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Application of Factoring in Business Operations

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Abstract

Assignment of receivables as an institution of current civil law is rooted in ancient legal systems. The abovementioned institution was introduced to the Polish legal system under the Code of Obligations of 27 October 1933. This solution occurs in various specific forms serving various legal and economic goals, beginning with the satisfaction of claims of individuals, to securing a claim, to improvement of financial liquidity of the assignor. Thanks to the constant development of the above legal institution it functions in numerous legal systems and constitutes a real support in securing business transactions and making them more efficient.

Keywords

assignment of receivables, factoring, financial liquidity

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Introduction

The article turns attention to a special form of the legal institution of factoring. The aim of the study was to verify whether the solutions, currently applicable in Polish law, concerning assignment of receivables under factoring offer tools that are of assistance in running a business. Moreover, the analysis will also include the issue of the scale of application of this legal solution in Poland. The study is based on the legal-comparative method. This allow for making a critical assessment of the current status of application of the abovementioned legal solution. Keeping in mind that maintaining financial liquidity is the basic element ensuring continued operation of a business, a thesis may be proposed that one of the tools that may effectively secure liquidity is factoring.

Application of factoring in business operations

Introductory remarks

By way of an introduction to the discussion of the application of factoring, it is worth mentioning briefly what it actually consists in. This legal solution actually is an evolution of assignment of receivables known in numerous legal systems. Factoring combines classical assignment of receivables and certain additional features that make it stand out among other legal solutions using the institution of assignment of accounts receivable. It is therefore a legal solution which allows for changing the entity entitled to a given receivable. The factoree, as the original owner of the right underlying his receivable from the debtor, assigns it to the factor – most frequently a financial institution – which in exchange for certain amount of money acquires this right. The factoree may earmark the money received as a result of the transaction for further operations and frees himself of the risk that the debtor fails to pay his debt. Factoring also offers several additional services in the form of the factor's assistance in the running of business activities. These may include bookkeeping and accounting services, legal and tax advisory, analytical support as well as assessment of risks associated with entering into a business relationship with a given entity.

Going further in the said analysis, stressed should be the dichotomous nature of factoring. Its first face has a purely legal character. The other one boils down to treating it as a tool for improving the quality of business operations. The knowledge on the first one, which has a form of assignment of receivables, may be drawn extensively from the accomplishments of the doctrine, Polish and foreign judicial practice as well as historical works on the development of various legal systems. On the other

hand, information on the application of factoring and its additional elements offering support to the entrepreneurs who have decided to employ it should be drawn from statistical sources.

It should be emphasised that the discussed legal solution is one of those institutions which undergo continuous evolution, thanks to which they are able to respond to the newly arising challenges in the legal environment of business transactions. For this reason, it is warranted to perform an analysis of statistical data on the application of factoring in everyday business transactions. Thanks to this it will be possible to verify the actual application of factoring in everyday transactions.

Application of factoring in business transactions on the Polish market

The analysed data are mostly based on the annual reports covering the period from 2018 to 2022 drawn by the Polish Factors Association and the Main Statistical Office (GUS).¹ The interpretation of the available data clearly indicates the dynamic growth of interest in factoring on the Polish market. One of the indicators of increased popularity of factoring is the constantly growing number of clients deciding to make use of this solution.

Passing to the analysis of the gathered material, first the continuous growth of the number of customers who decided to enter into a factoring relationship should be stressed. According to the GUS report of 23 June 2017, the total number of clients of entities offering factoring services amounted to 12,336 in 2015,² while after the end of 2022 it amounted to over 24,800.³ It means a growth by 101% over 7 years. The factoring sector on the financial market is in the cycle of intensive development. Respectively, in 2016 the number of clients increased on previous years by 20%. The year 2017 brought about a growth by 7.25%, and 2018 a growth by another 12.8%. In 2019 the growth was 6.26%, in 2020 – another 12% and 2021 – as much as 21.88%.⁴ These data allow for drawing several conclusions, which may be considered good omens for further development of the sector. Namely, the analysed period shows a continuous and stable growth trend as regards the number of client. These data substantiate the gradual consolidation of the position of factoring on the Polish financial services market. In this context, important are also exclusively positive rates of changes as they indicate growing confidence in the analysed service. Another conclusion that comes to mind concerns the already existing market strength of the discussed legal institution. Despite numerous problems caused by the COVID-19 pandemic, in the years 2020-2021 the rate of growth of the client base was high. It amounted to 12% and 22%, respectively. At the time when numerous industries and national

1. Pl. Główny Urząd Statystyczny.

2. Main Statistical Office, *Factoring activities of financial organisations in 2016*, <https://stat.gov.pl/obszary-tematyczne/podmioty-gospodarcze-wyniki-finansowe/przedsiębiorstwa-finansowe/dzialalnosc-faktoringowa-przedsiębiorstw-finansowych-w-2016-roku,2,12.html>, (access 16.06.2023).

