

**FACTORING IS A COMPLEMENT TO MODERN BANKING SYSTEM :
TURKISH CASE**

**A THESIS
SUBMITTED TO THE FACULTY OF MANAGEMENT
AND
GRADUATE SCHOOL OF BUSINESS ADMINISTRATION
OF
BILKENT UNIVERSITY
IN PARTIAL FULLFILMENT OF THE REQUIREMENTS
FOR THE DEGREE OF
MASTER OF BUSINESS ADMINISTRATION**

By CEM MURATOĞLU

June 1993

**HG
3752.3
.M87
1993**

FACTORING IS A COMPLEMENT TO MODERN BANKING SYSTEM:
TURKISH CASE

A THESIS

SUBMITTED TO THE FACULTY OF MANAGEMENT
AND
GRADUATE SCHOOL OF BUSINESS ADMINISTRATION
OF
BILKENT UNIVERSITY

IN PARTIAL FULLFILMENT OF THE REQUIREMENTS
FOR THE DEGREE OF
MASTER OF BUSINESS ADMINISTRATION

Cem MURATOĞLU
tarafından onaylanmıştır

By CEM MURATOĞLU

June 1993

HG
3752.3
.M 27
1993

3023068

I certify that I have read this thesis and in my opinion it is fully adequate, in scope and in quality, as a thesis for the degree of Master of Business Administration.



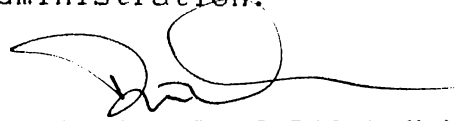
Assist.Prof.Can Simga Mugan

I certify that I have read this thesis and in my opinion it is fully adequate, in scope and in quality, as a thesis for the degree of Master of Business Administration.



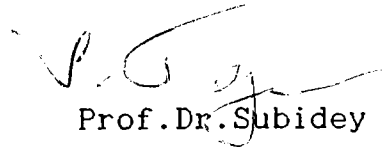
Assist.Prof.Erdal Erel

I certify that I have read this thesis and in my opinion it is fully adequate, in scope and in quality, as a thesis for the degree of Master of Business Administration.



Assist.Prof.Dilek Onkal

Approved for the Graduate School of Business Administration.



Prof.Dr.Subidey Togan

ACKNOWLEDGEMENTS

I would like to express my gratitude to Assist. Prof. Can Şimşak Muğan for her supervision, guidance and support throughout the study and I also would like to thank to the other members of my examining committee for their contribution.

ÖZET

FACTORİNG MODERN BANKACILIK SİSTEMİNİN TAMAMLAYICISIDIR : TÜRKİYE UYGULAMASI

Hazırlayan

Cem Muratoğlu

Tez Yöneticisi: Yrd.Doç.Dr. Can Şınga Mugan

Bu çalışma bir finansman tekniği olan factoringi tanıtarak Bankacılık sistemine olan katkılarını araştırmak amacıyla. Bu amaçla Dünyadaki uygulamalarından bahsedilerek factoring hakkında detaylı bir araştırma yapılmıştır.Öte yandan işletme sermayesi sıkıntısı yaşayan firmaların bankalar ve factoring şirketleri ile ortak çalışmaları halinde sorunlarını çözebileceklerini gösteren gerçek bir vaka çalışması da yapılmıştır.

Vakaya konu edilen firmanın mali yapısı ve projeleri incelenmiş, bu doğrultuda firmanın finansal tabloları likidite, finansal denge, karlılık, verimlilik ve finansal yapı bakımlarından irdelenmiştir. Firmaya sunulan çözüm ve uygulama safhalarında vaka çalışmasında yer almıştır.

Sonuç olarak, factoringin firmaların finansman sorunlarını çözmesi açısından her zaman tek başına yeterli olamadığı ve bankacılık sistemine tamamlayıcı bir unsur olduğu belirlenmiştir.

Anahtar Sözcükler: Alacaklar, factoring, akreditif, işletme sermayesi, nakit akışı, likidite, kredi yönetimi, önödeme.

ABSTRACT

FACTORING IS A COMPLEMENT TO MODERN BANKING SYSTEM : TURKISH CASE

By

Cem Muratoğlu

Supervisor: Assist. Prof. Can Şimşek

This study is to present factoring as a financing technique and to search its contributions to the banking industry. For this reason a detailed research is done by analyzing the implementation of factoring all around the world.

In addition, a real life case is studied in order to show that firms which have working capital deficits can overcome their problems when they cooperate with factoring firms and banks together.

The firm's (which incurred the problem of working capital in the real life case) financial structure and ongoing projects were analyzed in terms of liquidity, profitability, and efficiency.

Finally, it is concluded that the utilization of factoring only, may not be sufficient to solve the financial problems of the firms but instead it is a complementary to the banking system as a valuable instrument.

Key Words: Accounts Receivables, factoring, letter of credit, working capital, cash flow, liquidity, credit management, prepayment.

TABLE OF CONTENTS

	Page
1. INTRODUCTION.....	1
1.1. History.....	4
2. BASICS OF FACTORING.....	8
2.1. Definition of Factoring.....	8
✓ 2.2. Basic Definitions.....	8
2.2.1. Disclosed/Undisclosed.....	8
2.2.2. Recourse/Nonrecourse.....	9
✓ 2.3. Elements of Factoring.....	9
2.3.1. Receivables Management.....	9
2.3.2. Credit Management.(Bad Debt Protection).....	10
2.3.3. Sales Ledger Administration.....	10
2.3.4. Cash Flow Provision.....	10
2.3.5. Provision of Finance.....	11
✓ 2.4. Types of Factoring.....	12
2.4.1. Domestic Factoring.....	12
2.4.2. International Factoring.....	14
2.4.2.1. Reciprocal Export/Import Factoring.....	14
2.4.2.2. Single Factoring.....	16
2.4.2.3. Back-to-Back Factoring.....	18
2.4.3. Agency or Bulk Factoring (Disclosed).....	20
2.4.4. Invoice Discounting.....	20
✓ 2.5. Risk Assessment.....	21

✓ 2.5.1. Common Elements in a Supplier	
Sought by a Factor.....	21
✓ 2.5.2. The Supplier Risk.....	22
2.5.2.1. Viability.....	22
2.5.2.2. The Quality of Receivables.....	23
2.5.2.2.1. The Spread of	
Receivables.....	23
2.5.2.2.2. The Incidence of	
Credit Notes.....	23
2.5.2.2.3. The Receivables Turn..	24
2.5.2.2.4. Receivables to be	
Excluded.....	24
2.5.2.2.5. Seasonal Sales.....	24
2.5.2.2.6. Administration.....	24
✓ 2.5.3. The Debtor Risk.....	25
2.5.3.1. Bad Debt History.....	25
2.5.3.2. Credit assesment by the Supplier.	25
2.5.3.3. Credit Management by the	
Supplier.....	25
2.5.3.4. Industry.....	26
2.5.3.5. Nature of Debtors.....	26
2.5.3.6. Credit Terms.....	26
2.5.3.7. Purchasing Pattern.....	26
2.5.3.8. Debt Turn.....	26
2.5.3.9. Future Business.....	27

2.6.	Advantages and Disadvantages of Factoring.....	27
2.6.1.	Advantages.....	27
2.6.2.	Disadvantages.....	28
3.	DATA AND METHODOLOGY.....	29
✓3.1.	Problem Definition.....	29
3.2.	Data Source and Description.....	32
3.3.	Methodology.....	33
3.3.1.	Company Identification Report.....	34
3.3.2.	CM's Project and Need of Funding.....	36
3.3.3.	Financial Analysis.....	38
3.3.3.1.	Liquidity and Financial Stability Analysis.....	38
3.3.3.2.	Profitability and Efficiency Analysis.....	40
3.3.3.3.	Financial Structure Analysis.....	41
3.3.4.	Results.....	41
3.3.4.1.	The Results Related to Size.....	42
3.3.4.2.	The Results Related to Liquidity and Efficiency.....	42
3.3.4.3.	The Results Related to Profitability.....	43
3.3.4.4.	The Results Related to Financial Structure.....	43
3.3.5.	Discussions.....	44
3.4.	Decision.....	45
3.5	Solution.....	47
3.6.	Application.....	49

✓4. CONCLUSION.....	55
✓REFERENCES.....	58
APPENDIX : TABLES.....	61

LIST OF TABLES

	Page
TABLE I World Factoring Volumes.....	7
TABLE II Tests of Liquidity and Financial Stability.....	39
TABLE III Tests of Profitability and Efficiency.....	40
TABLE IV Test of Financial Structure.....	41
Appendix Tables :	
TABLE I-A Balance Sheet.....	61
TABLE II-A Income Statement.....	62
TABLE III-A Financial Analysis.....	63

1- INTRODUCTION

" Produce, sell and forget about the cash flow problems."

Factoring and its functions can be best summarized as above. Developed capitalist countries have been using factoring as a source of trade financing for years. However, accounting, banking, and other professional advisers in Turkiye have recognized the benefits of factoring only over the last few years. Many have responded by providing informed and constructive advice to their existing and potential clients, summarizing the advantages and disadvantages of factoring and when it might be used. In doing so, they have played a major part in helping to develop expanding businesses and in contributing to factoring's dramatic and sustained growth. There remains, however, a significant number of people, including many accountants, who are against factoring.(1) They have therefore failed to recognize or appreciate its potential. They regard factoring as an expensive form of finance used by companies as a last step before bankruptcy -finance of last resort-(2). This lack of appreciation of the advantages of factoring stems from failure to:

- * understand the services factoring has to offer
- * appreciate that factoring does not pretend to be suitable for all situations.

1-) Financial Times, 04.04.1991
2-) Financial Times, 04.04.1991

However, factoring's attraction to businesses is that it gets round the problem they frequently face when they try to raise more bank finance. Once a bank manager has lent up to what he considers is a prudent level, against the assets which the businessman can provide as security, he can usually go no further. At this point, factoring firms can become incubators. Factoring will solve the problem by using the company's unpaid invoices as its security and providing cash against the invoices. Most factors will immediately pay up to 80 percent of the value of invoices that are assigned to them. The remainder minus the factoring fees and interest charges on prepaid value of invoices will be paid when the factors collect the receivables from the customers.

