

European Research Studies,
Volume XVIII, Issue 3, 2015
Special Issue on “The Role of Clustering in Provision of Economic Growth”

pp. 51-62

Development of Factoring Market in Russia

Olesya Stroeva¹, Natalya Sukhorukova, Aleksandr Tsvyrko, Tatyana Ivashchenko

Abstract:

The article studies types of factoring used in the Russian Federation. The current state of the market of factoring services in the Russian Federation is analyzed, and main players which occupy leading positions in this market are determined. As a result of the conducted research if modern tendencies which take place in the Russian economy and analysis of the state of factoring market, and with the use of methods of scientific generalization, the tendencies of development of factoring market in Russia are substantiated. The main tendencies are: stagnation or reduction; growth of debtors' default level; reduction of factoring rates for SME and large business; development of electronic factoring. The authors determined key factors which allow Russian factoring companies to occupy corresponding niche in the sphere of international trade relations. It is determined that at the current stage, the top-priority directions in development of factoring market are: development of E-factoring, deals with small and medium business, and factoring without financing.

Key Words: *Factoring, Commercial Banks , Crediting, Factor, Factoring Operations, Factoring Services Market*

JEL Classification :

¹Russian Presidential Academy of National Economy and Public Administration, Moscow, Russian Federation, Tel: +79103000119; E-mail: stroeva-olesya@mail.ru

1. Introduction

Factoring develops gradually in Russia. While in the countries of Western Europe, factoring turnover constitutes more than 5% of GDP (in Great Britain and Italy – 10%), in Eastern Europe – 1.5-2% of GDP, in Russia it accounts for less than 0.1% of GDP. Around 67% of factoring turnover accounts for Europe, 22% - for America, 11% - for countries of Asia, and 1% – for Africa. Approximately 1,000 companies are involved with factoring in the world, and the volume of debit debt reaches EUR 1 trillion (Russian factoring market, 2015).

At present, it is impossible to speak about successful business without external financing – i.e., crediting and factoring. Factoring is a type of trade and commissioning operation, combining with crediting of client's current capital. The basis of factoring operation is purchase by bank (or factoring company - Factor) of commercial invoices of supplier for delivered products under the conditions of immediate payment and transfer by supplier to bank or Factor the right of demand of payment from debtor. There are two types of factoring in the global banking system: conventional and confidential. In case of conventional factoring, requirement is sold to bank and supplier reflects it on his accounts. In case of confidential banking, contractors of supplier do not know about bank's crediting its sales (Hughes & Mester, 2012; Grigorian & Manole, 2011).

2. Research Methods

The main goal of factoring is financing of current business, which shows a serious difference from crediting, which supposes investment activities on the whole. Factoring is a certain complex of financial services, the aim of which is transfer or cession of right for existing debit debt of organization. That's why factoring is a type of crediting aimed at received products or performed services. That is, when organization provides service of installment payment plan, there is no need for waiting until the end of designated term, for there is a possibility to receive money for commodities or services after their delivery from factoring agency, so-called intermediary (as a rule, these are credit organizations), not from buyer. The principle of debt collection is based on cooperation of bank and organization, without business. In this case, factoring agency takes responsibility to pay the debt, which provides advantages for business, as it has money.

The above shows that factoring is an excellent possibility for business to receive payment for products or services before their realization to final buyer.

Attractiveness of factoring is caused by the fact that it combines several functions:

- firstly, financing of current capital;
- secondly, collection of client's debt;
- thirdly, if envisaged by contract, factoring takes up risk of non-payment, thus playing the role of insurer of financial risks.

This complex of functions makes factoring an irreplaceable mechanism for small and medium enterprises, which traditionally have difficulties with access to credits.