3. Polish Factors Association, *Analysis of the factoring services market after 2022*, <https://faktoring.pl/analizy-i-statystyki/2022-2/>, (access 16.06.2023).

4. Polish Factors Association, *Analysis of the factoring services market after 2021*, <https://faktoring.pl/analizy-i-statystyki/2021-2/>, (access 16.06.2023); Main Statistical Office, *Factoring activities of financial organisations in 2020*, https://stat.gov.pl/files/gfx/portalinformacyjny/pl/defaultaktualnosci/5503/2/16/1/dzialalnosc_faktoringowa_przedsiębiorstw_finansowych_w_2020_roku.pdf, (access 16.06.2023); Main Statistical Office, *Factoring activities of financial organisations in 2017*, <https://stat.gov.pl/obszary-tematyczne/podmioty-gospodarcze-wyniki-finansowe/przedsiębiorstwa-finansowe/dzialalnosc-faktoringowa-przedsiębiorstw-finansowych-w-2017-roku,2,13.html>, (access 16.06.2023); Main Statistical Office, *Factoring activities of financial organisations in 2016*, op. cit.

economies struggled with not insignificant turmoils, factoring enjoyed growing confidence and interest on the part of businesses.

Passing to subsequent statistical data, it is worth indicating the rate of growth of the turnover of factoring organisations. The data have been drawn from the analysis of the Polish Factors Association, which does not affiliate all companies of this type in Poland, nevertheless represents a group whose market share is at the level of 93% of the value of receivables purchased.⁵ Between 2016 and 2022, the turnover of factoring companies grew from PLN 158.1 billion to PLN 460.6 billion, which means a growth by 191%. In 2017, the increase was at the level of 21%, in 2018 – 26.72%, in 2019 – 16%, in 2020 – 2.3%, in 2021 – 25.74%, and in 2022 – 27.09%.⁶

These data also show the steady development of the sector as regards intensification of turnover of factoring organisations. The years preceding the outbreak of the pandemic in Poland and elsewhere in the world witnessed considerable growths of over a dozen or even several dozen percent, which unequivocally testifies to the consolidation of the stability of the sector, strengthening of its popularity and greater confidence in this type of financial solutions. The year 2020, which in Poland was the time of the greatest restrictions as well as social and economic problems, considerably slowed down the development of this sector, though it should be categorically stated that there was no stagnation or regression. The factoring services markets warded off the consequences of the pandemic. The end of 2021 with its of 26% growth proves beyond doubt that the business overcame the negative effects of the pandemic. This could be due to several factors.

In the position of the doctrine describing the institution of assignment of receivables, that is also factoring, we encounter a statement that factors are most often the suppliers of commodities. Sometimes, such a description makes up a fragment of a definition of factoring.⁷ This position is entirely reflected in the statistical data depicting the share of factoring in individual sectors of the Polish economy. Namely, in 2022, production and distribution, that is the supply of commodities, came first. Altogether, the share of those sectors amounted to 81.6% of all factoring services. Further positioned were, *inter alia*, construction and transport. It is not a surprising result since the largest sectors of the Polish economy are characterised by a large scale of operations and have many customers with whom they cooperate. It involves considerable cashflows. In previous years, this share was on a similar level. In 2018 it was 82.4%, in 2019 – 78.6%, in 2020 – 79.9%, and in 2021 – 80.1%. It is evident that that share continued to be more or less 80%.⁸

5. Polish Factors Association, *Analysis of the factoring services market after 2021*, op. cit.; Main Statistical Office, *Factoring activities of financial organisations in 2016*, op. cit.

6. Polish Factors Association, *Analysis of the factoring services market after 2022*, op. cit.; Polish Factors Association, *Analysis of the factoring services market after 2021*, op. cit.; Polish Factors Association, *Analysis of the factoring services market after 2020*, <https://faktoring.pl/analizy-i-statystyki/2020-2/>, (access 16.06.2023).