On the other hand, in the " financial reforms " chapter of UDIDEM economic program it is mentioned that the aim is the integration to the standards structure and applications of developed countries by the use of new financial instruments(3). It is also mentioned that government will give all the incentives in order to expand the use of new instruments to finance trades.

This study aims to clarify the technical details of factoring and to review global factoring applications. More importantly, this study intends to explore the question

3-) Para, 09-15.02.1992

of whether the factoring system, when it is used by the "right" firms, is a real alternative to the banking system or it only helps to utilize banking facilities more efficiently.

Factoring has been introduced to Turkish business world during the last couple of years although it has been in existence in developed countries since 1950's. It is expected that, the companies preferring factoring as a financing alternative have low liquidity levels, suffer from cash flow problems, are growing fast and overtrading. These companies are expected to be young and small-to-medium sized companies thereby not able to raise the funds necessary to finance their growth.

Even though factoring is considered as a way of trade financing, this definition alone is not sufficient. Companies that are interested in factoring are offered a package of services which includes provision of finance too. Risk management, protection of suppliers against bad debts, collection of payments and sales ledger administration are the other services that can be available in the package.

This study both tries to give an overview of factoring as a financing alternative and tries to prove that it is a part of banking system, rather than being an alternative.

In chapter one, the development of factoring in Turkiye and world is discussed after a short overview of the history.

Chapter 2 tries to enlighten the definition and basics of factoring. Elements of factoring, namely, receivables management, credit management (bad debt protection), sales ledger administration, cash flow provision, provision of finance are discussed first. The special types of factoring which are simply combinations of several services are, also, given in chapter 2. This chapter ends with the risk assessment for factors, advantages and disadvantages of factoring.

Chapter 3, which is a case study, begins by explaining the purpose of the study followed by the explanation of data and methodology. Data and methodology part includes the manipulation of the data and procedure. In this chapter, the company used in the case is introduced to briefly give an overview of its financial structure and the needs of funding. Chapter 3 also includes the results of the analysis and the solution of the case. Finally, chapter 4 covers the conclusions derived from the study.

1.1 History

Factoring system was used for the very first time by the Babelians in 17th century (B.C.). Then, cronologically, Phoenicians, Romans, and German Bankers in the Middle Ages had used factoring (4). The German Bankers established

4-) ISO Bulletin, May 1991

agencies in overseas countries and contributed factoring terminology into literature. Those bankers called themselves "factor" and overseas country agencies "factorein".

In 17th century (A.D.) factoring companies established "factors house" in the United Kingdom in order to minimize the risk. This was the first step to institutionalization(5).

Factoring continued its development in the 18th century.

The factors acted as a trade conduit for cotton, tobacco, and indigo to the main commercial centers in Europe. During the Industrial Revolution, factoring firms were established by the major textile mills. Major German and British textile mills used factoring through "cotton factors" that they have established in North America(6). In the late 1800s, in order to protect the domestic industries, American government has declared Mc. Kinley Customs Tariff (1890) which increased the custom tax rates to 49.5 % . Such high custom tariffs reduced the international trade volume so the international factoring ceased at the end of the 18th century in the world(7)

In 19th century factoring companies started prepayments to exporters. In other words, they started to apply modern factoring.(8)

5-) Leo-Binder, The Development of Factoring, 1983 pp 2
6-) Hart, David, Factoring: A Lender's Option, 1991 pp 36-41
7-8) ISO Bulletin, May 1991

In Europe, factoring had a development, starting from 1960, in the United Kingdom.(9)

Germany adopted factoring along American lines early in the 1960s and then it spreads across the rest of Europe. Currently, there are 13 factoring companies in Germany.(10)

The application of monetary policies after 1980 has contributed to the factoring industry in Italy. In 1988s there are around 70 factoring companies in Italy while there were only 5 companies in the beginning of 1980s. In this country 70 percent of market is shared by 15 companies. (11)

In Sweden the first factoring company was established in 1963. Today there are more than 20 factoring companies in this country. (12)

International Factors Group founded Societe Factoring de France in 1964 in France. Facto-France-Heller started domestic factoring in France in 1966(13).

Factors Chain International (FCI) was established in 1968 as the umbrella organization for independent factoring companies.(14)

9-12) Akça, H.Ali, HDTM Bulletin, 1991/3 No:10

13-) ISO Bulletin, May 1991

14-) FCI, The International Factoring Report, 1990

Europafactoring was founded in 1988 in Brussels(Belgium).
Europafactoring will coordinate the financial
institutions (including factoring companies) of
European Community after 1993. (15)

Facto Finans is the first Turkish factoring company which was
established by Iktisat Bankasi in 1988.(16)

Aktif Finans, Heller Factoring, Esfactoring, Turfactoring and
Devir Factoring some other factoring companies that were
established later.(17)

Finally, the worldwide factoring volumes and yearly changes
during 1983 -1991 are shown in **Table I.**

Table I WORLD FACTORING VOLUMES

Years	Factoring Turnover (Billion Dollars)	% Increase
1983	66.9	---
1984	71	6
1985	85.3	20
1986	104.1	22
1987	139.8	34
1988	160.1	14
1989	195.1	21
1990	244	25
1991	266	9

Source: Factors Chain International

15-) Akça, H.Ali, HDTM Bulletin, 1991/3 No:10
16-17-) Para, 09-15/02/1992

2. BASICS OF FACTORING

2.1. Definition of Factoring

Factoring is defined as a contract by which the factor is to provide at least two of the services (finance, the maintenance of accounts, the collection of receivables and protection against credit risks), and the supplier is to assign to the factor on a continuing basis, by way of sale or security, receivables arising from the sale of goods or supply of services.(18)

2.2. Basic Definitions

2.2.1. Disclosed/Undisclosed

A disclosed facility is one under which the supplier's customer is advised of the interest and involvement of the factor. This is invariably done by a legend on the invoice which states that the receivable arising from the invoice has been assigned to or sold to any factor.

An undisclosed (or confidential) facility is one under which the supplier/factor arrangement is not declared to the customer unless or until there is a breach of the agreement on the part of the supplier or, exceptionally, where the factor considers himself to be at risk.

18-) Factors Chain International Report, 1991

2.2.2. Recourse/Nonrecourse

These terms refer to the risks of a customer being unable to meet his obligations, i.e. the credit risk. Under a recourse arrangement the supplier will carry the credit risk in respect of receivables he has sold to the factor. The factor will have recourse in the event of non-payment for whatever reason, including the financial inability of the customer to pay. Effectively the factor has the option to sell back to the supplier any receivable not paid by a customer regardless of the reason for nonpayment.

Under a non-recourse facility the factor assumes the risk of non-payment by those customers credit approved by him, up to the amount of that approval, and subject to the reason for non-payment being solely due to a customer's financial inability to pay.

It should be noted that all factoring facilities are with recourse to the supplier in the event of a receivable proving invalid. For example, if the supplier delivers the wrong product to his customer, the customer is entitled to return the goods delivered and extinguish any obligation to make payment.

2.3- Elements of Factoring

2.3.1. Receivables Management

In a classical factoring form, company sells its trade debts

to a factor. Factor will use the receivables of the supplier as its security and be in charge of operating receivables management for client.

2.3.2. Credit Management (Bad Debt Protection)

This credit management service can be particularly helpful in areas such as international trade where the lack of knowledge of customers and risk of default may be increased.

For companies worried about bad debts, and in particular where the loss of one debt could be catastrophic, this service of 100 percent protection on approved credit sales is invaluable.

2.3.3. Sales Ledger Administration

Having purchased the debts the factor manages them by carrying out all the sales accounting and administration. This often allows management to spend more time running the business and exploiting business opportunities.

2.3.4. Cash Flow Provision

Factoring firms also provide a regular cash flow to companies that may not be in need of prepayments but, instead, would like to receive the payments at the maturity. Factors can provide cash flow either by Fixed Maturity Period (FMP) or by Pay-as-Paid methods.

Fixed Maturity Period (FMP) :

The factors guarantee payment to their supplier a fixed number of days after they have purchased the receivable. The factor will examine the books of his supplier and ascertain the average number of days taken by his customer to pay. The factor will agree to pay his supplier the amount of receivables purchased (less charges) at the fixed maturity period whether or not the customer have paid the factor.

Pay-as-paid :

It is not always possible to determine an average receivable turn, for example in seasonal industries, or where a supplier is selling on varying terms of payment so that the receivable turn depends on the incidence of sales to different customers. In such cases the factor will offer a facility on a pay-as-paid basis,i.e. he will pay the supplier when he is paid by the customer.

2.3.5. Provision of Finance

The provision of finance for working capital requirements is one of the reasons most companies turn to factoring. Factors provide a financial facility which typically allows up to 80 percent of the value of debts to be drawn down by the client. The remaining 20 percent, less charges, is paid over either after a specified period or when the invoice is paid by the client's customer.

2.4- Types of Factoring

2.4.1. Domestic Factoring

This type of factoring agreement is arranged if the supplier and the debtor are making business in the same country.

The domestic factoring contracts cover the outright purchase of the receivables of supplier which arise from the sale of goods or supply of services in the domestic markets.

Depending on the agreement, the factor is to provide some services like prepayment, the sales ledger administration, the collection of receivables and protection against credit risks.

