International Trade Financing and Risk Management Manual

Apparel Export Promotion Council

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Incorporated in1978, Apparel Export Promotion Council (AEPC) is the official body of apparel exporters in India that provides invaluable assistance to Indian exporters as well as importers/international buyers who choose India as their preferred sourcing destination for garments.

A quick look at how AEPC has been the moving force behind lot of achievements: From one office in 1978, it has over 40 offices in just a span of 30 years. From just being a quota monitoring entity, AEPC is today a powerful body for the promotion and facilitation of garment manufacturing and their exports. For Indian exporters, AEPC is quite literally a one-stop shop for information, technical guidance to work force and market intelligence. Members have access to updated trade statistics, potential markets, information on international fairs and assistance in participating at these fairs. It also plays a large role in identifying new markets and leading trade delegations to various countries.

In recent years, AEPC has worked tirelessly in integrating the entire industry - starting at the grass root level of training the workforce and supplying a steady stream of man power to the industry;

identifying the best countries to source machinery and other infrastructure and brokering several path breaking deals for its members and finally helping exporters to showcase their best at home fairs as well as be highly visible at international fairs the world over .

Twice a year, AEPC showcases the best of India’s garment export capabilities through the prestigious India International Garment Fair, playing host to over 350 exhibitors displaying the exotic, the haute, the prêt, the contemporary and much more. With AEPC's expertise and all the advantages that India has, it makes for a truly win-win situation – Indian exporters grow stronger each year in their achievements, skills and proficiency, while international buyers get superior solutions for their garment imports.

Apparel Exports

The post quota period for Indian Apparel exports has marred with high volatility. Initially, the currency fluctuations in 2007-08, and then the global meltdown in 2008-09, have pulled down apparel exports growth to single digit (5%).The estimated figure for April-September 2009-10 is US$ 4840 million.

India's percentage share in World apparel exports have dipped over the last five years (including estimated figures for 2009-10).From 31% in 2005-06, it has declined to negative growth of 7 per cent. The following table shows this

Financial Year	Value of Exports(in US$)	% Growth	% Share of RMG in Textile Exports
2005-06	8626	31	56
2006-07	8894	3	54
2007-08	9698	9	52
2008-09	10933	13	57
Apr- Sept2009-10	4840	-7	56

In the fiscal year, 2007-08, the readymade garment export amounted to US$ 9.7 billion.USA, UK, Germany were the top three destinations with the cumulative share of 51%.

India's Apparel Exports to Top Destinations

S. No	Country	2007-08 (in US$ million)	2008-09(p)	%Change 2008-09/2007-08
1	USA	2836	2587	-8.8
2	UK	1197	1033	-13.7
3	Germany	862	865	0.3
4	France	707	730	3.3
5	U A E	691	924	33.7
6	Italy	424	418	-1.4
7	Netherland	371	433	16.7

8	Spain	368	490	33.2
9	Canada	252	264	4.8
10	Saudi Arab	215	232	7.9

(Source: DGCI&S, AEPC Estimates)

FACTORING

“Factoring is a service involving the purchase by a financial organization, called a factor, of receivables owned to manufacturer and distributors by their customers, with the factor assuming full credit and collection responsibilities.”In other words, factoring is a financial transaction whereby an exporter sells its accounts receivable (i.e., invoices) to a third party (called a factor) at a discount in exchange for immediate money with which to finance continued business.

It is a type of financial service provided by the specialist organizations. It is one of the oldest forms of business financing. It can be regarded as a cash management tool for many companies like garment industry where long receivables are a part of business cycle. Factoring is a service that covers the financing and collection of account receivables in domestic and international trade.

Factoring has been in permanence since the dawning of trade and commerce. It can be trailed back to the period of a Mesopotamian king Hammurabi. A pervasive use of the concept began in American colonies before the revolution started. During those times raw materials like timber, fur and cotton were shipped from the colonies and before they reached the destination merchant bankers in London and other parts of Europe used to advance funds for the raw material. The practice was very beneficial to the colonists, as they didn't have to wait for the money to begin their harvesting again. With the Industrial Revolution the concept of factoring got narrowed down to credit. In the 60's and 70's with an increase of interest rates there was a surge in private factors. The trend strengthened in 80's with further increase in interest rates and changes in the banking industry.

With various expenses and inflexible rules involved with banking, factoring is a safe and easy method for financial expansion and growth. Working capital arranged through factoring is an easy means to cover purchasing, operating and provides the much-needed freedom from varied book keeping functions like credits and collections.