Factoring members are:

- firstly, supplier – factor's client, i.e., creditor;
- secondly, buyer, i.e., debtor;
- thirdly, factoring agency (intermediate), which is called factor.
-

Factoring servicing of clients is a multi-stage process, each stage of which has its purpose. It is advisable to distinguish three stages of this process:

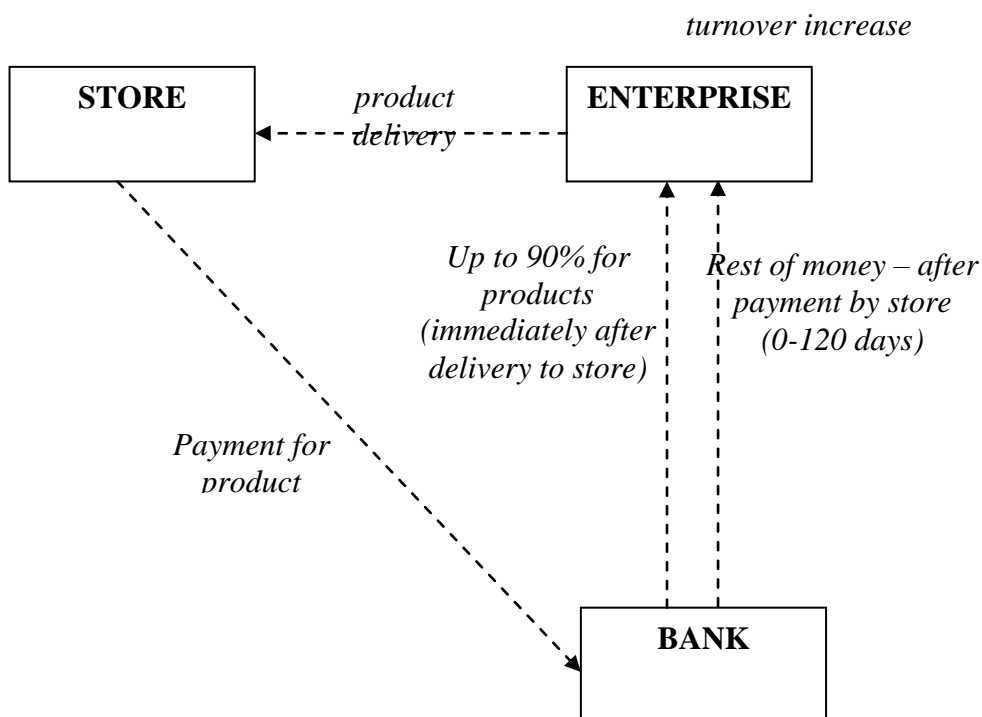
1st stage – preliminary work;

2nd stage – documents preparation;

3rd stage – monitoring of factoring deal.

Factoring helps the agreement parties to stay with their interests with the least possible risks. That is, supplier receives his assets, buyer sells products, and factor receives certain commission from the deal. Unlike crediting, factoring does not require guarantee or warrantor. Besides, factoring terms are flexible, and final interest rates are much lower than with other types of crediting (Nadezhdina & Sandakov, 2015). Figure 1 shows a scheme of factoring operations.

Figure 1 – Scheme of factoring operations



Factoring develops with the development of modern market. Adjusting to modern tendencies, factoring acquires more and more types which can offer potential clients a lot of innovational solutions (Stroeve, Mironenko, Merkulov & Chubarets, 2015; Stroeve, Sukhorukova, Tsvyrko & Ivashchenko, 2015):

1. Factoring with recourse. Used with realization of goods with payment delay. Factor usually purchases no more than 90% of debit debt. When the term expires, recourse emerges – and factor receives a right to demand from enterprise (client) the financing. At that, factoring company faces almost zero risks. Especially convenient for partnership with regular clients.
2. Factoring without recourse. Factor has to claim the debt from creditor or buyer if he hasn't paid all invoices it time. This service creates a lot of risks for factor, so it is much more expensive than the one with right of recourse. This type of factoring is especially actual during working with new clients – creditors.

