भारतीय लघु उद्योग विकास बैंक

SMALL INDUSTRIES DEVELOPMENT BANK OF INDIA

We empower Micro, Small & Medium Enterprises

Policy Paper Series, 2010

A Study on FACTORING

MSME Financing and Development Project [MSMEFDP]

SIDBI is implementing a multi-agency, multi-activity Project on Financing and Development of MSMEs. The Department of Financial Services, Ministry of Finance, Government of India is the Nodal Agency for the Project. The World Bank, Department for International Development (DFID) UK, KfW Germany and GTZ Germany are the international partners in the Project.

The Project is aimed at making MSME lending an attractive and viable financing option as also facilitate increased turnover and employment in the sector. The Project has three major components: (A) Line of Credit from World Bank and KfW, (B) Risk Sharing Facility, and (C) Technical Assistance (TA). The Project addresses demand side issues of credit and streamline access to qualitative financial and non-financial enterprise oriented services. Technical Assistance (TA) from DFID is being utilized for strengthening the credit information system, credit rating, structuring of innovative products, capacity building of the participating banks, policy and regulatory issues and promotion of market oriented business development services for the sector. Overall the MSMEFDP intends to create an enabling sustainable environment for the growth and development of the MSME sector in India.

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A STUDY

ON

FACTORING

Prepared by Dun and Bradstreet Information Services India Private Limited

Commissioned by

भारतीय लघु उद्योग विकास बैंक

SMALL INDUSTRIES DEVELOPMENT BANK OF INDIA

We Empower Micro, Small & Medium Enterprises

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Foreword

Factoring is one of the important mechanisms to address the MSME sector's issues of resource constraints, delayed payment and receivable management. Although, over the past two decades, factoring has emerged as an important means of financing, especially in the developed economies, the same is yet to realize its potential in developing countries like India where it forms only a small fraction of the total bank credit.

Small Industries Development Bank of India (SIDBI) Being the principal financial institution for the MSME Sector in India has been on the forefront of promotion and development of the Micro Small and Medium Enterprises Sector. As a part of our policy advocacy role, we have brought out the present study report , through M/S Dun & Bradstreet Information Services Pvt Ltd. The study attempts at mapping of issues faced by MSMEs in raising credit along with the current status of factoring in India vis-à-vis other countries. In order to gain insights from the international experiences, the study has documented international best practices in this field. An attempt has been made in this report prepared by D&B to examine the legal and regulatory issues and modifications have been suggested in the draft legislation. The study is based on secondary sources as well as interactions / feedbacks with Banks, factoring companies and MSME stakeholders. The study also makes certain policy recommendations.

The study on factoring was undertaken under the Policy Advocacy component of Technical Assistance by DFID, UK under the multi-agency multi-activity MSME-Financing and Development Project (MSMEFDP). SIDBI is the Implementing Agency of MSMEFDP and Department of Financial Services, Ministry of Finance- Government of India is the Nodal Agency .The international partners of the MSMEFDP are DFID UK; The World Bank; KfW and GTZ Germany.

I am sure, the study will serve as an important input for facilitating policy measures changes, provide suitable environment for sustainable growth of factoring in India and thus help a vibrant and a key sector of our growing economy – the MSME sector. I commend all concerned for bringing out this useful and well- researched publication for the betterment of the Indian MSMEs.

R M Malla

Chairman and Managing Director

Small Industries Development Bank of India

EXECUTIVE SUMMARY

An Overview of Factoring in India

Factoring is a receivables management and financing mechanism which is designed to improve cash flows and cover the credit risk of the seller. This arrangement of financing and receivables management is highly suited to the needs of the micro, small and medium enterprises (MSMEs) in India, which face serious resource constraints in managing collections and sales ledger. In 1988, the Kalyanasundaram Committee examined the scope of offering factoring services in India, which formed the basis for introduction of factoring services in India.

SBI Factors and Commercial Services Private Limited (SBI Factors) and Canbank Factors Limited were the first two factoring companies to begin operations in 1991. India still has limited number of players engaged in providing factoring services. Most of the players engaged in providing factoring services currently are specialised factor institutions, commercial banks, specialised financial institutions (like ECGC) and some other non banking financial companies. Currently, factoring business in India is highly concentrated. The top three players control majority of the total business.

In 2008, factoring turnover reached Rs 332,280 million, which constituted roughly 0.68% of India's GDP and 1.24% of total bank credit. Factoring turnover has displayed a robust growth over the past decade, with particularly high rates of growth (in INR) achieved during 2001-2002 (96%) and 2005-2006 (85%).

Factor companies in India offer various types of factoring services depending upon the requirement of the client. Various kind of factoring services offered include - with recourse and without recourse factoring, domestic and international factoring; and disclosed and undisclosed factoring. Over 90% of the factoring done in India relates to domestic transactions. Amongst domestic factoring, recourse factoring is predominant with non-recourse accounting for almost less than 1% of domestic factoring turnover. The key industries that utilise factoring services in India are textiles, iron and steel, chemicals, pharmaceuticals and electrical engineering.

Factoring and MSMEs in India

The MSME sector is grappled with a number of problems, such as delayed availability and/ or shortage of funds, high cost of funds, inadequate infrastructure and marketing problems. Shortage of adequate credit for working capital is one of the biggest problems faced by MSMEs in India. In wake of working capital financing issues faced by MSMEs, factoring has the potential to emerge as a valuable alternative means of finance.

The primary gains for MSMEs availing factoring services are availability of instant cash and elimination of risk of default (in case of non-recourse factoring). Other benefits of factoring for MSMEs include outsourcing of collections and sales ledger management, which frees up resources for marketing or other business development purposes. Further, factoring without recourse removes credit sales receivables from the balance sheets of clients, thus resulting in improved accounts receivable days and a better current ratio.

Despite several benefits of factoring for MSMEs, it has not grown up to the potential primarily due to lack of awareness about factoring among most MSMEs. Small enterprises, in general, are not completely aware about utility and benefits of different factoring products and are apprehensive to opt for factoring, primarily due to fear of recovery procedures used by the factor companies and fear of disclosing commercial details to a third party. Those having awareness about the product also view factoring mainly as a financing mechanism rather than a complete integrated receivables management service.

Factoring Environment in India

The legal, regulatory and support environment for factoring business in India has limitations, due to which factoring volumes in the country are very low in comparison with other major economies. In India, there is no consolidated legal framework with specific provisions covering all aspects of factoring transactions. Levy of high stamp duties applicable on assignment of debts and lack of appropriate legal recourse for enforcement of claims by factors/ clients have dampened the potential growth of factoring in India.

The Reserve Bank of India (RBI) is the regulatory body supervising banks/ banks' subsidiaries/ and Non-Banking Financial Companies (NBFCs) undertaking factoring in India. At present, factoring business can be carried out by either banks or NBFCs. Both these entities have a different set of regulations and legislations governing them. Banks can undertake factoring activities departmentally without any prior approval of RBI, but NBFCs require prior approval of RBI for undertaking factoring activities as their core business. Further, while Banks have access to Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) and Debt Recovery Tribunals (DRT) for recovery under with-recourse mechanism, NBFCs do not enjoy access to such Acts. Thus, independent factoring companies in India face greater challenge compared with banks conducting factoring operations.

In terms of credit information infrastructure, at present Credit Information Bureau (India) Ltd (CIBIL) is the only credit bureau of India. However, availability of updated and complete credit information in India has been a concern area for a long period. Owing to the weak and non-dynamic credit information infrastructure in the country, currently factoring companies are relying on their internal due diligence procedures, which has limitations for increasing the factoring business.

Factoring in International Markets

The most modern form of factoring began in the United States in the textiles & garments industry in the 1940's. Within the European region, the UK was the first country to adopt factoring in the 1960's; in the Asian region, Japan, Singapore and Taiwan were some of the countries to practice factoring at an earlier stage. At present, factoring services are available in over 66 markets, including many developing countries. The Factors Chain International (FCI), formed in 1968, provides cross border factoring facilities for exporters and importers through its 242 factor members located across 65 countries.

World factoring turnover grew at an annual rate of approximately 11% during 2004-2008 and reached as much as €1,325 billion in 2008. Domestic factoring continues to represent a significant share of total factoring services rendered – about 86%. Non-recourse factoring (37% of world factoring turnover) continues to be the dominant form of factoring in most developed countries.

A major reason for the development of non-recourse factoring in developed markets is the conducive environment with respect to the regulatory, legislative and information infrastructure. The best international practices on the legal framework for factoring includes a legal infrastructure that address the issues with respect to legal assignment of receivables, security interests of the property, requirements for registration system for collaterals, and rights of secured creditors in case of bankruptcy.

Conducive regulatory environment for factoring requires a balance between no regulations and too restrictive regulations, such that factoring companies are not discouraged to do business, at the same time ensuring that entities without expertise and adequate financial backing do not disrupt the financial market development by entering into factoring business.

An ideal taxation framework for factoring does not include any stamp duties.

A strong information infrastructure implies regular availability of information on payments performance of all borrowers, either through third party exchanges like credit bureaus, through factoring companies' own database or through availability of bank reports. A comparison of factoring environment in India vis-à-vis key foreign markets has been provided in the report, which reveals the key reasons with respect to regulatory, legal, taxation and credit information infrastructure that differentiate level of factoring development and volumes of factoring in India as against those in developed nations.

Feasibility of Non-recourse Factoring in India

An important precondition for the success of non-recourse factoring is the presence of strong support infrastructure. In order to ascertain the feasibility of non-recourse factoring in India, we need to assess it from both the demand side (prospective clients) as well as the supply side (factors). While on the demand side, non-recourse factoring has high potential, on the supply side most of the factoring entities are hesitant to undertake non-recourse factoring in the domestic market under the current scenario.

There is huge demand potential for non-recourse factoring in India, which is substantiated by two different methodologies adopted to determine demand potential, namely open account sales method and curve fitting analysis.

Cost benefit analysis of non-recourse factoring, with recourse factoring and bill discounting reveals a higher net benefit in case of non-recourse factoring, despite attracting relatively higher interest costs than the other two means of financing. Thus, if net benefits of factoring are communicated to the MSMEs, the demand for such services would be much higher.

In the current environment, most factoring firms in India are hesitant to undertake non-recourse factoring in the domestic market as it involves assumption of high risk and there is absence of adequate credit insurance and suitable information on credit and payment record to assume such risk. Additionally, the recovery laws in India for non-banking entities are weak and legal procedures involve huge time and costs.

In the present scenario, reverse factoring could be an appropriate model for developing non-recourse factoring in India. The non-recourse factoring has a high growth potential in India provided supply side constraints are suitably addressed. One of the most successful examples of reverse factoring on a non-recourse basis in a developing economy is that of NAFIN development bank in Mexico. Indian authorities could consider development of a factoring model similar to NAFIN's 'Productive Chains' programme.

Legal Framework

Since the introduction of factoring in India, it has been subjected to various existing legal provisions. However, over the last decade, several changes have taken place in operational and legal field pertaining to banking as also commercial transaction, registration of documents, etc. A few of such Acts relevant for factoring include Recovery of Bank Dues & the SARFAESI Act, 2002; Provision of payment of interest on delayed payments under Micro, Small and Medium Enterprises Development Act, 2006; Establishment of Credit Information Companies under Credit Information Companies (Regulation) Act, 2005; Recognition of electronic transactions under Information Technology Act, 2000; and introduction of process of registration of documents by means of electronic devices under the Registration Act, 1906.

A special legislation for factoring is desirable for efficient and viable operation of factoring transactions. The draft legislation for Factoring can be suitably modified in respect of clauses which deal with Definitions; Assignment of Debt; Notice of Assignment of Debt; Prohibition of further Assignment; Special provision for enforcement of claim by factor; and Amendment of certain enactments.

Additional clauses have also been suggested, which can be incorporated in the draft legislation with respect to interest on delayed payment, obtaining credit information and enabling factoring transaction by way of 'electronic form', stamp duty exemption or remission, priority of assignment in case of insolvency, letter of disclaimer/ waiver, clog on factoring and other aspects related to establishment of factoring organisation, scope of factoring business, creation of supervising authority, forum for adjudication of disputes etc.

Recommendations

Factoring in its current status, is perceived by MSMEs, as more of a financing medium rather than an integrated receivables management service; and as such marketing consciousness needs to bring out the positive impact of factoring, as a service more than just financing. Factors should work towards extending their reach, by developing a large, well-connected network, backed by state-of-the-art technology. Factors should strive towards developing a database of existing clients and customers to mitigate the problem of borrowers' informational opacity, and also identify and extend this database to the sectors which are most likely to use factoring services.

Factoring can be promoted for MSMEs by developing special schemes in that regard. Innovative mechanisms based on e-business models and the Receivables Exchange can be introduced for accelerating the growth of factoring in India. NTREES (Trade Receivables Engine for E-discounting), recently launched by National Stock Exchange (NSE) and SIDBI , is a right step in this direction.

In order to improve the demand for factoring services, various industry associations, MSME associations and factoring companies can jointly organise multiple workshops, seminars, and education & training sessions to improve awareness about factoring products. Factors should provide complete accounts receivables management to their clients so that the clients can reduce the collection cost and benefit from factoring.

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Introduction

Globally, factoring has emerged as a useful financing instrument over the last two decades, especially for the micro, small and medium enterprises (MSMEs). In India, factoring has a high potential to serve the working capital needs of manufacturing sector, especially of MSMEs but is yet to emerge as a popular financing mechanism. Main reasons cited for the under-development of factoring in India include legislative and regulatory hurdles like heavy stamp duty; lack of access to legal recovery under Debt Recovery Tribunals; cost of funds; inadequate support infrastructure like credit availability and insurance; and lack of awareness among potential users.

In the context of above background, SIDBI has assigned Dun & Bradstreet to conduct a study on Factoring for MSMEs in India. The study aims to assess the existing status of factoring in India and understand the issues and challenges faced by the industry on the regulatory, legislative and external infrastructure front, and provide suitable recommendations to overcome these challenges. This study also aims to examine the need for any modifications in the draft legislation, which was drafted in 2002. The scope of the study also includes benchmarking the factoring practices in India with the global best practices and accordingly arriving at suitable solutions to the issues faced by factoring companies and MSMEs.

Since at present, factoring is largely offered with recourse in India, this study also aims to establish the feasibility of non-recourse factoring, subject to appropriate changes in the factoring environment, regarding which, suitable recommendations have been made.

Terms of reference

The terms of reference of the study were as under:

I. Mapping of issues
II. Assessing the existing status, constraints and concerns on the policy front
III. Documenting international best practices (approach and strategies)
IV. Examining the feasibility of the factoring without recourse as acceptable in international arena
V. Drawing up future agenda and a road map ahead in alignment with international best practices towards market for factoring companies
VI. Suggest suitable areas of modifications in the draft legislation

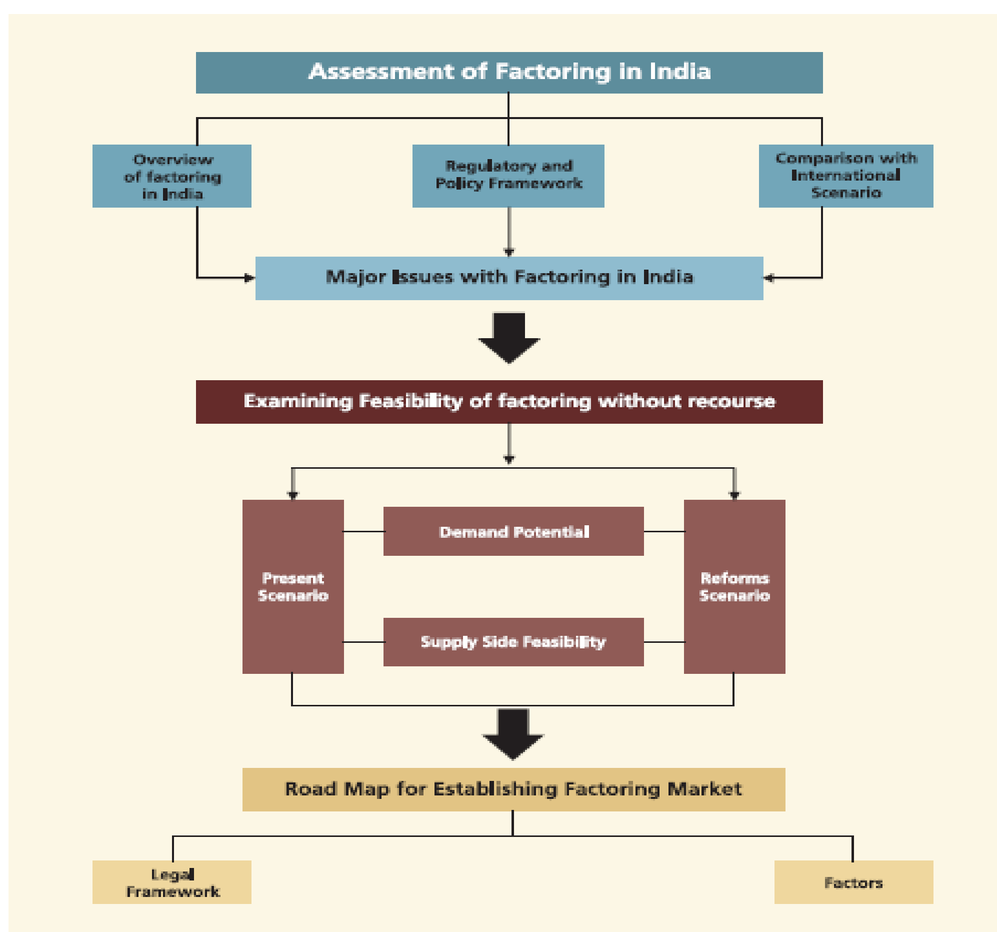
VII. Suggest a structure for organising a validation/ awareness workshop with support from a suitable agency

Methodology

The methodology used for conducting the study on 'Factoring for MSMEs in India' was a mix of primary and secondary research methods. In order to enable effective assessment of the factoring industry, information was collated from various secondary sources, including published reports, legislations, regulatory guidelines and other authored literature. The list of relevant secondary research sources are furnished in annexure 11. This facilitated understanding of the operational procedures and issues faced by the industry.

In order to supplement and validate the understanding of the mechanics and issues at hand, a comprehensive primary research was undertaken. The project team devised structured questionnaires, which were used to elicit opinions of the stakeholders concerning the factoring industry. D&B conducted two-stage interviews with factor companies (Domestic and international), Factor associations, MSME industry associations, banks, the RBI and other major stakeholders of the industry, including credit insurance companies and credit information bureaus, for the aforesaid purpose. The details of the participant companies in various meetings are given in annexure 6.

Exhibit I: Schematic diagram of the methodology adopted



The assessment of the factoring industry aimed at revealing the major issues with factoring in India. This assessment was done by studying the operational aspects of factoring, the regulatory, legal and support infrastructure status and the comparison with the global best practices.

Based on the responses of the respondents and the vast secondary research, the feasibility of non-recourse factoring was assessed, from both demand as well as supply side. Discussions with all stakeholders have enabled D&B to prepare recommendations for establishing a strong and viable factoring industry in India. Specific recommendations have also been made for modifications to the draft factoring legislation under consideration. Additionally, suggestions have been made specifically for factor companies, regulators and policy makers to promote factoring among MSMEs in India. Accordingly the report also includes such observations which are based on interactions made by the members of the study team with staff & officials of certain institutions and verbal response received from them.

Structure of the report

This report is structured as follows:

The first chapter **'Factoring in India: An Overview'** is an assessment of the evolution and growth of the factoring industry in India. This chapter also discusses the current scenario in the industry, detailing the types of factoring prevalent in the country, the major players and the types of industries availing of factoring services.

The second chapter **'Factoring and MSMEs in India'** discusses the performance of MSMEs in India and the status of MSME finance. It further highlights the issues faced by MSMEs in obtaining credit and the potential they would present for factoring companies and banks.

The next chapter deals with the overall **'Factoring Environment in India'**, including the legislative and the regulatory framework and the support infrastructure for factoring. The broad provisions and guidelines applicable to factoring in the country are detailed in this chapter. Also, this section discusses the primary issues and concerns with factoring as derived from the study on factoring in India. Herein, the concerns for factoring companies and MSMEs in availing factoring services are highlighted individually.

Chapter 4- **'Factoring in International Markets'** deals with the trends in the global factoring market and the practices in international markets. This section details the region wise composition of factoring volumes and their growth in recent years. Different countries have been compared on parameters such as factoring volumes, legal and regulatory procedures for factoring companies and the support infrastructure available. This section studies the best practices in the international context by means of six country case studies.

Chapter 5- **'Feasibility of Non-recourse Factoring in India'** is aimed at ascertaining the feasibility of non-recourse factoring in India. This chapter assesses the demand potential and supply side feasibility of non-recourse factoring in the current scenario, and reveals the key hurdles to the feasibility. Contingent on the reforms and elimination of these hurdles, the feasibility of non-recourse factoring in India is also established.

Chapter 6 deals with the **'Legal Framework'** applicable to factoring companies, the modifications desired in the legal framework to promote factoring, specific changes to the draft legislation and other legal recommendations.

Chapter 7 lays down the **‘Recommendations’** for regulatory bodies and government agencies, and factoring companies separately, which would contribute in making factoring (especially non-recourse) successful in India.

Chapter 8, **‘National Workshop Structure’** provides the structure for a workshop to discuss the issues and concerns, recommendations and increase awareness about the benefits and potential of factoring as a financing medium for MSMEs. This chapter details the topics for discussion at this workshop, the session plan and the indicative content for the individual sessions.

Chapter 1

Factoring in India: An Overview

Key Points:

- *In 1988, Kalyanasundaram Committee examined the scope of offering factoring services in India, which formed the basis for introduction of factoring services in India.*
- *SBI Factors and Commercial Services Private Limited (SBI Factors) and Canbank Factors Limited were the first two factoring companies to begin operations in 1991.*
- *India still has limited number of players engaged in providing factoring services. Most of the players engaged in providing factoring services currently, are specialized factor institutions commercial banks, specialized financial institutions (like ECGC) and some other non banking financial companies.*
- *In 2008, factoring turnover reached EURO 5200 million (Rs 332,280 million), which constitutes roughly 0.68% of India's GDP.*
- *However, factoring turnover in India in 2008 constituted merely 1.24% of total bank credit in the same period.*
- *Factor companies in India offer various types of factoring services depending upon the requirement of the client. Various kind of factoring services offered include - with recourse and without recourse factoring, domestic and international factoring; and disclosed and undisclosed factoring.*
- *Over 90% of the factoring done in India relates to domestic transactions.*
- *The key industries that utilise factoring services in India are textiles, iron and steel, chemicals, pharmaceuticals and electrical engineering.*
- *Currently, factoring business in India is highly concentrated. The top three players control majority of the total business.*

This chapter provides a broad overview of factoring in India, charting the growth path followed by the industry so far in India. The chapter also includes the current status of factoring in terms of turnover, factoring types, key players and the user industries served.

Factoring & Evolution thereof in India

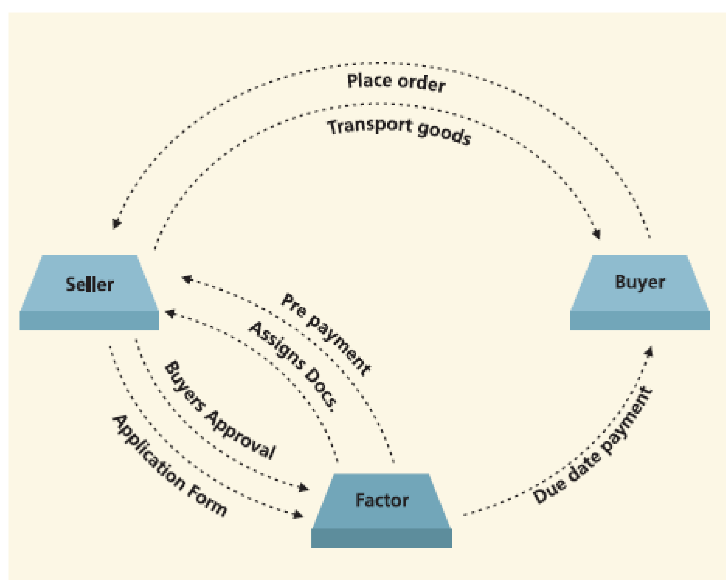
1.1. The word 'factor' has been derived from the Latin word *'Facere'* which means 'to make or do' i.e. to get things done. As per the Webster dictionary, the 'factor' is an agent as a banking or finance company engaged in financing the operation of certain companies. Factoring is a receivables management and financing mechanism which is designed to improve cash flows and cover the credit risk of the seller. This arrangement of financing and receivables management is highly suited to the needs of the micro, small and medium enterprises (MSMEs) in India, which face serious resource constraints in managing collections and sales ledger. Besides, MSMEs in India face an ever increasing pressure from the risk of delayed payments and bad debts, both of which can be addressed through factoring.

Box 1.1: Factoring mechanism

Factoring mechanism

Factoring constitutes a suite of financial services offered under a factoring agreement, which includes receivables financing, credit protection, accounts receivables collection and management, sales ledger administration and advisory services. There are three parties involved in a factoring arrangement – the client (the seller of goods/services), the debtor (the buyer of goods/ services), and the factor. The factoring mechanism is detailed in the exhibit below.

Exhibit 1.1: Factoring mechanism



When the seller sells the goods to the buyer on credit, he is in need of working capital finance, which can be obtained either through traditional banking means or through factoring. In case of factoring, the seller of the goods approaches the factor company and places a request for factoring facility for his receivables. The Factor company processes the application of the client (seller) by scrutinising latter's financial statements and conducting credit assessment. Based on the client

assessment, the Factor either approves or rejects client's request. Once approved, the Factor assigns overall factoring limit to the client. Before commencing factoring facility, the factor seeks Letter of Waiver/ Disclaimer from client's banks. The Factor also examines the sales ledgers of client's customers and conducts buyers' due diligence, post which sub-limits are set for client's customers. After this, an in-house approval of factoring arrangement is granted to the client. Factoring Company is then required to send letter of notification to the client's buyers and the buyers are required to accept the same and send it to the Factor. Post this; a factoring agreement is signed between the client and the Factor with respect to buyers who accept the notification. The Client is then required to submit original invoices with assignment clause written on them and proof of delivery of those invoices. Once invoices are submitted, the Factor makes advance payment to the client (which is generally up to 80% of the total invoice value) and deducts its commission and interest charges. Thereafter, the Factor manages client's sales ledgers, sends due date reminders to client's customers and collects payments as and when due. Upon receipt of full payment, the Factor pays the balance amount due to the client.

1.2. The committee appointed by the government (1985)[1] on economic reforms for reviewing the working of the monetary system had in its report provided several directions, with respect to future shape of financial sector reforms and made various recommendations in relation thereto. The committee amongst its recommendations had advocated bringing in stricter credit discipline and reduction in the importance in the cash credit, greater resort to financing of working capital through loans, bills, and receivables. Various other committees were set up to review the state of financing in the country, and some of them, including the **Vaghul Committee on Money Market Reforms (1987)** made references to the need for introducing factoring in India. Factoring was finally initiated in India as a result of the recommendations of the **'Report of the Study Group for Examining Introduction of Factoring Services in India'**, popularly known as the **Kalyanasundaram Committee report (1988)**. This committee was set up by the government to study the problems of micro, small and medium enterprises (MSMEs) and to assess whether factoring as a financing medium, which was already thriving in many developed markets, would aid in addressing those problems. The committee observed that MSMEs in India faced a serious cash flow problem, due to delayed payments, and that factoring was an ideal service to address those needs. The RBI accepted the recommendations of Kalyanasundaram Committee report and recommended launch of domestic factoring in India.

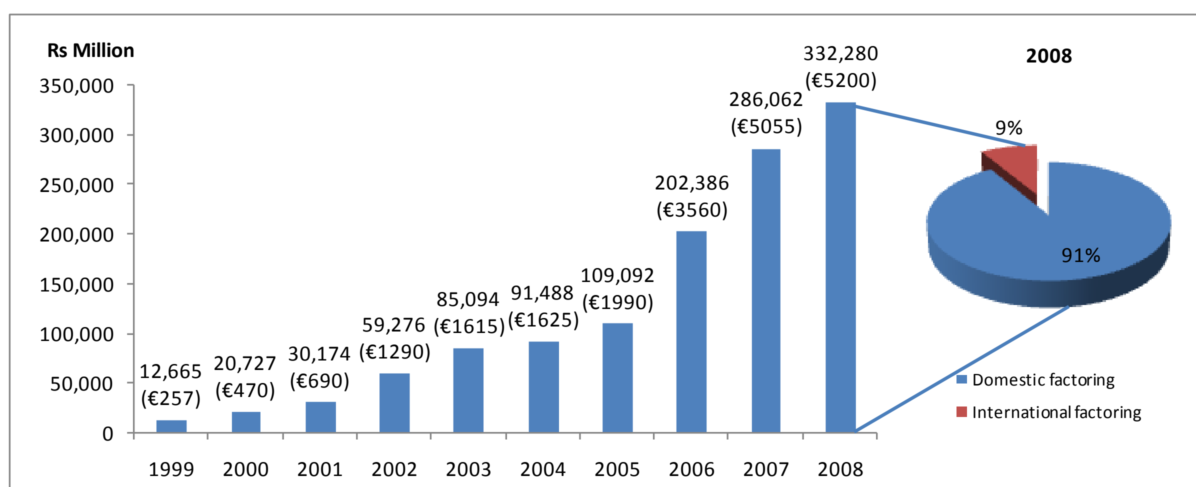
1.3. SBI Factors and Commercial Services Private Limited (SBI Factors) was the first company to begin factoring operations from April 1991. SBI Factors was promoted by State Bank of India, Small

[1] The chairman of the committee appointed by the government in 1985 for reviewing the working of monetary system was Dr. Sukhamoy Chakravarty

Industries Development Bank of India (SIDBI), Union Bank of India, State Bank of Saurashtra and State Bank of Indore. Later, in September 1991, the second factoring company, Canbank Factors Limited, which was promoted jointly by Canara Bank, Andhra Bank and SIDBI, started its operations. Another player offering factoring services in the 1990s was Foremost Factors, which began operations in 1997 (Foremost factors is now known as 'IFCI Factors'). In 1994, presumably with a view to give further impetus to the factoring system, RBI permitted the banks to undertake the activity departmentally through their select branches having requisite skills and infrastructure for the purpose. Thereafter, some more players joined the league in the next decade, i.e. Global Trade Finance (GTF), [which commenced operations in 2001 as a joint venture promoted by Exim Bank, West LB, Germany and IFC, Washington (the private sector arm of World Bank)], and Export Credit Guarantee Corporation of India Limited (ECGC) also undertook such functions departmentally. Some foreign banks viz. Hong Kong and Shanghai Banking Corporation (HSBC), Standard Chartered Bank and Citibank also started offering factoring services (departmentally).

1.4. At present, factoring turnover constitutes roughly 0.68% of India's GDP (current prices at factor cost 2008) as against 0.11% during 2000. Factoring turnover has displayed a robust growth over the past decade, with particularly high rates of growth achieved during 2001-2002 (87%) and 2005-2006 (79%). One of the reasons contributing to the high rate of factoring growth since 2002 has been the high economic growth of the country. Post 2004, leading factor companies increased their marketing activities considerably, especially for MSMEs, which has accelerated factoring growth during this period.

Chart 1.1: Factoring growth in India (Rs Million)



Note: Figures in brackets are in Million Euros

Source: Factors Chain International, D&B Research

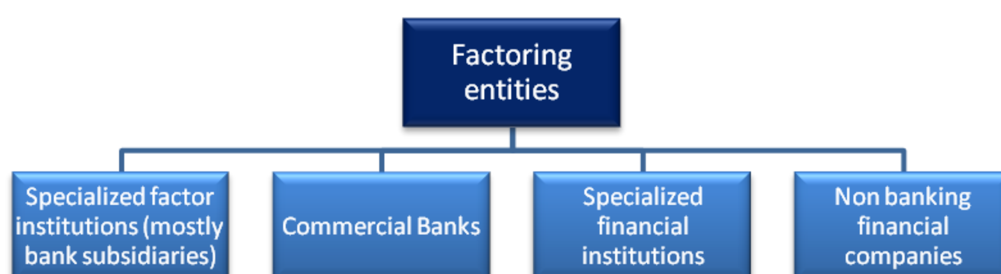
1.5. Despite the high growth rates achieved, as compared to the usage of other financing mediums, factoring penetration in India is still very low. Factoring turnover in India in 2008 constituted merely

1.24% of total bank credit in the same period. The primary reason for low share of factoring in bank credit and GDP is the lack of awareness about the product; factoring in India is largely seen as an alternative financing product, than an overall receivables management service, and hence factoring business essentially competes with other lending products and has not been able to gain popularity against traditional lending methods.

Major players

1.6. India still has limited number of players engaged in providing factoring services. Most of the players engaged in providing factoring services currently are specialised factor institutions (such as SBI Factors, Canbank Factors, IFCI Factors, Global Trade Finance), commercial banks (such as HSBC, Standard Chartered Bank, Citibank, ICICI Bank, Axis Bank etc) specialised financial institutions like ECGC and some other non banking financial companies like Birla Global Finance Company and Bibby Financial Services.

Exhibit: 1.2: Factoring entities in India



Source: D&B Research

1.7. A major reason for limited number of factoring companies in India is that there are regulations governing the entities that can practise factoring in India. The RBI permits scheduled commercial banks to undertake factoring services departmentally, without the requirement of a RBI license, or to set up a separate subsidiary (NBFC) for the purpose. Existing NBFCs also do not require a license for entering domestic factoring, but require an authorised dealer license to undertake international factoring. Setting up of new NBFCs for undertaking factoring business, would however require the relevant license from the RBI.

1.8. Currently, factoring business in India is highly concentrated. The top three players control majority of the total business. In January 2008, SBI acquired 91% stake in GTF, with the remaining stake being with Bank of Maharashtra. The process of merging the two subsidiaries of SBI is underway. This merger would further add to the concentration in the factoring business in India, since these two companies jointly control 46% of the market share.

Types of factoring

1.9. Factor companies in India offer various types of factoring services depending upon the requirement of the client. Various kind of factoring offered include - with recourse and without recourse factoring; domestic and international factoring; and disclosed and undisclosed factoring. A brief description of each of these factoring services is provided below, along with their relative share in the Indian factoring market.

With- recourse and without-recourse factoring

1.10. A factoring arrangement can be entered into with recourse or without recourse to the seller. In case of with recourse factoring, the factor has legal recourse to the seller, in case the debtor fails to pay on maturity. Thus the factor acts as an agent for collection of bills and does not cover the risk of customer's failure to pay debt or interest on it. Alternatively, in non-recourse factoring, the factor does not have recourse to the seller in case of default, and bears the credit risk in case of the buyer's inability to pay. *However, there is generally a limited recourse in case of non-recourse factoring in case of trade dispute between the buyer and the seller regarding quality and supply of goods.* In general, non-recourse factoring services are costlier as the factor undertakes higher risk. Non-recourse factoring proves beneficial in case of international trade finance, since it limits the credit risk of the client, which is higher in international trade. In India, most of the factoring undertaken in the domestic market is with recourse. Though non-recourse factoring is undertaken by companies in India, its share is very low (less than 10%- according to interactions with various factor companies). The key reasons for low share of non-recourse factoring are that credit information infrastructure in the country is weak and legal recovery of dues in the country takes a considerable long time.

Domestic and International Factoring

1.11. Domestic factoring is undertaken for financing of receivables within the country, and involves only one factor. Factoring for cross-border sales transactions is called international factoring. It is also called export or import factoring depending on the location of the factoring customer. The factor either handles the transactions directly, or uses a cooperation partner in the respective country (Two factor arrangement). Over 90% of the factoring done in India relates to domestic transactions. International factoring in India comprises predominantly of export factoring, with a very minuscule contribution from imports. Among the factor companies in India, ECGC is predominantly involved in export factoring, whereas most of the other companies have a greater proportion of domestic factoring than international factoring. During 2004-2008, international factoring turnover of Indian factors has grown at a CAGR of 26.6% while that of domestic factoring has grown at 34.5%. The

growth in export factoring has primarily been led by the growth in India's exports during the last five years and increased awareness of factoring products among exporters.

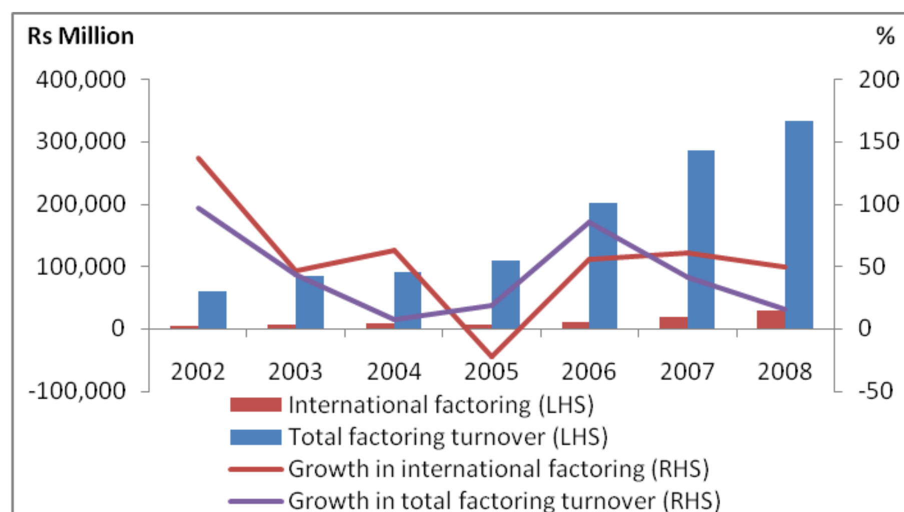
Table 1.1: Domestic and international factoring turnover in India (Rs Million)

Year	Domestic factoring	International factoring	Total factoring turnover
2001	28,425 (€650)	1,749 (€40)	30,174 (€690)
2002	55,140 (€1200)	4,136 (€90)	59,276 (€1290)
2003	79,035 (€1500)	6,059 (€115)	85,094 (€1615)
2004	81,635 (€1450)	9,853 (€175)	91,488 (€1625)
2005	101,417 (€1850)	7,675 (€140)	109,092 (€1990)
2006	190,448 (€3350)	11,939 (€210)	202,386 (€3560)
2007	266,822 (€4715)	19,241 (€340)	286,063 (€5055)
2008	303,525 (€4750)	28,755 (€450)	332,280 (€5200)

Note: Figures in brackets are in Million Euros

Source: Factors Chain International

Chart 1.2: Factoring growth in India (Rs Million)



Source: Factors Chain International (FCI)

1.12 In other economies, the growth of international factoring is largely driven by the increase in quantum of exports on open account terms. India's exports have still not moved towards open account terms as significantly, so as to drive the growth of international factoring. Though the prevalence of Letter of Credit (LC) has declined over the years in international trade, it is still used to a considerable extent in India. Further, pre-shipment and post-shipment credit from banks, present stiff competition to international factoring since the rates applicable to them are considerably lower. Other important aspects that affect growth of international factoring are the issues relating to; position of the parties with respect to mutual rights and obligations in the event of insolvency of either party or the importer, jurisdiction, laws governing the parties and cross border insolvency.

Disclosed and Undisclosed Factoring

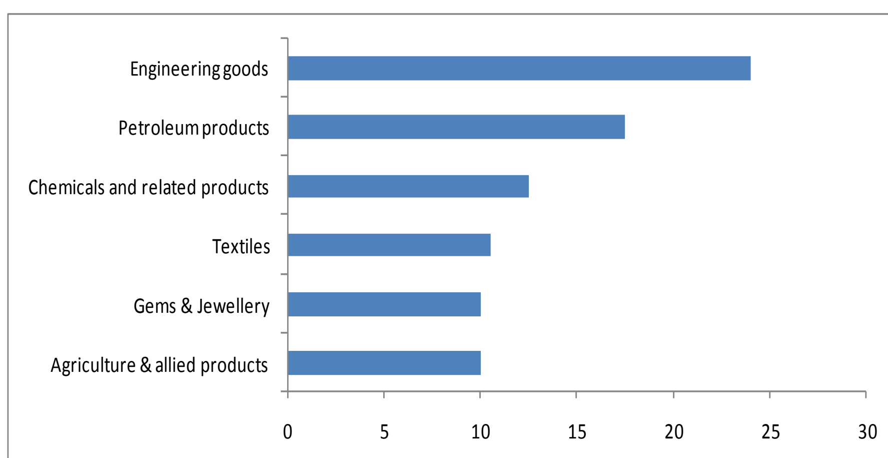
1.13 Under disclosed factoring, the debtor is informed of the assignment of debts to the factor, and is accordingly required to cooperate with the factor for future transactions and collections. Alternatively, under undisclosed factoring, the debtor is not informed of the agreement entered into between the seller and the factor. In this case, the debtor makes payments directly to the seller's account, and the factor is not directly involved in the debt collection process. Most of the factoring done in India is disclosed, which is also a common practice globally. Under disclosed factoring, the factor sends notice of assignment to all the debtors of the client and factoring is undertaken only for those debtors who accept the assignment. On the other hand, undisclosed factoring is offered by factoring companies only to a limited extent as it involves high risks and necessitates due diligence on the client as well.

User segments

1.14 Factoring companies offer their services to almost all industries, subject to the availability of receivables of less than 90 days. However, factoring services are largely used by manufacturing, and to a limited extent, by trading concerns. Though factoring services can be customised to the needs of the service sector, factoring companies are not very enthusiastic about the prospects from services sector. This is mainly due to the intangible nature of this sector and the highly variable credit periods applicable.

1.15 The key industries that utilise factoring services in India are textiles, iron and steel, chemicals, pharmaceuticals and electrical engineering.

Chart 1.3: Industry-wise contribution to factoring in India (%)



Source: World Factoring Yearbook, 2009

1.16 Factoring is offered to entities of all sizes, but different factoring companies in India have different client bases. Most foreign banks undertaking factoring services focus on large corporates as prospective factoring clients. They have only a small share of MSME clientele. On the other hand, Factoring NBFCs, have a considerably larger MSME clientele, primarily due to lower net owned funds (NoFs) and consequently, lower single borrower exposure limits (which is limited to 15% of NoFs).

1.17 As discussed earlier in this chapter, the penetration level of factoring in India is still low. This report aims to establish the factoring framework for MSMEs in India and hence it is important to understand various issues that are acting as hurdles to growth of factoring, in general and for MSMEs, in particular. In the next chapter, we discuss the importance of factoring for MSMEs in India and address various issues and concerns faced by them.

1.18 **NTREES as a Change Agent**- In December 2009, NSE and SIDBI have launched **NTREES (NSE Trade Receivables Engine for E-Discounting set up in association with SIDBI)** aimed at facilitating discounting of MSME bills on their supplies to large purchaser companies **(Annexure 5).** NTREES is a step in the direction of promoting enabling environment for reverse factoring in India. Presently, it is piloted through SIDBI . Later on, other institutions are expected to join on this E- platform. This is a part of SIDBI's financing and developmental support to MSMEs and is a unique concept which will prove to be a win-win situation for MSMEs, purchaser companies, banks and FIs.

Chapter 2

Factoring and MSMEs in India

Key Points:

- *The MSME sector face a number of problems, such as delayed availability and/ or shortage of funds, high cost of funds, inadequate infrastructure and marketing problems. Shortage of adequate credit for working capital is one of the biggest problems faced by MSMEs in India.*
- *In wake of working capital financing issues faced by MSMEs, factoring has the potential to emerge as a valuable alternative means of finance.*
- *The primary gains for MSMEs from the use of factoring, is the availability of instant cash and elimination of the risk of default (in case of non-recourse factoring).*
- *Most MSME units view factoring only as a financing mechanism rather than a complete integrated receivables management service. Thus, when compared with alternative bank finance products like bank credit, the cost of availing factoring services is higher.*
- *Small enterprises, in general, are not completely aware about utility of different factoring products and are apprehensive to opt for factoring, primarily due to fear of recovery procedures used by factors and fear of disclosing commercial details to a third party.*
- *If factoring has to further develop in India, the issues and concerns faced by MSMEs with respect*

Introduction

2.1. The MSME sector plays a significant role in terms of balanced and sustainable growth of the Indian economy by way of employment generation, development of entrepreneurial skills and contribution to export earnings. The micro and small enterprises sector has been contributing nearly one-third of the manufacturing sector output and exports and providing employment to nearly 32.2 million people through about 13.3 million units, located in both the rural and urban areas across India.

Table 2.1: MSE sector performance in India

Year	Number of enterprises ('000 nos.)			Employment ('000 persons)	Production (Rs billion) at current prices
	Registered	Unregistered	Total		
2003	1591	9358	10949	26021	3148.50
2004	1697	9698	11395	27142	3645.47
2005	1753	10106	11859	28257	4297.96
2006	1871	10471	12342	29985	4978.86
2007	2098	10746	12844	31252	5851.12
2008P	2468	10899	13367	32228	6951.26

P: Projected

Source: Ministry of Micro, Small and Medium Enterprises

As per the estimates in the 4 th census , the sector accounts for 40% of the industrial output , more than 30% of country's exports, second largest employer next to agriculture (around 60 million person), and per unit fixed investment is Rs. 33.78 lakh only. It is estimated that there are about 2.6 crore micro, small and medium enterprises (MSMEs) located in both the rural and urban areas spread across the country.