7. K. Kreczmańska-Gigol, *Faktoring w teorii i praktyce*, 3rd ed., Wydawnictwo “Helion” 2007.

8. Polish Factors Association, *Analysis of the factoring services market after 2022*, op. cit.; Polish Factors Association, *Analysis of the factoring services market after 2021*, op. cit.; Polish Factors Association, *Analysis of the factoring services market after 2020*, op. cit.; Polish Factors Association, *Analysis of the factoring services market after 2019*, <https://faktoring.pl/analizy-i-statystyki/2019-2/>, (access 16.06.2023); Polish Factors Association, *Analysis of the factoring services market after 2018*, <https://faktoring.pl/analizy-i-statystyki/2018-2/>, (access 16.06.2023).

Given many types of factoring available on the market, the analysed reports of the Polish Factors Associations and the Main Statistical Office divide the applications of various subtypes of factoring into three categories that are most popular. The first one is full service factoring and recourse factoring, the second one – domestic and international factoring, whereas the third one – non-confidential (disclosed) and confidential (non-disclosed) factoring. In 2022, most popular in the first group was recourse factoring. This type of service accounted for 51.03 of all contracts. Full service factoring accounted for the remaining part.⁹ This almost equal division leads to a noteworthy conclusion. Despite that fact that the costs of full service factoring associated with the transfer of the risk of the debtor's insolvency onto the factor are higher, this solution enjoys almost equal interest as recourse factoring. Thus as conclusion may be drawn that the entrepreneurs who use factoring are guided by the actual needs of their businesses rather than seek the cheapest possible way of resolving the problems they are facing. What is important, the growth of popularity in this group was 22% for full service factoring and 32% for recourse factoring on the preceding year 2021.¹⁰

It should be stressed that as regards the comparison of 2019 and 2020 this proportion is totally different. In this case we deal with evident slowing down and decline of popularity of the abovementioned forms of factoring. Namely, the number of full service factoring contracts in 2020 was by 3% smaller than in 2019.¹¹ Therefore, the decline in the number of contracts is not surprising, especially when we consider the important feature of this subtype, i.e. transfer of the debtor's insolvency risk. It may be stated that at that time factorees might have been more eager to conclude this type of contracts, whereas the calculation of the potential risk on the part of factors led to their reluctance to conclude full service factoring contracts. In the case of recourse factoring, the year 2020 ended with the 9% growth of the number of contracts concluded.

Passing to the second category of contracts, i.e. domestic and international factoring, the overwhelming majority of them were domestic ones. Over the last 5 years, domestic factoring was almost 5 time more popular.¹² From 2017 until the end of 2022, the popularity of domestic factoring increased by 100.1%. On the other hand, for international factoring this growth amounted to 146.7%. Taking into account absolute figures, it should be stated that the year 2022 was ended with the turnover of the total value of PLN 380.36 billion for domestic factoring and PLN 80.15 billion for international factoring.

9. Polish Factors Association, *Analysis of the factoring services market after 2022*, op. cit.

10. Ibidem.

11. Polish Factors Association, *Analysis of the factoring services market after 2020*, op. cit.

12. Polish Factors Association, *Analysis of the factoring services market after 2022*, op. cit.; Main Statistical Office, *Factoring activities of financial organizations in 2017*, op. cit.

The third category that was analysed is the division into confidential and non-confidential factoring. Being aware that the debts are more effectively collected from the customers who know about the presence of a provider of factoring services in the business relationship of their creditors, factorees show greater discipline and timeliness in paying their dues. For this reason, the overwhelming majority of transactions was embraced by non-confidential factoring. In 2022, this option was selected for factoring services worth PLN 422.5 billion. On the other hand, confidential factoring amounted to PLN 38.4 billion. In the analysed four-year period, from 2018 the interest in non-confidential factoring increased by 91.57%. In the case of confidential factoring this growth amounted to 70.65%.

Over merely 5 years, the value of this type of contracts increased almost twofold. The rate of growth over the years was as follows: In 2018, the growth amounted to 29% on the preceding year, 2019 – 17%, 2020 – 5%, 2021 – 27%, whereas 2022 – 28%.¹³ The above presented evidently rapid development of the popularity of non-confidential factoring points to a significant aspect. Namely, it is noted in the doctrine and in practice that one of the fears of factorees associated with their making use of the service is a negative change in their perception by debtors. Such change may contribute to the deterioration of business relationships. In the debtor's opinion, using the factoring service may be a manifestation of the creditor's mistrust of their business partner. On the other hand, the debtor may interpret such information as a manifestation of financial problems, which may also discourage them to continue the business relationship with the factoree. However, the analysis of statistics points out a positive trend among entrepreneurs. On the basis of the collected data it may be stated that the Polish factoring market is ever better understood by entrepreneurs and is no longer treated as something foreign, unfamiliar, and what follows – bad and unwanted. Enhanced consciousness results in greater interest in factoring.