3. Internal factoring. Supposes that all members of a deal are located in the same country and place.

4. International factoring. Supposes that the members of a deal could be various subjects of various countries. In this case, two factors take part in a deal – one represent supplier, another represents buyer.

5. Open factoring. It supposes that creditor-buyer knows that agreement includes factor which conducts payments at his expense. In this case, debtor is informed of redirection of payments to the address of factor company, which is stated in commercial invoice.

6. Closed factoring. Supposes that debtor should not be informed of factor's participating in a deal.

7. Reverse factoring. It is important for creditor, i.e., buyer, as it allows postponing payments of credit debts for goods that are already received. At that, second participant of agreement does not lose anything.

8. Factoring for works or services. It supposes that factor enters agreement later than with other types of factoring. This type is actual when, due to certain force majeure circumstances, company experiences urgent need for external financing.

Russian market of factoring is open; any factoring company or bank that are registered on the territory of the RF and perform activities for providing services (financing, debit debt management, debt collection, risk protection) for monetary claims cession can enter it (Kondrashov, 2012). Expert RA agency conducted study of factoring market and determined the largest Factors (Fig. 2) (Factoring market, 2015).

The study analyzes work of 26 largest players in the factoring market as of year-end 2014, the cash flow of which constitutes around 95% of total volume of factoring market. The rates of growth of factoring market in 2014 reduced by three times – from 30% to 9%. Nevertheless, activization of demand from small and medium business and growth of volume of factoring operations without payment of financing allowed the market to reach RUB 2 trillion.

In 2015, Factors paid special attention to portfolio quality, which led to tough struggle for clients from trade segments with stable demand. As a result, nominal volumes of market reduced by 10-15%, even despite the expected effect from the Sberbank activities and quick inflation. Volume of monetary demands, transferred in 2014, constituted appr. RUB 2.06 trillion, which is 9% more than in 2013. Positive dynamics in the market was ensured by work of Factors in first half of the year

(+17.3%), while during the last three quarters of the year the market didn't grow, as compared to the same period of the previous year (growth rates in III and IV quarters constituted 3% and 2%, correspondingly). Negative influence on market volumes was performed by reduction of demand from large business and Factors' changing approaches to risk evaluation. The market dynamics was supported by the segment of small and medium business, the volume of deals in which grew by 28%, as compared to the previous year, and constituted RUB 500 billion.

Aggravation of payment discipline of debtors ensured quick growth of the volume of factoring operations without payment of financing. Facing the growth of factoring cost and reducing payment discipline of intermediaries, large suppliers were obliged to refuse financing, preserving demand for Factors' services for payment collection. In their turn, Factors – under the condition of margin reduction – also started promoting services for management of debit debt more actively, thus hoping to increase the share of income which is less subject to interest risks. As a result, total volume of factoring operations without financing payments, which account for factors, grew by 44% over the year, reaching RUB 214 billion.

In 2015, the market features strengthening of risk management and tough struggle for clients with sustainable business. Development of factoring market in 2015 is determined by increased cost of loaned assets, reduction of consumer activity of population, and strengthening of problems of financial character. Risk zone covers companies that work in the spheres of construction, sales of electronic devices and cars. Market members struggle for clients involved in the segment of sales of everyday products, as the crisis will influence them in a less degree. Servicing these enterprises will support the market's volumes.

The volume of factoring market in 2015 reduced by 10–15%. Development of the market supposes average annual oil price of USD 50 per barrel and inflation level of 15–17%. Implementation of these preconditions will lead to reduction of market volumes by 10–15%. In case of implementation of optimistic scenario, the market, as of year-end 2015, will show dynamics which is close to zero. Pessimistic scenario supposes that reduction of market turnover can reach 40%. The market will be supported by expected activation of Sberbank Factoring LLC and deals with SME, the demand from which will stay at a high level during the whole 2015. Nominal growth of market volumes will be supported by increased inflation. All three scenarios suppose preservation of geopolitical tension, reduction of real GDP, and aggravation of indicators of internal and external trade turnover.