Problems faced by MSMEs

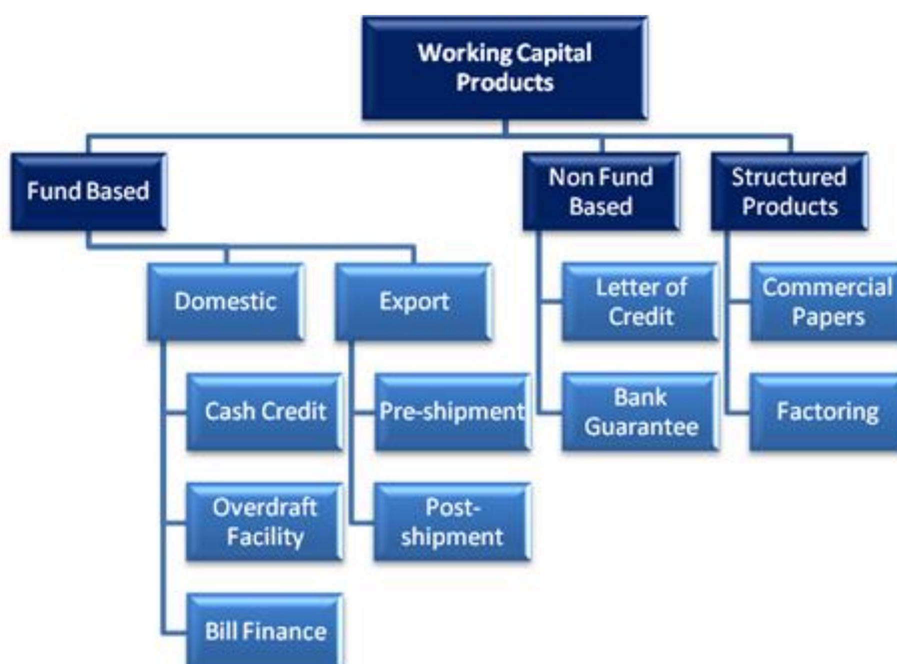
2.2. While the strategic importance of MSMEs to the economy is undisputed, for various reasons, this sector is grappled with a number of problems[2], such as delayed availability and/ or shortage of funds, high cost of funds, inadequate infrastructure and marketing problems which are the major factors causing poor growth of MSMEs in India. A restricted flow of credit to the MSME sector is the single most important factor that is circumscribing the growth of MSMEs in the country.

[2] Report of The Working Group on Rehabilitation of Sick SMEs (RBI, 2008)

Issues with MSME finance

2.3. Shortage of adequate credit (especially working capital) is one of the biggest problems facing MSMEs in India. In general, working capital requirements of MSMEs in India are financed through internal resources as well as through external borrowings. At present, MSMEs manage their internal finance largely through internal accruals, loans from relatives and acquaintances etc. Amongst the external borrowings, apart from bank credit for working capital finance, major sources of funds available in the Indian market include bank credit, short-term loans, bill finance, commercial papers and factoring of account receivables, etc. as illustrated in the exhibit below.

Exhibit 2.1: Working capital products



Source: D&B Research

2.4. In India, bank credit is provided by way of cash credit and working capital demand loan (WCDL). Though commercial paper is also one of the important source of financing working capital requirements of companies, the same is not easily available to MSMEs, since higher credit ratings (e.g. AAA) is one of the eligibility criteria for such finance and as such the same is available generally to large companies having such ratings.

2.5. Bill financing is also a popular means of financing for MSMEs in India. During early 1990s, RBI had frequently issued various guidelines to encourage bill financing in India with a view to inculcate a measure of financial discipline among borrowers in India. To promote bill financing, for a long time interest on bill discounting had been kept lower than the minimum interest chargeable for cash credit or overdraft facilities. At present, banks can charge interest rate on discounting of bills

without reference to prime lending rate and are thus free to offer competitive rate of interest on bill discounting facility.

2.6. Pre- and post-shipment credit are among the most popular ways of financing of export receivables. Pre-shipment credit is offered to an exporter by way of 'packing credit' to enable him to finance the purchase or import of raw materials, processing, manufacturing and packing of the goods meant for exports. Such loans are granted on the basis of a letter of credit (LC) or a confirmed and irrevocable order for export of the goods. Post-shipment credit is offered to an exporter to finance export sales receivables after the date of shipment of goods till the date of realisation of export proceeds.

2.7. Among the non-fund based products, letter of credit is widely used to support international trade in India. Letter of credit is an obligation undertaken by the bank to make payment to the seller after all the criteria are met. Bank guarantee is a similar product, under which the bank undertakes to pay the seller in case the buyer defaults on payment.

2.8. Though factoring has been introduced and adopted as an alternative means of working capital finance for MSMEs, the share of factoring in total working capital finance continues to be low. Factoring turnover in India is estimated to contribute around 1.24% of total bank credit.

2.9. Despite the availability of various means of working capital finance, MSMEs in India are often not able to avail credit for meeting their working capital requirements due to various reasons such as lack of proper maintenance of financial records as required for the purpose of credit and non-availability of requisite collateral. The recent credit crunch has added to the woes of the sector, making credit difficult to come by. Due to the liquidity crisis, banks have tightened lending norms and are extremely cautious while lending to borrowers with high risk profile. MSMEs, which are generally considered high risk segment, are thus finding it even more difficult to raise credit in current scenario.

Potential for MSME finance through factoring

2.10. In wake of working capital financing issues faced by MSMEs, factoring has the potential to emerge as a valuable alternative means of finance. Factoring (especially non-recourse factoring) could be a highly advantageous service for MSMEs, with benefits in accordance with the costs incurred on it. The primary gains for MSMEs from the use of factoring, is the availability of instant cash and elimination of the risk of default (in case of non-recourse factoring). This section highlights the benefits that the MSMEs would most likely receive from the use of factoring services.

2.11.**Improved cash flows:** The primary reason for sickness in small and medium enterprises has been identified by MSME associations as the lack of timely funds. Majority of MSMEs in India are faced with delayed payments on receivables from the customers, and also a delayed release of funds from the financers. In general, there has been slow growth of credit to the MSMEs by the lenders due to high rate of NPAs in small enterprises[3]. Moreover, since a large number of MSMEs in India (especially exporters) are highly dependent on large buyers, non-receipt of payment on time often disrupts the financial health of these units. Since factoring provides instant cash on receivables, the funding problem of MSMEs can be easily solved.

2.12.**Elimination of default risk:** Factoring without recourse eliminates credit risk for the clients, which is transferred to the factor company. This is a valuable service for MSMEs, as their sensitivity to default risk is usually very high.

2.13.**Fixed assets freed up for collateralisation for other credit requirements**: Since factoring generally does not use fixed assets for collateralisations against advances, these assets of the clients are freed up, which can be used as collateral against other loans, for other business needs.

2.14.**Resources freed up from sales ledger management for use in business development:** A majority of MSMEs face a dearth of resources for various functions of the business. With collections and sales ledger management being outsourced to the factoring companies, MSMEs would be able to utilise the freed up resources for marketing or other business development purposes. Besides, due to specialisation, factor companies are better placed to conduct these functions effectively.

2.15.**Increased ability to extend open account terms to clients:** Since extending open account terms of credit involves higher risk, MSMEs are able to offer these terms only to long standing reliable clients, in the absence of open-account receivables finance and adequate credit protection. However with factoring, MSMEs can enjoy better cash flows and reduced default risks, which would enable them to offer open account terms of credit to their clients, which would in turn help their businesses to grow. In India, most of the international sales are conducted through LCs as against on open account terms in other countries (especially China). If MSMEs in India allow open account credit terms to their international customers, it would give a huge boost to their overall export revenues.

[3] Report of The Working Group on Rehabilitation of Sick SMEs (RBI, 2008)

2.16.**Improved financials:** Factoring without recourse removes credit sales receivables from the balance sheets of clients, resulting in improved accounts receivable days and a better current ratio. Since factoring would also reduce the additional debt requirements for working capital, it helps in improving the debt-equity ratio and the debt service coverage ratio of the entities. The benefits to MSMEs in terms of improved financials from factoring (non-recourse) can be assessed as under:

Table 2.2: Benefits to MSMEs in terms of factoring

Items	Before Factoring	After Factoring	Benefit to MSME
AR days	107	23	Lower collection period or receivables flow in on a predetermined schedule, possessing a lower collection period is seen as optimal for MSMEs, as this means that it does not take a company very long to turn its receivables into cash and companies have sufficient cash to pay off own expenses (such as operating and administrative expenses).
AR balances as % of revenue	31.7%	7%	Lower collection period results into lower AR balances
Cash as % of total expenses	2.9%	8%	More cash available to meet payroll, add sales, pay suppliers, or meet any obligation
Debt	⇧	⇩	Factoring reduce the additional debt requirements for working capital funding.
Effective interest rate	⇧	⇩	Lower debt requirement reduces effective interest rates
Bad debt	⇧	⇩	Lower bad debts, as Factors assume the risk of customers payment defaults (in case of non-recourse factoring)
Debt Asset ratio	0.5	⇩	Improvement in debt asset ratio, implies that the company is less leveraged
Current ratio	0.8	⇧	Improvement in current ratio, high current ratio indicates a good probability that the enterprise can retire current debts
Revenue growth (past year)	6.8%	⇧⇧	Higher revenue growth as faster cash turnaround would enable MSMEs to grow aggressively
EBITDA growth (past year)	-6.8%	⇧	Higher revenue growth, better negotiations with suppliers enables the company to improve EBITDA
** Illustrated for textile industry (FY08)*			

Source: D&B Research

2.17.The above analysis clearly establishes that there is a high potential for factoring in the MSME sector. From the MSMEs perspective, factoring is the most suited product as it serves the financing, receivables management and credit protection requirements of the units, without any requirement of collaterals. However, at present factoring services to MSMEs in India is way below its potential,

primarily due to lack of awareness about factoring and also due to reluctance of many factor companies to offer factoring to MSMEs. While the latter issue is discussed in detail in the next chapter, in the following section, we examine various issues faced by MSMEs with factoring in India under current scenario.

Issues and concerns faced by MSMEs

2.18. ***Apprehensions of prospective MSME clients:*** Small enterprises, in general, are not completely aware about utility of different factoring products and are apprehensive to opt for factoring, primarily due to fear of recovery procedures used by factors and fear of disclosing commercial details to a third party.

a) *Apprehensions about recovery procedures used by factors*: Clients, especially MSMEs are reluctant to outsource collection and follow up activities, on account of concerns about the procedures used by factors for follow up and recovery. MSMEs are particularly concerned about the future relationship with their customers and its impact on the prospective business.

b) *Reluctance to share sales ledger with factors*: MSMEs are reluctant to share details of their clients and dealings with third parties, which is required for availing factoring services. Besides, borrowers in India generally prefer banks to NBFCs, which add to their reluctance to provide sales ledger to independent factoring companies.

2.19. Factoring perceived only as a financing mechanism: Most of the factoring firms in India undertake factoring business for selective customers of MSME clients on the basis of better credit worthiness and payment record. Consequently, even though MSMEs have engaged in factoring arrangement, they are not relieved of the entire sales ledger management and collections and are required to allocate resources for the same. As a result, MSMEs find value of factoring arrangement only as a financing medium and not for sales ledger management/ collections, which is supposed to be the key differentiating and value added feature of factoring against other means of financing.

2.20. Higher cost of factoring services as compared to other modes of finance: As discussed in earlier point, most units view factoring only as a financing mechanism rather than an integrated receivables management service. In comparison with traditional banking means, interest charges for factoring are generally higher. For instance, while Bills under LCs (90 days) attract 6.5%-7.5% interest and bills without LCs are available at 8%-10%, interest charges applicable under factoring is at present 12.5%-13.0%. Thus, when compared with alternative bank finance products like bill discounting, the cost of

availing factoring services is high. MSMEs prefer to avail the least cost funding mechanism, and thus are reluctant to opt for factoring services.

2.21. ***Restricted branch network of factoring companies:*** Most factoring companies in India do not have a vast branch network (most of them have less than 10 branches) largely restricted to metropolitan cities. MSMEs across the country thus do not have direct access to factoring companies, and hence to their services.

Table 2.3: Branch network of factors

Factor	Number of Branches
SBI Factors	11
GTF	14
Canbank Factors	9

Note: Information is as of August 2009
Source: Company websites, D&B Research

2.22. At present, factoring in India is faced with constraints on both demand and supply side. On the demand front, there is a huge business potential from MSMEs (due to large number of MSMEs), the growth has not been up to the potential due to various problems faced by MSMEs as discussed in paragraphs 2.18 to 2.21 above. On the supply side too, factor companies are hesitant to offer factoring services to MSMEs due to various reasons discussed in the next chapter (paragraph 3.14 onwards).

Chapter 3

Factoring Environment in India

Key Points:

- *The legal, regulatory and support environment for factoring business in India is not satisfactory, due to which factoring volumes in the country are very low in comparison with other major economies.*
- *In India, there is a need for a consolidated legal framework with specific provisions covering all aspects for factoring transactions.*
- *Levy of high stamp duties applicable on assignment of debts and lack of appropriate legal recourse for enforcement of claims by factors/ clients have hampered the potential growth of factoring in India.*
- *The Reserve Bank of India (RBI) is the regulatory body supervising banks/ banks' subsidiaries/ and Non-Banking Financial Companies (NBFCs) undertaking factoring in India. At present, factoring business can be carried out by either banks or NBFCs. Both these mechanisms have a different set of regulations and legislations governing them. Banks can undertake factoring activities departmentally without any prior approval of RBI, but NBFCs require prior approval of RBI for undertaking factoring activities as their core business.*
- *Factoring companies in India seek credit information reports from various sources including banks, credit bureau, credit rating companies, credit insurers, etc. However, availability of updated and complete credit information in India has been a concern area for a long period.*
- *High cost of credit insurance is a major hindrance to the growth of factoring services.*

In this chapter, we examine the current legislative, regulatory and support environment in which factoring operates in India to enable an understanding of issues and constraints that are hampering the growth of factoring.

Legislative framework

3.1. In India, there is no specially enacted legal framework for factoring transactions. However, factoring transactions as undertaken by factoring organisations attracts provisions of certain laws in force, i.e., Indian Contract Act, 1932; Indian Sale of Good Act, 1930; Transfer of Property Act, 1882; Civil Procedure Code, 1908; Recoveries of Debts due to Banks and Financial Institutions Act, 1993; Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002; India Stamp Act, 1889; The Provincial Insolvency Act, 1920; and Power of Attorney Act, 1882.

3.2. The law governing assignment of debt is to be found in Section 130 of the Transfer of Property Act, 1882 which provides for a transfer of debt by executing an instrument in writing. It provides that after the execution of instrument in writing, the transfer of debt will be complete and effectual. The Act also specifies that notice to the debtor is not necessary to complete the transfer of a debt. Prior to receiving the notice of assignment, if the debtor has any defence against the creditor, it would not be affected by the transfer. Thus, a factor does not receive a better title to the debt than that enjoyed by the client.

3.3. As per existing laws, there are no explicit provisions with respect to priorities between successive assignments of the same debt. General rule that applies is that between two assignees, the first having given notice to the debtors of assignment of debt has a prior claim to subsequent assignee. However, the possibility of litigation by a subsequent assignee with the plea of bonafide purchaser for consideration on the ground that he was not aware of the previous assignment may not be ruled out. Thus, if due to the negligence of the first assignee, another person takes such plea and prefers his claim on the basis of assignment in his favour, the first assignee (in this case - factor) may face litigation. Kalyanasundaram Committee had suggested establishment of a system for filing of notice of agreement between factor and client in a central registry to be maintained by an appropriate statutory authority. Such arrangement would also provide scope for a factor to verify any such existing agreement/ assignment before taking an assignment. However, till date no such registry has been established.

3.4. As per the Indian Stamp Act, duty is payable on an instrument that denotes a specific transaction. The factoring agreement, stating an assignment of debt, thus attracts a stamp duty. Stamp duties on such document are stipulated by States, and the rates are often not same across different states. In some states, stamp duties are very high, which pushes up the cost of factoring. Kalyanasundaram Committee had suggested that stamp duty on assignment of book debts should be completely exempted, perhaps not generally, but specifically for assignment in favour of a factor. However, stamp duty is not yet exempted on assignment of book debts.

3.5. In case of defaults in payment of debts by the debtor, factors have to adopt recourse through intervention of the courts for recovery of their dues. Such recourse involves high cost of litigation and longer duration thereof for adjudication of claims and thereafter execution of the decree becomes another hurdle. In case of factoring with recourse, the factor generally has recourse to the client, and if so required, it can recover its dues by way of enforcing the securities obtained, i.e. collateral, if any, taken at the time of factoring agreement. Under the SARFAESI Act, security interest created in favour of any secured creditor may be enforced without the intervention of court or tribunal, by such creditor. However, advantage of such recourse is not available so effectively as the said Act also has been subject matter of chain of litigations wherein issues relating to extent and scope and implications of provisions of said Act have been raised from time to time. Besides said impediment in this regard, at present, the rules of SARFAESI are applicable only to Banks and Financial Institutions. Thus, NBFCs undertaking factoring operations are not able to avail such recourse and enforce their security interest against the debts of the supplier/ client under the said Act.

3.6. Absence of a well established legal framework for factoring has hampered the growth of factoring business in India. Thus, a special legislation is required to address the gaps in the existing laws with respect to assignment of receivables and recovery of dues by factor companies. At the same time, suitable amendments are required to the existing laws so as to provide advantage thereof for effective working of factoring business. Detailed analyses of the current legal environment, identification of legislative issues and suitable recommendations for a special legislation for factoring have been discussed in Chapter 6 of the report.

Regulatory framework

3.7. Reserve Bank of India is the regulatory body supervising all financial services in India, including factoring. In accordance to the recommendations of Kalyanasundaram Committee, the Banking Regulation Act, 1949 was amended to enable commercial banks to undertake factoring services in India. Thus, RBI issued guidelines in 1991 for enabling banks to conduct factoring business. According

to these guidelines, banks were permitted to set up separate subsidiaries jointly with other banks for factoring purposes but could not directly/ departmentally undertake factoring. However, post 1994, banks were allowed to undertake factoring departmentally through their select branches having requisite skills and infrastructure for the purpose. At present, while Banks can undertake factoring activities departmentally without any prior approval of RBI, NBFCs (subsidiaries of Banks) require prior approval of RBI for undertaking factoring activities as their core business. NBFCs also require an "Authorised Dealer License" from the RBI to engage in *international factoring business,* besides other compliances required to be made in cross-border transaction, which would amongst others, involve issues relating to foreign exchange, jurisdiction, applicable law relating to regulations and obligations of parties to the transaction, position of the parties in case of insolvency, etc.

Table 3.1: Regulations applicable to factoring in India

Parameters	Regulation/ Rules
License and approval	Banks do not need prior approval for undertaking factoring activities departmentally; NBFCs require approval of RBI for undertaking factoring as their core service and they also require authorised dealer license for engaging in International factoring.
Funding	Factoring companies meeting eligibility guidelines (refer paragraph 3.8) can seek finance from Banks; most Factoring NBFCs are non-deposit taking and thus cannot raise public deposits.
Minimum capital requirement	Banks' exposure to factoring activities cannot exceed 10% of their total advances; capital adequacy requirement of systemically important non-deposit taking NBFCs is 10%; Exposure ceilings with respect to single borrower is limited to 15% of bank's/ NBFC's capital funds and for the borrower group – up to 40% of bank's/ NBFC's capital funds.

Source: D&B Research

3.8. For funding, Factors can raise line of credit from banks and RBI guidelines in this behalf have laid down certain conditions to be complied with. As per RBI guidelines[4], banks are permitted to provide financial assistance to factoring companies subject to satisfaction of following criteria:

i. The companies carry out all the components of a standard factoring activity, viz., financing of receivables, sale-ledger management and collection of receivables.

ii. They derive at least 80 per cent of their income from factoring activity.

[4] "Bank Finance to Factoring Companies", RBI /2007-08/235 DBOD .BP. BC. No. 60 /08.12.01/2007-08, Reserve Bank of India, Mumbai, 2008

iii. The receivables purchased/financed, irrespective of whether on 'with recourse' or 'without recourse' basis, form at least 80 per cent of the assets of the factoring company.
iv. The assets/income referred to above would not include the assets/income relating to any bill discounting facility extended by the factoring company
v. The financial assistance extended by the factoring companies is secured by hypothecation or assignment of receivables in their favour

In terms of raising money from the market, non-banking factors raise funds from various sources like ECBs, mutual funds, debentures, overnight borrowing, etc. However, NBFCs undertaking factoring business do not raise public deposits (initially Canbank Factors and SBI Factors were deposit taking NBFCs but at present all factoring NBFCs are non-deposit taking).

3.9. In relation to norms for lending and credit exposure for factoring organisations, RBI has stipulated that factoring activities should be treated at par with loans and advances, and thus should be given risk weight of 100% for calculation of capital to risk asset ratio. RBI guidelines also provide that Banks' exposure to factoring activities should be balanced vis-à-vis the aggregate credit and should not exceed 10% of their total advances. Capital adequacy requirement of systemically important non-deposit taking NBFCs is 10%. This CRAR requirement has to be increased to 12% by March 31, 2010 and 15% by March 31, 2011. As per RBI guidelines, the exposure ceilings with regard to single borrower will be limited to 15% of bank's/ NBFCs' capital funds and for the borrower group to 40% of bank's/ NBFC's capital funds.

3.10. Having regard to the aforesaid aspects, the regulatory environment for non-banking factoring companies can be revisited by RBI. Another issue which needs regulator's consideration is that of NBFCs' access to low cost funds and ability to provide its services at competitive costs vis-à-vis banks, who are also players in this field, and are in an advantageous position in this regard. Other issues and concerns faced by non-banking factor companies in comparison to banks have been discussed later in this chapter. In the following section, we discuss another major aspect related to factoring environment i.e. **Information infrastructure**.

Information infrastructure

3.11. Factoring companies in India seek credit information reports from various sources including banks, credit bureau, credit rating institutions, credit insurers, etc. Availability of credit information in India has been a concern area for a long period. However, with the establishment of first credit information bureau in the country, viz. Credit Information Bureau (India) Ltd (CIBIL), there has been a marked improvement in availability of credit information for various credit institutions. CIBIL,

which launched its services in 2004, is catering to both consumer and commercial segments. Thus, it provides valuable information to the factors on the credit history of its clients as well as clients' buyers. At present, 187 credit institutions are members of CIBIL. The database of CIBIL constitutes 150 million accounts. The commercial bureau, launched in 2006, has a database of 4 million accounts and provides data with respect to both positive and negative data. According to Doing Business 2009 (World Bank), the coverage of credit information provided by credit bureau is mere 10.5% of the adult population as against 100% in case of several developed countries like Australia, Canada, USA and UK.

3.12.The Credit Information Companies (Regulation) Act 2005, which has been brought into force with Rules/Regulations framed, provides for establishment and regulation of credit information companies and for efficient collection and dissemination of credit information. The Act stipulates that every existing credit institution shall be a member of at least one credit information company. Having regard to the meaning of the term 'credit institution' as provided under clause (f) of section 2 of the said Act, all the following are credit institutions;

(i) a corresponding new bank, the State Bank of India, a subsidiary bank, a co-operative bank, the National Bank and regional rural bank;

(ii) a non-banking financial company as defined under clause (f) of Section 45-I of the Reserve Bank of India Act, 1934 (2 of 1934);

(iii) a public financial institution referred to in Section 4-A of the Companies Act, 1956 (1 of 1956);

(iv) the financial corporation established by a State under Section 3 of the State Financial Corporation Act, 1951 (63 of 1951);

(v) the housing finance institution referred to in clause (d) of Section 2 of the National Housing Bank Act, 1987 (53 of 1987);

(vi) the companies engaged in the business of credit cards and other similar cards and companies dealing with distribution of credit in any other manner;

(vii) any other institution which the Reserve Bank may specify, from time to time, for the purposes of this clause;

In April 2009, RBI issued 'in-principle-approval' to three more companies to set up Credit Information Companies, viz. Equifax Credit Information Services Pvt Ltd, Experian Credit Information Company of India Pvt Ltd and Highmark Credit Information Services Pvt Ltd. The definition of the term 'borrower' as provided under clause (b) of said Act of 2005 is so wide that in due course, coverage of data collected by credit information companies would include large part of credit facility extended by credit institutions. The Act also provides scope for collection of 'credit information', which as per the said Act means any information relating to;

(i) the amounts and the nature of loans or advances, amounts outstanding under credit cards and other credit facilities granted or to be granted, by a credit institution to any borrower;

(ii) the nature of security taken or proposed to be taken by a credit institution from any borrower for credit facilities granted or proposed to be granted to him;

(iii) the guarantee furnished or any other non-fund based facility granted or proposed to be granted by a credit institution for any of its borrowers;

(iv) the creditworthiness of any borrower of a credit institution;

(v) any other matter which the Reserve Bank may, consider necessary for inclusion in the credit information to be collected and maintained by credit information companies, and, specify, by notification, in this behalf;

The flow of credit information is also expected to become more efficient and to have much wider coverage with the launch of credit services by these companies. We have considered the scope of functions of credit information companies as per the said Act and found that as per Section 14 of the said Act, a credit information company may engage in any one or more of the following forms of business;

(a) to collect, process and collate information on trade, credit and financial standing of the borrowers of the credit institution which is a member of the credit information company;

(b) to provide credit information to its specified users or to the specified users of any other credit information company or to any other credit information company being its member;

(c) to provide credit scoring to its specified users or specified users of any other credit information company or to other credit information companies being its members;

(d) to undertake research project;

(e) to undertake any other form of business which the Reserve Bank may, specify by regulations as a form of business in which it is lawful for a credit information company to engage.

Thus, the aforesaid functions, which are to be undertaken by such companies would provide the relevant information to factors/clients/customers and which in turn would certainly dispel the element of uncertainty which exists today in their decision making process for want of such information.

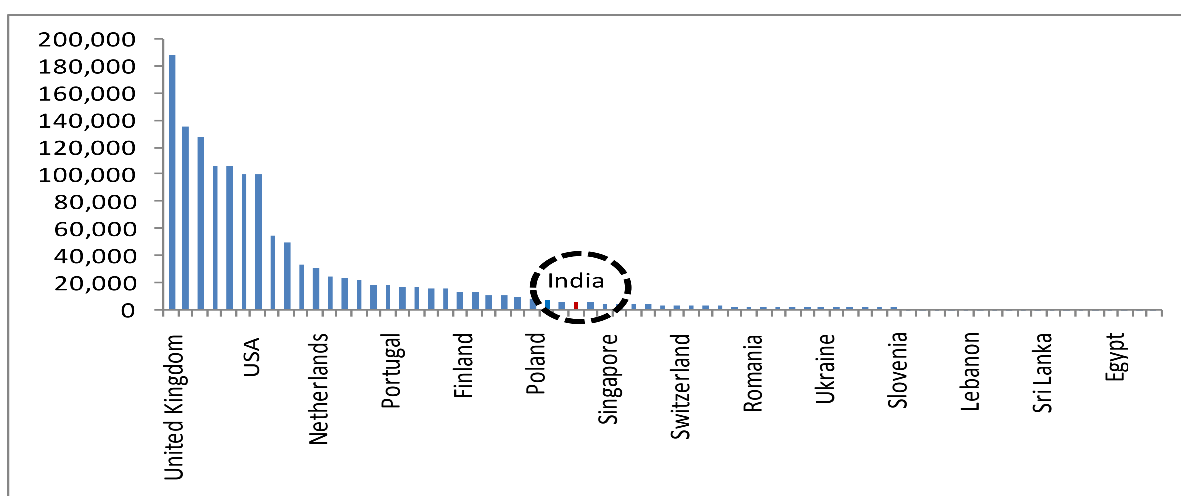
3.13. In 2006, India also introduced an electronic registry for security rights granted by companies. The Registrar of Companies maintains an electronic registry in which all documents filed electronically are stored. As per Ministry of Company Affairs' notification (GSR 557 (E)) in The Gazette of India (dated September 14, 2006), "the electronic registry so set up shall enable public access and

inspection of such documents as are to be required in public domain under the Act on payment of the fees as prescribed by the Act or the rules made there under". Factor companies/ Banks can thus register the collaterals with this electronic registry and thus notify their charge on the property. This enables creditors to make informed decision while lending against certain collateral of a company. This also facilitates claims on the registered collateral by the secured creditors under the SARFAESI Act. However, this central registry has a limitation that it stores and provides information on charges only for companies and thus charges procured from small proprietary and partnership firms cannot be notified in such central registry. Data relating to registered transactions are also maintained in the records kept by the office of sub-registrar, registrar etc., as per the provisions of Indian Registration Act 1908; and perhaps the system could also be adopted for the data relating to factoring transactions, by way of providing suitable provisions in this behalf in the proposed draft legislation.

Issues and Concerns with Factoring in India

3.14. As discussed in the aforesaid sections, the legal, regulatory and support environment for factoring business in India is not satisfactory, due to which factoring volumes in the country are very low in comparison with other major economies. Factoring turnover in India in 2008 stood at only € 5,200 million (Rs 332,280 million), as compared to € 188,000 million in the UK, € 100,000 million in the US, € 55,000 million in China and € 22,055 million in Brazil. In this section, we highlight various pressing issues faced by factoring companies, which are restricting the potential reach of factoring business in India.

Chart 3.1: Factoring in India vis-à-vis other countries (2008 Turnover- € Million)



Source: Factors Chain International

3.15. ***Reluctance to go for assignment of debt due to high stamp duty:*** As discussed in previous sections, statutory assignment of receivables attracts stamp duty, which is generally very high (according to

our interactions with various factor companies, it is around 3% of the factored debt value). Consequently, stamp duties inevitably increase the cost of factoring vis-à-vis other banking products. The high stamp duty thus discourages factoring companies from executing the deed of assignment. Instead, most of these companies merely execute an agreement to assign, and take power of attorney to exercise the assignment after the maturity of debt. In case of a default post maturity of debt, the factor company exercises the power of attorney and executes the assignment deed and pays stamp duty on same. Though this is not a satisfactory arrangement, factoring companies continue to practice this (in the absence of exemption of stamp duties). During our interactions with factor companies, all have expressed their concern for stamp duty costs and have asked for exemption of stamp duty from assignment of debts. Until the issue is addressed, factoring firms would continue without the legal assignment of debt at the time of entering into a factoring contract. Thus, there is a need to address this issue to make factoring procedure cost effective and simple.

3.16.***Uneven playing ground between NBFCs undertaking factoring services and banks:*** Currently, factoring business can be initiated either by setting up an NBFC or by banks undertaking factoring services through their departments. Both these mechanisms have a different set of regulations and legislations governing them (see table below). This creates an uneven competitive scenario among the factoring entities. There is a requirement to create a level playing field between factor companies, to enable competition and more efficient administration of services.

Table 3.2: Guidelines for NBFCs vis-à-vis Banks undertaking factoring services

Asset classification	NBFCs have an edge over banks in terms of asset classification guidelines from the RBI. NBFCs recognise assets for which interest is overdue for six months or more as non performing assets, as opposed to banks, which recognise assets with interest over due for 90 days or more as non performing assets. Since NBFCs have a greater breather available, they find it easier to provide grace period to their borrowers – which could be as much as 60 days. Since banks have to comply with BASEL norms, they are under greater pressure with respect to asset quality and have to be extra cautious when extending funds.
Single and group borrower exposure limits	NBFCs, being smaller entities as compared to banks, have smaller Net Owned Funds (NOFs). The single borrower and group borrower exposure limits (15% and 40% of NOFs), translates to lower exposure limits for NBFCs as compared to banks. Hence, banks are able to provide factoring to large corporates on a greater scale as compared to NBFCs. Due to better credit standing of large corporates and better margins, banks' portfolio are more directed towards larger entities, as compared to NBFCs.
Funding sources and cost	Banks have a clear edge above NBFCs, when it comes to their sources and costs of funds. A significant portion of funding for banks is through low cost deposits (CASA deposits), which non-banking factoring companies do not have access to. NBFCs rely largely on short term market borrowings, to fund their operations. The costs are comparatively very high which makes factoring costs high. Borrowings of NBFCs are largely sourced from banks and mutual funds. The cost of

	funds is usually 2-3 percentage points higher for NBFCs than banks, which significantly reduces their competitiveness.
Access to SARFAESI Act and DRT	The recovery procedures available to banks are better than those at the disposal of NBFCs. Banks have access to SARFAESI Act as well as DRTs, which the NBFCs do not have. Besides, additional issues with respect to the non availability of first charge on receivables, lowers the competitiveness of NBFCs.
Charge on receivables	Banks, in course of their banking transactions, obtain and enjoy first charge on all assets of the borrower, including their present and future assets. As a consequence of such a condition, factoring companies do not enjoy first charge on the receivables factored to them, which also makes recovery of dues difficult.
Captive customer base	Banks have access to an existing and much larger customer base, as compared to NBFCs. They have the privilege to be able to tap this captive customer base, and expand their factoring businesses. According to the needs of the customer, and the viability to the bank, customers can be suggested suitable receivables financing mechanisms, all available at the same bank. Moreover, the bank can offer lower rates to retain the client. This opportunity is not available to NBFCs, who have to attract new customers.

Source: D&B Research

As is evident from the above, NBFCs have more restrictive regulations than banks. While there are inherent advantages that banks have over NBFCs, certain regulations like access to SARFAESI can be suitably modified to provide a level playing field for banks and NBFCs in terms of recovery under with recourse mechanism.

3.17.***Weak recovery laws and slow legal enforcement:*** In India, the recovery laws, as per the laws enforced are not so effective for NBFCs. NBFCs do not have access to faster recovery procedures under the SARFAESI Act and the Debt Recovery Tribunals (DRT). During our interactions with factor firms, it was revealed that in majority of 'with recourse' factoring transactions are supported with collaterals. However, since factor companies do not have access to SARFAESI provisions, they are required to initiate civil suits in case of default. Most factor companies regard such legal procedures of recovery as very cumbersome and as a last option. Consequently, most of the factor firms are extremely careful in selection of clients and their customers, and prefer to do business only with companies with good credit ratings.

*3.18.**Issues with availability of credit insurance:*** Credit insurance has been identified as a potential tool for accelerating the growth of non-recourse factoring. High cost of credit insurance is a major hindrance to the growth of factoring services. The costs associated for availing credit insurance cover have increased considerably in recent times owing to the credit crisis. Credit insurance companies have become more conservative in their risk appetite and are reluctant to provide cover to factoring business. According to some insurance companies, claims from factoring companies grew

considerably during the period of crisis, which has also driven the premiums upwards for providing cover to factoring business. High premiums, inadvertently pushes the cost of factors, due to which they find it difficult to take insurance cover. Other reason discouraging factor companies to take credit insurance is the difficulty in settlement of genuine claims from insurance companies in recent times. Insurance companies often reject claims on grounds of non-adherence to the terms of the contract.

3.19.***Weak credit information infrastructure:*** The credit information infrastructure in India is weak. Most factors rely on bank reports for information on the client's and debtors' financial standings. Though CIBIL provides information on defaulters, not many sources are available for providing information on payment history of clients. Moreover, the information on any account in the credit bureau is updated only when the same is notified by the member financial institution, which is usually not done on a frequent basis. If an erstwhile defaulter has made settlement of all dues, his name from the list of defaulters is generally not removed soon. Thus, even though a prospective client/ client's customer could have cleared its past dues, it could still result in rejection of factoring application. Owing to the weak and non-dynamic credit information infrastructure in the country, factoring companies generally rely on their internal due diligence procedures, which is not adequate for increasing the factoring business. Moreover, factor companies have not been able to develop extensive databases of their own till date.

3.20.***Opaque financial statements of MSMEs:*** Factor firms find it difficult to provide services to MSMEs as most MSMEs in India do not prepare proper or audited financial statements. In absence of past financial records, it is difficult for factoring companies to accept applications. However, this hindrance is common to factoring companies, as it is to banks and other financial institutions.

3.21. Taking into account the current legislative, regulatory and information environment applicable to factoring in India and all the associated issues and concerns, it is suggested that the government and other concerned agencies may consider addressing issues in the light of the above, read with other parts of this report. Specific recommendations on improvement of legislative, regulatory and support infrastructure environment have been provided in detail in chapters 6 and 7 of the report.

Chapter 4

Factoring in International Markets

Key Points:

- *The most modern form of factoring began in the United States in the textiles & garments industry in the 1940's.*
- *Within the European region, the UK was the first country to adopt factoring in the 1960's; in the Asian region, Japan, Singapore and Taiwan were some of the first countries to practice factoring.*
- *At present, factoring services are available in over 66 markets, including many developing countries.*
- *The Factors Chain International (FCI), formed in 1968, provides cross border factoring facilities for exporters and importers through its 242 factor members located across 65 countries.*
- *World factoring turnover grew at an annual rate of approximately 11% during 2004-2008 and reached as much as €1,325 billion in 2008.*
- *Domestic factoring continues to represent a significant share of total factoring services rendered – about 86%.*
- *Non-recourse factoring (37% of world factoring turnover) continues to be the dominant form of factoring in most developed countries.*
- *A major reason for the development of non-recourse factoring in developed markets is the conducive environment with respect to the regulatory, legislative and information infrastructure.*
- *The best international practices on the legal framework for factoring includes a legal infrastructure that address the issues with respect to legal assignment of receivables, security interests of the property, requirements for registration system for collaterals, and rights of secured creditors in case of bankruptcy.*
- *Conducive regulatory environment for factoring requires a balance between no regulations and too restrictive regulations, such that factoring companies are not discouraged to do business, at the same time ensuring that entities without expertise and adequate financial backing do not disrupt the financial market development by entering into factoring business.*
- *An ideal taxation framework for factoring does not include any stamp duties.*
- *A strong information infrastructure implies regular availability of information on payments performance of all borrowers, either through third party exchanges like credit bureaus, through factoring companies' own database or through availability of bank reports.*

Introduction

4.1. Globally, factoring has been practiced successfully for several decades. The most modern form of factoring began in the United States in the textiles & garments industry in the 1940's and eventually spread to other sectors and industries. Within the European region, the UK was the first country to adopt factoring in the 1960's. By the 1970's, UK clearing banks began to participate in factoring and the growing interest in factoring as a service was evident from the increase in the number of banks holding shareholder positions in factoring companies. The large number of cross border transactions in the European region led to the extension of factoring to cover export services. Today, export financing or foreign receivables financing form close to 15% of total factoring services rendered. In the Asian region, Japan, Singapore and Taiwan were some of the first countries to practice factoring. These countries adopted export factoring to finance their expanding trade. Subsequently, other Asian countries such as Korea, Thailand, and Indonesia have also introduced factoring. At present, factoring services are available in over 66 markets, including many developing countries.

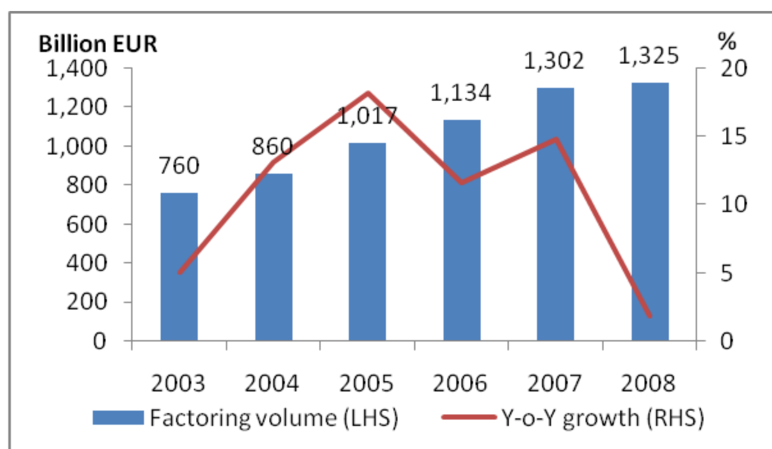
4.2. In the next section, we discuss in detail the growth trends of factoring in various countries. Thereafter, from paragraph 4.11 onwards, we examine the best practices and environment for factoring operations in various international markets, highlighting the ideal conditions for development of factoring in any economy. Later in the chapter, from paragraph 4.43 onwards, we present detailed case studies on six countries (US, UK, Germany, Singapore, Turkey and Thailand) including both developed and developing countries, to assess the environment and practices that have contributed to the growth and development of factoring in these countries. The analysis of best international practices and specific case studies has enabled us to do a benchmarking of factoring operations in India vis-à-vis key factoring markets, which is detailed towards the end of the chapter (paragraph 4.122 onwards).

Current Trends in the Global Factoring Market

4.3. World factoring turnover grew at an annual rate of approximately 11% during 2004-2008 and reached as much as €1,325 billion in 2008. While textiles & garments, electronics have traditionally been the main industries utilising factoring services, an increasing number of industrial equipment, farm equipment, office equipment and processed food manufacturers are beginning to employ the services of factor agencies. Non-recourse financing continues to be the dominant form of factoring in most developed countries. Amongst factoring transactions covered by the Factors Chain International, while non-recourse factoring accounts for 37%, recourse factoring accounts for about 26% and the balance of the transactions are accounted for by invoice discounting and collections.

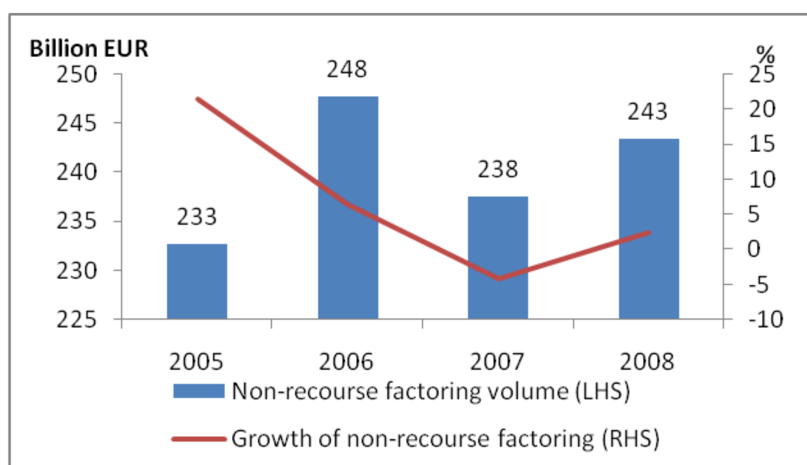
Over the years, invoice discounting has grown rapidly and certain markets have become primarily ‘invoice discounting’ oriented such as the UK. It has been observed that though invoice discounting has grown at a high pace, it is largely concentrated in countries with Anglo-Saxon legal framework which provides invoice discounters a greater degree of security than most other legal systems[5].

Chart 4.1: Growth of Factoring in the World



Source: Factors Chain International

Chart 4.2: Growth in non-recourse factoring



Note: The data corresponds to FCI members only

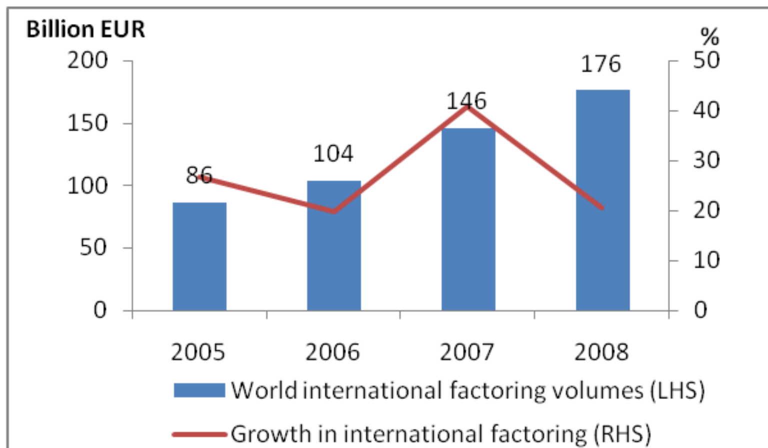
Source: Factors Chain International

4.4. Domestic factoring continues to represent a significant share of total factoring services rendered – about 86%. Although international factoring constitute less than 15% of total factoring volumes, these transactions are increasing at a fast pace and grew at an annual rate of almost 27% during the 2004-2008 period. Currently, international factoring volumes for most countries lie in the range of between 5% and 25%. However, international factoring volumes for a few countries such as China, Denmark, Netherlands and Taiwan were substantial, representing over 30% of total factoring turnover in these countries in 2008. During the last year itself, international factoring turnover

[5] *Source: World Factoring Yearbook 2009, Introduction by Jeroen Kohnstamm (Secretary General, Factors Chain International)*

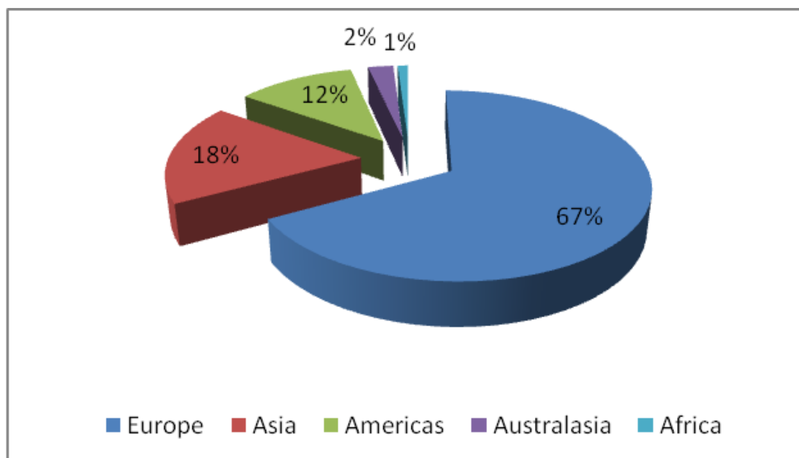
increased by more than 20%. The chart below depicts the recent growth in international factoring transactions.

