PRESENT STATUS AND EXPECTED BENEFITS OF FACTORING SERVICES IN BANGLADESH

CHAPTER VII

PRESENT STATUS AND EXPECTED BENEFITS OF FACTORING SERVICES IN BANGLADESH
The present chapter attempts to analyze and discuss the present status, expected benefits, and some other relevant aspects like non-performing assets and factoring, and effects of factoring services on cost, liquidity, profitability and capital of both the providers and users.

1. Present Status and Causes for not Introducing Factoring Services in Bangladesh.

1.1. Factoring services, which are quite popular all over the world, are less heard of in Bangladesh. Most of the owners and managers of existing and newly set-up small and medium size enterprises are not aware of the factoring services. Even bank and finance executives are relatively less informed of these services. The Bangladesh Bank has also not taken any measure regarding this till now. But in recent past, some studies, as mentioned earlier, have suggested factoring services to facilitate the economic growth and financial discipline.

1.2. Globally, Americas and West European countries are regarded as matured market and Asia Pacific region is considered as most dramatic regional growth area whereas Latin America, Central Europe, Middle East and South Asia are at the beginning of probable factoring boom. But some recent surveys show that awareness is still disappointingly low. International Factoring Survey 1998, in its worldwide survey of the 100 industries, has indicated that factoring is a fairly new concept for many of the interviewees and only a small percentage is currently using factoring services. Horan (1999, p. 90) claims that 6 per cent of the small and medium sized enterprises of Ireland have used factoring services although 66 per cent of them have heard of factoring services.

1.3. We now turn to causes why factoring services are yet to be introduced in Bangladesh. We believe that product introduction and development start with the analysis of underlying causes. These causes are mentioned in Table 7.1.
### TABLE 7.1

Present Status and Causes for Not Introducing Factoring Services in Bangladesh.

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Particulars</th>
<th>Bank and Finance Executives</th>
<th>Manufacturers</th>
<th>Academicians</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>BB</td>
<td>NCBs</td>
<td>PCBs</td>
<td>FCBs</td>
</tr>
<tr>
<td>1.</td>
<td>Lack of expertise and knowledge about factoring.</td>
<td>3</td>
<td>2</td>
<td>7</td>
<td>4</td>
</tr>
<tr>
<td>2.</td>
<td>Lack of proper initiative (from Govt., policy makers, financial institutions, and individuals).</td>
<td>2</td>
<td>4</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>3.</td>
<td>Backwardness of financial market</td>
<td>3</td>
<td>3</td>
<td>7</td>
<td>1</td>
</tr>
<tr>
<td>4.</td>
<td>Absence of organised trade and industrial sector</td>
<td>2</td>
<td>2</td>
<td>8</td>
<td>2</td>
</tr>
<tr>
<td>5.</td>
<td>Weak legal framework</td>
<td>1</td>
<td>2</td>
<td>7</td>
<td>4</td>
</tr>
<tr>
<td>6.</td>
<td>Default culture</td>
<td>-</td>
<td>1</td>
<td>6</td>
<td>2</td>
</tr>
<tr>
<td>7.</td>
<td>Lack of recognized customers' credit rating arrangements.</td>
<td>-</td>
<td>2</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>8.</td>
<td>Burden of extra cost</td>
<td>-</td>
<td>-</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>9.</td>
<td>Effect relationship with customers</td>
<td>-</td>
<td>-</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>10.</td>
<td>Non-transparency of bookkeeping</td>
<td>1</td>
<td>-</td>
<td>5</td>
<td>1</td>
</tr>
</tbody>
</table>

Source: Questionnaire Responses.
PRESENT STATUS AND EXPECTED BENEFITS OF FACTORING SERVICES IN BANGLADESH

2.1. Lack of awareness, knowledge and understanding of factoring and absence of well-qualified professionally skilled and service-oriented staff is the important barrier in introducing factoring services. About 70 per cent of the interviewees mention these barriers, who indicate that lack of published material and research have further added to these barriers. Their opinion is that bankers, financial executives and businessmen are better informed only about traditional forms of financing like overdraft, cash credit etc. and accustomed to using letter of credit as the most dependable and major instrument of settlement.

2.2. Lack of proper initiatives has been ascribed maximum percentage as yet another major cause for invisibility of factoring services in Bangladesh. Nearly 90 per cent respondents consider that Government, Bangladesh Bank, financial institutions and policy makers should have taken suitable measures so as to provide legal support for introducing factoring business apart from education, guidance and support. They add that with a view to conceptualizing and appreciating this new concept a series of seminars, research and academic debate could have been organized.

