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TRENDS OF THE FACTORING TURNOVER IN INTERNATIONAL COMPARISONS

Case Study

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JEL Classification
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Abstract

The factoring scheme was developed by the competition between the market operators and the need for the most favourable conditions of sale. The seller is constrained to provide loans on a broad scale therefore the seller may have liquidity problems. In cases of this kind, the seller can apply to a factoring company in order to access sources, instead of a bank loan. The factoring service has a price. Decision of the financial managers can largely contribute to choosing the appropriate funding form to retain the continuous liquidity situation of an enterprise. Aim of the article is to present the main tendencies of the factoring turnover in international comparisons, highlighting the characteristics of the financial service by its direction, sectorial distribution and customer size in Hungary. It has been estimated that the factoring financing approaches 10% of the short-term loan stocks of SMEs required from banks which indicates that the factoring is now far beyond the marginal financial service but it is an essential element of the short-term financing toolkit.

INTRODUCTION

Factoring is not other than the assignment of a right to such a monetary claim which is included in commercial invoices and not covered by bankers' security. The claim primarily arises from transportation of source materials, raw materials and consumer goods and it has short-term and generally does not exceed 180 days. In accordance with the development in the world of business, factoring has periodically changed and it pops up again and again in modern forms adjusted to the need of the economic operators (Salinger, 1995). In addition to quality and production costs of the goods and services coming onto the market, establishment of the commercial conditions also plays a more and more important role. The more favourable payment conditions the seller or service provider offer, the easier he/she can find a business partner. Sale on credit demands capital utilization from the seller which may cause funding and liquidity problems for SMEs. The financial market can very effectively remedy the abovementioned problem via the factoring service.

In the 1950s, factoring had been limited to the United States only but it has spread in all continents since then. Coming of the American factors under bank ownership facilitated its spread in Europe as well. This process significantly contributed to the growth of the world trade which started to develop rapidly in the 1960s (Réczei, 1988) and the largest turnover was already in Europe in the 1990s (Martinkó, 2002).

The authors will present the most important features of the factoring as a financial service and the benefits thereof against other lending forms. They will analyse the major developing trends of the factoring turnover in international comparisons, based on the data of the International Factoring Association (FCI) between 2008 and 2015. As well, the authors will analyse the evolution of the service by its direction, sectorial distribution and customer size, based on the data of the Hungarian Factoring Association (hereinafter: MFSZ) between 2009 and 2016.

ADVANTAGES OF USING THE FACTORING SERVICE

- Factoring is not equal to the borrowing, e.g. there is no need to provide a mortgage security.
- There is no need for bankers' security because solvency of the customer represents the "security".
- Start-up, capital-poor or maybe loss-making enterprises can also utilize factoring for their claims.
- Experience shows that the customers' willingness to pay and payment discipline increase thus the risk arising from the non-payment decreases or ceases thereby the company will continue to remain solvent and its supplier credits decrease.
- Cash flow of the enterprise accelerates thus liquidity of the company improves and can receive an advantage when placing the order or borrowing.
- Rotational speed of the assets increases, the incomes becomes more predictable; the enterprise can continuously transport and will not lose its customers. The enterprise can retain its position in the market and its competitive position can improve.
- The bank partly assumes the risk of sale on credit from the seller of commodity. Factoring replaces the expensive application of the bank guarantee, letter of credit, bill of exchange or other securities.
- The bank ensures the record and collection of the claims (Darabos et al., 2015).

Factoring has disadvantages in addition to its numerous advantages. Inter alia, if the supplier is factoring the claim before the expiry date or due to late payment then the market perception of a customer of the commercial transaction could deteriorate or the business relationship could end up. Furthermore, the charge of factoring is high since this is also a hazardous transaction like the lending; the risk arising from the non-payment of the customer must be taken into account.

