CHAPTER VIII

POLICY ISSUES RELEVANT TO INTRODUCTION OF FACTORING SERVICES IN BANGLADESH
This chapter aims at developing a suitable policy framework on accounting, organizational, financial, and legal aspects of the factoring service in the perspective of Bangladesh in order to encounter the situation while launching the service.

1. ACCOUNTING SYSTEM FOR FACTORING BUSINESS

1. Accounting treatment of both factoring company and client company depends on the precise relationship between a factoring company and its client company (Salinger 1979, p.133). This relationship is solely determined by the agreement between them. A typical factoring agreement provides for the outright purchase by the factor of all the client's book debts as they arise in the normal course of business. It will very often provide for the circumstances in which a debt sold to the factor will be deemed to be "with recourse" or "without recourse". As a whole, the accounts must reflect the legal position and the legal position is determined by the contracts. The accountants will have to have good understanding of the relationship of the parties to a factoring agreement.

Accounting system of Factoring business is placed in Chart 8.1 and discussed below under the two heads namely (i) Accounting System in the Factor's Books and (ii) Accounting System in the Client's Books.

2. ACCOUNTING SYSTEM IN THE FACTOR'S BOOKS

2.1. A Company, which factors its debts, will mail its invoices direct to the factor instead of its customers. Normally, the factor will require the original and one copy of every invoice. The original is forwarded to the customer and the copy is kept by the factor for record purposes. The factor issues the invoices to the customers either in his own name or at least with a clear indication thereon that debts have been assigned to him. In case of assignment, assignment clause has to be printed on the invoice itself (Foster 1978, p. 94).
ACCOUNTING SYSTEM FOR FACTORING BUSINESS

Accounting System for a Factor

Sales Ledger

Factor creates sales ledger of his own for clients' customers

Monthly Statement

Submitted to the client for his information

Financial Statements

These have to be agreed with the books of accounts.
These will be more or less of the same shape as the financial statements of other financial institutions.

Factor Accounts

Client maintains only one-trade debtors' account under the head of factor accounts.

Current Account

Factors run a current account for the client.

Statement for Collection and Aging of Accounts Receivable,

This can be organised and presented by developing a data processing system.

Financial Statement

1) Amounts received in form of pre-payment is an off-balance sheet form of finance.
2) Balance amount of receivable is shown in the balance sheet.

Contingent Liability, if any, should be disclosed.

The amounts received as prepayment under with recourse factoring are shown as a contingent liability till invoices are paid.
2.2. Points to be Considered

Grant (1967, p.537) prescribes for the following checklist for a factor company's accountant when he receives the invoices:

2.2.1. Check whether the assignment in favour of the factor is disclosed or not. The only security the factor has is the legal assignment of the debt to him, and this is only valid if the debtor has notice of the assignment.

2.2.2. Check the additions of the assignment schedule and ensure that it agrees in detail with individual invoices and delivery slips.

2.2.3. Check the invoices against credit limit (normally a credit limit is set in advance for dealing with each individual customer, and a blanket limit for smaller transactions not requiring separate approval).

2.2.4. In case of very small transactions, the factor is likely to look very carefully at the arrangements, which have been made for continuing the practice in the event of sickness or death. He would also, of course, wish to be satisfied that there is adequate insurance cover for loss of profits and claims from clients.

2.3. Day to Day Operations

2.3.1. In purchasing the book debts of a client, a factor creates a 'sales ledger' of his own, leaving the client with one debtors' account in his books.

2.3.2. Factor should also run a 'current account' for the client. This will be furnished as follows.

2.3.2.1. It will be credited with the purchase price of each debt purchased.

2.3.2.2. The account will be debited with the following:

2.3.2.2.1. All the amounts prepaid to the client. It is usually 80 per cent of the invoice amount assigned.
2.3.2.2.2. Finance charges, cost of collection, and other service charges. Moreover, additional fees, cost and charges, if any, will also be debited to the account.

2.3.2.2.3. All statutory payments to be made by way of taxes, dues, duties, cesses, levies, etc.

2.3.2.2.4. Legal costs incurred by the factor for advocate's services on client's behalf or otherwise, stamp duty, and penalty, if any, will be debited to the accounts.

2.3.3. The factor will prepare a monthly statement. He will submit statements to the client giving details of the amounts debited and credited by the factor. Bolton comments in this regard, "Information given by the factor on a weekly and/or monthly basis must be adequate both for the client and the auditor (See, Brandenberg 1987, p.101).

2.4. Management of the Client's Accounts Receivable

For managing and controlling the clients' accounts receivable, the factor's accountant should always need to know the value of outstanding balances, the age of the accounts, amount overdue, the collection activities, and business and economic conditions in general. Accountants can access this information by developing a data processing system. Such information might be organised and presented in a comprehensive report similar to that given in Table 8.1.

2.5. PROFIT AND LOSS ACCOUNT

Profit and loss account / income statement has to be agreed with the books of accounts. It will be more or less in the same shape as that of other financial institutions.

2.5.1. Profit and loss account is to be credited with factoring income. This income includes finance charges, service charges, processing fees, etc. This income should be accounted for on an accrual basis as
## TABLE 8.1

### SUMMARY OF COLLECTION AND AGING OF ACCOUNTS RECEIVABLE

#### JANUARY, 2000

<table>
<thead>
<tr>
<th>Age Category</th>
<th>Balance Outstanding January 1.</th>
<th>Collection in Month</th>
<th>Per cent Collected</th>
<th>Balance Outstanding January 31.</th>
<th>Aging per cent (% of outstanding of each age to total outstanding)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current</td>
<td>TK 20,00,000</td>
<td>TK 16,00,000</td>
<td>80%</td>
<td>TK 22,00,000</td>
<td>55%</td>
</tr>
<tr>
<td>30 Days</td>
<td>TK 9,00,000</td>
<td>TK 5,85,000</td>
<td>65%</td>
<td>TK 8,00,000</td>
<td>20%</td>
</tr>
<tr>
<td>60 Days</td>
<td>TK 6,20,000</td>
<td>TK 3,10,000</td>
<td>50%</td>
<td>TK 5,00,000</td>
<td>12.5%</td>
</tr>
<tr>
<td>90 Days</td>
<td>TK 2,40,000</td>
<td>TK 60,000</td>
<td>25%</td>
<td>TK 2,00,000</td>
<td>5.0%</td>
</tr>
<tr>
<td>120 Days</td>
<td>TK 3,15,000</td>
<td>TK 34,650</td>
<td>11%</td>
<td>TK 3,00,000</td>
<td>7.5%</td>
</tr>
<tr>
<td></td>
<td>TK 40,75,000</td>
<td>TK 25,89,650</td>
<td></td>
<td>TK 40,00,000</td>
<td>100%</td>
</tr>
</tbody>
</table>

per usual accounting principles. But in case of non-performing assets, income ought to be accounted on realization basis. But here the company should follow the guidelines of central bank.

2.5.2. Other incomes like profit on sale of fixed assets will also be credited to profit and loss account.

2.5.3. Interest on fixed loans, cash credit, inter-corporate deposits, etc, and administration and other expenses are the main areas of expenditure of factoring company. These are to be debited to profit and loss account. Moreover, depreciation, provision for non-performing assets (NPAs) and provision for taxes will be placed on the debit side of profit and loss account.

2.5.4. In the area of appropriation, proposed dividend, reserve for contingencies and transfer to general reserve should be recorded according to organization’s policy.

2.6. BALANCE SHEET

Factor’s balance sheet will also take more or less the same shape as that of other financial institutions. It will be furnished with the following groups of items of liabilities and assets:

2.6.1. Liability Side:

2.6.1.1. ‘Shareholders’ funds’ comprising of capital, reserves, and surplus will be the first item on the liability side of the factor’s balance sheet. Under reserves and surplus, all types of reserves like general reserve, reserve for contingencies, statutory reserve will be grouped.

2.6.1.2. ‘Loan funds’ are sourced as secured loans as well as unsecured loans. Secured loans can come through bank overdraft and cash credit, which are secured by hypothecation of factored debts/
factored bills receivable. Sources of unsecured loans are mainly short-term loans, commercial paper placed with banks, inter-corporate deposits, and public deposits, etc.

