The Benefits of Reverse Factoring

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Small and medium-sized enterprises (SMEs) can use a reverse factoring programme to match the liquidity gap created during a specific credit period.

Factoring of trade receivables has gained increased popularity during the last decades with an emphasis on the latest years. Key drivers of this growth are:

- The gradual transition from the bank guaranteed commercial credit to open account practices
- The EU-accession plan involving new market entrants from Central – Eastern Europe following the demise of the Soviet circle of influence
- China 's familiarization with non bank trade finance tools such as factoring and receivables financing at the expense of traditional bank guarantees
- The new conceptual trend of the Banking system placing factoring under the umbrella of a more traceable hence safer supply chain financing principle
- The reluctance, in general, of Banking Institutions to extend short term credit on an uncollateralized basis

Reverse Factoring as part of the factoring spectrum of services has been enjoying a somehow different reception on behalf of the corporate community for a number of specific benefits it provides and also for the fact that it mostly accommodates the small and medium sized players of particular sectors.

Reverse factoring by definition involves a strong Buyer and many smaller or dependent suppliers in need of a financing platform that will match the liquidity gap created by the credit period. The Factor provides financing against trade receivables based on the creditworthiness of the Buyer, its commitment to provide accurate and irrevocable information with regards to its payables to each and every supplier participating in the programme.

The benefits for the supplier are more than obvious: access to a credit line that converts invoices into fresh money without pledging other tangible collaterals and access to preferential rates negotiated by the Buyer himself not to mention other side privileges such as the possibility for insurance against default of the Buyer without extra costs and room for further ancillary business with the parent Banking Group of the Factor.

However, the key element of success for the Reverse Factoring is the fact that a supplier with weak or even problematic financials gains access to credit from a financial institution for as long as it sells good products or services to a big company. A record of undisputed sales is most likely the only prerequisite for accessing such a programme.

This is the reason behind the increasing demand for reverse factoring schemes from countries in a transitory period whose private sectors are young, often undercapitalized and dependent on sizeable multinational or foreign buyers in search of local and cheaper supplies. The Food Retail industry is a typical example of the situation in question.

Although reverse factoring is popular in this kind of countries, it is obvious that its success is very much related to the challenges of regulatory, legal and tax nature that may hinder a factoring institution from entering into the business. The tax deductibility of interest on factoring arrangements, VAT treatment, bankruptcy law complications and cross border capital controls may be some of the most important problems that have to be resolved once and for all. Part of these

issues is related to the treatment of factoring. In countries where factoring is recognized as a commercial transaction that involves a sale and a purchase and a financial service obeying to a specified Financial Act, many of the above questions are transparently and efficiently addressed.
When it comes to the Buyers, the advantages of Reverse Factoring are also very significant. It is worth mentioning the most important such as cost reduction through increased liquidity, DPO improvement, positive image to suppliers as the Buyer achieves preferential rates for the benefit of its suppliers by leveraging on its bargain power. It is further obvious that any Buyer would be happy to be in the position to make life easier for its suppliers without committing its own resources but these of a financial intermediary. In periods of costly liquidity, reverse factoring is translated to efficient cash management for the Buyer.
But what is for the factoring company apart from the obvious benefits of interest income and fee generation? The most important side gain from a reverse factoring scheme is the bulk approach of new clients with potential not only for further factoring business with a wider spectrum of debtors, but also for cross fertilization with other departments of the Banking Group.
Reverse Factoring may be used as a valuable hook product for capturing the Buyer's main transaction account since all its payments to suppliers will be effected through this account.
However, Reverse Factoring cannot be offered effortlessly by any factoring institution because of its high requirements in IT infrastructure and standardization procedures. Also, in cases of full automated processes the lack of legislation on electronic security may be proved a severe impediment to the development of the product.
In conclusion, Reverse Factoring in all its aspects, ranging from a single-step funding scheme to an elaborated mechanism, is a valuable tool that promotes SME financing in a uniquely efficient manner for all parties involved.

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