

RISK ASSESSMENT FRAMEWORK & MITIGATION TECHNIQUES IN FACTORING

**SELLER RISK
BUYER RISK
RECEIVABLES ASSESSMENT
OPERATIONAL RISK**

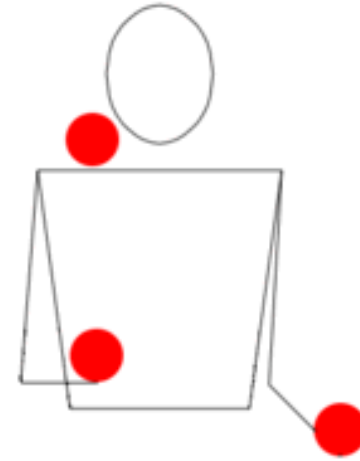
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THREE LEGS OF RISK APPROACH IN FACTORING

- **Seller financials, product – Seller Assessment**
 - What is the financial strength and management of your Client ?
- **Debtor quality – Debtor Assessment**
 - Are the debtors capable of paying?
- **Quality of debt – Receivables Assessment**
 - Is the debt you are buying suitable for factoring?



SELLER RISKS & SELLER CONTROL



RISK MITIGATION - ASSESSMENT

Seller Assessment Framework

Seller Selection

- Company structure and Management
- Future business planning
- Financial strength
- Bankruptcy order / lawsuit
- Seller performance

Industry & Product

- What's the industry development and outlook?
- Manufacturing Process & Quality
- Country of origin
- Raw materials: Level of dependency; Alternative sources; Dispute risk
- Technical issues

Receivables Portfolio

- Assignable: Ban on Assignment? Charges over the assets?
- Collectable
- Receivables Ageing
- Any bad debt / overdue payment?
- Credit / Debit Notes
- Buyer concentration

SELLER SOLVENCY

The better the
solvency

- Less risk of insolvency of the seller
- Less risk of seller fraud
- Better recourse in case of disputes
- Better quality of the buyers

SELLER ASSESSMENT: FINANCIAL RISK

Audited Balance Sheets of last 3 years

- equity ratio
 - receivables, liabilities
 - turnover, cost of goods
 - cash-flow, profitability (EBIT, EBITDA)
-
- Order situation and validation of planning figures/budget
 - Current monthly statements/year-to-date analysis
 - Receivables ledger of debtors/creditors incl. ageing balance
 - Bank account statements
 - Fulfillment of tax/social insurance liabilities
 - Potential legal costs with respect to lawsuits



THE MOST SUITABLE BUSINESS FOR FACTORING?

Sales are on open account terms

Sellers are financially sound companies with acceptable levels of turnover

Buyers are creditworthy commercial businesses

The goods delivered or the services performed are “sell and forget”

There are no contractual features (or less formal arrangements) that reduce the value of the Receivable

There is a robust proof of delivery system

There is a good spread of debt

Turnover is growing and is not seasonal

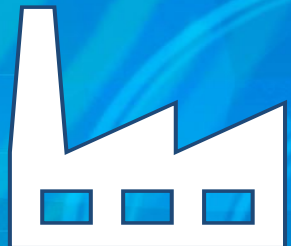


SECTORS



Wholesale

- FMCG
- Clothing
- Home appliances
- Consumer electronics



Manufacturing

- Metals
- Chemicals
- Automotive industry
- Other raw materials



Services

- IT
- Marketing
- HR/recruitment services
- Transportation
- Logistics



Other

- Energy sector
- Construction
- Public Sector
- ?
- ?

SOME EXAMPLES



Dairy products producer selling to a food retailer

SOME EXAMPLES



Chemicals to produce plastics

SOME EXAMPLES



HR Company recruiting staff for a big corporate

SOME EXAMPLES



Aluminum processing industry selling to an aluminum cans producer

SOME EXAMPLES

Hotel construction



SOME EXAMPLES



SOME EXAMPLES



Public Sector

SELLER SELECTION - 4 KEY CHECKPOINTS



ASSIGNABILITY



COLLECTABILITY



VIABILITY



ADEQUACY OF SERVICE

Factorable Accounts Receivables

SELLER SELECTION - ASSIGNABILITY



Assignable without any legal constraints

- Ban on assignments to third parties
- Pledge over current assets

SELLER SELECTION - COLLECTABILITY

If seller fails, will I recover my financing from the A/R?