2.6.1.3. ‘Current liabilities and provisions’ comprise of sundry creditors, amount due to clients on collection of factored debts, interest accrued, provision for taxes, proposed dividends, provision for gratuity, and other statutory obligations.

2.6.1.4. ‘Contingent liabilities’, if any, like tax disputes in appeal, cheques discounted with bankers, claims against the company not acknowledged as debts should be disclosed in the foot note to balance sheet.

2.6.2. Assets Side:

2.6.2.1. ‘Fixed asset’ is one of the main areas of application of funds. This should be presented in detail with opening amounts, additions, deductions, and closing figures. Method of providing depreciation has to be written under accounting policies followed for the balance sheet.

2.6.2.2. Current assets, loans and advances’ are the prime areas of application of funds. Under this head, sundry debtors, cash and bank balances, loans and advances can be included. Sundry debtors i.e. debts factored should be classified into performing and non-performing assets in terms of guidelines laid down by the Bangladesh Bank (B.B.). Non performing assets should also be classified as standard, sub-standard, doubtful and loss assets. Provision for factored debts should also be made as per guidelines laid down in this regard by Bangladesh Bank. Cash and bank balances will comprise of cash on hand and balances with banks in current account. Loans and advances, if any, will include advances recoverable, sundry deposits, loans against public deposits, dues from the employees of the company, and other loans and advances.
2.7. Disclosures

Accounting policies, which are considered important in relation to the company’s accounts, should be disclosed. Significant accounting policies relating to accounts can be accounting convention, income recognition, investments, fixed assets, depreciation, assets classification, factored debts, employees’ retirement benefits, provision for classified loans, contingent liability, etc. Moreover, explanatory notes that are required for easy and further classification should be given in financial statements.

3. ACCOUNTING SYSTEM IN THE CLIENT’S BOOKS.

3.1. The accounting of a company that is being factored is greatly simplified. The company will have only one trade debtors’ account under the head of “factor account” for the debts falling within the scope of the factoring agreement.

3.2. Day to Day Operations

Client maintains the “factor account” in his account books. The corollary of the crediting by the factor of the “current account” with the purchase price of debts purchased is the debit of such purchase price to ‘factor account’ in the client’s books. The debit to the ‘current account’ of amounts paid by the factor by way of prepaid, finance charges, cost of collection, legal costs, statutory payment, etc are reflected in the client’s books by a credit to the ‘factor account’. The amount outstanding in ‘factor account’ will equate the balance on the ‘current account’ with the factoring company.

3.3. Balance Sheet

The amounts paid by the factor on account of the outright purchase of debts are analogous to amounts
paid by customers for the purchase of goods or services. The finance provided by the factor in the form of "pre-payments" against such purchased debts does not appear in balance sheet. The amounts received by the client can be added to the existing balance of cash and will appear under cash balance on the same side in the balance sheet. Apart from this, the amount can be used to pay creditors or for discharging other short-term liabilities i.e. bank overdraft, etc. Therefore, this procedure will reduce the same amount from both sides of the balance sheet. This is, therefore, fully an "off-balance sheet form of finance". Brandenberg (1987, p. 101) also points out the same theme. However, the balance amount of receivables (usually 20 per cent of accounts receivable) from factoring is shown as receivables in the balance sheet of clients both in case of "with recourse" and "without recourse" factoring.

3.4. Contingent Liability

3.4.1. In case of 'with recourse factoring', the amounts received from the factors as pre-payments till invoices are paid are shown as a contingent liability by way of a foot note in the balance sheet of the client. At the same time, creation of contingency in the balance sheet is required for recourse in respect of the possible failure of the debtors to accept goods or invoices. The amount for contingency must depend on the client company's directors' view and auditor's opinion. Salinger (1979, p.133) also expresses the same opinion. In his language, "A question will emerge in the precise
mind of an accountant: to what extent should the amount of the contingent liability to the factor include the contingency for recourse in respect of the possible failure of the debtors to accept goods or invoices? The answer to this must depend on the client company's directors' view on the acceptability of the products and auditor's opinion of that view. But the amounts to be shown as a contingent liability for this potential recourse should be the same as the amount which would have been provided in the accounts in the absence of factoring agreements for 'returns, allowances, and counter claims in respect of the outstanding debts'.

3.4.2. For without recourse factoring, this type of finance will not appear in the balance sheet even as a contingent liability. Because the client will have no liability in respect thereof even if the customer fails to pay up or makes default in payment of the debt. Notably, factors are not in a position to protect their clients against trade disputes under 'without recourse factoring' arising from disputed qualitative aspect of goods supplied or services provided. Depending on the extent of situation, contingent liability should also be shown here, for the amount of prepayment because accounting should make available all information of the financial nature relating to the financial condition of the business.

3.5. Disclosures

According to" the Statement of Financial Accounting standard No. 77", for factoring "with recourse", the client's financial statements shall disclose (1) the amount of contingent liability, significant terms of the transfer agreement, and recourse provisions, related parties' transactions, and so forth (2) the balance of the receivables transferred that remains uncollected at the date of each balance sheet presented (FASB 1995, p157). In India, SBI Factors and Commercial Services Ltd. has approached Institute of Chartered Accountants of India for circulating directives in the matter of accounting treatments of factored receivables. In Sri Lanka, factoring is recognized as a 'specified business undertaking' under the Sri Lanka Accounting and Auditing Standards Act, No. 15 of 1995.
However, there is no specified accounting standard for factoring. Financial Reporting Standard No. 5 – Application Note C – Factoring of Debts (United Kingdom), is adopted by auditors in presenting the financial statements of clients who factor debts (Senaratne 1999, p.229).

4. Factoring and the Auditor

The impact of factoring on the auditor needs to be considered. The client maintains only one sales ledger account, the balance on this account may be subjected to a positive confirmation in writing, and this is then verified. It will also be possible to get the factoring company to give a summary of sales for the year, i.e. total month by month or some other similar breakdowns. Reconciliation of these figures with the client’s sales daybook will prove the sales in total for the year. The auditor can also insist upon delivery slips being rendered with each invoice as a proof of delivery. The auditor will thus be able to verify actual shipment dates (Grant 1967, p.539)

5. Conclusion

Accountants are free to maintain the books of accounts both for the client and factoring company. But accounting information for users must be adequate and authentic. Salinger (1979,p.132) suspects in this respect that some accountants of small clients with factoring agreements may fail to examine the agreement in details, which may result in preparation of the accounts of clients incorrectly. Accountants should, therefore, maintain the accounts in such a way as the accounts should reflect the precise relationship between a factoring company and its client company. Bangladesh Bank can initiate suitable action and issue guidelines with the help of professional accountants’ bodies like Institute of Chartered Accountants of Bangladesh (ICAB), and Institute of Cost and Management Accountants of Bangladesh (ICMAB), so that it would be easier to follow uniform procedures and be helpful in furtherance and development of this new type of service.

1. Of the various decisions, the crucial decision, which a factor is required to take is that of pricing of factoring services. The existing practice is to quote rates based on the situation in which individual cases are placed. There has been a band of charges within which quotations are given to individual customers. The criteria that generally weigh in this regard are the type of industry in which the client is categorized, the annual sales volumes of the client, the average amount of the client’s sales, the number of customers to whom a client may sell, the credit standing of the client’s customer, and the terms of sale which are extended to customers, etc. Kalyanasundaram Committee (1988, p.35) also shows almost the same criteria for quoting rates for the clients. Kuvalekar (1997, p.4) argues that it is always more appropriate to fix and quote the rate based on credit rating of client and that of his customer. SBI Factors and Commercial Services Ltd., India, has developed “Credit Risk Assessment System (Annexure-2) by itself for quotation.

2. Pricing of factoring services is determined through the adding of base rate and margin. The base rate is dependent upon the various costs required to be borne and appropriate costing system to be adopted by the factoring organisation. This rate / cost can be divided into two components. These are (i) the interest charges^1 applied only to the monies actually advanced, (ii) the factoring charges^2 based on a percentage of turnover of factored company. Moreover, the pricing strategy to be followed depends on costing system i.e. absorption costing^3 or marginal costing^4.