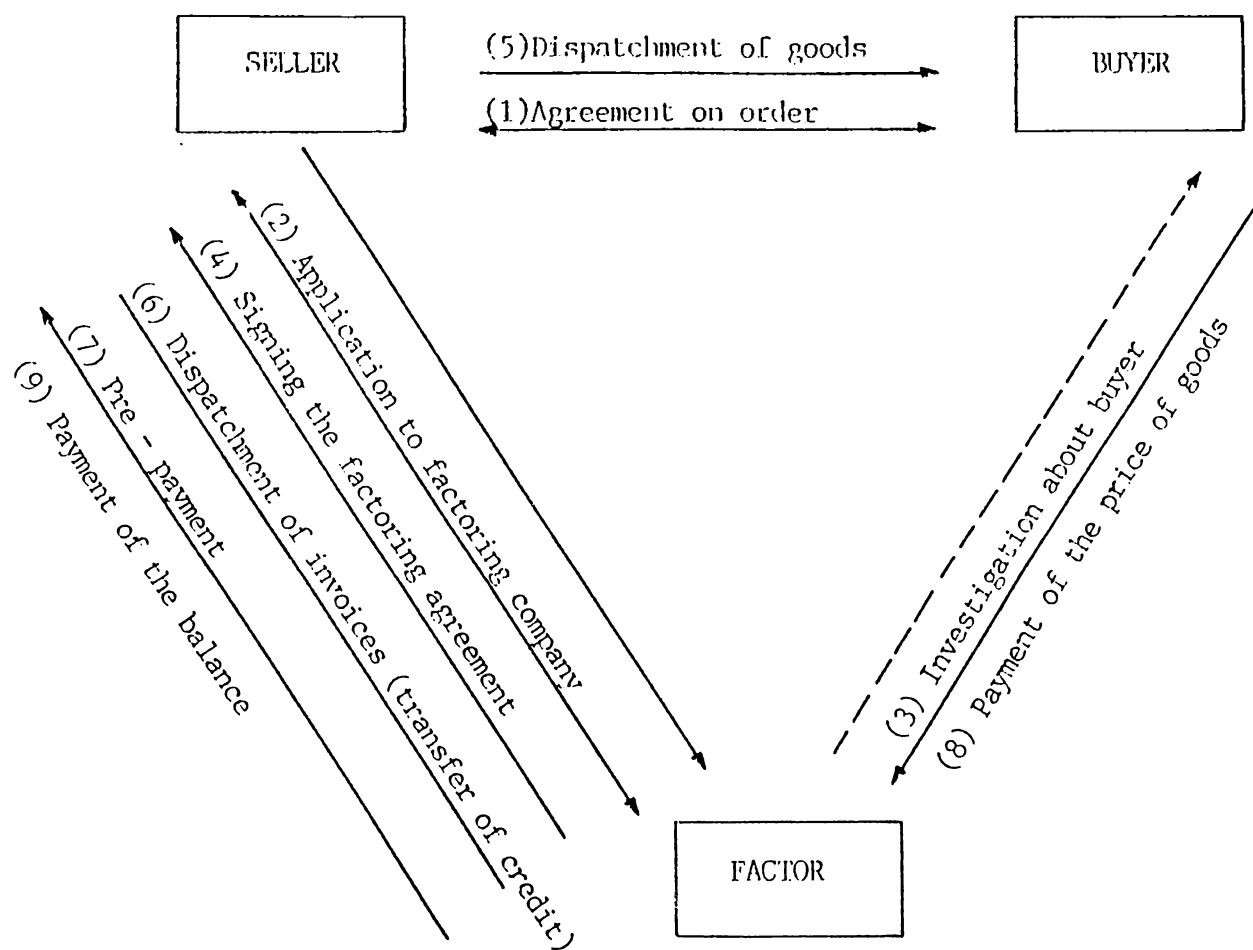
Domestic factoring starts with the supplier assigning to the factor his outstanding receivables. The supplier will also need to provide the factor with details of those receivables including full information about his customers. (the name and address and any other information pertinent to the collection of receivables)

The Factor will make his examination on the supplier's sales ledger and the documents provided, and at the end of his surveys the factoring agreement is made between the Factor and the supplier.(19)

Exhibit 2.1 illustrates the document/transaction flow of a domestic factoring process.

19-) Factors Chain International Report, 1991

Exhibit 2.1. : Document / Transaction flow in domestic factoring



Source : Factors Chain International Report, 1991

2.4.2. International Factoring

The recognition of benefits derived from domestic factoring urged exporters and/or importers to use similar instruments for their businesses. Making business with an entity abroad may be difficult not only because of geographical distances but also the differences in languages, laws, and trade methods.

The factoring industry has extended its facilities for international businesses by providing the full domestic package of credit protection, sales accounting, credit management and finance, by a variety of methods.

The most popular and widely used international factoring types are explained below:

2.4.2.1. Reciprocal Export/Import Factoring

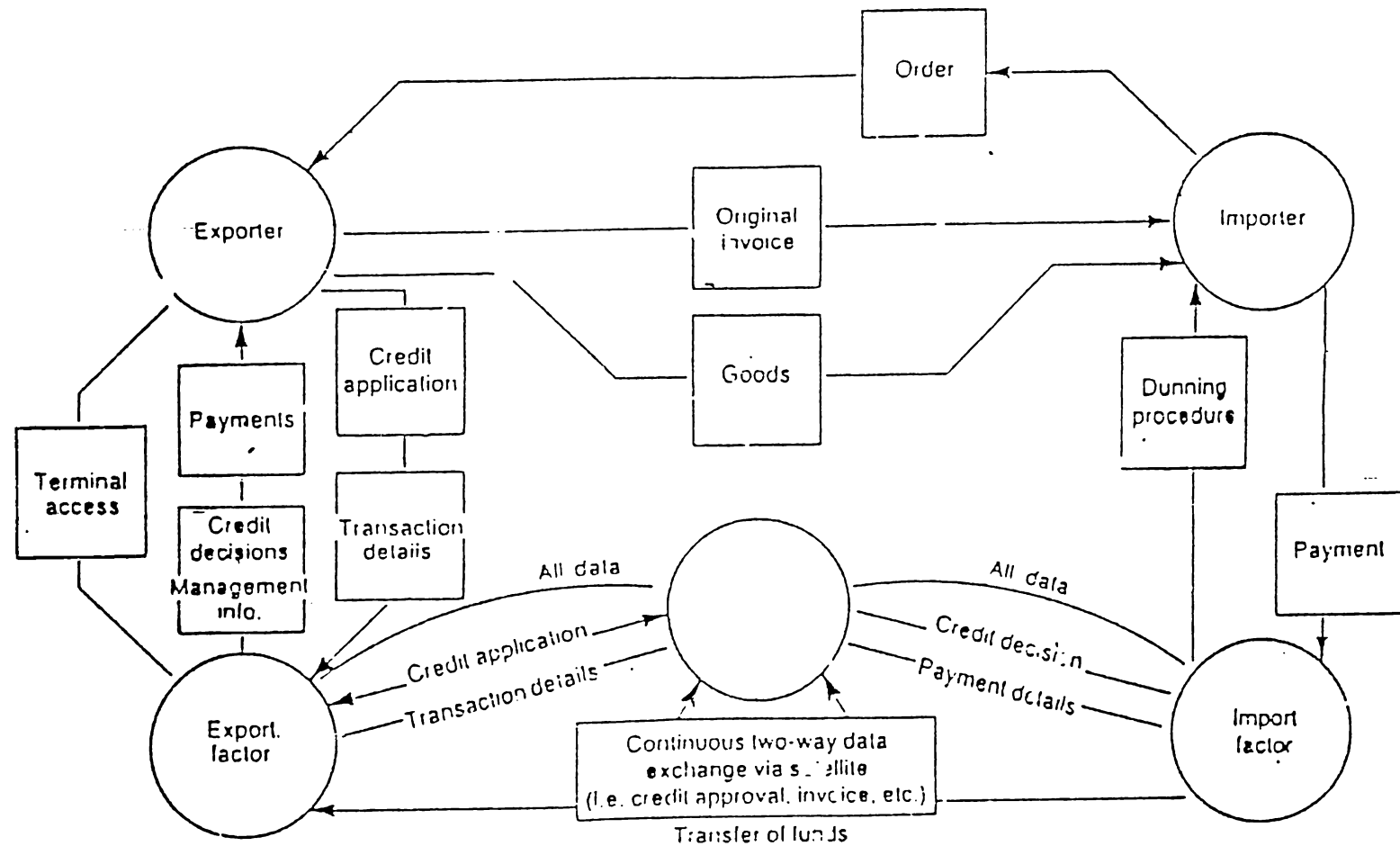
The most common way for a factor to provide facilities for exporters is through a system whereby he will subcontract certain elements of his services to a factor in the importers' countries.

Thus the relationship of supplier - factor - customer is replaced by that of supplier - export factor - import factor - customer.

Exhibit 2.2 illustrates the document/transaction flow of a reciprocal factoring process. (20)

20-) Factors Chain International Report, 1991

Exhibit 2.2 : Document / transaction flow in reciprocal factoring



Source : Factors Chain International Report, 1991

The export factor retains the full legal relationship with his supplier as for domestic business. The supplier does not enter into a legal agreement with the import factor. However, he will be aware of the import factor's part in the transaction and this will be included within the factoring agreement.

The export factor will subcontract the following to the import factor:

- * Underwriting of the trade credit risk of the importer and the undertaking of payment of unpaid receivables by a certain time after maturity.
- * Collection of the receivables from the customer, including any legal action, in the absence of disputes or non-approved debts, will normally be borne by the import factor.
- * The transfer of the funds to the export factor in the currency of the invoice.

