Factoring & its Relationship with Selected Macroeconomic Factors: A Comparative analysis of India & China

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ABSTRACT

Factoring is used all over the world that is both in developed and developing countries. Even though absolute factoring volume is smaller in emerging countries as compared to developed countries, factoring plays relatively an important role for SMEs and new firms in emerging markets as their access to bank financing remains limited. The Indian factoring volume increased at approx. 85% from 2007 to 2014. But, India's factoring volume stands at a mere 1.8% vis-à-vis global factoring volume. Whereas the China's factoring volume grew at approx. 1231% from 2007 to 2014 contributing to 17.30% vis-à-vis worldwide factoring volume. This paper brings fresh evidences of Factoring scenario at the emerging economies - India & China and examines the relationship & dependence of selected macroeconomic variables of respective nations with that of their factoring turnover. In this study, both correlation & multiple regression analysis is employed to test for the dependence of selected macroeconomic variables on the respective country's factoring turnover for the period 2007 to 2014. Macroeconomic variables used in this study are Gross Domestic Product(GDP), GDP Per Capita & Domestic Credit to Private sectors. Empirical result reveals that these selected macroeconomic factors influence the factoring turnover at China indicating strong positive correlation with significance test being accepted at 90% confidence levels. While results reveal opposite trends at India with low negative correlation & further result of insignificant test being proved at the same 90% confidence levels. Added to analysis, the paper further extends the literature to find the possible reasons for such differences in the economic & legal framework among the two emerging countries namely India & China.

Introduction

The paces of expansion of today's dynamic business within and with various countries and markets have necessitated the need for the concept of factoring. Though factoring seems to be new, has a long and history, which exists from several centuries.

Factoring service is a form of working capital financing provided to industry, trade & service sectors based on their post-sale debtors or bills receivables values. "Factoring is a continuous legal relationship between a financial institute (The factor) and a business concern (The client) selling goods or providing

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services to trade customers (The customers) on open account basis where the factor purchases the client s book debts (Accounts receivables) either with or without recourse to the client and in relation there to control the credit extended to customers and administers the sales ledger".

The factoring practiced today has gone through phases of transformation from the past. From selling of merchandise to advance payments the scenario has been replaced by financing the credit and collection functions which were of greater values. Other factors are the growing industrialization and incremental growth in the industrial production and sales, tiny collection and efficient management of receivables have gained importance.

Factoring is used in developed and developing countries around the world. The importance of factoring as a primary source of working capital financing is emphasised & rigorously used in selected industries. In Developed countries like USA, Japan etc., usage of factoring as a primary source of working capital financing is widely accepted. Petersen and Rajan (1997) and Atanasova and Wilson (2002) showed that 70 percent of small U.S. firms and 80 percent of firms in the U.K provide trade credit to their customers [[20]]. The global predictions of factoring suggest that factoring may be accepted as more advantageous compared to other lending forms in the coming days. Factoring is assumed to be a powerful tool in providing financing as it absorbs high risk, its key determinant is that underwriting in factoring relies on risk classification of the accounts receivable themselves rather than the risk of the seller.

Factoring is quite different from other traditional forms of commercial lending. Here the receivables are underwritten considering the creditworthiness of the seller rather than the value of the seller's underlying assets. In traditional lending relationship, the lender looks to underlying assets only as a secondary source of repayment. The primary source of repayment is always considered to be the seller. In the case of factoring, the seller's creditworthiness is considered to be secondary. In certain countries, borrowers have the advantage of using receivables as collateral for loans. The difference between the two is that, in case of the later the lender secures the underlying assets or receivables as collateral, whereas the former takes legal ownership of the assets. Therefore, traditional lending requires secured lending laws, digital collateral registries, and efficient judicial systems, which rarely exists in emerging countries. However, factoring requires a suitable legal environment to sell or transfer accounts receivables. Its dependency on other legal framework such as collateral laws or efficient judicial systems as in case traditional lending products is less. Bakker, Klapper, and Udell (2004) indicated that a supportive legal and regulatory environment encourages the factoring industry to grow.[3]

India is becoming the hub of various businesses especially for information technology and is Providing new avenues for various types of industries, which indicate greater potential for factoring in India. Factoring is being tailored specifically for post-sale finance requirements arising out of credit sales. In spite of these, factoring services is not gaining the momentum as other financial instruments.

