CHAPTER 1

INTRODUCTION
CHAPTER 1

INTRODUCTION

1. Introduction
2. Need for the study
3. Review of Literature
4. Statement of problem
5. Objectives of the study
6. Scope of the study
10. Research methodology
11. Research design
12. Concepts used in the study
CHAPTER-I

INTRODUCTION

Money provides the necessary lubrication for wheel of business and industry to move smoothly. A healthy cash flow is essential for meeting the commitments statutory or otherwise and to keep up production schedules. These days where most of the sales is based on credit, non can be sure of prompt payments. Irregular realization results in inadequate cash flow and all consequential problems. The working capital can even grind to halt. so one question that agitates every supplier is - Is there a way to ensure smooth cash flow? fortunately the answer is “FACTORING”.

Factoring is the out right purchase of credit approved accounts receivables, with the factor assuming bad debt losses. Factoring is a sales accounting service with important additional benefits of use of finance and protection against bad debts. Collection of debt particularly by the small and medium scale companies is a problematic area. The average collection period has been on the increase in recent times. As a result, the interest cost of financing book debts in India is more than double of what normally prevails in advanced countries. As a business proposition, increase in cost of capital reduces profit and competitiveness of company in the market. To avoid this situation company need factoring service.
Through factoring, the financial company or a bank buys the clients invoices on a continuous basis, pre-pay up to 80% of the value of the invoices immediately and perform the accounting function of the sales ledger maintenance and the collection/realization of invoice purchased. The factor makes payment to the company on the date agreed or at the end of collection period or the day of collecting the account, whichever is earlier. In certain cases the agreement may provide to the firm as advance against receivables colleted and not due for payment. The limit of advance is mutually agreed.

There is a substantial scope for factoring service in India. Factoring is a new concept facilitating ready cash from credit sales, it has been introduced for the 1st time in the country with the establishment of SBI factors and commercial services Ltd by the S B I, in 1991 along with SBIF, Can bank factors Ltd, Andra bank, SIDBI, Punjab National bank, Alahabad banks have been providing factoring services in the country.

NEED FOR THE STUDY:

The RBI study group in the year 1988. did the survey on the post sales financial facilities available in the banking system in our country and comes to conclusion that it would be great assistance to Indian industry and trade if factoring services are made available. It is obvious that new service which is recently introduced needs to be supported and nurtured.

Factoring as a product is well established and highly accepted throughout the world. It is a powerful instrument in financial service market to cater to the post sales working capital requirement of industrial trade and service sector. It will pay a very dominant and effective role in the financial sector of the country. Despite of gaining a lot of advantage, there are few issues, which become stumbling block for further growth of factoring business in India.
It is important to have bank sponsored factoring companies all over India unless the service is widely made available it will not be taken seriously by all concerned, as an effective alternative to post sales finance provided by banks. Absence of policy guidelines from banks to their field staff on how to handle request from their borrowers who wish to avail factoring facilities. At present factoring company have introduced only domestic recourse factoring. The legislative changes required to introduce non recourse factoring and international factoring.

Factoring being a fund based activity needs a dependable source of cost effective fund with the bank interest rates coming down it is all the more important that this aspect is given a serious thought, export factoring which is need of the hour, cannot be viable unless the funds are subsidised. It would be helpful if RBI could come out with policy guidelines on this aspect.

It is desirable that this nascent financial service, which can serve a very useful purpose in trade. Finance should stand on firm foundation and gain recognition of all concerned by their efficient & profitable operations.

In a nutshell, the majority of the factoring institutions in India are developing in rhythm of western countries. In order to make these institution regain their operational and financial health there is an urgent need of putting the service, production, marketing, finance, and other performance of the institution under the microscope to diagnose the exact causative factors and prescribe effective remedies. In this context the present study assumes a special significance.
REVIEW OF LITERATURE:

1: Shashank Bhusan Lall *

By keeping on view of new type of institutions and instruments in mobilizing and deploying resources, author has made a study into the areas of venture capital and factoring services which are established with the objective to help the small and Medium sector.

In this regard, he explained the major functions that are provided by the factor and the kinds of services available. He depicted the origin of factoring service in India, its legal status, scope, and cost of factoring. Further, he said that factoring has the potential of becoming an important mode of finance for small scale sector. He suggested that banks can take-up factoring by setting up of separate subsidiaries which work throughout the nation by wide bank network. He highlighted the major problems faced by financial institutions to find the factoring as very lucrative area. He further stated that factoring is not a single stage job but a long-term solution where the working capital cycle keeps operating. He finds that private companies may take-up factoring and be successfully.