2.3. The financial system, the nerve-centre of the entire economic system, of Bangladesh comprises of an unorganized credit market\(^1\). That is why it has been rarely seen to direct capital to production and profitable investment projects and to inculcate the much desired habits of saving and investment. Regarding this, 67.14 per cent respondents have viewed that backwardness of financial market is an

\(^1\) In Bangladeshi banking industry, sectoral allocation of credit based on total reliance on the market mechanism has not yielded the desired results. Because of higher turnover, bankers prefer trade credit to industrial credit. In case of private banks, loanable funds get channeled to owners' business houses at favorable terms. Moreover, administrative credit regime results in imbalance of production and trading sector. That is why some credit which flows based on the creditworthiness of the borrower faces higher interest and collateral requirements.
important barrier in introducing these services. But it is true that the financial market of Bangladesh is now in a transition stage - from a stagnant to a dynamic one - although it is still influenced by the deep-rooted economic, ideological, and political issues.

2.4. Industrial sector in Bangladesh is characterized by inappropriate investments, inefficient resources use, overcrowding in certain sectors, and wide-spread debt default. 57.14 per cent of the respondents opine that industrial sector is unorganized and is not capable of playing a constructive role in educating the business community as a whole as regards the advantages and benefits of various types of finance.

2.5. Nearly 57 per cent of the respondents accuse lack of speedy and transparent legal process responsible for not introducing factoring services. They argue that factoring services can not be launched unless appropriate changes are made in the relevant Acts. Unlike countries like USA and UK, Bangladesh does not have a 'Prompt Payment' Act¹ to provide legal backing for prompt payment and quicker collection.

2.6. Default culture is also considered as a cause by 33 per cent respondents. They state that the attitude of business to the payment of debt has deteriorated and many companies have made it a habit to delay and not to pay until much after the due date as a part of their cash management program.

2.7. Absence of ‘Credit Rating Agency’ has also come up as a reason. In Bangladesh, we do not have any comprehensive and reliable ‘Credit Rating Machinery’. Respondents (48.57 per cent) mention that ‘Credit Rating and Information Services Ltd. (CRISL)’, single credit rating agency of Bangladesh, is almost unfamiliar to the industrialists and financial sectors.

1. In general terms, the Act obliges purchaser who obtains goods or services from supplier on credit to pay for them by the due date for payment. Where a purchasing fails to do this, an interest penalty is imposed on the outstanding debt (Horan 1999, p. 91).
2.8. A few respondents have mentioned some other causes, for example, burden of extra cost, effect relationship with customers, non-transparency of book-keeping as reasons for invisibility of this service.

3. There is a close association among bank and finance executives, manufacturers, and academicians in the ranking on causes for not introducing factoring services in Bangladesh as indicated by Rank-correlation among them. The calculated rank correlation among the manufacturers and bankers; manufacturers and academicians; and bankers and academician is 0.6878, 0.6378 and 0.8333, respectively. These associations are also statistically proved at 5 per cent level of significance.

4. In summing up the above analysis, the findings as regards the causes of not introducing factoring services in Bangladesh and their relative importance are as below. The most important cause found is lack of proper initiative. Next in importance are lack of expertise and knowledge about factoring services, and backwardness of financial market. Other factors, next in importance, are absence of organised trade and industrial sector, and weak legal framework.

5. Comparison with other studies

The causes for not introducing factoring services in Bangladesh found here are supported by the findings of several previous studies. Ataman (1999, p.134), Siu (1999, p. 207), Sengupta et.al (1993, p. 1202), Singh (1988, p. 25), and Brandenberg (1987, p.101) indicate that reasons for unfamiliarity with factoring are lack of published materials, cultural lethargy, legal problems, absence of Government support and conscious efforts. Deolalkar et.al. (1994, p. 6) mention regularity control, faith in traditional source of finance, cost factor, lack of vigorous exchange of trade through land routes and sea routes as causes for slow and rather negative attitude for starting of factoring services. At the same time, some previous studies do not support all the causes of this section. Maberly (1979, p. 98) claims that an argument frequently heard against factoring is that customer will be hostile to use of a third party organisation to handle the debt collection process. This view is just not borne out by facts.

214
2. Helpful for Clients in Solving Some Vital Problems

1 Working capital, sales, export and management undergo qualitative differentiation in all business organizations, as these are critical areas. With a view to locating to what extent factoring could be helpful in the said areas, the responses received have been recorded in Table 7.2. The data presented provide interesting information about the thinking of the people towards factoring in solving some vital problems of business areas.

