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SOURCES OF BUSINESS FINANCE

Factoring

Factoring is a financial service under which the 'factor' renders various services which includes:

(a) Discounting of bills (with or without recourse) and collection of the client's debts. Under this, the receivables on account of sale of goods or services are sold to the factor at a certain discount. The factor becomes responsible for all credit control and debt collection from the buyer and provides protection against any bad debt losses to the firm. There are two methods of factoring — recourse and non-recourse. Under recourse factoring, the client is not protected against the risk of bad debts. On the other hand, the factor assumes the entire credit risk under non-recourse factoring i.e., full amount of invoice is paid to the client in the event of the debt becoming bad.

(b) Providing information about credit worthiness of prospective client's etc., Factors hold large amounts of information about the trading histories of the firms. This can be valuable to those who are using factoring services and can thereby avoid doing business with customers having poor payment record. Factors may also offer relevant consultancy services in the areas of finance, marketing, etc.

The factor charges fees for the services rendered. Factoring appeared on the Indian financial scene only in the early nineties as a result of RBI initiatives. The organisations that provides such services include SBI Factors and Commercial Services Ltd., Canbank Factors Ltd., Foremost Factors Ltd., State Bank of India, Canara Bank, Punjab National Bank, Allahabad Bank. In addition, many non-banking finance companies and other agencies provide factoring service.

Merits

The merits of factoring as a source of finance are as follows:

- (i) Obtaining funds through factoring is cheaper than financing through other means such as bank credit;
- (ii) With cash flow accelerated by factoring, the client is able to meet

his/her liabilities promptly as and when these arise;

(iii) Factoring as a source of funds is flexible and ensures a definite pattern of cash inflows from credit sales. It provides security for a debt that a firm might otherwise be unable to obtain;

(iv) It does not create any charge on the assets of the firm;

(v) The client can concentrate on other functional areas of business as the responsibility of credit control is shouldered by the factor.

Limitations

The limitations of factoring as a source of finance are as follows:

(i) This source is expensive when the invoices are numerous and smaller in amount;

(ii) The advance finance provided by the factor firm is generally available at a higher interest cost than the usual rate of interest;

(iii) The factor is a third party to the customer who may not feel comfortable while dealing with it.