Factoring differs from a bank loan in three main ways. First, factoring differs from traditional bank loans because the credit decision is strictly based on receivables rather than other factors like how long the company has been in business, working capital and personal credit score. Secondly, factoring is not a loan; it is the purchase of financial asset. Finally, a bank loan involves two parties whereas factoring involves three – buyer, exporter and factor.

Factoring is different from forfaiting in the sense that in factoring, a firm sells all its receivables while in forfaiting, the firm sells one of its transactions.

Characteristics of factoring

1. Usually the period for factoring is 90 to 150 days. Some factoring companies allow even more than 150 days.
2. Factoring is considered to be a costly source of finance compared to other sources of short term borrowings.
3. Factoring receivables is an ideal financial solution for new and emerging firms without strong financials. This is because credit worthiness is evaluated based on the financial strength of the customer (debtor). Hence these companies can leverage on the financial strength of their customers.
4. Credit rating is not mandatory. But the factoring companies usually carry out credit risk analysis before entering into the agreement.
5. Cost of factoring=finance cost + operating cost. Factoring cost vary according to the transaction size, financial strength of the customer etc.

The cost of factoring varies from 1.5% to 3% per month depending upon the financial strength of the client's customer.

6. For delayed payments beyond the approved credit period, penal charge of around 1-2% per month over and above the normal cost is charged (it varies like 1% for the first month and 2% afterwards).

Types of Factoring

Disclosed and Undisclosed: In disclosed factoring client's customers are notified of the factoring agreement. Disclosed type can either be recourse or non recourse. In undisclosed factoring, client's customers are not notified of the factoring arrangement. Sales ledger administration and collection of debts are undertaken by the client himself. Client has to pay the amount to the factor irrespective of whether customer has paid or not. But in disclosed type factor may or may not be responsible for the collection of debts depending on whether it is recourse or non recourse.

Recourse and Non recourse: In recourse factoring, client undertakes to collect the debts from the customer. If the customer doesn't pay the amount on maturity, factor will recover the amount from the client. This is the most common type of factoring. In non recourse factoring, factor undertakes to collect the debts from the customer and client is not liable for any losses that factoring company may suffer.

Domestic and International Factoring: In the domestic factoring, the three parties involved, namely, customer(buyer), client(seller-supplier) and factor (financial intermediary) are domiciled in the same country. In export factoring there are usually four parties involved in cross-border factoring transaction. They are: exporter (client), importer (customer), export factor and import factor

Factoring is a flexible financial tool because it allows funds to be generated when required, so that opportunities are not lost.

A business will factor their account receivables for many reasons and some of them are-

- Strong cash flow- factoring helps in the immediate cash flow, a factoring company will advance a greater sum of money than other lending institutions.
- Protects against bad debts- Factoring helps a business to take greater control over their credit decisions and in this way it helps to protect against bad debts
- Improves management- With the help of factoring, management can concentrate on more important issues like running and growing business rather than administering collections and similar work.
- Creates more revenue- As the funds are easily available, so it helps in creating more revenue. The business works more aggressively and effectively towards the attainment of more revenue.

So, Factoring provides lot many advantages. Some of them are-

Advantages

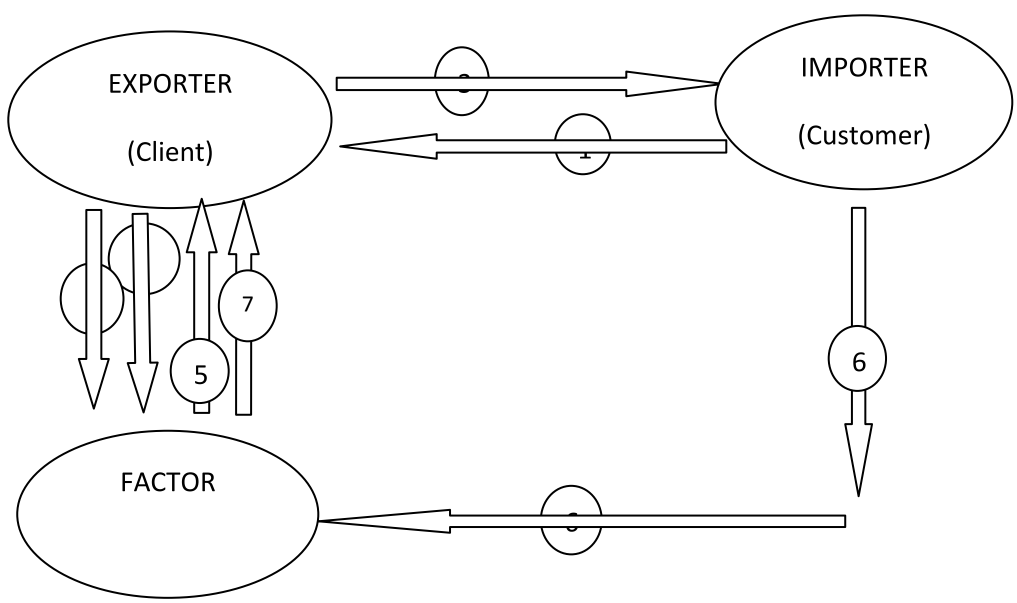
- Factoring helps to turn the receivables instantly into cash
- It provides credit protection for the receivables
- It helps the business to meet increasing sales demand and expand. When without recourse factoring arrangement is made, the client can eliminate the losses on account of bad debts. This will help him to concentrate more on maximizing production and sales. Thus, it will result in increase in sales, increase in business and increase in profit.
- Factoring helps in saving time as the invoice financing company collects the money itself.
- The client can avail advisory services from the factor by virtue of his expertise and experience in the areas of finance and marketing. This will help the client to improve efficiency and productivity of his organization. Besides this, with the help of data base, the factor can readily provide information regarding product design/mix, prices, market conditions etc., to the client which could be useful to him for business decisions