The analysis of the data from the last years shows a continuously strong and dynamic development of the factoring sector in the Polish market. The data from the time of the pandemic reveal that despite such difficult times for business this sector has survived. It will undoubtedly become more and more valuable and popular in the forthcoming future. The phenomenon of factoring should be treated as a decidedly favourable one since it is but another factor positively stimulating the domestic market for further development and consolidations of the Polish economy in both internal and international relations.

13. Polish Factors Association, *Analysis of the factoring services market after 2022*, op. cit.; Polish Factors Association, *Analysis of the factoring services market after 2021*, op. cit.; Polish Factors Association, *Analysis of the factoring services market after 2020*, op. cit.; Polish Factors Association, *Analysis of the factoring services market after 2019*, op. cit.; Polish Factors Association, *Analysis of the factoring services market after 2018*, op. cit.

Advantages and disadvantages of factoring

Analysing the strengths of factoring one should primarily point out the fast and relatively easy access to considerable funds. This constitutive feature of factoring enables factoree to operate on a larger scale, to undertake greater risks, since they have the backing of professional entities which secure their interests. Of course, it is not full security, nonetheless allows for making bolder decisions. Cash received by a factoree allows him e.g. to prolong the term of payment, which in consequence may result in a greater number of orders they receive. This, in turn, contributes to attaining a greater economy of scale, which in almost every industry is tantamount to consolidation of market position and considerable increase of revenues.

An important factor which must not be forgotten is the pace of factoring operations as regards cashflows. Taking advantage of modern mobile solutions, the factoring organisations make it possible for their client to conclude contracts and submit invoices for assignment online. Under such system, cash may be received within 24 hours from signing the contract. It is regarded as one of crucial advantages. Access to quick cash allows also for payment of own dues on time and avoiding the risk of having to pay interest for delay or other contractual penalties. Moreover, entrepreneurs avoid the hazard of being entered in the register of debtors, which in the future would considerably complicate the procedure of getting any loan or credit.

Another advantage is linked with the form of non-confidential factoring, under which the debtor is informed that as a party to a business relationship (factoree) they use the factoring service. According to the statistics analysed by the Polish Factors Association, business partners/debtors who are knowledgeable as regards the application of factoring services in the case of their transaction are more disciplined as regards timely payments of all their dues. This is evidenced by the constantly growing interest in the use of non-confidential factoring services.¹⁴

As it has been mentioned above, this service opens up access to funds for the factoree. Their appropriate allocation leads to a more rapid development of the company, which later on provides access to successive bigger funds. We deal here again with the economies of scale. Well thought out decisions in this matter may lead the factoree to rapid expansion of their business operations. It should be noted that there is another, dangerous side to this issues. Being sure of access to considerable cash resources the decision maker may disrupt his own supplies to the realised investment

14. Polish Factors Association, *Analysis of the factoring services market after 2022*, op. cit.

project and its scale. A large amount of cash may cause that desiring to develop their operations further the factoree makes a too hasty investment decision, resting on the assumption that regardless of whatever they do they still have sufficient funds at their disposal. This is one of the risks associated with having a relatively easy access to funding. The certainty of raising more funds may make one inclined to making insufficiently justified financial moves.

As an alternative to operating loan, factoring is much more easily available for an average user. The companies offering this service do not pose such rigorous threshold conditions as financial institutions granting operating loans. A potential factoree does not have to operate on the market for at least one year. Creditworthiness is neither a necessary issues here. On the other hand, important is the greater availability than in the case of solutions based on the principle of the abovementioned operating loan. Availability may be understood also as the degree of the potential factoree's involvement, the result of which is raising funds for financing business operations. What is equally important is that the money raised under factoring may be allocated for any purpose. Money received from a bank in the form of an operating loan may be controlled as regards its allocation.

One of the basic functions of factoring is taking over *del credere* liability associated with the risk of debtor's insolvency. It should be emphasised that this is not a fixed element of each factoring contract. Whether the factor obliges themselves to assume the risk of debtor's insolvency depends on the type of the receivable, debtor's degree of solvency and the decision of both the factoree and the factor.¹⁵ This advantage may turn out to be an invaluable relief for the entrepreneur. Assumption of liability constitutes a practical closing of the matter of collection of receivables on the part of the factoree. Obviously, the costs of such service is higher, where rather one should not count on payment of more than 90% of the par value, but it free the factoree from a number of problems associated with no satisfaction of the claim by the debtor. In exchange for a smaller profit, the factoree may focus on further development and running his business operation.