*Journal: Indian Journal of Business Pacers June 1999
Volume - 2 No-3 Page- 123 to 130.
Title: Financial Services: Avenue open for small scale sector.
Designation: Lecturer in commerce Vanijya Mahavidyalaya, Patna.
2. G.S Bhatra and B.S. Bhatiya

In the books of Management of financial services the author has explained the, future and prospects of factoring services in India. He stressed on the liquidity problem, stating that liquidity problem is a major hindrance in the development of trade and industry and it is only the factoring service that solve the liquidity problem of industry. He suggested the measure of boosting the factoring service to establish specialised credit investigating agencies to see that only genuine business transaction are dealt with by factor.

3. V. Srikrishna

Author conducted a study on factoring in Hyderabad Region, and gratefully acknowledged the guidelines received by top officials of SBI Hyderabad circle, and has expressed the suggestion based on interaction with the small-scale industries and others during a study.

The study group has examined the scope of factoring, Types of factoring, Effect on profitability mechanics of operation, The possible side effect on the seller who uses the service and the buyer who pays; The structure of factoring industry and the role of commercial banks.

He stated that, many Indian producers are unable to sell their product without packaging them with credit. But credit is a scarce commodity for both seller and buyer. A factor equipped to provide his critical input buys the receivables from the seller at a small discount and waits for the buyers to pay him.

*1.Book: Management of financial services
Title: Factoring as a financial service., Page: No 286.
Designation: Department of Business Management Punjab University Patiyala

Title: Factoring. Page: No 392 to 402.
Designation: Credit Officer International Davison SBI central office Mumubi
4. **THE BANKER – JUNE 1990**

In this article the working capital problems of suppliers of goods and services are categorically stated, and factoring is mentioned as a measure of a solution of working capital problem.

It further explains the measure taken by the RBI examine the introduction of factoring services in India and appointment of study group in this regards and suggestions made by the study group.

It stressed more on introducing a legislation requirements to pay the interest for delays in payment for supplies made to them.

It highlighted the introduction of export factoring and its advantages, and the measures to attract the customer, to undergo the export factoring.

5. **M.N. GOIPORIA**

In his article titled 'factoring'- He has explained the attempt made by the RBI to develop the bill market in the country, and further explained the reason why the bill market scheme did not strike roots in India, and the hindrances of indifferent success of the bill market scheme.

He depicted the factoring as a relieving measure to the business particularly small industry and trade of the burden of collecting their dues from their trade debtors. He suggested the factoring institution to computerize its operations so that to generate enough data on the payments behaviour of large number of firms and companies in the country.

---

*1 Journal: The Banker June – 1990
Page: No 57to 59.

* 2 Journal: SBI Monthly May - 1990
Title: New Dimension in Banking, Factoring ., Page No; 218 to 219.
Designation : Chairman of SBI
CURT RENDALL ;*

6. Curt Rendall the chairman of ICAA'S National SME' Committee, deputy chairman of small business Development corporation of new south Wales.

In his Article titling -'A factor in their success' says small business has lot to gain from factoring- especially in terms of growth. He feels that in these days factoring is not much more expensive than a bank over draft, yet it gives its user the freedom to fund growth.

He described the factoring as a solution for many financial crises of small and medium sale organisation both in Australia and over seas.

He further explains that in Australia the rates charged were often more like those of the money lenders of the temple, and so it dropped out of main stream lending, ending up on the fringe, Generally it carried bad connotations it was often said that any one who was factoring was going broke.

He further explained the modern factoring a form of funding that no longer belongs on the fringes but needs to become main stream.

* Journal: Charter March-1999
Designation: Chairman of ICAA.
7. **K. K. BAJAJ*¹**

In his article, the steps taken by the RBI to introduce the factoring service in India have been systematically explained. Zone wise spread of factoring service and the prominent banks that are rendering factoring services in India have been clearly stated.

Meaning of factoring and its scope, mechanism, types, benefits of factoring, factoring position and its concentration on specific activity in USA, UK. have been stated clearly.

---

8. **L.M. BHOLE *²**

Under the title of "Factoring" the author has explained the meaning of trade receivables and the difficulty faced by the seller by the trade receivables. Highlighting the difficulty of slow payment, author has explained measure of the over coming from this difficulty. He further stated that factoring is one of the best measure that helps the seller resolved from the responsibility of collection dues, sales ledger management and inadequate Working capital further he stated the mechanism of factoring and the parties of arrangement.