2.1.1. The interest charge depends on cost of funds. The major cost in factoring is the funding cost: a variable cost. Different sources of funds could be: promoters’ contribution, participation in inter-bank

^1 Interest charges are also popularly called discount charges.
^2 Factoring charges are also known as commission charges / factoring fees, etc.
^3 Under absorption costing, unit /service cost is determined by considering the fixed costs as well as variable costs (direct costs and variable overheads).
^4 Under marginal costing, unit / service cost is determined by considering only the variable costs (direct costs and variable overheads).
call money market, raising equity capital from the public, mobilisation and acceptance of public deposits, issue of debentures, and arranging line of credit from banks, etc. To keep the cost of funds as low as possible and to maintain a reasonable spread, factoring organisations have to attempt a good mix of the above stated sources. But funding strategy of using bank credit should be least for factoring companies because they will be competing with banks, and they should charge their clients a rate not higher than charged by banks. But if factoring company is a subsidiary of a bank, which trend is visible all over the world including Singapore, Thailand, India, then it can entirely look to the parent bank for funds at interest rates ruling in the inter-bank market (at rates charged by a parent bank to its branch). Bangladesh Bank can allow the factoring companies to raise their funds from other sources as well.

2.1.2. Interest rate is charged on the funds outstanding and calculated on a day-to-day basis. It should be equal to or slightly above the interest rate being charged by banks on their cash credit and overdraft facility. Nearly 85 per cent of the respondents put this comment in determining pricing policy. Galli (1999, p.97) shows that spread should be from 1 per cent to 4 per cent on advanced funds. Singh (1988, p.26) advocates that it could be expected to be somewhere between 14 per cent to 15 per cent. In Bangladesh, as lending rates both for term lending and working capital are to be decided by the banks themselves, factoring organisations can fix the rate based on cost of funds and international scenario.

2.2. Factoring charge is regarded solely as a charge for services rendered. The service charge represents the charges for rendering non-fund services such as credit screening, ledger keeping and collection of book-debts, coverage of write-off of bad debts, and other advisory services.

2.2.1. The first cost is the credit screening cost. It is a semi-variable cost. Under this service, customers of the sellers of goods i.e. clients’ buyers are to be screened for their credit worthiness. If all customers of clients are to be screened and approved by the factoring company, this cost is likely to be fairly high. This cost may vary from 0.3 per cent to 0.6 per cent in Bangladeshi conditions. Kalyanasundaram Committee (1988, p.38) shows this range from 0.45 per cent to 0.6 per cent.
2.2.2. The next important cost is for ledger keeping and collection of book-debts. It is also a semi-variable cost. The factoring companies would have to estimate what the collection costs for a particular company for a particular year are likely to be. They will assess this cost by considering past experience of the client company in respect of the average collection period and extrapolate it for the next year realistically in the light of the likely future market conditions and other environmental trends. This cost may vary somewhere between 0.3 to 0.5 per cent. Singh envisages (1988, p. 26) that this cost can be up to 0.7 per cent in extreme case.

2.2.3. The third significant semi-variable cost is the cost of write-off of bad debts. The client company would like to give all these functions to factoring company and pay the price. In this case, the factoring company should make its own write-off. In normal cases, the write-off cost is likely to be about 0.3 per cent to 0.6 per cent. The cost would be high if factoring companies become garbage handlers – clearing agencies only for problem industries.

2.2.4. The last important fixed cost is overhead cost of infrastructure. Infrastructure costs include the building, furniture, equipment and manpower costs. The cost will have to be spread over the total volume of business. The higher the scale of operations, the higher the utilization of factor and so, the lower will be the average cost. It could be as low as 0.3 per cent to 0.5 per cent. Singh (1988, p. 26) fears that it might range anywhere from 1 to 2 per cent.

3. Factoring charges solely depend on the utilisation of services. Suppose a factoring company offers a full package of all non-funding services including credit screening, collections, write-off, it could charge somewhere between total 1.32 per cent to 2.42 per cent (considering 10 per cent margin with cost of services). Grant (1967, p.53) shows factoring fee which is normally between 1 per cent and 2 per cent of

1. It is assumed that all employees are permanent and getting fixed amount of salary during the year.

253
the turnover. Galli (1999, p.27) indicates from 0.30 per cent to 1.50 per cent for administration commission. Pandey (1994, p. 46) suggests range from 2.5 per cent to 3 per cent for the service charge.

Cost and Pricing: The factoring 'cost and pricing' estimates are as follows:

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Elements of Cost</th>
<th>Percentage of Cost</th>
<th>Margin @10%</th>
<th>Pricing</th>
<th>Basis calculation for</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Variable Cost of funds</td>
<td>14.00</td>
<td>14.00</td>
<td>1.4</td>
<td>15.4</td>
</tr>
<tr>
<td>B</td>
<td>Semi-variable costs:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Credit Screening</td>
<td>0.3-0.6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Ledger keeping and collections costs</td>
<td>0.3-0.5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cost of write-off</td>
<td>0.3-0.6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C</td>
<td>Fixed salary and overhead costs</td>
<td>0.3-0.5</td>
<td>1.2-2.2</td>
<td>12-22</td>
<td>1.32-2.42</td>
</tr>
</tbody>
</table>

4. Estimation of cost of funds is 14 per cent per annum, 1 per cent lower than current cost of cash credit funds (it is assumed that cash credit rate is 15%). With this cost and a 10 per cent margin, the factoring company can charge interest at the rate of 15.4. Four other costs in aggregate are from 1.2 per cent to 2.2 per cent, which can rise with 10 per cent margin to between 1.32 per cent and 2.42 per cent. Sometimes, during the year, the factor may estimate monthly an amount of minimum charge. If the aggregate of the factoring charges falls below the minimum charge, then the client shall pay the factor the minimum charge. At an initial stage, it would have to quote the price, which would fetch it business and could also go as low as possible. In some cases, it may have to do its costing more aggressively, cut sharp and be satisfied with lower and lower margins of even 0.05 or below.

1. Singh (1988, p.27) envisages a 10 per cent margin on costs in India. Maberly (1979, p.98) is in favour of 4.5 per cent on base rate for the UK. Here, Singh's view is considered. In Bangladesh, as already mentioned, factoring companies are free to fix the price of their services based on the costs and international scenario.
5. In comparison to the total cost of cash credit and bank overdraft, it is indicated that the client requires to pay about 0.5 to 2.0 per cent extra by enlisting services of factor. Nonetheless, the client may still be willing to go in for factoring because of the benefits of additional services rendered by the factor. In case of international factoring, it is assumed that the exporter would be required to pay 1.5 per cent extra. Even after this, because of finance extended, credit risk coverage, sales ledger management, debt collection and relief from risks and off loading administrative problems connected with exports, the exporter may be willing to patronize the factoring companies. The rough working of cost and price estimates are based on views expressed by top executives of banks, producers, chambers of commerce, and academicians in Bangladesh. However, much would depend upon the operational efficiency of the factoring company. If it is able to keep its costs low, it could offer the new service at a cheap price. This would help the factoring company to keep prices competitive and profit margins good enough to cover costs and register high profits simultaneously.

3. Legal Issues of Factoring

1.1. The importance of regulating and monitoring factoring business can not be overestimated. Prudent laws and regulations must be in place to do so. But very few countries have a comprehensive legal framework for factoring operations. In the USA, the Uniform Commercial Code (UCC) contains certain clauses, which deal with factoring and financing of trade debts. In Italy, there is in existence the specific legislation governing factoring transactions (Sengupta 1991, p.16). Similarly, in Spain, a draft law specifically relating to factoring is being currently discussed in Parliament at working group level (Rodriguez- Mantinan, 1999, p. 125).

1.2. The legal experts of Bangladesh, interviewed by the researcher, are of the opinion that a comprehensive legal framework should be structured to define the term ‘factoring’ and to establish the rights, duties, liabilities, and obligations of the parties involved in an unambiguous manner. Ostrowski
POLICY ISSUES RELEVANT TO INTRODUCTION OF FACTORING SERVICES IN BANGLADESH.

(1999, p.111). Dandekar (1991, p.131), Kalyanasundaram Committee (1988, p.97) are also of the same view that government should pass appropriate laws for introducing factoring services. However, there is also another viewpoint that it may take a long time to enact a full-fledged legal framework in a country like Bangladesh. Therefore, let the operation start within the given legal framework with some amendments. Sengupta et al (1991, p.53) support the latter viewpoint for India.

