WORKING CAPITAL FINANCE

ABM Module C Chapter 19 By Ashish Sir

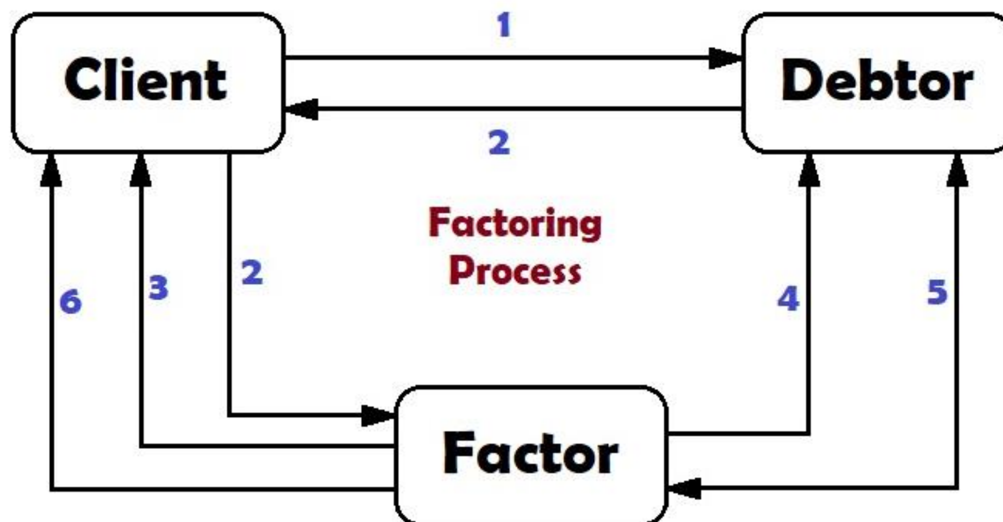
� FACTORING (ACCOUNTS RECEIVABLE FINANCING) �

� What is Factoring? �

Factoring, also known as **accounts receivable financing** or **debtor financing**, is a method where a company (client) **sells its outstanding invoices (receivables) to a financial institution (factor) at a discount** to receive **immediate cash**.

� **It helps businesses improve cash flow** by getting funds upfront instead of waiting for customer payments.

� **Banks cannot directly provide factoring services**, but they can promote **subsidiary companies** to do so.



� Parties Involved in Factoring �

ING SESSIONS

? Party	? Role
Debtor (Buyer) ?	Purchases goods/services **on credit** and must pay after the credit period ends.
Client (Seller) ?	Sells goods/services **on credit terms** to the debtor.
Factor (Financier) ?	A financial institution that **buys receivables at a discount** and collects payments from debtors.

? Example:

- **Company A (Client)** sells **₹10 lakh worth of goods** to **Company B (Debtor)** on **60-day credit**.
- **Company A needs cash immediately**, so it sells the receivable to a **Factor (NBFC or Financial Institution)** at **a discount of 5%**.
- The **Factor pays ₹9.5 lakh upfront** to **Company A** and later **collects ₹10 lakh from Company B**.

? How Factoring Works? ?

? Step	? Process
1 Seller Provides Goods/Services ?	The **Client (Seller)** sells goods/services to the **Debtor (Buyer)** on **credit terms**.
2 Factor Purchases Receivables ?	The **Client sells invoices (accounts receivable)** to the **Factor** at a discount.
3 Factor Provides Instant Cash ?	The **Factor pays the Client** immediately (after deducting a small discount).
4 Factor Collects Payment ?	The **Factor collects full payment** from the **Debtor** when due.

? Example:

LEARNING SESSIONS

- **An export company** ships goods worth **₹50 lakh** to an overseas customer.
- Instead of waiting **90 days for payment**, the **company sells its invoice** to a **Factoring Institution at a 4% discount**.
- The **company receives ₹48 lakh immediately**, and the **Factor collects ₹50 lakh from the buyer after 90 days**.

? Types of Factoring ?

? Type	? Description
Recourse Factoring ?	The **seller bears the risk** if the buyer **fails to pay**.
Non-Recourse Factoring ?	The **Factor bears the risk** of **non-payment**.
Domestic Factoring ?	Both **seller and buyer are in the same country**.
International Factoring ?	The **seller and buyer are in different countries**.
Invoice Discounting ?	The **Factor gives a loan against receivables** instead of buying them.

? Example:

- In **Recourse Factoring**, if the buyer **does not pay**, the seller **must return the amount** to the Factor.
- In **Non-Recourse Factoring**, if the buyer **defaults**, the **Factor bears the loss**.

? Advantages of Factoring ✅

LEARNING SESSIONS

CAIIB 2.0 ALL PDFs and Videos https://iibf.info/caiib

? Advantage	? Benefit
Improves Cash Flow ?	Businesses get **immediate funds** instead of waiting for payments.
Reduces Credit Risk ?	In **Non-Recourse Factoring**, the **Factor takes the risk of non-payment**.
No Collateral Required ?	Factoring is **secured by receivables**, so **no additional collateral is needed**.
Focus on Business Growth ?	Businesses can use the **funds for expansion** instead of waiting for payments.