Disadvantages

- The basic disadvantage of factoring is that it may lead to ruined relations with the customers especially if factor engages in aggressive or unprofessional practices when collecting accounts
- Cost is another disadvantage; cost involved in factoring agreement may be more than the cost of other methods of financing available in the business.
- If the client has cheaper means of finance and credit (where goods are sold against advance payment), factoring may not be useful

MECHANISM OF FACTORING

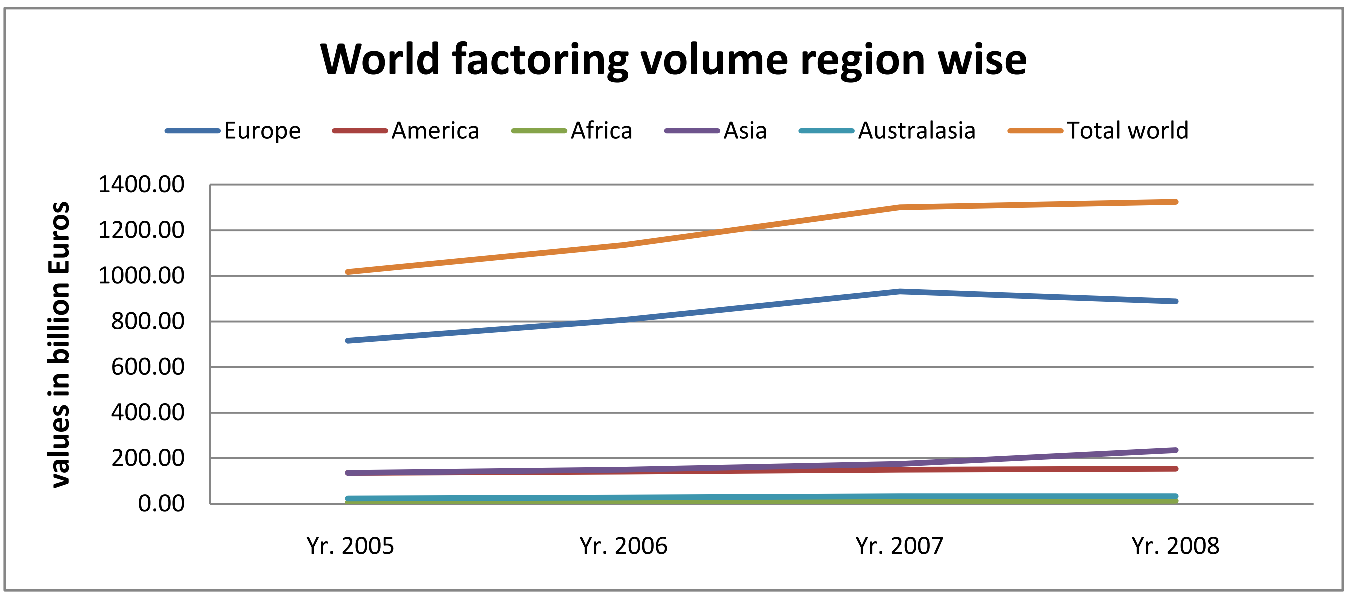
How does it work?



