CHAPTER - 11

CONCLUSIONS AND RECOMMENDATIONS

11.1 Introduction

In the previous chapters of this dissertation an attempt was made to scan the global developments of factoring coupled with status report of factoring services in India. The scope and prospects for introducing international factoring in India were also discussed. Further, an attempt was also made to bring out the various problem areas and issues that are likely to emerge once this service is introduced in the country. Many of the recommendations by way of coping up with strategies to counter these impediments were also deliberated in the corresponding chapters. However, with a view to present a concise picture, some of the important issues along with recommendations are given in the following paragraphs.

11.2 Major Issues for Consideration

There is a substantial scope for introduction of international factoring in the country. There is a demand for it as well from the likely users that is, the exporting community. It would definitely open up an alternate window for the exporters, especially the expanding ones, wherefrom they can avail of all services which include both the financing and administrative ones (including debt protection facility) from a single provider. However, there are many issues that need close scrutiny before the service is actually launched. These issues can broadly be classified into three groups as under:

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(i) Issues relating to legal aspects,
(ii) Issues relating to policy and strategic dimensions, and
(iii) Issues relating to organisational and structural aspects.

11.2.1 Legal Issues

(a) Absence of a comprehensive legal framework for international factoring (for that matter even for domestic factoring) which may give rise to several complications including the very nature of the agreement itself, the rights, duties and obligations of the various parties involved in such a transaction and so on.

(b) Applicability of the laws regarding validity of assignment of debts and the possible resultant dispute arising in case of insolvency of the exporter/importer regarding the right of recourse of the factor.


(d) Stamp duty consideration in respect of assignment by the exporter in favour of the export-factor and the export-factor in favour of the import factor.

(e) Problems arising from the concepts of Ban on Assignment and Retention of Title jeopardising the interest of the factor.
(f) Problems in granting the status of an Authorised Dealer (AD) to a factor proposing to undertake export factoring business.

(g) Problems relating to amendment in the provisions of Foreign Exchange Regulation Act, (FERA) 1973 regarding payment of commission by an Indian export factor for its correspondent import factor abroad and continuation or otherwise of the responsibility of the exporter towards realisation of export receivables even after entering into a factoring contract.

11.2.2 Policy and Strategic Dimensions

(a) Types of services (with recourse and without recourse) to be offered.

(b) Launching import factoring services at the initial stage.

(c) Pricing policy and structure to be adopted keeping in view the cost of resource mobilisation as well as the price offered by the competing suppliers that is, the banks.

(d) Eligibility criteria, financial as well as non-financial, for selecting an exporter/importer client.

(e) Need for development of a credit rating system within the organisation.

(f) Automation of operations.

(g) Marketing of factoring services alongwith the strategies to be adopted including formulation of schemes.
Cooperation between a banker and a factor especially with reference to obtention of letter of waiver from the financing banker.

(i) Supervision and monitoring authority for factoring organisations in the country.

11.2.3 Organisational and Structural Issues

(a) Organisational framework to launch the services in India.

(b) The relationship dilemma between an international factor and other agencies like parent bank (in case of bank sponsored subsidiary), other banks, Export Credit Guarantee Corporation (ECGC) of India Ltd., etc.

(c) Requisite organisational preparedness and structure.

(d) Types of personnel - debate regarding insiders versus outsiders and their characteristics.

(e) Role of training and development.

11.3 Major Recommendations

Some of the major recommendations to counter the impending challenges are described in the following paragraphs.

11.3.1 Legal Aspects

(a) A comprehensive legal framework should be enacted encompassing the various aspects of factoring (both domestic and international) to define the
rights, duties and obligations of various parties involved in such transactions.

(b) Looking into the pros and cons of different types of factoring services, it would be advisable to go in for two-factor system compared to direct export/import factoring. This would be primarily to safeguard the interest of the Indian export factor. Any way, apart from Export Credit Guarantee Corporation (ECGC) of India Ltd., no other bank or even the existing domestic factoring companies do possess the requisite expertise to assess either the country-risk or the importer-risk. This would need compliance with two aspects. Firstly, India has to ratify the Convention on International Factoring adopted by International Institute for Unification of Private Laws (UNIDROIT), in Canada in 1988 as a contracting state. Secondly, Indian factoring companies need to establish correspondent factors abroad by being members of any of the international factoring chains say, Factors Chain International.

(c) Factoring transactions should be, by statute, totally exempted from the payment of stamp duty. The exemption available to Indian banks in respect of bills of exchange drawn on them having a usance period of not more than 90 days should be extended to the factoring organisations as well. If total exemption is not possible, a beginning can be made by
exempting the invoices assigned, up to a specific amount say, Rs. 50,000 for each transaction by amendment of the Indian Stamp Act.

