UNIVERSITY OF THE ALGARVE

SCHOOL OF ECONOMICS

FACTORING IN FAMILY FREIGHT FORWARDER COMPANY – CASE STUDY

MATEJA HRVATIN LOUREIRO

MASTER THESIS

MASTER IN BUSINESS FINANCE

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Supervisor: Celísia Baptista, Ph. D., School of Management, Hospitality and Tourism

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DECLARAÇÃO DE AUTORIA DE TRABALHO

Declaro ser a autora deste trabalho, que é original e inédito. Autores e trabalhos consultados estão devidamente citados no texto e constam da listagem de referências incluída.

Mateja Hrvatin Loureiro

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To my family

ACKNOWLEDGEMENTS

The present dissertation represents the end of one of the most intense chapters of my life. This chapter started immediately after graduating on from the Economic and Business Faculty in my home town a few years ago, when I packed my bags and moved to Portugal.

On this journey I met so very many interesting people that marked my life. But first of all I cannot overlook the people that have been with me forever. I would like to express a special thank you to my mum and my dad for all the support and love that you have given me and for raising me into a remarkable woman. I of course cannot overlook my brother and thank him for driving me crazy so many times.

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The last lines are for my husband. This paper is the result of your endless encouragement and undeterred support. Thank you for being who you are and for accepting me for who I am. I am looking forward to our next adventure.

ABSTRACT

Each freight forwarder company must independently determine whether factoring is the right choice for them and if will pay off. If the factoring as a financial method would not be economically viable, it certainly would not exist. There are several different financing methods, which are more or less useful. However, not all of them are appropriate for every company, just like all buyers do not represent equal risks for the suppliers. The same buyer can pay one supplier within the agreed period, and not pay the other supplier at all. Still, the most important elements are the agreement made with the customer, the method of insuring ourselves and the method of monitoring the implementation of the agreements. Problems rarely occur overnight and that is why we have to constantly supervise our buyers; otherwise account receivables can occur.

My thesis contributes to the ongoing research into how the use of factoring within the Slovenian economic environment can help a small freight forwarder company to grow. In effect, the specific characteristics of the Slovenian economic, legal and institutional environment make such an analysis an interesting one to explore. I used data from a family freight forwarder company TOP Hrvatin in drugi d.n.o. in order to establish future company growth by applying factoring as a right choice of financing.

After applying all the data and preparing the company's financial plan, my results suggest that factoring is not the right choice for financing future investments for this particular freight forwarder business. Furthermore, the results even show that factoring is an extremely undeveloped financing method in Slovenia and that practically there is no legal base for its use.

Key words: Factoring, account receivables, Freight Forwarder, Small and Medium enterprise (SME)

RESUMO

Cada empresa de Logística deve fazer os seus próprios cálculos e decidir se o *factoring* é a escolha correta e se produzirá resultados positivos para o seu caso específico. Se o *factoring* como método financeiro não fosse economicamente viável, certamente não existiria. Existem vários métodos financeiros diferentes, mais ou menos úteis, no entanto, nem todos são apropriados a cada empresa, assim como nem todos os clientes representam o mesmo risco para os fornecedores. O mesmo cliente pode pagar a um dos seus fornecedores dentro do período de tempo acordado, mas não a outros. Ainda assim, o mais importante é o nosso acordo com o cliente, como nos resguardamos e como supervisionamos a implementação dos acordos. Os problemas raramente aparecem repentinamente e é por isso que temos de supervisionar constantemente os nossos clientes, caso contrário, poderão ocorrer dificuldades na cobrança das faturas.

Este trabalho tem como objectivo analisar se o *factoring* pode ajudar uma pequena empresa de Logística eslovena a crescer. Com efeito, as características específicas do ambiente económico, jurídico e institucional esloveno tornam tal análise bastante interessante de realizar.

O estudo foi aplicado à Top Hrvatin in drugi d.n.o., uma pequena empresa familiar. Em alternativa ao financiamento através do factoring, foi também analisada a opção empréstimo bancário tradicional. Em ambos os casos foi desenvolvido o respetivo plano financeiro. A conjugação dos aspetos legais e financeiros sugerem que o *factoring* não é a escolha mais correta de financiamento para os investimentos futuros da empresa. Os resultados mostram ainda que o *factoring* é um método de financiamento extremamente subdesenvolvido na Eslovénia, praticamente não existindo base legal para a sua utilização.