2.1 Problems of Working Capital

The main problem facing a company, particularly fast growing small and medium scale, is that of finding sufficient working capital. It is revealed from the table that respondents are very confident that factoring will be capable of solving the working capital problem. Nearly 91 per cent mention that working capital problem could be solved through factoring services. Of them, bank and finance executives, and academicians put absolute support for this as 100 per cent of them agree on this point, whereas manufacturers have shown some caution as 80 per cent of them agree with this. Reasons behind this may be bitter experiences with the prevailing systems for working capital and absence of factoring services in Bangladesh till now. Moreover, lack of adequate funds with the debtors, and dispute over the quality or quantities of the goods supplied are also reasons, which may not be solved by factoring services. But at the same time, it is true that under factoring, the amount of finance available is always linked directly to sales expansion. Moreover, flexibility, minimum set of financial criteria to application, no requirements for security and no reduction of debtor value make the factoring as an ideal way of financing for growth all over the world. So, finance released easily (without hassles) in this way can be used to support extra activities aimed at progress and reducing dependence on debtors, and it can enable the company to solve its working capital problem. Hyderabad (1998, p. 185), Pandey (1994, p. 42), Wooller (1981, p. 98), Maberly (1979, p. 97) also opine that by releasing funds tied in accounts receivable, factoring mechanism
<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Particulars</th>
<th>Bank and Finance Executives</th>
<th>Manufacturers</th>
<th>Academicians</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>BB</td>
<td>NCBs</td>
<td>PCBs</td>
<td>PCBs</td>
</tr>
<tr>
<td>1</td>
<td>Problems of working capital</td>
<td>3</td>
<td>4</td>
<td>10</td>
<td>4</td>
</tr>
<tr>
<td>2</td>
<td>Problems of collection of book-debts from customers</td>
<td>3</td>
<td>4</td>
<td>10</td>
<td>4</td>
</tr>
<tr>
<td>3</td>
<td>Coverage of bad debts loss</td>
<td>2</td>
<td>3</td>
<td>10</td>
<td>4</td>
</tr>
<tr>
<td>4</td>
<td>Management efficiency</td>
<td>3</td>
<td>3</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td>5</td>
<td>Increment sales</td>
<td>3</td>
<td>3</td>
<td>7</td>
<td>3</td>
</tr>
<tr>
<td>6</td>
<td>Promotion of exports from Bangladesh</td>
<td>3</td>
<td>4</td>
<td>8</td>
<td>4</td>
</tr>
</tbody>
</table>

Source: Questionnaire Responses.
facilitates more investment in purchases, stocks, manufactures and sales. On the other hand, Batchelor (1992, p. 75) shows in his survey that only 12 per cent of accountants and 9 per cent of managers appreciate that factoring could lead to an improvement in cash flow.

2.2. Collection of Book-debts from Customers

The collection of outstanding accounts can be a time-consuming onerous task and costly process. In Western countries, it is common practice to place an outstanding account in the hands of solicitor or debt collectors. This practice does not exist in Bangladesh. It is revealed that nearly 85 per cent of the respondents are confident that problem of collection can be solved through factoring services. Under factoring procedure, as soon as the information is entered the factor’s computer, a letter is sent to the client’s customer requesting payment within a few days. From this point onwards, the computer monitors all proceedings throughout the collection process. The customer will, therefore, be under pressure to make prompt payment, as his reputation will be at stake. With this rapid collection, factoring can reduce the production cycle of clients by almost half and in effect double the circulation of capital in the business, because it is found that the cycle of production is six months from manufacturing to date of payments including three months credit. Dave (1992, p. 743), Beckman (1985, p. 118) argue that because it is fully automatic and all steps are carried out according to the appropriate time frame with expert people at the helm, recovery rates are higher under factoring.

2.3. Coverage of Bad Debts Loss

Bad debts can never be eliminated but greater profitability can be achieved by maintaining these at the minimum level. 80 per cent of the respondents are hopeful that factoring will improve the profitability by avoiding the risk of bad debts. Elimination of, or reduction in, bad debts could also be possible either through credit insurance, or more sophisticated credit control technique or both. But the factor has the advantage of dealing with certain industries and a large number of customers with different profiles and
habits. Thus, he is able to include distinct skills of analyzing the paying habits of customers (repayment behavior).

2.4. Management Efficiency

About 63 per cent hold view that factoring will bring more professional approach and efficiency to the management of clients. Management time will be used with focus on technology, production, marketing, personnel, and other managerial functions. They argue that except the above functions (since the factor is able to provide in-depth credit information and financial counselling on hundreds of thousands of companies) the client can plan, run and improve business, and avoid easily the poor quality and risky customer through exploiting the opportunities of selection, gradation etc. on the basis of dependable data supplied by the factor. Tripathy (1994, p. 71) and Boldin et al. (1981, p. 76) view that factoring can lead to greater management and operating efficiency. Since the client will be relieved of the credit and collection chores, more time will be available to devote to the actual business of manufacturing, merchandising or selling.

2.5. Incremental Sales

Sellers’ inherent worries are ‘where does the next cash come from? And how do we collect our money to get on with the job?’ Factors remove these worries of clients by gearing cash and providing credit insurance coverage. Therefore, sales get promoted. But only 52 per cent respondents, least of all, express their response towards this. It reveals that people are in doubt about the positive outcomes of factoring on sales. Moreover, it is felt that sale is a function of quality of goods, competitive price, competition in the market, and demand for the product. And these aspects can not be altered if factoring services are introduced. But it is proved all over the world that factoring enables client to make use of spare capacity to expand turnover and clientele without jeopardizing the clients’ relationship with their customers.
Boldin and Mulholland (1981, p. 76) mention that factoring can maximize the client’s sales potential. Since factor has access to almost unlimited credit information, the factor may be more willing to accept new or higher credit risk over that which the client may be willing to accept, spread over numerous individuals / customers.