Chart 4.3: Growth of International Factoring



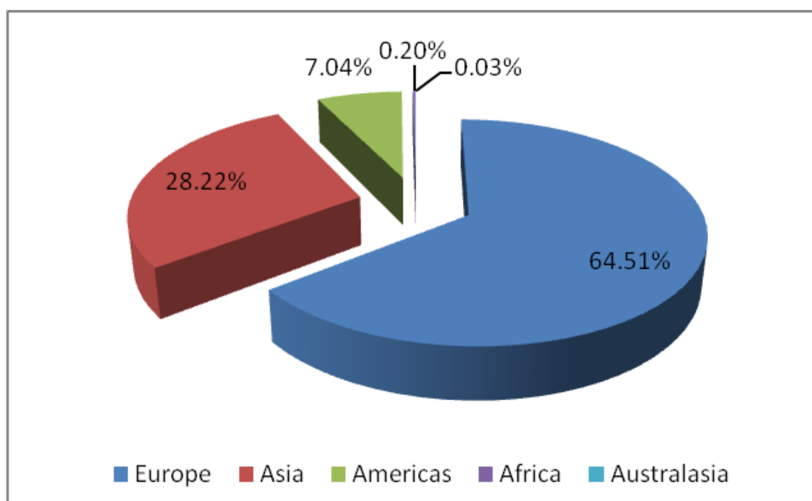
Source: Factors Chain International

Chart 4.4: Region-wise composition of domestic factoring volumes (2008)



Source: Factors Chain International

Chart 4.5: Region-wise composition of international factoring volumes (2008)

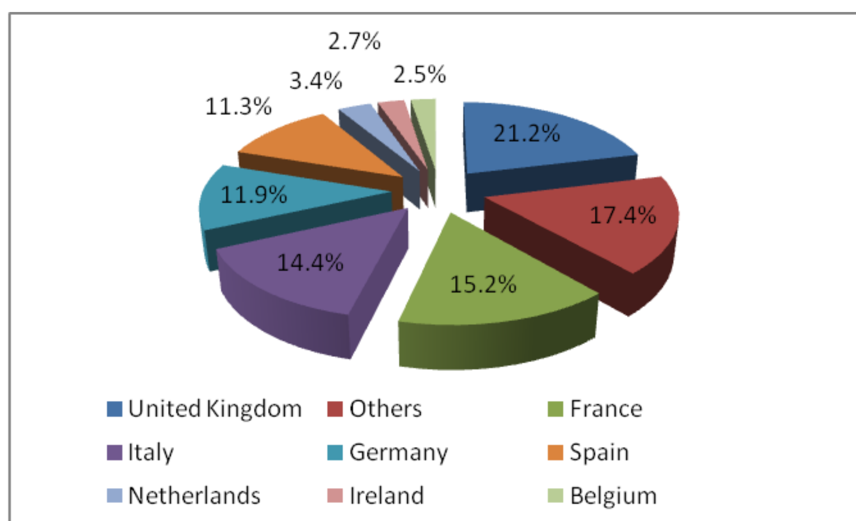


Source: Factors Chain International

Europe

4.5. Amongst the regions, Europe constituted 67% of the total factoring market in 2008. Although this represents a sizeable proportion of the total market, the European region's share in the total factoring market has witnessed a marked decline from the 71% market share that it recorded in the previous year. The UK continued to hold the largest share in the European factoring market, comprising over 21% of the total factoring turnover in this region. However, due to the decline in the value of the pound sterling vis-à-vis the euro, the factoring market (expressed in euro) declined by as much as €100 million in 2008. A regulatory framework that is conducive to factoring has facilitated the growth of factoring activities in the UK; the UK now has about 90 companies that offer factoring services, the largest number of companies present in a single country within this region. Just 5 of the 35 countries that practice factoring in the European region - the UK, Germany, Spain, France and Italy – accounted for as much as 75% of the total factoring market in Europe in 2008. Germany, which accounts for as much as 25% of the European region's total international factoring turnover, continues to register robust growth in factoring volumes. Total factoring volumes in Germany grew at an annual rate of 23.9% during the 2004-2008 period. Factoring volumes in Spain have also grown at a remarkable annual rate of 22% during the same period. Aside from the traditional Western European economies, a few Eastern European economies including Russia, Romania, Slovenia, and Lithuania have introduced factoring in order to cover their exports with other EU partners.

Chart 4.6: International Factoring Volumes of European countries



Source: Factors Chain International

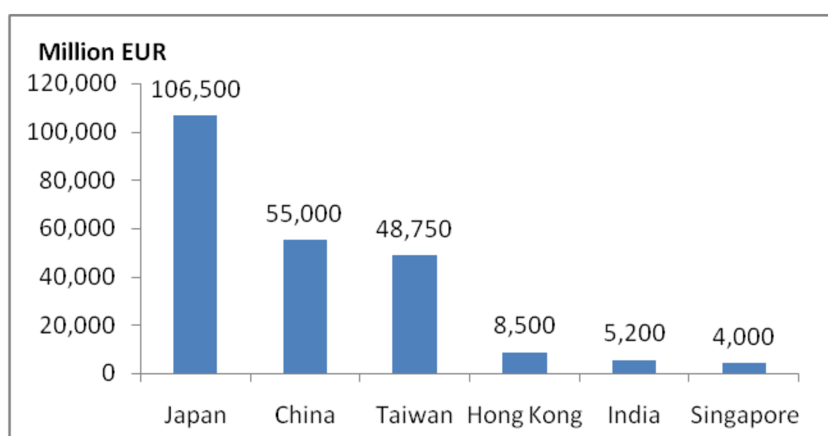
Asia

4.6. While Europe witnessed a decline in its share of world factoring volumes, there has been a substantial increase in the Asian region's share in factoring volumes. Today, the Asian region

generates close to 20% (approximately 17.8%) of world factoring volumes. Japan was the first country in this region to adopt factoring; accordingly, factoring volumes in this country are the largest. Given that a number of the major trading areas are located within this region, it is not surprising that Asia accounts for about 28% of total international factoring volumes. Expectedly, China contributes more than 50% of international factoring turnover within the Asian region. Factoring volumes in China have grown at an annual rate that is close to 90% during the 2004-2008 period and reached € 55 billion in 2008, making it the second largest market for factoring within Asia. Almost 45% of factoring activities within China pertain to export financing reflecting the recent change in world trade trends. In fact, China was the largest contributor to export factoring transactions in 2008. China, Japan and Taiwan together constitute almost 90% of the factoring volumes witnessed in the Asia region. Although Taiwan began to practice factoring only at a later stage, factoring activities grew at a fast pace and today the country has the largest number of factor agencies within the Asia region. Enterprises located in Taiwan employ both export factoring as well as import factoring services. Further, a substantial portion of Taiwan's exports are conducted on open account terms as against the letter of credit. Another region with relatively large international factoring volumes is Hong Kong. South Korea, which re-introduced factoring for exports (after the Asian currency crisis) has also experienced strong growth in international factoring volumes, an annual rate of 130% during the 2004-2008 period.

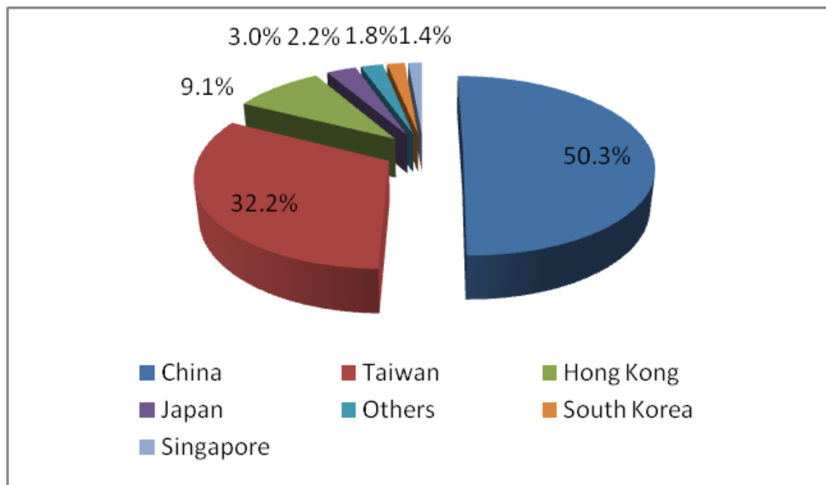
4.7. Although India introduced factoring almost two decades ago, factoring volumes in India remain miniscule relative to the size of the economy. Nevertheless, factoring volumes have risen considerably during the last three years and reached € 5.2 billion (Rs 332,280 million) in 2008. International factoring, however, continues to constitute a small percentage (about 9%) of the total factoring business generated. (Details on Indian factoring industry and environment have been discussed in previous chapters).

Chart 4.7: Asian countries which generate the highest factoring volumes (2008)



Source: Factors Chain International

Chart 4.8: Country-wise share of international factoring volumes in Asia (2008)

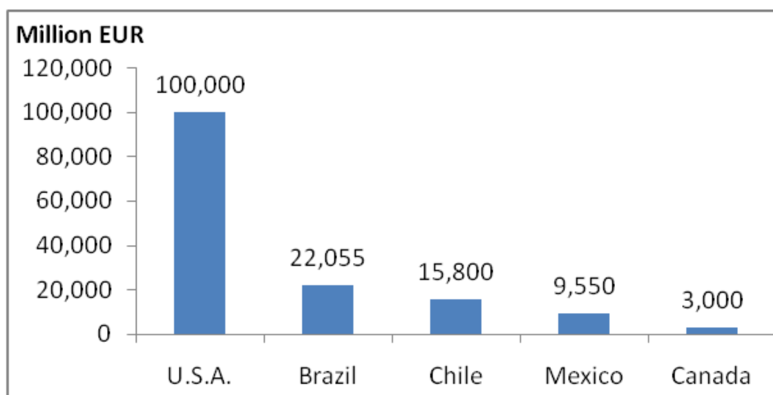


Source: Factors Chain International

The Americas

4.8. Factoring volumes in the Americas grew at a modest annual rate of about 9% during the 2004-2008 period and contributed approximately 12% of world factoring volumes in 2008. The US, the first country that adopted the modern style of factoring, generated almost 65% of factoring volumes in the Americas and 7.5% of volumes in the world market in 2008. Almost 25% of factoring transactions generated in Canada emanated from international factoring activities. In recent years, several Latin American countries and in particular Brazil and Chile, have witnessed strong growth in factoring volumes. While Brazil's share in the American region's factoring business had increased from 9.6% in 2002 to 14.3% in 2008, Chile's share has risen from just 2.7% in 2002 to 10.2% in 2008. Chile, Mexico, Columbia have set up international operations, which although small continue to grow every year. However, in most Latin American countries (aside from Honduras), the factoring business remains concentrated in the domestic market. Recently, the FCI has taken efforts to expand in these Latin American markets, reflecting changes in trade patterns.

Chart 4.9: Countries in the Americas that generate the highest factoring volumes (2008)

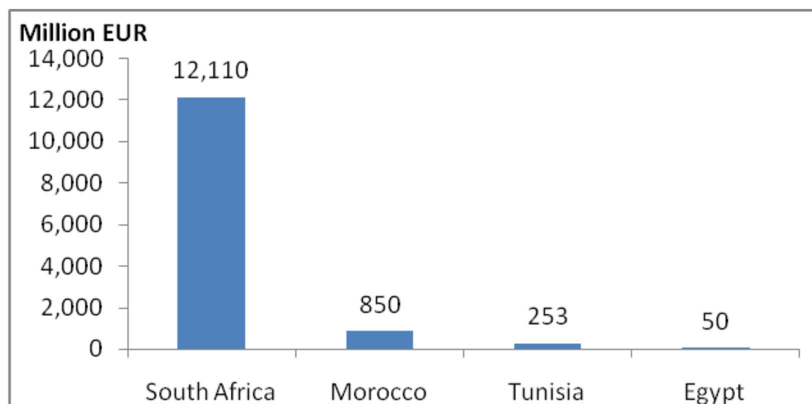


Source: Factors Chain International

Other regions

4.9. In the African region, South Africa was the first to country to introduce factoring. Factoring volumes in South Africa accounted for about 91% of total business generated in this region. Morocco, the other large player in this region, generated almost 18% of its business through international transactions in 2008. Aside from Morocco and South Africa, Tunisia and Egypt have also set up international factoring operations in their countries. Egypt adopted factoring only in 2004 and has experienced robust growth in volumes since 2006. Factoring volumes in Egypt more than doubled in 2008 as compared with the previous year.

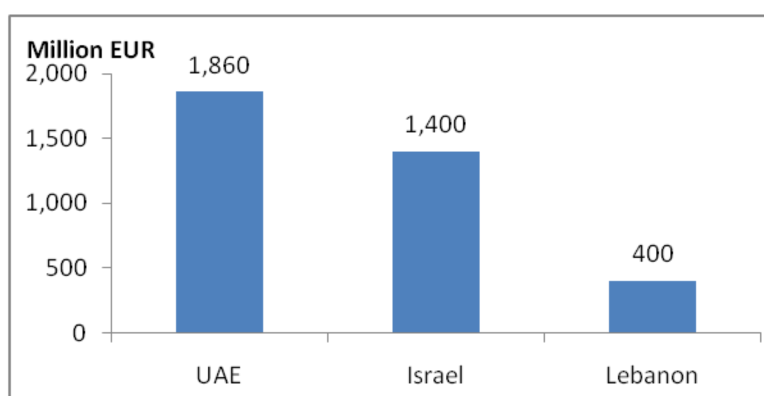
Chart 4.10: Countries that generate highest factoring turnover in Africa (2008)



Source: Factors Chain International

4.10. Australia accounted for more than 90% of business generated in Australia and New Zealand. Growth in the factoring business in Australia has been steady due to the strong regulatory framework prevailing in the country. Saudi Arabia and UAE introduced factoring operations only recently. Factoring activities in the UAE witnessed a substantial jump in 2008; factoring volumes rose by more than €1000 million, supported by strong domestic factoring services. Given that the Middle East region is a global trading hub, international factoring volumes are expected to rise over the next few years.

Chart 4.11: Countries that generate highest factoring turnover in Middle East (2008)



Source: Factors Chain International

Box 4.1: Global factoring associations

Global Factoring Associations

With increasing globalisation, the importance of export financing to cover cross-border transactions gained recognition. As a result, international factoring associations were formed. The FCI (Factors Chain International) was formed by a network of 5 factoring associations from across Europe in the Netherlands in 1968. This association provides cross border factoring facilities for exporters and importers through its 242 factor members located across 65 countries. The IFG (International Factors Group), formed in 1963, in Belgium is another Trade Association that currently represents the Factoring and Asset Based Finance Industry. The IFG association has over a 100 members spread across 50 countries. However, of the two associations, the FCI has greater representation in developing countries.

The FCI enhanced its geographical presence to include the new trading regions in the world, including the BRIC countries, i.e. Brazil, Russia, India and China. The association is also attempting to expand its presence in Central America, Eastern Europe, other South Asian countries, East Asia and Africa. Currently, the top positions for FCI export factoring include China, Turkey, France, Japan, Spain and Greece. Top positions for FCI import factoring remain the US, some EU countries followed by Taiwan, Japan, Hong Kong and China. Factoring volumes covered by the FCI grew at an annual rate of 14% during the 2004-2008 period. The FCI is estimated to cover more than 80% of international factoring transactions.

Members of the Factor Chains International association are governed by the GRIF or the General Rules for International Factoring, developed by the FCI Legal Committee. The rights and responsibilities of the export factor as well as the import factor involved in the inter-factor agreement are thus governed by the GRIF Code of Conduct. The GRIF Code also provides for arbitration in case of dispute between parties. Communication between FCI members is conducted through web-enabled EDI (Electronic Data Interchange) infrastructure, thus enhancing the quality, efficiency and reducing the costs with which information is exchanged between parties.

Several national factor associations have also been set up across the world, particularly in markets where factoring is frequently practiced by enterprises.

Best practices in international context

4.11. As discussed in the previous section, non-recourse factoring is practised predominantly in the developed countries, while most of the emerging and developing economies continue to practise mainly recourse factoring in their domestic markets. A major reason for the development of full factoring (non-recourse) is the conducive environment with respect to the regulatory, legislative and information infrastructure in the developed markets. To assess the potential of developing non-recourse factoring for MSMEs in India, it is important to understand the best factoring practices in international context which provide a feasible and conducive environment for the development of factoring, especially non-recourse factoring, in any economy. In this section, we discuss the model framework for factoring which can be used as a benchmark to evaluate the current factoring environment in India, in terms of the legislative and judicial framework, regulatory framework, taxation structure and information infrastructure.

Legislative and judicial framework

4.12.The legal and judiciary infrastructure of a country plays an important role in determining the development of factoring in an economy. There are two aspects to the legal infrastructure influencing factoring operations in the country – first, commercial and bankruptcy laws of the country specific to the property rights associated with accounts receivables and second, the enforcement of these laws.

Commercial and Bankruptcy Laws

4.13.Many countries do not have any special legislation for factoring as their existing commercial laws cover the elements required for factoring operations. For factoring purpose, country's legal infrastructure needs to address the issues with respect to legal assignment of receivables, security interests of the property, requirements for registration system for collaterals, and rights of secured creditors in case of bankruptcy. Some of the key questions that need to be addressed by the general laws of the country or a specific factoring law include:

- Can accounts receivables be assigned to a third party?
- What are the rights of the party to whom receivables are assigned?
- Can a contract for sale of goods prohibit assignment of receivables?
- Can the supplier of goods reserve/ retain title to goods even after assignment?
- Must the assignment be notified to the buyer in order to be legally enforceable, and in what form must this notification take place?
- Is there a developed bankruptcy law?

4.14.At present, commercial codes of most countries (including India) have provisions for lawful assignment of receivables to a third party. Initially, the German Civil Code allowed 'Ban on assignment' by the buyers, wherein parties to a sale contract could agree that account receivables arising from the contract cannot be assigned to a third party. Consequently, legal assignment to a factor was practically impossible in Germany. However, during early nineties, the German laws were amended to prohibit such a clause of ban on assignment. In case of the UK, a ban on assignment in the contract between the supplier and the buyer can prohibit the assignment of debt, but this is usually not practised and factor companies carefully scrutinise the contract agreement between the buyer and the seller before entering into a factoring contract with the seller. Thus, for effective factoring operations, countries' laws should prohibit the inclusion of 'ban on assignment' clause in the purchase agreement. Otherwise, factoring companies need to cautiously check the contract between the prospective client and his buyer for any such clauses.

4.15.In terms of notification requirements, while many countries require a written notice to be sent to the debtors along with provisions of assignment legend on the invoices, a few countries like the UK

and Germany do not require any written notification to constitute a legally enforceable contract. In the UK, an oral notification (through a phone call) of assignment is also sufficient, as long as there is evidence that a notification was made. In case of invoice discounting in the UK, there is no need to give notification of assignment to the buyer. In general, it is observed that factoring with recourse need not include notification but factoring without recourse usually includes notification. A few countries like the UK also require registration of assignment agreements with a common registry, without which factoring firm cannot claim a title on receivables in case of client's insolvency.

4.16. Commercial codes of some countries like Germany may include the concept of prolonged retention of title, which allows the seller to reserve the title to goods and proceeds of sale by the debtor, unless he has paid in full. This restricts the ability of the factor to take recourse against the client if there is direct payment by the debtor to the seller or if there is a default. Consequently, only non-recourse factoring is practised in Germany (Details are provided in the case study of Germany in paragraph 4.71-4.86).

4.17. For factoring, creditor rights and contract enforcement in the commercial and bankruptcy laws are extremely important; in countries which recognise factoring as a lending operation, creditor rights need to be strong for enforcement of collaterals in the case of firms' bankruptcy. Moreover, in case there is a default in payment of factored receivables, creditors can effectively enforce their rights on the collateral to meet any deficiency in payments only if the bankruptcy laws of the country provide for protection of security interests.

4.18. Countries like the UK, the US, Australia and Canada have well developed legal system comprising unambiguous commercial laws with respect to security interests as well as the bankruptcy laws. Furthermore, these countries also have well-defined collateral registration system (Details are provided in the case study of the US in the next section- see para 4.43-4.56). Consequently, asset based lending is practised successfully in these countries.

4.19. Efficient collateral laws will allow all types of assets to be used as collateral and would have provisions for out-of-court settlement of collateral. Small firms often cannot provide fixed assets/ immovable property as collateral and thus are often not able to get adequate credit. If receivables, other movable property, future assets are included in the scope of acceptable collaterals, MSMEs will be able to garner greater credit. Several countries have reformed their laws in recent times and now allow all types of assets – present and future, tangible and intangible – as collateral. According to a World Bank study, when Slovakia allowed all types of assets to be used as collateral, credit to private sector in the country increased by 10%. Some other countries that expanded the range of assets to be used as collateral include China (allowed accounts receivables as collateral in 2007),

Denmark (introduced floating charge in 2007, which allows businesses to use a pool of changing assets as collateral), Croatia (allowed inventory as assets for collateral in 2006) and Japan (allowed future assets to be used as collateral in 2005).

4.20. In many countries, despite the presence of collateral with the creditors, they often find it difficult to liquidate the collateral in case of default or bankruptcy due to weak legal enforcement of collateral (generally involving long time and costs in court battles). When a creditor knows that liquidating collateral is easy and can be done in minimal time, the credit granted is much higher. Thus in recent times, several countries have introduced out-of-court enforcement of collateral, thereby increasing the extent of credit. Many countries have provisions for summary proceedings, which enables enforcement of collaterals quickly (requiring almost 50% less time). When India introduced summary proceedings (under SARFAESI Act) in 2004, it was estimated that time taken to enforce collateral would be reduced from almost ten years to mere six months. However, the summary proceedings in India are at present can be initiated only by banks and financial institutions (which does not include NBFCs undertaking factoring).

4.21. Efficient bankruptcy laws also improve access to credit. Economies with good bankruptcy laws are characterised with three main features – they seek to rehabilitate viable business and liquidate unviable ones; they aim to maximise the value received by creditors, shareholders and employees of the insolvent business by having provisions for either turning around of business, sale or liquidation, whichever generates maximum value; and they have clear provisions for ranking of creditors. In such economies, recovery rate is much higher than those countries without such laws. According to Doing Business 2009 (World Bank), bankruptcy laws are most efficient in Ireland, Japan, Canada and Singapore, while least efficient in Indonesia, Philippines and India. Several countries have lately made reforms in their insolvency laws by establishing special bankruptcy laws, by granting greater power to creditors and by tightening time limits and streamlining appeals. Some of the economies that have undertaken such reforms in recent times include Finland, France, China, Indonesia, Italy, the US, Vietnam and Korea.

Table 4.1: Where is Bankruptcy most efficient?

Time (years)			
Fastest		**Slowest**	
Ireland	0.4	Ecuador	5.3
Japan	0.6	Indonesia	5.5
Canada	0.8	Haiti	5.7
Singapore	0.8	Philippines	5.7
Belgium	0.9	Belarus	5.8
Finland	0.9	Angola	6.2

Norway	0.9	Czech Republic	6.5
Australia	1.0	Maldives	6.7
Belize	1.0	Mauritania	8.0
Iceland	1.0	India	10.0
Cost (% of estate)			
Least		**Most**	
Colombia	1.0	Micronesia	38.0
Kuwait	1.0	Philippines	38.0
Norway	1.0	Samoa	38.0
Singapore	1.0	Solomon Islands	38.0
Bahamas	3.5	Vanuatu	38.0
Belgium	3.5	Venezuela	38.0
Brunei	3.5	Sierra Leone	42.0
Canada	3.5	Ukraine	42.0
Finland	3.5	Liberia	42.5
Georgia	3.5	Central African Republic	76.0

Source: Doing Business Database 2009, World Bank

Legal enforcement

4.22.It is not sufficient to have strong commercial and bankruptcy laws in place if the enforcement of these laws is not strong. The role of judiciary in settlement of disputes is also of extreme importance to ensure effective factoring operations in any country. The Doing Business 2009 (World Bank) indicates strong contract enforcement in countries like Singapore, Hong Kong, New Zealand and the US, as these countries take less time and costs in enforcing a legal contract. In Singapore, for instance, it takes only 150 days to resolve a commercial dispute. One reason for this is that in Singapore, court documents can be filed electronically and each case is monitored from the moment it is filed until it is finally decided. Contrary to this, contract enforcement is extremely weak in South Asian countries like Bangladesh, India and Sri Lanka. In general, in the economies with fastest average times to enforce a contract, there are specialised commercial courts or specialised commercial sections within existing courts and these also specify the limits on the number and length of adjournment once a case has started.

Table 4.2: Efficiency of contract enforcement across countries

Procedures (number of steps)			
Fewest		**Most**	
Ireland	20	India	46
Singapore	21	Kuwait	50
Hong Kong, China	24	United Arab Emirates	50
Rwanda	24	Belize	51
Austria	25	Iraq	51
Belgium	25	Oman	51
Netherlands	25	Timor-Leste	51

Iceland	26	Sudan	53
Luxembourg	26	Syria	55
Czech Republic	27	Brunei	58
Time (days)			
Fastest		**Slowest**	
Singapore	150	Sri Lanka	1,318
Kyrgyz Republic	177	Trinidad and Tobago	1,340
Uzbekistan	195	Colombia	1,346
Lithuania	210	Slovenia	1,350
Hong Kong, China	211	India	1,420
New Zealand	216	Bangladesh	1,442
Belarus	225	Guatemala	1,459
Bhutan	225	Afghanistan	1,642
Kazakhstan	230	Suriname	1,715
Korea	230	Timor-Leste	1,800
Cost (% of claim)			
Least		**Most**	
Bhutan	0.1	Comoros	89.4
Iceland	6.2	Cambodia	102.7
Luxembourg	8.8	Burkina Faso	107.4
United States	9.4	Papua New Guinea	110.3
Norway	9.9	Indonesia	122.7
Korea	10.3	Malawi	142.4
China	11.1	Mozambique	142.5
Poland	12.0	Sierra Leone	149.5
Hungary	13.0	Congo, Dem.Rep.	151.8
India	39.6	Timor-Leste	163.2

Source: Doing Business Database 2009, World Bank

4.23.In countries where bankruptcy laws related to creditors' rights and security interests (collateral liens) are not strong, full factoring (non-recourse) involving outright purchase and sale of receivables between the factor and the client are most suited. In the case of full factoring, factors are not creditors and hence the need to claim rights over collateral, either on default by the debtor or bankruptcy of the client, does not arise. Under such factoring mechanism, credit protection is a major function of the factoring firms and hence a well established information infrastructure becomes a key requisite (Information infrastructure is discussed in detail later in this chapter, see paragraph 4.32-4.42).

Regulatory framework

4.24.Different economies follow different regulation framework with respect to factoring. In some economies there may be no specific regulation for factoring (the US, the UK, etc), wherein factoring is regulated within the existing legal and fiscal framework of the country, while in case of other economies (like India), factoring is governed by a regulatory body which governs the operations of

Non Banking Financial Companies (NBFCs) with rules different from those applicable to the commercial banks. In such cases, the regulatory body (mostly the Central Bank) lays down criteria for establishment of factoring companies. On the other hand, in some economies factoring is closely regulated and there are restrictions on entities that can engage in factoring, like in Russia factoring activity is restricted to licensed commercial banks. However, in practice there are certain factors in Russia that operate without banking license. Consequently, Russian parliament is currently considering a legislation that will free the factors from the requirement of being classified as banks and they would then be re-classified as unlicensed financial providers. In Germany, factoring has now become a regulated activity. Since January 2009, factor companies are now placed under the same regulatory authority as banks, i.e. German Federal Financial Supervisory Authority.

Table 4.3: Regulatory treatment of factoring companies in major countries

Country	Factors treated as banks	Factors not treated as banks	Expected change
Brazil		✔	
Bulgaria		✔	
Canada		✔	
Chile		✔	
China		✔	✔
Germany	✔		
Hong Kong		✔	
India		✔	
Russia	✔		✔
Spain		✔	
Sweden		✔	
UK		✔	✔
USA		✔	

Note: The information relates to independent factor companies. Those operating within banks are obliged to comply with banking regulations

Source: World Factoring Yearbook, 2009

4.25.The regulatory environment has a direct impact on the factoring operations in an economy. In case of no regulations, factoring companies operate as per the corporate governance rules while too restrictive regulations can hinder the development of factoring as these create barriers to entry. There is a need to strike a balance such that factoring companies are encouraged to do business, at

the same time ensuring that entities without expertise and adequate financial backing do not disrupt the financial market development by entering into factoring business.

4.26.UK, USA and Brazil are largely unregulated with respect to factoring operations and thus host several factoring companies (90 in case of the UK, 120 in the US and 674 in Brazil). While in the UK and the US markets, factoring turnover has grown substantially due to absence of restrictions, in case of Brazil, factoring companies remain under-capitalised and are only concentrated in domestic market with extremely low volumes of international factoring as absence of any regulations have led to a splurge of factoring entities without expertise and adequate financial backing. The reason for splurge of independent factoring companies in Brazil is that factoring is classified as a commercial activity and not a banking activity in Brazil and is subject to Brazilian Commercial Code and Civil Code rather than regulated by Brazilian Central Bank. In Canada too, factoring industry is not covered by the banking law and factors have strongly resisted introduction of greater oversight and regulation.

4.27.In contrast, Vietnam market is over-regulated, which has restricted factoring growth in that market in comparison with that of other countries. In Vietnam, factoring is considered a lending operation and thus all restrictions applicable to lending instruments are applicable to factoring as well. Since factoring in Vietnam is conducted as a department of banks and is treated as one of the specific lending products, banks have focused on dealing with important liquidity issues in recent times than on developing of factoring products. Due to classification as a lending product, demand for factoring is also restricted as most MSMEs prefer traditional financing methods like Letter of Credit (LC) to factoring.

4.28.In view of the recent financial crisis, most governments have felt the need of having regulations in place for all financial services, including factoring. Moreover, in countries where factoring is new or underdeveloped, it is advisable to have a regulatory framework that defines factoring, parties to factoring contracts, various features of factoring, and sets criteria for factoring companies with respect to corporate form, minimum capital, lending and credit exposure ratios, ownership status and the scope of business.

Taxation structure

4.29.The fiscal framework applicable to factoring operations can have a significant impact on the cost of factoring operations and hence its development. From the taxation point of view, it is important to understand the VAT and sales tax applicable to factoring transactions and income tax provisions applicable to factoring firms. In many countries, where factoring is a relatively new financial service, VAT and sales tax treatment of factoring is often unclear and thus it is essential to clearly define the tax provisions for various factoring operations. The key tax related parameters to be considered for factoring include:

Applicability and rate of VAT/ sales tax to financial/ factoring services

Applicability and rate of stamp duty while entering into factoring agreement

4.30. In some countries like USA and Hong Kong, VAT is not levied on factoring services, thereby contributing to its development in the country. In countries where VAT is applicable to factoring services, it is generally applicable to service fees for receivables administration and ledger management but not on the discount charges levied for late payments. In Singapore and UK, VAT is applicable on the service fee but not applicable on the discount charges.

4.31. Similarly, there is a need to clarify whether stamp duty is applicable while entering into factoring transactions. Stamp duties on factored invoices can hamper the growth of factoring in an economy and thus, an ideal factoring framework will not include any stamp duties. In most of the developed factoring markets, stamp duty is exempted (the US, the UK, Germany, Singapore and Hong Kong).

Information infrastructure

4.32. During factoring process (especially non-recourse factoring), availability of good credit information is extremely important to assess the client as well as his debtors prior to entering a factoring contract. If the credit information infrastructure in the country is strong, factor firms are willing to purchase the receivables with confidence as past payment records of the prospective clients can be easily assessed. Thus, a strong information infrastructure in the country facilitates growth of factoring and greater availability of credit to MSMEs. A strong information infrastructure implies regular availability of information on payments performance of all borrowers, either through third party exchanges like credit bureaus, through factoring companies' own database or through availability of bank reports. In the absence of credit information bureaus/ business registries, the time to process loans, cost of providing loans and chances of default are all high.

4.33. Worldwide, the number of countries having at least one credit bureau has increased from around 96 in 2005 to 132 in 2008. Research studies have shown that introduction of credit registry increases the repayment rate and hence provides greater access to credit. According to some studies, repayment rate in developing economies can increase by up to 80% with the introduction of credit registry/ bureau.

4.34. The presence of credit bureaus/ registries is not sufficient alone; coverage, scope and quality of credit information provided by these credit bureaus are key determinants in improving access to credit. The international best practices for credit bureaus include laws for credit information with following elements:

a) Reporting and accessing of credit information is not limited only to financial institutions but also includes telecom companies, retailers and utility companies
b) The minimum threshold for inclusion of credit data is not high (to increase coverage)

c) Both positive and negative information on accounts is available (positive information including assets, loan outstanding, payment behaviour, etc and negative information including defaults and arrears)
d) Information on defaults is removed from the system once debts have been repaid
e) Information is stored for a period of 5-7 years
f) Individuals are allowed to check their information and to report any erroneous data
g) There are provisions for a mechanism to correct for mistaken information in the credit bureau

4.35.While there are credit bureaus in over 130 countries, not all of these are well developed in terms of coverage, scope and quality of information as credit information laws in several countries do not provide for all the elements listed above (some countries do not even have credit information laws). Credit Bureaus in the US and the UK are most efficient as they cover all the elements discussed above (see table below).

Table 4.4: Credit information availability in credit bureaus of select countries

Indicator	Are data on both firms and individuals distributed?	Are both positive and negative data distributed?	Does bureau report credit information from retailers, utility companies and trade creditors?	Are more than 2 years of historical credit data distributed?	Does the law provide that borrowers can inspect their data in the credit registry?
USA	Yes	Yes	Yes	Yes	Yes
UK	Yes	Yes	Yes	Yes	Yes
Germany	Yes	Yes	Yes	Yes	Yes
Singapore	Yes	Yes	No	Yes	No
Thailand	Yes	Yes	No	Yes	Yes
Hong Kong	Yes	Yes	No	Yes	Yes
China	Yes	Yes	No	Yes	No
Brazil	Yes	No	Yes	No	Yes
India	Yes	Yes	No	Yes	No

Note: The data includes information availability in either private or public credit bureaus

Source: Doing Business, World Bank

4.36.In most developed countries, the coverage of credit information in their credit bureaus is extensive; credit bureaus in Argentina, Australia, Canada, Iceland, Ireland, New Zealand, the UK and the US provide credit information for 100% adults. In India, the coverage has improved from 1.7% of adult population in 2006 to 10.5% in 2009. This has been facilitated with the inclusion of commercial segment information in country's credit bureau (CIBIL).

Table 4.5: Borrowers covered by credit registries (% of adults)

Most		Least	
Argentina	100	India	10.5
Australia	100	Nepal	0.24
Canada	100	Algeria	0.20
Iceland	100	Mauritania	0.17
Ireland	100	Ethiopia	0.13
New Zealand	100	Madagascar	0.07
Norway	100	Yemen	0.07
Sweden	100	Nigeria	0.06
United Kingdom	100	Zambia	0.05
United States	100	Guinea	0.02

Source: Doing Business Database 2009, World Bank

4.37. Several economies are undergoing reforms in their credit information systems. During the last few years, countries that expanded the set of information collected in their credit registries include Hong Kong, Sri Lanka, Georgia, Romania, Tunisia, Vietnam and Mauritius. Georgia's credit bureau, for instance, now provides information on repayment patterns and outstanding loan amounts and this has increased the coverage in the country by almost twenty times.

4.38. In past, several economies have introduced measures to improve the quality of credit information provided by the credit bureaus. While some economies have provisions for penalties for credit institutions that fail to update the credit histories or withhold credit information (Mongolia, Nepal), many economies have introduced data protection laws, which allow borrowers to access their data and demand corrections (Greece, Uruguay).

4.39. Another significant factor that accelerates access to credit is the presence of unified collateral registries. Registration of collateral secures the rights of the creditor and ensures that no one else has a priority lien. In a few countries, charges over movable property are enforceable only if there is a corresponding registry (Turkey, Syria) and hence these countries have established unified collateral registries, which allow creditors to notify their claim to others. Several East European countries have recently established unified collateral registries. India too established an online collateral registry in 2006. However, this registry includes information only on companies. Since most of the MSMEs in India are proprietorship or partnership firms, information on their collaterals is not registered.

4.40. Though many countries have initiated reforms in their credit information system by establishing credit bureaus and introducing laws for credit information, the coverage and scope of credit information remains inadequate and hence acts as a hurdle to growth of factoring services. To overcome the challenge of weak credit information infrastructure, factor companies in many

countries practice reverse factoring. Under this mechanism, a factor company depends upon credit information of a few large companies for financing accounts receivables from latter's MSME suppliers. Consequently, the factor has to assess the credit risk of only a few large firms, with high credit rating. Reverse factoring has enabled high growth in factoring business in economies like Mexico.

Box 4.2: Reverse Factoring: Case of Mexico

Reverse Factoring: Case of Mexico
Heller Financial, a factoring firm, has a reverse factoring arrangement with Wal-Mart in Mexico. Wal-Mart offers its Mexican suppliers the option of getting their receivables factored by Heller Financial. Thus, small sellers can receive up to 80% of prepayment for their invoices on Wal-Mart. Although the sellers do not have existing relationship with the factoring firm, they are able to enjoy financing on Wal-Mart's credit risk. Such arrangement not only benefits the sellers, but also Wal-Mart as it is able to negotiate better credit terms with them and also reduce its transaction costs (by making one bill payment to the factor instead of multiple payments to the sellers).

4.41.Assessment of current information environment of the country is essential as it enables the regulatory body to establish appropriate framework to promote development of public credit registries/ private credit bureaus and to introduce laws for improving data coverage and for data protection. Evaluation of information infrastructure can also enable factoring industry to assess the need for practising and promoting reverse factoring.

4.42.In the following section, we assess the factoring environment in major international factoring markets and how it has played a role in development of factoring in these countries. Based on our initial interactions with FCI and statistical analysis of country-wise factoring turnover, we have shortlisted three developed markets viz. the US, the UK and Germany; and three emerging economies viz. Singapore, Turkey and Thailand for conducting detailed country studies. In the concluding section, we have mapped the best international practices for factoring with the current factoring environment in India, to identify the areas of reforms for development of factoring in India.

International experience: Country case studies

The United States

4.43. USA was the first country to have adopted the modern style of factoring and not surprisingly generates a significant portion of world factoring volumes. Factoring activities in the US date back to the 1920's when factoring services were introduced to serve textile and apparel companies that were not able to obtain traditional forms of finance from banks. Until the 1980's, factoring was typically practiced by large enterprises and involved substantial funds. The US savings and loans crisis during the 1980's and 1990's resulted in a financial slowdown and banks began to tighten regulations governing the lending of funds to institutions. As a result, new and small enterprises,

which did not have easy access to traditional sources of financing, began to increasingly turn to factors to meet their working capital finance requirements. Currently, small and medium enterprises constitute the majority of clients for factoring businesses in the US. While both recourse and non-recourse factoring are recognised and practiced, more than 80% of transactions are conducted on a non-recourse basis. More than 80% of transactions are conducted on a notification basis, which means that the supplier notifies buyers of the assignment of receivables to a factor agency.

4.44. As much as 75% of factored sales emanate from the retailing/consumer products. Apparel and textile companies continue to constitute more than 50% of factored sales. The other main sectors that utilise factoring services are furniture, business services, electronics, transportation, construction, energy, telecommunications, printing and staffing services.

4.45. Factoring volumes of the US have grown at an annual rate of a little more than 5% during 2004-2008 and reached € 100,000 million in 2008, of which 90% were derived from domestic factoring transactions. However, international factoring transactions are growing fast as an increasing number of the US based textile and other consumer product firms have started operations in emerging economies where labour costs are low. The country signed and ratified the UNIDROIT convention on international factoring in 2004.

Regulatory and legislative environment

4.46. USA is considered as one of the most developed factoring markets in the world as regulatory and legislative environment in the country is most conducive to the growth of factoring services, especially full factoring (non-recourse factoring). Factoring is largely unregulated in the US; factoring companies are not required to obtain licenses/approval from the Federal Government for providing services. However, factor agencies' collection activities are regulated by the US Fair Debt Collection Practices Act which state permissible activities and conduct required of debt collection agencies. In the event that the buyer defaults on payments, the factor agency can charge penalties such as an increase in the interest rate based on initial agreement/contract or on the courts.

4.47. USA does not have a specific factoring legislation but has well developed commercial and bankruptcy laws that have facilitated the growth of factoring activities. The Uniform Commercial Code (UCC) contains various legal elements required for operating factoring services. In order to promote the harmonisation of laws across the 50 States, the Uniform Commercial Code was developed; this code is not the law but it is a set of recommendations for laws to be adopted by States. The various States have adopted the UCC, with some States modifying some of the recommended laws marginally as deemed necessary by the State Legislatures.

4.48. Laws governing the assignment of receivables are simple and clear, both in terms of legal procedures as well as costs involved. Both current as well as future receivables can be assigned. The US also accepts receivables that are assigned electronically. Electronic signatures are recognised and electronic transactions are supported by the Electronic Commerce Acts.

4.49. The Uniform Commercial Code (UCC) also contains laws to govern the creation & enforcement of security interests in intangibles, including debts. Specifically, Article 9 of the Uniform Commercial Code provides suggestions for the development of a framework that governs secured lending. The factor agency is required to sign a statement with the seller's signature on it and file the statement in the State of the seller. This system also enables public notification of factors' rights over the receivables and collateral and ensures that factor has the rights as a lender/ purchaser of the financed receivables, which can be legally enforced in case of default by the debtor or bankruptcy of the client.

4.50. The process of filing liens is simplified and the time required is shortened since the US also allows for group lien filings. This implies that secured lenders can file a single lien on all accounts receivables as compared with several other countries where each receivable has to be identified by invoice number and serial number.

4.51. Creditor rights' in case of insolvency of the supplier or default on the part of the buyer are also well defined. The first secured party to perfect its security interest or file its financing statements is given priority over other secured creditors, irrespective of whether the party filed fixed charges or floating charges. In the event of bankruptcy/insolvency of the client, the factor agency's rights may be adversely affected if a financing statement has not been filed. However, security interests in receivables usually lose priority over federal tax lien rights except under certain circumstances. For instance, if the receivables existed and were covered by a perfected security interest before the federal tax lien was filed.

4.52. The US judiciary system is effective and the cost of entering into legal proceedings is relatively low, both in terms of time and money. According to Doing Business 2009 (World Bank), judgment can be concluded and payment received in 300 days and average costs involved in enforcement of contracts are 9.4% of the total claims.

4.53. The taxation system has been fairly conducive to the factoring business with few taxes charged on services provided by these firms. Factoring services in the US are not subject to VAT and the

assignment of debt is not subject to stamp duty. Factors are only required to pay a nominal fee on the filing of the financing statement with the Government office in its State.

4.54.The strong growth witnessed in the non-recourse factoring business in the US is supported by its robust credit information infrastructure. The credit information system is well developed and information coverage is vast. There are several sources and tools available to avail of credit information including commercial credit bureaus and several agencies that provide credit reports. Small business credit scoring, a technology that provides firms with access to credit data at relatively low costs, has also become quite popular. Several lending institutions also use electronic ledgers to input receivables information along with their customer's Dun & Bradstreet ID numbers. The electronic ledger is then automatically updated with D&B ratings for customers.

4.55.With the growth of the credit information industry, many credit insurance firms have also been set up. Factor agencies often use credit insurance firms to cover their domestic factoring transactions. Some of the credit provided by lending institutions to MSMEs is also guaranteed by the Small Business Administration (SBA). However, some large factor agencies have dedicated credit departments that undertake the underwriting of sellers and their buyers and thus these firms do not utilise credit insurance for domestic factoring transactions. This model has considerable advantage as it allows factor firms to undertake detailed scrutiny of the sellers and their buyers. Moreover, with credit insurance tightening credit in wake of recent crisis, it is difficult to get approvals from credit insurance companies.

4.56.***Summing Up:*** Although the US does not have a specific factoring legislation, the UCC provides sufficient guidance for the creation and enforcement of security interests for governing factoring activities. Clearly defined creditor rights, strong enforcement laws, a conducive taxation environment and a well developed credit information system that covers both MSMEs and large enterprises have been beneficial for the growth of the factoring industry. Recently, there has also been an increase in the number of electronic transactions. The Receivables Exchange (TRE), an online market that facilitates the purchase and sales of accounts receivables through real time auctions also launched its trading platform in 2008. Since then, the number of MSMEs trading their receivables on TRE has increased significantly. In the current economic crisis, with banks stepping up credit eligibility requirements, the factoring business and volumes on the Receivables Exchange are likely to increase over the next few years. Since factoring services are provided only after conducting detailed analyses of sellers and buyers, these services could expect to grow in light of the current economic crisis, as financial institutions value more conservative means of lending.

