IMPROVING CASH FLOW THROUGH FACTORING OR FORFAITING

Factoring and Forfaiting are becoming popular vehicles for financing local and International trade currently. This phenomenon is attributed to the changing economic conditions that have contributed to change trader's financing choices. In my view stringent rules that are being enforced both locally and internationally and complexity of financing methods have virtually forced the business community to look for less cumbersome methods of financing cross boarder and inland trade. In this context businesses across the nation and around the globe are finding factoring and forfaiting to be better options rather than traditional financing when it comes to enhancing cash flow and growing their business.

The benefits of factoring and forfaiting really outweigh most of other form of short-term financing. Many industries such as manufacturers, exporters, wholesalers, distributors, engineering, contractors and service companies are all benefiting from factoring/forfaiting. Factoring/forfaiting is easier to qualify for than a bank line of credit as the underline criteria is more focused on the strength of the business' customers, and not their own. Unlike a bank line of credit, a factoring/forfaiting line grows with the cash flow needs of the business. The business' customers benefit from extended terms while the business receives payment soon after their invoices are generated or shipping documents are presented to the bank.

What is Factoring and how does it Work?

Factoring is a receivable-based financing which converts invoices into cash within relatively a short period after products are supplied or services are rendered. It provides immediate cash flow on an ongoing basis, unlocking a frozen asset. Invoices are advanced up to 90% of their face value and cash availability grows as receivables grow. Remittances in settlement are sent to the factor's designated account for convenient posting, and reports are provided to keep the business owner current on payment history. The factor helps their business clients by verifying the credit quality of their debtors and with setting realistic credit limits. The factor also assists with collection efforts to avoid slow-pay issues. Although factoring is more suitable for inland trade financing it also can be made used to finance international trade very effectively. This is going to be more effective in the near future when Uniform Rules for Bank Payment Obligation (URBPO) comes into effect. International Chamber of Commerce (ICC) and Society for Worldwide International Financial Telecommunication (SWIFT) have got together to promulgate a set of rules that effectively strengthen the open account payment system hitherto is being financed mostly by factoring. Once the rules come into effect with the payment obligation is being guaranteed by banks invoices may be advanced up to 100% by the factors without recourse.

What is Forfaiting and how does it work?

Forfaiting is also a receivable-based financing program that is more suitable for financing exporter's receivables at a discount by paying cash. In a forfaiting transaction, the forfeiter (Bank or a Finance company) becomes the entity to whom the importer is obliged to pay its debt. Unlike factoring, in a forfeiting transaction the receivables are usually guaranteed by the importer's bank – the forfaiter frees the exporter from credit and from the risk of nonpayment by the importer who purchased the goods on credit. On the other hand while giving the exporter cash in advance, forfeiting allows the importer to buy goods for which he cannot immediately pay in full. The receivables, becoming a form of debt instrument that can be sold on the secondary market, are represented by bills of exchange or promissory notes, which are unconditional and easily transferable debt instruments. Whilst I admit that forfeiting has gained international recognition as a receivable-based financing program, its full potential to embrace financing of trade globally was not harnessed until International Forfaiting Association and International Chamber of Commerce joined hands to promulgate Internationally Accepted Rules for Forfaiting. As a result Uniform Rules for Forfaiting (URF) is due to be introduced at the beginning of 2013 and it is expected to create a huge impact on financing of international trade.

Factoring/ Forfaiting Benefits

Factoring/Forfaiting is ideal for any business that is suffering from cash flow issues, experiencing growth, losing new business due to lack of working capital, struggling to pay payables and payroll, or just feeling like a bank to their customers. Factoring/Forfaiting not only provides a business with more cash flow than a bank line of credit, it also provides the following benefits: maximum cash availability from invoices within 24-48 hours, ability to take advantage of trade discounts, pay payables and payroll on time, improve collections and reduce bad debt, offer terms to customers, assistance with monitoring and setting debtor credit limits, more predictability of cash flow, a built-in repayment mechanism, reduces clerical functions, and gives peace of mind.

With my own experience I know that business owners typically do not use a bank line of credit to stabilize cash flow. They see it as a loan and often use it inappropriately. Factoring and Forfaiting teach businesses cash discipline. Bank lines of credits do not offer the same benefits and features as factoring or forfaiting. Banks simply extend a line of credit such as Packing Credit, Overdraft and Bills Discounting facility and hope it is used properly.

Before choosing the right financing vehicle for any business, consider the cash flow needs and ask the following questions: Is my business recording a growth? Am I losing out on new business opportunities due to insufficient cash flow? Are my receivables turning slower than I expect? Am I losing sleep over cash flow issues? If you answered "yes" to any of these questions, Factoring or Forfaiting is a solution worth considering depending on your line of business. Remember that traditional financing facilities provided by the banks might not always suit your business model.

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