2.4.2.2. Single Factoring

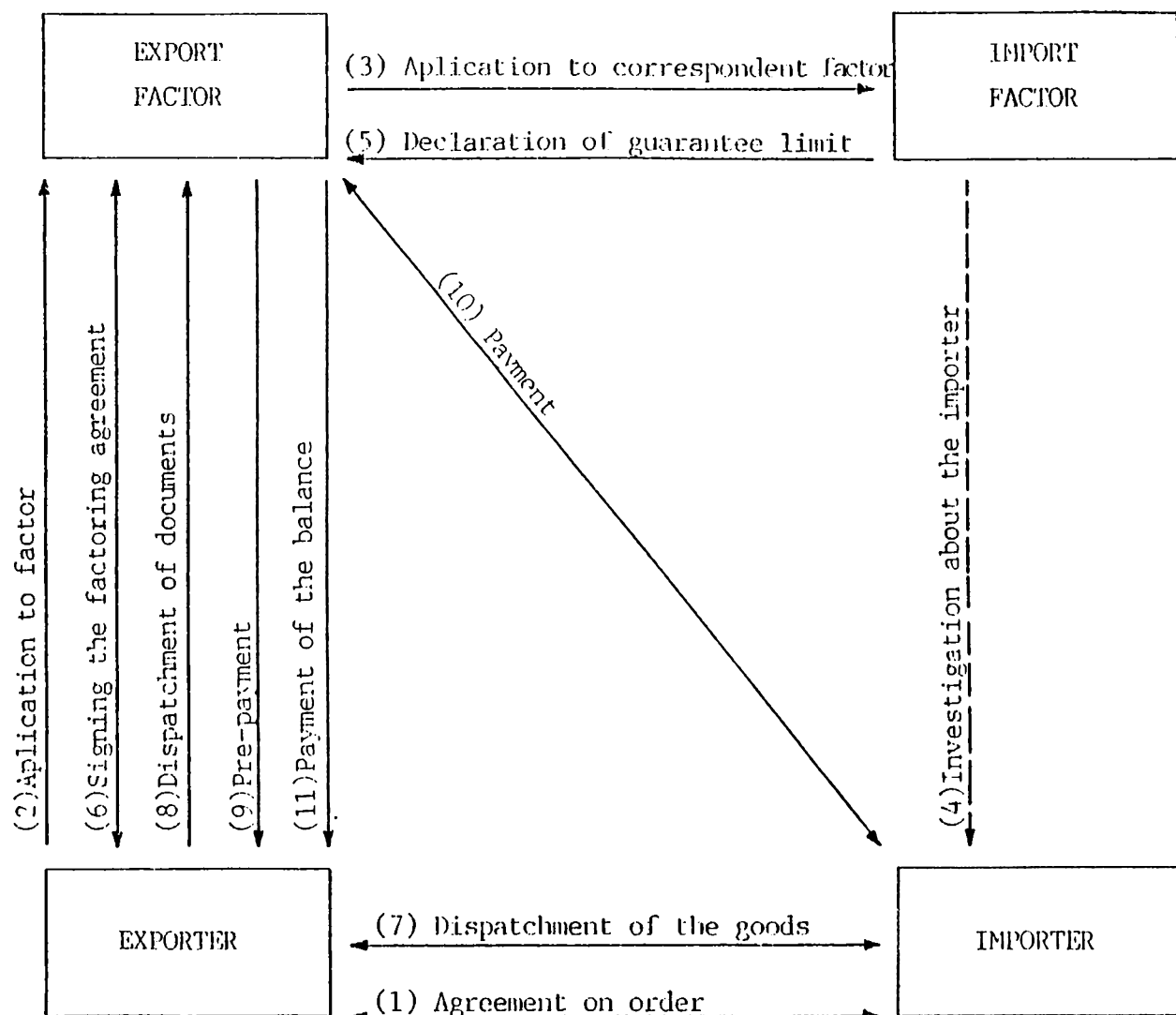
Single factoring is very similar to reciprocal factoring.

It is cheaper than reciprocal factoring since the import factor is involved only when there is a need for trade credit protection or if there is a possibility of late payments.

Export factor is responsible for maintaining sales accounting in single factoring.

On the other hand, if the collections of receivables can not be made in 60 days after the maturity then the receivables

Exhibit 2.3. : Document / Transaction flow in single factoring



Source : Factors Chain International Report, 1991

are assigned to import factor and he will apply for legal action. However, by 90 days after maturity import factor has to make payments.

Exhibit 2.3 illustrates the document/transaction flow of single factoring.

2.4.2.3. Back-to-Back Factoring

This kind of factoring is suitable for companies having a subsidiary abroad through which they sell goods.

The arrangement of factoring agreement between two associated companies is prohibited by factoring legislation. The factors developed back-to-back factoring by which facilities of international factoring can be available for such companies.

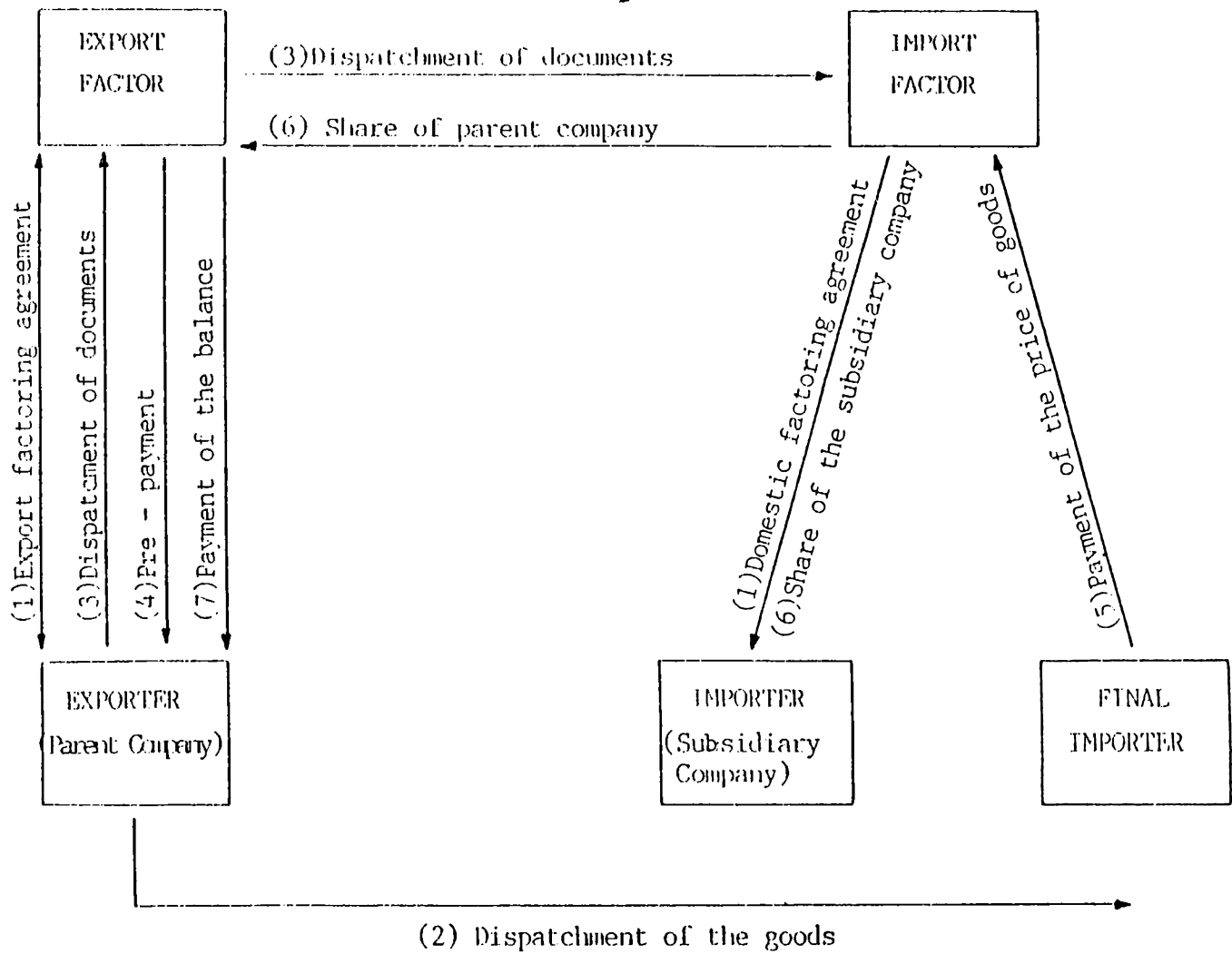
Exhibit 2.4 illustrates document/transaction flow in back-to-back factoring.

Importer (subsidiary of exporter) makes a domestic factoring agreement with the import factor for his domestic sales.

At the same time exporter makes an export factoring with the export factor. By this way the importer eliminates the risks of unpayments.

Then the exporter sends the goods to the subsidiary company and assigns the outstanding receivables to the import factor. The subsidiary company will also assign his receivables arising from his domestic sales to the import factor. (It may be either recourse or non-recourse)

Exhibit 2.4 : Document / Transaction flow in back-to back factoring



Source : Factors Chain International Report. 1991

The export factor makes a prepayment to the exporter.

The import factor, on the other hand, collects the receivables at the maturity from the domestic debtors and pay the exporter and importer.(22)

2.4.3. Agency or Bulk Factoring (Disclosed)

This type of factoring is developed for the companies that may not like their customers to know that they have made a factoring agreement. However, the business may still need credit protection, and the supplier may also consider that the finance provided by a factor is the most efficient form of funding for his business.

In such a case, the factor will purchase the receivables and appoint the supplier as his agent for his collection.

A legend on the invoice will disclose the factor's interest to the customer but instead of instructing him to make payment to the factor it will ask him to send his payment to the supplier which is acting as agent of the factor.

This arrangement has the advantage that the factor's workload and costs in credit assessment are reduced, so reducing the fee for the facility.(23)

2.4.4. Invoice Discounting

Where finance only is required it may alternatively be provided on a non-disclosed basis and this is generally known

22,23 -) Factors Chain International Report, 1991

as invoice discounting, receivables financing, or confidential factoring. Invoice discounting is generally considered to be high risk and will be offered only where the supplier is financially strong.

The purpose of invoice discounting is to provide finance, and the supplier's funding requirements rather than sales accounting and credit management.

The factor will want to ensure he has a reasonable spread of receivables and to minimize his monitoring of the receivables purchased.

2.5 .Risk Assessment

Factoring involves risk. There are the risks associated with financing businesses - the supplier risks - and the risks associated with the non-recourse element of the business where applicable, i.e. the assumption of the credit risk on the customers - the debtor risks.