As of the end of 1st quarter of 2015, total volume of transferred monetary claims constituted RUB 350 billion. Thus, volume of factoring market reduced by 22%, as compared to the same period of the previous year.

Top-3 players of the market include VTB Factoring, Promsvyazbank, and Petrocommerts Bank which moved ALFA-BANK (it had been third as of year-end 2014). In 2014, factoring market will face a range of serious challenges. Firstly, threat of growth of “bad” debts will lead to stricter selection of small and medium enterprises, which receive goods. Besides, there is probability that some suppliers will work only with prepayment.

Another limiting factor is reduction of accessibility of banking funding for Factors, as a result of increase of key interest rate of the Bank of Russia, which took place in March 2014, and of aggravation of liquidity situation. At that, outflow of capital and aggravation of possibility to attract additional foreign financing will also influence the banking sector in a negative way. With growth of default rate of portfolio, all these circumstances may lead to increase of factoring cost for final consumers.

Additional pressure on market indicators will be done by unstable ruble rate. Certainly, ruble depreciation somewhat pushed consumers to purchase imported products of long use (for example, electrical goods and cars) for the purpose of avoiding depreciation of their savings. However, not only the prices for expensive electrical goods, but for specific everyday use goods, were changed in March. In its turn, increase of prices for imported products opens opportunities for increasing volumes of sales for national manufacturers, which, to a certain extent, will compensate the reduction of demand for products of their foreign rivals, and, as a consequence, will ease the collapse of this segment.

A perspective direction for the market development is still the segment of state orders financing, but probability of significant increase of volume of deals for state orders is rather low. A supporting point is still international factoring; but this segment is not open for all Factors, and the growing geopolitical tension may lead to difficulties in expansion of volumes of transborder activities to the West. That’s why in 2014, the share of financing of international deals constitutes no more than 4% of the market. The share without recourse in the total volume of the market is 34–36% - under the condition that Factors’ approaches to evaluation of small and medium debtors will be subject to significant correction. Otherwise, it will reduce to 30–32%.

Without access of Factors to the factoring market of state orders and with preservation of dynamics of real GDP at the level of 2%, the rates of growth in 2014 constituted 20%. This allowed the market to reach RUB 2.3 trillion.

The conducted analysis allowed distinguishing the following directions of development of factoring market in Russia.

1. Stagnation or reduction. At that, while in 2014 positive growth of volumes of transferred monetary claims was expected, in 2015 it is expected that factoring market will reduce by more than 5%.

2. Growth of debtors' default rate. This is accompanied by strengthening of price competition and reduction of marginality of factoring business, which is the main restraining factor of factoring market development.

3. Reduction of factoring rates for SME and large business.

4. Development of E-factoring.

As a result of survey of Factors' top managers (Results of survey of top managers, 2015), performed by RAEX (RA Expert) within annual professional conference "Factoring in Russia – 2015", devoted to perspectives of factoring market, the main directions of market development were determined. The respondents included representatives of such Factors as VTB FACTORING LLC, Promsvyazbank OJSC, ALFA-BANK JSC, Petrocommerts Bank, RB Factoring LLC, NFK group of companies, FK Otkrytie Bank OJSC, Metallinvestbank OJSC, MOSKOVSKIY CREDITNIY BANK OJSC, FK LIFE LLC, POLITEX group of companies, TKB OJSC, MDM BANK OJSC, R.E. FACTORING LLC, FK KLEVER CJSC, FEK LLC, OFK-MANAGEMENT LLC, TsentroKredit OJSC, FTK LLC, etc. (Results of survey of top managers, 2015).