? Example:

- A small business **gets ₹5 lakh in cash immediately** from factoring instead of waiting **3 months for customer payment**.
- The business can **buy raw materials, pay salaries, and expand faster**.

? Summary Table ?

? Category	? Details
Definition ?	Selling **accounts receivables (invoices)** at a discount for **instant cash**.
Parties Involved ?	**Debtor (Buyer), Client (Seller), Factor (Financial Institution)**.
Key Feature ?	**Immediate liquidity** without waiting for customer payments.
Types ?	**Recourse, Non-Recourse, Domestic, International, Invoice Discounting**.
Risk Management ?	In **Non-Recourse Factoring, Factor bears non-payment risk**.
Calculation Example ?	₹20 lakh invoice at **6% discount → Seller gets ₹18.8 lakh, Factor earns ₹1.2 lakh**.

? Conclusion ?

? **Factoring helps businesses** get **quick funds without taking loans**.

? **Reduces credit risk** in **Non-Recourse Factoring**.

LEARNING SESSIONS

CAIIB UPDATES. WHATSAPP CAIIB Group to 8360944207

? **Useful for exporters** and companies with **long payment cycles**.

? **Banks cannot directly do Factoring**, but they can **set up subsidiaries** to manage Factoring services.

? FORFAITING (EXPORT RECEIVABLE FINANCING) ??

? What is Forfaiting? ?

Forfaiting is a financing method where an **exporter sells their medium- and long-term receivables (export bills) to a financial institution (forfaiter) at a discount** on a **non-recourse basis**.

? Key Features:

? **Exporter receives 100% upfront payment** from the **forfaiter**.

? **No risk for the exporter**—if the importer defaults, the forfaiter bears the loss.

? **Used for medium & long-term trade receivables** (beyond 6 months).

? **No collateral or guarantees required from the exporter**.

? **Example:**

- **Company A (Indian Exporter)** sells **₹10 crore worth of machinery** to **Company B (Foreign Importer)** with a **3-year credit period**.
- Instead of waiting **3 years for payment**, **Company A sells the receivable to a forfaiter at a discount of 6%**.

LEARNING SESSIONS

- **Company A gets ₹9.4 crore immediately**, and the **forfaiter collects ₹10 crore over 3 years** from the **importer**.

? How Forfaiting Works? ?

? Step	? Process
1 Exporter Sells Goods ?	The **exporter (seller)** sells goods/services on **credit terms** to the importer.
2 Exporter Sells Receivable to Forfaiter ?	The **exporter sells the receivable (bill of exchange/promissory note) to a forfaiter** at a discount.
3 Forfaiter Provides Instant Cash ?	The **forfaiter pays the exporter upfront (after deducting a discount)**.
4 Forfaiter Collects Payment from Importer ?	The **forfaiter collects full payment from the importer** over time.

? Example:

- An Indian **automobile manufacturer** exports **cars worth ₹50 crore** to a foreign dealer with a **5-year credit term**.
- Instead of waiting **5 years**, the **manufacturer sells the receivable to a forfaiter** at a **7% discount**.
- **The manufacturer receives ₹46.5 crore immediately**, and the **forfaiter collects ₹50 crore from the importer over 5 years**.

LEARNING SESSIONS

? Forfaiting vs Factoring ??

? Feature	? Forfaiting ?	? Factoring ?

CAIIB 2.0 ALL PDFs and Videos https://iibf.info/caiib

Purpose ?	Export Financing	Domestic & Export Receivables Financing
Type of Credit ?	Medium & Long-Term (More than 6 months)	Short-Term (Less than 6 months)
Risk Bearing ?	**Non-Recourse** (Forfaiter bears risk)	Recourse or Non-Recourse (depends on agreement)
Receivable Type ?	Based on **Bills of Exchange / Promissory Notes**	Based on **Invoices & Account Receivables**
Security Required ?	No collateral needed	May require guarantees
Who Uses It? ?	**Exporters** with long credit periods	**Companies** needing short-term liquidity

? **Key Difference:**

? **Forfaiting is for Exporters**, while **Factoring is for both domestic and export businesses**.

? **Forfaiting provides 100% finance upfront**, while **Factoring may have a partial advance**.

? Advantages of Forfaiting ✅

? Advantage	? Benefit
100% Finance ?	Exporters get **full payment immediately** without waiting for the credit period.
No Risk for Exporter ?	If the **importer defaults**, the **forfaiter bears the loss** (non-recourse basis).

LEARNING SESSIONS

CAIIB UPDATES. WHATSAPP CAIIB Group to 8360944207

No Collateral Needed ?	Exporters don't need to provide any **additional security**.
Boosts Exports ?	Encourages exporters to **offer competitive credit terms** without liquidity issues.

? **Example:** An **electronics exporter** in India can **offer a 2-year credit term** to international buyers **without worrying about delayed payments**.

LEARNING SESSIONS

? TERM LOANS ??

CHAPTER – 21 PART 1 ABM MODULE C BY ASHISH SIR

? What are Term Loans?