INTERNATIONAL TRENDS

In the international business life, the letter of credit had been the most commonly accepted form of payment for decades. In the rapidly changing world of today, along with the speedy increase in international trade, we are witnessing the re-upturn of factoring. Namely, not only the importers use this payment method but the exporters have also recognised its advantages, for instance, they can further improve their competitiveness on the market. Namely, nowadays, almost all greater (international) banks have subsidiaries providing factoring service – equally in the developed and developing countries – which can offer their international factoring services relating to close cooperation for the whole size range of the entrepreneurial sector, in different sectors.

There was a significant change on the factoring markets of the world between 2008 and 2015 since the increase in turnover almost doubled – with fluctuations – during this period, despite the fact that several countries and continents were hit by the global economic crisis erupted in 2008. Based on Table 1, it can be seen that the strongest growth took place in the Asian continent between 2008 and 2015 (161%), followed by Europe (including Eastern Europe) with its plus 65 percent growth. There were also positive developments in the Middle East and North Africa but these changes are infinitesimal compared to their world economic position. In 2015, turnover of the world increased by 6.2% compared to the previous year. Within that, turnover decreased by almost 9% in Asia and increased by 6.4% in Europe. Based on these data, it can be said that factoring as a financial service played an important and ever-growing role, in addition to other financial services, in the short term funding of enterprises during the period of the crisis – and the following years.

Figure 1 illustrates the data of six countries whose factoring turnover is the largest in the world and it also demonstrates the pace of increase in turnover of all countries. The indicated countries represented 64% of factoring turnover of the world which is a volume at almost the same level of the European market. Within the Asian continent, role of China became larger on the market, namely it preceded the former leader United Kingdom by 2011. Nay, more: China still keeps its position to date, contrary to Japan where there was a decline being more than 35%. Based on the average, since 2008, Israel, Singapore, Hong Kong, Taiwan and the United Arab Emirates have also increase their turnover significantly within the continent (FCI, 2017).

With regard to the leading European countries, after a smaller decrease in turnover in 2009, data shows increase again. In the years between 2009 and 2015, Belgium (156%), Lithuania (79%) and Turkey (103%) accomplished significant increase. Not only SME sector utilizes the factoring services more frequently in the countries showing increase in turnover but the large corporations (with price income over EUR 10 million) often utilizes this form of funding as well. (MFSZ, 2017)

With regard to the Central and Easter European region within Europe, it can be said that its proportion has hardly increased since 2008, its weigh was only around 5.2% in 2015 (MFSZ, 2016). Based on Figure 2, it can be seen that there was a restructuring in the evolution of factoring turnover of the countries compared to 2008. In 2014, Poland already became a driving force of the development, taking the place of Russia. This change is due to two factors: in one respect, factoring turnover has been dynamically developing in Poland since 2010, on the other hand, the continuous increase in turnover has stopped in Russia since 2009; there was a 40 percent decline in 2015 and 20 percent decline in 2015, compared to the previous year. Hungary is located in the mid-range among these countries even despite the fact that there was a 20 percent decline in the factoring turnover in 2008 and the level of 2008 was reached by 2015 only. The companies of Ukraine were also concerned by the global economic crisis of 2008 which also affected the factoring market; credits of the companies' claims decreased by 40% in total. Funding of companies just started again but the economic consequences of the Ukrainian-Russian war erupted in 2014 and continuing since then had an impact on the funding of companies as well.

Within Europe, by investigating the factoring penetration (factoring turnover/GDP - the indicator was calculated for the year of 2014.), it can be said that the role of factoring is more powerful in the countries having developed market economy and strong SME sphere. Among the Central and Eastern European countries, the share of Lithuania (15%) AND Poland (8%) should be noted while the factoring turnover is only 3% within GDP in Hungary and is 1% in case of Ukraine. (own calculation based on the data of IMF, 2016; FCI, 2015)