As compared to 2014, expectations of Factors' top managers as to market dynamics became more optimistic. Thus, while a year ago all respondents were expecting positive growth of volumes of transferred monetary claims, at present 23% of respondents consider that market volume will reduce by 15-25%, 18% consider that its growth rates will reduce by 5-15%, and 5% of respondents expect reduction by more than 25%. Approximately 36% of respondents forecast the rates of growth of the market for 2015 within $\pm 5\%$. Only 18% of the respondents are positive – they expect the market growth to be more than 5% as of year-end 2015. Only 18% of the respondents are optimistic concerning dynamics of the market in 2015.

As to dynamics of particular companies, forecasts are more optimistic. Thus, a third part of respondents think that the volume of transferred claims will grow by more than 15%, another third part expects the growth rate of business to be 5-15%. 19% of respondents are more conservative – they plan that dynamics will be around $\pm 5\%$ as of year-end 2015. Pessimists, who expect reduction of volume of transferred claims by 5-15%, constitute 10%. Even lesser number of respondents (5%) think that volume of their companies' business will reduce by more than 15% in 2015. According to 66% of the respondents, volume of factoring business of their companies will grow by 5% in 2015.

A key challenge for development of factoring market in 2015 is the growth of default rate of debtors (59% of respondents). Among significant threats, top

managers distinguish strengthening of price competition and reduction of marginality of business (14% of respondents each). Reduction of demand for factoring and growth of the number of fraud operation are among the factors that hinder the market development – 9% and 4% of the respondents, correspondingly.

At the beginning of 2015, real share of “bad” assets in Factors’ portfolios constituted 8-11%. Deals with expired waiting period accounted for 14% of total factoring portfolio. Real share of “bad” assets in Factors’ portfolios constituted less than 5% at the beginning of 2015. More than 2/3 of the respondents evaluate the real share of “bad” assets in Factors’ portfolios at the beginning of 2015 as 8% or more than 9%.

As to the share of problematic assets of Factors as of year-end 2015, only 14% of top managers are optimistic: they consider that the share of problematic assets of Factors will reduce at the end of 2015 (only 2% of respondents thought so a year ago). 14% of the respondents expect the change of the share by ± 0.5 %. The remaining respondents expect the growth of the share of Factors’ problematic assets within 3% as of year-end 2015. (8% of respondents), 3-5 % (32% of respondents), or more than 5 % (32% of respondents). 72% of respondents expect the share of Factors’ problematic assets grow by 14% as of year-end 2015.

Forecast for 2015 as to dynamics of factoring deals in the segment, where supplier and buyer are representatives of SME, leaves a lot to be desired. More than 70% of the respondents think that factoring rates in the segment of small and medium business will reduce. At that, 19% forecast reduction of rates by more than 2%. Stabilization of rates at the level of 2014 is expected by 14% of respondents. 14% of respondents suppose that factoring rates for small and medium business will grow by more than 2%. Most of respondents (72%) expect reduction of factoring rates in segment of SME by 14%.

Forecast for 2015 as to dynamics of factoring rates in segment, where supplier and buyer are representatives of large business, is no less hopeful. As a result of the survey, top managers agree that the growth of factoring rates in the segment where supplier and buyer are representatives of large business cannot be expected in 2015. At that, 96% of respondents forecast reduction of rates: 73% expect reduction by more than 1%, the other 23% think that rates will reduce insignificantly (within 1%). According to 4% of respondents, factoring rates in this segment will remain at the level of 2014.

In 2015, factoring rates in the segment of large business will reduce. Average marginality of factoring deals of the largest companies in 2014 had a tendency similar to general situation in the factoring market in the Russian Federation.

Thus, as of year-end 2014, 33% of respondents evaluate marginality of factoring deals of their companies as less than 5%. Third part of respondents state that marginality of their Factors’ business constituted 5-8%. Profitability at the level of

8-11% is shown by the business of 19% of respondents. Remaining 15% of companies – according to top managers – showed marginality at the level of 11-14% for 2014. According to 2/3 of respondents, marginality of factoring deals of their companies in 2014 didn't exceed 8%. As of year-end 2015, on the basis of forecast, marginality of factoring deals of large factoring companies will fluctuate.