2.5.1. Common Elements in a Supplier Sought by a Factor

Any factor would like its client to possess the following elements within its company profile when they apply for an arrangement.(24)

- * Good quality product or service
- * Management experienced in their business
- * Good internal control system

24-) Factors Chain International Report, 1991

- * Defined terms of trade
- * No long term contracts
- * No sale or return or consignment selling
- * No stage payments
- * Minimal contra-accounts
- * Assignable debtors
- * Good spread of receivables
- * Growth - the prospect's growth is of major importance in a successful relationship

2.5.2. The Supplier Risk

The factor's assessment has two stages. He needs to satisfy himself as to the viability of his supplier, and then he must consider the quality of receivables he will be purchasing.

2.5.2.1. Viability

The factor must look at the company's past, present and future. The previous operational and financial performance of the supplier will provide useful background information. The factor will also produce an analysis of the company's financial performance by examining its audited financial statements.

This look at the company's history will usually take place at the first contact with a prospective supplier, when the factor will ask for a proposal form to be completed.

The next stage is called survey. The examination of the current financial position of the company provides a base for

assessing its future viability.

2.5.2.2. The Quality of the Receivables

The factor must satisfy himself as to the quality of the receivables because in case of the supplier ceasing to trade the factor will be able to get his money from the factored receivables. The information about the receivables that the factor will seek includes:

2.5.2.2.1. The Spread of Receivables

The supplier must have a reasonable spread of customer, i.e. he should never be dependent on one large customer who, for example, may owe 35 per cent of the receivables. If the customer will fail to remit the payment then the factor will suffer a high loss.

In addition, if such a large customer will cease to purchase goods from the supplier this will affect both supplier and the factor.

2.5.2.2.2. The Incidence of Credit Notes

The factor will look at the credit notes issued during the previous six or twelve months for the causes, the number of notes issued, and their value in relation to total sales. In particular he must look to see if there has been any increase in these notes in recent months, or a predominant reason, such as faulty products, in the immediate past.

2.5.2.2.3. The Receivables Turn

A debt turn shorter than average for the industry can indicate that the prospect is a preferred supplier in the eyes of his customer.

2.5.2.2.4. Receivables to be excluded

Since the factor buys and finance the receivables he should normally exclude the following receivables to protect himself.

- * sales to associated companies, or to companies under common ownership or control.

- * Sales made under consignment or under sale or return conditions.

- * Receivables arising from long term contracts where there is provision for invoices to be raised at agreed stages of completion of the work.

- * sales of products where there is a after-sale obligation on the part of the supplier.

2.5.2.2.5. Seasonal Sales

It is more difficult for the factor to monitor a supplier's performance throughout the year.

2.5.2.2.6. Administration

A factor will look at the sales accounts system to ascertain at which point invoices are raised and from which source documents.

2.5.3. The Debtor Risk

Assessment of the debtor risk is important to both recourse and non-recourse factors where prepayments are involved, for it is from the debtors that the factor expects to receive repayments of his funding. The non-recourse factor has an extra consideration, which is to determine how much he must include in his charge for accepting the credit risk on the debtors.

At the survey stage the factor will extract various items of information to form the basis of his assessment, including:

2.5.3.1. Bad Debt History

This is usually looked at over the previous three years. Assessment comes not only from the percentage, but also from the pattern of the losses.

2.5.3.2. Credit Assessment by the Supplier

The absence of any formal credit checking will inevitably lead to higher losses. The factor must look at the procedures adopted by the prospect in order to assess their influence on the past bad debt performance.

2.5.3.3. Credit Management by the Supplier

The longer a debt is outstanding the harder it is to collect. Examination of the timing of bad debts and the collection procedures of the supplier will reveal whether any losses might have been avoided if a more disciplined collection and

warning system had been adopted.

2.5.3.4. Industry

A well established factor will know the normal bad debt risk in individual industries.

2.5.3.5. Nature of Debtors

The factor will take into account the ease with which credit information can be obtained on the type of organization to whom the supplier sells.

2.5.3.6. Credit Terms

Included in the supplier's customer list may be some to whom he grants extended credit terms, perhaps 30 days longer than normal. As the amounts outstanding will be greater than if shorter terms were used, any bad debts will consequently be higher.

2.5.3.7. Purchasing Pattern

Customers buying regularly every month can be more easily monitored than those buying only every three months or so.

2.5.3.8. Debt Turn

A relatively short debt turn for the industry will usually reduce the factor's perceived risk for that supplier.

2.5.3.9. Future Business

The factor should be able to ascertain if sales growth will result from increased business with existing customers or from additional sales to new customers.

2.6 Advantages and Disadvantages of Factoring

2.6.1. Advantages

Since the firm assigns the collection of receivables to the factor, the risk of buyer not paying does not exist anymore for the firm. However, this is true if there is no conflict in the quality or quantity of goods or services.

As the risk is removed considerably, the firm can act freely.

The quality of the balance sheet is improved with decreased accounts receivables and decreased number of debtors.

Term sales improve the firm's competitive advantage.

Most of the default risks in export business such as economical, political and exchange rate risks are undertaken by the factor.

If full factoring is in consideration, as the sales ledger administration will not be held, the management will have more time to spend on production, marketing and planning. Besides some ambiguities in financial planning will be removed as the payments are received on time.

2.6.2. Disadvantages

The factoring commission fee may be expensive depending on the size of the company. The companies with high volumes of small value invoices may find the cost prohibitive since the factor charges according to the level of throughput related to the value of the business.

Factoring is not available for long term financing purposes. The receivables used in factoring have no long maturity so that the system is not suitable for all kinds of businesses.

Since the system is based upon the receivables, it is not possible to raise loans for projects if the company does not have other activities out of which it can obtain invoices.

3. DATA AND METHODOLOGY

3.1 Problem Definition

1990s will be a new era for trading companies in terms of payment facilities. Traditional methods are being replaced by more secure techniques created by the financial institutions. Banks are still the most secure places for the companies trading both crossboard and domestic. However, institutions like Factors and Forfaiters can play similar role for the businessmen.

By the development of communication, markets are connected to each other and a very challenging environment has been created for almost every industry. Finance industry is one of the sectors where the challenge has created very competitive environment too. Traditional banking is no more sufficient for the businessmen who want to survive and continue to grow with the pressure of high competition. Banks were the first institutions that rapidly adapted themselves to the changes. Introducing of new products like factoring, forfaiting, leasing, different types of loans etc. is the result of this adaptation. (25)

Today's banking is not only to raise loans or keep deposits. Banking is a package of financing services of any kind. Bank managers become the financial consultant of the businessmen and grow together. Banks can do consultancy to the firms by

25-) Para, 09-15/02/1992

offering the products like;
Loans (cash/non-cash),
Deposits(current/term),
Export/Import Financing Alternatives (letter of credit,
letter of guarantee, cash against goods, cash against
documents, sight drafts,etc.),
Treasury Management Products (futures, options, forward,
swap, cap, collar, fra etc.),
Capital Market Unit Products (equities, bonds, notes etc.)

Recently, Bank managers realized that to capture more market share they must find new techniques in addition to the ones listed above. Finally, couple of years ago Turkish firms are offered factoring by using their nonbankable assets (accounts receivables i.e. invoices) as the security for the loans raised. The reason of using factoring may differ depending on the firms' need of funding. However, the reason to offer factoring by banks is only to be able to carry on with the existing customers and not to have additional risks.

Factoring as a promising sector seems to number of people, including many accountants, as a source of funding for the merchandisers in the future.(26) In fact, this is not true at all. Banks with their existing structure are able to be the major source of funding and create new techniques whenever it is necessary.

26-) Dunya, 05.05.1991

In Turkiye, depending on the economic conditions, the main reason for most of the firms to use factoring services is prepayment.(27) In other words, firms come to factoring companies with the aim of raising funds which they can not do by themselves. Because of economical constraints, the customers can not pay their debts in cash and they ask for term sales. Thus, even if a firm can sell all of its products, since it can not collect its receivables on time, it faces liquidity problems. Besides, the inflationary atmosphere decreases the value of receivables if there are delays.

In such a high competitive atmosphere, it is clear that the firms will continue to use factoring as well as other banking products. This will surely urge banks to establish more factoring companies to carry on with their existing or prospect customers to make more profit.

This study attempts to prove that the factoring itself is not an alternative to banking but only a complementary part of trade financing supported by banks. This study also aims to point out that the banks offer factoring in order not to loose their existing customers and to capture more market shares by adding new customers into the existing portfolio.

27-) Para, 15.02.1992

The methodology to be followed in this study is to analyze a company which is an existing customer of a bank. The idea is to understand the company's structure , strengths and weaknesses, existing relations with the banks, projects, and finally the needs of the company. Case study will also include the solutions offered by the bank and the final position of the firm after utilising the solution.

3.2 Data Source and Description

All the data and events are real and the company is the existing customer of Citibank for 2 years.

The Balance Sheets and Income Statements are for the recent three years, namely 1990, 1991, 1992. The Balance sheets and the Income Statements are audited and refined by the bank.

Since the bank would like to keep the names to be confidential all the names used are not real. However, other than names of company, bank, and the third institutions the data presented here is real.

The data source consists of the followings:

1. Balance Sheet (1990 - 1992) (See Table I-A)
2. Income Statement (1990 - 1992) (See Table II-A)
3. Company Profile
4. Company Information Form
5. Customers Profile (Company's Customers)
6. Partnership

7. Management and Organisation Chart
8. Curricullium Vitaes of Partners
9. Company's Property List
10. Partners Property List
11. Recent List of Bank Loans
12. Regular Call Reports (Visits)

3.3 Methodology

To evaluate the global structure of the company, the regular call reports were analysed and the company identification report was prepared.

The Company Identification Report (CIR) includes company's ownership, management style, history, bank relations, trading activities, market share, customers, plants, distribution channels, and competition.