Palavras-chave: Factoring, Contas a receber, Freight Forwarder, Pequenas e Médias Empresas (PME)

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CHAPTER 1

INTRODUCTION

Receivables constitute a notable part of the current assets of a freight forwarder company. But, for investment in receivables, a freight forwarder company has to sustain certain costs, such as the costs of financing receivables and the costs of collection from receivables. Further on, there is a risk of bad debts and therefore it is crucial to have proper control and management of receivables.

The development of the factoring concept in various developed countries of the world has led to some agreement towards defining the term. Factoring can largely be defined as an arrangement in which receivables arise out of the sale of services. Factoring is the outright sale of accounts receivable to a third party without recourse; the purchaser assumes all credit and collection risks. The factor collects the full amount from the customer and keeps the difference. The amount the factor will advance depends on the quality of the accounts receivable. The cost of factoring includes the factor`s commission for credit investigation of the customer, interest charges, and the discount from the face value of the receivables.

The growth of international trade and the development of different methods of transport over the years enlarged the range of its services. Today, freight forwarders play a crucial role in international trade and transport. The services that freight forwarder provides may often range from routine and basic tasks, such as booking of space or customs clearance to a comprehensive package of services, covering the total transportation and distribution process. Originally, a freight forwarder was a commission agent performing routine tasks on behalf of the exporter or importer, such as loading and unloading of goods, storage of goods, arranging local transport and obtaining payment for his customs.

Hence, the factor becomes accountable for all credit controls, sales accounting and debt collection from the buyers. Factors provide services ranging from bill discounting abilities offered by the commercial banks to a total takeover of the administration of credit sales, including maintenance of sales ledgers, collection of accounts receivables, credit control, protection from bad debts and provision of finance and rendering of consulting services to their clients. Thus factoring is a tool of receivables management employed to release the funds tied up in credit extended to customers and to solve problems relating to collection, delays and defaults of the receivables.

I investigated my key research question by using data from a family freight forwarder company TOP Hrvatin in drugi d.n.o. and the company's financial plans for the next few years. My main findings can be summarized as follows. First I examined the break-even analysis of the company and the list of their fixed assets and depreciation. The new investments that the company is planning to make to guarantee the future growth are featured there. Further on I set out the company's balance sheet in case of using factoring and in case of using a bank loan. Because of all of the legal limitations that concern factoring, forwarding, transportation and non-payment discipline, a detailed representation of the main company's features is illustrated. As explained in the chapters that follow, factoring is an especially attractive financing method in developing countries where it is more complex to raise working capital.

On the one hand we have a financial method that is not properly regulated in Slovenia and where, due to the legal disorganisation of factoring contracts, problems can occur. On the other hand we have a freight forwarding business that is well regulated, one could even say that it is regulated too much. Freight forwarding has strong roots in international legal systems, which represent also a base for the Slovenian legal framework. However, both of the investigated features have existed over a long period of time and nowadays represent a powerful form of business in a distressed economy.

My goals is to link factoring as a financial method and freight forwarding and see if in the Slovenian economic and legal environment they could represent a growing force for a family business.

The remainder of this dissertation is as follows: Chapter 2 reviews the relevant theory and some of the existent empirical studies. Chapter 3 reviews the legal framework. Chapter 4 summarises my research design and presents my results. Finally, Chapter 5 recapitulates the main conclusions of this study, discusses its limitations and suggests possible avenues for further research.

CHAPTER 2

LITERATURE REVIEW

This chapter provides the theoretical foundations underlying the empirical work developed in the subsequent chapters. It also reviews a number of empirical studies that already shed light on how expansion of factoring in a small financial environment, can influence a small freight forwarder business.

2.1 Theoretical and empirical background

To fully understand the modern practice of factoring, it is necessary to study its origins. Although factors have existed for thousands of years, the blow of interest rates on businesses in the 1970's created renewed significance in factoring. Even after interest rates fell drastically, factoring continued to fill an increasingly larger gap in the financial structure of the economy, especially when limited bank financing is accessible. To guarantee a fluent goods movement, freight forwarders are main players who organise the transportation chain and who work directly with companies customers. Freight forwarders act as intermediates between shippers and transportation carriers. Most companies contact freight forwarders as the only window for transport organisation, and a significant part of shipping volume carriers receive from freight forwarders. It is, therefore, surprising that there is relatively little literature about potential, growth and development of freight forwarder business.