1.3. In Bangladesh, under present situation, factoring activities like other normal modes of financing, can operate within the provisions of existing laws scattered over a number of Acts, chiefly the following:

- **Transfer of Property Act.**
- Negotiable Instruments Act.
- Public Demand Recovery Act.
- The Money Loan Court Act.
- Bankruptcy Act.
- The Financial Institutions Act.

In the above background, the most important legal issues relating to factoring, which need immediate consideration are:

2.1. **Assignment of Debts**

The factor must necessarily take an assignment of the book debts of the client in order to collect the debts in its own right. The existing provisions of the ‘Transfer of Property Act’ are quite adequate insofar as they require that an assignment is to be made by an instrument in writing. But according to these provisions, notice to debtor is not necessary to complete assignments. It means the debtor is fully protected in law by making payment direct to the client in place of the factor, which can vitiate the entire...
POLICY ISSUES RELEVANT TO INTRODUCTION OF FACTORING SERVICES IN BANGLADESH.

process of assignment. In this context, ‘Transfer of Property Act’ may be suitably amended by making notice of assignment to the debtor compulsory. Alternatively, under the present situation, there should be a pre-condition to send a notice of assignment to the debtors by the client or factor for any pre-payment made to the client.

2.2. Priority of Assignment

As discussed earlier, notice of assignment to the debtors is not required under the ‘Transfer of Property Act’ to make a valid assignment. But problem arises regarding knowledge about the assignment of debts both for the debtors and the subsequent assignees. The general rule based on the case of ‘Dearle vs Hall’ (1827) is as follows: as between two assignees, the first to give notice to the debtors has the prior right provided that he is not aware of an earlier assignment at the time of the assignment to him (See, Sengupta et.al. 1991, p. 64). In order to remove the confusion and the probable risk of double financing in future, Pandey (1994,p.49), Kalyanasundaram Committee (1988, p. 103), Sengupta et.al. (1991, p. 65) suggest to devise a system of filing the notice of agreement between the factor and his client in a ‘central register’ to be maintained by an appropriate statutory authority. The suggestion is akin to the ‘Uniform Commercial Code’ (UCC) in USA, where any document denoting public interest must be registered.

2.3. Prompt Payment Act

The large buyers are delaying payments in Bangladesh either deliberately or because of cash-flow problems. The edifice of factoring may be shaken if the situation continues to be the same. Legal penalties should be provided for delays beyond a specified period. Suppliers should be entitled to receive interest at the commercial rate for a delayed payment. For these, a ‘Prompt Payment Act’ should be enacted. Singh (1988,p.26) notes that like the United States and the United Kingdom, we do not have a
POLICY ISSUES RELEVANT TO INTRODUCTION OF FACTORING SERVICES IN BANGLADESH

‘Prompt Payment Act’ to provide legal backing to prompt payments and to speed up collection. This Act has been enacted in the U.K. and Ireland very recently to change the payment culture.

2.4. Ban on Assignment

A contract for the sale of goods or services can stipulate that the debts arising out of the sales cannot be assigned by the seller. Hence, large industrial houses and public sector units may restrict the rights of transfer even to a factor. The famous ‘Helstan Case’ in the U.K. (Helstan Securities Ltd. vs. Hartfordshire—County Council – 1978, 3 AER 262) is an often cited case in this regard (Salinger 1984, p.131). In this case, the contract between a contractor and a local authority for providing certain services – contained an explicit clause under which the contractor is precluded from assigning his rights to a third party. However, the contractor assigned the debts to a finance company and eventually the matter went to court and the court declared the assignment as invalid. To avoid this situation in Bangladesh, it is suggested that Sale of Goods Act may be amended so that any such stipulation in the contract shall be of no effect. Article 9 of the Uniform Commercial Code in the USA does incorporate such provision (Kalyanasundaram Committee 1988, p. 103).

1. Prompt Payment of Accounts Act 1997 came into operation in January 1998 in Ireland. In general terms, the Act obliges purchasers who obtain goods or services from a supplier on credit to pay for them by the due date for payment. Where a purchaser fails to do this, an interest penalty is imposed on the outstanding debt (Horan 1999, p.89).

1. A significant step to change the payment culture has been made in the UK in the form of ‘The Late Payment of Commercial Debts (interest) Act 1998’. This Act enables to charge 8 per cent over base rate on overdue invoices (Higley 1999, p.141).
2.5 Stamp Duty

The 'master factoring agreement' is an instrument for transfer of receivables (property) and is covered under the 'Stamp Act' for the payment of duty. For making factoring popular, the factor should be exempted from stamp duty. Kalyanasundaram Committee (1988, p. 101) notes that in countries where factoring has taken roots, assignments do not attract stamp duty and, where it does, exemptions have been granted for cases where the value of the transaction is not very large. In the UK, stamp duty has been exempted for transactions where the debt is not more than £10,000. So, complete or partial exemption in terms of specified amount of sales from specified sectors may be granted. In addition, according to the other school of thought, if the basic legal relationship between the client and factor is changed to the 'debtor' and 'creditor' from that of the 'assignor' and 'assignee', the stamp duty can be avoided (Sengupta et al. 1991, p. 57).

2.6 Legal Support for Realization of Debts through Court Action

The factors may be compelled to resort to courts for recovery of assigned debts, if debts are not paid in time. It is, therefore, necessary to give some legal support for quicker recovery of factored debts. Vontor (1999, p. 60) claims that court recovery of debt is quite problematic because the legal system works very slowly and in many cases it favours the debtors and not the creditors.

2.7 Invoices and Factoring Agreements

Legal framework should be provided by suitable legislation whereby the invoices, involved in factoring transactions should be treated at par with bills of exchange for initiating legal proceedings, if needed. In addition, factoring agreement as evidence should be accepted as such in the court in case of defaulting client. Ataman (1999, p. 136) notes that factoring companies face legal problems in the case of defaulting...
clients, for example, non-admittance of the factoring agreement by the courts as legally acceptable evidence.

2.8. Capital Adequacy, Deposits, and Monitoring

Factoring is a specialised financial service. Sound financial position and high credit standing are incumbent for a factoring organisation to succeed. Recent collapse of 'London and Provincial (L & P) Factors Ltd. has loudly pronounced these requirements as extremely urgent. According to Green (1993, p. 44), insolvency among factoring companies is so rare that people assume it can not happen. L and P’s collapse is a shock for its clients, possibly a fatal one for some of them. There is, therefore, a need to regulate the entry of organisations into factoring in terms of capital adequacy, extent of raising public deposits, monitoring of their operations, meaningful supervision, etc. Bangladesh Bank would be the appropriate authority for this purpose. In Turkey, recent regulatory changes have led to an increase in the capital requirement needed to establish a factoring company and a minimum capital base/ requirement to establish a branch. The financial limits in both these cases are approximately US $ 2m (Ataman 1999, p. 134).

3. An efficient legal environment is required for introducing and sustaining factoring services on a viable basis. It is urged that Government of Bangladesh initiates suitable steps to permit the starting of factoring by simultaneously granting appropriate exemptions from and making some relevant amendments to the existing laws. But expeditious steps are also suggested in order to promote and put in place an independent legal framework for factoring operations to be successful.
POLICY ISSUES RELEVANT TO INTRODUCTION OF FACTORING SERVICES IN BANGLADESH.

4. Services to be Provided by Factoring Organizations on the Basis of Priority

1. When a business concern becomes the client of a factor, it eliminates the credit, collection, and bookkeeping expenses and is protected against bad debt losses. In addition, it instantly converts its non-productive accounts receivable to cash. There are different kinds of factoring services prevailing in the world. To know which services are most suitable in the context of practical financial and industrial scenario of Bangladesh, a three degree scale was placed in questionnaire viz. immediately, marginally, and not required, respectively, for each type of factoring service. The responses received have been assessed in Table 8.2, and the following inferences have been drawn.