The United Kingdom

4.57.The United Kingdom was one of the first countries in the European region to adopt factoring. By the 1970's, factoring activities gained momentum with an increase in the number of independent factoring companies and as a large number of clearing banks began to partake in factoring activities. The most rapid growth in this industry was however, witnessed during the last 20 years. Factoring was initially offered as a fully disclosed full fledged product; however today, there are various forms of factoring as well as other types of asset based lending in the market. The asset based finance market is well established in the UK with firms offering factoring, invoice discounting, lending against other stocks/ assets. The UK has one of the largest asset based lending markets today with volumes reaching €188 billion in 2008. Volumes have grown at an annual rate of about 3% during the 2002-2008 period; however about 93% of these volumes catered to domestic transactions.

4.58.The factoring industry is dominated by banks although there are a few non bank financial institutions that provide factoring services. Non bank financial institutions prefer to provide finance packages that combine factoring with other services as compared with plain vanilla factoring services, since they are unable to compete with banks in terms of cost of funds. In the UK, banks are convinced that factoring is a safe and profitable product and have thus pushed their branch networks in selling factoring and invoice discounting as key products. One of the reasons for increased bank focus on factoring business is the Spectrum judgement (passed about ten years back), which provided that banks cannot control debtor assets under a conventional bank facility like overdraft and expect to recover the same from debtors. The judgement further provided that if Banks are controlling debtor assets, it requires more detailed and specialised management of same, in a manner similar to factoring or invoice discounting. Consequently, over the last decade, the level of overdraft lending in the UK has become much lower than the factoring and invoice discounting.

4.59.Amongst the type of products offered by members of Asset Based Finance Association (ABFA), domestic invoice discounting is the main service utilised by companies. Almost 80% of sales were of domestic invoice discounting services, 11% were domestic factoring services. Import and export factoring constitute only 1.5% of total sales. The client selection usually differs for invoice discounting and factoring products. Often, financial institutions and banks recommend factoring services to smaller clients who require credit protection, in their opinion. Both recourse and non-recourse factoring are practised in the UK; non-recourse is specifically targeted at small and medium players who have greater needs of credit protection and are unable to raise finance through conventional banking mechanism.

4.60.About 30% of factoring volumes in the UK emanate from clients in the manufacturing and services sectors each, followed by clients from the distribution sector (about 19%). A large number of clients (almost 40%) are small sized firms with annual turnover below £500,000 (approximately 629,840 Euros) and just 1% of clients had turnover above £50 million (approximately 63 million Euros). Although the number of small clients is very high, the total value advanced is significantly high for larger clients; as at December 31, 2007, factoring advances to large clients (annual turnover above £50 million, or €63 million) were £4,627 million (approximately 5828.5 million Euros) as against £542 million (approximately 682.7 million Euros) advanced to smaller clients (annual turnover below £500,000, or 629,840 Euros).

4.61.It is common for factoring firms to provide their services to clients/suppliers on a whole turnover basis. All invoices of a supplier are financed and collection services, receivables management are provided for all buyers of suppliers. Factoring firms in the UK believe that this practice enables them to reduce risk since the primary risk is that of the client/supplier turning insolvent.

Regulatory and legislative environment

4.62.Like the US, factoring services in the UK are also not regulated and there is no special legislation governing factoring. Invoice finance and factoring companies in the UK do not require a license to operate and are not directly regulated by any authority. There are no minimum capital requirements for non bank firms that provide factoring services. However, the Financial Services Authority does supervise factoring companies indirectly with reference to any associated credit insurance. Companies are also to register and comply with respect to Anti Money Laundering Laws.

4.63.The Civil code governs the assignment of debt and the creation & enforcement of security interests. It is possible to assign existing as well as future debts in the UK. In order to achieve a legal assignment, agreements must be registered at the Bills of Sales Registry (especially for whole turnover assignments where the client is an unlimited partnership or sole trader). Without registering the agreement, the factor agency has no title to the accounts receivables if the client is declared insolvent. The assignment process in the UK is simple; an electronic assignment is also legal, as long as there is a written and signed agreement that records the wording of any Electronic Data Exchange notification. However, a ban on assignment within a contract between the supplier and his buyer could prohibit the assignment of the debt.

4.64.For the purpose of notification of assignment to the debtor, an introductory letter can be sent or the assignment legend can be affixed on invoices. However, even a statement or an oral declaration of the assignment in title is usually sufficient. Factor agencies are required to notify debtors of the change in assignment of title in order to be able to issue court proceedings to collect receivables.

Notification is also necessary to obtain priority over other subsequent security holders in case of insolvency.

4.65. In terms of the security charge, factoring firms usually use a floating charge when creating a security interest. The UK also provides regulations for a national registry where security interest are registered so as to give notice to all creditors/claimants of the existence of security interest in the supplier's collateral. However, while it is recommended that factoring firms register their security interests, it is not mandatory to do so.

4.66. The judiciary system in the UK is very effective and legal enforcement, in general, does not take much time. In case the debt is overdue, factor agencies are permitted to ask for late payment interest; the rate could be determined by the Late Payment of Commercial Debts Act 1998 or the contract or courts. In case payment is made to the supplier as opposed to the factor agency, as per the law, the factor agency can force the buyer to make a second payment as long as there is evidence of notification of assignment. However, in practice, usually the factor agency asks the supplier to pass on the payments and in cases where the supplier does not transfer the payments, the factor agency usually deducts this amount from the supplier's eligible funds and provides less to the supplier the next time the agency is approached for financing.

4.67. Several credit insurance companies provide credit protection for factoring in the UK. This is also one of the reasons for a high proportion of non-recourse factoring in total factoring turnover. The high availability of credit insurance is due to the existing credit infrastructure in the United Kingdom where credit information coverage is high. As per the latest World Bank 'Doing Business in 2009' report, the UK ranks number 2 in the world in terms of getting credit information. Private bureau coverage is estimated to be 100% of adults. There are several consumer as well commercial credit information providers including First Reports, FTS Credit Services, Graydon, ICC information, Status International, Equifax, etc. Like the US, Several lending institutions also use electronic ledgers to input receivables information along with their customer's Dun & Bradstreet ID numbers. The electronic ledger is automatically updated with D&B ratings for customers.

4.68. Besides purchasing credit insurance, several factoring firms also undertake their own underwriting of domestic buyers and their sellers. It is relatively easy for factoring firms in the UK to undertake a detailed analysis of clients and their buyers since they have access to the Company House and can obtain ratings and financial information from the Company House. In the current economic downturn, a large number of suppliers are even turning to self insurance. When entering into a contract with the factor agency, these suppliers sometimes also transfer the rights of insurance to the factor agency.

4.69.The taxation environment is also fairly conducive for the factoring business. For factoring companies, service charge is subject to a VAT levy of 17.5%; discount charges are currently exempt from VAT. There is no difference in the tax treatment between banks offering factoring services and NBFCs, in terms of VAT. The assignment of debts has been exempted from stamp duty effective 2003.

4.70.***Summing up:*** The regulatory and legal system in the UK has been highly conducive for the development of invoice discounting and factoring activities. Well defined laws governing the assignment of title and the enforcement of security interests have facilitated the growth of financing activities including factoring. Factor agencies also have access to the financial information of their clients and clients' customers through Company House, credit bureaus and credit information providers. In light of the recent economic turmoil, it is expected that factoring volumes increase as a detailed analyses and scrutiny of firms before providing finance will become more desirable.

Germany

4.71.Factoring services were introduced in Germany in the late 1960's. However, the industry witnessed slow growth in the first two decades, primarily due to legal impediments and ignorance and misconceptions of the nature of business among enterprises (factor firms were considered to be a 'lender of last resort'). There were two main legal impediments – first, the German Civil Code allowed the buyer to include the clause 'to prohibit the assignment' in a supply contract, whereby assignment to factors was impossible; second, German laws provided for prolonged retention of title to the seller, whereby seller of goods reserves the title to goods and sales proceeds until paid by debtor in full. Due to the latter rule, only non-recourse factoring is recognised in Germany. Although the prolonged retention of title continues, former legal hurdle allowing ban on assignment in supply contract has been done away with since 1994. Consequently, factoring services witnessed modest growth during late nineties.

4.72.Factoring witnessed a good growth post 2000 as slowdown in economic growth during that time led to banks tightening their regulations governing lending, which forced SMEs in Germany to locate more available means of financing especially factoring. During 2002-2008, factoring volumes grew at an annual rate of approximately 22% and reached as much as €106 billion in 2008 as compared with €30 billion in 2002. International factoring, in particular, remained strong with volumes reaching €29 billion in 2008. Germany has remained a leader in international factoring, accounting for almost 17% of global export-import factoring volumes. Some of Germany's main international partners are Benelux, France, Eastern Europe, Austria, Great Britain, Italy, Switzerland, Scandinavia, Spain, and the US. Germany has also signed and ratified the UNIDROIT agreement on international factoring.

4.73.In-house factoring (similar to invoice discounting) constitutes about 78% of factoring transactions, standard factoring accounts for 20% of volumes and maturity factoring just about 3% of factoring volumes in Germany. Further, since recourse financing was not given adequate legal recognition, most transactions have been conducted on a non-recourse basis, up until now. A bulk of the users in the German market are from the wholesale, metal processing, food, metal products, automotive and electronics sectors. Medium and large enterprises form a bulk of clients for factoring firms.

Regulatory and legislative environment

4.74.Up until recently, factoring activities in Germany were not regulated. Without strict regulations and with no minimum capital requirements, factoring activities in Germany mushroomed and today there are more than 150 financial service providers in the factoring space. However, it is estimated that about 30 of these firms account for 80-90% of volumes with the balance conducting operations such as collection services. The business is dominated by financial institutions, insurance companies and subsidiaries of foreign banks.

4.75.Due to the growing importance of factoring to the German economy in recent times and the subsequent need to provide factoring firms a level playing ground with banks, the German Government made factoring a regulated financial service within the German Banking Act (KWG), with effect December 2008. As a result, factoring firms are now required to procure a license to operate. No license is however required for maturity factoring since it does not involve financing. German companies planning to operate abroad also need a permit from the German Financial Authority (BaFin). Further, factoring companies based in another European Economic Area (EEA) state can provide factoring services in Germany or factoring services through a German subsidiary without obtaining a license from the German Financial Authority.

4.76.Under the new framework, while recourse factoring is governed by the banking act, non-recourse factoring continues to be governed by trade laws. Accounting norms for German factor agencies have also become more stringent under this legislation. These firms have to submit annual accounts, management and auditor reports to the German authority now.

4.77.The legislation, however, allows factoring companies (practicing non-recourse) exemption from certain regulations applicable to banks relating to solvency ratios, liquidity ratios, participation limits, risk concentration limits, monthly return notifications. In addition, no minimum capital requirement for factoring companies continues.

4.78.The assignment of receivables is simple and straightforward as per the German Law. A written contract must be entered into between the factor agency and the supplier and the contract must be a revolving one to be considered valid. As mentioned earlier, German legal system does not recognise recourse financing as lending against the security of debt. Further, 'prolonged retention of title' prevents factoring firms from practicing this type of factoring. When practicing recourse factoring, factoring companies are at a disadvantage since suppliers have the title to receivables until goods are paid for.

4.79.With regard to the buyer (the debtor) the assignment only becomes legally valid when the buyer is informed. This is usually done by a simple or registered letter from the seller (the initial creditor). Knowledge of the assignment by the buyer is assumed when the latter has paid several times to the factor (concluding action). In Germany factoring contracts are based on a global and advance assignment of receivables.

4.80.Another shortcoming of the German regulatory system is that it does not provide a central registry for security interests. As a result, the secured lender has to depend upon the borrower/supplier's representation of the presence/absence or relative priority of competing liens.

4.81.The taxation environment is more conducive for factoring activities with the recent move to make factoring a more regulated activity. Factoring companies are now governed by the same tax laws as banks, providing them with a more even playing ground. They are therefore now also eligible for a trade tax privilege, earlier reserved for other banks and other credit institutions. Under the old regulations, 25% of financing expenses incurred by factoring companies were not deductible for trade tax. However under the German Banking Act, all financing expenses are deductible for trade tax purposes. With this regulation, German factoring companies are more on par with foreign factoring companies as well as other domestic lending institutions.

4.82.The German Government also does not levy stamp duty on factoring services. The factoring service fees however are subject to VAT. VAT is calculated on the factoring margin, the difference between the amount paid by the factor agency to the supplier and the amount of debt collected by the factor agency. Any additional factoring fee is also subject to VAT.

4.83.The credit information infrastructure is well developed and has thus enabled the growth of non-recourse factoring. The success of the factoring business in Germany would not be possible without the robust credit infrastructure available in the country particularly given that only non-recourse factoring is legally recognised. Companies can obtain information to assess creditworthiness from a

variety of sources including bank references (via Internet), commercial registers or electronic company registers, commercial credit registries such as Experian etc, credit information reports from Dun & Bradstreet. Many insolvency cases are also reported to the commercial register and announced publicly by the local courts.

4.84.In addition to private credit bureaus, the Deutsche Bundesbank also maintains a credit registry and requires all financial institutions in the country to contribute data. Deutsche Bundesbank collates and processes information received from all financial institutions and then informs these institutions of borrowers' indebtedness as well the total number of lenders providing funds to them. This mandatory contribution of data is supported by the German Banking Act. The Act also provides for disclosure or data protection laws thus restricting unauthorised use of such data.

4.85.Factoring companies also frequently transfer debtor risk to credit insurance agencies. There are several agencies in Germany that provide credit insurance services such as Euler Hermes, Atradius, Coface. Usually the premium on credit insurance is based on turnover, while exceptionally; it may be based on the monthly approved outstanding balance. It certainly depends on the negotiations between the factor and the credit insurer, as to which 'premium system' is agreed upon.

4.86.***Summing up:*** Although the legal system does not completely recognise recourse factoring, the non-recourse market has grown supported by a strong credit information system. In order to enhance their business, an increasing number of factoring companies have begun to adopt pricing models where small clients are charged on the basis of their turnover and large customers are charged just interest. With continued high corporate insolvency rates in the current economic crisis, factoring has also acted as a risk management technique for suppliers. There are several new product developments and applications such as reverse factoring, factoring in takeovers. The Government also permitted the factoring of lawyer fees and tax consultant fees, conditional on the acceptance of specialised clearing houses. The market has however, not reached its potential; factoring quota relative to GDP stands at just 3.58% as compared with 14% for the UK. Regulatory authorities and the Government have taken several measures in the last few years that should continue to boost volumes over the next few years. Factoring volumes are expected to continue to grow rapidly as the economy slows and firms continue to turn to non traditional sources of funds and continue to seek credit protection. Although recourse factoring volumes may grow, non-recourse factoring will remain the predominant form of factoring given that the prolonged retention of title continues to be practiced.

Singapore

4.87. Although Singapore introduced factoring in the 1970s, this business activity gained momentum in the 1980's and 1990's when a large number of factoring companies were set up by banks through subsidiaries, independent companies, finance companies. While the number of factors operating in Singapore declined during the Asian financial crisis, factoring volumes have picked up once again in recent years. Currently, factoring is mainly offered as a mainstream banking facility. Singapore has between 15-20 firms that provide factoring services in the country, a number that is large when compared with the size of the economy.

4.88. During the 1980s to 2005 period, the Government initiated schemes to assist MSMEs. One such scheme was the Local Enterprise Finance Scheme (LEFS 1985) through which companies could enjoy preferential interest rates. Further, Spring Singapore, an enterprise development agency for MSMEs, managed LEFS factoring and underwrote 50% of any loss incurred through financing factoring clients. The LEFS was instrumental in boosting factoring volumes. However, the LEFS was withdrawn in 2005 as factoring industry had well developed by then. Since factoring in India is still evolving, Indian government bodies can also initiate similar special schemes for MSMEs who opt for factoring services.

4.89. During the 2004-2008 period, factoring volumes in Singapore grew at an annual rate of about 11%. International factoring volumes, in particular have witnessed rapid growth, accounting for close to 18% of total factoring volumes in 2008. The increase in international factoring is reflective of the rising level of inter-regional trade in the Asia Pacific region. Singapore is also a member of UNICTRAL (United Nations Commission on International Trade Law) and therefore abides by international commercial law.

4.90. While recourse factoring is the predominant form of factoring in Singapore, an increasing number of multinational firms have begun to demand non-recourse factoring due to financial accounting benefits. Under, the Financial Accounting Standards board 140, a company can de-recognise its assets if sold on a non-recourse basis. The demand for non-recourse factoring amongst MSMEs is also rising with increasing awareness about the benefits of non-recourse factoring in the current economic crisis.

4.91. The manufacturing and trading sectors utilise factoring services and together they account for more than 40% of factoring volumes in Singapore. In particular, electronic products, machinery & electrical appliances, paper products, industrial chemicals & plastics, foods and beverages are the main

industries that utilise factoring services. Transport & communication, business services and financial services sectors also utilise this service.

Regulatory and legislative environment

4.92. There is no specific law or regulation that governs factoring; however the Civil Code has well established legal principles that govern the assignment of title, creation and enforcement of security interests.

4.93. In terms of assignment of debt, receivables are assigned without restriction. However, as per the Civil Law in Singapore, the debtor/buyer needs to be notified of the assignment of debt to the third party or factor agency. Upon notification however, it is obligatory for the buyers to make payments directly to the factor agency/bank. A buyer's acknowledgment or consent is not required for a legal assignment. It is also not essential to register the agreement at the Company House or Registrar if receivables have been purchased. However, if a charge has been made on the receivables, factor companies are required to register this charge at the Company House. Upon registering the charge on accounts receivables, if it is found that another bank already has a charge on the receivables, the factor company can request the bank to waive its right to the receivables.

4.94. With the transfer of receivables, it is mandatory for the factor agency/bank to collect payments from the buyers, and most of them undertake collections on their own.

4.95. In case of non-payment by client's debtor, the factor agency is entitled to sue the debtor for the amount owed as long as the debtor is still solvent. The factor agency is also permitted to engage in private negotiations with the debtor before filing for insolvency. However, if the debtor is bankrupt, the factor companies make the required payment to their client and recover the money through credit insurance in the case of non-recourse factoring.

4.96. The judiciary system in Singapore is effective and time taken for legal proceedings is short. Factor agencies can usually expect to recover legal dues within 4-6 months of starting the legal proceeding. Settlement of dispute in a short time is possible since court documents in Singapore are filed electronically and each case is monitored from the time of filing suit till the time of final court decision. In Singapore, technology is effectively utilised in legislative proceedings; the courts are computerised and computer screens on Singapore's courts show the expected wait time for each case and the lawyer is alerted on his cellphone via text message when the judge is ready to hear his case.

4.97. The tax system in Singapore is very conducive for the growth of the factoring business. Only domestic service fees are subject to a Goods and Service tax (GST) rate of 7% (as compared with

17.5% in the UK). The Government has also exempted factoring transactions from stamp duty thus lowering the cost of funds for factoring services as well as simplifying factoring documentation.

4.98.Credit information is adequate and their coverage vast, thus providing support for domestic non-recourse transactions. There are several sources of credit information in the Singapore market including Credit Bureau Pte Ltd, Credinet, Equifax, commercial credit reporting agencies such as Dun & Bradstreet. Further, the DP SME Commercial Credit Bureau, which began its operations in 2002 also provides information and credit reports on MSMEs.

4.99.Technology has also played an important role in development of factoring in Singapore. Online factoring is also common and is supported by regulations such as the Payments Systems Act and the Electronic Transactions Act. The Payment Systems Act provides a consistent system for the Monetary Authority of Singapore to oversee payment systems. As a result, the average time required to approve financial documents has reduced significantly. The Electronic Transactions Act provides for the legal acknowledgment of digital signatures, providing support to all electronic commerce transactions in Singapore. Recently, IFS (International Factors Singapore) Ltd initiated an online factoring hub called IntFactor where financing for online transactions is provided by IFS. IntFactor also allows clients to request for funds electronically.

4.100. ***Summing Up:*** Singapore has well defined laws governing the assignment of title, the creation of security interests, and protection of creditor rights. The judicial system is also effective and time taken to issue legal proceedings in cases of payment defaults is also low. Singapore's strong legal and judiciary system coupled with Government efforts to provide a push to the MSME segment have aided in the development of the factoring in this market. The availability of credit information and insurance has also been conducive to the development of this industry. Factoring, particularly, international factoring is expected to continue to increase over the next few years as inter-regional trade continues to rise.

Turkey

4.101. Factoring was first introduced by a bank in Turkey in 1988. Soon after, the first independent factoring company began its operations. The industry remained completely unregulated until 1994 when the first set of regulations on the establishment and operation of factoring companies came into legislation. Since then, the business has grown rapidly, at an annual rate of about 26% during the 2002-2008 period and there has been a steady rise in the number of independent factoring companies. As of September 2008, there were as many as 73 factoring companies; however, just 45 of these companies accounted for more than 80% of domestic volumes and 99% of international volumes. There is intense competition between players in the market; there are more than 70

factoring companies while turnover remains just €18 billion. A high proportion of the factoring volumes are provided by the 20 or so banks. Given the lack of adequate domestic credit insurance, it is not surprising that a significant portion of domestic factoring volumes are with recourse. Amongst the sectors, the textiles and clothing sector contributed about 13.5% of total clients' sales, followed by construction (10.4%), transport & communication (9.8%).

Regulatory and legislative environment

4.102. Up until recently, factoring companies were unregulated. However, with the increasing popularity of this service and the rising competition among factor agencies, it was decided in 2006 to bring factoring companies under the Banking Regulation and Supervision Agency (BRSA). As a result, factor agencies now have to operate as per guidelines provided by the BRSA for the 'Establishment and Operation of Leasing, Factoring and Financing Companies'. Factor companies are required to seek permission from the Banking Regulation and Supervision Board before establishment and operations. The Board permits the setting up of the factoring company only after careful scrutiny of shareholders. There is also a minimum capital requirement of YTL (New Turkish lira) 5 million which is approximately EUR 2.63 million (2008 exchange rate) and the company must be joint stock company. These regulations should serve to prevent incompetent firms from setting up factoring operations. Factoring companies are also not allowed to issue letters of guarantee.

Box 4.3: BRSA's Regulation on Principles for Establishment and Operations of Financial Leasing, Factoring and Financing companies

BRSA's Regulation on Principles for Establishment and Operations of Financial Leasing, Factoring and Financing companies

The regulation governing establishment and operations of factoring companies in Turkey consists of nine parts covering Objective and scope, basis and definitions; Permissions for establishment and operation; Amendment made to articles of association and provisions governing transfers of shares; Managers; Provisions concerning contracts to be drawn up by companies; Limitations; Accounting, reporting and auditing; Ceasing of companies; and Other provisions. The specific guidelines provided in various sections of this regulation are discussed in brief below:

1) It is obligatory that factoring companies should be established as joint stock companies and should have a paid up capital of not less than five million New Turkish Lira.

2) The commercial title of company must contain the phrase "Faktoring Sirketi" (Factoring Company).

3) Establishment of factoring company requires permission from the Board (Banking Regulation and Supervision Board).

4) Post conclusion of procedures for establishment, the company needs to obtain an operating license from the Board for commencing operations.

5) A company established outside Turkey requires permission from the Board to open first branch in Turkey. For this, it needs to meet certain conditions related to minimum capital (five million New Turkish Lira), promoters' qualification, minimum years of working in the field of operation, etc.

6) Opening of local branches and representation offices by factoring companies is subject to permission of the Board. Companies intending to apply to the Board to open branches or representation offices must operate in compliance with the limits of transactions covered by this Regulation and must have a paid capital of one million New Turkish Lira for each such branch or representation office. The Board issues "Branch License Certificates" to branches if considered appropriate upon evaluation.

7) Positive opinion by the Board is sought in evaluation of any amendment made to the articles of association of companies.

8) Board permission is essential if the share of a particular person in the capital of the company is in excess of ten per cent or if there is a transfer of shares resulting in a shift of control in the company.

9) The founders, members of the company's executive board and managers must meet the conditions listed for general qualifications related to shareholding in banks without operational permission, or in organisations operating in money or capital market without operating license and non existence of criminal record, etc. The managers of factoring companies are required to have graduate education with bachelor's degree and at least seven years' professional experience in field of finance or management.

10) It is obligatory for factoring companies to conclude written contracts with their customers for transactions to be made.

11) The factoring company cannot issue guarantee letters and cannot raise funds through deposits.

12) Factoring companies cannot buy or assume collection of any receivables already arisen or to arise out of sales of goods or services, which cannot be certified by means of invoices or other similar documents, even if they are based on bills of exchange.

13) Companies have to follow a uniform accounting system in compliance with procedures and principles established by the Board in this regard.

14) Operating licenses of the company will be cancelled by the Board in case of events where company has failed to notify any change of address to the Agency within prescribed time limits; or committed deeds and transactions contrary to those prescribed by the regulation more than twice within one calendar year; or activities of companies established abroad are discontinued by competent authorities of countries where there head offices are located,

15) Permission of the Board is required for any mergers, transfers, divisions and liquidations of the company.

4.103. With factoring now regulated by the Banking Regulation and Supervision Agency, the receipt of invoices is now required for factoring and there is strict control with respect to same.

4.104. The laws required to assign title are fairly simple in Turkey. In order to achieve a legal assignment, the supplier and the factor agency must enter into a factoring agreement to transfer the title of receivables. It is also possible for buyers to enter into agreements with suppliers where the assignment of receivables is banned. In such a scenario, the written permission of both the supplier and the buyer is required before each receivable can be assigned.

4.105. A written notification to the buyer is also required to transfer the ownership of receivables; however the assignment of receivables in itself does not need to be registered. Notification of the

buyer is not necessary if the transaction is with post dated cheques however, if the transaction is only with invoices, notification to the debtor is necessary. The supplier must sign a NTR – notification and transfer of receivables form and then attach photocopies of invoices for each assignment.

4.106. In Turkey, sellers generally receive post-dated cheques from their debtors for the receivables. Thus, it is a common practice in Turkey for factoring companies to accept post dated cheques as collateral along with the invoices; about 80% of trade is conducted through post dated cheques. Factoring companies sometimes also use promissory notes as additional collateral. Fixed mortgages are almost never used as collateral. Factoring companies in Turkey also believe that since fixed mortgages are long term, they are not suitable for providing collateral to accounts receivables.

4.107. In case of supplier insolvency, apart from using post dated cheques as stated earlier, the factor agency can also begin proceedings for debt collection as per Turkish law and regulations. However, all Government receivables enjoy priority over the factor agency's security interest.

4.108. Factoring companies are not subject to stamp duty on the assignment of debt in Turkey. All factoring companies are subject to Banking and Insurance Transaction Tax rate of 5%. Banks that offer factoring services are permitted to make provisions for defaults and can deduct these from taxable income. Independent factoring companies, on the other hand are not allowed to make provisions or deduct from taxable income. Independent factoring companies are therefore not on a level playing field with domestic banks. As a result, the costs of funds are substantially higher for factoring companies as compared with banks.

4.109. There are a few credit bureaus and credit information service providers such as the Kredi Kayıt Bürosu (KKB), which include both positive as well as negative credit information. However, coverage is very limited and information is not easy to access or even adequate. With the subsequent lack of credit insurance available for domestic factoring, non-recourse factoring volumes have not picked up.

4.110. Further, several enterprises, particularly MSMEs, are not aware of the availability of this type of working capital finance. As a result, up until recently, it was not uncommon for buyers to react adversely when the supplier announced a transfer in the ownership of receivables to a factor agency. In order to address this issue, the Turkish Factoring Association has conducted several symposiums, meetings and has taken efforts to spread the awareness of factoring benefits.

4.111. ***Summing Up:*** Although the credit information system has not fully developed and MSME awareness about the availability of factoring has increased only recently, factoring volumes in Turkey have been growing at an annual rate of about 26% during the last 6 years. Nevertheless, factoring turnover constitutes only 2.5% of its GDP in comparison to 11-12% for more mature markets. Several efforts are being made to market the benefits of factoring to the target segments. The BRSA's draft law on factoring, which is expected to be implemented soon will ensure that factoring rules and concepts in Turkey are more in line with international rules and concepts. It is expected to reduce fraudulent practices through measures such as the invoice registration system. Factoring firms will also be required to confirm with Standard Accounting Principles to ensure firms meet with corporate governance regulations. Since the BRSA will be keeping a vigil on factoring firms and their shareholders, it is expected that only strong and adequately qualified firms will practice factoring, thus reducing non-essential rivalry. Factoring volumes are expected to continue to increase at a fast pace over the next few years and the industry is estimated to be valued at as much as US$ 100 billion (approximately EUR 68.3 billion- 2008 exchange rates) by 2012.

Thailand

4.112. Factoring was first introduced in Thailand during the 1980's; however the growth of the factoring business in Thailand was restricted due to the 1990's Asian crisis during which a number of Thai factoring companies were liquidated. This business however witnessed some recovery during the last decade. Factoring volumes in Thailand grew at an annual rate of about 10.9% during 2002-2008. Domestic factoring services account for more than 95% of total factoring transactions.

4.113. Retail banks, bank affiliates and independent companies offer factoring services in Thailand. Commercial banks were permitted to offer factoring services by the Bank of Thailand only in 2004. Subsequent to this legislation, a number of retail banks entered the business, resulting in greater competition in the factoring market. There are also a few global factoring players. However, it is estimated that the turnover of the four-five major factoring companies still account for more than 50% of market share.

4.114. More than 90% of factoring volumes in Thailand are accounted for by recourse factoring transactions. A significant percentage of factoring clients (40%) belong to the manufacturing sector, followed by the trading sector (33%) and the services sector. In terms of annual turnover, a larger number of clients (38%) belong to the 'less than 50 million Bahts' (1 million Euros) segment. The proportion of clients from the '200 million bahts' (4.2 million Euros) segment has been declining over the years. Factoring has also been able to attract medium size firms in recent years due to the more positive perception and stronger awareness in the market.

Regulatory and legislative environment

4.115. There are significant differences in regulations governing the factoring operations of banks versus independent factoring companies. While banks are regulated by the Bank of Thailand and bank subsidiaries are indirectly supervised by Bank of Thailand, independent factoring companies do not have separate regulatory authority. Factoring services have not yet been classified as a financial service and therefore they are unable to raise funds through public deposits. This puts independent factoring companies at a great disadvantage as the cost of raising funds for independent factoring companies becomes significantly higher. Factoring firms are also not allowed to charge an interest rate since they are not financial institutions; they instead charge a commission. However the commission that independent factoring firms charge is significantly higher than the interest rate that banks are permitted to charge.

4.116. There are no mandatory minimum capital requirements although the Thai Factoring Association does provide guidelines on minimum capital requirements; this amount is at around 30 million Bahts (0.6 million Euros).

4.117. In terms of the assignment of title of receivables, it is essential for the factoring firm to provide notification to the buyer. In order to have a legal assignment, the consent and signature of both the buyer and supplier are required. It is also quite common for factoring firms to take additional collateral such as cash and fixed asset mortgages when purchasing receivables. For instance if a factor extends a credit line of 10 million Bahts (0.2 million Euros), the factor may request the supplier to provide 10% collateral of cash. If the supplier is unable to make this payment, the factor may collect a certain amount and then deduct the rest while making the initial pre-payments to the supplier. The Thai system does not provide regulations for the registration of lien.

4.118. The judicial system in Thailand is not very effective and factoring companies that want recovery through a legal process may have to wait for 2 to 3 years. As a result, it is very uncommon for factor agencies to issue legal proceedings in case of default or insolvency of the buyer/supplier. Instead, the factor company prefer to liquidate the collateral or write-off its customers account.

4.119. The credit information system is also not very well developed and although there are a few credit bureaus and bank databases with relevant credit information, factoring companies have limited information since they cannot access bank databases. Most factoring companies have not developed a competitive database.

4.120. ***Summing Up:*** The inadequate development of the credit information system, inefficiency of the judicial system in Thailand have restricted the growth of factoring volumes, particularly, non-recourse factoring volumes. MSMEs are also not adequately aware of these services although awareness seems to be growing. This issue is usually addressed by a national factoring association. A factoring association was started in the year 2000; however only about 15-20 of the factoring companies are currently members of this association (due to the requirement of membership fees). The Finance Ministry has been developing a legal framework for factoring in conjunction with the Thai Factoring Association. With a new law governing factoring, it is possible that some of the inequalities between independent factoring firms and banks will reduce.

Cost comparison of factoring in India vis-à-vis key international markets

4.121. The cost of factoring services in various markets is different with respect to the one-time set-up fee (see table below). However, the interest/ discount charges in most countries range around 2.0-4.0% over the countries' reference bank rates. Factoring commission in most countries ranges between 0.15% and 2.50%.

Table 4.6: Cost comparison of factoring set-up in select countries

Countries	One-time setup fee	Interest/Discount charges	Commission/Service fee
USA	$500-$2000 (approx 342-1367 EUR)	3.0-5.0%	0.50%-2.00%
UK	£500-£1500 (approx 625-1889 EUR)	LIBOR+(2.0%-4.0%)	0.75%-2.50%
Singapore	$50 per domestic customer (approx 34 EUR) $150 per export customer (approx 134 EUR)	Prime rate+(1.0%-2.0%)	0.50%-1.00%
France	NA	Prime rate+(2.0%-3.0%)	0.40%-0.80%
India	0.5% of limit for facility	Prime rate+(2.0%-3.0%)	0.15%-1.00%

Note: These are only indicative figures

Source: D&B Research

Benchmarking factoring in India vis-à-vis key international markets

4.122. A comparison of factoring environment in India vis-à-vis key foreign markets reveals the major reasons behind underdevelopment of factoring services in India as against those in developed nations. The benchmarking exercise with respect to factoring environment in India against the factoring environment in the key countries (as discussed above) has been done with respect to the legislative and judicial environment, regulatory environment, taxation structure and credit information infrastructure. For all these broad parameters, comparison of factoring practices in India has been done with international best practices, i.e. factoring practices which are usually followed in

well developed factoring markets as discussed in earlier section (Best practices in international context; paragraphs 4.11 to 4.42).

4.123. In terms of the legislative environment for factoring, Indian commercial laws with respect to assignment are mostly in line with international best practices, though rule of law requires to be strengthened to enable timely and cost effective legal enforcement. The areas where Indian laws need to be improved are the bankruptcy and collateral laws, as these are not in tandem with the international best practices. Detailed comparison of India's legislative and judicial environment vis-à-vis international best practices is provided in the table below.

Table 4.7: Legislative and judicial environment

Indicators	International best practice*	Countries following best practice**	Environment in India
A special legislation for factoring exists	Not necessary	Most countries do not have special legislation; Turkey would enact a special legislation soon	No
Assignment constitutes legal sale of receivables	Yes	Yes for most countries	Yes, if NoC is available from Bank
Prohibition of assignment can be done in a sale contract between buyer and seller	No	USA, Germany, Singapore, Hong Kong, Turkey	Yes, if contract between buyer and seller has a clause of 'ban on assignment'
Seller can retain title to receivables even if these are factored	No	USA, Hong Kong, Singapore, Turkey (However, Germany allows retention of title)	No
Notification of assignment to the debtors is necessary	Not necessary in case of recourse but necessary for non-recourse	Not necessary in USA, but necessary in most countries (UK, Hong Kong, Singapore, Turkey)	Not necessary by law but notification is given as a general practice
Electronically assigned receivables are recognised	Yes	USA, UK, Singapore, Germany, Hong Kong	No
All types of assets (tangible or intangible, fixed or current, etc) are recognised as collaterals	Yes	USA, Singapore, UK, Hong Kong	Yes
Registration of collateral lien is necessary	Yes	USA, Singapore	Yes, but registration is done only for companies

Secured creditors have absolute priority to their collaterals over unsecured creditors in case of defaults or bankruptcy	Yes	USA, UK, Singapore, Hong Kong, Germany	No
It takes less than one year to legally procure claim on collaterals	Yes	Singapore, USA, UK, Hong Kong	No
Out-of-court settlement of collaterals is allowed	Yes	USA, UK, Hong Kong, Singapore	Yes

** International best practice for each indicator has been identified based on factoring practices followed in well developed factoring markets.*

*** List of countries is not exhaustive*

Source: D&B Research

4.124. In terms of regulatory environment, India does not match the international best practices. Regulatory norms in India are different for banks and NBFCs, while in many countries there are no specific regulations governing banks or other institutions for undertaking factoring services. Detailed comparison of India's regulatory environment vis-à-vis the international best practices is provided in the table below.

Table 4.8: Regulatory environment

Indicators	International best practice*	Countries following best practice**	Environment in India
Factoring activities are regulated by Central Bank or any other supervisory authority	Not necessary	No in USA, UK, Singapore and Hong Kong but Yes in Germany	Yes
Factoring activities are restricted only to banks	No	UK, USA, Germany, Singapore, Hong Kong	No, but independent factor companies must be a financial entity
Only licensed players can undertake factoring activity	No	UK, USA, Singapore, Hong Kong	Existing banks/ NBFCs do not require license to start factoring operations, but any non financial entity will have to seek license from RBI
There is a minimum capital requirement for operations	No	UK, USA, Germany, Singapore, Hong Kong	Yes, banks and NBFCs are subject to capital adequacy norms
Factoring activities are recognised as lending activity	No	USA, Germany	No, but factoring is largely practiced as lending

Factoring firms have restrictions on raising finance (e.g. restriction to use equity, etc)	No	UK, USA, Germany, Singapore, Hong Kong, Turkey	No

** International best practice for each indicator has been identified based on factoring practices followed in well developed factoring markets.*

*** List of countries is not exhaustive*

Source: D&B Research

4.125. The taxation structure for factoring in India is in contrast to most developed markets. In most of the well developed factoring markets, stamp duties are not levied while factoring in India attracts substantial stamp duty. At present, VAT is not applicable to factoring services in India, which is also the case in USA and Hong Kong.

Table 4.9: Taxation structure

Indicators	International best practice*	Countries following best practice**	Environment in India
Stamp duty is levied on assignment agreement	No	UK, USA, Germany, Singapore, Hong Kong, Turkey, Thailand	Yes
VAT / Service tax is applicable on factoring services	Not necessary; if applicable then only on the service fee component	No VAT in USA and Hong Kong; VAT is applicable on service fee in UK, Singapore, Germany, Turkey and Thailand	No
Tax provisions for Bank and Non Bank factors are same	Yes	UK, USA, Singapore, Hong Kong	Yes

** International best practice for each indicator has been identified based on factoring practices followed in well developed factoring markets.*

*** List of countries is not exhaustive*

Source: D&B Research

4.126. Indian laws on credit information are mostly at par with the laws in developed markets but credit information availability in India is much below that of international standards as the coverage of credit information (in terms of number of borrowers and scope of information) is substantially low. Consequently, access to credit insurance in India is also inadequate.

Table 4.10: Credit information infrastructure

Indicators	International best practice*	Countries following best practice**	Environment in India
At least one credit bureau is present	Yes	Most countries have at least one credit bureau	Yes
Credit bureau provides credit information for more than 75% of adults	Yes	USA, UK, Singapore, Hong Kong	No
Both banks and non bank factors have equal access to credit information	Yes	USA, UK, Singapore, Hong Kong, Germany, Turkey	Yes, but if factor is member of the credit bureau
Credit bureau provides credit information from retailers and utility companies	Yes	USA, UK, Germany, Brazil	No
Credit bureau provides both positive and negative information	Yes	USA, UK, Germany, Singapore, Hong Kong, China	Yes
Credit bureau provides more than 2 years of historical data	Yes	USA, UK, Germany, Singapore, Hong Kong, China	Yes
Borrowers can inspect their data in credit bureau	Yes	USA, UK, Germany, Hong Kong	No
Factors extensively utilise credit insurance for domestic factoring business	Yes	UK, USA, Germany, Singapore, Hong Kong	No
Factors have a well developed own credit information database	Yes	USA, UK	No
A unified collateral registry is in operation, which is indexed by grantor's name of security right	Yes	UK, Singapore, Hong Kong	Yes, but information is available only for companies

** International best practice for each indicator has been identified based on factoring practices followed in well developed factoring markets.*

*** List of countries is not exhaustive*

Source: D&B Research

4.127. The above comparison of India's factoring environment with international best practices clearly establishes the need for reforms in the legislative and regulatory framework and for development of credit information infrastructure in India if factoring (especially non-recourse) has to be developed.

Chapter 5

Feasibility of Non-Recourse Factoring in India

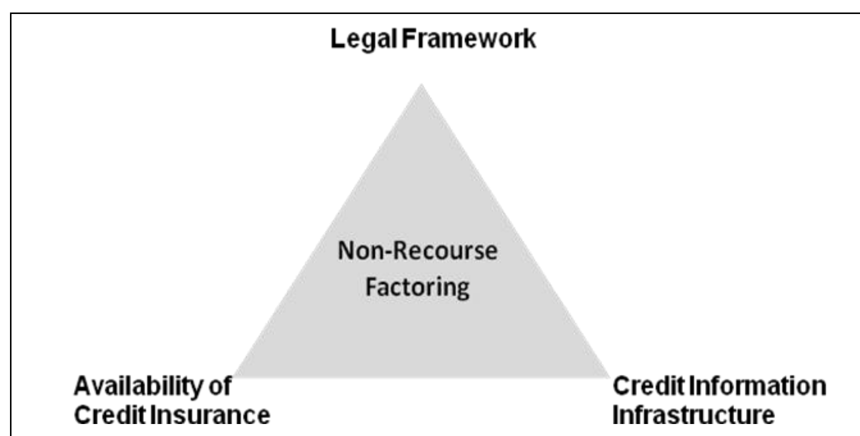
Key Points:

- *An important precondition for the success of non-recourse factoring is the presence of strong support infrastructure.*
- *In the current environment, most factoring firms in India are hesitant to undertake non-recourse factoring in the domestic market as it involves assumption of high risk and there is absence of adequate credit insurance and suitable information on credit and payment record to assume such risk.*
- *Additionally, the recovery laws in India for non-banking entities are weak and legal procedures involve huge time and costs.*
- *In the present scenario, reverse factoring could be an appropriate model for developing non-recourse factoring in India.*
- *The non-recourse factoring has a high growth potential in India provided supply side constraints are suitably addressed.*
- *Two different methodologies have been used to ascertain the demand potential for factoring in India – open account sales methodology and Curve fitting methodology*
- *Net benefit for factoring without recourse is relatively higher than that for recourse factoring and bill discounting*

Introduction

5.1. The previous chapter indicated that factoring without recourse is practised predominantly in developed nations like USA, UK, Italy and Germany. The primary reason for development of non-recourse factoring in developed countries is their well developed financial markets, which allows factoring companies to obtain reliable credit information on the customers of their clients. Additionally, in these countries, credit insurance is sufficiently available, bankruptcy laws are well developed and recovery through legal proceedings is very quick. This enables factor companies to offer non-recourse factoring, to meet the increasing demand from MSMEs for credit protection. Hence, an important precondition for the success of non-recourse factoring is the presence of strong support infrastructure.

Exhibit 5.1: Basic elements for factoring without recourse



Source: D&B Research

Ascertaining feasibility of non-recourse factoring in India

5.2. In order to ascertain the feasibility of non-recourse factoring in India, we need to assess it from both the demand side (prospective clients) as well as the supply side (factors). While on the demand side, non-recourse factoring has high potential, on the supply side most of the factoring entities are hesitant to undertake non-recourse factoring in the domestic market under the current scenario. The analysis from both demand and supply side is discussed below.

Demand potential for non-recourse factoring in current environment

5.3. In order to ascertain the overall demand potential for factoring service in India, we have assumed a methodology based on open account sales finance similar to the one adopted in the Kalyanasundaram committee report (refer paragraph 3.7 and 3.8 of the said report). We have also attempted to assess the demand potential for factoring five years hence, i.e. 2014-15 based on this

methodology. Apart from the methodology adopted in the Kalyanasundaram committee report, we have also arrived at the current and future potential for factoring based on ***'S-curve'*** analysis.

A. Open Account Sales Methodology

According to our interactions with banks and factors, it is understood that at present around 75% of the manufacturing output (MSME and large firms collectively) is sold on open account basis, which translates into roughly Rs 5,853 billion[6]. Further, as per our discussions with stakeholders, it is understood that firms avail bank finance for roughly 80% of these open account sales, which amounts to Rs 4,682 billion. Thus, remaining open account sales is potentially available for factoring, which amounts to Rs 1,171 billion. However, at present the factoring turnover of India stands at mere Rs 332 billion, which is just 28% of the potential as arrived above.

Based on our interactions with the factors, we expect that the proportion of open account sales to total output of manufacturing sector will increase to around 80% by 2014-15. D&B's forecast for manufacturing output (current prices) for 2014-15 stands at Rs 14,045 billion, which implies that open account sales of manufacturing sector in 2014-15 will be around Rs 11,236 billion. We have further assumed two scenarios with respect to receivable financing through traditional banking and factoring, and accordingly arrived at potential for factoring services by 2014-15. According to these scenarios (details are below), the potential for factoring turnover by 2014-15 ranges between Rs 2,247 billion and Rs 2,472 billion.

Table 5.1: Factoring potential in India

			2014-15	
	Unit	2008-09	Scenario 1	Scenario 2
Manufacturing GDP	Rs billion	7,804	14,045	14,045
Proportion of open account sales	%	75	80	80
Potential of financing of open account sales for factoring	%	20	20	22
Factoring potential	Rs billion	1,171	2,247	2,472

Source: D&B Research

In the first scenario, we assume that there is no change in the pattern of financing of open account sales, i.e. 80% of open account sales will continue to be financed through traditional banking means

[6] Value of manufacturing output for 2008-09 (RE) at current prices stood at Rs 7,804 billion

and balance 20% will be available for factoring. This implies that the finance available for factoring in 2014-15 for factoring will amount to roughly Rs 2,247 billion, which is 6.8 times the current factoring turnover.