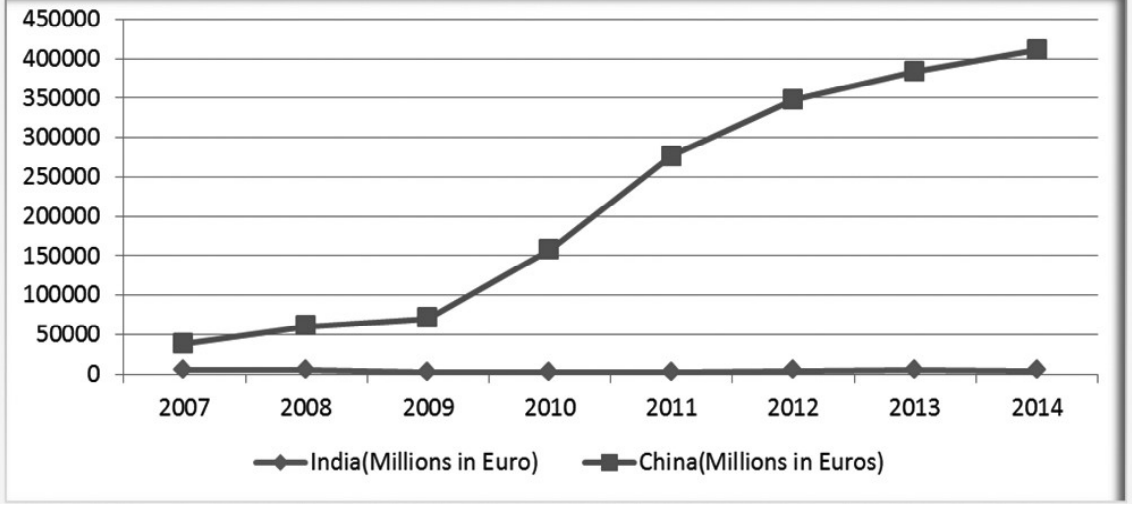
According to Factor Chain International, India's factoring turnover in 2012 was around 3500 million euros domestic factoring and 3650 million euros in total as compared to a total of 21, 32,231 million euros worldwide. The Indian factoring volume grew at approx. 85% from 2007 to 2014. However, India's factoring volume stands at a mere 1.8% vis-à-vis worldwide factoring volume. Whereas the China's factoring volume grew at approx. 1231% from 2007 to 2014. However, China's factoring

volume stands at a mere 17.30% vis-à-vis worldwide factoring volume. As per them, though they are global network of factoring companies in India, due to absence of a legal framework regulating factoring, it has played a minimal role in factoring. A quick glance of factoring volume of India and China has been depicted in the figure-1 for your reference.

Broadly, this paper is structured as follows: Section 1 consists of the Introduction; Section 2 conveys the objectives of this study, Section 3 consists of the literature on Trade credits and Factoring. The data samples & methodology are described in Section 4 while Results and statistical analyses are indicated in Section 5. And finally, the conclusions of the study are presented in Section 6.

Comparison of factoring turnover of "China" and "India":

Figure 1 : Factoring volume of India & China.(8 year data)



Source : Factor Chain International

Objectives of the study

This paper brings fresh evidences of Factoring scenario at the emerging economies - India & China.

a. It examines the relationship between selected macroeconomic variables of respective nations with that of their factoring turnover.

b. It analyses the dependence of selected macroeconomic factors on Factoring volume in specific.

Literature Review

Factoring is used all over the world that is both in developed and developing countries. Even though absolute factoring volume is smaller in emerging countries as compared to developed countries, factoring plays relatively an important role for SMEs and new firms in emerging markets as their access to bank financing remains limited.

Previous evidences in literature suggests that "trade credit" is highly preferred in countries where greater barriers to SME financing exists. Demirguc-Kunt and Maksimovic (2001) investigates the use of trade credit in 39 countries across the world and finds that trade credit use is higher larger in countries with weak legal environments than the bank credits.