---

*¹ Journal: The Banker June 1998
Page: 55 to 56
Title: Factoring service make a debut in India.

*² Title: Factoring, Author: L.M. Bhole
Author further throws the light on factoring services is abroad explaining this he said that factoring is an accepted and fairly well developed financial services in U.S.A, U.K and Europe and even South America. There it covers both national and international business in the U.S.A and U.K this service is made available mainly by banks through subsidiaries or specialised departments.

He expressed his desire to introduce the factoring service in India. He highlighted again the problems of lengthening of the trade credit period faced by the company. He also explained the measure taken by the RBI to alleviate this problem.

9. CRISPIN WOOD.*

Under the title of Factoring the Option the Author has made a sincere attempt to explain the condition of manufacturers and trades man who selling the goods/services on the basis of credit. At the same time he explained the buyer behaviour of delay in payments saying that these customer who were so quick to lift their order will not settle their bills with the same speed here also author highlighting the problem of delay in payments emphasized the introduction of the factoring services further he explained the detail the mechanism of factoring arrangement.

*1 Title: Factoring the Option.
Author: Crispin wood.
Journal: Charter October, 1994- Vol -65 No-9- Peg No- 14 to 16.
Crispin Wood strongly criticised the slow acceptance of factoring services in Australia by the small scale and medium scale business. He says that factoring is a sign of financial sophistication, a means of maximising the working capital rather than being symptomatic of business on its legs.

Highlighting the importance of factoring, he also explained one of the most common misconceptions, i.e., factoring is no small same as borrowing money. He further stated that in countries where factoring has been a long-established practice such as Germany, France, and the United States, the facilities are generally provided through a bank usually the same bank that the business uses for its other financing requirements.

The basic difficulties of Indian small/medium-scale industries in collection of receivables, working capital crises, liquidity problems also have been clearly explained. In his opinion, the interest cost of financing book debt in India is more than double of what normally prevails in advanced countries.

He has mentioned that there is a substantial scope for factoring services in India, and he substantiated with the estimated output of manufacturing of small/medium and large scale sector. He also included the various suggestions made by the RBI study group for examining induction of factoring services in India.
STATEMENT OF PROBLEM:

The researcher has always wondered at the miraculous growth of factoring institutions all over the world. Based on the recommendations of C. Kalyanasundaram committee RBI allowed the banks to float subsidiaries to undertake the factoring activities in India. Hence few banks were come front and started business. It is almost a decade has passed from the introduction of factoring services in India, but the entire service is still in veil, and no other institutions are showing much interest to start the independent factoring institutions. As per the report of factors chain international for the year 2003, there are 1003 independent factoring institutions all over the world out of which 6 belongs to Indians, i.e almost 0.59 % of the world total institutions. Being a 7th biggest country of the world India just having 6 companies and in Karnataka it is one and only the CBF is an independent factoring institution. Analysing the slow growth of factoring service in India it brings up back to the question whether factoring is necessary service in our country? and if the answer is yes, what should be done to make it more wide spread?

Factoring is a powerful financial instrument that assists the working capital of small scale and large-scale industries, why it has not been widely made available.

It was felt that the initial enthusiasm shown in starting factoring companies has not been sustained over a period of time.

Why the Indian factoring institutions are not been able to expand their service towards without recourse factoring and international factoring even though these services are highly demanded by the customer.
There is no specific legislation governing the activity of factoring in this country. The position regarding priority between successive assignments is not clear.

In a factoring where the buyer debtor is notified of the arrangement his obligation to the factor for making payment is also not well established. The position regarding stamp duty also has not been spelt out.

Quick disposal of recovery proceedings through the debt-recovery tribunal (DRT) is not available to factor as they are not covered by order 37th civil procedure code for the summary proceedings. In short the legal structure in which factoring company operates is considerably lazy.

It is also pertinent to note that few factoring companies in spite of working in unfavorable environment are developing new and innovative products suitable to different type of clients.

This exceptional phenomenon has kindled a curiosity in the minds of the researcher. A need was felt by him to undertake a dynamic analysis of the major functional area of the factoring institutions with a view to comprehend the factors behind their performance, hence the statement of a research problem is,

“Factoring service in Karnataka State; A Diagnostic study ”
OBJECTIVES OF THE STUDY:

The main objectives of the study are;

1) To study the growth of factoring service all over the world.

2) To study the growth of factoring service in India.

3) To study the growth of factoring service in Karnataka.