In the second scenario, we assume that there will be a moderate shift in financing of open account sales in favour of factoring; i.e. 22% of open account sales will be available for factoring services. This means that factoring turnover has a potential to reach Rs 2,472 billion by 2014-15, which is 7.4 times the current factoring turnover.

B. Curve-fitting Analysis

To determine the actual potential of factoring in India, curve-fitting methodology has been used. In this process, cross-sectional data of 22 countries for gross domestic product on purchasing power parity basis (GDP-PPP) and factoring volume for 2008 has been considered. The rationale behind using curve fitting is to establish relationship between GDP-PPP and factoring volume.

The estimation process used various types of curves to fit to the above data set. Based on the best and the most significant fit, quadratic curve methodology has been selected. Implicit in quadratic curve estimation are assumptions of slow initial growth followed by rapid growth of the underlying variable. We have used GDP-PPP instead of nominal GDP, as the former takes into account purchasing power across countries and makes it comparable.

Based on the quadratic curve estimation, potential of factoring in India turns out to be around €14,000 million in 2008 (approximately INR 896 billion) as compared to actual factoring volume of €5200 million (INR 332 billion), which is approximately €8800 million (INR 563 billion) below the estimated potential (mere 37% of the potential). In other words, we had potential to achieve factoring business to the tune of €14000 million in 2008 itself (INR 896 billion). Going forward, looking at GDP PPP value for 2014, factoring in India (in € terms) should grow five times than its current level to approximately €25,500 million (INR 1,632 billion[7]).

Considering the potential for factoring arrived at from the two different methodologies above, it can be clearly established that irrespective of the difference in the overall potential by the two methodologies, at present the factoring turnover is far below potential and if factoring is given a regulatory and promotional push, it can grow tremendously in the next five years.

[7] Based on 2008 exchange rates

C. Cost-benefit Analysis

As discussed in earlier chapters, factoring has distinct advantages over other means of financing, as it offers an integrated management of receivables. In this section, we evaluate the costs and benefits associated with recourse and non-recourse factoring as against bill discounting.

We have considered an illustration of a company XYZ Ltd with annual turnover of Rs 10 million. The company sells all goods on credit for a period of 90 days. In order to finance its working capital through receivables, the company can either go for factoring or for bill discounting. The net benefit to the company under these mechanisms is discussed hereafter in this section. The relative costs and benefits associated with different financing means are provided below:

a) Bill discounting: This involves two types of costs (i) costs associated with in-house management and (ii) costs of availing bill discounting facility. The details of these costs are provided in the table below.

Table 5.2: Cost associated with bill discounting

S.no	Cost component
1	Cost of In-house management
	Cost of long term funds invested in receivables
	Administration/ ledger management costs
	Bad debts
2	Cost of Bill discounting facility
	Interest costs

b) Costs associated with factoring: These are provided in the table below.

Table 5.3: Costs associated with factoring

Recourse	Non-recourse
Commission	Commission
Discount charges	Discount charges
Cost of long-term funds invested in receivables	Cost of long-term funds invested in receivables
Bad debts	

In the current context, the key industry norms and various interest rates/ other charges are provided in the table below.

Table 5.4: Key assumptions for cost benefit analysis

Parameter	Cost indicators
Factoring advance payment	80%
Interest/ discount charges on factoring with recourse	12.5%
Interest/ discount charges on factoring without recourse	13.5%
Interest on bill discounting (L/C)	7% for 90 days
Interest on bill discounting (non L/C)	9% for 90 days
Factoring commission/ handling charges	0.15%
Facility set-up fee	0.5% of facility limit
Interest on long-term funds	17%
Bad debts	1%
Administrative overheads (receivable management)	2% of turnover
Expected increase in sales due to shift in administrative workforce to sales	3%

Source: Factoring companies, Banks, D&B Research

Based on the indicators in the above table, the costs and benefits associated with factoring with recourse and non-recourse and bill discounting are detailed hereunder.

i. Bill discounting

Table 5.5: Cost Benefit Analysis – Bill discounting

S.no	Cost/ Benefit	Value (Rs)	Working
Costs			
1	*Administration/ ledger management costs*	200,000	10 mn 2%
2	*Bad debts*	100,000	10 mn 1%
3	*Interest costs for bill discounting*	225,000	10 mn 90 days/ 360 9%*
4	Total	525,000	
Benefits			

5	*Savings on cost of funds invested in receivables*	85,510	Working note (e)
6	*Total*	85,510	
Net Benefit		**(439,490)**	S.no 6 – S.no 4

* Assuming bill discounting is non L/C

ii. Factoring with recourse

Table 5.6: Cost Benefit Analysis – Factoring with recourse

S.no	Cost/ Benefit	Value (Rs)	Working
Costs			
1	*Factoring setup fees*	40,000	10 mn 80% 0.5%
2	*Commission/ handling charges*	15,000	10 mn 0.15%
3	*Discount charges*	249,625	Working note (c)
4	*Cost of long term funds invested in receivables*	85,510	Working note (e)
5	*Bad debts*	100,000	10 mn 1%
6	*Total*	413,135	
Benefits			
7	*Savings from outsourcing receivables management*	200,000	10 mn 2%
8	*Expected rise in turnover due to shift in workforce*	3,00,000	10 mn 3%
9	*Total*	5,00,000	
Net Benefit		**86,865**	S.no 9 – S.no 6

iii. Factoring without recourse

Table 5.7: Cost Benefit Analysis – Factoring without recourse

S.no	Cost/ Benefit	Value (Rs)	Working
Costs			
1	*Factoring setup fees*	40,000	10 mn 80% 0.5%
2	*Commission/ handling charges*	15,000	10 mn 0.15%

3	*Discount charges*	269,595	Working note (d)
4	*Cost of long term funds invested in receivables*	85,510	Working note (e)
5	*Total*	410,105	
Benefits			
6	*Savings on bad debt loss*	100,000	10 mn 1%
7	*Savings from outsourcing receivables management*	200,000	10 mn 2%
8	*Expected rise in turnover*	3,00,000	10 mn 3%
9	*Total*	6,00,000	
Net Benefit		**189,895**	S.no 9 – S.no 5

Working Notes:

(a) Factoring commission = 10 million 0.15% = Rs 15,000

(b) Eligible amount of advance = 80% (10 million - 15,000) = Rs 7,988,000

(c) Discount charges (with recourse) = Rs 7,988,000 12.5% 90/360 days = Rs 249,625

(d) Discount charges (without recourse) = Rs 7,988,000 13.5% 90/360 days = Rs 269,595

(e) Cost of funds invested in receivables in case of factoring:

Amount of turnover not advanced = Rs 10 million – Rs 7,988,000 = Rs 2,012,000

Cost of own funds (assumed to be similar to long term bank finance) = 17%

Thus, Cost of funds invested in receivables = Rs 2,012,000 17% 90/ 360 days

= Rs 85,510

The above analysis clearly indicates that while non-recourse factoring involves higher interest costs than recourse factoring and bill discounting, the net benefits are relatively higher for the former. Thus implies that if MSMEs are communicated about the inherent benefits of factoring relative to its costs, their apprehensions on the cost front can be minimised to a great extent. This would in turn increase the demand for factoring (especially non-recourse factoring) amongst Indian MSMEs.

Supply side feasibility of non-recourse factoring under current scenario

5.4. In the current environment, most factoring firms are hesitant to undertake non-recourse factoring in the domestic market as it involves assumption of high risk and there is absence of adequate credit insurance and suitable information on credit and payment record to assume such risk. Moreover, the recovery laws in India for non-banking entities are weak and legal procedures involve huge time

and costs. The key hurdles faced by factoring firms in providing non-recourse factoring in the domestic market are provided in the table below.

Table 5.8: Key hurdles faced by factoring firms

Basic environment	Status in India	Issue/ Concern
Credit information infrastructure	▪ The credit information infrastructure is weak. ▪ Currently, the coverage and quality of credit information available is far from satisfactory. ▪ The information availability on MSMEs is even more restricted.	▪ Not many information/sources are available for providing information on payment history of clients ▪ Primary reliance on internal due diligence procedures
Credit insurance	▪ Credit insurance market is not well developed ▪ Costs associated for availing credit insurance cover are too high post global credit crisis	▪ Growth of non-recourse factoring is constrained due to inadequate availability of credit insurance at reasonable price ▪ Since credit crisis, factors find it extremely difficult to settle their claims with insurance companies
Legal environment	▪ Weak recovery laws ▪ Slow legal enforcement; legal recovery is a long drawn process in India	▪ Factoring companies are not legally protected in case of default ▪ Procedure of recovery from debtors is very cumbersome and a last option ▪ Factor firms are extremely careful in selection of clients and not willing for non-recourse factoring

Source: D&B Research

Promotion of reverse factoring/ payables factoring:

5.5. In the present scenario, reverse factoring could be an appropriate model for developing non-recourse factoring in India. Reverse factoring involves purchase of payables from high credit quality buyers, usually large and established players. Under this arrangement, the factor provides finance to regular suppliers of a large client with respect to receivables due to them from the latter. In an economy with inadequate credit information, this mechanism is highly advantageous to all the three parties – factor, supplier as well as buyer. For the factor, the key advantage of reverse factoring is that it needs to conduct credit assessment only of a few selected buyers, which are generally players with high credit worthiness. Thus, factor essentially assumes low-risk while providing finance to MSMEs, which generally are considered to be high risk customers. For the MSME suppliers, the benefit is huge as they readily get finance for their receivables, which is otherwise very difficult to get through traditional banking. Under reverse factoring, a factor may even finance up to 100% of the invoice value. Reverse factoring is also useful for the buyer as it is able to negotiate better credit

terms with its suppliers. Moreover, reverse factoring saves the buyer substantially on the transaction costs, as the buyer has to make just one bill payment to the factor rather than multiple bills to individual suppliers.

5.6. The concept of reverse factoring has been successfully implemented in various emerging markets in south east Europe and Central and South America. Given the undernourished credit information environment in India at present, non-recourse factoring can be developed by way of reverse factoring. One of the most successful examples of reverse factoring on a non-recourse basis in a developing economy is that of NAFIN development bank in Mexico. NAFIN has been running a factoring programme called "Productive Chains" programme since 2001. The details of this factoring programme have been provided in the box below.

Box: 5.1: NAFIN's Factoring Programme

NAFIN's Factoring Programme

NAFIN (Nacional Financiera) is a development Bank in Mexico, which was created by the Mexican government in 1934 as a state-owned development bank with the goal of providing commercial financing. Since 2000, NAFIN has emphasised on the use of new technology to provide MSMEs loans and to complement lending with greater training and technical assistance.

The factoring program of NAFIN is integrated with the Mexican e-government model that aims to use the internet to provide quicker and cheaper government services. NAFIN offers on-line factoring services to MSME suppliers. The program is called the "Cadenas Productivas", or "Productive Chains" program, which works by creating "Chains" between "Big Buyers" and small suppliers. This programme has been extremely successful in providing finance to MSMEs. As per World Bank's report[8] on reverse factoring in 2004, NAFIN had by then established Productive Chains with 190 Big Buyers (about 45% in the private sector) and more than 70,000 small and medium firms and about 20 domestic lenders were participating in the programme, including banks and independent finance companies.

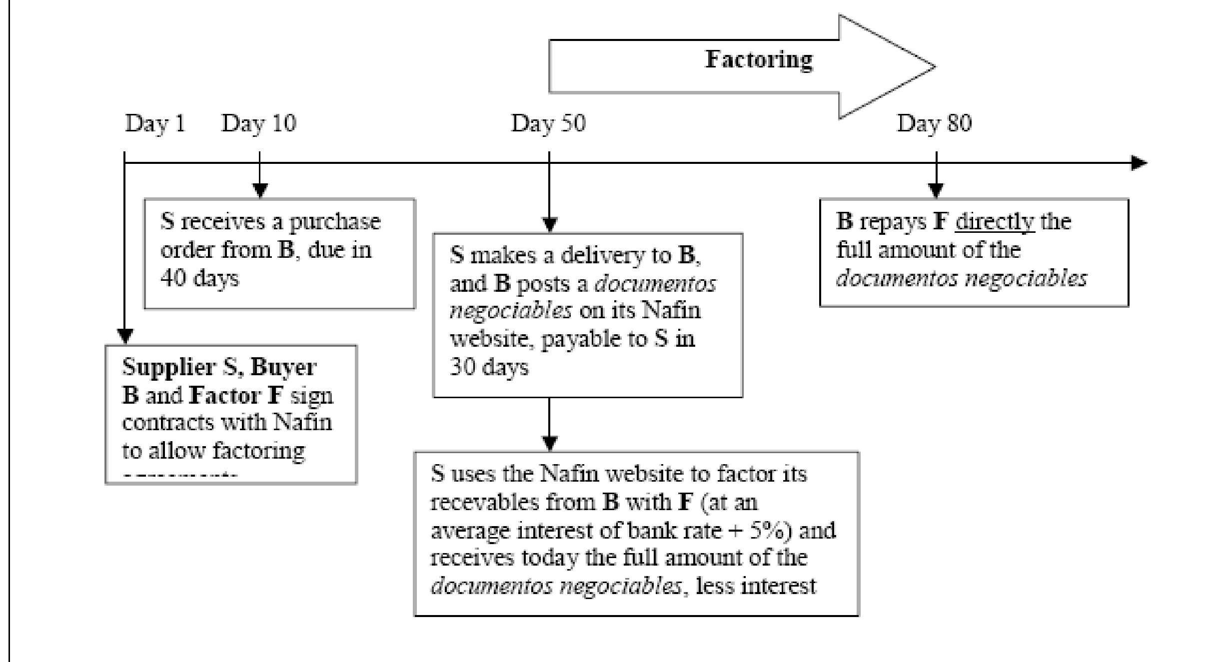
The key characteristics of this program are that it is done on a non-recourse basis and it operates an electronic platform. Firstly, since non-recourse factoring is practised, small firms are able to increase their cash flows with an improvement in the balance sheets. Secondly, electronic/on-line factoring services reduces time, costs and improves security. Under this programme, all transactions are completed within 3 hours and money is credited to supplier's account by the close of the business, which provides instant liquidity to the suppliers. The electronic platform also allows all commercial banks participate in the program, which gives national reach, via the internet, to regional banks. With the implementation of electronic factoring services, NAFIN's market share in factoring grew from a 2% in 2001 to 60% in 2004.

[8] The Role of 'Reverse Factoring' in Supplier Financing of Small and Medium Enterprises (2004)

Mechanism

The main parties in this programme are:- NAFIN, Big buyer, suppliers and the lenders. NAFIN maintains an internet site with a dedicated page for each Big Buyer. Suppliers are grouped in “chains” to big buyers to whom they have a business relationship.

Once a supplier delivers its goods and an invoice to the buyer, the buyer posts on its NAFIN webpage a “negotiable document”, equal to the amount that NAFIN should factor. Next, the supplier uses the internet to access its buyer’s NAFIN webpage and clicks its receivable. Any lender that has a relationship with the buyer and the supplier and is willing to factor the receivable will appear on the next screen, along with a quote for the interest rate at which it’s willing to factor this specific receivable. The “Multi-bank” approach, allows lenders to compete to factor suppliers’ receivables. To factor its receivable, the supplier clicks on a shown factor and the amount of its negotiable document less interest is transferred to its bank account. When the invoice is due, the buyer pays the factor directly.



5.7. Indian authorities too could consider development of a factoring model similar to NAFIN’s ‘Productive Chains’ programme. The RBI could consider instituting a separate body for this purpose or invite an existing development bank to take up the role of factoring under such e-business model. Details on cost estimates for setting up NAFIN like system in India have been provided in annexure 10.

5.8. In India, sectors that are suitable for reverse factoring include Automobile and Retail. Automobile sector in India consists of a few large auto manufacturers, who have a large number of small and

medium auto component suppliers. According to industry estimates, there are over 6,500 suppliers of auto-components to automobile players in India. Factor companies can thus initiate tie-ups with these large auto manufacturers to provide factoring services to their suppliers. Similarly, retail sector in India comprises some large retailers, who procure their products from a large number of small and medium suppliers. As per industry estimates, each large retail company (with multiple verticals) in India have around 3000-4000 regular vendors, majority of which are small and medium suppliers. By entering into tie-ups with these big retail companies, factor companies can increase their business multifold. Under such mechanism, factor companies can offer non-recourse factoring to a large number of MSME suppliers by assuming credit risk of a large player.

Table 5.9: Leading automobile and retail companies in India

Major Automobile companies	Major Retail Companies
Maruti Suzuki	Pantaloon Retail
Mahindra & Mahindra	K Raheja
Hyundai Motor India	Reliance Retail
Honda Siel Cars India	Tata Trent
Tata Motors	Vishal Retail
Bajaj Auto	Landmark Group
Hero Honda	RPG Spencer's
TVS Motor	India Bulls
Ashok Leyland	Archies

Source: D&B Research

Factoring for large clients with dependent customers

5.9. Besides reverse factoring, factor firms can also adopt an alternative model for increasing non-recourse factoring, wherein non-recourse factoring is offered to a large client, whose customers are absolutely dependent on the client for their business and hence payment from these customers is assured. For instance, factor firms can offer non-recourse factoring to large auto manufacturers, whose key customers are their exclusive dealers. Since these dealers are wholly dependent on auto manufacturers for their business, factors can be assured of payments of debts from them.

Supply side feasibility of non-recourse factoring under reformed scenario

5.10. Although non-recourse factoring is not feasible (except by way of reverse factoring, as stated in paragraph 5.6 above) in the current environment prevailing in India, it can be introduced successfully once the support infrastructure improves substantially. In chapter 7, we have provided specific recommendations to improve the support infrastructure for factoring. Assuming that the recommendations will be implemented and the support infrastructure will improve substantially in

the near future, in this section we assess the feasibility of factoring companies to undertake non-recourse factoring under such scenario.

5.10.1. **Large untapped market:** As discussed in paragraph 5.3(A) and (B) above, there is immense demand potential for non-recourse factoring in India, especially among MSMEs. Thus, factoring firms can benefit from a large market, hitherto untapped by them. This will give a huge boost to their business volumes.

5.10.2. **Increased confidence in expanding business:** Easy availability of information on credit and payment record of clients and their customers will enable factoring firms to undertake credit assessment of the client's customers with confidence and hence facilitate expansion of non-recourse factoring business with high pace.

5.10.3. **Availability of credit insurance:** Currently credit insurance companies worldwide are faced with huge claims in the wake of credit crisis. Consequently, they have restricted their risk exposure to factoring firms and raised the premiums. It is expected that in next two-three years, when the credit situation stabilises, credit insurance companies would re-consider premiums for factoring companies and the insurance cover could be available at lower rates. At the same time, a stable credit environment will reduce the number of insurance claims, encouraging insurance companies to settle all genuine claims without difficulty. With availability of credit insurance at competitive prices and settlement of default claims, factor companies would be willing to expand non-recourse factoring services as the risk of default would be easily transferred to the credit insurance companies.

5.10.4. **Lower costs:** With the implementation of legal reforms, as referred to in chapter 6, stamp duty costs are expected to reduce considerably. Moreover, with easy availability of credit information and credit insurance, costs related to risk management under non-recourse factoring is also expected to reduce. With lowered costs, factor firms will be able to provide non-recourse factoring at attractive prices, thus boosting the demand for these services further.

5.10.5. **Fast recovery of dues:** If legal and judicial reforms are undertaken, as referred to in chapter 6, the procedures, time and costs involved in legal recovery of dues will considerably reduce. If the proposed Factoring of Debts due to Industrial and Commercial Undertakings Bill, 2002 (with modifications) is enacted, factors will be the legal owners of the assigned receivables and have complete right to claim payments due on those receivables, and in case there is a default by any debtor, factor can legally proceed against that debtor to recover the payment due (along with the

interest for delayed payment). With a supportive legal and judicial environment, factor firms will also be ready to assume higher risk under non-recourse factoring.

5.11. The aforesaid analysis clearly establishes that non-recourse factoring has a substantial growth potential in India provided supply side constraints as described in paragraph 5.6 above are suitably addressed. This is possible only through major reforms of existing legal framework and information infrastructure. Specific reform measures on the legal front have been addressed in the next chapter and once these are implemented, non-recourse factoring will get an automatic boost.

Chapter 6

The Legal Framework

Key Points:

- *Subsequent to submission of the report by Kalyanasundaram Committee, several changes have taken place in operational and legal field pertaining to banking as also commercial transaction, registration of documents, etc.*
- *We are of the view that a special legislation for factoring is desirable*
- *In this chapter, we have provided modifications that can be made to the proposed draft legislation -The Factoring of Debts due to Industrial and Commercial Undertaking Bill, 2002*
- *The draft legislation can be modified for the clauses 2, 3, 4, 7, 9 and 10.*
- *Additional subjects could be included with respect to:*
    - *Interest on delayed payment*
    - *Obtaining credit information and enabling factoring transaction by way of 'electronic form'*
    - *Stamp duty exemption or remission*
    - *Priority of assignment in case of insolvency*
    - *Letter of disclaimer/ waiver*
    - *Clog on factoring*
    - *Other aspects related to establishment of factoring organisation, scope of factoring business, creation of supervising authority, forum for adjudication of disputes etc.*

Introduction

6.1. Kalyanasundaram Committee which has gone into the totality of the matter relating to, introduction of factoring organisations, factoring services, and the legal framework required in respect thereof, had in chapter IX of its report categorically mentioned ***following two aspects, the*** relevance whereof cannot be denied or disputed at any point of time in relation to factoring business.

> "9.2 The legal framework in which factoring business can be done with confidence must provide the following:
>
> i. Define the ***rights, liabilities, duties and obligations of the parties involved,*** in a clear and comprehensive manner, so that the parties can plan their affairs with certainty;
>
> ii. **Be supportive of the transactions and procedures involved,** so that they may be undertaken and completed simply and inexpensively."

6.2. Having regard to the aforesaid aspects and functional aspects of transaction of factoring the Kalyanasundaram Committee had considered the adequacy of the laws as in force at that point of time (please refer to paragraphs 9.6 to 9.10 of the said report), and suggested **'Legal Framework'** for factoring business and recommended to include provisions therein (please refer to paragraphs 9.11 to 9.21 of the said report) in respect of;

i. Assignment of debt;

ii. Stamp duty,

iii. Notification to debtor and priorities,

iv. Clog on factoring,

v. Support for realisation of debts through court action,

vi. Impact of money lending legislation, and

vii. Regulation of factoring organisations.

Generally what it should take into account

6.3. For developing an appropriate Legal Framework relating to factoring business in any country including India, *consideration of the* ***following aspects*** is very important and they need to be

combined together. ***In addition*** *consistency* of proposed law *(**governing factoring business**) with other laws and regulations also needs to be ensured and as such we need to take into consideration the following;*

(a) existing Legal framework i.e. laws as in force, Rules, Regulations framed and directions issued there under; in relation to contracts and assignment of debt;

(b) other laws and regulations as in force which either refers to factoring business, or which in any manner relate to and affect factoring activity; and

(c) regulatory body having authority to regulate/ supervise, factoring and para banking activities of banking companies and functions of non-bank financial service sector generally; and

(d) matters relating to factoring business or incidental thereto.

If one looks at the existing **laws as in force in India** in the light of above *it would be pertinent to take note of what is stated hereinafter**.***

Existing laws (as in force in India)

6.4. As per the existing legal structure ***factoring transactions*** as undertaken at present, *attract mainly the provisions of:*

(i) Indian Contract Act, 1872 *(9 of 1872);*

(ii) Transfer of Property Act, 1882 *(4 of 1882);*

(iii) Presidency-towns Insolvency Act, 1909 (*3 of 1909*);

(iv) Provincial Insolvency Act, 1920 (*5 of 1920*); and

(v) Indian Sale of Good Act, *1930 (3 of 1930).*

New enactments subsequent to submission of the report of the Kalyanasundaram Committee

6.5. *Subsequent to submission of the said report of Kalyanasundaram Committee* on 19th December, 1988, several developments have taken place in operational and legal field pertaining to banking as also in relation to mode of commercial transactions, registration of documents, etc. which amongst others has provided scope and option for transition from paper based actions to electronic forms. A few of such aspects and ***new enactments*** relating thereto *which appear to be relevant to the context of factoring business are referred to hereunder;*

i. ‘The Recovery of Debts Due to Banks and Financial Institutions Act, 1993,(51 of 1993)’, which amongst others provides for expeditious adjudication and recovery of debts due to banks and financial institutions;

ii. *‘the Securitization and Reconstruction of Financial Assets And Enforcement of Security Interest (SARFAESI) Act, 2002* (54 of 2002)”, which amongst others provides for setting up of a Central Registry System for registration of transaction of Securitization and reconstruction of financial assets and creation of security interest there under ;

iii.‘*the Micro, Small and Medium Enterprises Development Act, 2006* (27 of 2006)’, which in addition to other aspects covered thereby also cast statutory obligation upon a buyer for payment of interest in the event of delay on his part in making payment of consideration money for the goods & services supplied/ rendered by the supplier;

iv. ‘*the Credit Information Companies (Regulation) Act, 2005* (30 of 2005)’ which amongst others provides for establishment & regulation of Credit Information Companies with a view to facilitate collection and dissemination of credit information by such companies and matters relating thereto;

v. ‘*the Information Technology Act, 2000,* (21 of 2000)’, in terms whereof transactions (carried out by means of electronic data interchange and other means of electronic communication) have been given statutory basis & legal recognition; and

vi. ‘the *Registration Act, 1908* (16 of 1908)', which in terms of provisions of provisions of Part XI-A’ included thereto provides for registration of documents by means of electronic devices.

Assignment of debt

6.6. At present *‘assignment of debt’* is governed by the provisions of Section 130 of the Transfer of Property Act, 1882. The said section does not make it mandatory for a factor (as an assignee) to give notice of assignment of debt to respective debtor. On assignment, if the notice of assignment has not been served on the debtor, though the factor gets right to recover its debt from the customer with due process of law, the debtors’ rights and obligations in its contract with the Supplier (i.e. Client of a factor) do not change. In other words, it may be said that in absence of service of notice of assignment, the legal position of a ‘debtor’ is not affected as the debtor has no knowledge of the

existence of factoring contract / assignment of debt in pursuance thereof. Accordingly the debtor has no legal obligation to remit the amount to the factor and the debtor is free to continue to pay to its supplier regardless of factoring contract / assignment of debt in pursuance thereof.

6.6.1. Needless to point out that the *rationale for providing requirement of issuance of notice of assignment of debt to a customer* (i.e. debtor) is to ensure that debtor is informed of such transaction as in absence of knowledge of such transaction, it may not be expedient in the interest of justice to expect the debtor to abstain from taking any action affecting the right & claim of an assignee of the debt.

6.6.2. The object of providing requisite information to the debtor by way of issuance of a notice of assignment of debt could be achieved in an alternative manner, i.e. *by way of inclusion of appropriate provision in the proposed draft legislation to provide* for;

a. **filing of data pertaining to transaction of assignment of debts** in a **common central register** (maintained for the purpose by a competent authority designated in this behalf);
b. creating statutory obligation upon factor to make proper inquiry (from its client as also by way of inspection of such register) to ascertain the existence of assignment, if any, of the debt to be factored; and
c. giving rise to legal presumption of notice of assignment of the debt, once an entry of transaction of assignment of book debts is made in **common central register** as referred to in 'a' herein above.

6.6.3. With the inclusion of provisions as per above, once data relating to an 'Assignment', is entered in the register maintained for the purpose, any factoring company intending to;

a. factor any book debt and get it assigned in its favour; or
b. accept charge or encumbrance in its favour in relation to a book debt;

would be legally obliged to ascertain the existence of any prior assignment of such debt and failure to do so on its part will deprive it of its right to make any claim in preference against right of an existing assignee of such debt.

Aforesaid provisions if included in the proposed draft legislation would have its implication in particular in relation to *claim of competing assignees of a debt already factored*, or having any other charge or encumbrance on such debt. In this connection reference may be made to the text of 'United Nations Convention on the Assignment of Receivables in International Trade (2004), provided as Annexure 4 to this report, as the same also (though in International perspective) include 'Priority Rules based on Registration'.

6.6.4. Thus, inclusion of provisions as per above would enable;

i. a factor to ascertain any existing charge or encumbrance on the debt, prior to assignment thereof in its favour, and to judge the quality of debt to be factored, as today there is no effective statutory mechanism available to ascertain existing factoring contract; and

ii. would also enable the first factor of a debt to have statutory protection against any adverse claim by a subsequent competing factor of the debt already factored by the first factor.

Implication of imposing prohibition on further assignment

6.6.5. No doubt imposing statutory prohibition against a client from making any further assignment of a debt already factored may to some extent have an impact and to some extent may reduce the chances of a subsequent assignment of a factored debt by the client. However, in absence of there being a provision in the proposed law, providing legal implication of such subsequent assignment, and also punishment or penalty, or both, for contravention of such prohibition by the client mere prohibition without adding therein such provisions, may not serve the purpose in intends to achieve. Therefore, *in a special legislation of the proposed nature it would also be desirable to include penal provision for contravention of any such provision of the Act.* In addition, it may also be appropriate to ***provide as a legal obligation on part of a client*** to disclose any such existing factoring contract and ***also upon the prospective factor*** to make due enquiry about the same. The proposed law need to provide the legal implication of failure on part of any one of the party to a factoring transaction to comply with such requirement.

Definition of "Client"

6.6.6. "Client"

In the draft law provided by SIDBI, the term "**client**" has been defined as an **industrial or commercial undertaking** that has entered into a factoring arrangement with a factor. The term "**industrial or commercial undertaking"** as defined under sub-clause (i) of clause 2 of the proposed draft legislation means an **undertaking** carrying on the business of manufacturing, purchase, sale or supply of goods or service. *The definition of the term 'undertaking' is not provided in the proposed draft legislation.*

Needless to mention that clients (i.e. 'suppliers') who are entering into the transaction of factoring of debt at present are of different categories viz. company, partnership firm, Hindu Undivided Family firm, and it could also be a co-operative society, trust or any other body as referred to under clause (n) of Section 2 of the Micro, Small and Medium Enterprises Development Act, 2006. The term 'supplier' has been defined under clause (n) of Section 2 of the Micro, Small and Medium Enterprises Development Act, 2006, which includes;

(i) the National Small Industries Development Corporation, being a company, registered under the Companies Act, 1956 (1 of 1956);
(ii) the Small Industries Development Corporation of a State or a Union territory, by whatever name called, being a company registered under the Companies Act, 1956 (1 of 1956); and
(iii) any company, co-operative society, trust or a body, by whatever name called, registered or constituted under any law for the time being in force and engaged in selling goods produced by micro or small enterprises and rendering services which are provided by such enterprises.

In our view in the proposed draft legislation;

i. definition of the term 'undertaking' may be provided in such a way so as to include within its scope all those who are covered by the definition of the term 'supplier' as provided under clause (n) of section 2 of the Micro, Small and Medium Enterprises Development Act, 2006; or alternatively
ii. the definition of the term 'client' as provided under said sub-clause (b) of clause 2 may be modified and made as inclusive definition, by way of including the term 'supplier' as provided under clause (n) of Section 2 of the Micro, Small and Medium Enterprises Development Act, 2006.

We have provided the definition as inclusive definition, by way of including the term **'supplier'** as provided under clause (n) of section 2 of the Micro, Small and Medium Enterprises Development Act, 2006.

“Future Debt”

6.6.7. “Future debt” –

The definition of the terms **‘factored debt’** and **‘debt’** [as provided under sub-clause (e) of clause 2] and definition of the term ‘future debt’ [as provided under sub-clause (g)] of the proposed draft legislation may create ambiguity and lead to contradictory meanings of the term ‘future debt’.

In our view, there is no need to provide separately the definition of the term ‘future debt’ in the proposed draft legislation.

“Industrial or Commercial Undertaking”

6.6.8. Definition of the term as provided in the draft law as provided by SIDBI, is in order *subject to our comments in relation to definition of the term “client”.*

Priority in Case of Insolvency

6.7. **Insolvency -**

Besides the issue of priority of claim on a factored debt amongst successive assignees of the factored debt, the issue relating to priority in case of insolvency between an assignee and liquidator/ administrator/ official assignee (appointed in proceedings for insolvency/ liquidation), is a **larger issue**. We have considered the ***two insolvency laws*** in force i.e. the Presidency Towns Insolvency Act, 1909 (3 of 1909), the Provincial Insolvency Act, 1920 (5 of 1920); and Companies Act, 1956. The issues relating to insolvency and implications thereof which relate to the transaction of factoring where one of the parties is a foreigner is of no lesser importance.

6.7.1. In this connection, we have also taken into account the observations made in the report of ‘***The Advisory Group on Bankruptcy Laws (Volume I & II)’*** published by the Reserve Bank of India (“**the Bank**”). Said Advisory Group was set up by the Bank under the chairmanship of *Dr. N. L. Mitra* as a sequel of the Bank having set up, in consultation with the Government of India, a Standing Committee on *‘International Financial Standards and Codes’ (during December 1999).*

We quote below **some of the observations** as made in the said report of the Advisory Group with respect to implications of aforesaid laws/ adequacy thereof;

> *"Finally, the country does not have one comprehensive code of security interest creation, determining priorities and enforcing the same without intervention of the court. In so far as the intervention of the court is concerned, the evidential system is so poor and repetitive that it takes the court long time to assess the merit of the case and provide justice. Many of the securities created on collateral basis are not covered by any law and therefore the fate of these contract instruments are entirely subjected to the uncertainties in the judicial process of the common law system.*
>
> *Therefore, Indian Legal system on bankruptcy is not only immature and partial, but the system is also suffering from acute uncertainty, unpredictability and incompetence." (at pg. 5 of Vol. II)*

"The Indian laws concerning insolvency and winding-up closely follow the principles of English common law. The Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920, are substantially along the lines of Bankruptcy Act 1914 (repealed). Neither of these two Indian Acts make any reference to cross-border insolvency. Thus, Indian insolvency laws do not have any extra-territorial jurisdiction, nor do they recognise the jurisdiction of foreign courts in respect of the branches of foreign banks operating in India………… …………………………………………… …………………………. At present, the nation is considering the adoption of UNCITRAL Model Law on Cross-Border Insolvency to equip the Indian law with sufficient provisions to deal with international insolvency. The purpose of the UNCITRAL Model of Law is to provide effective mechanisms for dealing with cases of cross-border insolvency. The Model law ensures (a) co-operation between courts and other authorities of various states in cross-border insolvency; (b) greater legal certainty for trade and investment; (c) fair and efficient administration of cross-border insolvency; (d) protection and maximisation of value of assets; and (e) facilitation of the rescue of financially troubled businesses. If adopted, Indian law shall require suitable changes dealing with the challenges arising from cross border bankruptcy." (at pg. 142 of Vol. II)

6.7.2. We understand that aforesaid UNCITRAL Model Law on Cross-Border Insolvency *has not yet been adopted by India (*Update position in this regard could be ascertained from Ministry of Law)*. Kalyanasundaram Committee had recommended for adoption of uniform rules to provide a legal framework within which export factors would operate. In relation to that, Kalyanasundaram Committee had suggested that, 'India may ratify and accept the UNIDROIT Convention on International Factoring (please refer para 6.48 and Annexure XVI of the said report). Although we have not been able to lay our hands on any authentic source of information*, informal inquiry in this behalf suggest that;*

a. UNCITRAL Model Law on Cross-Border Insolvency; and

b. UNIDROIT Convention on International Factoring;

have not yet been adopted by India.

(Update position in this regard could be ascertained from Ministry of Law)*

6.7.3. Besides adoption of the aforesaid Model Law/ Convention, export factoring would also require appropriate amendment of provisions of Foreign Exchange management Act (FEMA). Reference may also be made to the various aspects referred to in this behalf in chapter VI and VII of the said report of Kalyanasundaram Committee.

Having regard to the aforesaid position, we are of the view that *in relation to factoring transaction involving parties governed by Indian laws, the issue of priority,* if any, to be provided to a factor vis-à-vis official assignee or liquidator, as the case may be, *would be dealt with by the court as per aforesaid laws.* Accordingly we have provided a provision in this regard in **clause 19** of the modified draft law. As regards dealing with such issues in relation to cross-border insolvency needs to be considered in totality and it may be appropriate to await the outcome of the report of the aforesaid committee and decision of the Government on adoption of appropriate Model Law/ Convention to deal with such issues, or otherwise.

Interest on delayed payment

6.8.Inclusion of appropriate provisions in the proposed law for enabling a factor to claim interest from the customer (the respective debtor) or client, in the event of delay on their part in making payment due to the factor , depending upon the nature of transaction of factoring undertaken by the factor & the terms of the factoring contract. Such provisions may be included on the lines of the provisions of chapter V of the *Micro, Small and Medium Enterprises Development Act, 2006 (27 of 2006),* or the provisions of *the Interest on Delayed Payments to Small Scale and Ancillary Industrial Undertakings Act, 1993 (32 of 1993),* with appropriate modifications thereof. As the application of provisions of other laws in force, unless specifically prohibited by the proposed law, is not barred, keeping in view the provisions of clause 2, and clause 35 of the proposed draft law, provisions of such law in relation to interest would be applicable also in relation to factoring contract.

Obtaining Credit Information

6.9. Kalyanasundaram committee in its report had discussed the issues as considered relevant at that point of time in relation to introduction of factoring services in India (please refer to Chapter III

of the report of the said committee). Amongst others, the said committee had mentioned about certain activities and emphasised that; factoring organisations should be equipped to effectively handle such activities and also suggested the minimum requirement in terms of infrastructure for such purposes (please refer to paragraphs 3.14 to 3.17 of the report of the said committee). As it may be seen, in the context of required skill on the part of factors, amongst others, collection and analysis of **credit information** on buyers (customers who are debtors in factoring) and guiding the sellers (clients) was one such factor and the requirement in terms of infrastructure for such purpose were suggested as 'network of offices', 'communication facilities' and **'computerisation'** (please refer to paragraphs 8.7 to 8.11 of the report of the said committee).

6.9.1. Thus, while the relevance and desirability of the skill and infrastructure (as referred to in paragraphs 3.14 to 3.17, and 8.7 to 8.11 of the report of the Kalyanasundaram committee) have assumed more importance in the present scenario (as time factor for completion of any transaction at the earliest opportunity has become more significant and essential) *the achievement/ implementation thereof, has become more feasible with the **new enactments** referred to in para-6.5 hereinabove.*

6.9.2. The law titled **'The Credit Information Companies (Regulation) Act, 2005'** and Rules/ Regulations framed there under, as in force provide for; regulation of credit information companies, collection and dissemination of credit information, besides other functions of such companies. As we understand four companies (as selected by the Bank) are in process of complying with the requirements for obtaining certificate of registration to undertake business of credit information companies as per the said Act.

6.9.3. *As regards the scope for factors to obtain credit information, keeping in view the definition of the terms **'credit institution' and 'specified user'**, as provided under clause (f) & (l), respectively of Section 2 of the Credit Information Companies (Regulation) Act, 2005**, in our opinion factoring organisations could be considered as falling within the ambit of said terms, and as such would be entitled to obtain credit information from a credit information company.** Alternatively, even assuming such a view is not acceptable by the Government for any reason, factoring companies could be brought within the purview of the said terms by the Bank by way of specifying the same in the regulation. Keeping in view the type of information required by the factors, such information may also be brought within the scope of the definition of the term **'credit information'** as provided under clause (d) of section 2 of the Credit Information Companies (Regulation) Act, 2005 by way of a subordinate legislation.*

6.9.4. In the event of factoring companies being considered as credit institution & specified user, as per para 6.9.3. herein above and inclusion of factoring transactions as part of the term, credit information, under the aforesaid act, factoring companies would be required to comply with the provisions of Section 15 of the said Act, i.e. to become member of at least one credit information company. Alternatively the Bank may provide them extension of time for complying with same till such factoring companies become financially sound. *Thus relevant information would come on the records of credit information companies (which may collect such credit information) and become available to those factoring companies who need to obtain such information for their proper evaluation of any debt they may intend to factor.*

Enabling Factoring Transaction by way of 'Electronic Form'

6.10. 'The Information Technology Act, 2000

New communication systems and digital technology have brought a revolution in the traditional mode of transacting business as the use of computers to create, transmit and store information in the electronic form instead of traditional paper based document, has become more popular and effective as it is cheaper and also easier to store, retrieve and speedier to communicate. With the enactment of the law titled **'The Information Technology Act, 2000**, now there is legal recognition for transactions carried out by means of electronic data interchange and other means of electronic communication, commonly referred to as **'electronic commerce'** which involve the use of alternatives to paper-based methods of communication and storage of information. *Therefore, inclusion of appropriate provisions in the proposed draft legislation, for adoption of scope for 'exchange of communication' by means of electronic media and undertaking factoring transactions or registration thereof, evidentiary value of data in electronic form, etc. on the lines of said Act in our opinion would provide better means for factoring transaction.* Accordingly **we have included provisions in this behalf in the modified draft law.**

Registration of Documents by Electronic Devices:

6.10.1. By adopting the provisions of 'Part XI-A', to 'the *Registration Act, 1908* (16 of 1908), under the proposed law, process of registration of documents pertaining to factoring transactions by means of electronic devices could be introduced.

[Note-Drafting of text for such enabling provision would depend on the policy decision of the Government with respect to;

(b) mode of registration of factoring contract & conditions relating thereto; and

(c) jurisdiction of the designated authority and office for the purpose as may be decided .]

Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993)

6.11. *Adoption of the provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 by way of inclusion of appropriate provision in the proposed draft legislation, would enable a factor to avail of such provision for recovery of its debt from the debtor & as such we have included the same in the modified draft law provided by us.*

Entry of factoring transaction available for public inspection & mechanism for the purpose

6.12. Legal provision in the proposed law, for providing such mechanism, could be included in different ways (please refer to the note under clause 16 of the modified draft law which is part of this report). The text included in clause 16 of the modified draft law is for one of such alternatives in this regard. For enabling registration of the transaction of factoring and maintaining entry thereof, one way could also be by using the Central Registry system as contemplated in chapter IV of *'the Securitization and Reconstruction of Financial Assets And Enforcement of Security Interest (SARFAESI) Act, 2002* (54 of 2002)' in the same way as it is set up under the said Act. Such use could be enabled by way of incorporating enabling provision under the proposed law, as application of other laws is not barred. However for drafting of the text for the purpose, one would need to know; the policy decision with respect to modality (to be adopted for the purpose, fees to be charged, jurisdiction based on the designated offices for the purposes as the Government may decide in this regard).

Stamp duty: Need for exemption or remission thereof

6.13. Kalyanasundaram Committee had recommended exempting the levy of stamp duty in relation to assignment of debt in favour of a factor. We have considered the issue relating to the same from legal point of view as also the need for the same from the users point of view (based on interaction with players of the field of business of factoring). While the need for waiver or remission with respect to payment of stamp duty has been strongly pleaded by factors/ clients, the legal position may not be ignored. As per the law in force, ***levy of stamp duty in such transactions falls within the domain of respective state governments*** and as such the easiest approach to get waiver or remission in this regard, is to send such request to them, as the State Governments are legally competent to provide the same, if they consider it appropriate to do so. **Alternative** procedure is to

include such transactions within the documents falling within the domain of Central Government, which may not be an easy object to achieve legally or even from revenue angle, as the state Governments may not like to give up totally and for ever, the revenue available to them. Precisely for such reason Kalyanasundaram Committee also had suggested to approach the state governments (please refer to paragraphs 9.13 to 9.15 of the report of Kalyanasundaram Committee).

Therefore, we are of the views that state governments may be requested to provide;

a. exemption from payment of stamp duty in relation to factoring of debt of MSME clients, and
b. for all others, it may consider reducing or remitting stamp duty in relation to factoring of debt.

Special provision for enforcement of claim by factor

6.14. Recourse for enforcement of factors' claim, if made available to a factor as per the provisions of XXXVII of the Code of Civil Procedure, 1908 (No. V of 1908) would provide scope for faster adjudication of claim by court than in ordinary money suit because;

(a) the procedure as per the said provision of Civil Procedure Code is a '<u>summary procedure</u>' wherein first summons to be issued is the '<u>summons for judgment</u>'. In such proceeding a defendant is not entitled to file his written statement as a matter of right as in an ordinary civil suits and the defendant herein is required to obtain requisite leave of the court which is granted only if the court is satisfied with prima facie defence of defendant as included in its application for obtaining leave of the court; and

(b) accordingly such procedure prevents a defendant from creating unreasonable obstruction without having any justifiable ground in support of his defence.

<u>Related Aspects to be Included</u>:

6.15. Besides what has been stated hereinabove, following aspects also need to be included in the proposed special legislation;

(i) Obligations of a Client, factor & Supplier;

(ii) Requirements for a factoring contract; and

(iii) Obligation to maintain confidentiality of information; obligation to maintain confidentiality of information;

(iv) Power of the Bank to impose penalty for contravention of the provisions of the act;

(v) Protection of action taken in Good faith;

(vi) Miscellaneous provisions relating to factoring transaction; and

(vii) Power of the Central Government to frame rules and issue notifications for implementation of the act.