2.6. Promotion of Exports from Bangladesh

Exporting is very much important to the Bangladesh economy. Export factoring will provide an additional window of facility to the exporters. It allows exporters to sell goods or/and services abroad on open account, check credit-worthiness of client’s customers through its correspondents, extend credit lines and provide advances against submission of invoices. Regarding this, nearly 65 per cent of executives are optimistic that it will bring the welcome boom to exports from Bangladesh. They mention that many good firms, particularly small and medium scale industry which are developing new products, are currently restricting themselves to the domestic market (Table 6.6(B)) because of the obvious risks of international trade and limited knowledge about the proper markets of their goods. It is expected that export factoring can be effective in boosting exports from Bangladesh through providing open account sales to the various countries under SAARC, ASEAN and EU by land route. Pandey (1994, p. 45) and Deolalkar (1994, p. 130) indicate that a large number of exporters, particularly the smaller ones who are not able to avail 'letter of credit' facilities, would benefit from factoring. Even those who can obtain 'letter of credit' may

1. Open Account Term: Where the seller and buyer agree to a specific credit period, without any formal guarantees. In the economies of North America and Western Europe, open account is a preferred method of domestic trading and it is increasingly becoming more important in the area of international cross border trade. Buyers favour it because it does not restrict their credit lines and allows them access to a greater variety of sellers and in addition to it, the costs are borne by the seller in extending credit, and it is thus cheaper for the buyer than the other methods of financing (Introduction to International Factoring, FCI, 1995,p.11).
benefit from factoring since ‘letter of credit’ is a transaction based facility and it becomes difficult to arrange it in the case of repetitive transactions with ease and promptly where delivery schedules are critical. International Factoring Survey 1998 claims that small and medium sized companies are competing in international market, still they lack the ability to deal with foreign risks and cannot afford longer terms of payment. These companies can boost their exports through the services of factors.

3. To sum up the findings in regard to overcoming client’s problems in various areas, it is found that there are high and varied expectations of respondents to factoring services in solving the various important problems of clients. But it is also true that these expectations may be changed by other forceful factors like uncertainty with reference to returns and profitability, growth and development, obtaining government approval, technical know-how, raising funds, etc. All these areas have deeper and thicker links with the success of factoring organisation.

3. Expected Benefits for the Service Providers

1.1. The association of the banks with factoring activities is prevalent in different forms all over the world. This business is being handled by subsidiaries of banks or departments of banks or by a private firm having the backing of a bank. Factors Chain International accepts only those organisations which have the backing of a bank, or financial institution, as a member of its fold, for having access to the services of international factors in other countries. Since 1963, factoring is a legitimate bank activity (Shay and Greer 1968, p. 152). Moreover, factoring is attractive because business is relatively stable. The volume typically grows moderately from year to year. Factoring can be steadily profitable. Customer turnover is low because a client does not want to make repeated announcements to his customers that he is changing the factor.
1.2. The senior executives interviewed in the various banks and financial institutions of Bangladesh are mentally ready to initiate factoring. Much would depend upon how the factoring service itself is launched. If banks introduce factoring, what benefits are expected by factors? With a view to knowing these expectations that will influence them to introduce the factoring service, the responses received from the bank and finance executives, and academicians have been presented in Table 7.3. and analysed below.

2.1. Fresh Means of Bank Business

In the competitive banking environment of Bangladesh, many banks and financial institutions have begun to search for new ways to bring in business. Factoring can be a finding in this new search that is viewed as such by the maximum respondents i.e. nearly 77.5 per cent of them. With the banks continually on the look out for fresh means of increasing their business, and providing better and more comprehensive services to their customers, it is natural that their eyes must now be turned in the direction of this relatively new form of finance which has swept through almost all over the world. According to the Kalyanasundaram Committee (1988, p. 41) almost all banks, in India, are of the view that factoring business could very well be left to be handled by them.

2.2. Prospects of High Profit

Profit maximization is basic to the working of banks and other financial institutions. In a competitive business environment, only the effective, innovative and dynamic financial institution will survive and thrive. Seventy per cent of the executives and academicians, who were interviewed, mention that factoring will introduce a new stream of profit line, if it is introduced. They have put the following arguments: (1) they have a lower cost of obtaining funds because they do not solely depend on the money and capital markets, but can solicit deposits; (2) consistent with the assumption of higher risk, the rates of return are higher than on most other bank activities; (3) as banks and financial institutions get more
# TABLE 7.3

**Expected Benefits, which may Accrue to the Providers**

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Particulars</th>
<th>Bank and Finance Executives</th>
<th>Academicians</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>BB</td>
<td>NCBs</td>
<td>PCBs</td>
</tr>
<tr>
<td>1</td>
<td>Fresh means of bank business</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>2</td>
<td>Prospects of high profit</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>3</td>
<td>Customers’ growth potential</td>
<td>2</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td>4</td>
<td>Use of other banking facilities</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
</tbody>
</table>

Source: Questionnaire Responses.
experience and managerial expertise, they should become more energetic in lending activity with higher risk like factoring. Shenai (1988, p. 65) argues that the factoring organisation promoted by a bank can use the clout of sponsoring banks in promptly recovering the receivables from public sector industries and thus improve its own earning capacity. Pilcher (1968, p. 151) remarks that earning from factoring can be every bit as high, if not better, than the most lucrative earning assets of a bank.