Third part of the respondents think that as of year-end 2015, marginality of factoring deals will reduce slightly (within 2%). Reduction by more than 2% is expected by 20% of the respondents, while other 20% consider that this indicator can increase by more than 2%. 15% of the respondents think that there is a probability of insignificant (within 2%) growth of profitability of their business in 2015, and only 10% expect stabilization of the indicator at the level of 2014.

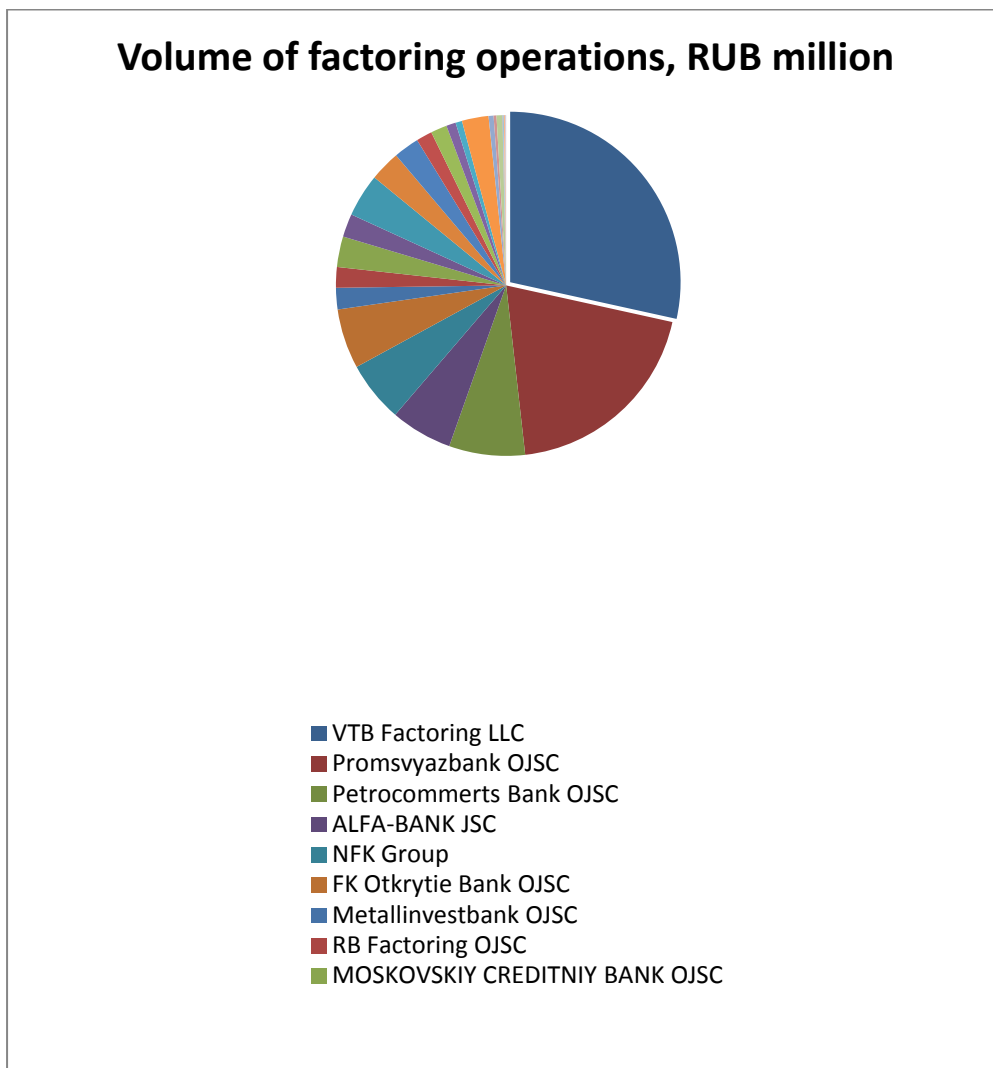
More than half of respondents expect reduction of marginality of factoring deals of their companies in 2015. The share of non-recourse factoring as of year-end 2015 is expected (in 2014, it constituted 34%). According to 83% of the respondents, the share of the market which accounts for non-recourse factoring will reduce by 2% in 2015. At that, almost a half of the respondents consider that the segment share will reduce by 5% or more. Only 13% of top managers think that the share of non-recourse factoring will stay at the level of 2014, showing change within 2%. Probability of the fact that the indicator will rise by more than 2% as of year-end 2015, is supported only by 4% of the respondents.