Leora klapper(2005) in their research paper titled "The Role of Factoring for Financing SMEs" examines that factoring is related to the value of a supplier's accounts receivable and receivables sold. His empirical findings state that factoring is larger in countries which witnesses greater economic growth and possess developed credit information bureaus.

NidhiBothra and Shampita Das(2013)in their paper titled "Factors Impending factoring in India" after discussions with several companies gather conclusions that though Factoring Act has provided for a facilitating environment, but still it's not sufficient enough for factoring to grow.

Raymond Fisman and Inessa Love (2003) in their paper titled "Trade Credit, Financial Intermediary Development, and Industry Growth" highlights the impact of implicit financing in the form of trade credit by showing that industries with higher dependence on trade credit financing exhibit higher rates of growth in countries with relatively weaker financial Institutions.

Van Horen (2004) in his paper titled "Trade Credit as a Competitiveness Tool; Evidence from Developing Countries" investigates the usage of trade credit in 42 countries and concludes that trade credit is used as a competitive tool. Trade credit is normally used by firms that are yet to establish themselves in the market and gain solid reputation. Also his findings conveyed that the firms located in the countries with an underdeveloped banking sector prefer trade credit.

Fisman and Raturi (2004) investigates that trade credit provision in 5 African countries are driven by competition in the environment. McMillan and Woodruff (1999) studies the usage of trade credit in Vietnam and suggests that small firms are more flexible towards both granting and receiving trade credit than large firms. His evidence concludes that small firms in emerging markets provide trade credit & are ready to hold illiquid receivables on their balance sheets. However firms in developed countries are often sceptical to pay cash on delivery to the supplier firms in emerging markets since they doubt the quality of the goods and and hence they need to time settle them(or prefer trade credit). They know that it would be highly difficult refund or revert the transaction in emerging countries due to presence of inefficient judicial systems.

Rajan and Zingales (1998) and Demirguc-Kunt and Maksimovic (1998) prove that a relation exists between the development of financial institutions & external financing. They presented evidences that firms in underdeveloped countries have different financing patterns than the developed countries.

Demirguc-Kunt and Maksimovic (1999) investigate the firms' capital structure in 30 developed and developing countries and prove that there exists difference in the financing pattern based on the development phase of their stock markets and banks, as well as the underlying legal infrastructure.

From the literature review the following inferences can be made:

- Trade credits are used as competitive tool by small & medium firms to establish a solid market reputation.

- Usages of trade credits are higher in small & medium firms in emerging countries & hence they hold higher illiquid accounts receivables than developed countries.
- Factoring is larger in countries with greater economic development and growth.
- Although, various studies are carried out to investigate the factoring determinants and anomalies in the past, investigation of the same from macroeconomic perspective were found to be limited. Hence this study adds to the existing literature by examining the macroeconomic determinants of factoring from Indian and Chinese perspective.

Sample and Research Methodology

This study covers a macro level analysis of comparing the factoring volume of India and China with selected macroeconomic factors respectively. We use an 8-year panel dataset on total factoring volume from Factor Chain International for two countries India & China from 2007 to 2014 and selected macroeconomic factors such as Real GDP, Domestic credit to private sectors and GDP per capita.

We shall test the hypothesis that there exists relationship between factoring and selected macroeconomic variables. To test these hypotheses, we shall include measures of macroeconomic development as our explanatory variables. First, we include the 1-year lagged value of GDP per capita (LAG_PCI) as a broad measure of development. Next, we include the 1-year lagged value of the real GDP as an indicator of economic growth (LAG_GDP). Finally, we include the 1- year lagged value of domestic credit to the private sector as a measure of credit availability (LAG_DCP).

Data definitions of all variables used for the study are shown in Table 1. We have selected one year lagged value of country's macroeconomic variables by assuming that the current year' country's position will affect the next years factoring volume with the evidence of a previous research paper of Leora Klapper which was used as a reference paper for this study. [12]

Table 1 : Definition of Variables

Variable Name	Description	Source
FACT_VOL	Total Factoring turnover in USD (Dependent variable)	Factor Chain International
LAG_GDP	GDP in USD, Lagged 1 year (Independent variable 1)	World Bank
LAG_PCI	GDP per capita in USD, Lagged 1 year. (Independent variable 2)	World Bank
LAG_DCP	Domestic credit to the private sector in USD, Lagged 1 year(Independent variable 3)	World Bank

Empirical Methodology

In this study we firstly examine the existence of relationship between the dependent variable i.e factoring volume and each of the independent variable i.e GDP, GDP per capita & Domestic credit to Private sector.