Consideration of the Draft Law (provided by SIDBI) and basis for modification thereof

6.16.We have considered the adequacy of the proposed draft legislation with the title **"The Factoring of Debts due to Industrial and Commercial Undertaking Bill, 2002"** as provided by SIDBI (which for the sake of reference in this report is referred to as **"the modified draft legislation"**) keeping in view what has been stated hereinabove. We have modified the **proposed draft legislation**, taking into account aforesaid aspects and with due consideration of;

(i) the relevance of the recommendations of Kalyanasundaram Committee as referred to at serial nos. (i) to (vii) in paragraph 6.2 herein above at this stage ; and also

(ii)the relevance of the various aspects & new enactments relating thereto as stated herein above.

Need For Special Legislation for Factoring Transactions:

6.17. Although there are countries which do not have special legislation for factoring transaction, if we look at their frame work it would appear that they have respective laws (though not a consolidated law) in place to deal with issues relating to or incidental thereto. We have discussed hereinabove;

(a) the legal frame work with which at present companies undertaking factoring business are governed;

(b) the provisions of new enactments in force, inclusion and adoption whereof is desirable in relation to factoring business; and

(c) certain aspects for which also statutory provision is desirable.

Keeping in view what has been stated herein above in relation to cross-border insolvency, in the context of export factoring, the major issue as discussed herein above would require detailed study and also involve policy decision. Nevertheless, even for domestic factoring in our opinion, a self-

contained law relating to factoring transactions would provide support for efficient and viable operation for such transaction. Therefore, we are also of the view that **Special Legislation**, covering various aspects as per above is desirable.

6.18. Keeping in view the fact that no major change appears to be necessary at this stage in respect of such regulatory and supervisory aspects as are applicable to existing factoring companies, while considering the structure of the proposed Draft Law for factoring *we have preferred to proceed on the basis of the said existing structure.* With a view to provide scope for modification thereof, if so necessary, at any point of time, we have included provision under clause 2 of the modified draft law.

Modified Draft Law:

6.19. (a) For the sake of ready reference we have provided a **modified draft of the proposed draft law (included as Annexure-3)** with 36 clauses with an attempt to cover all the relevant aspects in the light of what has been stated hereinabove. We have incorporated text for the provisions in the modified draft law, the inclusion whereof in our opinion is desirable for facilitating the business of factoring. Issues like;

(i) *clog on factoring* would become redundant as the proposed law provides for rights and obligation of the parties, and also the essential aspects which the law obliges the parties to include in the factoring contract;

(ii) impact of money lending legislation, would also not exist as the proposed law would have overriding effect on any law in force; and

(iii) as already stated hereinabove, all other relevant aspects have been included in proposed draft law.

(b) In respect of such provisions , inclusion whereof though in our opinion is desirable, we have not provided the draft of the text, as such provision need to be drafted on the basis of policy decision taken in respect thereof. We have included only our specific view in relation thereto as **"Note",** with indicative points, which in our considered view are relevant to the context and refer to the rationale for inclusion thereof. *Based on policy decision taken text of such provisions could be finalised in appropriate manner*. For example, while we are of the view that;

(i) for enabling registration of the transaction of factoring and maintaining entry thereof, there are alternative options for providing requisite system for the purpose. Reference may be made to the note under clause 16 of the modified draft law. As it may be seen for drafting of the text for the purpose, one would need to know; the modality (to be adopted for the purpose, fees to be charged, jurisdiction based on the designated offices for the purposes as the Government may decide in this regard). Such decision of the Government may take into account various factors viz. conditions subject to which the Government would consider to do so, or they may not, depending upon the man power and other aspects;

Such object of registration could also be achieved by way of assigning the task (of maintaining the register for the purpose, by way of designating some of the offices of sub-registrars/registrars (as contemplated under the Registration Act), or by providing for setting up of independent registry offices for the purposes of factoring business;

(ii) provisions relating to establishment of factoring companies, registration/licensing thereof. All these would depend as to whether Government decides to maintain the same structure of the regulatory standards /regulatory authority (which at present is vested with the Bank), criteria in relation thereto;

Issues relating to Letter of Disclaimer/ Waiver by Banks on requisition from Factors

6.20. Based on interactions with factors for present study, we understand that the issue relating to the constraints faced by the factors in obtaining letter of disclaimer/ waiver from the client’s banker (for finalising factoring transaction and commencement of factoring facilities to the client) still remains unresolved. We understand that factors have not been able to impress upon the banks for issuance of such letters and they are of the view that unless there is regulatory intervention with mandate to the banks in this regard, the delay or reluctance in issuance of such letters would continue. Needless to mention that for obtaining required discharge on the client’s book debt (to be factored), the factors need such letters. Therefore, issue relating to the issuance of such letters needs to be considered and resolved with regulator’s due intervention.

6.20.1.In this connection reference may be made to the provisions of Section 35-A of the Banking Regulation Act, 1949, which empowers the Bank to issue such direction to the banking companies in general or in particular, as it may deem appropriate, having regard to criterion as included in said Section-35A for exercise of its power in terms thereof. For the sake of ready reference we reproduce

the text of the said provision. As it may appear sub-section (2) of said Section 35-A also empowers the Bank to modify its direction issued in terms of sub-section (1) thereof. Thus, in the event of there being need to modify such direction the procedural aspects in comparison to modification of substantive provision of the proposed law (assuming a provision was to be included in the proposed law for issuance of letter of waiver by banks to factors). Therefore, in our opinion the Bank may consider issuing appropriate direction to the banking companies in exercise of it's power under said Section 35-A ibid.

Text of Section 35_A of Banking Regulation Act,1949

"35A. Power of the Reserve Bank to give directions.

(1) Where the Reserve Bank is satisfied that—

(a) in the public interest; or

(aa) in the interest of banking policy; or

(b) to prevent the affairs of any banking company being conducted in a manner detrimental to the interests of the depositors or in a manner prejudicial to the interests of the banking company; or

(c) to secure the proper management of any banking company generally,

it is necessary to issue directions to banking companies generally or to any banking company in particular, it may, from time to time, issue such directions as it deems fit, and the banking companies or the banking company, as the case may be, shall be bound to comply with such directions.

(2) The Reserve Bank may, on representation made to it or on its own motion, modify or cancel any direction issued under sub-section (1), and in so modifying or cancelling any direction may impose such conditions as it thinks fit, subject to which the modification or cancellation shall have effect. "

6.20.2. Banker is required to issue letter of disclaimer in relation to the hypothecation, pledge or other charges created by the client on the debts, goods and other assets of the client in their favour as security for the loans, advances and other facilities granted by banks to the client. The issue that needs consideration in this regard is;

(i) whether banker would release all it's existing charges on the debt; or

(ii) the release would be only with respect to limited debt and from the period , as included in the letter issued by the banker; and

(iii) with the addition of other conditions in relation thereto.

*[*Based on the policy decision taken in this regard, requisite direction may be issued by the regulator on the lines of the draft annexed wherein we have provided two schedules-"A" &'B". While "A" is for all encumbered property, "B" is for what is/are to be released. So the schedule "B" could be filled up as per the decision, i.e. release of all or a selected few. The term "Property" has been used in the draft for collective name of all assets.]*

6.20.3. Issuance of direction may be considered on the following lines:

"The Bank has considered the constraints faced by factoring companies in their effective functioning, and one of such constraint as brought to our notice is delay in issuance of "Letter of Disclaimer" by banking companies to factoring companies on receipt of requisition from them in this regard. Having considered the expediency of issuance of "Letter of Disclaimer" by banking companies in time, the Bank hereby directs all the banking companies as hereunder.

2. On receipt of a written requisition from a factoring company, hereafter banking companies shall issue letter of disclaimer in **"Form A"** appended to this direction to the factor **within …days** from the receipt of such requisition from the factor. With a view to cut the delay in transition of such requisition from the factor to a banking company, and issuance of the letter by bank as per said Form "A", a factor, and may use electronic mode, in addition to the paper based mode for exchange/transmission of such communication between them.

3. In case for any satisfactory reason a bank is not in position to issue the letter within the time as stipulated in para 2 hereof, the bank shall advise the reason to the factor, and also the probability of its being able to issue the letter within an extended time.

4. This direction is issued in exercise of powers in terms of sub-section (1) of Section 35 A of Banking Regulation Act, 1949. "

Form A

Draft Letter of disclaimer

To;

_________ (The factor)

____

Dear Sir,

Reg: Your requisition dt…for issuance of "Letter of Disclaimer" in relation to charges created by …(the client) on their *debts/ goods/ assets in our favour as security for the loan/ advance/…. facility granted by us

Please refer to your above noted requisition received by us on…………..

2. Please note that:

(i) ………….. (The client) has availed of the credit facility by way of…… (Nature of credit facility; viz. loan/advance/ or any other credit facility what the client named in the requisition has availed of from the bank) on……..; and

(ii) as security for the aforesaid credit facility granted by us said client has created charge in our favour by way of ………… (*nature of charges created by the client to be mentioned here; viz. hypothecation/ pledge/ or other charges created by the client) on their properties in the nature of ……….* the full particulars whereof are given in Schedule-A, hereunder (*Kind of debts/ goods/ assets of the client on which charge has been created may be included here and full particulars thereof may be provided in Schedule-A);

3. In consideration of your __________ (*the factor*) agreeing to grant/having granted factoring facilities to the said client, we affirm and declare that out of the aforesaid properties of the said client which bears charge and encumbrance in our favour, we hereby release the properties as referred to **in Schedule-B**, hereunder subject to the condition that;

(i) such release is/would be, effective from ________;

(ii) the realisation of proceeds of the said properties should be routed through the accounts of the clients with us; and

(iii) such release is valid so long as factoring facilities are availed by the client from you and until all moneys owing to or becoming due by them to you remain outstanding.

4. This letter of disclaimer is valid with respect to future receivables with effect from _______ and not with respect to the existing book debts.

<u>Schedule –A</u>

1. *(Particulars of the properties bearing charge in favour of the……… bank)*:-

2. Nature of charge created on the properties as per above & relevant particulars thereof:-

3. Relevant particulars of Credit facility availed of from the bank:-

<u>Schedule –B</u>

1. Particulars of the properties which are released:-

2. Particulars of existing encumbrance, if any, on the properties being released:-

3. Particulars of the properties which are to be factored:-

Yours faithfully,
"(the Bank)"

6.20.4. We may also point out that now with the inclusion of the provisions relating to:

(i) establishment of registration system and making it mandatory to register the factoring contract(Chapter V of modified draft law);

(ii) rights and obligations of parties to factoring contract" (under Chapter-VI), making it obligatory on part of a factor to make due enquiry, creation of statutory obligation on the part of a client to disclose all the relevant information to the factor , and also providing provisions dealing with the consequence of failure on the part of the factor to enquire , or the client to disclose the information;

(iii) system for providing credit information and inclusion of factoring transaction as part of credit information;

the proposed law, if adopted , would provide better scope for a factor to judge the quality of a debt to be factored and take appropriate commercial decision because factor would be aware of the existing charge, encumbrance, or factoring in relation to the debt to be factored.

Conclusion

6.21. Therefore, while we have provided total 36 clauses in the modified draft law and provided text for many of such clauses; for some of such clauses, in absence of specific mandate we have not provided text and included only note with reference to such provisions. We may state that the proposed law being a special legislation may be made as self contained law for factoring.

Chapter 7

Recommendations

Key Points:

- *Factoring in its current status as perceived by MSMEs is more of a financing medium rather than an integrated receivables management service, and as such marketing consciousness needs to be there to bring out the positive impact of factoring.*
- *Factors should carve out a niche in the services segment, namely, receivable management and generate revenues by way of commission rather than concentrate on lending and financing activities where the margins are low.*
- *Factors should provide complete accounts receivable management to their clients so that the clients can reduce the collection cost and benefit from factoring.*
- *Factors should develop database on existing clients and customers to mitigate the problem of borrowers' informational opacity.*
- *Factor companies should develop information on sectors/industries that use factoring as a source of financing extensively.*
- *Factoring companies should develop an infrastructure of offices supported by computers to increase their geographic reach.*
- *Various industry associations, MSME associations and factoring companies can jointly organise multiple workshops, seminars, and education & training sessions to improve awareness about factoring products.*

Introduction

7.1 An efficient factoring system can emerge as an effective option for serving the financing and receivables management needs of MSMEs provided conducive environment is created and fostered. The chapter on legal framework discusses the changes desirable in the legal framework and draft legislation and the additions that could be made (refer table below). Further, the amended draft legislation has been provided in annexure 3.

Table 7.1: Changes and additions required in the legal framework

Changes required	Additions required
Definitions Assignment of debt Notice of assignment of debt Prohibition of further assignments Special provision for enforcement of claim by factor Amendment of certain enactments	Interest on delayed payment Obtaining credit information and enabling factoring transaction by way of 'electronic form' Stamp duty exemption or remission Priority of assignment in case of insolvency Letter of disclaimer/ waiver Clog on factoring Other aspects related to establishment of factoring organisation, scope of factoring business, creation of supervising authority, forum for adjudication of disputes etc.

Apart from the above, given that the current level of awareness about factoring among MSMEs (as observed by the D&B study team) is not adequate for factoring service to flourish, we have identified a few areas where the factoring companies need to take more measures to accelerate growth of factoring in India, by increasing awareness, especially among MSMEs.

7.2 Recommendations for Factoring Companies

I. **Marketing of services** – Factoring in its current status as perceived by MSMEs is more of a financing medium rather than an integrated receivables management service. As such, factoring services need to be appropriately marketed to the MSMEs in order to promote the same (Please refer to the paragraph 7.4). In this context, the role of marketing and business development activities assume greater significance.

   Presently, since factoring is more focused on financing instead of sales ledger management and other services, factors need to modify the perception associated with the service. Factors should consider offering complete accounts receivables management for the client, instead of only the debts being factored. Since the current practice does not help the client to reduce collection cost as he needs to hire collection executive or setup collection department to

administer account receivables, factors should provide complete accounts receivable management so as to enable the clients to reduce the collection cost. This will also help the factoring companies to generate revenues by way of receivable management and advisory services, rather than concentrating on financing activities where the margins are low and competition from other financing institutions is higher.

II. **Extending reach**– Given that conducive factoring environment is created in India, we expect factoring business to grow substantially in the future. Under such circumstances, non-banking financial companies undertaking factoring business should have a larger branch network, duly supported by well-connected network systems, backed by state-of-the-art information technology. This would enable the factor companies to reach potential MSME clients spread across tier-1 and tier-2 cities and towns.

    Also, banks undertaking factoring businesses should ensure that factoring services are made available through a larger network of dedicated MSME branches with appropriately skilled staff having significant knowledge of factor business deployed therein.

III. **Develop/share database on existing clients and customers** – D&B believes that factors should develop internal database on existing clients and customers. Once this database is developed over a period of time, it can mitigate the problem of borrowers' informational opacity in business environments with weak information infrastructure on payment performance. A central pooled database of all factor companies can also be maintained by the Factors Association, which can be shared and utilised by all factor companies for their mutual benefit.

IV. **Identify sectors / commodities which are likely to take advantage of factoring services** – Factor companies can develop information base on sectors/industries that use factoring as a source of financing extensively. Understanding of the operational dynamics of these potentially factoring-intensive sectors would assist the factors in assessing the nature of financing requirements, working capital cycles, credit-worthiness of businesses and key risk factors. For instance, industries like wholesale, retail, consumer goods, electronics, metal processing, automotive, textiles and apparel, food and beverages, and chemicals form substantial business of factoring services in global markets.

    The expertise and information base built herein coupled with the internal database, as & when shared among factoring companies (as referred to in point 3 above), over a period of time, would ease cost of screening applications for factoring of debts, and significantly increase the

risk taking ability of the factors, thereby enabling rapid expansion of factoring activities in the country.

7.3 Recommendations for promoting factoring among MSMEs

It has been observed that MSMEs lack awareness about factoring products and their potential benefits for their business. Most of the MSMEs consider factoring to be an alternative financing mechanism to traditional finance methods, rather than as a receivables management tool. Hence, there is a need to spread awareness of factoring as an integrated receivable management financial mechanism. For this, various industry associations, MSME associations and factoring companies can jointly organise multiple workshops, seminars, and education & training sessions.

I. **Workshops and seminars**: Factoring companies can tie-up with national level institutions, leading associations to organise one-day workshops/ seminars in major MSME based cities and clusters on a periodic basis (every quarter). These workshops and seminars can include presentations by factoring experts, detailing benefits of various factoring products for MSMEs. Companies that have benefited from factoring services can be invited to give presentation and share their experience in availing factoring service and how it has benefited them. The target audience can include senior management of MSMEs, who are the key decision makers while availing financial assistance. The workshops should be interactive, enabling MSME participants to raise their issues and concerns and seek greater understanding of factoring. Along with one-day workshops, a national level workshop can be organised aimed at discussing/brainstorming on a road-map for developing factoring in India. D&B has provided a structure for such national level workshop in the next chapter.

II. **Promotional campaigns**: Factoring companies can utilise print and electronic media to spread awareness about factoring services through advertisements. Factoring companies can set-up a help desk wherein all business queries related to factoring services can be answered. Various print advertisements can provide these help-desk numbers to enable MSMEs to raise queries.

III. **Education weeks**: Factoring companies can utilise branches of their parent banks' in different cities to organise factoring education weeks, wherein factor company's representatives can educate bank's customers on various factoring products, procedures involved and potential benefits for enterprises. The prospective customers can be provided with pamphlets and short working papers on factoring, to increase their awareness about the service. Besides spreading awareness, such programs would also benefit factor companies in creating a database of firms which would be interested in availing factoring services.

IV. **Institute guidelines for providing service to MSME sector**: To promote factoring services to MSME sector, we are of the view that RBI can institute guidelines directing banks and specialised factoring firms to undertake a specified percentage of their business from MSME sector. Further, efforts are required from the factors to increasingly cater to this sector.

V. **Introduction of special schemes:** The government authorities can consider introduction of special schemes, similar to the LEFS implemented earlier in Singapore for MSMEs (refer paragraph 4.88). Under such scheme, factoring services for MSMEs can be made available at preferential interest rates, which would effectively lower the costs of factoring for MSMEs and thus increase demand for such services.

VI. **Identification of a development bank on the lines of NAFIN:** India could consider launching a MSME factoring programme on the lines of NAFIN in Mexico. All types of factoring services can be made available through such online set-up, with focus on non-recourse factoring. Such a programme can focus on the extended use of technology towards lending, as well as providing technical assistance to MSMEs.

For this purpose, a development bank/ suitable body can be identified, which would be responsible for developing and conducting the programme on an ongoing basis. Also, various commercial banks must be allowed to participate in the programme, in order to increase its reach.

VII. **Ensure credit information in the credit bureaus is updated on a frequent basis:** A commonly stated issue with the credit information infrastructure in India is that of information being updated at long intervals of time- by when, the relevance of the information is reduced. Unless, credit information is disseminated quickly, the credit information cannot prove reliable, especially in the case of MSMEs. Hence, it must be ensured through appropriate technological improvements, that all information available with the credit bureaus is disseminated at frequent intervals.

VIII. **Introduction of innovative factoring mechanisms:** The government authorities and industry bodies can consider establishment of innovative factoring setups like the NAFIN of Mexico (refer paragraph 5.6) or “The Receivables Exchange” of USA (see box below), which have contributed to high factoring growth in respective countries.

Box 7.1: The Receivables Exchange, USA

Another innovative concept: The Receivables Exchange, USA

The Receivables Exchange is an exchange in the US, wherein accounts receivable can be funded and traded like any other assets. The Receivables Exchange enables companies to sell their receivables to a global network of institutional investors and thereby, gain access working capital in a very short period of time, which could be as little as three days.

The Receivables Exchange makes the process simple and efficient for both the sellers (of the receivables, or the company in need of funds) and the buyers (the buyers of the receivables), which reduces the typical credit term of nearly 90 days or as much as 180 days, to three days. This makes the Receivables Exchange an appropriate means of financing for small and medium-sized enterprises.

How it works?

The seller is allowed to post as many eligible receivables as he may want, and as often as he likes. The seller can also set the auction parameters (like, the duration of the auction, the minimum advance amount, and the maximum fee he will be willing to pay). The buyer is also given adequate control, and he can post profiles indicating preferences, and also browse and search for auctions of interest. If receivable postings meet the criteria of both the seller and buyer, the buyer can bid on the postings.

The Receivables Exchange (TRE) functions through a proprietary, patent-pending trading platform, which is located on the user's computer, and allows for continuous access to the exchange. Because the 'Exchange' is a desktop application, it is integrated with the desktop and can run in the background and data can be stored locally. TRE also has an extensive privacy policy to protect the interests of its customers. The identity of all buyers on the 'Exchange' is kept anonymous and is not revealed to sellers, debtors and other buyers.

Sellers' wishing to post receivables on TRE is required to go through a risk assessment. Sellers on the exchange are subjected to corporate identity verification (third-party) for the purpose of fraud prevention. Once verified, TRE conducts a search for any outstanding liens, judgments or bankruptcies on the seller, in order to take precautionary measures, and prevent fraud.

Relevance in the Indian context

The Indian MSME sector is highly price sensitive with respect to credit. Through a transparent system such as the receivables exchange, the concept of receivables finance will get a boost. Besides, since this mechanism functions as an exchange, the seller will be able to make use of the best quotes for each receivable, and not be obliged to accept whatever rates are offered to him. Not only would such a system foster greater competition among buyers, but also encourage greater participation from the MSMEs due to the ease of operations.

7.4 Enactment of special legislation

Besides the aforesaid factors, reference may also be made to the issues referred to and views expressed in respect thereof in chapter 6 of this report (Legal Framework); we are of the view that enactment of a special legislation is desirable.

This coupled with judicial reforms must be implemented in a time bound manner, involving computerisation and technology upgradation of courts to facilitate quicker legal proceedings.

7.5 Easing bank finance to factoring companies

In order to ease availability of finance for factoring companies, the RBI could consider reducing the risk weight to advances for factoring companies. At present, the risk weight applicable for advances to factoring companies is 100% (RBI.No.2008-09/282, DBOD.BP.BC. 83 / 21.01.002/2008-09), which is still considered high by factoring NBFCs. They feel that reduction in risk weights would encourage commercial banks to lend more to factoring companies, at lower rates. Funding available at competitive rates would enable factoring companies to compete with other receivables finance options. Thus, if possible, RBI may consider a reduction in risk weight for factoring companies.

7.6 Roadmap and Future Agenda

Various suggestions made in sections above, including the legal recommendations provided in Chapter 6 can be implemented in various phases to ensure a conducive environment for current factoring operations and for development of non-recourse factoring, especially for MSMEs. D&B study team has drawn a roadmap and future agenda for implementation of above recommendations. The following table provides the road-map for introduction of various legal, judicial, regulatory and other measures in the short term (less than one year), medium term (one-two years) and long term (above two years).

Table 7.2: Roadmap and future agenda

Time-scale	Legal and judicial measures	Regulatory measures	Other support measures	Measures by factoring firms
Short term (less than one year)	Framing of special legislation for factoring based on legal recommendations and sending the bill to the parliament for approval	Standardise letter of disclaimer/ waiver	Identifying a development bank/ agency for establishing reverse factoring system similar to NAFIN's (Mexico) Productive Chains Programme	Start developing information database on sectors that can utilise factoring services
	Once factoring bill is passed, requests to be made to state governments to exempt/ reduce stamp duties on factoring		Organise a National level Workshop/ Seminar for increasing factoring awareness and addressing concerns of key stakeholders	
	Amendment/ inclusion of provisions in certain enactments, necessitated by passing of factoring bill such as Interest on delayed payments; making available credit information; undertaking factoring operations in electronic form; and implications of insolvency			
Medium term (one-two years)	Establishment of a central registry for filing assignment of book debts	Ensure credit information in credit bureaus to be updated on a frequent basis	Periodic (bi-monthly/ quarterly) seminars on factoring for MSMEs in various cities	Organise education weeks at parent bank's branches to create awareness about factoring products
			Development bank identified on lines of NAFIN to start operations; Set up exchange like "The Receivables Exchange"	Utilise print and electronic media for promotional campaigns
Long term (above two years)	Central registry to start operations		Pooling of factoring database of all factoring companies by FAI/ other association	Open more branches in tier 1 and tier 2 cities
	Implementation of judicial reforms involving computerisation and technology upgradation of courts to facilitate quicker legal proceedings			

Chapter 8

National Workshop Structure

Introduction

8.1. A national level workshop would be conducted by SIDBI to increase the levels of awareness about factoring services. The workshop would serve as a platform not only for creating awareness, but also for disseminating information and addressing concerns of major stakeholders in the factoring industry with a view to accelerate the development and growth of factoring, especially of non-recourse factoring.

8.2. The SIDBI would have a lead responsibility as the agency initiating and fostering the process of experience sharing among all stakeholders, including the factors, banks, government agencies, credit information providers, credit insurance companies and MSMEs; and in the administration of the national level workshop to promote factoring.

8.3. In this chapter, we present a framework for the proposed workshop including the objectives for the workshop, the target audience, the venue and the daily plan of the workshop, in terms of key sessions and individual topics of presentation and discussions in each session.

Objective of the workshop

8.4. The broad objectives of the national workshop on factoring would be:

I. To inform a broad based national audience, including MSMEs, large corporates, policy makers, regulators and various other stakeholders about the potential benefits of various factoring services to the economy and specifically for corporates and MSMEs

II. To facilitate information and international experience sharing among factors, potential and existing clients of factors, regulators, policy makers and other stakeholders

III. Creating a platform for discussion on the issues faced by factor companies in India, and the measures required towards resolving them

IV. Discussing the observations and recommendations made in this study and assessing expert opinion about the feasibility of adoption of its recommendations

Target audience

8.5. The target audience of this workshop will include factoring companies and associations (domestic and international), government officials from finance ministries, the RBI and major banks, other MSME financial institutions such as private funds, credit cooperatives, and venture capital firms, etc., credit insurers, credit information bureaus, MSME associations, existing and potential factoring clients (largely MSMEs) and policy researchers interested in MSME financing in India.

Selection of location and venue

8.6. The location for the workshop will be in accordance with the type of attendees expected. Since a number of regulators, policy makers, MSMEs and industry associations, would form part of the workshop and the panels, the location can be selected in proximity of majority participants. Since a large number of factor companies, banks, financial institutions and industry associations are based in Mumbai; the city would be the ideal host for the event. The number of participants from each target group, the type of seating arrangements desired, availability of staff for management are some of the factors among many others that would have to be considered while selecting the workshop venue, which would most likely be a convention centre in a five-star hotel in Mumbai.

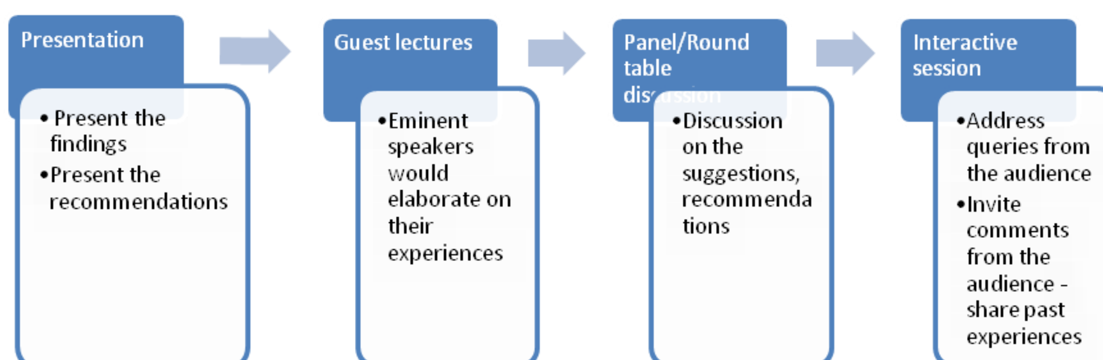
Format for the workshop

8.7. The workshop would consist of four sessions spread over two days. The workshop will start with a keynote address, which would provide an overview of factoring services in India. It will be followed by individual sessions for each of the identified topics. Emphasis in each of the sessions would be to make it interactive and have greater participation from the audience.

Contents for the workshop sessions

8.8. Each of the sessions will be conducted via a presentation on the topic at hand and a panel discussion among domain experts for the same, at the end of each day. Some special guest lectures will be conducted elaborating on the experiences of factor companies and associated concerns. The panel discussion, which will have eminent speakers from the concerned areas, will discuss the suitability of the recommendations made and other modifications/improvements desired. The panel discussions will conclude with an open house, wherein all participants' queries and suggestions will be addressed.

Exhibit 8.1: Content for the sessions



Selection of topics for discussion at the workshop

8.9. The topics for discussion at the workshop have been selected according to their relevance to the development of factoring, especially non-recourse factoring in India. The discussion points would cover the major issues with the factoring framework in India, the best practices in various countries and the recommendations made to improve the current factoring environment. The broad list of topics to be covered in the workshop would include,

- Issues with factoring in India
- Potential role of factoring in MSME development
- Recommendations
  - Legal, including modifications in the draft legislation
  - Regulatory and policy related
  - Development of support infrastructure
- Best practices in various countries benchmarking vis-à-vis Indian practices

8.10. Before the commencement of each session, participants would be provided with a paper summarising the observations of the study on the concerned area, and the issues that shall be discussed in the upcoming sitting. An introduction of the panellists would be circulated among the audience, along with a brief outline of discussions.

Exhibit 8.2: Session Plan

National Workshop for Factoring in India

<table>
<tr><th></th><th>9:30-10:00 AM</th><th>10:00-10:30 AM</th><th>10:30-11:00 AM</th><th>11:00-11:30 AM</th><th>11:30-12:00 AM</th><th>12:00-12:30 PM</th><th>12:30-1:00 PM</th><th>1:00-2:00 PM</th><th>2:00-3:00 PM</th><th>3:00-4:30 PM</th><th>4:30-5:30 PM</th><th>5:30-6:00 PM</th><th>6:00-7:00 PM</th><th>7:00-7:30 PM</th><th>7:30 PM onwards</th></tr>
<tr><td rowspan="3">Day 1</td><td rowspan="3">Registration</td><td rowspan="3">TEA</td><td rowspan="3">Keynote Address</td><td colspan="4">Factoring in India</td><td rowspan="3">NETWORKING LUNCH</td><td colspan="3">Issues and Concerns with Factoring in India</td><td rowspan="3">TEA BREAK</td><td rowspan="3">Panel Discussion and Open-house</td><td rowspan="3">Concluding Presentation</td><td rowspan="3">DINNER</td></tr>
<tr><td rowspan="2">Historical evolution and status of factoring in India</td><td>Guest lecture 1</td><td>Guest lecture 2</td><td rowspan="2">Role of factoring for MSME development</td><td rowspan="2">Legal and Regulatory</td><td>Support Infrastructure</td><td rowspan="2">Recommendations</td></tr>
<tr><td>Experiences of factors-1</td><td>Experiences of factors-2</td><td>Issues and concerns with credit insurance and credit information</td></tr>
</table>

<table>
<tr><th></th><th>9:30-9:50 AM</th><th>9:50-10:10 AM</th><th>10:10-10:30 AM</th><th>10:30-11:00 AM</th><th>11:00-11:20 AM</th><th>11:20-11:40 AM</th><th>11:40-12:00 Noon</th><th>12:00-12:30 PM</th><th>12:30-1:30 PM</th><th>1:30-2:00 PM</th><th>2:00 PM onwards</th></tr>
<tr><td rowspan="3">Day 2</td><td colspan="3">Factoring in advanced economies</td><td rowspan="3">TEA</td><td colspan="3">Factoring in emerging markets</td><td rowspan="3">Concluding Presentation</td><td rowspan="3">Panel Discussion and Open-house</td><td rowspan="3">Valedictory Speech</td><td rowspan="3">LUNCH</td></tr>
<tr><td>Case 1</td><td>Case 2</td><td>Case 3</td><td>Case 1</td><td>Case 2</td><td>Case 3</td></tr>
<tr><td>USA</td><td>UK</td><td>Germany</td><td>Thailand</td><td>Turkey</td><td>Singapore</td></tr>
</table>

Session Details

Day 1

8.11. The first day of the workshop would begin at 9:30 AM with the registration process, accompanied by tea. The sessions would open with the keynote address.

8.11.1. The Keynote address

The keynote address would be delivered by an eminent person, with widespread experience in the factoring industry. The address would encapsulate the status of the factoring industry in India and worldwide, and the rationale for pushing factoring for MSMEs in India. This address would serve as an introduction to the upcoming sessions and the road ahead to promote factoring.

8.11.2. Session 1: Factoring in India

a) Historical evolution and status of factoring in India

The first presentation of the day would encapsulate the journey of factoring in India so far. It would elaborate on the inception of factoring in the country and its growth trajectory since then.

b) Guest lectures: Experiences of factor companies

Two guest speakers would be invited from different factor companies to share their experiences (both positive and negative) with the business in India. These speakers would draw attention towards the practical issues faced by factor companies as well as the potential of factoring in India.

c) Role of factoring for MSME development

This presentation will be aimed at displaying to the factor companies, policy makers and MSMEs, how factoring as an integrated receivables management service would be an ideal funding source for the MSMEs in India. This presentation would differentiate factoring from other modes of bank finance, and present a case study to demonstrate the benefits of factoring over other modes of finance. This session would thus involve presentation of a cost-benefit analysis, and addressing the queries of the MSME participants by the presenters.

8.11.3. Session 2: Issues with Factoring in India

This session would brief the participants about the main issues with factoring, as revealed in the study and would discuss the possible solutions in the form of recommendations made in the study.

a) Legal and regulatory

The objective of this presentation would be to focus on current legal and regulatory framework applicable to factor companies. The desired modifications in the framework would also be addressed in the presentation.

b) Support Infrastructure

This session on support infrastructure development would involve participants from credit insurance companies, credit bureaus and policy makers, amongst others. The deliberations would focus on the path ahead for development of each of these areas, for the benefit of non-recourse factoring. This sitting would be divided into two major areas- credit insurance and credit information infrastructure.

c) Recommendations and Panel Discussion

The recommendations made by D&B in this study would be presented to the august gathering, wherein it would be analysed and discussed by the experts from the field of financial regulation, legal and policy makers, and their feasibility of adoption would be ascertained. Participation would also be invited from factor companies, to incorporate the industry's voice in the discussions.

d) Concluding Presentation

The last presentation would summarise the deliberations of all the sessions conducted during the day, before the gathering retires for dinner.

Day 2

8.12.The second day of the national workshop would be focussed on the international case studies and identification of the best practices with respect to factoring. Day 2 would include presentations on each of the countries studied, and a comprehensive assessment of the learning from these countries.

8.12.1. **Session 1: Factoring in advanced economies**

Three short presentations would be made, one on each of the advanced economies studied, encapsulating the factoring industry in that country, the number and types of players, kinds of factoring undertaken, operational procedures followed by the companies there and the major issues and reforms pertaining to that country.

8.12.2. **Session 2: Factoring in emerging economies**

In this session too, short presentations would be made for each of the emerging economies studied in this study.

8.12.3. Concluding presentation and panel discussion

Before the commencement of the panel discussion, all the major learning from the various countries will be summarised after which the house would be left open for discussion and debate. The panellists would be selected from the set of prospects from the six countries studied. In addition, representatives from international factor associations, such as FCI and IFA would also be invited to the panel.

8.12.4. Valedictory speech

The national workshop would conclude with a valedictory speech from the senior management at SIDBI.

8.13. Paper summing up all the major suggestions/recommendations

The summary of the workshop would be prepared in the form of a white paper, incorporating the discussions and comments of the sessions, which would serve as a one-point reference for all the deliberations made over the two-day workshop. This white paper would be circulated among all the participants after the conclusion of the workshop.

ANNEXURE

Annexure-1

Factoring Mechanism

Factoring is a receivables management and financing mechanism which is designed to improve cash flows and cover the credit risk of the seller. Unlike other forms of receivables financing, like bills discounting and forfaiting; factoring involves a continuous relationship between a factor and a seller, to finance and administer the receivables of the latter. Factors are financial companies which pay cash against the credit sales of the client, and obtain the right to receive the future payments on those invoices from the debtors of the client.

Functions of a factor

Factoring constitutes a suite of financial services offered under a factoring agreement, which includes receivables financing, credit protection, accounts receivables collection and management, sales ledger administration and advisory services.

I. *Receivables financing*: The factoring institution advances a proportion of the value of the book debts immediately to the client and the balance is paid on maturity of the book debts. This improves the cash flow position of the client, by replacing the credit sales for cash.

II. *Credit protection*: The factoring institution takes over the credit risk of the client, and agrees to bear the loss in case of default by the debtor. Credit protection is provided by the factor only in case of non-recourse factoring.

III. *Accounts receivables collection and management*: The factoring company collects the receivables of the client and also manages the credit collection schedule. By reducing the time invested by the client in such activities, it allows the client to focus on business development.

IV. *Sales Ledger management*: The factor undertakes sales ledger management, including maintenance of credit records, collection schedules, discounts allowed and ascertainment of balance due from all debtors.

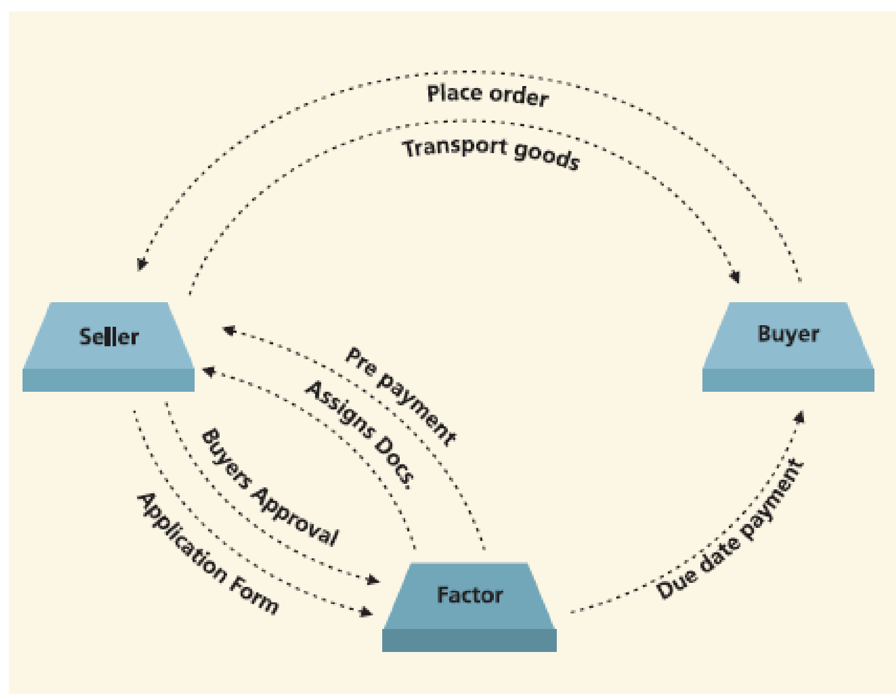
V. *Advisory Services*: A factoring company advises the client on its export and import potential, and also helps the client in identification and selection of potential trade debtors, based on the credit information available with it. The factor also advises on the prevailing business trends, policies, impending developments in the commercial and industrial sector etc.

Factoring mechanism

The parties involved in a factoring arrangement are:

1. The Client, or the seller
2. The Debtor, or the buyer
3. The Factor (International factoring may have a correspondent factor in addition to the domestic factor)

Exhibit A1.1: Factoring mechanism



Detailed Steps:

1. Client approaches Factor Company and requests for factoring facility.
2. Factor asks for Client's financial statements (last three years' balance sheet).
3. Client fills the application form and submits his last three years' financial statements.
4. Factor company conducts Client appraisal by conducting his credit assessment on the quantitative (this includes analysis of current ratios, gearing ratios, profitability ratios, etc.) and qualitative parameters such as integrity, management etc and approves/ disapproves client request.
5. Once approved, the Factor Company assigns overall factoring limit to the client. The client is required to submit sales ledger of his customers to the factor, who assesses the customers to determine limit of sanction according to the quality of customers.
6. Bank NOC / Letter of Disclaimer (LOD) are called for after sanction of limit but before operationalisation of the account.
7. In case of approval of client request, client is asked to submit following documents:
    a. documents for collateral, if any
    b. Personal guarantee of directors, etc
8. Factor Company examines the sales ledgers of client's customers and conducts Buyers' due diligence. For this, it seeks bank reports, credit reports from credit bureaus, D&B report, etc.
9. Based on the credit assessment of each customer of the client, Factor company sets credit limits for each customer.
10. Factor Company grants in-house approval.
11. Factoring Company is required to send letter of notification to the client's buyers and the buyers are required to accept the same and send it to the factor company.
12. A factoring agreement is signed between the client and the factoring company.

13. Client is required to submit original invoices with assignment clause written on these and proof of delivery of these invoices.
14. Factor Company makes advance prepayment (Up to 80% of invoice value).
15. Factoring company manages client's ledger, sends due date reminders to client's customers and collects payments as and when due.
16. Factoring company uses appropriate software to manage the above processes.
17. Factoring company pays balance due to the client upon receipt of full payment.

Detailed Steps in International Factoring (Two Factor Model)

1. The importer places the order for purchase of goods with the exporter
2. The exporter approaches the export factor (in the exporter's country) for limit approval on the importer. Export Factor in turn requests the import factor in the importer's country for the arrangement
3. The import factor assesses the importer and approves/rejects the arrangement and accordingly conveys to the export factor
4. Exporter is informed of the commencement or otherwise, of the factoring arrangement
5. The exporter delivers the goods to the importer
6. Exporter produces the documents to the export factor
7. The export factor disburses funds to the exporter up to the prepayment amount and forwards the documents to the Import factor as well as the Importer
8. On the due date of the invoice, the Importer pays the Import Factor, who in turn remits the payment to the export factor.
9. The exporter receives the balance payment from the export factor.

Charges applicable

Usually, a one time setup fee, a service fee and an interest charge is levied for a factoring transaction.

The service fee is levied for the additional services of the factor, besides financing. It is calculated as a percentage of the gross value of the invoices factored, and is based on:

I. The gross sales volume
II. The number of customers/debtors of the client
III. The number of invoices and credit notes
IV. The credit risk involved

Annexure-2

Draft legislation

DRAFT

The Factoring of Debts due to

Industrial and Commercial Undertakings Bill, 2002.

A Bill to provide for and regulate factoring of debts due to industrial and commercial undertakings and for matters connected therewith or incidental thereto.

1. **Short title, extent and commencement :-** (1) This Bill may be called "The Factoring of Debts due to Industrial and Commercial Undertakings Bill, 2002".

   (2) It extends to the whole of India, except the State of Jammu & Kashmir.

   (3) It shall be deemed to have come into force on the ---- day of---

2. **Definitions –** In this Bill, unless the context otherwise requires:-

   (a) "assignment" means the transfer of any doubt, claim or right in property of a client in favour of the factor arising under a factoring arrangement;

   (b) "client means an industrial or commercial undertaking who has entered into a factoring arrangement with a factor;

   (c) "customer" means any person who buys any goods or receives any services from a client for consideration and is under an obligation to pay the amounts due under the contract or contracts for purchase or sale of such goods or for supply of such services;

   (d) "factor" means any person who is engaged in the business of factoring and has entered into a factoring arrangement with a client;

   (e) "factored debt" or "debt" means the amount or amounts due or owing or accruing due or owing, both present and future, to a client from customer or customers under a contract for sale or purchase of goods or supply of services by the client to such customer or customers and assigned to a factor;

   (f) "factoring arrangement" means a contract concluded between a client and factor pursuant to which:

(i) the client agrees to assign to the factored debts, actionable claims or receivables arising from contract or contracts for sale of goods or supply of services made between the client and customer or customers;

(ii) the factor provides any two of the following functions:

1) finance (with or without recourse) including lines of credit, loans and advance payments;
2) maintenance of debtor accounts;
3) collection of debts, actionable claims or receivables due to the client;
4) protection against default in payment by customer or customers;
5) any other arrangements made between the factor and the client or the customer or the client with the customers as the Central Government may specify.

(g) “future debt” means receivable to be factored in future.

(h) “goods” means every kind of movable property, including services or supply of services, transferred to or acquired by customer or customers from the client which is subject matter of a factored debt;

(i) “industrial or commercial undertaking” means an undertaking carrying on the business of manufacturing, purchase, sale or supply of goods or services;

(j) “instrument” includes every document, whether an agreement, negotiable instrument , invoice or otherwise, by which any right or liability is, or purports to be created, declared, transferred, limited, extended, extinguished or recorded;

(k) “notification” means a notification published in the Official Gazette.

3. **Assignment of debt :-** (1) Notwithstanding anything to the contrary contained in Transfer of Property Act, 1882 (No.IV of 1882), a transfer of a debt in favour of a factor or any person acting on his behalf shall be effected by execution of an instrument in writing signed by the client or his duty authorised agent, which shall be complete and effectual upon the execution of such instrument and thereupon all the rights and remedies of the client, whether by way of damages or otherwise, shall vest in the factor whether such notice of assignment as provided in Section 4 be given or not.

(2) Every assignment of debt in favour of the factor or any person acting on his behalf in pursuance of the powers of sub-section (1) shall vest in the factor an absolute right to recover such debt as if he is the owner of such factored debt and on such vesting the factor shall have the same rights as that of the client.

(3) The factor upon execution of such instrument as aforesaid may on default in payment sue or institute proceedings for recovery of the assigned or factored debt in his or its own name without obtaining the consent of the client and without making him a party thereto.

4. **Notice of assignment of debt :-** Notwithstanding anything contained in sub- section (1) of section 3, a notice of assignment of debt to be given to the customer shall be in writing, printed, engraved, lithographed or impressed by such other manner and may be signed by the factor or the client or by a duly authorised agent of the factor or client and shall deemed to have been served on the customer if it is delivered or sent to the customer at the last known address of the customer on the record of the client or factor.

