Factoring and Confirming: not just an English fashion

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01. Factoring: What is it?

Factoring is an alternative financing instrument, consisting of the transfer of sales collections to a financial institution. It allows a company, for a certain fee, to receive money from a sale before the customer has paid.

It is a useful financing alternative for companies when their customers pay in periods of 30, 60 or 90 days, as well as a useful financing instrument for exports, since it allows companies to have the money from these sales available in cash, and ensures the monitoring of debtors by professional experts.

The financial instrument is materialized in a contract signed between the company and a financial entity, according to which the company transfers their portfolio of customer collections to the factor company, who deals with charging the customers of company.

A factoring contract, as Rosario Maria Medina Lopez states in his article on the subject, can include a complete range of complementary services such as:

- Administration and management of collection of commercial debts with the company,
- Commercial research of client companies with outstanding debts, and their classification according to the payment and solvency guarantees being offered,
- Detailed control of collections and payments,
- Cover of risk of insolvency: this is a benefit that increases the cost of the factoring contract, and which presents two different scenarios: factoring with resources – echtes factoring – where the financial entity assumes the risk of insolvency of the debtors, and factoring without resources – unechtes factoring – where the risk is not assumed by the financial entity,
- Obtaining funding by means of advance payment of invoices. The financial entity is obliged to advance to the company, the amount for the outstanding credits of the clients, which means that the company has cash funds available sooner, this being an alternative or complementary financing channel to traditional credit lines.

The rate or commission charged by the financial entity for factoring services varies between 0.5% and 2% of the total of transferred invoices, based on the number of debtors, location of the same, risk of collection, etc. In addition, if the company requests an advance for the credit amounts from the financial entity, it has to pay interests based on the advanced amount and period remaining to collect it.
Advantages

- Saves time and expenses, accuracy in obtaining reports,
- Guarantees collection from all customers,
- Simplifies accounting since, by means of the factoring agreement, the user company now has only one customer, who pays in cash,
- Enables you to receive advances on transferred credits,
- For managerial staff, offers a saving of the time invested in supervising and directing the organization of sales accounting,
- Can be used as a source of financing and obtaining working resources,

Disadvantages

- High cost of factoring, since the interest rate applied is usually higher than the conventional commercial discount
- The financial institution reserves the right not to accept some of the documents of the companies hiring the services
- Operations related to periphery products and long-term operations (more than 180 days) are excluded
- The company remains subject to the criteria of the financial entity to evaluate the risk of operations of its customers,
- Loss of capacity of negotiation with customers on possible contingencies, a factor which can have a negative impact on the customer relationship.
Some financial institutions have factoring products designed for the private market – commercial relationships between companies –, and others designed for the public sector – commercial relationships between a company and public bodies and administrations-. However, the most common classifications identify the following operations:

### Serving the content:

- Factoring with financing or credit-cash, where the user company receives immediate payment for the transferred credits from the financial entity, independently of the due date of the respective invoices, paying interest on the financing received and,
- Factoring without financing or maturity, where the credit amount is not paid in advance and the company receives the invoice amount at the moment when this is paid by the debtor to the financial entity.

### According to whether the contract is notified to the debtors or not:

A transfer clause is included in each invoice in text format, which states that the invoice is subject to the factoring contract between the financial entity and the company, and that the amount of the same must be paid to the financial entity. The clause can be hidden voluntarily when the company does not consider it appropriate that the debtors have knowledge of its relationship with a financial entity by means of this debt management system.
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03. Factoring: How does it work?

It is the formalization of a contract, by virtue of which a specialized company (the factor or factoring company -in Spain, these tend to be financial entities, banks and building societies) deals with the collection of invoices, drafts, receipts, promissory notes or other documents of credit, pending collection on the part of the company (the factored company or user).

Once the decision is taken to employ Factoring services for the management of collections, the process is the following:

- Submission of the portfolio of customers to be included in the factoring contract to the financial entity who makes an analysis of the geographic location of the clients, average volume of sales of each client company, established systems of collection and solvency of each client.