2.3. Customers' Growth Potential

Customers are the backbone of the banking system. Collected data reveals that 72.5 per cent of the bank and finance executives, and academicians expect that factoring services will bring a good chunk of small and medium scale industries, those who do not have easy access to the banks, as customers of the banks. They argue that the factored accounts receivable provide a source of future bank customers for either unsecured loans or deposits, since the evaluation of credit, and receipts of payment link the banks with a large number of business firms. Pilcher (1968, p. 151) has made arguments in favour of customers' growth potential: 'many other institutions and professions, which give advice such as accountants, solicitors, etc. may suggest to their own clients that they should approach a bank offering factoring services as a means of solving their particular financial problem, thus providing the banks with the opportunity of acquiring new customers'.

2.4. Use of Other Banking Facilities

By users seeking their factoring services, the banks and financial institutions are in an excellent position to persuade customers to use their other banking facilities. Sixty per cent executives and academicians agree with this. It is natural that a bank's customer earning higher profit through increased sales and greater financial and management efficiency via the factoring services provided, should steadily become a bigger user of bank's other services and facilities.
3. In summing up the above presentation, factoring will bring up some tangible as well as some ancillary benefits for all financial sectors. As mentioned above, much depends upon launching process of this service. If it is started by an independent factoring company then it will reap the profit or bear loss arising out of the factoring service. However, if a bank starts it either by opening a new department or through a subsidiary, it will not only reap the benefit or incur loss due to the financial services but will also derive some indirect benefits. But let us be perfectly clear on this point: factoring is not competitive to banking, it is complementary. So, as partners in financial sectors, benefits will accrue to each partner.

4. Non-performing Assets and Factoring

1. Loan defaults have remained the major problem in the financial sector of Bangladesh as elsewhere. At the end of 1996, the amount of classified loans was Tk. 110,545 million i.e. about 31.1 per cent of the total loan portfolio of the banking system in Bangladesh (Bhattacharya 1997, p.135). One of the most disturbing features of the classification scenario relates to preponderance of “bad loans” for all types of banks. About 72 per cent of total classified loans were categorized as “bad loans” as on June 30, 1997, while the “sub-standard” and ‘doubtful’ categories accounted for 12.84 per cent and 15.15 per cent, respectively. Moreover, the devaluation caused bad debt level to increase tenfold. (Knox 1998, p. 3). In Bangladesh, a loan recovery program was initiated in 1986 and thereby loan recovery targets were set for both industrial and agricultural loans. An action program was adopted which included debarment of defaulters from seeking elective offices at union, upzila and zila levels, prohibition of defaulters from holding directorship of banks, limitations on access to new loans, enactment of ‘Financial Loan Courts Act,’ and publishing the lists of the most egregious offenders. Even after taking these measures, the gloomy picture of classified loans is yet to be removed from the financial sector of Bangladesh.

2. In India, at the end of 1990, the Reserve Bank of India (RBI) announced its decision to permit debt discounting, an accepted practice in the West, by commercial banks under which one bank takes over the
outstanding of another bank at a discount through negotiations and mutual agreements (Shanker 1992, p. 11). Besides, Narsimham Committee had proposed the setting up of an ‘Asset Reconstruction Fund’ (ARF) stipulating that banks should sell their non-performing debts at a discount to the ARF, which will recover the amount in its own way. Indian Bank, UCO Bank, and United Bank have already received approval from the Ministry of Finance, Government of India, to float ‘Asset Reconstruction Companies’, which will help them to take over the NPAs of their parent banks.

3. Bangladesh Government is also looking for an effective instrument to get rid of the huge NPAs. They are also thinking about a model like ARF. The idea is that factoring can contribute a lot in this respect, although supporting literature is not available in this regard. Table 7.4 and Pie- chart 7.1. present the respondents’ responses regarding the role of factoring services in reducing the non-performing loans of financial institutions. It is evident from the data presented in the Table and pie-chart that both bank and finance executives, and academicians are very much hopeful as 92 per cent and 86 per cent of them favor factoring as a tool for reducing non-performing loans. The executives of the Chambers of Commerce are fully confident about the effectiveness of factoring services in this respect. They argue that factoring organisations are in a position to extend their service areas to the purchase of debts of financial institutions because of their large-scale operations, intense specialization and abundant resources. They also mention that fast collection can be assured through these organizations as it is expected that these are fully automatic in operation and all steps, for example sending of letters requesting for payment, payment monitoring, are carried out within the appropriate time frame. With this expected fast collection, classified loans can be controlled although these can never be eliminated completely. On the other hand, in the manufacturing and trading sectors, factoring, when used to its maximum capacity, will deal efficiently with all those niggling little debts and all the larger debts which destroy cash flow over a period of time and make loan repayment to banks difficult and unreliable. It is, therefore, expected that this new service will bring financial regularities in manufacturing and trading sectors resulting in creation of regular repayment habit and eventually reducing classified loans of the banking sector.
### TABLE 7.4

Factors can be Helpful in Reducing the 'Non-Performing Loans' of Financial Institutions.