Secondly, we run causal analysis to analyse the explanatory power of each of the independent variable using multiple regression analysis and there by testing the fitness of model using "R-square". And then we examine the individual "T-test" values to infer the significance results under the hypothesis framework as stated below.

Lastly, we shall draw inferences based on the comparative analysis between results of India & China & bring out the expected reasons thereof.

The hypothesis statement to be proved therefore shall be:

Hypothesis 1 : (For China)

H0 : There is no significant relationship between Factoring volume and any of the selected macroeconomic variables viz.GDP, GDP per capita & Domestic credit to Private sector in China.

H1 : There exists a significant relationship between Factoring volume and any of the selected macroeconomic variables viz.GDP, GDP per capita & Domestic credit to Private sector in China.

Hypothesis 2 : (For India)

H0 : There is no significant relationship between Factoring volume & any of the selected macroeconomic variables viz.GDP, GDP per capita & Domestic credit to Private sector in India.

H2 : There exists a significant relationship between Factoring volume & any of the selected macroeconomic variables viz.GDP, GDP per capita & Domestic credit to Private sector in India.

Analysis of relationship between factoring Turnover of "China" with its selected macroeconomic factors:

The pairwise correlations output (China) from SPSS using Pearson correlation procedure is shown in Table 2. The values in the correlation table are standardised and range from 0 to 1(Positive and negative). We observe that except for LAG_GDP, other two variables are highly correlated with Factoring turnover. Only LAG_GDP doesnot appear to be strongly correlated with Factoring Turnover as its correlation coefficient stands at 0.526. Further we observe that these Independent variables are strongly correlated with each other and hence are not independent of each other. Eg. LAG_PCI & LAG_DCP = 0.843. Therefore we broadly reject the null hypothesis and conclude that "There exists a relationship between Factoring volume & GDP, GDP per capita & Domestic credit to Private sector in China". Hence we further proceed to run regression thereby eliminating some of the independent variables as they may not be valid predictors.

Table 2 : Correlations output for China

		FACT_VOL	LAG_PCI	LAG_GDP	LAG_DCP
FACT_VOL	Pearson Correlation	1.000	.973**	.526	.899*
	Sig. (2-tailed)		.000	.181	.002
	N	8.000	8	8	8
LAG_PCI	Pearson Correlation	.973**	1.000	.606	.843*
	Sig. (2-tailed)	.000		.111	.009
	N	8	8.000	8	8
LAG_GDP	Pearson Correlation	.526	.606	1.000	.592
	Sig. (2-tailed)	.181	.111		.122
	N	8	8	8.000	8
LAG_DCP	Pearson Correlation	.899**	.843	.592	1.000
	Sig. (2-tailed)	.002	.009	.122	
	N	8	8	8	8.000

Regression analysis between factoring Turnover of "China" with its selected macroeconomic factors:

From the regression output, we obtain the regression model as indicated in Equation 1.The p-value is observed to be 0.001 with F-value of 67.357(as per Table 4), indicating that the model is statistically significant at confidence level of 99.99. The R-Square value is 0.981(as per Table-3). Observing Table 5 which indicates individual dependent variables, we consolidate that both LAG_PCI & LAG_DCP are significant at 90% confidence limit. Therefore we conclude that the selected variables act as key determinants of factoring turnover of China.