2.1.1 Theoretical contributions

2.1.1.1 Factoring

In the prevailing literature, factoring is analysed in the context of the workings of the financial system in an economy. Schumpeter (1911) pointed out that a well functioning financial system is crucial for technological progress and economic growth. The efficiency of an economy's financial system in apportioning financial resources depends on many factors including the robustness of its financial institutions and financial markets, the strength and integrity of its legal system, and the quantity and reliability of information with which suppliers and demanders of capital are able to assess risk. Weak laws and poor enforcement create agency problems that undermine the efficiency of a financial system. Factoring is particularly useful as a source of short-term working capital in such economies because receivables are sold, and factored receivables are not part of the estate of a bankrupt firm. In

addition, underwriting in factoring is based on the risk of the accounts receivables themselves, rather than on the risk of the borrower.

Weak laws, poor enforcement and the associated informational opacity that put the small and medium-sized enterprises (SME)[1] at a disadvantage as a borrower are rooted in poor governance. When it comes to the working of the financial system, governance problems have added complexities because they accentuate incentive conflicts and agency problems which are further compounded by government ownership and regulation of the financial institutions (Litan, Pomerleano, and Sundararajan, 2003).

While small firms are more vulnerable from financing and other restrictions than large firms, it is not only the size that justifies intervention, but rather the prospective of small firms to raise into medium and large enterprises and to conduce to the economy, and the fact that institutional and market malfunctions create an untie playing field between firms of different sizes. The focus should be on reforms of the business environment that influence all enterprises and encourage entrepreneurship (Klapper and Quesada-Delgado, 2007), but also on a strategy that can help SMEs overcome financing limitations particular to their firm size and risk.

Firm's motivation to use factoring is primarily related to its demand for asset-based finance, rather than choices related to the organisational structure of the firm. Thus, firms with higher costs of obtaining market-based financing will tend to use factoring to obtain funds. In addition, they assert that aggregate factoring volumes (as a percentage of total sales) should be higher in countries that possess greater information asymmetries resulting from weak legal and governance systems. Thus, we should expect to find that firms in countries with informational opaque business environments experience greater accounts receivable factoring activity (Summers and Wilson, 2000).

Recent studies show the importance of the business environment for firms' financing restrictions and patterns. Institutional development, measured extremely generally, is the most robust country characteristic forecasting cross-country dissimilarity in firms' financing barrier, even after controlling for cross-country differences in gross domestic product (GDP) per capital. Firms in countries with more significant levels of institutional development report

[1] The abbreviation "SME" is used in the European Union and by different international organizations such as the World Bank, the United Nations and the World Trade Organization (WTO). In most economies, smaller enterprises outnumber large companies by a wide margin. SMEs are said to be responsible for driving innovation and competition in many economic sectors.

considerably lower financing barriers than firms in countries with less developed institutions. The positive effect of financial and institutional development can also be observed in the use of external financing. However, most developing countries do not have laws and judicial systems that sufficiently support the enforcement of contracts, nor do they possess the technological infrastructure or access to commercial credit information required. In addition, factoring has a distinct advantage in providing funding to higher risk and informational opaque firms, particularly in emerging economies because factoring firms can base their purchase (lending) decision primarily on the creditworthiness of the firm paying the accounts receivable rather than on the client or borrower (Beck et al., 2006).

Factoring is a relatively new financial product that is applied on the domestic or domestic and international markets (Perman, 1984). Because of its benefits, factoring in the developed market economies is used as the leading form of financing based on assets and business, and it is extremely powerful source of external financing (Rovcanin, Omerbegovic and Halilbasic, 2005).