2. Credit Service:

2.1 Under this service, credit control and credit loss protection\(^1\) are provided by the factor, which relieves the clients of their credit loss. Nearly 51 per cent respondents favour credit service marginally while 37.84 per cent urge the starting of this service immediately and 10.81 per cent feel no requirement for this service. Out of them, executives of the chambers of commerce unanimously (4 out of 4) support introducing this service immediately whereas 60 per cent of the academicians consider it as an immediate required service. Manufacturers are also enthusiastic regarding this service as 63.33 per cent of them favour this service as marginally required one. But bank and finance executives are somewhat cautious here, as only 20 per cent of them want immediate introduction while 52 per cent express marginally

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\(^{1}\) Factor is able to advise its clients on whether to extend credit to a buyer or not, and if is to be extended, the amounts of credit which could be extended, as also the period therefor. Credit protection provided by factors involves its undertaking to purchase, without recourse, to the client (Supplier), every debt of approved customers (within the stipulated credit limit) which arises from the sale of goods (Kalayanasundaram Committee 1988, p. 17).
## TABLE 8.2

**Services to be Provided by Factoring Organisations on the Basis of Priority**

<table>
<thead>
<tr>
<th>Sl. No</th>
<th>Particulars</th>
<th>Bank and Finance Executives</th>
<th>Manufacturers Executives of Chambers of Commerce</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>Credit service (credit control and protection of credit loss).</td>
<td>I</td>
<td>2</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td></td>
<td>M</td>
<td>3</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td></td>
<td>N</td>
<td>2</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>Book -keeping service</td>
<td>I</td>
<td>1</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td></td>
<td>M</td>
<td>2</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>N</td>
<td>3</td>
<td>2</td>
<td>8</td>
</tr>
<tr>
<td>3</td>
<td>Collection service</td>
<td>I</td>
<td>2</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>M</td>
<td>1</td>
<td>8</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>N</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>4</td>
<td>Financing service (Finance against book debts)</td>
<td>I</td>
<td>3</td>
<td>4</td>
<td>7</td>
</tr>
<tr>
<td></td>
<td></td>
<td>M</td>
<td>3</td>
<td>3</td>
<td>12</td>
</tr>
<tr>
<td></td>
<td></td>
<td>N</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Advisory service</td>
<td>I</td>
<td>1</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td></td>
<td>M</td>
<td>1</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td></td>
<td>N</td>
<td>2</td>
<td>5</td>
<td>3</td>
</tr>
</tbody>
</table>

Here,  **I** = Immediately.
       **M** = Marginally.
       **N** = No Need.

**Source:** Questionnaire Responses.
needed and 28 per cent of them do not see any requirement of this service. It means that receivers of factoring services, executives of chambers, and academicians suggest introducing this service along with other factoring services whereas expected providers have some reservation regarding this, as in their view, credit service remains a distant prospect.

2.2. Credit service is quite popular in the countries with mature factoring service. For example, in USA, U.K., Germany, Italy, France, Singapore, this service is well provided and accepted. Some countries like Slovakia, Norway, where services are newly introduced offer ‘credit protection service’ because factoring companies find the producing companies financially weak and not worthy of recourse as client. The Japanese have been historically providing mainly finance but, due to severe recession, are now reducing their reliance on client for recourse and engage into credit protection service also. On the other hand, most of the rookie countries like India, Sri Lanka, Ireland, Portugal, Poland have not started providing credit protection services till now.

2.3. In Bangladesh, ‘credit protection service’ should not be offered at the beginning of factoring service in spite of its good demand. Credit service is provided on the basis of availability of domestic credit insurance facilities or on the basis of very widely spread factoring risks on large number of debtors or both. In Bangladesh, neither domestic credit insurance coverage nor well-equipped system (credit analysis agencies and credit libraries for information) is available to measure the factoring risk. Nielson, former chairman of FCI, who was the most experienced factoring executive with almost 40 years reputation behind him, emphasized this aspect and mentioned that we must have a very large number of debtors, very thorough computerized record of each debtor, historical experience record, on our books, to whom we can charge risk premia while introducing ‘credit protection service’ (Deolalkar et al. 1994, p.3). But Singh (1988, p.27) envisages that without ‘credit service’, factoring service is not likely to sell well as factoring could fall back on the client company if a particular book debt has not been paid by the buyer company.
3. **Book keeping Services:**

3.1. Accounts receivable ledgers and book-keeping services functions can be performed by a factoring organization far more efficiently and expeditiously than the average business concern can perform them. Respondents are not generally eager to introduce this service. Majority of our respondents (64.86 per cent) feel that there is no requirement for book keeping service to be provided by the factors to its clients while remaining 27.03 per cent and 8.11 per cent consider this service is ‘marginally’ and ‘immediately’ required, respectively. Of them, 60 per cent of the manufacturers, 75 per cent (3 out of 4) of the executives of chambers of commerce do not see any requirement for this service. Interestingly, 76 per cent of bank and finance executives are also of view that they do not feel any demand for this service. However, 46.67 per cent academicians feel the requirement of this service marginally. It is, therefore, revealed from the analysis that most of the executives interviewed give indications that there is no requirement to introduce book keeping service immediately.

3.2. Book-keeping service is an important area of service of a factoring company all over the world. Due to full computerization, large-scale operations and specialization in the maintenance of accounts receivable ledgers and book-keeping, factors offer this service efficiently. This service is offered from the initial stage. It is quite popular among small and medium size enterprises in most parts of the world.

3.3. In Bangladesh, factoring company, as usual, should offer this service from the very beginning of its launching, although respondents do not feel requirement for this. It is true that initially the involvement of factoring company will not be welcomed in the intimate part of the client’s operations. But eventually, efficiency in offering book-keeping service, maintenance of secrecy, and attractive proposition from cost point of view would make this service popular to industrial sectors particularly SSI and MSI.

4. **Collection Service:**
4.1. Delayed payments are the problem. Most of the respondents urge to introduce ‘collection service’ ‘immediately’ as 64.86 per cent executives consider it as an immediately required service whereas 29.73 per cent feel ‘marginally’ for this service and the remaining 5.41 percent do not see any requirement for this service. Amongst these, 75 per cent (3 out of 4) executives of chambers of commerce, 73.33 per cent academicians, and 66.67 per cent manufacturers feel that the ‘collection service’ is very important for the industrial sector and advocate for immediate implementation of the service. 56.00 per cent of the bank and finance executives are also of the view that ‘collection service’ should be started immediately whereas 40.00 per cent of them feel marginally to start this service. It is, therefore, seen that the ‘collection service’ is a very important service in the present scenario of our industrial and financial sector that is why 64.86 per cent respondents advocate for the immediate introduction of this service. ‘Collection service’ is almost compulsory task of a factoring company. In many countries, factors provide only credit and collection services whereas banks arrange for finance. Nordsiek (1999, p.74) views that the debt collection function of factors is becoming more important for all types of companies. At the end of 1997, turnover of collection service was about US $10,274 millions i.e. 5.79 per cent of the total domestic factoring turnover. But in Hong Kong, the situation is somewhat different. Siu (1999, p.210) mentions that the other challenge facing the factoring industry is that industrial companies do not like factors to collect direct from their customers. Companies are reluctant to let their customers know that they sell their book debts to a third party. There is a concern that customers will see this as an indication of financial weakness.

4.2. In Bangladesh, this service has a vast potential demand. So, factoring company must offer collection services from the very beginning through its fully automatic computer system, if factoring is introduced. There are larger companies and Government agencies, which do not pay promptly, and there are smaller companies, which get sick in many cases largely for the reason that they are not able to collect cash for their credit sales within reasonable period of time. There are also some industries such as jute, tea, leather, etc. where the market is down and they have serious problems of collecting receivables. They will be benefited from the service.
POLICY ISSUES RELEVANT TO INTRODUCTION OF FACTORING SERVICES IN BANGLADESH

5. Financing Service:

5.1. Scarcity of finance continues to hinder economic growth. Almost all respondents are unanimously keen towards the introduction of financing service, as an immediate required one, whereas only 9.46 per cent respondents consider this marginally. Of them, 100 per cent of manufactures and executives of chambers of commerce urge to introduce financing service immediately. It means severity of finance problem is there to a great extent. We have also seen this earlier in Tables 6.2 and 6.4(d). Apart from these, 88 per cent bank and finance executives and 73.33 per cent academicians are also of view that this service should be started immediately and the remaining small percentage i.e. 12 per cent bank and finance executives and 26.67 per cent academicians feel marginally for this service. It is, therefore, revealed that manufacturers prefer financing service by factors for easing cash flow problem and getting free from tons of restrictions and other problems associated with the existing methods of finance.