Equation 1 : For China
FACT_VOL = 7.71 (LAG_PCI) +4.36 (LAG_DCP) - 0.008 (LAG_GDP) - 5.90 (Constant)

Table 3 : Model Fitness

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.990*	.981	.966	3.1061E10

a. Predictors : (Constant), LAG_DCP, LAG_GDP, LAG_PCI

Table 4 : Analysis of Variance (ANOVA)

Model		Sum of Sqaures	df	Mean Square	F	Sig.
1	Regression	1.950E23	3	6.499E22	67.357	.001*
	Residual	3.859E21	4	9.648E20		
	Total	1.988E23	7			

a. Predictors : (Constant), LAG_DCP, LAG_GDP, LAG_PCI)

b. Dependent Variable : FACT_VOL

Table 5 : Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constatn)	-5.896E11	1.766E11		-3.339	.029
	LAG_GDP	-.008	.005	-.142	-1.591	.187
	LAG_PCI	7.710E7	1.293E7	.797	5.961	.004
	LAG_DCP	4.358E9	1.845E9	.312	2.363	.077

a. Dependent Variable : FACT_VOL

Analysis of relationship between factoring Turnover of "India" with its selected macroeconomic factors:

The pairwise correlations output (India) from SPSS using Pearson correlation procedure is shown in Table 6. We observe that all variables are negatively correlated with Factoring turnover. Also their coefficients are not strongly correlated. However we observe that these Independent variables are strongly correlated with each other and hence are not independent of each other. Eg. LAG_PCI & LAG_GDP = 0.998. Hence we further proceed to run regression to test significance for independent variables as they may not be valid predictors.

Table 6 : Correlations output for India

		FACT_VOL	LAG_PCI	LAG_GDP	LAG_DCP
FACT_VOL	Pearson Correlation	1.000	-.084	-.066	-.219
	Sig. (2-tailed)		.843	.875	.602
	N	8.000	8	8	8
LAG_PCI	Pearson Correlation	-.084	1.000	.998**	.922**
	Sig. (2-tailed)	.843		.000	.001
	N	8	8.000	8	8
LAG_GDP	Pearson Correlation	-.066	.998**	1.000	.932**
	Sig. (2-tailed)	.876	.000		.001
	N	8	8	8.000	8
LAG_DCP	Pearson Correlation	-.219	.922**	.932**	1.000
	Sig. (2-tailed)	.602	.001	.001	
	N	8	8	8	8.000

** Correlation is significant at the 0.01 level (2-tailed)

Regression analysis between factoring Turnover of "India" with its selected macroeconomic factors:

From the regression output, we obtain the regression model as indicated in Equation 2.The p-value is observed to be 0.407 with F-value of 1.235(as per Table 8), indicating that the model is statistically insignificant at confidence level of 95%. The R-Square value is 0.481(as per Table-7). Observing Table 9 which indicates individual dependent variables, we summarise that none of the selected variables namely LAG_GDP, LAG_PCI & LAG_DCP are significant at 90% confidence limit. Therefore the model is not considered to be a good fit to describe the determinants of Factoring turnover of India.

Equation 2 : For India
FACT_VOL = 3.88 (Constant) +0.042 (LAG_GDP) - 5.08 (LAG_PCI) - 7.38 (LAG_DCP)

Table 7 : Model Fitness (India)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.693*	.481	.092	1.18717E9

a. Predictors : (Constant), LAG_DCP, LAG_PCI, LAG_GDP)

Table 8 : Analysis of Variance (ANOVA)

Model		Sum of Sqaures	df	Mean Square	F	Sig.
1	Regression	5.223E18	3	1.741E18	1.235	.407*
	Residual	5.638E18	4	1.409E18		
	Total	1.086E19	7			

a. Predictors : (Constant), LAG_DCP, LAG_GDP, LAG_PCI)

b. Dependent Variable : FACT_VOL

Table 9 : Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constatn)	3.888E10	1.831E10		2.124	.101
	LAG_GDP	.042	.026	11.874	1.618	.181
	LAG_PCI	-5.077E7	3.412E7	-10.207	-1.488	.211
	LAG_DCP	-7.377E8	4.298E8	-1.877	-1.716	.161

a. Dependent Variable : FACT_VOL

Findings

On the basis of our analysis it's proved that the factoring turnover is negatively correlated with the selected macroeconomic variables of India & also witnessed an insignificant model fitness. Therefore we accept the null hypothesis-2 and conclude that "There is no significant relationship between Factoring volume & any of the selected macroeconomic variables viz.GDP, GDP per capita & Domestic credit to Private sector in India".

And contradicting to this, the same set of variables witnessed a positive correlation with factoring turnover of China and proved to be the best fit for regression model. This lead us to reject the null hypothesis-1 and conclude that "There exists a significant relationship between Factoring volume and any of the selected macroeconomic variables viz.GDP, GDP per capita & Domestic credit to Private sector in China".