5. **Client to be Trustee of the Factor :-** Any or all amounts received or any payments made to the client in discharge of satisfaction or to the account of any or all amounts owed and payable in respect of accounts receivables or other assets to which factor has right or interest shall be held in trust by the client for the benefit of the factor.

6. **Liability of the customer :-** Where a notice of assignment of debt in favour of the factor as provided in section 4 is served on a customer, the customer shall not be entitled to a valid discharge of his debts, unless he makes the payment of debt to the factor. The customer shall on receipt of notice of assignment also intimate the factor full details of the deposits or advance or payment on account made to the client before the receipt of notice of assignment in respect of the factored debts and also provide any other information to the factor relating to the debts as and when called upon by the factor.

7. **Prohibition of further assignments :-** On assignment of debt in favour of the factor, the client shall not be entitled to subsequently assign the same debt to any other factor or any other person.

8. **Rights of factor :-** Notwithstanding anything contained in any other law, where a Client at a different time purports to create rights or interest over the Account receivables or other assets and such rights or interest cannot exist or be exercised to their full extent together, each of such rights or interest shall, in the absence of a special contract or reservation binding the factor be subject to rights of the factor; and as between factors, each later created right or interest shall be subject to the rights or interest previously created.

9. **Special provision for enforcement of claim by factor :-** Notwithstanding anything to the contrary contained in the Code of Civil Procedure, 1908 (No.V of 1908) or any other law for the time being in force, the provisions of Order XXXVII of the Code of Civil Procedure, 1908 (No.V of 1908) shall apply for institution of suits or any other legal proceedings by a factor for recovery of a debt or other dues under a factoring arrangement.

10. **Amendment of certain enactments :-** The enactments specified in Part I and Part II the schedule to this Bill shall be amended in the manner specified therein and such amendments shall take effect on the date of commencement of this Bill.

11. **Power to remove difficulties :-** If any difficulty arises in giving effect to the provisions of this Bill, the Central Government may by order, do anything, not inconsistent with such provisions for the purpose of removing the difficulty:

Provided that no such order shall be made after expiration of three years from the date on which this Bill, receives the assent of the President.

12. Overriding effect :- The provisions of this Bill shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force.

SCHEDULE

[See section 10]

Amendment of certain enactments

PART I

AMENDMENT TO THE CODE OF CIVIL PROCEDURE, 1908 (No. V of 1908)

1. At the end of sub-clause (iii) of clause (b) of sub-rule (2) of Rule (1) in Order XXXVII, the following sub-clause shall be inserted namely:-

‘(iv) suit for recovery of debts under a factoring arrangement instituted by a factor’

Part II

AMENDMENT TO INTEREST ON DELAYED PAYMENTS TO SMALL SCALE AND ANCILLARY INDUSTRIAL UNDERTAKINGS ACT, 1993 (NO.32 OF 1993)

1. At the end of clause (d) of Section 2, the following explanation shall be inserted, namely:-

'Explanation.- Any property transferred to or acquired by a customer, which is a subject matter of an assignment of debt due to an ancillary industrial undertaking or small scale industrial undertaking, as defined under Industries (Development and Regulation) Act, 1951 [No.65 of 1951] in favour of a factor, shall be deemed to be 'goods' for the purpose of this Act.'

2. At the end of clause (f) of section 2, the following explanation shall be inserted, namely:-

'Explanation.- For the purpose of this clause, a factor under a factoring arrangement with a client, who is an ancillary industrial undertaking or small scale industrial undertaking as defined under Industries (Development and Regulation) Act, 1951 [No.65 of 1951], shall be deemed to be 'supplier'.'

Annexure-3

Amended Draft legislation

As modified by D&B based on the observations made in Chapter 6 of the Report

THE FACTORING OF DEBTS DUE TO
INDUSTRIAL AND COMMERCIAL UNDERTAKINGS BILL, 20.....

Chapter I: Preliminary

Sections

1. Short title, extent and commencement
2. Application of other laws not barred
3. Definitions

Chapter II: Registration of Factors.

4. Prohibition to commence or carry on factoring business
5. Application for registration
6. Grant of certificate of registration
7. Power of the Bank to cancel certificate of registration, permission
8. Appeal against order of the Bank

Chapter III: Management of Factors.

9. Management of Factors
10. Power of the Bank to determine policy
11. Power of the Bank to give directions

Chapter IV: Inspection & Audit of Factors

12. Inspection of Factors
13. Power And Duties of Auditors

Chapter V: Factoring of Debt

14. Assignment of debt
15. Notice of assignment of debt
16. Establishment of a registration system

Chapter VI: Rights and Obligations of Parties to Factoring Contract

17. Rights and Obligations of Customer
18. Liability of Customer
19. Insolvency of Debtor
20. Client to be Trustee of the Factor
21. Prohibition of further assignments
22. Rights of factor
23. Duties of factor and the client

24. Obligation of a Factor
25. Priority among several assignees of same debt
26. Confidentiality of information
27. Requirements for a Factoring Contract

Chapter VII: Offences and Penalties

28. Offences and Penalties
29. Cognizance of offences
30. Power of the Reserve Bank to impose penalty
31. Application of fines

Chapter VIII: Miscellaneous

32. Limitation
33. Protection of action taken in good faith
34. Bar of jurisdiction
35. Amendment of certain enactments
36. Power of Central Government to make rules

Schedule

Part I: Amendment to the Code of Civil Procedure, 1908 (No. V of 1908)

Bill No. .... of 20....*

[It may be made every where as '2010', after verifying from SIDBI & everywhere such changes may be made Or the year...may be left blank.]

THE FACTORING OF DEBTS DUE TO

INDUSTRIAL AND COMMERCIAL UNDERTAKINGS BILL, 20....*.

A

BILL

to provide for and regulate factoring of debts due to industrial and commercial undertakings and for matters connected therewith or incidental thereto.

Be it enacted by Parliament in the ... Year of the Republic of India as follows: -

CHAPTER I

PRELIMINARY

1. **Short title, extent and commencement: -** (1) This Bill may be called "The Factoring of Debts due to Industrial and Commercial Undertakings Bill, 20....*".

   (2) It extends to the whole of India, except the State of Jammu & Kashmir.

   (3) It shall be deemed to have come into force on the ---- day of---

Provided that different dates may be appointed for different provisions of this Act, and any reference in any such provision to the commencement of this Act shall be construed as a reference to the coming into force of that provision.

2. **Application of other laws not barred:** (1) The provisions of this Act shall be in addition to, and not, save as provided under this Act, in derogation of, the provisions of the Companies Act, 1956 (1 of 1956) or any other law for the time being in force.

(2) Save as otherwise provided under this Act, and subject to such exception or modifications, as may be made by the Central Government by way of notification issued in this behalf from time to time, provisions of Chapter IIIB of the Reserve Bank of India Act (2 of 1934), and the Banking Regulation Act, 1949, (10 of 1949), rules, regulations framed there under, and statutory guidelines

and directions issued by the Bank from time to time in terms thereof, in relation to factoring business undertaken by; a non-banking financial company and a banking company departmentally or through their subsidiaries or affiliated companies controlled by them, shall apply to all such;

(a) non-banking financial company which may be already undertaking factoring business having obtained the certificate of registration before commencement of this Act, and also to those of such companies which may be intending to undertake factoring business on or after commencement of this Act; and

(b) to such banking companies which may be already undertaking factoring business departmentally or through their subsidiaries or affiliated companies controlled by them having obtained the requisite permission or approval of the Bank before commencement of this Act, and also to those of such banking companies which may be intending to undertake factoring business departmentally or through their subsidiaries or affiliated companies controlled by them;

on or after commencement of this Act.

(3) (a) The provisions of Chapters; IV and V of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993), as in force from time to time, shall, as far as possible, apply with necessary modifications as if the said provisions and the rule referred to the amount of debt as defined under clause (e) of section 3 of this Act.]

(b)Central Government may by way of notification issued in this behalf from time to time, specify necessary modifications in relation to clause (a).

(c) A factor may file its claim against its client or customer in relation to a factoring contract, before the Tribunal and avail of the recourse as is available to a bank and financial institution for recovery of their debt, as per provisions of Chapter IV and Chapter V of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993); as per the procedure and subject to payment of such fee as may be prescribed.

[Note- The Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993) amongst others provides ;

- *(i)* *Recourse to 'banks' and 'financial institutions' for recovery of their 'debts' through Tribunals established under the Act;*
- *(ii)* *pecuniary cut off limit of amount of debt [under sub-section (4) of Section 1 thereof] for applicability of the provisions of the Act;*
- *(iii)* *definition of the terms;* 'debt' and *'financial institutions' [under* clauses(g) and (h) of Section 2 thereof]; and
- *(iv)* *as per sub-section (3) of Section 2 of this Act, the provisions of* Chapters IV and V of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993), would apply with necessary modifications to debt as defined under this Act.

*Therefore; if it is decided to extend the jurisdiction of Tribunal for providing the recourse to factors for recovery of debts (*as defined under this Act) *notifications in terms of the following provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993) may be required to be made by the Govt. for the purpose, i.e.*

(i)notification in terms of sub-section (4) of Section 1 for lowering down the pecuniary cut off limit of amount of debt, so as to enable filing of claim for recover of debt by factors; and

(ii) notification in terms of **sub-clause (ii) of** clause (h) of Section 2 *to specify 'factors' (as defined under this Act), as 'financial institutions' .]*

3. Definitions – In this Bill, unless the context otherwise requires: -

(a) "Assignment" means transfer of any debt, claim or right in property, of a client in favour of its factor arising under a factoring arrangement;

(b) "Banking company " shall have the meaning assigned to it in clause (c) of Section 5 of the Banking Regulation Act,1949 (10 of 1949);

(c) "Client" means an industrial or commercial undertaking that has entered into a factoring arrangement with a factor and includes a supplier within the meaning of clause (n) of Section 2 of the Micro, Small and Medium Enterprises Development Act, 2006 (27 of 2006);

(d) "customer" means a person who buys any goods or receives any services from a client for consideration and is under an obligation to pay to the client the amounts due in respect thereof as per the contract for sale of goods or supply of services, as the case may be and includes a buyer within the meaning of clause (d) of Section 2 of the Micro, Small and Medium Enterprises Development Act, 2006(27of 2006).

(e) "Debt" means obligation of a customer to pay the amount to its supplier as per the contract between them for sale of goods or supply of services, as the case may be, and includes—

(i)"present debt" which is existent, now due and owing;

(ii) "future debt" which is existent but accruing, or payment whereof is in future; and

(iii) also the amount as may be due and payable as per this Act, to a factor by its client, or its customer, as the case may be, in relation to a factored debt.

(f) "factor" means -

(i) a company formed and registered under the Companies Act,1956 (1of 1956);

(ii) a non-banking financial company as defined in sub-clause(f) of Clause (I) of Section 45 of the Reserve Bank of India Act,1934, (2 of 1934);

(iii) a banking company or their subsidiaries or affiliated companies controlled by them;

(iv) a corporation having power to undertake factoring business and incorporated by a Central or State enactment, as the case may be;

(v) such other institution as the Central Government may having regard to its business activity, or functions, by notification, specify as eligible to undertake factoring business;

which has been permitted by the Bank to undertake factoring business.]

(g) "factoring business" means following services, which a factor may provide to its client, for a fee or interest rate, or both; and for an agreed time period, as per the factoring contract between the factor and its client;

(i) finance (with or without recourse) including lines of credit, loans and advance payments;

(ii) finance the customer or customers of client by making payment of the bills or invoices drawn on client in respect of supply or purchase of goods and services made to the client;

(iii) maintenance of debtors' accounts;

(iv) collection of debts, actionable claims or receivables due to the client;

(v) protection against default in payment by customer or customers; and

(vi) any other arrangement as the Central Government may notify in this behalf.

(h) "Factoring contract" means an arrangement reached between a client and factor by way of a contract concluded between them pursuant to which:

(i) the client agrees to assign to the factor, its debts, actionable claims or receivables arising from contract or contracts for sale of goods or supply of services made between the client and its customer; and

(ii) the factor agrees as per such arrangement to provide to the client any of the two services which are part of factoring business.

(i) "Factored debt" means the debt which forms part of a factoring contract;

(j) "Goods" means every kind of movable property, including services or supply of services, transferred to or acquired by customer or customers from the client which is subject matter of a factored debt;

(k) "Industrial or commercial undertaking" means an undertaking carrying on the business of manufacturing, purchase, sale or supply of goods or services;

(l) "Instrument" includes every document, whether an agreement, negotiable instrument , invoice or otherwise, by which any right or liability is or purports to be created, declared, transferred, limited, extended, extinguished or recorded;

(m) "Non-banking financial company" shall have the meaning assigned to it in sub-clause (f) of clause (I) of Section 45 of the Reserve Bank of India Act, 1934 (2 of 1934);

(n) "Notification" means a notification published in the Official Gazette;

(o) "Prescribed" means prescribed by rules made under this Act;

(p) “this Act” means the Factoring of Debts due to Industrial and Commercial Undertakings Bill, 2009*;

(q) “the Bank”, means “the Reserve Bank of India”, constituted under Section 3 of the Reserve Bank of India Act, 1934 (2 of 1934);

(r) Words and expressions used herein and not defined in this Act but defined in the Reserve Bank of India Act (2 of 1934), the Banking Regulation Act, 1949, (10 of 1949), the Companies Act, 1956 (1 of 1956), the Registration Act,1908 (16 of 1908), the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993), the Information Technology Act, 2000 (21 of 2000), the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002), the Credit Information Companies (Regulation) Act, 2005 (30 of 2005), or the Micro, Small and Medium Enterprises Development Act, 2006 (27 of 2006), shall have the meanings respectively assigned to them in those Acts.

CHAPTER II

REGISTRATION OF FACTORS

4. **Prohibition to commence or carry on factoring business:-** Save as otherwise provided in this Act, no company, corporation, or institution, shall commence or carry on the business of factoring without obtaining a certificate of registration from the Bank under this Act.

5. Application for registration: (1) A company, corporation, or institution, intending to commence factoring business on or after the commencement of this Act, shall be as provided under sub-clauses (i) to (v) of clause (f) of Section 3 of this Act.
(2) An applicant being;

(i) a non-banking financial company; or

(ii) a banking company intending to undertake factoring business departmentally or through its subsidiary or affiliated company controlled by it ; or

(iii) a corporation, or an institution;

as provided under sub-clauses (i) to (v) of clause (f) of Section 3 as the case may be, shall file its application for obtaining certificate of registration in the manner as may be prescribed.

(3) Every such non-banking company, or a banking company, or its subsidiary or affiliated company controlled by banking company, which were in existence and carrying on factoring business on the commencement of this Act, shall also apply for obtaining certificate of registration in the manner as may be prescribed, and such applicants shall file their application ;

(i) before expiry of period of 'X' months from the date of commencement of this Act; or

(ii) within such extended period as the Bank may allow on their application subject to being satisfied about the reason for such extension.

Provided in case of such non-banking company, or banking company, or subsidiary or affiliated company, nothing contained in section 4 shall be deemed to prohibit them from carrying on factoring business, until a certificate of registration is granted to them, or they are prohibited by the Bank by notice in writing from continuing factoring business.

6. Grant of certificate of registration: (1) The Bank shall consider the application submitted to it under sub-sections (2) or (3) of Section 5, for obtaining certificate of registration to commence on, or to continue, as the case may be, factoring business, taking into account the criteria and requirements as may be in force for such applicants and satisfy itself that the applicant fulfils all such criteria and has duly complied with such requirements.

(2) The Bank may for being satisfied as per sub-section (1) if it considers necessary to do so, get the records or books of such applicant inspected by its officers or otherwise ,and may satisfy itself;

(a) that the applicant has minimum capital structure as per criteria referred to under sub-section (1);

(b) that the general character of the management or the proposed management of the applicant, has requisite standard of experience level for managing its affairs, in relation to factoring business; and

(c) it may, if so considered appropriate and necessary, require the applicant to comply with any other such condition, the fulfillment of which in the opinion of the Bank, shall be necessary to ensure that the commencement of the business of factoring by the applicant shall not be detrimental or prejudicial to the public interest or banking policy or financial system of the country.

(3) The Bank may, after being satisfied that the conditions as referred to in sub-section (1) are fulfilled, grant a certificate of registration**,** to the applicant to commence on the business of factoring, subject to such additional conditions which it may consider fit to impose, and if the applicant fails to fulfill any of such conditions or any of the provisions of this Act, the application may be rejected:

Provided that no application shall be rejected unless the applicant has been given an opportunity of being heard.

7. Power of the Bank to cancel certificate of registration: (1) The Bank may cancel; a certificate of registration granted to a factor under sub-section (3) of Section 6, if a factor:-

(i) ceases to carry on the business of factoring; or

(ii) has failed to comply with any of the conditions subject to which the certificate of registration, or permission, as the case may be, was granted under sub-sections (2) or (3) of Section 6 to it; or

(iii) at any time fails to fulfill any of the conditions referred to in sub-section (2) of Section (2) and Section 6;or

(iv) fails to:

(a) comply with the provisions of any law for the time being in force or any direction issued by the Bank under the provisions of this Act or the Acts referred to in sub-section (2) of Section 2; or

(b) has failed to submit or offer for inspection its books of account and other relevant documents when so demanded by the officers, persons or agency referred to in Section 12.

(2) Before cancelling the certificate of registration granted to a factor under this section on the ground that the factor has failed to comply with the conditions specified in sub-section (2) of Section (2) and Section 6 or the provisions of any other law for the time being in force or directions issued under this Act, the Bank, shall grant time ,to such factor, on such terms as it may deem appropriate for enabling such factor to take necessary steps to comply with such directions or provisions or fulfillment of such conditions, within such time :

Provided that if the Bank is of the opinion that the delay in cancelling the certificate of registration, or permission, of such factor shall be prejudicial or detrimental to the public interest or banking policy or financial system of country or factors, the Bank may cancel the certificate of registration, or the permission, as the case may be, without granting time as provided in sub-section (2).

(3) No order of cancellation of certificate of registration, or permission, granted to a factor, shall be made by the Bank unless such factor has been given a reasonable opportunity of being heard.

[*Note-Such additional conditions ,if any , which may also be a ground for cancellation of certificate of registration, or permission, may be included based on policy decisions taken in this behalf]*

8. Appeal against order of the Bank:

[*Note- Based on policy decisions taken in this behalf i.e. who would be appellate authority, the Govt. or any other authority, provision on the lines of similar provisions under the Reserve Bank of India Act (2 of 1934), Banking Regulation Act, 1949, (10 of 1949), or the Credit Information Companies (Regulation) Act, 2005, may be included]*

CHAPTER-III

MANAGEMENT OF FACTORS

9. Management of Factors:-

[Note-Provision under this clause would need to include criteria relating to constitution of the board, required expertise the members should have, power of the Bank to intervene/supersede the board/issue directions in this behalf]

10. Power of the Bank to determine policy:-

[Note-To enable the Bank to determine policy which shall be binding on the factors and parties to factoring]

11. Power of the Bank to give directions:--

[Note-To enable the Bank to issue directions to the factors in general or in particular as it may deem appropriate]

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CHAPTER-IV

INSPECTION & AUDIT OF FACTORS

12. Inspection of Factor:—(1) Notwithstanding anything to the contrary contained in Section 235 of the Companies Act, 1956 (1 of 1956), or any other law for the time being in force, the Bank, at any time, may on being satisfied that it is necessary to do so , cause an inspection to be made, by one or more of its officers or through such other persons or agency as the Bank may determine, of any factor and their books and accounts; and the Bank shall supply to the factor, a copy of its report on such inspection.

(2) If the officer of the Bank, or person or agency, as the case may be, making an inspection of a factor, under sub-section (1) calls for any books, accounts and other documents, any statement or information relating to the affairs of such factor, it shall be the duty of every director or other officer or employee of the factor to produce such books, accounts and other documents, statement or information ,in his custody or power within such time as the said officer or person or agency may specify in its requisition for the same.

(3) If it is deemed necessary to do so in the course of such inspection, the officer of the Bank or person or an agency, as the case may be, making an inspection under sub-section (1) may examine on oath any director or other officer or employee of the factor, in relation to their business, and may administer an oath accordingly.

(4) The factor shall be responsible to bear the expenses of, or incidental to, the inspection under sub-section (1) by any person or an agency referred to in sub-section (1), as the case may be.

(5) Nothing in sub-sections (1) to (4) shall apply to inspection of such factor which is a non-banking financial company undertaking factoring business, or a banking company undertaking factoring business departmentally or through its subsidiary or affiliated company controlled by it, and inspection of such factor shall be governed by the provisions of sub-section (2) of Section 2 of this Act.

[Note*: To enable the Bank to cause inspection of the factors by its officers, or otherwise*. If it is decided that inspection of all the factors, without making any distinction for factor being a non-banking financial company, or a banking company, or its subsidiary or affiliated company controlled by it, should be governed by the same provision of this Act, in such event, provisions of sub-section (5) may be deleted.]

13. Powers and duties of auditors.—(1) It shall be the duty of an auditor of a factor to inquire

whether or not the factor has furnished to the Bank such statements, information or particulars relating to its business as are required to be furnished under this Act and the auditor shall, except where he is satisfied on such inquiry that the factor has furnished such a statement, information or particulars, make a report to the Bank in this regard.

(2) The Bank may, on being satisfied that it is necessary so to do, in the public interest or in the interest of factoring business, or factors, issue directions in particular or in general with respect to audit of factor and submission of the report to the Bank.

(3) Where the Bank is of the opinion that it is necessary so to do , it may, at any time, by an order, direct that a special audit of the accounts of the factor in relation to any such transaction or class of transaction for such period or periods, as may be mentioned in the order, shall be conducted and the Bank may by such order or by a separate order either appoint an auditor or auditors or direct the auditor of the factor himself to conduct such special audit and the auditor shall comply with such directions and make a report of such audit to the Bank and forward a copy thereof to the factor.

(4) The remuneration of the auditors as may be fixed by the Bank, having regard to the nature and volume of work involved in the audit and the expenses of, or incidental to, the audit, shall be borne by the factor so audited.

5) Nothing in sub-sections (1) to (4) shall apply to audit of such factor which is a non-banking financial company undertaking factoring business, or a banking company undertaking factoring business departmentally or through its subsidiary or affiliated company controlled by it, and audit of such factor shall be governed by the provisions of sub-section (2) of Section 2 of this Act.

[Note*: To enable the Bank to cause audit of the factors* if it is decided that audit of all the factors, without making any distinction for factor being a non-banking financial company, or a banking company, or its subsidiary or affiliated company controlled by it, should be governed by the same provision of this Act, in such event, provisions of sub-section (5) may be deleted.]

(3) Every non-banking company, or a banking company, or its subsidiary or affiliated company controlled by banking company, in existence and carrying on factoring business on the commencement of this Act, shall also apply for obtaining certificate of registration in the manner as may be prescribed, and such applicants shall file their application ;

(i) before expiry of period of period of 'X' months from the date of commencement of this Act; or

(ii) within such extended period as the Bank may allow on their application subject to being satisfied about the reason for such extension.

Provided in case of such non-banking company, or banking company, or subsidiary or affiliated company, nothing contained in section 4 shall be deemed to prohibit them from carrying on

factoring business, until a certificate of registration is granted to them, or they are prohibited by the Bank by notice in writing from continuing factoring business.

14. **Assignment of debt:** (1) Notwithstanding anything to the contrary contained in Transfer of Property Act, 1882 (4 of 1882), a transfer of a debt in favour of a factor or any person acting on his behalf shall be effected by execution of an instrument in writing signed by the client or his duly authorised agent, which shall be complete and effectual upon the execution of such instrument and thereupon all the rights and remedies of the client, whether by way of damages or otherwise, shall vest in the factor whether such notice of assignment as provided in Section 15 be given or not.

(2) Every assignment of debt in favour of the factor or any person acting on his behalf in pursuance of the powers of sub-section (1) shall vest in the factor an absolute right to recover such debt as if he is the owner of such factored debt and on such vesting the factor shall have the same rights as that of the client.

(3) The factor upon execution of such instrument as aforesaid may on default in payment sue or institute proceedings for recovery of the assigned or factored debt in its own name without obtaining the consent of the client.

15. Notice of assignment of debt: Notwithstanding anything contained in sub- section (1) of Section 14, a notice of assignment of debt to be given to the customer shall:

(a) be in writing, printed, engraved, lithographed or impressed by such other manner and may be signed by the factor or the client or by a duly authorised agent of the factor or client;

(b) reasonably identify, the assigned debt or claim or right in property, as the case may be, and the client and the assignee;

(c) be deemed to have been served on the customer if it is delivered or sent to the custome**r** at the last known address of the customer on the record of the client or factor; and

(d) issuance of such notice of assignment of debt to the customer may be effected by means of electronic form as per the provisions of the Information Technology Act, 2000 (21 of 2000) and subject to such conditions as may be prescribed in this behalf.

16. Establishment of a registration system: - (1) Notwithstanding anything to the contrary contained in Transfer of Property Act, 1882 (No.4 of 1882), and the Registration Act, 1908 (16 of 1908), a registration system shall be established for the registration of data about factoring contract, and assignments of any debt, claim or right in property of a client in favour of the factor arising under a factoring contract.

(2) The registration system shall operate through such offices of Registrars and Sub-registrars, as may be notified in this behalf and the registration of data as per sub-section (1) shall be made in the manner and subject to payment of such fee, as may be prescribed in this behalf and a separate book shall be kept in the offices notified for the purpose.

(3) The particulars of every transaction of factoring contract, and assignment of debt, shall be filed by the factor with the registry system as per sub-section (2) within a week from the date of execution of the factoring contract:

Provided that the registering authority may, subject to being satisfied with the explanation of the cause for delay as furnished by the factor, extend the period for such filing.

(4) Inspection of the book maintained as per sub-section (2) may be allowed subject to such conditions and payment of such fee as may be prescribed in this behalf.

(5) Copies of entries in the book maintained as per sub-section (2) may be provided by Registrar or Sub-registrar of the notified offices, to a factor in relation to factoring contract, subject to such conditions and payment of such fee as prescribed.

[Note- Policy decision would be required to be taken in this behalf, as the registry system for the purpose could be made available in any of the following manner; i.e. whether;

(a) system of registration existing as per the Registration Act, 1908 (16 of 1908) is to be utilized, in such case the provisions under clause 16 may be considered; or

(b) the central registry system [as contemplated under chapter IV of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002)], is to be utilised (also for registration of factoring transaction as per this Act), by way of amending the provisions of chapter IV of the said Act (54 of 2002); or

(c) if a separate registry system is to be set up for factoring, such object could be achieved by way of inclusion of appropriate provisions on the lines of provisions of chapter IV of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002)].

CHAPTER-VI
RIGHTS AND OBLIGATIONS OF PARTIES TO FACTORING CONTRACT

17. Rights and Obligations of Customer: (1) In relation to a factoring contract;

(a) on assignment of debt, the customer shall have the right to be informed as per Section 15; and

(b) till service of notice on the customer as per Section 15, the customers' rights and obligations in its contract with the supplier shall remain unchanged, excepting only the change of the party, which may become entitled to receive the payment or the receivable from the customer.

18. Liability of Customer: Where a notice of assignment of debt in favour of the factor as provided in Section 15 is served, the customer shall;

(a) not be entitled to a valid discharge of his debts, unless it makes the payment of debt to the factor;

(b) intimate the factor full details of the deposits or advance or payment on account made to the client before the receipt of notice of assignment in respect of the factored debts and also provide any other information to the factor relating to the debt as and when called upon by the factor to do so.

19. Insolvency of Debtor: In case insolvency, or reorganization, or liquidation, proceeding is initiated against a customer before it could pay its debt to its supplier, or the factor, as the case may be, and obtain due discharge in respect thereof, claim of the factor or the supplier, as the case may be, shall be dealt with by courts as an unsecured creditor and law governing such proceedings.

20. Client to be Trustee of the Factor: (1) Notwithstanding anything to the contrary contained in any other law for the time being in force, where a debtor makes any payment to a client which represents payment due on a factored debt such payment shall be deemed to be for the benefit of the factor, and the client shall be deemed to have received amount of such payment as a trustee of the factor and the client shall promptly transfer such amount to the factor within...'X' days from the date of receipt thereof by the client (* number of days ***may be filled up based on decision taken in this behalf***)

(2) Where there is delay on the part of the client in transferring the amount to the factor within the period as per sub-section(1), except where such delay was caused due to reasons beyond his control , notwithstanding anything contained in any agreement between the buyer and the supplier or any law for the time being in force, the client shall be liable to pay to the factor, compound interest with monthly rests on that amount, from the date immediately following the expiry of such period , at three times of the bank rate notified by the Bank.

[Note: - With inclusion of specific provisions under this section , in particular the obligation cast on the part of the client to transfer the amount to the factor within a pre-stipulated period , & to pay the interest at the rate as stipulated therein for the delay, there does not appear any need for inclusion of any other provision for 'Delayed Payment' as per provisions of Chapter V of the Micro, Small and Medium Enterprises Development Act, 2006. In this connection reference may be made to the provisions of sub-section (1) of Section 2 of this Act, in terms whereof all the provisions of said Act of 2006 (as applicable to a 'Supplier', and 'buyer', including those of Sections 15,16,& 17 thereof), would apply to the contract between the 'client' and 'customer' (as the definitions of these terms also include the terms 'Supplier', and 'buyer)' as there is no contrary provision under this Act in this regard. Therefore, we have deleted the Part-II of Schedule to this Draft Law.

Keeping in view the provisions of sub-section (3) of Section 2 of this Draft Law & the definition of the term 'Debt' as provided under ***clause …of Section 3 of this Act, there does not appear to include the proposed amendment as per Part-III of the Schedule to the Draft law and as such we have also deleted the Part-III from the Schedule.]***

21. Prohibition of further assignments: - (1) On assignment of debt in favour of the factor, the client shall not be entitled to subsequently assign the same debt to any other factor or any other person without prior written consent of prior assignee.

(2) If a client makes another factor to enter into second factoring contract by way of misrepresentation, or suppression of relevant information in respect of its debt already factored, in such case the subsequent factor shall not have any priority or claim on such debt against the first factor, and claim, if any, of the subsequent factor shall be against the client which the second factor may enforce against the client without making the first factor as party to the proceeding, or making any claim on the factored debt.

(3) If a factor enters into a factoring contract with a client in respect of its factored debt without making due verification from the client about existence of prior factoring contract in respect of such debt, or enters into factoring contract despite having been informed by the client, as per Section 23 in such case, the second factoring contract shall be void.

(4) Any suppression of fact or misrepresentation by a client shall be deemed to be contravention of the provisions of the Act and make such client liable for penalty.

(5) Nothing in sub-sections (1) to (4) shall apply to such case of subsequent assignment of the same debt to any other factor or any other person, where the client and the first factor had included appropriate covenants in their factoring contract, and in terms of such covenants, it was agreed upon between them that the client could subsequently assign the same debt to any other factor or any other person subject to;

(a) the client obtaining prior written consent of the first factor in the form and manner as may be prescribed; and

(b) that such subsequent assignment has been made by the client to any other factor or any other person after obtaining such prior written consent of the first factor.

Explanation:-For the purposes of such subsequent assignment of the same debt to any other factor or any other person, irrespective of the number of the existing factor as per the sequence of the debt assigned by the client from time to time, the terms 'first factor' and 'second factor', shall mean the existing factor of the debt, and the subsequent factor in whose favour the debt is to be assigned with such prior written consent of the first factor.]

22. Rights of factor: Notwithstanding anything contained in any other law, where a client at different times purports to create rights or interest over the account receivables or other assets and such rights or interest cannot exist or be exercised to their full extent together, each of such rights or interest shall, in the absence of a special contract or reservation binding the factor in this behalf be subject to rights of the factor; and as between factors, each later created right or interest shall be subject to the rights or interest previously created.

23. Duties of factor and the client: In relation to a factoring contract before conclusion of such contract a factor shall inquire specifically from his client about any existing charge or encumbrance or assignment in relation to the debt to be factored and the client shall provide correct information to the factor in respect thereof.

24. Obligation of a Factor: (1) Without prejudice to provisions of Sections 21, 22, and 23, once the registry system as per Section 16 of this Act is brought into operation a factor shall;

(a) before entering into a factoring contract, inspect the books maintained as per Section 16 to ascertain the existing charge, encumbrance, or assignment, if any ,in relation to the debt to be factored by it, and failure or negligence on its part to verify the entries in the books maintained as per registry system under this Act shall deprive the factor of its claim on the factored debt against the previous assignee of the debt, or anyone else having claim in any capacity on such debt; and

(b) the factor after entering into factoring contract shall ensure the due compliance of filing the transaction of factoring contract as per sub-section (3) of Section 16.

(2) In relation to a factoring contract a factor shall;

(a) accept assignment of debt; and

(b) perform services;

according to the factoring contract.

[Note-Please refer to the note under Section 25}

25. Priority among several assignees of same debt: (1) Notwithstanding anything contained in any other provisions of this Act, once the registry system as per Section 16 of this Act is brought into operation if a debt already factored is again made subject of subsequent factoring contract by another factor, the priority of the right of assignees amongst them as assignee of the factored debt shall be determined;

(a) by the order in which data about the assignment are registered under section 16 regardless of the time of transfer of the debt; and

(b) if no such data is registered, priority shall be determined by the order of date of conclusion and final execution of the respective factoring contracts.

(2) Nothing in sub-section (1) shall apply to;

(a) a debt already factored has been made subject of subsequent factoring contract by another factor and the client has obtained the prior written consent of the first factor as per sub-section (5) of Section 21 of this Act for second assignment for such purpose; and

(b) the priority of the right of assignees in relation to such factoring transactions shall be determined as per the terms of the factoring contract in accordance with the provisions of clause (d) of sub-section (1) of Section 27 of this Act.

[Note-If this Act is brought into force and there appears to be time lag in making the registry system operational in any manner, it may be appropriate to notify different date for operation of provisions of Sections 24 & 25, as both relate to and are subject to introduction of registry system]

26. Confidentiality of information: Except the disclosure required to be made for the purpose of this Act, or when required to do so by order or requisition, as per any other law in force, by a court or an authority vested with requisite power in this regard, a factor shall ensure to maintain the confidentiality of information obtained from the supplier about the supplier, and its present or future customers, and the commercial activity and terms of sale between the supplier and its

customer.

27. Requirements for a Factoring Contract: (1) Without prejudice to the rights of the parties to include such other terms and conditions as may be permissible for them to include as per this Act, a factoring contract between a factor and a client shall include the following;

(a) the nature of the services to be provided by the factor;

(b) the present or future debt which are the subject of the factoring contract and are to be factored in terms thereof;

(c) the consideration for the factoring contract, and other conditions applied to the services to be provided by the factor in terms thereof; and

(d) conditions relating to determination of the priority of the right of assignees in relation to such factoring transactions where a debt already factored is again made subject of subsequent factoring contract by another factor, and the client has obtained the prior written consent of the first factor as per sub-section (5) of Section 21 of this Act.

(2) (a) Where a debt already factored is again made subject of subsequent factoring contract by another factor, and the client has obtained the prior written consent of the first factor as per sub-section(5) of Section 21 of this Act, the client shall certify in the factoring contract about the existence , or otherwise , of any pledge, encumbrance, or any other third-party claim against the receivables which are to be made part of the factoring transaction, or are to be assigned to the Factor under the factoring contract, in accordance with the terms of the factoring contract as per clause (d) of sub-section (1)

(b) In all other factoring transaction a client shall certify in the factoring contract, that there are no pledge, encumbrance, or any other third-party claim against the receivables which are to be made part of the factoring transaction, or are to be assigned to the Factor under the factoring contract.

(3) A factoring contract shall cease to exist after the expiry of the period of time for which it was concluded and in case no such period has been included in the contract, the factoring contract shall cease to exist after factored debt have been]

CHAPTER-VII
OFFENCES AND PENALTIES

28. Offences and penalties: (1) Whoever, in any return or other document or in any information required or furnished by, or under, or for the purposes of, any provision of this Act, willfully makes a statement which is false in any material particular, knowing it to be false, or willfully omits to make a material statement, shall be punishable with imprisonment for a term which may extend to **one year* and shall also be liable to fine which may be up to "X" rupees****.

(**Note-*period & value of "X ", in terms of amount as decided may be included here***)

(2) A client acting in contravention of the provisions of sub-section (2) of Section 27 shall be punishable with fine not exceeding "**Y"** rupees.

[***Note--* amount ** as decided for* "Y***", may be included here.]***

(3) A factoring company acting in contravention of the provisions of Section 26 shall be punishable with fine not exceeding "**Z"** rupees.

[***Note--* amount ** as decided for* "**Z**"***, may be included here.]***

(4) Any person who contravenes any provision of this Act or of any rule or order made there under, or obstructs the lawful exercise of any power conferred by or under this Act, or makes default in complying with any requirement of this Act or of any rule or order made or direction issued there under, shall, if no specific provision is made under this Act for punishment of such contravention, obstruction or default, be punishable with fine which may extend to **"W"** rupees* and where a contravention or default is a continuing one, with a further fine which may extend to "**W1"**- rupees** for every day during which the contravention or default continues.

[***Note--* amount ** as decided for "W" & "W1", may be included here.]***

(5) Where a contravention or default has been committed by a factoring company or a client or a customer being a company, as the case may be, every person who, at the time the contravention or default was committed, was in charge of, and was responsible to such company for the conduct of its business, shall be deemed to be guilty of the contravention or default and shall be liable to be proceeded against and punished accordingly:

Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act if he proves that the contravention or default was committed without his knowledge or that he exercised all due diligence to prevent the contravention or default.

(6) Notwithstanding anything contained in sub-section (3), where a contravention or default has been committed by a factoring company or a client or a customer being a company, as the case may be, and it is proved that the same was committed with the consent or connivance of, or is attributable to any gross negligence on the part of its chairperson, managing director, any other director, manager, secretary or other officer of such company, such chairperson, managing director, any other director, manager, secretary or other officer shall also be deemed to be guilty of that contravention or default and shall be liable to be proceeded against and punished accordingly.

(7) For the purposes of Section 28 and Section 29;

(a) "company" means anybody corporate and includes a firm or other association of individual, and
(b) "director", in relation to a firm, means a partner in the firm.

29. Cognizance of offences: No court shall take cognizance of any offence committed by a client or factoring company or a customer being a company, as the case may be, punishable under Section 28 except upon a complaint in writing made by an officer of the Bank generally or specially authorised in writing in this behalf by the Bank and no court other than that of a Metropolitan Magistrate or a Judicial Magistrate of the first class or any court superior thereto shall try any such offence.

30. Power of Reserve Bank to impose penalty. (1) Notwithstanding anything contained in Section 28, if a contravention or default of the nature referred to in sub-section (2) or sub-section (3) or sub-section (4) of Section 28, as the case may be, is made by a client, factoring company, or customer then, the Bank may impose on such client, factoring company, or customer --

(i) where the contravention is of the nature referred to in sub-section (2) of Section 28, a penalty not exceeding **"Y"** rupees;
(ii) where the contravention is of the nature referred to in sub-section (3) of Section 28, a penalty not exceeding "Z" rupees;
(iii) where the contravention is of the nature referred to in sub-section (4) of Section 28, a penalty not exceeding "W" rupees and where such contravention or default is continuing one, a further penalty which may extend to "W1." rupees for every day, after the first, during which the contravention or default continues.

(2) For the purpose of adjudging the penalty under sub-section (1), the Bank shall serve notice on client, factoring company, or customer, as the case may be, requiring it to show cause as to why the amount mentioned in the notice should not be imposed as penalty and a reasonable opportunity of being heard shall also be given to such client, factoring company, or customer.

(3) No complaint shall be filed against client, factoring company, or customer, as the case may be, in any court of law in respect of any contravention or default in respect of which any penalty has been imposed by the Bank under this section.

(4) Any penalty imposed by the Bank under this Act shall be payable within a period of **………days** from the date on which notice issued by the Bank demanding payment of the sum is served on the client, factoring company, or customer, as the case may be, and in the event of failure of such client, factoring company, or customer to pay the sum within such period, may be levied on a direction made by the principal civil court having jurisdiction in the area where the registered office of such client, factoring company, or customer being a company, is situated:

Provided that such direction under this sub-section shall be made only upon an application made in this behalf to the court by the Reserve Bank.

(5) The court which makes a direction under sub-section (4) shall issue a certificate mentioning therein the sum payable by client, factoring company, or customer, as the case may be, and every such certificate shall be enforceable in the same manner as if it were a decree made by the court in a civil suit.

(6) Where any complaint has been filed against client, factoring company, or customer, as the case may be, in any court in respect of the contravention or default of the nature referred to in sub-section (2) or sub-section (3) or sub-section (4) of Section 28, then, no proceedings for the imposition of any penalty on the client, factoring company, or customer, as the case may be, shall be taken under this section.

31. **Application of fines**: - A court imposing any fine under this Act may direct that the whole or any part thereof shall be applied in or towards payment of the costs of the proceedings, or for such purposes as may be directed by the court.

CHAPTER-VIII
MISCELLANEOUS

32. Limitation - Any proceeding for recovery of its amount as per the provisions of this Act shall be made within the period of limitation prescribed under the Limitation Act, 1963 (36 of 1963).

33. Protection of action taken in good faith:- (1) No suit or other legal proceedings or prosecution shall lie against the Bank or the Central Government or client, factoring company, or customer being a company, or their chairperson, director, member, auditor, adviser, officer or other employee, or agent or any person authorised by the Bank or the Central Government or client, factoring company, or customer being a company, to discharge any function under this Act, for any loss or damage caused or as is likely to be caused by anything which is in good faith done or intended to be done, in pursuance of this Act or any other law for the time being in force.

(2) Nothing contained in sub-section (1) shall affect the right of any person to claim damages against a client, factoring company, or customer being a company, or their chairperson, director, member, auditor, adviser, officer or other employee or agents, as the case may be, in respect of loss caused to him on account of any such Act or omission made by anyone of them and which is unauthorised or fraudulent or contrary to provisions of this Act.

34. Bar of jurisdiction: No court or authority shall have, or be entitled to exercise, any jurisdiction, powers or authority, except the Supreme Court and a High Court exercising jurisdiction under Articles 32, 226 and 227 of the Constitution, in relation to the matters referred to in Sections 5, 6, 7, and 8.

35. Amendment of certain enactment: The enactment specified in the Schedule to this Bill shall be amended in the manner specified therein and such amendments shall take effect on the date of commencement of this Bill.

36. Power of Central Government to make rules - (1) The Central Government may, by notification and in the Electronic Gazette as defined in clause (s) of Section 2 of the Information Technology Act, 2000 (21 of 2000), make rules for carrying out the provisions of this Act.

(2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely:-

(a) procedure for filing of claim by a factor against its client or customer in relation to a factoring contract, before the Tribunal and fee payable in respect thereof as per clause (c) of sub-section (3) of Section 2;

(b) the form and manner in which an application for obtaining certificate of registration as per sub-section (2) of Section 5, may be filed by a company, corporation, or institution, intending to commence factoring business on or after the commencement of this Act ;

(c) the form and manner in which an application for obtaining certificate of registration as per sub-section (3) of Section 5, may be filed by such non-banking company, or a banking company, or its subsidiary or affiliated company controlled by banking company, which were in existence and carrying on factoring business on the commencement of this Act;

(d) electronic form for issuance of notice of assignment of debt to the customer and conditions relating thereto as per clause (d) of Section15;

(e) procedure to be followed for registration of data, and fee payable in relation thereto as per sub-section (2) of Section 16;

(f) conditions relating to inspection of the book maintained in registry office and fee payable in respect thereof as per sub-section (4) of Section 16;

(g) conditions relating to issuance of copies of entries in the book maintained by registrar or sub-registrar of the notified offices, to a factor in relation to factoring arrangement and fee payable in relation thereto, as per sub-section (5) of Section 16;

(h) the form and manner for a client for obtaining prior written consent of the first factor as per clause (a) of sub-section (5) of Section 21;

(i) any other matter which is required to be, or may be, prescribed.

(3) Every notification and every rule made under this Act by the Central Government shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the notification, or the rule or both Houses agree that the notification should not be issued, or the rule should not be made, the notification , or the rule, as the case may be, shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.

SCHEDULE

[See Section 35]
Amendment of certain enactment

AMENDMENT TO THE CODE OF CIVIL PROCEDURE, 1908 (No. V of 1908)

1. At the end of sub-clause (iii) of clause (b) of sub-rule (2) of Rule (1) in Order XXXVII, the following sub-clause shall be inserted namely:-

‘(iv) suit for recovery of debts under a factoring arrangement instituted by a factor’

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Annexure-4

United Nations Convention on the Assignment of Receivables in International Trade (2004)

ANNEX TO THE CONVENTION

Section I. Priority rules based on registration

Article 1. Priority among several assignees

As between assignees of the same receivable from the same assignor, the priority of the right of an assignee in the assigned receivable is determined by the order in which data about the assignment are registered under section II of this annex, regardless of the time of transfer of the receivable. If no such data are registered, priority is determined by the order of conclusion of the respective contracts of assignment.

Article 2. Priority between the assignee and the insolvency administrator or creditors of the assignor

The right of an assignee in an assigned receivable has priority over the right of an insolvency administrator and creditors who obtain a right in the assigned receivable by attachment, judicial act or similar act of a competent authority that gives rise to such right, if the receivable was assigned, and data about the assignment were registered under section II of this annex, before the commencement of such insolvency proceeding, attachment, judicial act or similar act.