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Particulars</th>
<th>BB</th>
<th>NCBS</th>
<th>PCBs</th>
<th>FCBs</th>
<th>NBFIs</th>
<th>TOTAL</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Bank and Finance Executives</td>
<td>3</td>
<td>4</td>
<td>9</td>
<td>4</td>
<td>3</td>
<td>23</td>
<td>92.00</td>
</tr>
<tr>
<td>2</td>
<td>Executives of Chambers of Commerce</td>
<td>N = 4</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>100.00</td>
</tr>
<tr>
<td>3</td>
<td>Academicians</td>
<td>N = 15</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>13</td>
<td>86.67</td>
</tr>
</tbody>
</table>

Source: Questionnaire Responses.
Can Factoring Services Help in Reducing Non-performing Assets of the Financial Sector of Bangladesh?

- Bank and Finance Executives - Yes: 92%
- Bank and Finance Executives - No: 8%
- Executives of Chambers and Commerce - Yes: 14%
- Executives of Chambers and Commerce - No: 0%
- Academicians - Yes: 0%
- Academicians - No: 100%
4. It is true that factoring was not used for reducing NPAs till now. So, the first question that may be raised is that can it handle this business either academically or legally? But, if we look at various types of services of factoring like advances and term loans, we find that these are not covered under normal definition of factoring. However, these are made available by a factor to its clients for many useful purposes (Moore 1959, p. 727). Moreover, types of services rendered by factors are not uniform all over the world's economies. For example, in the USA, specific current assets (including inventory) financing scheme exists under factoring (Maberly 1979, p. 97). It is acceptable that the definition and areas of services included in factoring have been extended according to the needs of the time and economic environment. Second question that may be raised is regarding the availability of funds for buying huge amount of classified loans of the banking sector in Bangladesh. It can be possible if the whole banking sector comes forward jointly to launch only a few factoring organisations with sufficient capital.

5. Effect of Factoring Services on Cost, Liquidity, Profitability and Capital of Users' Industries

1. Cost, liquidity, profitability, and capital structure determine the command of an organisation in its industry coupled with the quality of services provided by it. With a view to knowing the impact of factoring services on the above, the responses received have been recorded in Table 7.5. Individual views expressed by the respondents provide an exposure to the type of thinking prevalent.

2.1. Cost

The basis of successful factoring services is that it should save the overall costs of clients. In response to the query concerning the 'perception regarding the effect of factoring services on client's cost', nearly 51 per cent have viewed that factoring will bring a positive impact on cost. They argue that the industrial units, specially small and medium scale units, need not require any elaborate administrative set up for the
TABLE 7.5

Effect of Factoring Services on Cost, Liquidity, Profitability and Capital of Users' Industries

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Particulars</th>
<th>Bank and Finance Executives</th>
<th>Manufacturers</th>
<th>Executives of Chambers of Commerce</th>
<th>Academicians</th>
<th>Total</th>
<th>N=74</th>
<th>Chi-Square Value</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>BB</td>
<td>NCBs</td>
<td>PCBs</td>
<td>FCBs</td>
<td>NBFIs</td>
<td>Total</td>
<td>N=30</td>
</tr>
<tr>
<td>1. Cost</td>
<td></td>
<td>P</td>
<td>N</td>
<td>P</td>
<td>N</td>
<td>P</td>
<td>N</td>
<td>N=25</td>
</tr>
<tr>
<td>2. Liquidity</td>
<td></td>
<td>P</td>
<td>N</td>
<td>P</td>
<td>N</td>
<td>P</td>
<td>N</td>
<td>N=30</td>
</tr>
<tr>
<td>3. Profitability</td>
<td></td>
<td>P</td>
<td>N</td>
<td>P</td>
<td>N</td>
<td>P</td>
<td>N</td>
<td>N=30</td>
</tr>
<tr>
<td>4. Capital</td>
<td></td>
<td>P</td>
<td>N</td>
<td>P</td>
<td>N</td>
<td>P</td>
<td>N</td>
<td>N=30</td>
</tr>
</tbody>
</table>

Note: 1. Some respondents mention that it is difficult to tell. It differs from client to client.
2. P= Positive; N =Negative.

Source: Questionnaire Responses.
credit realization resulting in substantial administrative cost saving, apart from economy in infrastructural expenditure like postage, telephone, telegraph, fax, etc. Moreover, with the steady and reliable cash flow facilitated by factoring, the client will have many other opportunities to cut costs and expenses like encashing cash discount for prompt payment and quantity discount for bulk purchase, ordering for materials/ components at the right time, at the right price from the right supplier, and avoidance of disruption in the production schedule, delivery schedule, etc.