The literature points to two crucial determinants of the level of factoring activity in an economy: first, the availability of financial information about enterprises; and second, the overall level of economic activity. Bushman and Smith (2003) present a framework for understanding the links between the availability of reliable financial information and enterprise efficiency level and firms' choice of financing method. Reliable and adequate information helps to identify promising investment opportunities with less error, lowers the principal-agent problem between shareholders and managers, and reduces the information asymmetry between investors and firms. A lack of adequate financial information, in general, and informational asymmetry between SMEs and financial institutions, in particular, is the most commonly cited reason for the existence and development of factoring. According to Mian and Smith (1992) and Smith and Shnucker (1994), firms factor accounts receivable to better manage their exposure to credit risk. Specifically, a factor that specializes in a trade with many buyers and sellers may be able to obtain information among sellers, which can help to reduce credit risk. This suggests that firms incurring larger costs of collecting information about the credit-worthiness of its customers should be more likely to factor its accounts receivables.

A country's legal and judicial environment may play an essential role in determining the mix of available financing products and the importance of factoring in that mix. A key issue for

factoring is whether the commercial law of the financial system views factoring as a sale and purchase transaction rather than as a loan. If it does, creditors' rights and loan contract enforcement are less relevant for factoring because factors are not creditors. But never the less they are not irrelevant to factoring (Klapper, Sarria-Allende and Sulla, 2002). Contract environment and creditor rights define the environment in which the factor fits into place in collection activities. This will affect underwriting principles because factors must take into account the anticipated cost and efficiency of their collection activities when they make credit decisions about which invoices to purchase. The commercial law of a financial system and the level of its enforcement help determine the environment in which financial contracting occurs. Commercial law indicates the property rights associated with a commercial transaction, and enforcement of these rights establishes the confidence of contracting parties in financial contracts. Together, these two characters constitute the rule of law. There are countries where commercial law is unambiguous and conductive to commercial transactions and where enforcement is predictable. On the other hand, there are countries where commercial law is ambiguous and incomplete, enforcement is problematic, and criminal and racketeering behaviour block the creation of new businesses, undermine existing ones, and deter foreign investment (EBRD, 2003).

A country's tax structure can also affect the size of the factoring industry. Stamp duties on factored invoices and other rates on factoring can slow down the growth of the industry. Value added taxes may also have an effect, depending on the structure of the tax system. Although the service fees associated with factoring should be subject to value added tax (VAT), the financing should be excused to ensure a rank playing field between factors and other lenders. Factors should enjoy the same tax management of provisioning for bad receivable as other lenders, but often they do not as they are not recognized as formal financial institutions, mainly if they are completely outside the range of formal regulation (Bakker, Klapper and Udell, 2004).

Before purchasing receivables, bank or non-bank based, financial institutions will spend time underwriting both the credit of the client (the business applying for the financing) and especially the client's customers (the businesses paying the receivable). The factoring institution will likely examine the track record of the business' collection ability and the payment history of its customers (Lotz, 1992). The more confidence the factoring institution has in the firm paying the receivables, the more likely it will purchase the accounts receivable.

Factoring is particularly appealing in middle-income countries where it is more difficult for firms to raise working capital and in the developing countries because information asymmetries between firms and lenders commonly make it difficult for firms to obtain financing. Hence, developing countries generally have weak governance systems including poor bankruptcy and secured transaction laws, which limit the use of real assets as collateral. Because accounts receivable are independent of a firm's business risk, an incentive exists for firms in developing countries to sell accounts receivable from high-quality customers as a source of short-term financing (Klapper, 2000).

Highly solid SMEs, which may not have access to loans from financial institutions, can often obtain financing through factoring. Hence, by providing accounts receivable factoring services could be an attractive expansion opportunity for developing country bank or non-bank based financial institutions to service the needs of small business clients. If done properly, banks and financial services firms can earn substantial profits while limiting their risk (Berger and Udell, 2004). By introducing or expanding their factoring services, such financial institutions can retain growing and profitable SME clients that they might otherwise forever lose. Perhaps more importantly, SMEs will have access to a new source of working capital financing that has been seriously lacking in the past (Ernets & Young, 2009).

2.1.1.2 Freight Forwarder

In the face of continued economic insecurity and heightened cost and margin anxiety across all industries, many shippers are taking a hard look at their transportation and logistics spend. Both international trade and the financial sector are crucial engines of growth in today's economies. The increasing importance of the two sectors is highlighted by their growing share in output over the last decades. International trading activities are fundamental part of the investment process. The financial sector supports the international trade:

- It helps to link the period between the need of founds for production, transportation, and the payment for such products by the importer, in other words the financial sector provides the working capital.
- It provides services which help the exporter to receive payment in the least costly and risky manner.
- It provides insurance against certain risks involved in the trading process. Insurance instruments involve freight and export credit insurance but also forward contracts.