5.2. Financing service is regarded as the main product of a factoring company all over the world. The financial crisis of mid-nineties in South East Asia has further enhanced the need for this service as weakness of the banking sector has resulted in an acute shortage of cash flow funding. Becher (1999, p.63) considers that prompt financing for dynamic, and healthy business enterprises is the main reason for Danish companies to consider factoring.

5.3. Analysis points that the financing service should be started immediately in Bangladesh. Currently many problems that are perceived to hinder flow of finance from the existing sources have resulted in industrial sickness. The problem is more acute in case of medium and small enterprises, which is expected to be eased by provision of the service of the factoring company.

6. Advisory Services:

6.1. Factoring organizations have special skills and experiences in offering advisory services. Nearly 59
per cent of our sampled executives favour 'advisory services' marginally for solving the production, marketing, personnel and sales problems which clients may encounter, while remaining 10.8 per cent support immediate introduction of 'advisory service' as a core business of factoring organizations. On the other hand, nearly 29.73 per cent of the respondents do not see any requirement for this service. Amongst them, handsome percentages of manufacturers (66.67 per cent) and executives of chambers of commerce (3 out of 4) feel for introduction of this service marginally. But, interestingly, bank and finance executives are not so enthusiastic as 40.00 per cent of them do not see any requirement for this service.

6.2. Factoring is an ever-present source of guidance in most of the countries for its clients through fee-based technical and consultancy service. Lee (see, Deolalkar and Joshi 1994, p. 4) representative of DBS Factors Private Limited, Singapore, mentions that they are maintaining detailed record of customers numbering around 7000 and on inquiry from others, the company is in a position to give a detailed consultancy report of customers within no time. They have created clear divisions for handling credit, accounting (operations) and consultancy. Moreover, for the Euro-based factor, the dual currency period (to middle of 2002) is likely to create administrative problems and process changes, which often lead to human error. In this regard, Lee (1999, p. 21) suggests that the factor should prepare itself to extend fee-based consultancy service for removing the associated risks consequent upon the introduction of this new currency (Euro) for their clients and debtors who may not be able to cope with the required systemic changes.

6.3. In Bangladesh, the entrepreneurs may not have adequate knowledge, time and resources to study procedures, learn about incentives or familiarize themselves with laws, culture, sources to seek assistance and sources of finance. So fee-based technical and consultancy services can provide much needed relief to them. Rahman (1995, p. 74) views that consultancy, particularly for meeting the special needs of new potential small and medium entrepreneurs, has not yet been developed in Bangladesh. The available consultancy services are still costly and beyond the reach of small and medium entrepreneurs in
Bangladesh. Factoring can fill up this essential gap by initiating ‘advisory services’ right from its early stage, though demand for these services is not foreseen so high by the respondents.

7. In summing up of the above analysis, it is found that financing and collection services have been accorded the highest importance and these are required to be implemented immediately, if factoring is to be launched in Bangladesh. At the same time, factoring organization may come out with book-keeping and advisory services, if market responds well. But credit protection service should be avoided at least for the initial period. Depending upon the market response and results achieved, after a few years, other financial services can be introduced.

5. Organizational Structure

1. Factoring is a new service in the Bangladeshi market. So, much will depend on how the factoring services are to be launched. The launching should provide full scopes for new ideas and new practices. Looking at the Bangladeshi realities, four approaches, which could be envisaged, were included in the questionnaire designed to assess respondents’ views regarding the organizational structure for launching factoring services. Views on these proposed approaches expressed by the executives are presented in Table 8.3.

**Conventional Approach**

The conventional approach means that it has the back up of large banking institutions. Under it, the existing banks, or groups of banks, financial institutions or a consortium are expected to promote new departments, or subsidiaries for offering factoring services. The factoring services would be treated as an extension of traditional banking. In the U.K., subsidiaries of banks or departments of banks are handling the factoring business. In the USA too, with some exceptions, factoring services are being provided by commercial banks or organisations backed by banks. In Asia, bank and financial institutions are the major promoters of maximum factoring companies. Factoring services have been launched in Singapore,
## TABLE 8.3

### Best Possible Agency to Offer Factoring Services in Bangladesh

<table>
<thead>
<tr>
<th>Sl No</th>
<th>Particulars</th>
<th>Bank &amp; Finance Executives</th>
<th>Manufacturers</th>
<th>Lawyers</th>
<th>Executives of Chambers of Commerce</th>
<th>Academicians</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>BB N=3</td>
<td>NCBs N=4</td>
<td>PCBs N=4</td>
<td>FCBs N=4</td>
<td>NBFIs N=4</td>
<td>Total N=25</td>
</tr>
<tr>
<td>1</td>
<td>Conventional Approach</td>
<td>-</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td></td>
<td>8</td>
</tr>
<tr>
<td></td>
<td>Factoring division of banks/NBFIs.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Subsidiary of banks/NBFIs.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>Market approach</td>
<td>-</td>
<td>1</td>
<td>6</td>
<td>1</td>
<td></td>
<td>8</td>
</tr>
<tr>
<td>3</td>
<td>Combination of conventional approach and market approach</td>
<td>3</td>
<td>-</td>
<td>1</td>
<td>-</td>
<td></td>
<td>5</td>
</tr>
<tr>
<td>4</td>
<td>Joint venture between banks and business houses.</td>
<td>-</td>
<td>3</td>
<td>2</td>
<td>3</td>
<td></td>
<td>10</td>
</tr>
</tbody>
</table>

Source: Questionnaire Responses.
Malaysia, Thailand, Japan, Korea, Hong Kong either by a subsidiary of bank or by financial institution, or by both of them. In China, the Bank of China and the Bank of Communication are offering these services. In India, these services have been launched under the subsidiary of parent banks. In Sri Lanka, 'central bank' has granted approval to three leasing companies and one merchant bank to commence factoring transactions.

A factoring organization backed by banking institutions will have higher credibility and sufficient financial strength for meeting all eligible and genuine business requirements. They also have expertise available in financing and collection of receivable, large net-work of branches, and easy access to credit information on both sellers and buyers. This type of organization can use the clout of the sponsoring banks in promptly recovering the receivables due from public sector and large-scale industries. Moreover, it would be helpful to pursue the social objectives by extending help to the small and medium scale industries on priority, which are found in difficulty.

As against this, additional weakness can creep into the banking sector of Bangladesh, if banking institutions back factoring. The conventional approach, as usual, may provide only a limited coverage with a modest rate of growth, high costs, low business volume and consequently low profits. According to Singh (1988, p.27) it would not only restrict the long-term potential of factoring but also close the door to an opportunity to develop a new and viable service in the economy.

2.1. Factoring Division of Banks and Non-bank Financial Institutions

Under this approach, banks and financial institutions would open new departments for handling factoring business as a core area. On the question whether factoring business should be taken up by banks and financial institutions departmentally, only a few respondents (16.45 per cent) express their positive response. Interestingly, only a few bank and finance executives (8 per cent) are of view that banks and financial institutions should launch factoring business. They mention that such an initiative will have...
impact of continuance of traditional work culture, absence of competition, and taking outside assistance rather than rely on the internal forces of the market mechanism itself. Kohnstamm (1999, p.6), chairman of FCI, mentions that when factoring is offered through a department or a division of a bank, actual business volumes achieved are often disappointing, even after several years of involvement.

2.2. Subsidiary of Banks or Non-Bank Financial Institutions

2.2.1. Banks and financial institutions can promote their subsidiaries for undertaking factoring business. They can float such an organization, singly or jointly with others. A very few respondents (5.06 per cent) are in favour of this approach for undertaking factoring services in Bangladesh. They are afraid of lack of co-ordination and poor supervision of shareholder banks as well as influence of parent banks in providing directions, dependence on parent bank, absence of business house representation, chance of extension of existing conservative banking culture to the subsidiary, limited coverage, and modest rate of growth.

2.2.2. In India, Reserve Bank of India (RBI) permitted State of Bank of India (SBI), and Canara Bank to start factoring services through their subsidiaries. Then SBI, in collaboration with Small Industries Development Bank of India (SIDBI), Union Bank of India (UBI), State Bank of Indore, set up on 26th February 1991, a new subsidiary styled “SBI Factors and Commercial Services Ltd.” In the same way, Canara Bank opened its subsidiary Canbank Factors Ltd. in 1991 in association with Corporation Bank and Andhra Bank.