- Contractually complete open account sales
- Quality of buyers & Buyer concentration
- Dilution & disputes
- Delivery methods
- Country Risk



SELLER SELECTION - VIABILITY

Check Points

- ✓ Financial status of seller
- ✓ Able, experienced and honest management
- ✓ Traded profitable for a number of years
- ✓ Prospect for the future growth, sells a large volume
- ✓ Operating in a developing sector of the economy

SELLER SELECTION – ADEQUACY OF SERVICE

Find out what seller's needs are

- Factoring Products
- Credit cover/Buyer limits
- Established finance limit
- Advance payment percentage
- Impact of factoring finance on bank lending
- Other factors, another factor's finance
- Buyer countries
- Volumes, Number of buyers and number of invoices,
- Profitability for the factor



SELLER ASSESSMENT: GOODS/SERVICES CHARACTERISTICS

- **Manufacturing & delivery process**
 - quality standards
 - Time frames
- **Country of origin (traders, re-sellers)**
 - Quality characteristics to be accepted in buyer's country
 - Environmental issues (toxic, hazardous products)
- **Raw materials / supplies**
 - Level of dependency
 - Alternative sources

SELLER ASSESSMENT: GOODS/SERVICES CHARACTERISTICS

➤ Technological Issues

- new vs. established technology

➤ Personnel's education

- specialized, competent, know-how, R&D

➤ After sales support

- How fast can seller react to a quality dispute?

❖ Even if a dispute is settled do not underestimate its causes and its impact on seller/buyer relationship

RISK MITIGATION - ASSESSMENT

B) Debtor Assessment Framework

Net Worth

Profitability

**Litigation / Dispute
with Seller**

**Buyer Acceptance
of Goods**

**Dependency of
Buyer on Seller**

Types of Buyers

**3rd Party Risk
Mitigant**

*e.g. Use Insurance,
Interfactor, Parental
Guarantee etc.*

RISK MITIGATION - ASSESSMENT

Receivables Assessment Framework

Portfolio of Buyers
The more buyers, the better

Percentage of Total Open Account Sales Factored

Control on Payment e.g. Controlled Collection, payment destination.

Buyer Concentration

Payment Term
e.g. Credit Tenor

Average Debt Turn

Dilution (Credit Notes)

Product Type
with/without recourse
with/non-notification

Length of Seller – Buyer Relationship

OPERATIONAL RISK IN FACTORING



OPERATIONAL RISK IN FACTORING



“PEOPLE RISK” MANAGEMENT

Internal fraud

- Deliberately manipulated (wrong) reports
- Misuse of company’s signature
- Use of other user’s passwords
- Remittance to wrong beneficiary
- Release of credit line to wrong buyer

Human Errors during processing

- Documents not checked adequately
- Wrong interpretation of reports
- Loss or lack of documents
- Remittance to wrong beneficiary
- Release of credit line on wrong buyer

People
Risk

How to avoid fraud

- Strong Control Framework - 4 eye principle
- Strict controls over daily operations, proxies & I.T. access rights

How to avoid errors

- Concrete procedures – 4 eye principle
- Reporting tools– alerts – exception lists
- Staff Training
 - Internal Training
 - Learning from mistakes

PROCESS RISK

Process Risk (Internal Processes) caused by lack of:

- Definition of roles and responsibilities;
- Formulation of written and detailed procedures;
- Definition of models and methods for monitoring and managing risks;

Process
Risk

LEGAL RISK

Legal risk caused by:

- **Non-compliance with law and regulations**
 - **Factoring legislation in seller's and buyer's country;**
 - **Factoring contracts terms and conditions;**
 - **Insurance Policies terms and contractual obligations;**
 - **General Rules for International Factoring (GRIF);**

Legal Risk

Legal Risk may expose the factor to potentially high losses!

“LEGAL RISK” MANAGEMENT

Local Civil &
Commercial Code:

Validity of
assignment of
receivables;

Local Factoring
Legislation;

Insurance Policies:

Maximum liability;

Main insurance rule
(all seller's buyers
being reported);

Timely reporting to
the insurer;

Monitoring of the
seller's obligations;

Regulatory
framework:

Supervising body
reporting, KYC, AML;

Legal Risk

TECHNOLOGICAL/IT RISK

Technological risk caused by:

- Malfunctioning of IT systems;
- Errors in the programming of applications (Edifactoring.com interfaces), wrong reporting;
- Interruptions in the functioning of systems;
- Security violation;

Technology
Risk



Facilitating Open Account – Receivables Finance



THANK YOU

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