and Commitment charges. The study concluded that SBI Factors was largely affected by SSI and suggested retention of SSI clients by adopting suitable marketing strategies. However, this study failed to analyse the factors influencing clients’ satisfaction.18

Review of studies related to factoring as a financing option is presented here

A study on “Factoring - its impact on liquidity and profitability of the factoring institutions” (2000) conducted by Raju, G., and Ramachandra Nair M.K., analysed how the changes occur in liquidity and profitability position of enterprises as a result of availing factoring services. They concluded that factoring could improve the liquidity of small and medium sized units.19

Khaled Soufani (2000) in his research study, “The determinants of factoring as a financing choice: evidence from the UK”, developed and tested the hypotheses that explained the choice of factoring as a financing source and the type of businesses using it in the UK. The tests focused on establishing a profile of borrowers, based on firm’s demographic characteristics such as age, turnover, industry and type of legal
ownership. In addition to that he extended the analysis to test whether there existed any association between the use of factoring and the availability of credit to firms, the collateral requirements by banks and its value, the value of the firm’s debt, and also whether the business was experiencing financial difficulties. The analysis was based on a survey of 3805 companies of which 212 were using factoring services. He concluded that each of stated factors was an important determinant in firm’s choice of factoring as a source of finance for working capital and an instrument to cash-flow improvement.20

A study on “Solving serious cash flow shortages in Factoring” (2001) conducted by Bob Branett staff writer, CCH Business owners’ toolkit suggested factoring of accounts receivable for solving the cash flow problems of small business units.21

Khaled Soufani (2002), in his study entitled “The decision to finance accounts receivables: The factoring option” had highlighted factoring as a financial service enabling enterprises to sell their accounts receivable to a factoring company in exchange for cash. This paper sought to profile the determinants influencing decision making in the UK factoring industry. Using data from an interview-based survey, this paper
established that the decision to purchase an enterprise’s accounts receivable was influenced by various factors such as the enterprise’s size, type of product or service it offered, industry, sector, age, type of customers, financial statement, the management team, operational suitability, collectability and credit notes.22

A study on factoring with special reference to SBI Factors and Commercial Services Private Limited, Coimbatore conducted by Surya G.S. (2002) compared the SBI Factors with the Canbank Factors in terms of selected indicators to analyse the strength, weakness, opportunities and threats of SBI Factors and Commercial Services Private Limited. The study concluded that factoring promotes professionalisation in debt collection management by encouraging a prompt payment culture and factoring would improve the current ratio and enable the borrower to enlarge the scale of operation.23

Lavanya, C., (2003) in her study “A comparative analysis of factoring as offered by SBI Factors and other receivable finance options”, examined the concept of factoring and the working mechanism of domestic factoring services offered by SBI Factors and compared the same with other receivable finances offered by commercial banks and
suggested measures to compete with other factoring companies and commercial banks offering other similar services.\textsuperscript{24}

An attempt of Savitha, P.R., (2003), on “Factoring as a technique of receivable management with special reference to SBI Factors and Commercial Services Private Limited” analysed the supremacy of factoring over other receivables finance.\textsuperscript{25}

Sebastian Joseph (2003) in “A study on factoring with special reference to SBI Factors, Coimbatore” made an attempt to find out the performance of the company in the Coimbatore region. The researcher concluded that SSI clients constituted majority of the clients of Coimbatore branch.\textsuperscript{26}

Ankur Agarwal (2004) in his study entitled “Factoring a technique for profit maximization by reduction in cost” analysed as to how factoring services could promote the best management of working capital. The researcher observed that cost of receivables could be reduced through factoring.\textsuperscript{27}

An empirical study on “Trade credit management and the decision to use factoring” (2004) was conducted by Barbara Summers & Nicholas

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Wilson. The researchers examined the firm’s decision to use factoring amongst a cross sectional sample of 655 manufacturing companies using a rich firm level database. The study developed and tested hypotheses that explained the choice of credit and financial management policy. The study revealed a strong evidence of financing demand explanation for the use of a factoring and also supported theories which relate the decision to use a factor. The motivation to use factoring according to the findings of the study related more to a demand for asset based finance from small companies than to firm level choices about organization structure.28

Dr. Teki Surayya (2004) in his article, “Marketing of factoring services with special reference to SBI Factors and Commercial Services Limited, Mumbai, India” stated that extending credit elevates sales of business corporations. Factoring enabled corporations to convert inactive assets into cash. Correlation between turnover and number of SSI clients stood at +0.72 and the percentage of awareness in the relevant market was only 24 per cent according to the researcher.29

Balasubramaniam, J., and Thilagavathi, S.T., (2005) conducted a study on “Application of modeling techniques in credit risk management and designing a package for factoring without recourse”. This study
focused on several models of risk management and advanced credit risk rating models. The study concluded that in factoring without recourse, the focus could be more on the client’s financial statements.\textsuperscript{30}

A study on “Accounts Receivable factoring – A viable solution for business” (2006) was conducted by David Springer, to assess the type of financing which would best fit small and medium sized enterprises to face cash flow problems. The study concluded that factoring as a financing tool helped the firms in meeting current working capital demands as well ensuring growth.\textsuperscript{31}

A study by Gayathri Devi, K., (2006) on “Current risk management; current practices and application of modeling techniques and their importance of credit culture in Factoring” measured the credit risk and exposure of clients of SBI Factors using the modeling techniques. To assess the clients’ operational performance Z score model was used and to compute and analyse the credit loss, distribution activate model was used. This study on credit risk management brought to light the credit risk and exposure of selected client companies.\textsuperscript{32}

In a study entitled “Analysis of factoring services usage among the existing clients of SBI Factors Commercial Services Private Limited”
conducted by Niti Gupta (2006), revealed that there was a significant growth in the turnover of clients after availing factoring services. The analysis pointed out that clients have shifted from other modes of receivable financing to factoring.33

Dr. Murugesan, M., (2006), in his research work, ‘Factoring finance and operating cycle”, described the factoring as a method of converting a non-productive inactive asset i.e., book debts into a productive asset. The findings of the study revealed that selling book debts to a factoring institution enhanced collection and administrative efficiency.34

Deepak Devgan and Harpeet Dusanjh (2007) in their article entitled “Factoring services: Nectar for corporate liquidity” highlighted the concepts, origin, mechanism and types of factoring services. Their main object was to know the factoring scenario at international level. They explained the strongest association of the Factors Chain International (FCI) into the largest factoring network in the world. They have also examined growth in factoring turnover of continents, domestic and international turnover, company-wise, growth in factoring turnover in selected Asian countries company-wise. The authors pointed out the immense growth potential of factoring services in India.35
In a study “SWOT analysis of factoring services in India” conducted by Dr. Rangarajan, R., and Gomathi, S., (2007) the researchers observed that the cost of operations were very high for the factor and consequently it eroded their profitability. They concluded that factoring is not a stand alone service product and that there was no fool proof framework available to protect the interest of the factor and other parties involved in factoring.\(^{36}\)

**CONCLUSION**

Review of related literature in the areas of performance of factoring institutions, clients’ satisfaction and factoring as a financing option has been made by the researcher to establish the validity of the research topic “Factoring Services : Performance analysis and measurement of clients’ satisfaction – A comparative study of SBI Factors and Commercial Service Pvt. Ltd. and Canbank Factors Ltd.” Various research studies conducted by a number of researchers during the post millennium period in the area of factoring reviewed here enabled the researcher to understand the gaps in those studies and hence the present study has been carried out.
REFERENCES