SITUATION OF THE HUNGARIAN FACTORING MARKET

In Hungary, the factoring service with actual business attitude has been present in the financial-business life since almost 20 years. The cascading liberalisation of the Foreign Exchange Act has enabled the enterprises to "deliver openly" for their foreign partners, preceding the letter of credit, guarantee and documentary collection required by the previous Act, herewith giving their customers a payment extension up to several months. A dynamic development has started in the Hungarian factoring sector when the foreign retail chains appeared. The retail chains created a strongly concentrated market. As customer, they dictated long payment deadlines to the suppliers. Consequently, the credit needs of enterprises (suppliers) mostly representing smaller capitalisation have grown. The classical factoring services punctually meet these needs. The supplier – utilizing the services of a factoring company – can considerably improve its competitive position without binding the capital invested in goods for longer term and, at the same time, the supplier can positively affect the cash flow. Last but not least, the supplier can ensure the continuous delivery.

Contrary to the international trends, the Hungarian factoring sector was in a stagnant state over several years. Inter alia, its reason was that most of the Hungarian enterprises and entrepreneurs unfortunately saw the factoring financial service as the last opportunity to raise resources when their claims had long since expired and their enterprises had not refunding resources.

The crisis erupted in 2008 punctually contributed to the growth of this business. Since the banks increased the severity of their risk management policies and procedures as well as the available refinancing resources became more limited and, at the same time, became significantly expensive. Signs of the expansions in the factoring turnover already became visible in 2010. On the whole, the total factored turnover already reach almost HUF 1 455 billion in Hungary by 2016, 95% thereof is domestic factoring (Figure 3). Numerous researches show that those enterprises are successful which can enter the circulation of the world i.e. they exports and/or imports. Services of factoring offer an opportunity to expand the export since those ones provide resources for the exporting activity and assist in recovering the foreign claims, insuring them against the non-payments. Thus, these services enable the Hungarian exporters to enter the market with competitive offers.

Insofar as we examine the distribution between sectors from 2009 to 2016 then we can consider a restructuring, like in case of the international trends (Figure 4). Weight of enterprises belonging to the industry has weakened and shifted to direction of the commercial sector. Share of the service providing enterprises has been continuously growing since 2010. The construction companies – despite the fact that there are presently signs of the upturn – have been actually excluded from the factoring, mainly due to those serious financial risks that characterized these enterprises during the years of the crisis. This is very unfortunate because the factoring would serve as a suitable credit facility for the reduction of circular indebtedness which is decisively peculiar to the construction sector. Share of the agricultural enterprises has increased to 12%. This share was 4% during the previous years. (MFSZ, 2017)

Number and composition of the enterprises utilizing the factoring have significantly changed during the period examined. According to the international trends, more and more large corporations benefit from the advantages of factoring in Hungary. In 2016, their share reached 57% in the total turnover (Figure 5). At the same time, the regrettable fact is that a part of the former medium-sized enterprises shrank to small-sized and, despite that, the rate of small enterprises fell to about a third (Nagy, 2016). Furthermore, the microenterprises are continuously excluded from the market of factoring. In one respect, it can be explained by the fact that the rate interests rose again in 2009, 2011 and 2012. On the other hand, the ability of microenterprises to borrow is still modest as well.

A relatively large and increasing number of the service providers and a diversity of the ownership structure were peculiar to the factoring market for many years. In recent years, we have been witnessing a strengthening concentration among the service providers. The unfavourable market situation connected with the crisis has played a role in this. However, the sector was also sensitive to the derecognition of the bank tax levied in 2010 which the independent factoring entities spectacularly suffered from. Due to the measure, every third member of the sector became loss-making. The following factor surely plays role in the aforementioned negative phenomenon that the factoring financing of the micro and small enterprises was forced back: the independent financial enterprises had mostly withdrawn from the market since they had financed the micro and small enterprises. Based on the order of 19 member companies of MFSZ by turnover, market share of the first five members was 88% of the total gross turnover in 2016 which indicates a significant concentration.

According to the estimation of the Hungarian Factoring Association, the factoring financing now approaches 10% of the short-term loan stocks of SMEs required from banks which indicates that the factoring is now far beyond the marginal financial service but it is an essential element of the short-term financing toolkit.