Other requirements can insure against non-compliance by the seller and risks arising from government policy changes.

Financial institutions provides a flexible money flow, which can variety from basic intra-bank transfers of money between two accounts to more sophisticated financial services, such as leasing or foreign exchange-related services. They can provide also relevant information to investors or traders, and they can inform their clients about present and future money and capital market situation. They broker business contacts, do market research and check credit worthiness of customers and their banks. Without these financial instruments, international trade would be much caught up. Historically, the development of international trade and finance has gone hand in hand (OECD, 1997a, 1997b).

Collecting customs duties by government agencies have been a basic part of trade through the history and along with the collections raised the demand for middlemen and agent who would move goods on behalf of the shipper or consignee. Customs brokers and agents who acted on behalf of shippers to organise freight transport and buy space on ships advanced into freight forwarders. The role of the freight forwarder has further expanded, and they have long-abandoned the understanding of being simple agents for the transport industry. Today's freight logistics providers are responsible for entire range of services in the supply chain. Logistics is defined as the process of planning, implementing and controlling the well-organised flow and storage of goods and their related information. As global logistics become more challenging, and as the reserves available through supply chain efficiency become more attractive, the outsourcing of procurement, distribution, and return logistics has become common practice. Freight forwarder can assume various logistical tasks in the supply chain and in doing so add value to the product (e.g., warehousing, distribution, inventory management, co-packing, repacking, and quality control). Freight logistics providers must be flexible and able to provide a diversity of services based on the customer's demand.

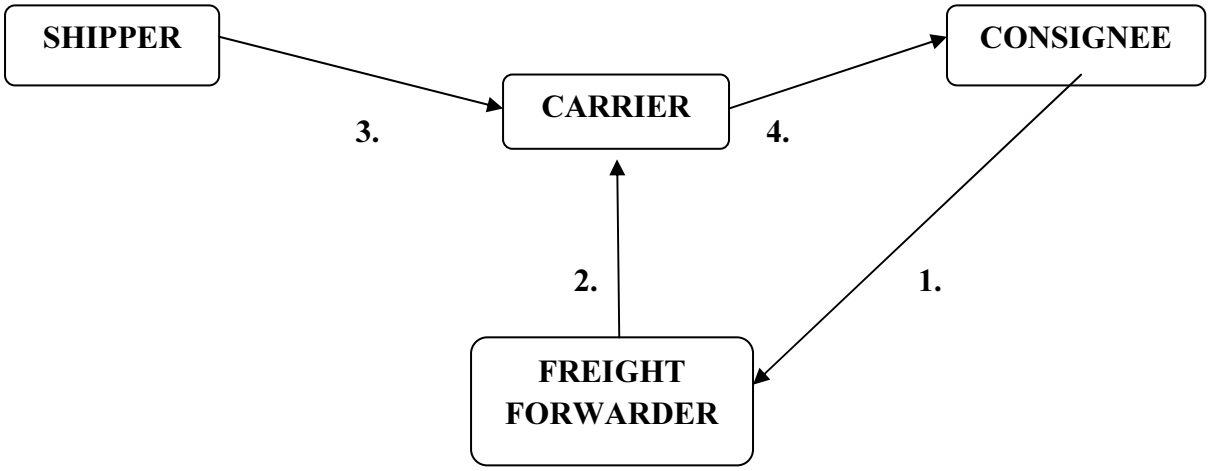
Freight forwarding is a logistics management service generally used in import and export of goods and other cargo items. The main advantage of using a freight forwarding service is the capacity to have a total outsourcing of activities mentioned above. A freight broker and a freight forwarder are basically the same thing. Each acts as a link between an individual seeking shipping service and an authorized carrier. Freight brokers never really touch the freight, instead they work to establish the needs of a shipper and match those needs with the best suited carrier. Some freight brokers specialise in shipping specific freight or shipping

within a specific region. The freight forwarder is, in simple terms, a logistics expert that takes an immense burden and ensures that the item is transported correctly from the point of origin to the destination location. Freight forwarding is common for international transfers. A freight forwarder may use several carriers to reach most advantageous schedules and pricing. Freight forwarders, who are well versed in the mechanics of international transport, handle international paperwork requirements and legalities remarkably economically (Castro, 1993).