Analysing the advantages of factoring worth noting is another valuable aspect. Providers of factoring services are usually large and well organised companies with substantial analytical and financial potential. Making use of the financial potential is a fundamental and obvious purpose for which an entrepreneur decided to establish a relationship with a factor. However, it should be stressed that entering into a relationship with a factoring service provider involves a possibility of using the extremely broad analytical potential of such an entity. As a professional entity, a factor has

15. M. Stec, *Prawo umów handlowych*, Vol. 5C, 1st ed., System Prawa Handlowego 2017, p. 731.

a large number of qualified employees, whose abilities to collect and process data are much greater than those of the factorees themselves. Going into greater detail, it should be underlined that as regards risk, market and customer analyses factoring services may be also used with tangible benefits by those entrepreneurs who have no problems with liquidity. Using the service for such purposes may be regarded as safeguarding the business against potential problems in the future.

Another advantage is undoubtedly flexibility of the service. Apart from a broad range of possible additional options, flexibility is also manifested by less strict bonds between the contracting parties. Practice shows that factoring contracts are concluded for an indefinite term with the possibility of their termination upon notice. In the case of an alternative operating load, signing of an agreement involves an obligation to use the funds that have been made available for a period of 36 to 48 months. Given considerable unpredictability of business operations it is hard to predict how business will be doing in such a distant future. Moreover, factoring does not reduce the financial capabilities of a company as opposed to the abovementioned operating loan.

In light of the above presented significant advantages of factoring, it should not be mistakenly recognised as the ideal solution for all problems entrepreneurs may have. Factoring also has several disadvantages. First of all, each service involves certain expenses. Usually, they do not exceed several percent. As regards fees, there are such charges as the commission fee, entry fee, operational fee, preparatory fee. Factorees are also obliged to pay interest on the funds that have been made available to them. Having in mind the fact that frequently an entrepreneur's profit amounts to 12% – 15%, a decision has to be made whether using the factoring service will not render the business operations unprofitable. It should be admitted that speaking about the price of a service as a disadvantage may be somewhat wrongly perceived, though it should be stressed that the basic aim of each company is to yield the highest possible profits, while generating potentially redundant expenses is not helpful.

Another disadvantage refers to the relationship between a factoree and their potential business partner as regards its aspect of mutual confidence. On one hand, using factoring may be perceived as a manifestation of financial problems that already exist on the company, which may be a bad omen for future cooperation with the factoree. It is obvious, however, that using factoring is tantamount to financial hardships. The other aspect concerns a negative evaluation of using factoring from the viewpoint of the factoree's confidence *vis-à-vis* their customer. Settling accounts with

the factor rather than the supplier the contracting party may assume that the supplier does not sufficiently trust the other party, which may result in the wearing out of the hitherto formula of cooperation and ending the business relationship, which obviously involves a loss for the factoree. It should also be stressed that factoring is not yet common enough so that learning that the service has been used by a given entrepreneur did not arouse suspicions of the other party. Undoubtedly, further development of the discusses legal solution for business will in time make it commonly used.

It should also be underlined that taking over the receivable by the factor not always puts a definite end to the process of asserting a claim. Full assumption of liability for the debtor's solvency is possible only under full service factoring, which is more expensive and less easily available. In other cases, after unsuccessful enforcement the factor is entitled to a return assignment of the receivable, which in turn makes the factoree obliged to return the money they have received earlier.

With a view to the above, it should be stated that factoring offers a favourable balance of advantages and disadvantages, and is a solution helping to improve financial liquidity of a company.

Conclusions

The efficient functioning companies is a key element that determines dynamic economic development of a country and prosperity of its people. One of the crucial elements determining the efficiency of a given company is its financial liquidity. It is frequently very problematic to secure. Offering support to entrepreneurs in the form of factoring is one of the tools that can provide financial liquidity necessary for its continuing as a going concern.

The available solutions meant to help maintaining financial liquidity of a company include a number of propositions. One of them is factoring. It may well be stated that this is one of the more favourable solutions. This thesis finds confirmation in statistics, which show a gradual increase of interest in this service among Polish entrepreneurs. The development of factoring carries a number of potential solutions that may comprehensively respond to the needs of the constantly changing market. The above presented features of factoring combines with its application allow for stating that it is a tool undoubtedly supporting business operations and thus improving its competitiveness on the market.

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