More than 80% of the respondents expect reduction of the share of non-recourse factoring in 2015 by more than 2%. The conducted analysis allowed determining main points of support for factoring market in the Russian Federation in 2015.

According to 43% of the survey participants, the main driver of market growth in 2015 will be the development of E-factoring, while the leader of last year survey – state order factoring – accounts only for 9% of respondents votes against 38% in 2014. Fourth part of the respondents count on deals with small and medium business, while 18% consider that supporting point of the market will be the segment of factoring without financing. Development of factoring in regions is considered to be a factor of support only by 4% of respondents.

Development of E-factoring, deals with SME and factoring without financing will be key points of market support in 2015.

Figure 2 – Largest factoring companies of the Russian Federation



3. Conclusion

In recent years, there has been significant expansion of demand for factoring services from clients and offer from banking sphere in Russia. Need for factoring is peculiar for all companies which work with the condition of payment delay. For example, such companies include subjects of food, pharmaceutical, light, oil processing, and car industries. According to experts, needs for these sectors in factoring, based on volumes of production of enumerated spheres, constitute dozens

of billions of dollars per year. With creation of conditions for development of factoring, growth rates of this market could constitute hundreds of per cent annually.

References

- Factoring market at the end of 1st quarter of 2015 decreased by 22%, 2015. Available at http://www.raexpert.ru/researches/factoring/factoring_1q_2015 (Access date: 04.06.2015)
- Grigorian, D., Manole, V., 2011. Determinants of Commercial Bank Performance in Transition: An Application of Data Envelopment Analysis, IMF Working Paper, 146
- Hughes, J.P., Mester, L.J., 2012. Efficiency in banking: Theory, practice and evidence. Research Department, Federal Reserve Bank of Philadelphia, Working Paper
- Kondrashov, V.A., 2012. Key factors of risk of banking innovations in the Russian Federation. *Finances and credit*, 13(493), 24
- Nadezhdina S., Sandakov A., 2015. Factoring as a form of re-financing of debit debt of agricultural manufacturers. *Bulletin of Altai State Agrarian University*, No. 7 (129), P. 148-153
- Results of survey of Factors' top managers at XI Annual Conference "Factoring in Russia – 2015: decreasing development", 2015. Available at http://www.raexpert.ru/researches/factoring/factoring_opros_2015 (Access date: 02.05.2015)
- Russian market of factoring in 2014: stumbled but did not fall, 2015. Available at <http://www.raexpert.ru/researches/factoring/2014> (Access date: 02.06.2015)
- Stroeveva O., Mironenko, N., Merkulov, P., Chubarets, O. 2015. Transformation of national innovative systems: Russian and foreign experience, *Asian Social Science*, Vol. 11. No. 20. P. 206-219
- Stroeveva, O., Sibirskaya, E., Khokhlova, O., Oveshnikova, L., 2014. Regionalization of the innovation management process, *Life Sci J*. No.11(8s). P. 297-301
- Stroeveva, O., Sukhorukova, N., Tsvyrko, A, Ivashchenko, T., 2015. Activization of innovative activities Russian commercial banks, *Mediterranean Journal of Social Sciences*, Vol. 6. No. 3. S6. P. 201-210