4) To analyse the trend in the return on investment (ROI)

5) To analyse the causative factor for the existing trend in the return on investment (ROI)

6) To analyse the operating profitability of the CBF Ltd.

7) To analyse operating cost and efficiency of CBF Ltd.

8) To offer suggestions for the better performance of the institute selected for the purchase of the study.

SCOPE OF THE STUDY:

The present study covers the workings of “CANBANK FACTORS LTD” in Karnataka State. It is a regional study with a micro focus on all major functional areas of the management of factoring services. For the purpose of examining the trend in ROI and throwing light on operating profitability and operating efficiency of CBF Ltd, from 1995-2003 period has been selected. Wherever the data of study period is not available previous data are also taken into consideration.
RESEARCH METHODOLOGY:

The present Study is primarily based on secondary data collected from the annual reports of the CBF Ltd. for the related years. Wherever necessary the required primary data have also been collected through personal interview with the officials of the CBF Ltd. The data thus collected have been properly classified and analysed with the help of the tools of managerial accounting like ratio analysis, trend analysis etc to make the present evaluation more meaningful. The important technique of the Financial analysis, is inter period, inter firm, over all performance analysis have been followed .The detailed procedure followed for evaluating the performance in a difference faces of management.

RESEARCH DESIGN:

The present study is Structured with the following chapters.

1: The introductory chapter presents bird eye view of the present study and it covers Need for the study, Review of literature, statement of problem Objectives, of the study scope of the study, Research Methodology, Research design, and the concepts used in the study.

2: The second chapter deals with brief history and growth of factoring services through out the world and growth In India as well as Karnataka.

3: The third chapter attempts to paint the background of development of factoring service in Karnataka focusing entirely on “CAN BANK FACTORS” Ltd.
4: The forth chapter provides the picture relating to the trend in Return on Investment of CBF Ltd under study period.

5: The fifth chapter aims at analysing the operating cost and efficiency of the CBF Ltd.

6: Sixth chapter highlights the operating cost and profitability.

7: The last chapter provides the useful suggestions for the efficient and effective operational management of the CBF Ltd under study in particular and of the Similar institution in the other parts of country in general.

