Sustainable Development of MSMEs

Factoring – An alternate mode of raising working Capital

IFCI Factors Limited
October 2012
Macroeconomic scenario
MSME Sector – Highlights

• 45% of the total industrial output
• 22% of India's GDP in 2012
• 40% of the total exports
• 69 million people employed
• 30 million units across the country
• 8000 products and more
Sustainability

“Ability to maintain the business without affecting the quality of the product/service, with consistency in increasing turnover and profitability”
Challenges faced by MSMEs

- Adequate and timely finance
- Availability of suitable technology
- Production capacity
- Ease of modernization & expansion
- Availability of highly skilled labor
- Policy constraints
“Survey* reveals that the most important reason for sickness in the sector is the absence of time bound programme for credit dispensation, (reported by 71% of sick units), shortage of working capital (48%), marketing problems (44%), power shortage (21%), non-availability of raw material (15%), equipment problems (10%), labour problems (7%) and management problems (5%)”.

“Spreading sickness in SME Sector” – ASSOCHAM

*Survey was undertaken in Uttar Pradesh, Haryana, Punjab, West Bengal, Rajasthan, Madhya Pradesh, Bihar, Himachal Pradesh, Jammu & Kashmir, Uttarakhand and Delhi
Working capital (WC)

**Importance of WC**

- Life-line of a SME, imperative for growth
- Gets locked up in receivables and payables, impacting cash flow

**Traditional sources of WC**

- Shareholder funds
- Overdraft financing
- Leasing
- Equity finance
- Trade credit
Challenges in raising WC

- Performance history
- Debt service track record
- Market information
- Availability of collateral
FACTORING – WHAT
What is Factoring?

Factoring is a continuing financing arrangement where a business concern assigns its accounts receivable to a third party called a “factor”, at a discount and an agreed factoring fee, which typically provides immediate liquidity to finance the operations of the business concern.
Factoring – Why & Who?

• Factoring provides funds based on the strength of the transaction between the client and its debtor rather than on collaterals and strong financials of the borrower.

• Factoring is ideal for SMEs in growth phase dealing with larger entities in capacity of supplier or customer.
FACTORING – HOW
Factoring – How

IFCI Factors Ltd. 
Your Customer 
You 

IFCI Factors Ltd. 
Your Customer 
You 

IFCI Factors Ltd. 
Your Customer 
You 

IFCI Factors Ltd. 
Your Customer 
You
Factoring – How (contd.)

IFCI Factors Ltd. pays You 100% of the invoice. Your Customer then pays the balance minus charges to You.
FACTORING – WHY
## Factoring Vs. Bill Discounting

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Bill Discounting</th>
<th>Factoring</th>
</tr>
</thead>
<tbody>
<tr>
<td>Funding</td>
<td>50 – 70 %</td>
<td>85 – 90 %</td>
</tr>
<tr>
<td>Disbursement</td>
<td>Periodically (monthly/fortnightly)</td>
<td>Instantly, against each invoice</td>
</tr>
<tr>
<td>Credit Period</td>
<td>60 – 90 days</td>
<td>30 – 180 days</td>
</tr>
<tr>
<td>Grace Period</td>
<td>Nil</td>
<td>15 – 30 days</td>
</tr>
<tr>
<td>Discounting Charges</td>
<td>Upfront</td>
<td>Monthly, based on amount outstanding</td>
</tr>
<tr>
<td>Collection</td>
<td>No service provided</td>
<td>Follow up</td>
</tr>
</tbody>
</table>
Factoring is best suited in..

Situuation Of Open Account Sales

Involving Continuing Relationships

Assignment Of Whole Turnover

Factoring is best suited in situations involving continuing relationships, particularly in open account sales where assignment of the whole turnover is involved.
EXPORT FACTORING
Export Factoring is

A complete financial package that combines export working capital financing, credit protection, foreign accounts receivable bookkeeping and collection services

.. the sale of your short-term foreign accounts receivable at a discount to an export factoring company for immediate cash
Inception of Factoring in India

- Recommendations of the Kalyansundaram Committee (1988)
- The express objective was to support SMEs
- Absence of the appropriate legal framework – sluggish growth
- Players – Banks, Subsidiaries of Institutions/Banks, NBFCs
Factoring – International Scenario

Factoring Volume in 2011

Global factoring market

- Worldwide factoring volume increased from 724 billion Euro in 2002 to 2015 billion Euro in 2011
- Asia’s factoring volume accounts for approx 25% of global factoring volume
- India share in total factoring business of Asia is only 0.6%
FACTORING REGULATION ACT, 2011
Factoring Regulation Act, 2011

- Registration of Factors with RBI

- Amendment to Section 8 of Indian Stamp Act, 1889 - Waiver of Ad-valorem Stamp Duty on Assignment

- Assignment of Receivables – Notice of Assignment

- Rights and obligations of parties to contract for Assignment of Receivables define

- Registration of Assignments – Central Registry
Challenges for factoring companies

Factoring co-existing Working Capital Banker by demarcation of charge on factored receivables

Classification of factoring funds advanced to MSMEs as Priority Sector Lending
IFCI Factors – About

**Strengths**
- Pioneers of factoring
- Member of Factors Chain International
- Pan-India presence
- Part of IFCI group
- Deep understanding of SMEs

**Products**
- Factoring
  - Domestic sales & purchase bill
  - Export & import
- Pre-shipment financing
- Advance against future receivables
- Short term corporate loan

**Industries**
- Automotive
- Metal/Steel
- Engineering
- Pharmaceuticals
- Textile
- Real estate
- Chemicals
- Infrastructure
- Electrical
- Power
- Hospitality
- Services
- Education
- Logistics
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