Section II. Registration

Article 3. Establishment of a registration system

A registration system will be established for the registration of data about assignments, even if the relevant assignment or receivable is not international, pursuant to the regulations to be promulgated by the registrar and the supervising authority. Regulations promulgated by the registrar and the supervising authority under this annex shall be consistent with this annex. The regulations will prescribe in detail the manner in which the registration system will operate, as well as the procedure for resolving disputes relating to that operation.

Article 4. Registration

1. Any person may register data with regard to an assignment at the registry in accordance with this annex and the regulations. As provided in the regulations, the data registered shall

be the identification of the assignor and the assignee and a brief description of the assigned receivables.

2. A single registration may cover one or more assignments by the assignor to the assignee of one or more existing or future receivables, irrespective of whether the receivables exist at the time of registration.

3. A registration may be made in advance of the assignment to which it relates. The regulations will establish the procedure for the cancellation of a registration in the event that the assignment is not made.

4. Registration or its amendment is effective from the time when the data set forth in paragraph 1 of this article are available to searchers. The registering party may specify, from options set forth in the regulations, a period of effectiveness for the registration. In the absence of such a specification, a registration is effective for a period of five years.

5. Regulations will specify the manner in which registration may be renewed, amended or cancelled and regulate such other matters as are necessary for the operation of the registration system.

6. Any defect, irregularity, omission or error with regard to the identification of the assignor that would result in data registered not being found upon a search based on a proper identification of the assignor renders the registration ineffective.

Article 5. Registry searches

1. Any person may search the records of the registry according to identification of the assignor, as set forth in the regulations, and obtain a search result in writing.

2. A search result in writing that purports to be issued by the registry is admissible as evidence and is, in the absence of evidence to the contrary, proof of the registration of the data to which the search relates, including the date and hour of registration.

Annexure-5

NTREES – A Platform for e-Discounting

Unlocking Liquidity for MSMEs

Micro, Small and Medium Enterprises (MSMEs) have been recognized as the true engines of growth not just in India, but all over the world. According to estimates, India has about 3000 large corporates and each corporate has registered suppliers/vendors – mostly MSMEs. Over 15 lakh MSMEs function as ancillaries to large corporates, diligently producing a large number of goods and services to these corporates.

Timely availability of adequate credit at competitive rates is sine quanon for the growth and sustainability of the MSMEs. Any delays in payments from large corporate result in often choking the operational cycle of an enterprise. Moreover, under the existing mode of receivable financing, (like, cash credit, bills discounting, invoice discounting, and factoring, etc), the credit risk is taken on the supplier's (MSMEs) strength and not the buyers (large corporates).

In order to address the issue of delayed payments, The Small Industries Development Bank of India (SIDBI) has introduced, way back in 1991, a scheme then called *Direct Discounting of Bills (Components)*. This was probably the first innovative attempt in introducing reverse factoring in India. Under this scheme, exposure is fixed on purchaser enabling instant discounting to the MSME suppliers. After certain facilitating modifications, the scheme is now known as Receivable Finance Scheme, with over 250 large purchasers reaching out to about 17000 MSME beneficiaries.

Taking a step forward and to make the process paperless, more effective etc. SIDBI joined hands with the National Stock Exchange (NSE) to launch a unique e-platform '**NTREES**', an acronym for Trade Receivables Engine for E-discounting to facilitate discounting of MSME bills on their supplies to large purchaser companies. The e-platform presents enormous opportunities to tap the receivables market which is estimated at around Rs 5,00,000 crore.

How it works?

NTREES replaces the paper-based physical mechanism with e-trading which will make discounting of bills transactions cost-effective, expeditious coupled with greater degree of transparency. Through NTREES, the financing institution will introduce the purchaser companies with an approved exposure limit. The purchaser company will then introduce the MSME vendors and post their invoices of bona-fide commercial transactions on their preferred platform. The purchaser companies shall have options to choose the "*bank option*", the "*multiple banking option*" or the "*open bidding option*" for discounting, based on its financial arrangement and requirements.

This will indeed be a win-win situation for MSMEs, purchaser companies, banks and FIs as explained *below*

NTREES : **A Win-Win Situation**

Suppliers	Financiers	Purchasers
Benefit of Credit-worthiness of large purchasers	Assumes lower credit risk – on higher quality purchaser	Facilitates vendor development
Efficient working capital financing (no collateral)	Genuine Instruments as buyer posts qualified instruments	Better terms of contract (credit period) with supplier
Get the best possible discounting rate for factoring	Operational excellence and reduced market expenses	Payables Management through platform
Easy and Hassle Free way of factoring the receivables	Access to wider market for factoring	

In the next phase, as more and more banks join this e- platform, it would emerge as a price discovery mechanism.

Annexure 6

List of Stakeholders Interviewed

Table A6.1: List of Factor Companies (Domestic) interviewed

Date	Name of Company/Association	Participant/s	Venue
Factor Companies			
July 1, 2009 July 16, 2009	**SBI Factors & Commercial Services Pvt. Ltd.**	**Mr. D. S. Das** (Managing Director & CEO) **Mr. B. Ramesh Babu** (Sr. Vice President & COO) **Mr. Ashok Kapadia** (Vice President) **Mr. Bhawani S. Baheti** (Manager)	SBI Factors and Commercial Services Pvt. Ltd., 903-906, 9th Floor, Raheja Chambers, Free Press Journal Marg, Nariman Point, Mumbai - 400021
July 22, 2009	**IFCI Factors Ltd.**	**Mr. Rakesh Kapoor** (Managing Director)	IFCI Tower, 5th Floor, 61 Nehru Place, New Delhi 110 019, India.
**	**Global Trade Finance Ltd.**	**Mr. Arvind Sonmale** (Managing Director & CEO)	**
June 30, 2009	**HSBC**	**Mr. Basab Mazumdar** (Head- Factoring & Receivables Finance, India)	HSBC, Hypercity, New Link Road, Mindspace, Malad (W), Mumbai- 400 064
June 25, 2009	**Export Credit Guarantee Corporation of India Ltd.**	**Mr. P. Prasad** (DGM- Factoring)	ECGC, Factoring Division, Express Towers, 10th floor, Nariman Point, Mumbai-400021.
September 2, 2009	**Canbank Factors Ltd.**	**Mr. Lakshman N. Sankade** (Managing Director)	Canbank Factors Ltd., No. 17, Sheshadri Road, Bangalore-560009.
** *Response via written questionnaire reply*			

Table A6.2: List of Banks interviewed

Date	Name of Company/Association	Participant/s	Venue
Banks			
July 16, 2009	**Development Credit Bank**	**Mr. V L Nayayana Rao** (Vice President & Head – Trade Finance)	Development Credit Bank Corporate Office, 301 Trade Plaza, 414 Veer Savarkar Marg, Prabhadevi, Mumbai - 400 025
July 20, 2009	**DBS Bank**	**Mr. Sanjeev Uppal** (Head – Global Transaction Services) **Mr. Anthony Rajan V.** (Manager- Global Transaction Services)	DBS Bank Fort House, 3rd Floor 221 Dr. D.N. Road, Fort Mumbai 400001.

Table A6.3: List of Associations interviewed

Date	Name of Company/Association	Participant/s	Venue
Associations			
July 22, 2009	**Federation of Indian Micro and Small & Medium Enterprises (FISME)**	**Mr. Anil Chowdhry** (Director)	FISME B4/161, Safdarjung Enclave DELHI-110029.
August 20, 2009	**Factors Association of India**	**SBI Factors** Mr. D. S. Das (Managing Director & CEO) Mr. B. Ramesh Babu (Sr. Vice President & COO) Ms. Amita Joshi (Company Secretary & Compliance Officer) **IFCI Factors** Mr. Rakesh Kapoor (Managing Director) **HSBC** Mr. Amit Dang (Head of factoring and receivables finance- taking over from Mr. Basab Mazumdar) Mr. Anurag Zutshi **Global Trade Finance** Mr. Arvind Sonmale (Managing Director & CEO) Mr. Sunil George Kuruvilla (Asst. Manager- Corporate Communications) **ECGC** Mr. P Prasad (DGM- Factoring)	SBI Factors and Commercial Services Pvt. Ltd., 903-906, 9th Floor, Raheja Chambers, Free Press Journal Marg, Nariman Point, Mumbai - 400021

Table A6.4: List of Credit Insurance and Information Companies interviewed

Date	Name of Company/Association	Participant/s	Venue
Credit Insurance Companies			
August 18, 2009	**Coface India**	**Mr. Samuel Jesuratnam** (Country Manager)	Telephonic Interview
September 4, 2009	**Euler Hermes**	**Mr. Vijaykumar Banoth** (Head- Risk underwriting)	Euler Hermes, Voltas House, 4th Floor, 23 JN Heredia Marg, Ballard Estate, Mumbai 40001.
Credit Information/Ratings Companies			
August 18, 2009	**Credit Information Bureau (India) Ltd. (CIBIL)**	**Mr. Arun Thukral** (Managing Director)	CIBIL, Hoechst House, 6th Floor, 193 Backbay Reclamation, Nariman Point, Mumbai 400 021

Table A6.5: List of Factor Companies (International) interviewed

<table>
<tr><th>Date</th><th colspan="2">Name of Company/Association</th><th>Participant/s</th><th>Venue</th></tr>
<tr><td colspan="5">International Factor Firms/Associations</td></tr>
<tr><td>July 16, 2009</td><td>Factors Chain International</td><td>The Netherlands</td><td>Mr. Joreon Kohnstamm
(Secretary General)</td><td rowspan="9">Telephonic Interviews</td></tr>
<tr><td>July 24, 2009</td><td>HSBC</td><td>UK</td><td>Mr. John P Beaney
(Head of International, HSBC Invoice Finance)</td></tr>
<tr><td>July 22, 2009</td><td>GMAC Commercial Finance Plc</td><td>UK</td><td>Ms. Yvonne Wedel-Andersen
(Regional Director-International Group)</td></tr>
<tr><td>July 30, 2009</td><td>CIT</td><td>USA</td><td>Mr. Peter Mulroy
(Senior Vice President and International Manager, CIT Commercial Services
& Chairman- FCI)</td></tr>
<tr><td>July 28, 2009</td><td>HSBC</td><td>Singapore</td><td>Mr. Kheng Leong
(Senior Vice President & Head Asset Based Financing)</td></tr>
<tr><td>July 27, 2009</td><td>Muang Thai Insurance PCL.</td><td>Thailand</td><td>Ms. Puntrika Baingern
(ex-Managing Director
Kasikorn Factoring Company Ltd.
Thai Factoring Association)</td></tr>
<tr><td>July 24, 2009</td><td>TEB Faktoring</td><td>Turkey</td><td>Mr. Cagatey Baydar
Ms. Beyza Durdagi</td></tr>
<tr><td>July 30, 2009</td><td>HSBC</td><td>Hongkong</td><td>Ms. Jeanny LP
(Senior Manager- Receivables finance)</td></tr>
<tr><td>July 30, 2009</td><td>BEAR Factoring Consulting</td><td>Germany</td><td>Mr. Bernhard Arnebold
(Managing Director)</td></tr>
<tr><td>**</td><td>DBS Bank</td><td>Hongkong</td><td>Ms. Amanda Lai Wah Chiu
(Managing Director
Head of Factoring – North Asia)</td><td>Response via written questionnaire</td></tr>
</table>

Annexure-7

Kalyanasundaram Committee Report Summary[9]

Background

Purchasers of goods and services are often delaying the payments, therefore, resulting in working capital problems for the suppliers, particularly the smaller ones. RBI has, therefore taken several measures to alleviate the difficulties of the suppliers. Banks have, however, not been effective in implementing these measures because of operational constraints. As the extension of factoring services was perceived by RBI to be one of the measures which could assist in expediting collection of dues, it constituted, in January 1988, a Study Group to examine the feasibility and mechanics of starting factoring organisation(s) in India.

Composition and terms of reference

The group, headed by Shri C.S. Kalyanasundaram, former Managing Director of State Bank of India, comprised senior officials from commercial banks, financial institutions, Government of India and RBI, as also a senior academician, having extensive knowledge in the fields of banking and finance. The terms of reference for the study included consideration of need and scope for one or more factoring organisations in the country, the nature of their constitution- either they should be in public, private or joint sector, the change in legal framework that would be necessary for promoting factoring business, feasibility of extension of factoring services to exporters and other matters relating to factoring.

Methodology

The group constituted a committee each to look into specific areas of (a) demand assessment and feasibility (b) Legal issues (c) factoring for exports. Further, it made extensive reference to text books and write-ups in periodicals, etc. on the subject. It also solicited the views, on various aspects relating to the subject, from bankers, representatives of trades/industry associations and organisation and others, through written responses, through a comprehensive questionnaire devised by the Group and holding meetings with them at representative centres in the country. A team, comprising the chairman, the convenor and the chairman of committee on Export factoring, also visited a few developed countries for discussing conceptual , practical and legal issues relating to domestic and international factoring.

Concept and types of factoring services

The group gathered that factoring services as a tool for assisting the suppliers in the matter of financing and collection of receivables is being extensively and increasingly used in several economically developed countries during the last three decades, although these services have been offered in one form or the other since the nineteenth century in few countries. Modern factoring involves a continuing arrangement under which a financing institution assumes the credit and collection functions for its client, purchases his receivables as they arise (with or without recourse to

[9] This is a reproduction of Summary Chapter of Kalyanasundaram Committee report (1988)

him for credit losses, i.e., customers financial inability to pay), maintains the sales ledger, attends to other book keeping duties relating to such accounts receivables and perform other auxiliary functions. The various services offered by Factors for domestic sales are of six types, viz, (i) Full Factoring, (ii) Resource Factoring,(iii) Maturity Factoring (iv) Advance Factoring, (v) Undisclosed Factoring and (vi) Invoice discounting.

So far as international trade is concerned, it is customary to use a two-factor system whereunder there is an Export Factor and Import Factor. Under this arrangement, while the Export factor will provide for financing and other services as required by the exporter, the import factor will undertake the credit assessment of importers, establish credit lines on them wherever possible, undertake control of receivables and take whatever steps that is necessary to collect outstanding dues. Recourse factoring, direct export factoring, direct import factoring and back-to-back factoring are some of the different variations of factoring services available to exporters.

Need for factoring services in India and assessment of demand therefore

Taking all the relevant aspects into account, the Group believes that there is sufficient scope for introduction of factoring services in India, which would be complementary to the services provided by the banks. The group is also of the view that the introduction of export factoring services in India would provide an additional facility to exporters.

There was sufficient indication from respondents that suppliers from different sectors would welcome factoring services. Since banks are already financing domestic receivables and providing credit against export receivables at concessional rates, many suppliers may prefer to avail of only one or more of the other services (i.e. administration of sales ledger, credit protection and collection of dues.) offered by factors, while continuing to avail of finance from banks. While quantification of the demand has not been possible, it is assessed that it would grow sufficiently so as to make factoring business as a commercially viable proposition within a period of two/three years.

On the export front, it is perceived that there would be a fairly good availment of various services offered by export factors, as the exports from India on non LC terms are as much as about 60% of total exports. Even those exporters who are now able to secure LCs may find export factoring attractive, as LC, being transaction oriented, are not ideal for repetitive transactions. Also, there is growing resistance from overseas buyers to provide LCs.

With a view to attaining a balanced dispersal or risks, factors should offer their services to all industries and all sectors in the economy. However, care has to be taken to ensure that the new institutions acquire an in-depth knowledge of the working of industries before assuming the risks.

Pricing of various services

The pricing of various services by factors would depend on various aspects, such as, creditworthiness of customer, his track record, quality of portfolio, turnover, average size of invoices, etc. However, the base level would be dependent on the various costs to be borne by the factoring organisations, the most important element being the cost of funds.

Factors should attempt to keep a mix from among the various sources of funds, to keep the cost of funds as low as possible, in any case not exceeding 13.5% p.a. so that a reasonable spread is available. Since factors will be competing with banks in financing receivables, they will have to charge their clients a rate not higher than that charged by banks.

RBI may consider allowing factoring organisations to raise funds from the Discount and Finance House of India Ltd., as also other approved financial institutions', against their usance promissory notes covering receivables factored by them, on the lines of revised procedure under Bills Rediscounting Scheme.

The Group is of the view that the price for the financing services would be around 16% p.a. and the aggregate price for all other services may not exceed 2.5% to 3% of the debts services.

Organisational set up

Different views as regards to the number of factoring organisations, as also who should be their promoters, were placed before the group. In the Group's opinion, in the beginning only select promoter institutions/groups/individuals with good track records in financial services and competent management should be permitted to enter into this new field.

As regards the coverage of industries/sectors by such organisations, it has been suggested that initially the organisations may be promoted on a zonal basis, say, and one each for North, East, South and West. Such an arrangement would obviate the necessity of each organisation having an all-India network.

The Group is also of the view that there are distinct advantages in the banks being associated with handling of factoring business. Apart from the fact that they have considerable experience in financing and collection of receivables, they also have access to credit information on both sellers and buyers; besides, their large network of branches, as also the availability of sufficient financial resources, would provide additional advantages to them.

There was divergence of views on whether factoring business should be handled by banks departmentally or through their subsidiaries. Taking into account various dimensions of the problem, the group is of the view that subsidiaries or associates of banks are ideally suited for undertaking this business. Initially it would be desirable to have only four or five organisations which could be promoted, either individually by the leading banks or jointly by a few major banks having a large network of branches.

Factoring activities could perhaps be taken up by the proposed Small Industries Development Bank of India, preferably in association with one or more commercial banks.

Educating business community about factoring

Factoring being an entirely new concept, the group recommends that as and when it is decided to promote factoring organisations, the business community should first be educated about the nature and scope of these services and the benefits accruing there from. In this regards it perceives that the branches of banks would serve as a useful medium for extensive dissemination of information.

Mechanisation of factoring operations

Factors cannot extend their services efficiently, effectively and economically without the support of computers, as also quick and dependable means of communications. Therefore, concurrent with consideration of various aspects relating to commencement of factoring operations, the promoters should initiate measures for organising a network of computers/dedicated lines linking the branches / agents in different parts of the country for the accounting, follow-up, remittances and other activities involved in factoring business.

Credit investigation

Up-to-date reliable information relating to market reputation, financial standing, business prospects, etc of parties engaged in buying and selling goods and services is of utmost importance; however, at present there are no specialised agencies in India which collect and furnish this information, as are operating in industrially developed countries. Hence, the Central Government and RBI should initiate appropriate measures immediately for setting up such specialised agencies, irrespective of the needs of the factoring organisations. Till such agencies become fully operative, factors may have to rely on such information on clients/customers as could be collected through banks or other sources, not withstanding their limitations.

Linkage between banks and factors

Since it is envisaged that the suppliers will be able to obtain financial services from both banks and factoring organisations, it is necessary to provide for proper linkages between banks and factors. Thus there should be arrangements whereunder banks and factors furnish to each other information relating to parties which approach more than one agency. It is also envisaged that there could be a three party tie-up, to cover the debt being assigned to factors by suppliers and the former borrowing from banks. Alternatively, the supplier would borrow from bank(s) and avail of debt protection, collection and sales ledger management services from factor. Beside, there are other areas also in which banks and factors should collaborate for better working capital management, in view of specialised knowledge, skills and contacts of the factors. Such collaborative effort could help in prevention of sickness in units.

SSI Units and factoring

SSI units have been facing constraints in their operations on accounts of inadequacy of working capital caused by delay in receiving payment for their suppliers. A large number of SSI units are managed by their promoters and / or person with technical orientation who are unable to pay continuous attention to the areas of debt collection, accounting and working capital management. By and large, such units do not have an organisational setup and/ or expertise in the area of credit management to attend to follow-up and recovery of dues from buyers.

SSI units perceive that factors, with their systematic, specialised and professional approach, would be in a position to assist them in debt collection. The credit protection services of factors would entitle them to be assured of payments on fixed dates, as also protection against customers default.

As regards financing of receivables, while factors would provide another source of finance to SSI units, they cannot be expected to offer finance at concessional rates, as is presently being done by banks to eligible units. For continued availment of concessional finance, linkage between banks and factors is suggested.

While the potential demand for factoring services from the SSI sector is estimated to be sizable, it would take some time before this demand could crystallise. In this connection, the Group considered the question of reservation of a specific percentage of total business factoring organisations for SSI sectors to give an initial boost to factoring for this sector. In its view, this may not be desirable, especially in the initial stages, as it could be a danger to the factoring organisations commercial viability. Moreover, factoring developing such reservations may not be necessary at all.

The group is of the view that factoring for SSI units could prove to be mutually beneficial to both factors and SSI units and factors should make every effort to orient their strategy to crystallise the potential demand from this sector.

Export Factoring

The advantages of export factoring are not only really connected to the financing element, but to the complete package of factors services. In a view of the availability of concessional export finance by banks, financing by factors will only be attractive if offered at concessional rates. For this factors will required finance from banks at concessional rates on which subsidy will have to be provided to the banks. Besides, the export credit (Interest Subsidy) scheme, 1968, will have to be modified suitably. This issue needs examination by RBI in detail.

If pre-shipment credit is granted by banks and post- shipment credit by factors, it will have to be ensured that the proceeds of the post- shipment credit granted by the factors liquidate the pre-shipment credit granted by banks.

Introduction of export factoring in India will certainly provide an additional window of facility to the exporters. Further, the position of realisation of export proceeds of shipment made by the Indian exporters is sufficiently encouraging for interested organisations to offer factoring services to exporters from India.

In case factoring is to be introduced, the question arises whether an exporter would be absolved of his responsibility of realisation of export proceeds once the factor pays to the exporter the value of the bill/invoice factored by it. In this regard, in terms of section 18(8) of FERA, 1973, both the exporters and export factors would be liable for repatriation of export proceeds. This provision has to be modified suitably by RBI, indicating that when factoring is done on 'with recourse' basis only, the exporter will be liable for realisation of export proceeds. When export factoring is on 'without recourse' basis, the responsibility will rest with the factor alone. However, in the latter case, if export proceeds are not repatriated, RBI may not caution- list export factor and / or report the matter to the Enforcement Directorate, as is done in the case of exporters who fail to ensure repatriation of proceeds.

If factoring is introduced in India, factors will need uniform rules to operate in the international market. It is suggested that India may ratify and accept the UNIDROIT Convention on International Factoring. Similarly, it would be beneficial for Export factors to join one of the international chains of factors.

The group is in favour of extending the factoring services to exporters in India, notwithstanding the facts that they are currently being extended credit at concessional rates by banks and ECGC provides the cover for the risks involved.

Among the various organisations which have been dealing with exporters, banks and ECGC appear to be more eminently suitable for handling export factoring. The group is of the view that besides bank(s) sponsored factors, ECGC or an organisation sponsored by it, may be permitted to undertake export factoring. Any such organisation however will have to seek approval of RBI to undertake business of export/import factoring.

For ensuring that the exporters continue to receive finance and credit protection without any additional cost and, at the same time, avail of other services provided by factors, there could be

suitable linkages between the concerned agencies. In one such model, ECGC would provide all services expected from export factor, except the financing services, which would be provided by the banks, while under the other model the bank(s) sponsored factor would provide all the services, including credit protection, the finance being provided by bank(s).

ECGC has represented that if banks (or their subsidiaries/ associates) are also asked to undertake full scale export factoring, it will have an adverse impact on the risk portfolio of ECGC; besides, it would disturb the present insurance arrangement in terms of reasonableness of cost, flexibility and range of insurance protection. It has, therefore suggested that ECGC alone may provide credit protection (to the extent of 100%) and other services excluding finance, which may continue to be provided by banks. However, the group believes that an element of competition is absolutely necessary for insuring satisfactory services to the exporters and they should have the opportunity to make their own choice and decision regarding the factor whose services they will avail of.

In view of its experience , data bank it has build up, and relationship with the agencies/ affiliates abroad , ECGC could start factoring business within a short period, while banks will take a fairly long time before the commence export factoring. This position gives ECGC an edge over banks. Besides, being familiar with ECGC and its services, exporter too, need not apprehend any threat or challenge from banks, which would be later entrants.

With the expected growth in the international trade, exporters, particularly the smaller ones, are likely to find services of export factoring attractive. As such, steps should be taken for introduction of export factoring services concurrently with the extension of such services or domestic credit sales.

Legal framework

Government of India may consider introducing legislation requiring government agencies, public sector undertakings and others to pay interest for delays (beyond a specific period) in payment for supplies made to them , on the lines of legal framework in some of the countries abroad and such legislation may also cover factored debts.

Indian law does not, at present, comprehensively deal with various aspects involved in factoring business. As such, it would be necessary to promote special legislation to support the establishment and operations of efficient and viable factoring organisations.

To enable a factor to be in a position to collect the debts in its own rights, it must take an assignment of book debts of clients. Existing provisions of Section 130 of the transfer of property act, 1882 are quite adequate to protect the interest of the factor.

To make factoring economically viable, it is essential that assignment of book debts in favour of a sector is exempted from stamp duty. Various states should, therefore, be required to remit the stamp duty since no factoring business is being done concurrently in the country, remission would not result in any loss of existing revenue of the states. If, however, complete remission of stamps duty is not acceptable, assignment up to specified amount on sales from specific sectors may be exempted from such duty.

Notice of assignment become necessary to prevent the debtor paying the debt to the client of a subsequent assignee and also enables the factor to claim the payment of debts in its own right. If stamp duties on assignment are waived, notice of assignment can be given by the factor as soon as it ‘approves’ the debt for factoring; for this purpose, no further statutory support is necessary.

As regards priority between successive assignments, it must provide through specific legislation that subsequent assignments shall, in no event, have priority over the first assignment in favour of the factor. A system of filling notice of the agreement between the factor and its client in a central register, to be maintained by an appropriate statutory authority may also be provided.

An influential buyer could insist that the contract with the supplier should contain stipulated to the effect that the supplier cannot assign the debts due by the buyer. Hence, it may be provided, through legislation that any such stipulation shall be of no effect.

To direct development of factoring on healthy lines, there is a need for a system of regulating the entry of entrepreneurs who would be keen on starting factoring business, prescribing norms about their minimum capital requirement and extent of deposits which could be raised by them from the public and for monitoring their operations. In the groups view, RBI would be the appropriate authority for framing and implementation of the relevant regulations.

The civil procedure code may be amended to clarify that the factored debts can be recovered by resort to summary procedure under order 37 of the code in terms of which the defendant is not entitled, as of right, to defend the suit, which he can do in the case of ordinary suits.

Annexure- 8

The Uniform Commercial Code

The Uniform Commercial Code (UCC or the code) which was first published in 1952, helped in achieving uniformity in commercial legislation across states, at the same time allowing for flexibility to accommodate any special circumstances in the individual states. The code was the joint project of the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute (ALI). The Code by itself was not a law, but only a recommendation of the laws that should be adopted by the states. Upon enacted in a state by the state's legislature, it became true law and was codified into the state's code of statutes.

When the Code was adopted by the respective states, it was either adopted in totality or with specific changes as deemed necessary by the state legislature. The Code, in one or another of its several revisions, has been enacted in all of the 50 states, as well as in the District of Columbia, the Commonwealth of Puerto Rico, Guam and the U.S. Virgin Islands.

Table A9.1: The Articles of the UCC

ART. NO.	TITLE	CONTENTS
1	**General Provisions**	Definitions, rules of interpretation
2	**Sales**	Sales of goods
2A	**Leases**	Leases of goods
3	**Negotiable Instruments**	Banknotes and drafts (commercial paper)
4	**Bank Deposits**	Banks and banking, check collection process
4A	**Funds Transfers**	Transfers of money between banks
5	**Letters of Credit**	Transactions involving letters of credit
6	**Bulk Transfers and Bulk Sales**	Auctions and liquidations of assets
7	**Warehouse Receipts, Bills of Lading and Other Documents of Title**	Storage and bailment of goods
8	**Investment Securities**	Securities and financial assets
9	**Secured Transactions**	Transactions secured by security interests
10	Date of enactment and acts to be repealed	

Basic explanation of UCC articles

The UCC consists of ten articles. Article 1, titled General Provisions, details principles of interpretation and general definitions that apply throughout the UCC. Article 2 covers areas such as sales contracts, performance, creditors, good faith purchasers, and legal remedies for breach of contract. Article 3, which replaced the Uniform Negotiable Instruments Law, covers transfer and negotiation, rights of a holder, and liability of parties, among other areas. Article 4 covers areas such as collections, deposits, and customer relations. Article 4 incorporated much of the Bank Collection Code developed by the American Bankers Association.

Article 5 of the Uniform Collection Code deals with letters of credit, while Article 6 covers bulk transfers. Article 7 covers warehouse receipts, bills of lading, and other documents of title. Article 8, meanwhile, is concerned with the issuance, purchase, and registration of investment securities; it replaced the Uniform Stock Transfer Act. Article 9 is another provision that is particularly important to small business owners, along with Article 2. Dealing with secured transactions, sales of accounts, and chattel paper, it replaced a number of earlier laws, including the Uniform Trust Receipts Act, the Uniform Conditional Sales Act, and the Uniform Chattel Mortgage Act.

Finally, an Article 10 is included which provides for states to set the effective date of enactment of the code and lists specific state laws which should be repealed once the UCC has been enacted (Uniform Negotiable Instruments Act, Uniform Warehouse Receipts Act, Uniform Sales Act, Uniform Bills of Lading Act, Uniform Stock Transfer Act, Uniform Conditional Sales Act, and Uniform Trust Receipts Act). In addition, Article 10 recommends that states repeal any acts regulating bank collections, bulk sales, chattel mortgages, conditional sales, factor's lien acts, farm storage of grain and similar acts, and assignment of accounts receivable, because all of these areas are covered in the UCC. Individual states also add to the list of repealed acts at their own discretion.

Additional articles

The ALI and the NCCUSL periodically review and revise the UCC. Since the code was originally devised, the House of Delegates of the American Bar Association approved two additional articles: article 2A on personal property leases, and article 4A on fund transfers. Article 2A establishes model rules for the leasing or renting of personal property (as opposed to real property, such as houses and apartments). Article 4A covers transfers of funds from one party to another party through a bank. This article is intended to address the issues that arise with the use of new technologies for handling money.

Most states have adopted at least some of the provisions in the UCC. The least popular article has been article 6 on bulk transfers. These provisions require the reporting of payments made, which many legislators consider an unnecessary interference in commercial relationships. In 1989, the National Conference of Commissioners on Uniform State Laws recommended that Article 6 of the UCC, dealing with bulk sales, be repealed as obsolete. However, it remains in force in several jurisdictions.

Some other changes/revisions in the UCC

In 2003, a major revision of Article 2 modernizing many aspects (as well as changes to Article 2A and Article 7) was proposed by the NCCUSL and the ALI.

A major revision of Article 9, dealing primarily with transactions in which personal property is used as security for a loan or extension of credit, was enacted in many states with an effective date of July 1, 2001.

The controversy surrounding with what is now termed the Uniform Computer Information Transactions Act (UCITA) originated in the process of revising Article 2 of the UCC. The provisions of what is now UCITA were originally meant to be "Article 2B" within a revised Article 2 on Sales. As the UCC is the only uniform law that is a joint project of NCCUSL and the ALI, both associations must agree to any revision of the UCC (that is, the model act, though revisions to the law of a particular

state only require enactment in that state). The proposed final draft of Article 2B met with controversy within the ALI, and as a consequence the ALI did not grant its assent. The NCCUSL responded by renaming Article 2B as the UCITA.

Summary of Article 9 and its relevance to factoring

Article 9, Secured Transactions, covers security interests in real property. A security interest is a partial or total claim to a piece of property to secure the performance of some obligation, usually the payment of a debt. This article identifies when and how a secured interest may be created and the rights of the creditor to foreclose on the property if the debtor defaults on his obligation. The article also establishes which creditors can collect first from a defaulting debtor. Hence, this article is critical to factoring transactions, as it establishes the right of the factor (or any other creditor as the case may be) to collect claims from debtors.

Part 4 of article 9 gives the details of the filing rules under the UCC. It includes matters such as place of filing, erroneous filing, requisites and validity of filing, assignment of secured interest, release of collateral, fees etc.

Under Article 9 in most states, the proper place to file is where the debtor is located. For debtors that are not individuals, filing is done in the state where the debtor’s business is registered or where the principal place of business is located. If there is more than one location, filing is done where the chief executive office is located, and if the debtor is an individual, filing is to be done in the state of the debtor’s principal residence.

The duration for a financing statement is five years, after which it lapses unless it is continued.

Differences between states

Most states in the US adopted similar versions of the UCC, with minor structural modifications (For example, in Louisiana, major subdivisions of the UCC are referred to as chapters instead of articles, since the term “articles” is used in that state to refer to provisions of the Louisiana Civil Code. Arkansas also has a similar arrangement. In California, they are titled "divisions" instead of articles.), with the exception of Louisiana. Louisiana enacted most provisions of the UCC with the exception of Article 2, preferring to maintain its own civil law tradition for governing the sale of goods. However, states stand on different levels in adoption of the various revisions in the UCC articles.

Here, we include filing procedures in a few states - one of which is Louisiana (which has not adopted the UCC in its entirety) and others like New Jersey and California.

Louisiana

In January, 1990 Louisiana adopted the Uniform Commercial Code (with the exception of article 2). This statewide notification system replaced Louisiana's chattel mortgage laws and for the first time, provided lenders with statewide information regarding liens on movable, personal property. As the last state to adopt the UCC, Louisiana implemented a filing system that benefited its users by allowing the filing of financing statements with any of the 64 parish clerks of court. The Secretary of State provided equipment to the 64 local filing officers and access into a statewide database that is maintained by the Secretary of State's Office. Effective July 1, 2001, Louisiana implemented the Revised Article 9.

New Jersey

UCC filing in New Jersey, as in many other states, can be done through over the counter as well as online. Uniform Commercial Code filings from New Jersey, includes information such as debtor names and addresses, filing number, date of filing, secured parties and assignees, status, and filing location. Some filings may also contain information on collateral, filing history, and tax liens, which can be obtained directly from the Secretary of State or county level filing offices.

The New Jersey Division of Revenue administers the State's UCC search service.

California

In California, as in most other states, the Secretary of State's office is the central filing office for the financing statements and other lien documents provided for in the Uniform Commercial Code (UCC). In order to prevent identity theft and protect the personal privacy of people whose information appears in the documents filed with the Secretary of State, the social security numbers are removed from the copies.

Filing fees

The filing fees are different for the different states in the US. Different kinds of filings attract different fees, which also differs according to the number of pages per filing or the mode of filing (web based or paper format). The table below gives an indicative list of filing fees in some states.

Table A9.2: Filing fees

Alabama	$15
Arkansas	$16
California	$10
Florida	$35
Maryland	$25
Michigan	$15
New Jersey	$25
Texas	$15
Louisiana	$30

Source: Secretary of State Websites

Annexure-9

Cost estimates for setting up Central Registry

Table A10.1: Central Registry: Cost Break-up

S.no.	Cost Component	Sub-component	Amount (Rs)
1	Physical Infrastructure	Computer equipments	9,805,466
		Office equipments	2,875,800
		Packaged Software	6,206,353
		Hardware for Data Recovery Centre	5,349,682
		Office space	120,000,000
		Office space (data recovery centre)	12,000,000
		Furniture and fixtures	8,000,000
2	Software development		2,346,000
3	IT support (outsourced)		1,800,000
	Total Cost		**168,383,301**

Note: These are only approximate cost estimates for setting up Central Registry based on certain assumptions and excludes cost of operations like human resource cost

Key assumptions

1. Number of staff/ users in the proposed Central registry is 200.
2. It is assumed that the office space required will be 8000 sq ft in main office and 1000 sq ft for the data recovery centre. The cost per unit for commercial real estate is assumed to be Rs 15000/ sq ft in the city of main centre and Rs 12000/ sq ft in the city where data recovery centre will be set up.
3. The cost of interiors (furniture and fixtures) is assumed to be Rs 1000/ sq ft.
4. It is assumed that such project will require around 15 IT associates (mix of analysts, architects, systems engineer, integration consultant, project manager, project lead, testers, programmers, developers, etc). The project is assumed to continue for around three months and accordingly cost has been calculated based on requisite man hours.
5. It is assumed that IT support will be outsourced

6.

Annexure-10

Cost Estimates for Setting up system like NAFIN

Table A11.1: NAFIN like system: Cost Break-up

S.no.	Cost Component	Sub-component	Amount (Rs)
1	Physical Infrastructure	Computer equipments	4,430,466
		Office equipments	2,427,400
		Packaged Software	483,139
		Office space cost (Rs 15000/ sq ft)	33,000,000
		Furniture and fixtures (Rs 1000/ sq ft)	2,000,000
2	Software development		4,409,100
3	IT support (outsourced)		1,800,000
	Total Cost		**48,550,106**

Note: These are only approximate cost estimates for setting up an online trading platform based on certain assumptions and excludes cost of operations like human resource cost

Key Assumptions

1. It is assumed that an existing development bank/ agency will set up an online trading platform like NAFIN, Mexico
2. Number of additional staff required by the concerned agency is assumed to be 50.
3. It is assumed that additional office space required will be 2200 sq ft. The cost per unit for commercial real estate is assumed to be Rs 15000/ sq ft.
4. The cost of interiors (furniture and fixtures) is assumed to be Rs 1000/ sq ft.
5. The software development will be a key component of total cost for setting up an online trading platform. It is assumed that such project will require around 20 IT associates (mix of analysts, architects, systems engineer, integration consultant, project manager, project lead, testers, programmers, developers, etc). The project is assumed to continue for around six months and accordingly cost has been calculated based on requisite man hours.
6. It is assumed that IT support will be outsourced

Annexure-11

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ABBREVIATIONS

A

AR: Average Receivables

ALI: American Law Institute

B

BRSA: Banking Regulation and Supervision Agency

C

CAGR: Compounded annual growth rate

CIBIL: Credit Information Bureau (India) Ltd

CRAR: Capital to Risk Weighted Assets Ratio

D

DRT: Debt Recovery Tribunals

E

EBITDA: Earnings before Interest, Tax, Depreciation and Amortisation

ECB: External Commercial Borrowings

ECGC: Export Credit Guarantee Corporation of India Limited

EDI: Electronic Data Interchange

EEA: European Economic Area

EU: European Union

F

FCI: Factors Chain International

G

GRIF: General Rules for International Factoring

GTF: Global Trade Finance

H

HSBC: Hong Kong and Shanghai Banking Corporation

I

IFG: International Factors Group

K

KS Committee: Kalyanasundaram Committee

L

LC: Letter of Credit

LEFS: Local Enterprise Finance Scheme

LoD: Letter of Disclaimer

M

MSME: Micro, Small and Medium Enterprises

NBFC: Non-banking Finance Company

N

NOC: No Objection Certificate

NOFs: Net Owned Funds

NCCUSL: National Conference of Commissioners on Uniform State Laws

R

RBI: Reserve Bank of India

S

SAFAESI: Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest

SIDBI: Small Industries Development Bank of India

T

TRE: The Receivables Exchange

U

UCC: Uniform Commercial Code

UNCITRAL: United Nations Commission on International Trade Law

V

VAT: Value Added Tax

Small Industries Development Bank of India (SIDBI)

SIDBI, set up on April 2, 1990 under an Act of Indian Parliament, is the Principal Financial Institution for the Promotion, Financing and Development of the Micro, Small and Medium Enterprise (MSME) sector and for Co-ordination of the functions of the institutions engaged in similar activities. Financial support is provided by way of Refinance to eligible Primary Lending Institutions (PLIs), such as, banks, State Financial Corporations (SFCs), State Industrial Development Corporations (SIDCs), Micro Finance Institutions (MFIs), and Direct Finance through its 103 branches, catering to more than 600MSME clusters. Since its inception, SIDBI has been endeavoring to meet the diverse needs of the MSMEs through various tailor-made schemes and fulfill its stated Vision.

MISSION STATEMENT

"To empower the Micro, Small and Medium Enterprises (MSMEs) sector with a view to contributing to the process of economic growth, employment generation and balanced regional development."

VISION STATEMENT

"To emerge as a single window for meeting the financial and developmental needs of the MSME sector to make it strong, vibrant and globally competitive, to position SIDBI Brand as the preferred and customer friendly institution and for enhancement of shareholder wealth and highest corporate values through modern technology platform".

DIRECT FINANCE

SIDBI, over the years, has evolved itself to meet the various types of credit requirements of the MSME sector by directly offering tailor-made financial products and services. Some of the major schemes of SIDBI under Direct Finance are:

A. Term Loan Assistance-

Term loans are provided for i) Setting up of new projects and for technology upgradation / modernisation, diversification, expansion, energy efficiency, adoption of clean production technologies, etc. of existing MSMEs (ii) Service sector entities and (iii) Infrastructure development and upgradation.
Various schemes under Term loan assistance are the privileged customer scheme, scheme for Energy Saving and Clean Production Technology Projects in MSME Sector , risk capital fund etc.

B. Working Capital Assistance

Working Capital Term Loan
The objective of the Scheme is to provide term loans to MSMEs to meet the shortfall in working capital including WC margin.

Working Capital arrangement with IDBI Bank
SIDBI has a strategic arrangement with IDBI Bank to provide Working Capital Limits to its MSME customers by utilising the banking platform of IDBI Bank.

C. Support Against Receivables

MSME Receivable Finance Scheme
SIDBI operates the MSME Receivable Finance Scheme (RFS) for MSME sellers / eligible service providers in respect of sales & services rendered to purchaser companies. Under the Scheme, SIDBI fixes limits to well performing purchaser companies and discounts usance bills of MSMEs / eligible service sector units supplying components, parts, sub-assemblies, services, etc. so that the MSME / service sector units realise their sale proceeds quickly. SIDBI also offers invoice discounting facilities to the MSME suppliers of purchaser companies.

D. Foreign Currency Loans

SIDBI offers forex assistance to its MSME customers in various forms including foreign currency term loans, booking of forward contract, etc.
SIDBI also offers Line of Credit in Foreign Currency to institutions / banks for extending export and domestic credit to MSME units / Export Houses / Trading Houses, etc.

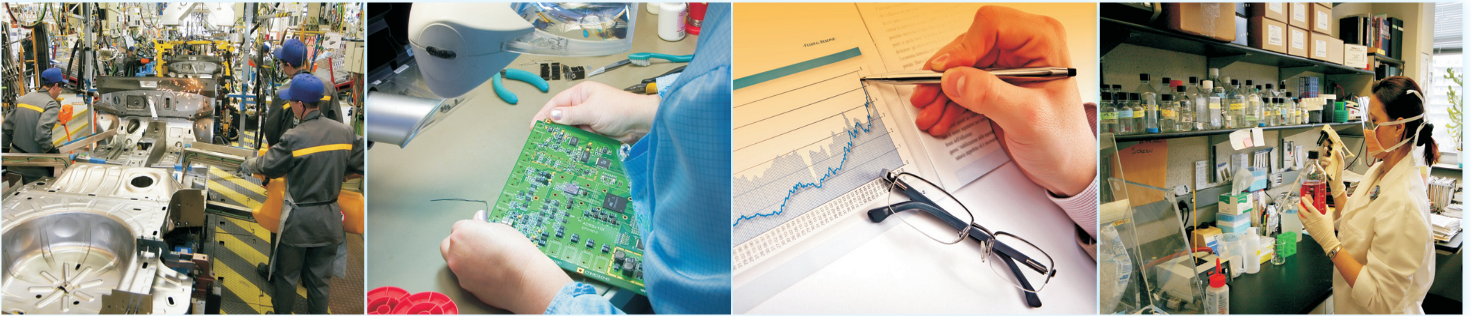
भारतीय लघु उद्योग विकास बैंक

SMALL INDUSTRIES DEVELOPMENT BANK OF INDIA

We empower Micro, Small & Medium Enterprises

with **SIDBI** *it's*

Advantage MSMEs



Avail assistance under our different schemes.

DIRECT CREDIT SCHEME — Finance at competitive interest rates for setting up, expansion, modernisation, technology upgradation and diversification of your business enterprise

RECEIVABLE FINANCE SCHEME — Credit against bills / invoices raised on Corporates, PSUs & other Service Enterprises.

MICRO FINANCE — Credit to Micro Finance Institutions for on-lending and Capacity Building support for MFIs.

RISK CAPITAL — Meeting capital requirements of start-ups and existing MSMEs.

ENERGY EFFICIENCY INVESTMENT — Credit for energy efficient projects at special interest rates.

And more.....

MSME Financing and Development Project (MSMEFDP)

Three major components:
A. Credit Facility
B. Risk Sharing Facility
C. Technical Assistance

The Project is a multi-agency, multi-activity initiative aimed at making MSME lending an attractive and viable financing option as also facilitating increased turnover and employment in the sector.

The Project, besides augmenting flow of credit to MSMEs, addresses demand side issues of credit and streamlining access to qualitative financial and non-financial services in clusters, policy advocacy, capacity building of banks/ FIs and support for credit information and rating.

Please visit MSMEFDP at www.msmefdp.net & SIDBI at www.sidbi.in

Toll Free No. 1800-22-6753

SIDBI's Branch Office Network

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Hyderabad
Hyderabad-Micro Fin.Br.
Rajahmundry
Vijayawada
Visakhapatnam
Arunachal Pradesh
Itanagar
Assam
Guwahati
Guwahati-Micro Fin.Br.
Bihar
Patna
Chhattisgarh
Bilaspur
Raipur
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Faridabad
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