The second step was to do Financial Analysis. The last three years data (Balance Sheet & Income Statement) were analysed and refined. To evaluate the financial structure and the performance of the company certain yardsticks were required. In this analysis, certain accounts and ratios, relating two pieces of financial data to each other, were used as the yardsticks.

In this study, some of the ratios are compared with the past ratios so that the composition of change is studied and the improvements or deteriorations in the financial condition and performance of the firm over time is determined. Not only

ratios, but also raw figures like " net sales" are compared over time, as well.

The financial statements of the company were analyzed from three different perspectives. First perspective was the liquidity and financial stability aspects. Second, profitability and efficiency analysis was made. Finally, the financial structure was examined. Also the trend analysis for net sales and net profits was carried out.

The third step was to analyse the company's projects and credibility for the financial institutions. The most important part of this section was to understand the company's needs and to prepare a package of solution. Call reports, list of bank relations, and the other information were used to complete this part.

3.3.1 Company Identification Report

CM-Machinery Limited was established in 1988 in Ankara. The initial capital of the company was 1 Billion TL and increased to 5 Billion TL in 1991.

CM is mainly doing business with the State Enterprises and supplying many different types of goods and services to those organisations. Major products that the company sells are equipments, machineries, fuel oil, coal, trucks and some agricultural products like corn, wheat etc.

CM Group is composed of the following companies.

CM Machinery Corporation

CM-Ruger Hydrolic Motors Co.

CM Contracting Co.

CM Marketing Co.

Martinelli Limited. (Subsidiary established in Italy)

CM-Ruger has two hydrolic motor plants in Istanbul and Corum. Both of the plants are producing about 2000 motors per year and the turnover of this company in the last year is about 300 Billion TL. CM-Ruger is generally making term sales and almost 85% of the total turnover is obtained by the term sales. So it is a good estimation that the company has 255 Billion TL of accounts receivables in the last year.

Martinelli Limited was established to export different products from Italy and many European countries to Turkiye.

All the companies have their own management and group has no consolidated Balance sheet and Income Statements. However, any kind of business contacts and state relations are carried out by the CM-Machinery and the other companies are responsible to operate the business.

The total turnover of the company was about 390 Billion TL in 1992.

The group is operating in very different markets and facing a lot of competition. However, good contacts with the state and

business world enables the company to be strong in the market. Import of goods like coal, fuel oil and production of hydrolic motors are the major activities of the company and those are the markets where the company is strong.

CM-Ruger Hydrolic Motors Co. has more than 40 agencies all around Turkiye and distributing its products through these agencies.

Bank Relations

CM-Machinery has been carrying out the bank relations for all the group. CM applied many different tenders and generally needs noncash loans (letter of guarantees and letter of credit) for the tenders. Company has credit lines in some of the major Turkish Banks. iş Bankası, Halkbank, Vakıflar Bankası, Garanti Bankası, İktisat Bankası and Citibank are some of the banks where company already has some non cash credit lines. Total credit line of the company in banks is more than 10 million USD.

3.3.2 CM's Project and the Need of Funding

CM-Machinery recently won a tender from a State Enterprise amounted 80 million USD. Project is to supply Hydrolic motors, trucks and import some agricultural and mining products with a certain quality. For this tender, CM took a letter of guarantee amounted 3 million USD. State Enterprise will open a 60 million USD deferred letter of credit in favor of

Martinelli Limited. The letter of credits are to be paid in one year.

CM's Management visited Citibank to discuss the project with the account manager of the bank. State Enterprise and CM are both credible firms to the bank. Project which was evaluated by the bank staff was found to be risky for the Bank's conditions. In summary the project was as follows:

Project was about to provide 458 hydrolic motors, 14 trucks, and 55 million USD amounted wheat and coal to the State Enterprise. Hydrolic motors will be produced in Istanbul and Corum plants. Trucks will be imported from USA and Germany. Wheat will be imported from Canada and coal will be imported from South Africa. For all imports Martinelli Limited is going to work as an exporter so the Letter of Credits will be opened in favor of this company.

Total project will last 20 months. However, CM has to provide the goods on a monthly basis with a time schedule prepared by the State Enterprise previously.

Since the State Enterprise will open 1 year deferred Letter of Credits, CM will be paid in one year after opening of each L/C. State Enterprise will open L/Cs every month and the amount of each one will be about 5 million USD.

CM as the leader of the group reinvests all the income obtained from the activities of the whole group. However,

in order to initiate the 80 million USD amounted project, CM-Machinery needed working capital. CM management forecast the total need of funding as 2.5 million USD.

CM's Bank credit lines were fully occupied. In order to find more credits these lines should be increased. However, CM management would not want to give any more property as a security to the banks. This is why the Banks had to turndown CM. The other reason to turn down CM's request was that Bank has found the project risky and would not like to raise loans for working capital in this specific project.

3.3.3. Financial Analysis

3.3.3.1. Liquidity and Financial Stability Analysis

For analysing and comparing the liquidity and financial stability of the firm, the current ratio, acid-test ratio, collection period, inventory days, cash conversion period were calculated. These ratios and their formulas are listed in **Table II**.

In addition, the net sales of the firm and the net profit for the last three years analysed and the trend was found. The ratios used in this perspective are used to judge CM's ability to meet short-term obligations. In essence, these tests were used to compare short-term obligations with the short-term resources available to meet these obligations.

Table II TESTS OF LIQUIDITY AND FINANCIAL STABILITY

NAME OF RATIO	FORMULA	RESULT AS
CURRENT RATIO	$\frac{\text{CURRENT ASSETS}}{\text{CURRENT LIAB.}}$	RATIO
ACID-TEST RATIO	$\frac{\text{MON. CURR. ASST.}}{\text{CURRENT LIAB.}}$	RATIO
COLLECT. PERIOD	$\frac{\text{DEBTORS}}{\text{NET SALES}} \times 100$	%
INVENTORY DAYS	$\frac{\text{INVENTORY}}{\text{COST OF SALES}} \times 360$	DAYS
CASH CONVERSION PERIOD	$\text{DEBTORS DAY} + \text{INVENTORY DAYS} - \text{CREDITORS DAYS}$	DAYS

The current ratio and acid-test ratio were chosen with the aim of detecting the degree of the cash requirements of the firm.

The debtors-to-sales ratio was calculated to be able to detect percentages of receivables within the net sales. This was found to be important since the higher percentage of receivables in the current assets will enable CM to use factoring.

The cash conversion, collection, and payment periods are also important measures of being able to use factoring.

3.3.3.2. Profitability and Efficiency Analysis

For the analysis of profitability and efficiency part, the net profit ratio together with the return on investment ratio were calculated. Table III lists the ratios and formulas.

Table III TESTS OF PROFITABILITY AND EFFICIENCY

NAME OF RATIO	FORMULA	RESULT AS
RETURN ON INVESTMENT	$\frac{\text{NET PROFIT}}{\text{TOTAL NET ASSETS}}$	%
NET PROFIT RATIO	$\frac{\text{NET PROFIT}}{\text{NET SALES}}$	%

The return on investment ratio is the most important measure of the performance as it indicates the comparative efficiency with which the whole company is run. This ratio was selected because it measures the earning power of the total permanent investment in the company.

The net profit ratio was calculated to reflect the profit potential of the firm after allowing for the marketing, distribution and administrative expenses.

3.3.3.3. Financial Structure Analysis

In the analysis of financial structure, the mix of the debt and equity finance used in capital structure was tested by the debt-equity ratio. **Table IV** shows the ratio and formula.

The debt-equity ratio was calculated since the ratio includes CM's both short and long term debts. Short term debt is riskier than long term debt because the interest and principal are both usually due and payable within a year. As this ratio rises, the financial risk increases.

Table IV TEST OF FINANCIAL STRUCTURE

NAME OF RATIO	FORMULA	RESULT AS
DEBT-EQUITY RATIO	$\frac{\text{TOTAL DEBT}}{\text{STOCKHOLDER'S EQ.}}$	%

3.3.4. Results

The results of the financial analysis which are summarized in **Table III-A** can be classified as;

(1) the results related to size of the company, (2) results related to the profitability of the company, (3) results related to the liquidity of the company and finally (4) the results related to the financial structure of the company.

3.3.4.1. The Results Related to Size

The net sales of CM in the last three years has increased significantly. 11.3 Billion TL of net sales in 1990 has increased by 316.6 % to 47.3 Billion TL in 1991. In 1992 there was only 7.4 % increase in net sales, it turned out to be 50.8 Billion TL. The revenues obtained are generally made up of the sale of coal, wheat and corn. So the overall performance of the CM group can not be figured out from the existing data.

The net profits comparing to the net sales are very low. The profit of the CM-Machinery in 1990 was 131 million TL only and it increased by 111% in 1991 to 277 million TL. The net profit in 1992 was increased to 429 Million TL by 55%.

The total assets of CM was 1.7 Billion TL in 1990 and increased by 263.8% in 1991 to 6.4 Billion TL. The total assets in 1992 was 16.3 Billion TL. This is another measure of growing of CM.

3.3.4.2. The Results Related to Liquidity and Efficiency

The Current Ratio of CM decreased to 1.24 in 1992 comparing it to 2.19 in 1990. However, the acid-test ratio followed a stable trend during the last three years and it became 0.68 in 1992. The 1990's figure was 0.69 and 1991's figure was 0.72.

3.3.3.3. Financial Structure Analysis

In the analysis of financial structure, the mix of the debt and equity finance used in capital structure was tested by the debt-equity ratio. **Table IV** shows the ratio and formula.

The debt-equity ratio was calculated since the ratio includes CM's both short and long term debts. Short term debt is riskier than long term debt because the interest and principal are both usually due and payable within a year. As this ratio rises, the financial risk increases.

Table IV TEST OF FINANCIAL STRUCTURE

NAME OF RATIO	FORMULA	RESULT AS
DEBT-EQUITY RATIO	$\frac{\text{TOTAL DEBT}}{\text{STOCKHOLDER'S EQ.}}$	%

3.3.4. Results

The results of the financial analysis which are summarized in **Table III-A** can be classified as;

(1) the results related to size of the company, (2) results related to the profitability of the company, (3) results related to the liquidity of the company and finally (4) the results related to the financial structure of the company.