2.2.3. This approach is somewhat suited for undertaking factoring services in Bangladesh. Because some particular benefits like financial support, full autonomy, large network of parent banks, available information, experience and counselling from parent banks, experienced executives, specialization in finance could be automatically available from this approach. But respondents’ responses are not encouraging for this approach. If this approach could be followed, some banks with good track record might possibly be permitted for launching factoring services jointly.
3. Market Approach

3.1. The market approach implies launching of factoring service in the private sector as an independent activity. It starts with demand orientation, and involves aggressive selling and achieving extensive coverage. As regards the market approach, only 17 per cent of the respondents view that factoring business can succeed only if it is treated at par with other commercial enterprises and, as such, should be left to the private sector. They indicate that competitive pressure would arise in this approach to achieve low cost, low margin, high volume, and high profits.

3.2. By contrast, factoring organizations in the private sector are likely to experience that they may not be able to raise sufficient resources at competitive costs for handling business of the expected magnitude. They may also suffer from the drawback of being at the mercy of big industrial organizations from which receivables are to be collected. It could lead to excessive competition, which may possibly turn unhealthy through too many factors chasing the limited available business. Because of that, hardly any successful history is associated with this approach. In USA, there were a large number of small operators in the market but many among them did not succeed in their venture. They were either taken over by banks or merged with factoring organization set up by the banks (Kalyanasundaram Committee 1988, p.43). In Brazil, there are 726 affiliated companies, which are small undertakings and can not be considered as suitable operators (Souza 1999, p.160).

3.3. Moreover, in Bangladesh, factoring organization run by private entrepreneurs exclusively on profit consideration may not be able to meet the varied requirements of the units from the ‘medium scale industrial (MSI)’ and ‘small scale industrial (SSI)’ sectors, which particularly need these services.

4. Combination of Conventional Approach and Market Approach

272
4.1 Under this approach, private sector factoring companies supported by big business houses and also factoring organization promoted by single bank or pool of banks and financial institutions could exist in the market. Only a few respondents i.e. 14 per cent are of the view that both could co-exist in a spirit of healthy rivalry and compete with each other in extending services to clients and bringing down the cost of factoring services.

4.2 This approach exists in Italy, Turkey and Mexico. In Italy, this is going on well, and they are maintaining growth rate at double-digit i.e. 15 per cent. But in Turkey and Mexico, this concept is stuck. Ataman (1999, p.136) complains that factoring companies backed by industry houses suffer from an environment of unfair competition coming from bank sponsored factoring organizations, and restricted funding and selling facilities. He also adds that such companies do not have access to central bank records in order to check the payment capacity of client companies. In Mexico, there was an orderly exit of factoring companies, in the last five years, the number of factoring companies fell from 67 to 27. Some companies were merged with the factoring companies backed by banks.

4.3 In Bangladesh, this approach would not succeed. A factoring organization sponsored by banks will have higher credibility, enough resources, considerable experiences in financing and collection of receivables, easy access to credit information and large net-work of branches. So, in front of these facilities, it is tough for factoring companies supported by business houses to compete with factoring companies backed by banks. Even if this approach is accepted, like other countries, eventually organizations backed by business houses would either be merged with organizations backed by banks or they would quit the market. Moreover, social aspects could be overlooked by the factoring organization backed by only business houses.

5. Joint Venture

5.1 Joint venture would be promoted by a few leading commercial banks in association with one or more
POLICY ISSUES RELEVANT TO INTRODUCTION OF FACTORING SERVICES IN BANGLADESH.

business houses. Under it, a group of banks, financial institutions and business houses will promote a separate financial institution with separate entity and will offer factoring services. In this association, only a selected few financial institutions, business houses group/individuals with good track record in financial services and business activities coupled with competent management could be permitted to enter this new field.

5.2. Regarding this, nearly 47 per cent of the respondents, maximum out of four alternatives, suggest that factoring business can succeed only if it is launched under 'joint venture between banks and business houses'. Among them, 80 per cent (4 out of 5) lawyers, 75 percent (3 out of 4) chambers of commerce's executives and nearly 53 per cent of the manufacturers favour this concept. According to them, such organization would enjoy availability of sufficient financial resources, easy access to credit information on both sellers and buyers, central bank's help to verify the payment capacity of customers, advantage of the large network of the promoters' branches and sources of business, etc. Besides, because of recognition as financial institution, it would be possible to ensure close relationship between the bankers and the factors.

5.3. On the other hand, because of participation of the business house, this type of organisation will ensure the necessary experiences and skills through recruitment of executives from the parent banks and personnel or professionals from the open market to handle various types of factoring services. Moreover, they may have an innovative approach in various areas and it could be ensured through competition that they are able to run with maximum efficiency. At the same time, the central bank can ensure the social needs for SSI sector and MSI sector, not totally sacrificing the interest of factor, through this type of services are undoubtedly financial institutions.

1. In June 1963, James Saxon, then comptroller of the currency, issued a ruling that factoring was a legitimate bank activity (Shay and Greer 1968, p. 152). Therefore, organizations that offer factoring services are undoubtedly financial institutions.

274
organization. So, their expectation is that factoring will gain wider acceptance as a highly efficient financial service in all spheres of commerce and industry through this approach.

5.4. In Singapore, factoring was started under this approach. During mid 1970s, Heller Group in a joint venture with OCBC bank and DBS bank launched a factoring company. Later on, in 1984 (after 14 years), the Government lent support to factoring and the result was that the big four local banks, for example, DBS Bank, Overseas Union Bank, United Overseas Bank, and OCBC Bank, started factoring business through their own subsidiaries.

5.5. The Bangladesh situation, which is characterized by inadequate mobilization of savings, misallocation of credits, wide-spread loan defaults and delinquencies, and inefficient credit delivery, is somewhat ripe for adopting the approach of ‘joint venture between banks and business houses.’ This approach will start with available financial resources, required experiences and skills, sufficient networks and information channels with emphasis on market orientation, low cost, high volume, high profit, extensive coverage, demand orientation, and selling financial services through new culture, new manpower dominated largely by youth full of aggressive selling attitude. Moreover, for having the membership of Factors Chain International (FCI), Netherlands, especially to enter the arena of ‘international factoring’, this type of organization would not face any problem, because of the backing of banks and financial institutions. In forming joint venture, it is desirable to consider only a few leading banks and business houses, with good track record. In this connection, BASIC and BSCIC could be considered positively as they have considerable expertise in financing and managing of SSI sector and MSI sector.

6. CONCLUSION

Careful launching of factoring companies is very important. As already mentioned, ‘joint ventures
between banks and business houses’ are most suited for launching factoring business in Bangladesh. After taking this view, it is utmost important to determine the number and phases of launching factoring organizations. Here experiences of Singapore could be used. Like in Singapore, it would be desirable to have a few factoring companies, say a maximum of three or four, to begin with, to avoid excessive competition in the initial stages. Besides, the number of branches should also be restricted and permitted on felt need basis. At least in the early a few years, such a strategy should be followed, as it is very important that the new institutions set good standards and build a good reputation to inspire confidence in the public. After some years, as to whether the organization may be allowed to compete with the then existing ones, is a matter that would be decided on the basis of experience gained. But launching of factoring service will be worthwhile, irrespective of approaches, only after having a culture of high level of specialization, skills, technology, deregulation, price competition, low margin, very high volumes, full freedom at branch level, extensive coverage, and good profit.

7. COMPARISON WITH OTHER STUDIES

Singh (1988, p.27) favours the market approach. He mentions that the Indian situation is ripe for adopting the market approach to launching the factoring service because public sector banking is not oriented towards cost reduction, and the conventional approach will be expensive in the long run. Shenai (1988, p.65) suggests that a combination of conventional approach and market approach would be a suitable alternative for a country like India which has a mixed economy. Kalyanasundaram Committee (1988,p.43) considers that subsidiaries or associates of banks are ideally suited for undertaking factoring organization and such organizations may be promoted either individually by the leading public sector banks or jointly by a few among them.
6. Appropriate Sectors for Factoring Services

1. Factoring is required to make available to all industries and all sectors in Bangladesh (see, chapters VI and VII). To know which sectors should be targeted on priority basis for factoring, views of the respondents are presented in Table 8.4.