There is a tendency justified by researches that the expansion of factoring market is adjusting to the developing trend of the macro economy. Between 2010 and 2013, GDP actually stagnated in Hungary and then reached the level before crisis (year of 2008) by 2014, after a slight increase. The factoring financing has accordingly changed as well. Though the increase in the sector was generated by one operator (OTP Bank entering in 2013) but the market moved towards the recovery which is indicated by the fact that half of the market operators could also produce growth. In addition, such publicly-funded factoring products were established which explicitly enabled SMEs to be able to utilize the factoring financing under such conditions which were better than the market conditions.

CONCLUSION

Factoring, as a financial service, has helped a lot of enterprises through the difficulties of the crisis. Since, in case of well-factorable constructions, the charges of factoring (1.5-2%) are sometimes lower than expenses of the current asset loans providing an alternative solution. The competitive advantage of the factoring can be definitely detected if we add the following features of factoring to the financing service: claim insurance, debt collection, customer evaluation and recordkeeping services as well as the positive effect on the balance sheet and the security situation of the enterprise.

A wider domestic use of factoring would contribute to

- use of the enormous potential in the supplier and B2B (business to business) sectors – thereby it could enable the operators of micro- and SME sectors to create jobs,
- improvement of the domestic and export competitiveness,
- whitening of the black and white economies,
- moderation of the chain debts,
- Establishment of the business culture, stable and predictable management of the enterprises.

New overall national plans are not required for the further increase in the Hungarian economy but it is needed to make thousands of enterprises' ideas for further improvement realizable and to establish supporting assets and institutions. Not a strategy or economy politicians should tell the direction deemed appropriate but the entrepreneurs of SMEs should be simply allowed to discover the opportunities in the Hungarian economy, to utilize and operate those ones in a secure micro environment in the long term..

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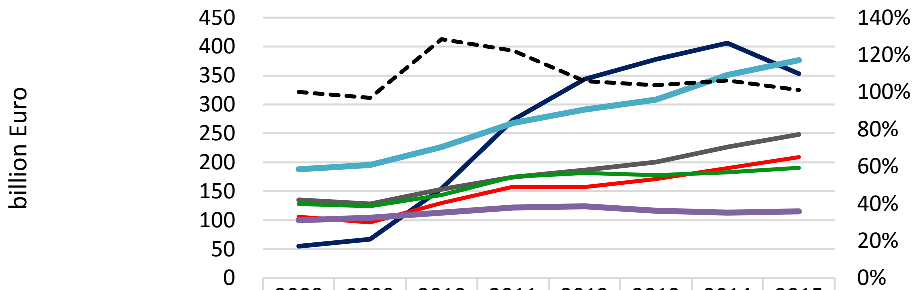
ANNEXES

Table 1.
Factoring turnover of continents between 2008 and 2015 (EUR billion, last year=100%)

Continents	2008	2009	2010	2011	2012	2013	2014	2015
Europa	889	877	1045	1219	1299	1354	1463	1557
Americas	154	142	186	207	188	192	207	194
Africa	13	15	17	23	24	23	21	25
Asia	235	210	355	508	572	599	615	555
Australia	33	40	46	58	50	40	42	42
Total World %	100%	97%	128%	122%	106%	104%	106%	101%

Source: FCI, 2017



	2008	2009	2010	2011	2012	2013	2014	2015
China	55	67	155	274	344	378	406	353
Germany	106	96	130	158	157	171	190	209
France	135	128	153	175	186	200	227	248
Spain	100	104	113	122	124	117	113	115
United Kingdom	188	196	226	268	291	308	351	377
Italy	128	124	144	175	182	178	183	190
Total World %	100%	97%	128%	122%	106%	104%	106%	101%

*Figure 1.*Six countries having the most significant factoring turnover between 2008 and 2015
Source: FCI, 2017