Collection period of CM is moderately low but followed an increasing trend parallel to the increases in net sales. In 1990 CM was able to collect the receivables in 7.5 days. However, this figure was 16.6 days in 1991 and it became 47.6 days in 1992.

The other measure of liquidity and also efficiency is the cash conversion period. The figure was 3 days in 1990 and it became -4.9 days in 1991 and -5.7 in 1992. Minus sign is the indicative of paying the debts later than the collection of receivables.

3.3.4.3. The Results Related to Profitability

Net Profit Ratio of CM is considerably low. The net profit of CM was 1.2 % of the total sales in 1990. The figure was 0.6 % in 1991 and 0.8 % in 1992.

Similar to the Net profit ratio, Return on investment of CM is also low and followed a decreasing trend during the last three years. In 1990 the Return on Investment ratio was 7.4 %. However, the ratio decreased to 6.8 % in 1991 and became 3.8 % in 1992.

3.3.4.4. The Results Related to Financial Structure

Debt to Equity Ratio is calculated to find the total liabilities to the stockholder's equity. The ratio is very low and showing that the operations are financed generally by the capital. The ratio was 0.3 in 1990. 1991's figure was 1.0

and it become 1.9 in 1992.

The net worth of the company has followed an increasing trend in the last three years. 1.3 billion TL was the 1990's networth figure. In 1991 it became 3.3 billion TL and turned out to be 5.6 billion TL in 1992. However, the increase in net worth is generally provided by the capital increases.

3.3.5. Discussions

The results of the financial analysis led to the following conclusions about the financial structure and performance of CM-Machinery.

The size of CM is growing regularly in terms of total sales and total assets. The general trend shows that CM is promising to grow to be a medium sized company.

The net profit figures are yearly increasing. However, the increase in the profit figure is not parallel to the increase in sales. This finding indicates that although the company is growing, it is not able to generate as much profit.

The current ratio and acid-test ratio both the measures of the liquidity of CM. The ratios are not so high but the stable level of acid test ratio is an indicator of CM being able to overcome the liabilities by the use of its current assets. One of the main reason of decrease in the liquidity ratios is the increase in the collection period. However, In the trade business in order to have a big increase in sales,

many firms prefer term sales.

The proof of the strong liquidity and efficiency of CM, despite all above, is the cash conversion periods. CM is able to sell the goods and collect the receivables before it pays the debts. This enables CM to run the business without getting into cash problems.

The net profit ratios and return on investment ratios show that the company is not profitable. Such low figures are good indicators of not raising big amount of loans to CM since the profit margins are not sufficient to pay the loans back on time.

CM management generally finance their activities by their own capital. The main reason of this, as explained above, firm is not able to have higher leverage. Debt to equity ratios are so small and the networth of the company is increased by the increases in the capital generally.

3.4. Decision

After reviewing of the financial analysis and the other studies about the credibility of CM, Bank's management have decided not to create more risks by raising loans to the company.

The low profitabilty of CM was one of the key factors that led the Bank's Management to decide not to raise loans. CM, in fact, a very fast growing company. However, considering the

information supplied by CM, it is clear that the company is getting difficulties to make higher profits. The low level of profit may not be enough to make CM able to pay the loans back on time.

Similar to profitability, a very low rate of return obtained from the investments, is another indicator of running the business inefficiently. One may also conclude that the company may not increase its sales and assets unless it works with a very low profit margin. The low profitability and inefficiency are very important indicators of danger for raising loans to CM by the Bank's Credit marketing Department.

The other key factor to turndown CM was the low debt to equity ratio. In fact, for many bankers, the low ratios are preferable. However, this low figures in this case are the indicators of not having the capacity of carrying higher leverage. CM's bank relations are also supporting this conclusion. Most the bank loans obtained are noncash like letter of guarantee and letter of credit. This means that CM would not have more financing expenses like interest other than the commissions of letters taken from banks. Taking loans will change the financial structure of the company and current profit margin will not be sufficient to handle financing expenses.

Bank staff also considered the higher investments as a negative point for raising loans. The Bank's loan strategy

will not allow to fund the companies for their investments. The reason of such a strategy is to know that the investments will pay back in a longer term. However, Citibank generally funds itself by short term loans taken abroad.

Despite above all, there are some positive points in the financial structure of the company. The liquidity and higher growing potential are also considered by credit marketing group and found to be worth to find an alternative for CM. CM has no difficulty to collect its receivables on time. Moreover, The collection period is only 47 days and it is considerably low in the markets where all the competitors are making term sales.

3.5. Solution

CM-Machinery needs 2.5 million USD in order to initiate the project. The money will be used to make the first shipment of the coal from S. Africa. The miners in this country are small companies and are not able to make term sales more than 15 days. The transportation company in S.Africa also would like to be paid in cash.

The Banks Credit Marketing Group offered CM a solution. The plan was composed of four steps.

1st Step:

CM will ask the State Enterprise to open the first letter of credit in Citibank.

The total value of the L/C will be 5 Million USD.

The Bank will get 2% commission over the total value of the L/C.

The L/C will have a maturity of 1 year.

CM will discount the L/C abroad in a bank which Citibank will decide.

2nd step:

CM-Machinery will factor the invoices from the sale of hydrolic motors by CM-Ruger Hydrolic Motors Co.

Citibank will arrange the factoring agreement with its subsidiary Citifactoring in Istanbul.

The factoring commission will be 1% over the total volume of invoices. The total volume of invoices will be equivalent of 3.125 Million USD.

Citifactoring will arrange an Undisclosed Domestic Factoring and immediately pay 80% of the total value of invoices to CM.

The interest rate applied for the prepayment will be 3 % more than Citibank's interest rate.

3rd Step:

CM will buy 2.5 Million USD from Citibank and transfer this

money to S.Africa to the accounts of Miners and the Transportation Company.

Since at the same time CM will buy the goods and send to Turkiye the L/C will be valid and CM will be able to discount the L/C in the Bank that Citibank will decide.

Citibank will find a bank abroad which will discount the L/C with the best price for CM. The indicative rate of discount will be $\text{libor} + 0.5$.

4th step

CM will pay back the loan raised by the factoring company
In the next month the second L/C will be opened by the State Enterprise at any bank. CM will pay the miners and the transporters with the remainder of the revenue obtained from the first shipment.

Final Step:

In the third month most of the receivables factored will be paid and CM will get a working capital.

3.6. Application

CM management accepted the plan prepared by the Citibank's Credit Marketing Group. The project financing plan took place in more than 3 months.

January 13, 1993

Bid/Offer Cross rate for 1 \$ = 8796/8813 TL

- * Citibank opened a 1 year deferred Letter of Credit in favor of Martinelli Limited.
- * The total value of Letter of Credit was \$ 4.814.000.
- * L/C commission was 2% over the total value.
- $\$ 4.814.000 * 0.02 = \$ 96280$
- * State Enterprise paid 1/4 of the commission at the opening and remainder would be paid quarterly.
- * The total cost of 1st L/C at the opening for SE:

L/C commission = 1/4 * 96280 * 8813	= 212.100.000 TL
Other charges & expenses	= 178.600.000 TL
Total	= 390.700.000 TL

January 22, 1993

Bid/Offer Cross Rate for 1 \$ = 8879/8896 TL

- * While SE opened the 1st L/C, CM-Machinery applied Citifactoring for an Undisclosed Domestic Factoring.
- * CM-Machinery forwarded all the necessary documents (Balance Sheet, Income Statement, List of Customers of CM-Ruger Hydrolic Motors Co., Invoices etc.) to Citifactoring.
- * Average maturity of invoices was 83 days and total value was 35.6 Billion TL.
- * Following the analysis of all the documents, Citifactoring decided to make an agreement with CM-Machinery.
- However, Citifactoring accepted only 30.63 Billion TL

amounted invoices to be factored.

* Citifactoring charged 1% factoring fee over the value of invoices to be factored and accepted to pay 80 % of total value as prepayment to CM-Machinery.

* The cost of factoring agreement composed of ;

Factoring Fee = 306.300.000 TL

Other charges = 183.800.000 TL

Total 490.100.000 TL

* Citifactoring applied 81 % interest rate for prepayment.

Prepayment : 80 % * 30.63 Billion TL = 24.504.000.000 TL

Less charges: 490.100.000 TL

Prepayment (Net) : 24.013.900.000 TL

Citifactoring paid CM totally 24 Billion TL.

* CM converted 24 Billion TL into \$ 2.697.842 at Citibank.

* CM transferred \$ 1.963.778 to the accounts of Miners and \$ 347.800 to the accounts of Transportation Company in S.Africa. The remaining \$ 386.264 was kept in CM's current account at Citibank.

February 4, 1993

* Following the shipment of coal, Martinelli Limited presented the documents to Banco Di Roma, the correspondent bank of Citibank.

* Banco Di Roma confirmed the validity of L/C and advised CM

through Citibank.

* CM discounted the L/C at Banco Lariano with a discount rate of Libor+0.5. (Libor for 1 year was 3.4375)

Banco Lariano paid \$ 4.631.630 to Martinelli Limited.

($1/1.039375 * \$ 4.814.000 = \$ 4.631.630$)

February 8, 1993

Bid/Offer Cross Rate for 1 \$ = 9126/9144 TL

Martinelli Limited transferred \$ 4.631.630 to the accounts of CM at Citibank.

* Between 22/01/1993 and 08/02/1993 Citifactoring charged 972 Million TL interest expense for prepayment.

Principal	:	24.000.000.000 TL
-----------	---	-------------------

Interest Expense	:	972.000.000 TL
------------------	---	----------------

Tax (5% over interest expense)	:	48.600.000 TL

Total	:	25.020.600.000 TL
-------	---	-------------------

CM converted \$ 2.741.683 into 25.020.600.000 TL and transferred it to the accounts of Citifactoring and closed the prepayment and interest expenses.