✓**Purpose:** Used for acquiring **fixed assets** like:

? Land & Building ?

? Plant & Machinery ?

? Infrastructure Projects ?

? Education Loans ?

? Personal Loans & Consumption Loans ?

✓**Repayment**: **Fixed schedule** (e.g., **monthly/quarterly EMIs**)

✓**Loan Duration: Long-term (3–15 years)**

✅**Key Financial Indicator:** **Debt Service Coverage Ratio (DSCR)** – to check repayment capacity

? What is a Working Capital Loan?

✅**Purpose:** Used for **short-term business needs**, such as:

? Buying raw materials ?

? Paying wages/salaries ??

? Covering operational expenses ?

✅**Repayment:** Normally **1 year**, but **payable on demand**

✅**Loan Duration:** **Short-term (up to 1 year, renewable)**

✅**Key Financial Indicator:** **Liquidity Ratios** – to assess short-term financial health

---

? Working Capital Term Loan (WCTL) – A Special Case ?

? In **exceptional cases**, banks sanction **term loans for current assets** – called **Working Capital Term Loan (WCTL).**

? Typically used **when a borrower's working capital needs are high and require long-term funding.**

✅**Example:** A textile manufacturer in **Tirupur** needs funds for **purchasing cotton in bulk for the entire year**. Instead of short-term working capital, the bank provides a **3-year WCTL** with structured repayments.

LEARNING SESSIONS

? Key Differences: Term Loan vs. Working Capital Loan

Criteria ?	Term Loan ?	Working Capital Loan ?
Purpose	Fixed Asset Purchase ?	Day-to-Day Operations ?
Duration	**Long-term** (3–15 years) ?	**Short-term** (≤1 year) ?
Repayment	**EMIs** (Monthly/Quarterly) ?	**Payable on demand**
Key Financial Check	**Debt Service Coverage Ratio (DSCR)** ?	**Liquidity Ratios** ?
Example	Buying a **factory or machinery** ?	Buying **raw materials for production** ?

? Repayment Schedule – No One-Size-Fits-All Approach

✅**Repayment terms depend on the borrower's cash surplus.**

✅**Each loan is structured based on expected future cash flows.**

✅**Example:** A **startup IT company in Bangalore** gets a **term loan of ₹50 lakhs** for setting up an office. The bank **customizes the repayment schedule** based on the company's **expected revenues from software projects**.

? Deferred Payment Guarantees (DPGs) & Project vs. Term Loan Appraisal ??

? What are Deferred Payment Guarantees (DPGs)? ?

LEARNING SESSIONS

✅**Definition:** When a **buyer of fixed assets** does not pay the supplier immediately but follows a **repayment schedule**, and the **bank guarantees this repayment**, it is called a **Deferred Payment Guarantee (DPG).** ��

✅**Nature: Non-Fund Based Finance** – The bank does not provide funds initially but **guarantees** repayment.

✅**Example:** � **A farmer in Punjab** buys a **tractor worth ₹10 lakh** but agrees to pay in **5 yearly installments**. The **bank guarantees** the repayment to the **supplier (tractor company).**

✅**What happens if the buyer defaults?**

If the **buyer fails** to pay the supplier, the **bank must pay** on their behalf. At this point, the bank's exposure becomes **fund-based** (like a loan).

✅**Key Risks:**

� Similar to **term loan risk** �

� If the borrower defaults, the **bank incurs a liability** �

� Same **appraisal criteria** as term loans �

� Difference Between Project Appraisal & Term Loan Appraisal �

Aspect	Project Finance Appraisal �	Term Loan Appraisal �
Scope	Evaluates **entire financial needs** of the enterprise (incl. working capital)	Evaluates **only a specific loan** (e.g., for buying a machine)

LEARNING SESSIONS

Focus	Long-term feasibility of the **entire business/project**	Viability of **repaying the loan** ?
Considerations	IRR, ROI, **Techno-Economic Feasibility**, Managerial Competence, Risk Analysis ?	**Projected Cash Flow & DSCR** for next 2–3 years
Example	Financing a **new solar power plant** ??	Financing **a new truck for a transport company** ?
Use Case	**Large-scale projects** (Infrastructure, Manufacturing, Startups)	**Small business expansions**, loans for individuals (Housing, Education, Vehicle) ???

✅**Example**: ? **A company building a new highway project** will need a **detailed project appraisal**.

? **A transport business buying 2 trucks** will only need **term loan appraisal** (simple DSCR check).

? Key Takeaways ?

? **DPGs → Non-Fund Based Finance**, but can become fund-based if borrower defaults.

? **Same risk & appraisal criteria as term loans** ?

? **Project Finance Appraisal → Full business viability analysis** ?

? **Term Loan Appraisal → Simple cash flow analysis (DSCR check)** ?

? **Choose project finance for large investments, term loans for specific purchases**

LEARNING SESSIONS

📌 **Understanding these concepts helps businesses & individuals secure the right financing! 💰🏢**

LEARNING SESSIONS

CAIIB UPDATES. WHATSAPP CAIIB Group to 8360944207