2. Small Scale Industrial (SSI) Sector

2.1. SSI sector has been assigned an important role in the economic development of a developing country like Bangladesh in terms of massive employment and moderate output with lower investments. In spite of its economic importance, the sector faces liquidity problems because of mainly (i) delayed payment; (ii) reluctance of banks to extend credits against receivables; and (iii) lack of its expertise in the credit management. Factoring assists SSI units in the above areas. It is, thus, quite popular among small size enterprises all over the world. In the U.K., members of the Factors and Discounters Association (FDA) provided £ 5.4 billion with a growth rate of 14 per cent to small and medium enterprises (SMEs) at the end of 1999 (Smith 2000, p. 36).

2.2. Regarding this, nearly 75 per cent of the respondents (Table 8.4) view that many small-scale industries are looking forward to the availability of factoring services. Of them, 100 per cent (4 out of 4) of executives of chambers of commerce and nearly 82 per cent of the manufacturers are keen towards the factoring services for the sector. Manufacturers mention that SSI units have been facing the working capital problems. They do not have expertise in the area of credit management for following up recovery of dues from debtors. Moreover, they are handicapped in their timely and correct decision making.

1. Small industry will mean enterprises employing fewer than 50 workers excluding the cottage units and/or with a fixed capital investment of less than TK 100 million (Industrial Policy 1999, Bangladesh, p.6).
<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Particulars</th>
<th>Bank and Finance Executives</th>
<th>Manufacturer s (including exporters)</th>
<th>Executives of Chambers of Commerce</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>
<td>NBFIs</td>
</tr>
<tr>
<td>1.</td>
<td>Small scale industrial sector</td>
<td>2</td>
<td>1</td>
<td>7</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>2.</td>
<td>Medium scale industrial sector</td>
<td>3</td>
<td>2</td>
<td>6</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>3.</td>
<td>Large scale industrial sector</td>
<td>1</td>
<td>2</td>
<td>6</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>4.</td>
<td>Export Sector</td>
<td>3</td>
<td>2</td>
<td>4</td>
<td>1</td>
<td>3</td>
</tr>
</tbody>
</table>

Source: Questionnaire Responses.
because of lack of expertise and absence of a good information system. They are hopeful that the factors would be in a position to assist SSI units in the above areas. Bank and finance executives (64 per cent) and academicians (66.67 per cent) also suggest the same. Bank and Finance executives mention that they have their own constraints like inadequate information about entrepreneurs of SMEs, limited time, lack of trust, and absence of legal support in financing against book-debts to the SSI sector.

2.3. The economic significance of SSI sector in Bangladesh is well rehearsed in the research works done on the subject in Bangladesh. However, the long and short of the story is that financing remains a perennial problem facing the SSI sector in Bangladesh (Ahmed 1999, p. 11; Rahman et al., 1997, p. 99; Cookson 1999, p. 7). A recent study (Bangladesh Unnayan Parishad, 1998) of a sample of 47 enterprises selected from different parts of Bangladesh reinforces the above observation that restricted access to institutional credit works, as the most binding constraint to the development of small industries in Bangladesh. Factors with their systematic, specialised and professional facilities can assist SSI units in the above areas. On the other hand, factors could be assured of readily available substantial business from the SSI sector. Factors should, therefore, make every effort to capture this potential demand.

2.4. Senaratne (1999, p. 227) mentions that factoring is popular, mainly among small and medium size enterprises in Sri Lanka. About 70 per cent of the clients are proprietorship and partnership concerns. Ahmed (1999, p. 7) views that there is no problem in taking receivables as security for small and medium enterprises. These are more potential than land and building in Bangladesh. However, the banks can not take them as security under the present law. May be it can be legalized for small and medium industries. Kalyanasundaram Committee (1988, p. 58) notes that the factors would be in a position to assist SSI units.

3. Medium Scale Industrial (MSI) Sector

For the MSI sector, factoring is as vital as for the SSI sector. Table 8.4 shows that around 76 per cent of the respondents, slightly more respondents than for SSI sector, are in favour of factoring services for the sector. Of them, executives of chambers of commerce (4 out of 4), manufacturers (80 per cent) and academicians (80 per cent) are of the view that factoring should be made available for the sector. Sixty four per cent of the bank and finance executives also express the same view. In this regard, manufacturers, and bank and finance executives mention the same reasons for MSI sector as for the SSI sector. They are hopeful that factors would be in position to assist the MSI sector.

4. Large Scale Industrial (LSI) Sector

4.1. Factoring has been marketed as a tool that has not been accorded much attention by the large-scale industrial sector. However, factoring companies have, now, begun to concentrate more on large sized companies. The large manufacturers are also increasing their focus to improve their liquidity through factoring services.

4.2. Nearly 54 per cent of the respondents advocate that equal attention should also require to be paid for the LSI sector. Academicians (67 per cent) and manufacturers (55.55 per cent) emphatically suggest

1. Medium industry will cover enterprises employing between 50 and 99 workers and / or with a fixed capital investment between TK 100 million and TK 300 million (Industrial Policy 1999, Bangladesh, p.6).

2. Large industry is defined to include all industrial enterprises employing 100 or more workers and / or having capital of over TK 300 million (Industrial Policy 1999, Bangladesh, p.6).
factoring for the LSI sector. Academicians argue that because factoring is an ‘off balance sheet’ procedure and it does not increase debts and dilute ownership equity, it must be welcomed by the large-scale industrial sector. Manufacturers mention that besides maintaining their liquidity, they expect the factoring service for keeping financial stability of their suppliers those who belong to small and medium industrial sectors. However, bank and finance executives (48 per cent) and executives of chambers of commerce (1 out of 4) are not very enthusiastic regarding the factoring service for the LSI sector.

4.3. In Bangladesh, the failure of the lending mechanism, the weakness and immaturity of the equity market to supply funds and lack of flow of foreign investment are all well organised. In the case of private banks, loanable funds may get channeled to their own business houses at favorable terms. The bankers prefer trade credit because of higher turnover rates whereas industrial lending may get least preference. Although some credit goes for creditworthy client yet the majority of the potential borrowers are likely to remain outside the scope of the bank finance. To ease the financing situation, the use of factoring should be launched for this sector as well.

4.4. Factoring in France, Turkey, Ireland, Chile and Mexico is widely spread across a large range and size of business. Ataman (1999, p. 134) mentions that factoring companies have shifted their attention away from small and medium sized firms and begun to concentrate more on medium and large sized companies. Valenzuela (1999, p. 178) identifies that factoring in the past was concentrated in medium and small sized companies. Currently, factoring has a broader scope, targeting large corporations with financial products that include more sophisticated structuring.

5. Export Sector

5.1 Exporters, particularly, small and medium sized firms, face the export-financing problem (see, chapter
VI). In this perspective, to the question whether export-oriented organisation should be targeted for factoring, nearly 60 per cent of the respondents express positive responses. Executives of chambers of commerce unanimously suggest introducing factoring services for both the exporters and importers. Academicians (60 per cent), manufacturers (60 per cent) and bank and finance executives (52 per cent) show favour for the service and mention that factoring will help the Bangladeshi industries to make greater in-roads in the overseas market and to achieve sounder base to operate in the home market.

5.2 Globally, more than fifty countries are exercising international factoring besides other traditional trade instruments. Moreover, some countries, namely, China, Iceland, and Romania have introduced only the international factoring. In Germany, many companies have started international factoring fast and the domestic factoring later.

6. Factoring services should be made available for all sectors of trade and industry. However, since delays in receiving payments affect small and medium industrial (SMI) sectors very acutely, it is suggested here to implement factoring services for these sectors immediately. In addition, majority of the potential large entrepreneurs remain outside the scope of required finance because of failure of the lending mechanism, weakness of equity market and low flow of foreign investment. To ease the financing difficulties, the use of factors should, also, be made available for the LSI sector. Apart from these, factoring should require to be launched for the export sector to make greater in-roads in the overseas market.

7. References


7. Cookson, F. E. (1999), (views expressed in a round table meeting on obstacles to Small and Medium Enterprise Development organised by The Daily Star), April 12.