The remainder \$ 1.889.947 transferred CM's current account and the balance of this account became \$ 2.276.211.

February 23, 1993

Bid/Offer Cross Rate for 1 \$ = 9169/9187 TL

SE opened another 1 year deferred L/C in favor of Martinelli

Limited at Citibank.

The total value of L/C was \$ 4.685.000

All the conditions were as same as the 1st L/C and SE paid totally 396.4 Million TL.

L/C commission : 215.200.000 TL

($1/4 * 4.685.000 * 0.02 * 9187$)

Other charges & tax: 181.200.000 TL

Total : 396.400.000 TL

February 25, 1993

Bid/Offer Cross Rate for 1 \$ = 9177/9195 TL

CM transferred \$ 1.912.450 to the accounts of Miners and \$ 331.513 to the accounts of Transportation Company in S.Africa from its current account at Citibank and the balance of this account decreased to \$ 32.248.

March 5, 1993

The second shipment of coal was made from S.Africa & the documents presented to Banco Di Roma.

Following the confirmation of validity of L/C, Martinelli Limited discounted it again at Banco Lariano with a discount rate of $\text{libor} + 0.5$. Libor for 1 year was 3.4312.

Banco Lariano paid Martinelli \$ 4.507.790.

($4.685.000 * 1/1.039312 = \$ 4.507.790$)

March 9, 1993

Martinelli transferred 4.507.790ⁱ to the accounts of CM at Citibank.

April 22, 1993

Citifactoring collected 13.61 Billion TL from the customers of CM and transferred it to the accounts of CM at Citibank. CM transferred all the money into CM-Ruger Hydrolic Motors Co.'s account at Iktisat Bankası.

Since CM stabilized its cash flow following the 2nd. L/C, they solved their working capital problem and continue to carry out the project.

4. CONCLUSION

One of the aim of this study was to give a brief overview of factoring as a financial tool and to find out the reasons that the firms apply for factoring considering their financial conditions and performances.

It is sure that the advantages of factoring are valued only when it is used by the " right " firms with the suitable type of factoring, depending on the need of company. A sales ledger administration service may be too costly for a small firm with thousands of small invoices or a large company may not need insurance of credit.

On the other hand, if factoring is utilized efficiently, the advantages seem to outweigh the disadvantages.

In order to appreciate the results of this study correctly, the major limitation to the study should be considered. The results are obtained from the analysis of a situation which includes only one company. However, considering the general structure of the company, the firm fulfilled all the requirements for being a candidate for a use of factoring as a source of funding.

Keeping in mind the limitation to the study, the evidence showed that the majority of the firms utilizing factoring are small to medium sized firms which are growing fast and in need of cash because of over-trading. They are allowing the level of business to expand with an inadequate financial

base. Therefore, they have undertaken high liabilities causing high financial risks in case of decline in profitability.

The study shows that these firms are in general beneficiaries of factoring services. The factoring service can help these firms to collect their receivables and to improve their liquidity by providing prepayments.

The other aim of this study was to prove that factoring itself can not help the companies to grow healthy.

Sometimes the factoring industry and banking community are erroneously viewed as competitors. In reality, a bank and a factor complement each other. Any company with financial strength, assets, and stability that a bank would require is not a viable candidate for factoring. Factors readily admit it is not possible for them to compete with a bank based strictly on cost of money.

A factor fills a different niche than a bank does. When a company no longer fits the factoring client profile, referral to a bank is appropriate. The same reasoning applies when a bank cannot help a customer. When the bank provides an alternative for customers they have to turn down, the customer gets the funding needed, the bank is still attending to its customers' needs, and the factor provides assistance that was not available through traditional financing. A factor is really an incubator for a business to help it

through transitional times. Once the company is a viable candidate for bank financing, the bank will have a new customer with a proven track record.

A factor can offer unique solutions for what are often serious issues for a bank. In today's environment, banks are more selective when providing capital for a business. Unless the business meets the criteria established by the bank, the only alternative is a turn down. This can have a serious effect on the bank-customer relationship and can mean loss of future business. A turn down is difficult, and when there is no alternative offered, it can be frustrating for a bank customer.

If a banker can offer the customer a viable alternative, there is a better chance he can maintain a depository relationship. This is when a referral to a factor can be in the best interest of both the bank and the customer. A factor can provide a company with the needed capital to get it through transitional periods until it becomes bankable. In addition, the bank wins because the relationship has been maintained.

REFERENCES

- 1- Figgis, P., Senior Manager in Price Waterhouse
- 2- Batchelor,C., Financial Times, 04/04/1991
- 3- Emen. I., Para, 09-15/02/1992
- 4- Seval, S., Dunya, 05/09/1991
- 5- Iplikçioğlu, L., Seminar on Factoring and Its Türkiye Application, 20/06/1991, İzmir
- 6- Kırım, A., Seminar on Factoring and Forfeiting, 27-28/03/1992, Interbank, İstanbul
- 7- Onel, Aykut, ISO Dergisi, Başlangıcından Bu Yana Factoring Sisteminin Evrimi, Mayıs 1991, s. 47-53
- 8- Leo-Binder Degenschild Dr, The Development of Modern Factoring, 1983, pp 2
- 9- Le Toux J, Factoring Contracts, pp 40
- 10- Hart,David, Factoring: A lender's option, Journal of Commercial Bank Lending, v73n12 PP:36-41 August 1991
- 11- Factors Chain International, Seminar Notes, Netherland, 1989
- 12- FCI-The International Factoring Report 1990
- 13- Para, 9-15 February, 1992
- 14- Akca,H.Ali, İhracatın finansmanında factoring ve Türkiye uygulaması, Hazine ve dış ticaret dergisi,1991/3 No:10
- 15- Some daily papers
- 16- Ekonomist, 12-4-1992, Year:2, No:15
- 17- Tanay,Ferruh, Factoringin katkısı, Panorama, Nov.1990

18- Tanay, Ferruh, Dünya, April 25, 1991

19- Arat, Hasan, Dünya, April 25, 1991

APPENDIX

Table I-A BALANCE SHEET

THE FIRM: CM MACHINERY CO.		(MILLION TL)		
YEAR DATE	1990 31/12	1991 31/12	1992 31/12	
CASH	64	59	655	
MARKETABLE SECURITIES				
ACCOUNTS RECEIVABLES	236	2,182	6,719	
INVENTORIES	206	417	3,718	
OTHER ACCOUNTS RECEIVABLES	33	1,912		
OTHER CURRENT ASSETS	411	50	2,272	
TOTAL CURRENT ASSETS	950	4,620	13,364	
PROP., PLANT, EQUIPMENT	791	1,728	1,764	
LONG TERM ACC. RECEIVABLES			1,225	
INTANGIBLE ASSETS	18	52	16	
INVESTMENTS				
TOTAL ASSETS	1,759	6,400	16,369	
CURRENT LIABILITIES		68	2,374	
ACCOUNTS PAYABLE	346	3,052	8,179	
ACCRUED EXPENSES	64	2		
TAXES PAYABLE				
OTHER LIABILITIES	24		226	
TOTAL CURRENT LIABILITIES	434	3,122	10,779	
LONG TERM LIABILITIES				
TOTAL LIABILITIES	434	3,122	10,779	
PAID-IN CAPITAL	1,000	2,500	5,000	
RETAINED EARNINGS	385	838	650	
(-) ACCUMULATED LOSSES	(60)	(60)	(60)	
TOTAL SHAREHOLDER'S EQUITY	1,325	3,278	5,590	
TOTAL LIAB. AND EQUITY	1,759	6,400	16,369	

Table II-A INCOME STATEMENT

THE FIRM: CM MACHINERY CO.		(MILLION TL)		
YEAR DATE	1990 31/12	1991 31/12	1992 31/12	
NET SALES	11,354	47,305	50,802	
COST OF SALES	11,200	45,799	41,295	
OPERATING EXPENSES	572	1,099	10,779	
AMORTISATION	151	329		
OTHER OPERATING EXPENSES	116	6	5,713	
OPERATING INCOME	(685)	72	(6,985)	
OTHER REVENUES	816	205	7,414	
OTHER EXPENSES				
INCOME BEFORE INT. AND TAX	131	277	429	
INTEREST EXPENSES				
INCOME BEFORE TAX	131	277	429	
TAX				
NET INCOME	131	277	429	

Table III-A FINANCIAL ANALYSIS

THE FIRM: CM MACHINERY CO.

YEAR DATE	1990 31/12	1991 31/12	1992 31/12
IMPORTANT ITEMS (MILLION TL)			
NET SALES	11,354	47,305	50,802
OPERATING INCOME	(685)	72	(6,985)
NET PROFIT	131	277	429
TOTAL SHAREHOLDER'S EQUITY	1,325	3,278	5,590
TOTAL ASSETS	1,759	6,400	16,369
NET WORKING CAPITAL	516	1,498	2,585
YEARLY GROWTH (%)			
NET SALES		316.6	7.4
OPERATING INCOME		(110.5)	(9,801.4)
NET PROFIT		111.5	54.9
TOTAL ASSETS		263.8	155.8
IMPORTANT RATIOS (%)			
NET PROFIT/NET SALES	1.2	0.6	0.8
NET PROFIT/TOTAL ASSETS	7.4	6.8	3.8
OPERATING INC./NET SALES	(6.0)	0.2	(13.7)
TURNOVER			
NET SALES/TOTAL ASSETS	6.5	11.6	4.5
COLLECTION PERIOD (DAYS)	7.5	16.6	47.6
INVENTORY TURNOVER (DAYS)	6.6	2.4	18.0
PAYMENT PERIOD (DAYS)	11.1	24.0	71.3
CASH CONV. PERIOD (DAYS)	3.0	(4.9)	(5.7)
CURRENT RATIO	2.19	1.48	1.24
ACID-TEST RATIO	0.69	0.72	0.68
DEBT			
DEBT-EQUITY RATIO	0.3	1.0	1.9