(d) Sales of Goods Act, 1932 should be amended by prohibiting the inclusion of the clause **Ban on Assignment** in tune with the provisions of Section 9 of Uniform Commercial Code (UCC) in the US.

(e) For ensuring priority of assignment within the country, a system should be introduced whereby the factor is to notify the debts factored with a public authority. The Companies Act, 1956 should be modified towards making the existing Registrars of Companies (RoCs), the public authority as suggested above.

(f) Legal amendment should be affected whereby the invoices, involved in factoring transactions are treated at par with bills of exchange for initiating legal proceedings, if needed, by way of summary suit under Section 37, Criminal Procedures Code (CPC).

(g) Exchange Control Manual should be suitably modified to grant the status of an authorised dealer to an export factor.

(h) Foreign Exchange Regulation Act, 1973 should be amended permitting the payment of commission by an Indian export factor to its correspondent factor abroad, and also absolving the export factor from responsibility of ensuring remittance within the country.
11.3.2 Policy and Strategic Aspects

(a) All factoring companies should be brought under the regulatory control of some authority. In the long run, it would be wise to develop the concept of self regulatory organisations (SROs) encompassing the activities of all finance companies including factoring organisations. However, it is suggested that to begin with, the Reserve Bank of India should act as the monitoring, controlling and regulatory authority for all factoring companies in the country. It is also suggested that every intending factoring company must get prior approval from the RBI, before commencing the activity. This would ensure the following:

1. Availability of data at one place,
2. Knowledge about true state of affairs of the industry,
3. Acquaintance regarding problems facing the industry,
4. Safeguarding interest of depositors,
5. Ensuring momentary management.

(b) From the viewpoint of prudential management, the following recommendations are made:

1. **Capital Adequacy** Every factoring company should have a minimum paid up capital of Rs. 5 crores.
2. **Capital Asset Ratio** The capital adequacy norm should provide that the ratio of capital to risks adjusted assets of a factoring company should be minimum 8 per cent. The term capital here means the tangible net worth.

The risk weightage to assets (in percentage) are to be allotted as under:

(i) Assets held in terms of cash in Zero
    hand/bank or in approved government securities

(ii) All other assets 100

3. **Debt Equity Norms** The maximum permissible limit should be 10:1 (i.e. the total external borrowings including public deposits not to exceed ten times the net owned funds). The term net owned fund, here, means the tangible net worth.

4. **Liquidity Ratio** The norms should be specified that every factoring company must maintain liquid assets either in cash or in bank or by way of investment in approved government securities at least to an extent of 10 per cent of the deposits received by them.

5. **Exposure Risk Management** No factoring company should be allowed to provide credit to a single exporter of an amount exceeding 20 per cent of its net owned funds. For the group accounts, this ceiling should be prescribed at 30 per cent.
6. **Deployment of Funds** The normal principle should be that the funds raised by the factoring companies are used for factoring purpose only. The term "factoring" here includes both the international and domestic factoring activities. However, to start with it may not be possible for a factoring company to invest its entire funds exclusively for factoring purposes. Therefore, a phased programme of deployment of funds is suggested as under:

<table>
<thead>
<tr>
<th>Year of operation</th>
<th>Minimum Percentage of funds earmarked for factoring activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. 1st year of operation</td>
<td>50</td>
</tr>
<tr>
<td>2. 2nd year of operation</td>
<td>60</td>
</tr>
<tr>
<td>3. From 3rd year onwards</td>
<td>70</td>
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</tbody>
</table>

(c) The Reserve Bank of India should monitor the performance of each factoring company on half yearly basis. The information should consist of:

1. Funds raised (source and quantum),
2. Details of activities - exporter wise position of funds deployed,
3. Overdue position - exporter wise details,
4. Abridged balance sheet giving the details of service charges levied.
(d) It may also be contemplated to establish a "Factoring Bank of India" to act as the apex level coordinating agency. This contemplated bank besides acting as the centralised rating agency may also act as the focal body for coordinating the factoring activities in the country.

(e) Both the activities, namely full service (without recourse) export and import factoring should be launched. However, in view of the risks involved and also that full information on many customers (importers within India) are not fully and readily available owing to lack of credit rating agencies, the approach should be cautious.

(f) Charges for international factoring should be kept as minimum as possible so that it becomes attractive for the exporting/importing enterprises. At the same time, the financial viability aspects of the factoring organisations have also to be kept in view. In the above backdrop, the following charges are suggested:

(i) **Administrative Charges** should be in the range of 1-3 per cent of projected export turnover.

(ii) **Discount Charges** should be at par or maximum 1 per cent above the bank interest applicable for post-shipment finance.