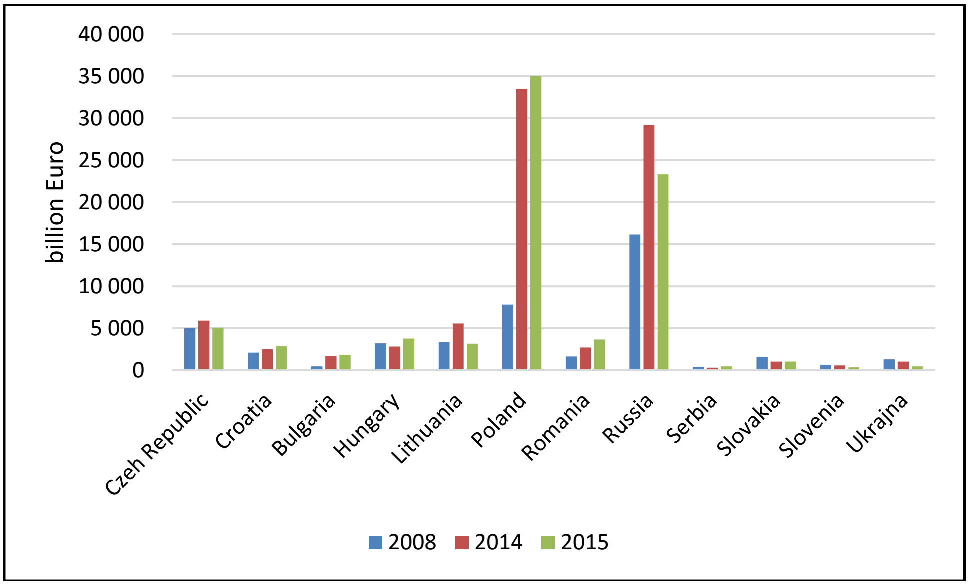
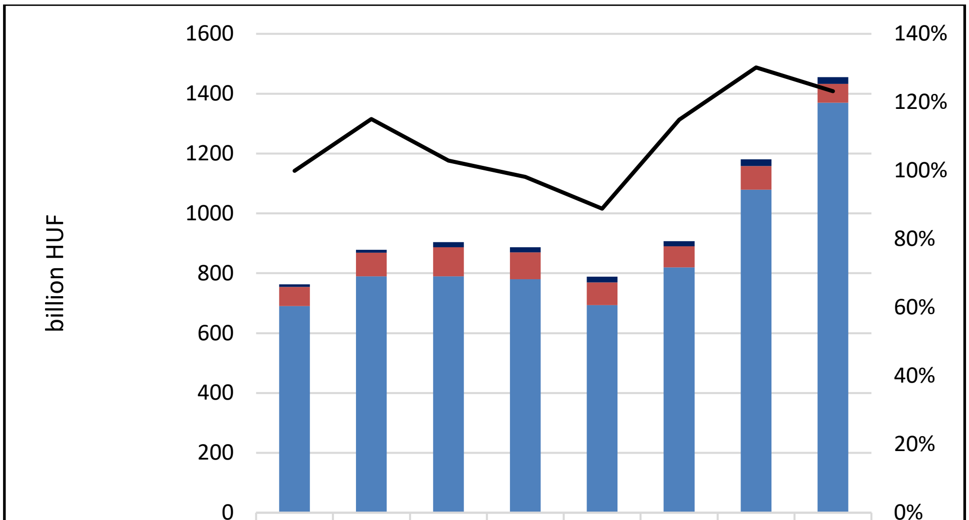


Figure 2. *Evolution of factoring turnover of the Central and Eastern European countries*
Source: FCI, 2017



	2009	2010	2011	2012	2013	2014	2015	2016
import	8	9	18	18	19	17	22	22
export	65	79	97	90	76	70	79	63
inland	690	790	790	780	694	820	1080	1370
Total changes	100%	115%	103%	98%	89%	115%	130%	123%

Figure 3. *Factoring turnover by its direction, in Hungary between 2009 and 2016*
Source: based on data of MFSZ, 2017