By contrast, about 49.00 per cent feel that factoring will bring an extra cost burden on the clients. Reasons behind such reservation are that many companies are unaware of the true cost of their administration, collection, finance, and bad debt, etc. Moreover, there are misconceptions about factoring since it is yet to be introduced in Bangladesh. But it is a fact that this claim is true if the overall service is regarded solely as being a means to raise only additional cash and no other benefits at all are derived from the services of the factoring operations.

2.2 Liquidity

Factoring is designed to increase the liquidity of the clients. Almost cent per cent of the respondents agree that the amount tied up in accounts receivable released by factoring leads to an improvement in liquidity of suppliers. Factoring involves change in the asset structure of the firm as receivables get converted into cash. This makes the assets structure of the firm more liquid and enhances its capacity to meet maturing obligations. Moreover, turnover of stocks into cash is speeded up as a result of which there is more liquidity.

2.3 Profitability

Factoring increases the client’s profitability, if the general returns in the business are more than the
service charges paid to the factor. As regards impact of factoring services on profitability of clients, it is revealed from the table that 87 per cent of the respondents are in favour of positive impact on profitability. Of them, bank and finance executives and executives of chambers of commerce forward this unanimously. They mention overall two reasons behind this: (1) with finance provided by the factors, the client shall do more business, which can again be factored thus allowing him to increase his profit from business; (2) the factor’s commission substitutes for cost of insurance premium, outlay for credit information from specialized agencies, staff salaries for sales ledger maintenance, cost of collection, etc, since the factor takes charges of all these functions. Moreover, incremental sales, advantages of taking trade discounts, avoiding opportunity costs for locked up funds should bring a positive impact on profitability. On the other hand, a few respondents (8 per cent) put their reservation and express the negative impact on profitability. It is true if a firm is not suitably placed to take advantages of factoring like limited opportunity to invest excess amount, unwillingness to transfer sales ledger administration to a third party, already having satisfactory collection stream, no seasonal fluctuation of cash flow – then there is no opportunity to increase the profitability of the client with these services. That’s why a firm has to compare and evaluate financial statements before and after factoring of receivables. When financial statements after the factoring are better off than before availing of the service, it would be a wiser decision to go in for factoring decision. Moreover, one of the basic principles to be adopted by the factoring company is that it will not factor a company unless it can see quite clearly that the company is going to make a larger net profit.

2.4. Capital

Factoring helps a firm to obtain needed cash without increasing debt or diluting ownership equity. It is evident from the table that respondents are optimistic about the positive impact of factoring services on clients’ capital. Sixty eight per cent express their positive response. Of them, both bankers and academicians (80 per cent) are more hopeful. Factoring does not appear on the company’s balance sheet.
as borrowing, so it does not impair company’s equity power. Moreover, normally this increases profit which is the result of increased liquidity. This profit would certainly increase the company’s capital. Since it provides such a source of funds which is always linked directly to sales extension, company need not sell its equities for additional funds. There is also the hidden benefit to the owners of the company that they lose no measure of control over the operations of their business. Eventually, if the company comes to sell equity, it will obtain a better price for it because the company has impressive financials. However, manufacturers (53 per cent) and executives of chambers of commerce (2 out of 4) expect that factoring will bring a positive effect on the client’s capital. They do not show their excess optimism. Confusion regarding these services, as not yet introduced, and faith in the traditional sources of finance, might be the reasons for this type of response.

3. Results of Chi-square test show that there is no significant difference in the opinion of bank and finance executives, manufacturers, executives of chambers and commerce, and academicians on perceived effects of factoring services on cost, liquidity, profitability, and capital of the users’ industry.

6. Effect of Factoring Services on Cost, Liquidity, Profitability and Capital of Banks and Non-bank Financial Institutions

1. The basis of involvement in providing the factoring service is that it should bring forth excellent prospects for high profits for the service providers through its positive impact on cost, liquidity and capital. Cost, liquidity, profitability and capital will be the causative forces in successful and smooth rendering of factoring services. These causes are listed in the questionnaire to assess the viewpoints of the bank and finance executives, executives of chambers of commerce, and academicians regarding the
impact of factoring services on cost, liquidity, profitability, and capital of providers. Their responses are presented in Table 7.6.

2.1. Costs:

Costs are associated with any fresh means of business. Respondents (50 per cent) feel that this would bring negative impact on existing cost pattern of the providers i.e. it would increase the existing cost pattern. Of them, 60 per cent of the bank and finance executives feel negative impact whereas others feel it is minimum. They feel that it would be an expensive undertaking to set up the factoring division / subsidiary / separate organization. Apart from the cost of engaging staff with necessary expertise, relatively large sums of money would also be involved in building up credit information and in running the division until sufficient business grows to produce profits. This may make them reluctant to allocate the scarce funds for developing new activities at the expense of the demands of their usual existing business. By contrast, almost the same number of viewers (50 per cent) foresee the positive impact and mention that reasons behind their expectation are lower cost of obtaining funds, opportunity to use the existing infrastructure and manpower with know-how. However, it is true that any organisation must sacrifice something, at least during early period, for a new stream of business to be a success.