9. CONCEPTS USED IN THE STUDY:

<table>
<thead>
<tr>
<th>Sr.No</th>
<th>Accounts Receivable</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Accounts Receivable</td>
<td>Accounts Receivable is an amount of indebtedness represented by an invoice not yet paid to the buyer.</td>
</tr>
<tr>
<td>2</td>
<td>Buyer</td>
<td>Buyer is the seller's customer. He is liable to pay the accounts receivables arising from the supply of goods or the provision of a service.</td>
</tr>
<tr>
<td>3</td>
<td>Charge-back</td>
<td>Charge-back is the buyer's right to deduct an unauthorized amount from an invoice when the pays it. The export factor and import factor must agree how much of this underpayment the import factor can in turn charges back to the export factors.</td>
</tr>
<tr>
<td>4</td>
<td>Client</td>
<td>Client is a business institution supplying goods/services on credit and availing the factoring arrangements. He is also known as supplier.</td>
</tr>
<tr>
<td></td>
<td>Code</td>
<td>The code of International factoring Customs. FCI's rule governing international factoring between an export factor and import factor.</td>
</tr>
<tr>
<td>---</td>
<td>------------------------------</td>
<td>-----------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>6</td>
<td>Credit Cover</td>
<td>The cover the import factor grants to the export factor for shipments or service from the seller.</td>
</tr>
<tr>
<td>7</td>
<td>Credit Note</td>
<td>The document the seller issue to the buyer showing the amount the seller owes for goods returned, adjustment to errors so on.</td>
</tr>
<tr>
<td>8</td>
<td>CUSTOMER:</td>
<td>A Person or to a business organisation to whom the goods service have been supplied on credit. He is also known as destor.</td>
</tr>
<tr>
<td>9</td>
<td>Documents against acceptance (D/A)</td>
<td>The conditions under which the documents attached to a bill of Exchange (BOE) will be given to buyer provided that he pays the BOS. Only then can the goods be realised to the buyer.</td>
</tr>
<tr>
<td>10</td>
<td>Documents against Payment (D/P)</td>
<td>The conditions under which the documents attached to a bill of Exchange (BOE) will be given to buyer, provided that he pays the BOS immediately. Only then can the goods be realised to the buyer.</td>
</tr>
<tr>
<td>11</td>
<td>Direct Payment</td>
<td>Payment by the buyer to the If of an assigned invoice.</td>
</tr>
<tr>
<td>12</td>
<td>Dispute</td>
<td>A defence, counter-claim or set off raised by the buyer. As a result of a dispute, the buyer may withhold payment of accounts.</td>
</tr>
<tr>
<td>13</td>
<td>Due Date</td>
<td>The date on which a payment is due to be made.</td>
</tr>
<tr>
<td>14</td>
<td>EDI</td>
<td>Electronic data interchange. A method of exchanging information electronically between treading partners.</td>
</tr>
<tr>
<td>15</td>
<td>EDIFACT</td>
<td>An international standard for EDI Its name stands for Electronic Data interchange for Administration, Commerce and Transport.</td>
</tr>
<tr>
<td>16</td>
<td>EDI Factoring</td>
<td>A world wide registered trade mark of FCI and EDIFACT standard for the factoring industry.</td>
</tr>
<tr>
<td></td>
<td>Term</td>
<td>Definition</td>
</tr>
<tr>
<td>---</td>
<td>-----------------------------</td>
<td>-----------------------------------------------------------------------------</td>
</tr>
<tr>
<td>17</td>
<td>Eligible debt</td>
<td>Debt which are approved by the factor.</td>
</tr>
<tr>
<td>18</td>
<td>Export factor (EF)</td>
<td>The factor, located in the seller's (or export's) country, with whom the seller has a factoring agreement of contract.</td>
</tr>
<tr>
<td>19</td>
<td>Import factor (IF)</td>
<td>The factor located in the buyer's (or imports) country, whose service the FE engages. He carries out collection of accounts receivables and assumes the credit risk.</td>
</tr>
<tr>
<td>20</td>
<td>Indirect Payment</td>
<td>Payment of an assigned invoice from the buyer to the export factor, seller, or seller's agent instead of to the IF who is legally entitled to payment.</td>
</tr>
<tr>
<td>21</td>
<td>Invoice</td>
<td>An document the seller issue to the buyer, which gives details of the goods or service, provided and the amount the buyer owes.</td>
</tr>
<tr>
<td>22</td>
<td>Letter of Credit (L/C)</td>
<td>An engagement by a bank or other person, made, at the request of a customer buyer, to pay a certain sum to a beneficiary or seller. This payment is in compliance with conditions specified in the credit. The L/C is a common method of payment in long distance trade where the L/C opened in favour of the seller.</td>
</tr>
<tr>
<td>23</td>
<td>LIBOUR</td>
<td>London Inter bank Ordinary Rate. The interest rate on the London Inter bank money market.</td>
</tr>
<tr>
<td>24</td>
<td>Notice of Assignment</td>
<td>Written notice to the buyer that the accounts receivables has been assigned and is payable, to the IF. Normally appears on the voice.</td>
</tr>
<tr>
<td>25</td>
<td>Open accounts sales</td>
<td>An arrangement in which the goods/services are sold by the client to the customer on credit without arising any bill of exchange or promissory note.</td>
</tr>
<tr>
<td>26</td>
<td>Payment terms</td>
<td>The specific terms (such as when payment is due) related to the payment of an invoice. Usually stated on</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>----------------</td>
<td>------------------------------------------------------------------</td>
</tr>
<tr>
<td>27</td>
<td>Payment under guarantee (PUG)</td>
<td>A payment of an approved account receivables by the import factor to the export factor 90 days after due date of the invoice concerned, if no dispute is raised by the buyer.</td>
</tr>
<tr>
<td>28</td>
<td>Open account sales</td>
<td>An arrangement in which the goods/services are sold supplied by the client to the customer on credit without arising any bill of exchange or promissory note.</td>
</tr>
<tr>
<td>29</td>
<td>Retention</td>
<td>Margin maintained by the factor.</td>
</tr>
<tr>
<td>30</td>
<td>Seller</td>
<td>The export factor’s client, who provides goods or services, invoices the buyer for them and whose accounts receivable are factored by the factor.</td>
</tr>
<tr>
<td>31</td>
<td>Shipment</td>
<td>The sending of goods ordered. Defined in the code as: goods placed in the transit to or to the order of buyer; where by common carrier or seller’s own transport</td>
</tr>
<tr>
<td>32</td>
<td>Value Date</td>
<td>The Date, after the invoice date, from which payment terms are calculated. The use of a value date results in an additional credit period for the buyer.</td>
</tr>
<tr>
<td>33</td>
<td>Trade dispute</td>
<td>Dispute arising over the quality, price, or delivery of goods of services.</td>
</tr>
</tbody>
</table>