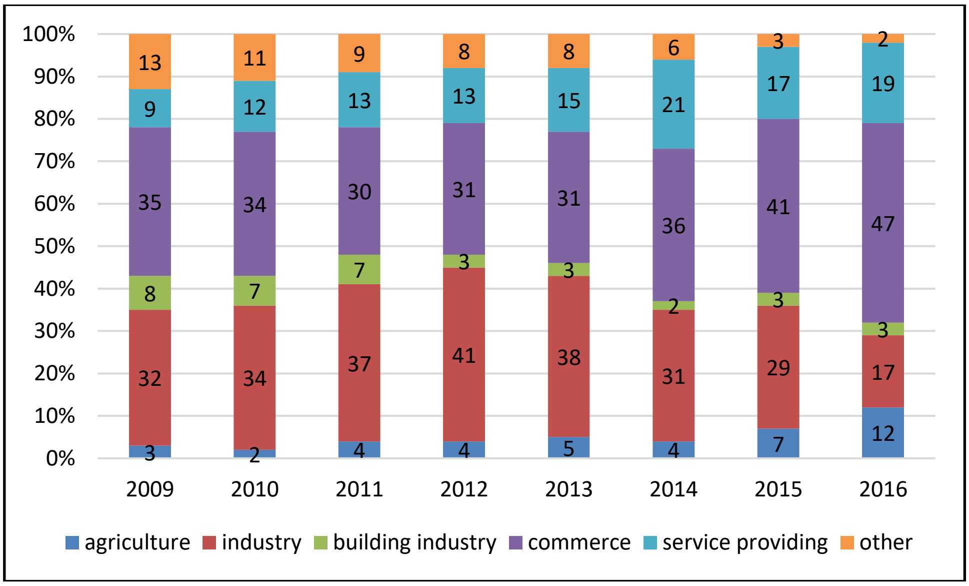


Figure 4. *Sectorial distribution of the MFSZ customers' turnover (%)*
Sourse: based on data of MFSZ, 2017

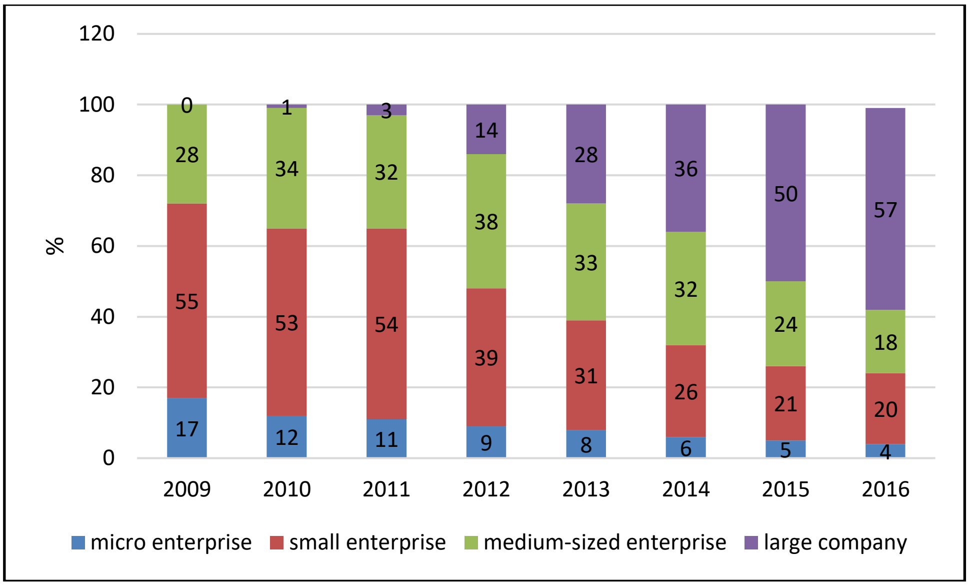


Figure 5. *Distribution of customers of MFSZ by corporate size*
Source: based on data of MFSZ, 2017