The above graph represents the model of factoring and the way it is being done-

- First, importer places an order with the exporter.
- Secondly, exporter gives the details of the transaction to the factor.
- Thirdly, exporter dispatches the goods to the importer and sends an invoice well to pay the amount on due date to the factor.
- Exporter submits the copy of invoice to the factor.
- Factor pays the amount to exporter.
- Customer pays the amount to the factor on due date.
- Factor pays the balance to client

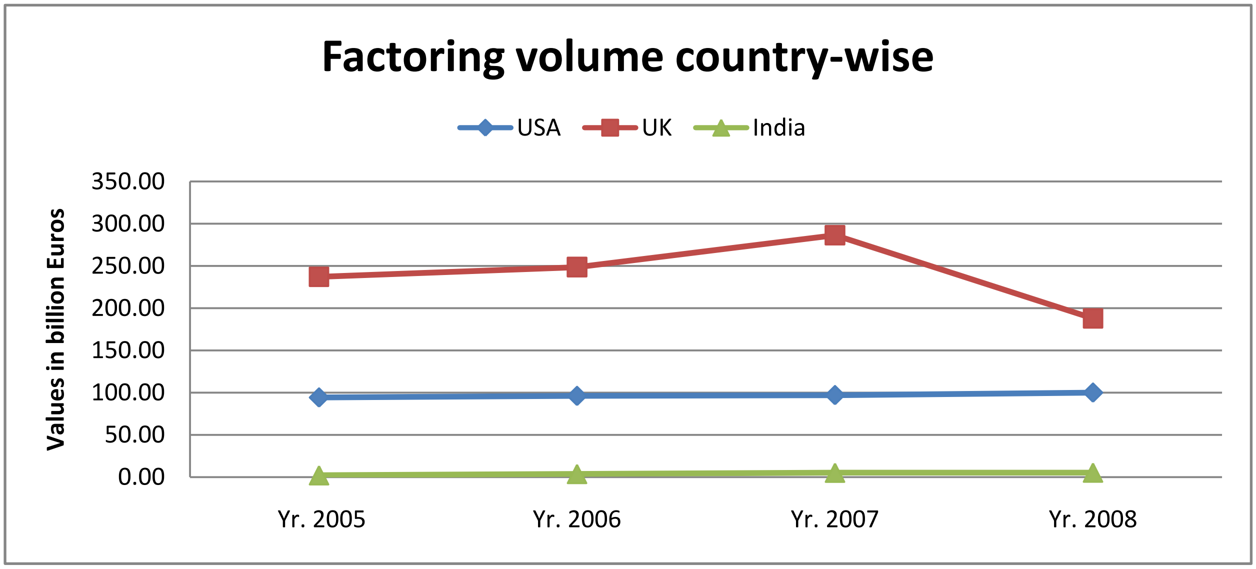
Total factoring volume region-wise



Source: Factor chain international

In 2008, the total world volume for factoring increased by 2 per cent, compared to almost 15 per cent in 2007. We can see that Europe has shown an upward trend till 2007, and then a downward trend. If we see the trend of Asia, it is stagnant in initial years i.e. till 2006 and then has shown a little upward trend till 2007. After 2007, a notable increase is seen and thus factoring volume crossed 200 billion. Africa and Australia showed a similar and a stagnant trend. The factoring volume of America is very similar to Asia, but after 2007, America's factoring volume is seen stagnant only The overall results illustrate that exporters and importers, around the world, are becoming more and more familiar with the advantages to be derived from a factoring arrangement: working capital, credit risk protection and collection service for the exporter.

Factoring Volume Country-Wise



Source: Factor chain international

From the above diagram, it is seen that till 2007, UK has shown an upward trend, but after 2007, factoring volume decreased significantly. USA has shown a stagnant growth in factoring volumes. India has shown a notable increase in factoring volumes since 2005. In 2007 factoring volumes were Euro 5.20 billion in comparison to Euro 1.99 billion in 2005. So we can say that factoring is moving upward in India, and soon factoring will spread its wings across the length and breadth of the country.

Factoring Services in India

Though factoring services have been introduced since 1991 in India still it is quite new in the sense that factoring product is not widely known in many parts of the country. The companies which provide factoring in India are Canbank Factors Limited, SBI Factors and Commercial Services Pvt. Ltd,The Hongkong and Shanghai Banking Corporation Ltd.Global Trade Finance Limited,Export Credit Guarantee Corporation of India Ltd,Citibank NA, India and Small Industries Development Bank of India (SIDBI):

It is quite implied that factoring is a very easy and fast method. Still, it has not seen a substantial growth in India, as compared to China and Vietnam. There are certain hiccups that have come up in the way of realizing the full potential of factoring in India. One of the main reasons for it is the legal framework of India. Generally factoring companies need legal protection as all advances are uncollateralized, protection for the same is not provided.

Still there is only one direction in which factoring can go in India: upwards. As the awareness level about the benefits of factoring increases, factoring will spread its wings across the length and breadth of the country.