(g) The Principal source of funds for an international factoring company would be the equity and preference share capital subscribed by the
promoters/public. This should, however, be supplemented with market borrowings with an intelligent mix of the two. Since the international factoring operations may involve substantial outlay of funds, possibilities may be explored of the parent bank(s) offering subsidised lines of credit to the subsidiaries offering such services. Factoring companies should also be permitted to enter call money market (both as a borrower and lender) to a limited extent. Reserve Bank of India should formulate suitable policy in this regard.

(h) There is definitely a need to prescribe certain financial and non-financial criteria for the prospective clients (exporters and importers) to be eligible for entering into a factoring contract. A framework of this criterion is suggested hereunder:

(i) The constitution of the client should preferable be a corporate body,

(ii) It should be an existing unit for at least 5 years having satisfactory profitability track record of minimum 3 years,

(iii) Minimum tangible net worth should be Rs. 50 lacs,

(iv) Minimum turnover for the last year should have been Rs. 50 lacs,

(v) Spread on a single importer (for export-factoring) should not exceed 25%,
(vi) There should not be past history regarding dispute with customers during last five years.

However, the above list is only suggestive in nature. Similarly, the strength of the management, nature of the product and strength of the importer (for export factoring) should also be given due weightage.

(i) All factoring companies must have their operations fully computerised ab initio. The approach towards computerisation should not only take care of the internal process aspects but also cater to linkage requirements with external environment through a trade-network like Electronic Data Interchange (EDI). The recently developed software by Factors Chain International, Amsterdam, The Netherlands, known as EDIFACTORING is a welcome development in this direction, that will enable an international factor to communicate not only with its correspondents but also with exporters, importers, and banks. Indian factoring companies interested in launching international factoring services should equip themselves with such modern information technology.

(j) There is a need to foster strong cooperation based on mutual trust between the banking and factoring fraternities. The bankers should not hesitate giving the letters of waiver/disclaimer to the factors, relinquishing their
charge on future receivables. The Reserve Bank of India should formulate suitable guidelines in this regard.

(k) Factoring companies, by statute, should be permitted to manage foreign exchange risks on behalf of their clients, by various means including booking of forward contract.

(l) International factoring is a new product in the country’s financial services market. There is therefore, an imperative need to create awareness about the concept and its associated benefits. A series of seminars, workshops may have to be organised in this regard. Banks, existing factoring companies and associations of exporters have to take a lead in this matter.

(m) The findings of the study could not establish that the thrust of the international factoring product to start with should relate to any particular industry or exports to a set of definite countries. Therefore, no definite recommendation can be made in this regard. If one looks at the experience of domestic factoring companies, it is observed that they also do not have any industry focus. Therefore, barring (i) high risk industries (whose products do not have any alternate market or are highly susceptible to volatilities of environment etc.) or (ii) exports to very high risk countries (as per the ratings of Standard and Poor or Moody), international factoring is a suitable product in all open-ended international trade transactions.
However, a factor has to exercise prudence before considering each proposal on its merits, taking into consideration economy, country and business risks involved.

11.3.3 Structural and Organisational Aspects

(a) Both banks and Export Credit Guarantee Corporation (ECGC) of India Ltd. are ideally suitable to start this service. Existing factoring companies engaged in domestic factoring business are also keen to enter this area. However, since the concept is new, too many players entering into the field may create a problem. Hence, it is suggested that to start with existing factoring companies (SBI Factors and Commercial Services Pvt. Ltd. and Canbank Factors Ltd.) may launch the service in collaboration with ECGC. After a year or so, when the experimentation succeeds, other banks may enter the arena. However, if a big industrial/financial house with a proven track record in financial services market is interested to start this activity, the Reserve Bank of India should consider the proposal on merits.

(b) Only persons with suitable cognitive abilities and appropriate personality traits (described in chapter 10) should be recruited in the factoring organisations. Since the concept is new and skills needed are different, training interventions, both on-the-job and off-site, should be continuous
in order to update knowledge, sharpen skills and reorient the attitude of the
working executives.

11.4 Concluding Remarks

It is reiterated that this is a pioneering research work undertaken in the area of
international factoring in a developing country like India. It is thus expected that this work
has been in a position to establish the need for starting this innovative product in the
country’s financial market, besides bringing out the major issues and problems. Certain
suggestions have also been offered towards adopting appropriate strategies to cope with
the likely problems. It is earnestly hoped that findings of this study would be useful to
all interested in making international factoring a success in India.

The study makes a modest attempt to add to the existing literature on international
factoring by exploring possibilities to introduce the same in a developing country like
India. The existing literature shares experiences of developed countries only. With this
document, new dimensions of the subject are looked into.