- Based on this analysis, the financial entity makes a contract proposal, indicating which client companies it is willing to cover for invoices, the minimum volume of transfer and cost of its services, expressed as a commission based on the volume of collections and geographic location of the clients managed by the entity.

- If the company accepts the proposal, it will have to contact each of the client companies affected by the contract, to inform them that from a specific date, they will need to pay the financial entity, who will submit to them the invoices to be collected in the period and manner established.

- Finally, technical adjustments to the invoicing systems of the company must be carried out, in order to make communication of invoices to the financial entity as simple and as smooth as possible.

All major banking entities offer this type of products, and approaching the banking institution with which you normally work is a good way to begin negotiating possible contracts of this type.
04. Confirming: What is it?

If Factoring consists of transferring collections to a third entity, confirming is the exact opposite: it consists of transferring the payments.

It is a service offered by financial entities which involves management of the payments of a company to its suppliers, offering them the possibility of advance payments. It enables the company contracting the service, therefore, to guarantee its sales collections and simplify its management of payments for purchases.

Confirming is an attractive option for companies that:
- Have a high number of supplier companies,
- Have a complex payments system,
- Wish to lengthen the payment period or improve their conditions of purchase.

Advantages

- **For the client company:**
  - Improve the image it has with its suppliers because they receive the guarantee of a financial institution,
  - Avoid costs of emission of promissory notes and cheques or manipulation of drafts,
  - Avoid the incidents which are produced in the standing order of receipts,
  - Avoid telephone calls to suppliers to find out about the state of their invoices,
  - Avoid the monitoring of several current accounts to reconcile the charges of drafts, promissory notes or cheques,
  - The company maintains the payment initiative,
  - Receive information which can be very useful in purchases management.

- **For the supplier company:**
  - Can charge its invoices in cash, prior discount of the financial costs, eliminating completely the risk of non-payments,
  - Receive the concession of a line of credit without limit and without consuming its own credit,
  - Avoid payment of stamp duty when making collections through transfers.
Disadvantages

- **The client company:**
  - Even though it maintains the initiative in payment, the client company is obliged to work with a particular financial institution, with the loss of manoeuvre capacity that this entails,

- **The supplier company:**
  - Loses the initiative in collection, transferring it to the customer.
05. **Confirming: How does it work?**

It begins with the negotiation and signing of the confirming contract with the financial entity in question, and payment of a deposit for the average volume of payments transferred in the operation.

The rest of the process involves the following actions:

- On receipt of invoices from the suppliers, the confirming company proceeds to verify and confirm them.
- Once the invoices have been confirmed, the invoicing details are communicated to the financial entity, along with the date and amount of the payments to be liquidated.
- The financial entity contacts the supplier to inform it that its invoice is confirmed and that, therefore, it can advance collection of the same, simply by communicating it to the financial entity.
- The supplier decides whether to accept the conditions of the advance collection offered by the financial entity, and communicates the same.

In the case of acceptance of conditions, the supplier company has two options:

- Charge by means of bank transfer to an account of its choice; or,
- Open an account for the payer company into which, once communicated, the invoice will be paid.

In the case that the supplier is not interested in advancing the collection, it will receive a promissory note with the due date established in the invoice.

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06. More information

At most of the banking institutions operating in Catalonia

- ABANFIN: "Introducción al factoring i confirming"
  http://www.abanfin.com/modules.php?name=Localizador&fid=ff0bcab

  [online article] Revista Sociedad de la Información.com, nº 8, 2004

Last day accessed: 23/11/2009

Written by the Barcelonanetactiva team from the following sources of information:

- “Instrumentos financieros” in web of Dirección General de Política de la PYME: >Inicio > Financiación PYME >Instrumentos financieros “Instrumentos financieros” :
  http://www.ipyme.org/es-ES/Financiacion/Instrumentos/Paginas/default.aspx

- ABANFIN: "Introducción al factoring y confirming"
  http://www.abanfin.com/modules.php?name=Localizador&fid=ff0bcab

  [online article] Revista Sociedad de la Información.com, nº 8, 2004

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