2.2. Liquidity

As regards the impact of factoring services on the liquidity of the providers, it may be observed from the Table that 37 respondents out of 44 (84 per cent) observe that it would bring an excellent positive impact on liquidity. Executives of chambers of commerce put 100 per cent (4 out of 4) confidence in the positive impact on liquidity. Factoring companies have most of their assets that mature within 6 months. In management of short-term assets and continuous cash-inflows of receivables marketing, factoring companies do experience temporary surpluses. It may create idle money and serious interest rate risk also.
## TABLE 7.6

**Effect of Factoring Services on Cost, Liquidity, Profitability and Capital of Expected Providers (Banks / NBFI s)**

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Particulars</th>
<th>Bank and Finance Executives</th>
<th>Executives of Chambers of Commerce</th>
<th>Academicians</th>
<th>Total</th>
<th>Chi-square value</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Bb</td>
<td>Nc Bs</td>
<td>Pc Bs</td>
<td>Fc Bs</td>
<td>Nbf Is</td>
</tr>
<tr>
<td>1</td>
<td>Cost</td>
<td>P</td>
<td>N</td>
<td>P</td>
<td>N</td>
<td>P</td>
</tr>
<tr>
<td>2</td>
<td>Liquidity</td>
<td>P</td>
<td>N</td>
<td>P</td>
<td>N</td>
<td>P</td>
</tr>
<tr>
<td>3</td>
<td>Profitability</td>
<td>P</td>
<td>N</td>
<td>P</td>
<td>N</td>
<td>P</td>
</tr>
<tr>
<td>4</td>
<td>Capital ¹</td>
<td>P</td>
<td>N</td>
<td>P</td>
<td>N</td>
<td>P</td>
</tr>
</tbody>
</table>

Note: 1. Executives of chambers of commerce were not asked the question on ‘the effect of factoring services on the capital of providers’.
2. P= Positive; N =Negative.

Source: Questionnaire Responses.
Zadek (1999, p. 25) views that if business is slow and the factor receives a large amount of repayments, it ends up with a lot of cash. That’s why, there are requirements of short-term investment avenues and borrowing facilities for a period less than 6 months with a flexible rate of interest.

2.3. Profitability

The basis of launching factoring service is that it should increase the factor’s profitability. Nearly 98 per cent respondents hope that factoring would bring a positive impact on the profitability of the providers. It has already been mentioned and analyzed earlier (Table-7.3) that there is an excellent prospect for high profits. Moreover, the presence of strong small and medium scale industries in the industrial sector of Bangladesh would brighten up the opportunity very much.

2.4. Capital

Bank and financial institution’s capital is now widely considered as one of the most important issues in the financial sector. Bangladesh has imposed “Risk Based Capital Requirement” on commercial banks through BRPD circular no. 01, 1996. Table reveals that respondents are very much cautious regarding the impact on the capital. Twenty-seven viewers out of 40 (i.e. 67 per cent) mention positive impact on the capital. The bank and finance executives (72 per cent) are more positive regarding this. Since capital is a cushion against which to charges off losses, the riskier the asset composition, the more is the capital required, to maintain a given level of soundness. In a factoring company, risk assets are only receivables, which can mature within 6 months only. Moreover, ‘with recourse factoring’ reduces factor’s risk to a minimum level. The liquidity of the assets, thus, comprising factors’ portfolio makes it possible to have a small capital base. Again, if a factor deftly diversifies its portfolio over large number of small customers, the associated risks can be spread and thereby reduced.
3. Results of Chi-square test show that there is no significant difference in the opinion of bank and finance executives, executives of chambers and commerce, and academicians on perceived effects of factoring services on cost, liquidity, profitability, and capital of providers.

7. Summing Up

To sum up, the analysis of this chapter reveals that factoring services will be helpful for clients in solving some problems in various vital areas like working capital, collection of book debts from customers, incremental sales, coverage of bad debt loss, promotion of exports from Bangladesh, management efficiency, etc. It will also be attractive to the whole financial sector as it generally brings fresh means of business, prospects for high profit, customers' growth potential and use of other financial services. Moreover, the respondents confidently expect that it can be an effective financial instrument to reduce the huge NPAs of the financial sector of Bangladesh. Secondly, it is found from the analysis that factoring services will have positive (desirable) effect on the cost, liquidity, profitability, and capital of both providers and users. This analysis, thus, accepts the two hypotheses, respectively, formed in the beginning of this study. First one is that bank and finance executives, manufacturers, exporters, executives of chambers of commerce, academicians, and lawyers in Bangladesh perceive that factoring service will be useful in Bangladesh. Second one is that the perceived effect of factoring services on cost, liquidity, profitability and capital of factors and clients are the same across the bank and finance executives, manufacturers, executives of chambers of commerce, and academicians.

8. References

PRESENT STATUS AND EXPECTED BENEFITS OF FACTORING SERVICES IN BANGLADESH


PRESENT STATUS AND EXPECTED BENEFITS OF FACTORING SERVICES IN BANGLADESH