Further, based on the detailed research through secondary sources such as Case studies, Research journals, newsletters at India-factoring, Factor Chain International & World Bank, we could ascertain relevant possible reasons which are aligned with the research reports from both Indian and Chinese context. From the Indian perspective we relied on the analytical report of Nidhi Bothra and Shampita Das titled as "Factors Impending Factoring - Why is factoring not picking up in India post enactment of the new Act?" copywrited by Vinod Kothari & Company

17th September, 2013 for the same. And possible reasons for both Chinese and Indian perspective were derived from the Annual Review Report 2015 of Factoring Chain International.[1][21]

Possible reasons for proven trends at "India"(that is Negative correlation & insignificant model fit)

- **Banks offer better services than factoring**: Banks have numerous schemes of lending and but NBFCs possess certain disadvantages over banks such as, non-availability of own funds, short-term borrowings becomes expensive for providing factoring services, greater interest rates etc.
- **Availability of other better options than factoring:** Banks provide well-structured credits instruments to corporates & clients in large varieties. Hence obtaining factoring services from NBFCs may become difficult and hence th client would rather prefer an overdraft facility provided by the banks, which is much simpler quicker and can be obtained at ease.
- **Factoring being secondary source:** The factors have a role playing only when the corporates require more funds than which is offered by the banks. Other than these, the turnaround time for factors takes long time, so clients prefer banks over factors.
- **No Credit Insurance facility in India:** Credit insurance policy is followed internationally by the factoring companies to mitigate their credit risk. However the credit insurance is not permitted currently in India.

- **Debt recovery measures and platforms of India are not efficient:** These act as another major drawback to the Factoring businesses in India. Factor will be under loss in case of "without recourse factoring" to some frauds and if they fail to repay the credit.
- **Limited Reach to SME s:** Small and Medium Enterprises (SMEs) who find this route more preferable constitute major clients for factoring companies. But the factoring has not reached them completely and hence has remained unpopular.

Possible reasons for proven trends at "China"(that is positive correlation & significant model fit).

- **SMÉ's access to bank funding is very less:** As quoted by a Chinese "broking firm", only 4% of the 42 million SMEs in China have access to traditional bank finance. Most of the commercial Banks provide credits to companies with high net worth, as the banks' profit margin is protected by the government of China. Hence commercial banks show less motivation to extend loans to SMEs as they bear higher risks.
- **People prefer business than jobs:** Cost Inflation is under rise in China at 1.8%, and the food price inflation is at 2.4%. This has pushed employees to run businesses on their own, which can provide sufficient salaries to lead contended life.
- **Delayed payments by the customers for the invoice generated on them:** As per survey conducted at Peking University, they find that 30% of Chinese businesses were impacted by delayed customer re-payments in 2011. Due to lack of central credit regulatory system in China, debtors normally dictate the terms of their repayment -if at all they pay. This further pushes these companies to resort to factoring.

Conclusion

The main objective of the study is to determine the interrelationships between the country's factoring turnover & its selected macroeconomic factors respectively. Very few studies exists in this area of factoring. Although the related trends are well documented for developed countries[Leora Klapper,2005], however the comparative study between India and China was not done extensively. This study extends the literature by considering the effects of selected macroeconomic variables on the country's factoring volume. In this study, both correlation & multiple regression analysis is employed to test for the dependence of selected macroeconomic variables on the respective country's factoring turnover for the period 2007 to 2014. Macroeconomic variables used in this study are Gross Domestic Product(GDP), GDP Per Capita & Domestic Credit to Private sectors. In the regression Model, Factoring turnover is used as a dependent variable while the above stated three macroeconomic variables are used as independent variables. Empirical result reveals that these selected macroeconomic factors influence the factoring turnover at China indicating strong positive correlation with significance test being accepted at 90% confidence levels. While results reveal opposite trends at India with low negative correlation & further result of insignificant test being proved at the same

90% confidence levels. Added to analysis, the paper further extends the literature to find the possible reasons for such differences in the economic & legal structural situation among the two emerging countries namely India & China.

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