There are two main ways how freight forwarder works:

- A freight forwarder can be contacted by the shipper's customer (Figure 2.1);
- A freight forwarder is contacted by the shipper (Figure 2.2);

Figure 2.1 - Freight forwarder is contacted by the shipper's customer

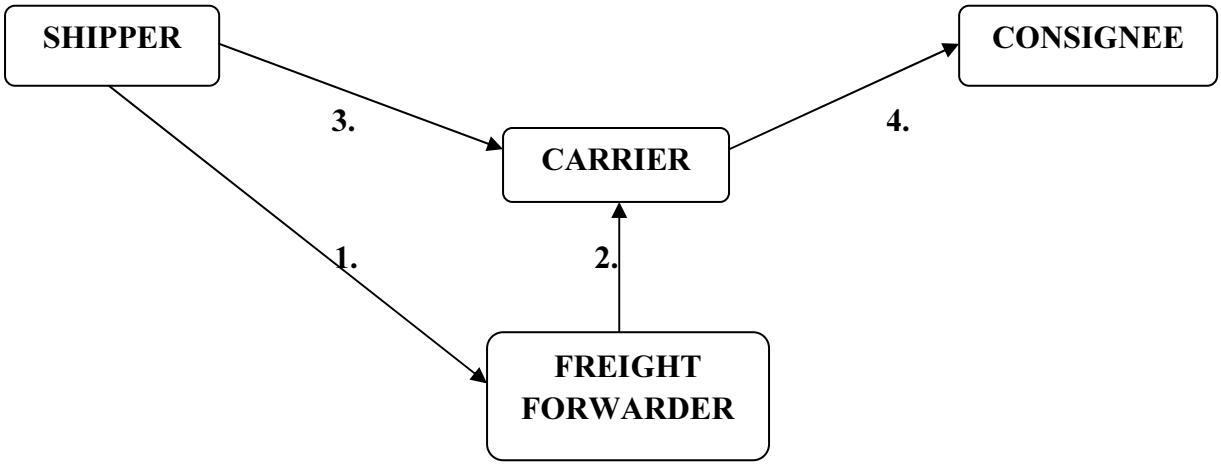


Source: LTL Freight Information (2010)

Figure 2.1 is represents an information flow from the moment that a freight forwarder is contacted by the consignee. After a freight forwarder received a transportation order he contacts' a carrier (Point 2.) and they communicate from the time of loading (Point 3.) until the shipment is delivered to the customer (Point 4.).

As demonstrated by Figure 2.2 freight forwarder is contacted by the shipper and this is beneficial for the shipper because freight forwarder establishes a relationship with the carrier and arranges all other details (e.g., costs, pick up, delivery). This can save money and time to the shipper.

Figure 2.2 - Freight forwarder is contacted by the shipper



Source: LTL Freight Information (2010)

When choosing a right freight forwarding company, one needs to consider and understand their expertise and experience in carrier services that include sea transport, air transport, trucking and rail services. Additionally, some companies only transport within a specific geographic region or even within a single country. Using a freight forwarder service can save time, money and the human resources costs of recruiting these highly skilled job functions. These advantages may make sense for the bottom line of businesses, depending on the volume, distance and complexity of shipping requirements (EBRD, 2003).

Freight forwarders' financial risk stems from the company's financial activities and uncertainties that may occur by making the difference with the expected financial returns, resulting in possible losses. In recent years, international freight forwarding market became much more competitive, due to the expansion of international freight forwarding companies. The main financial risk is the risk of capital recovery, as a service took place after the recovery of monetary capital income in the amount of time and has on the uncertainty. Freight forwarders financial risk is based on existence of (KPMG International, 2012):

- Lack of information: International Freight Forwarding Company effective decision-making depends on a variety of market information outside the company. When market information is not complete, the financial risk directly increases. International Freight Services are facing a buyer's market and increased competition and this leads to market information asymmetry, which

leads to a customer's credit assessment miscalculation, resulting in financial risk.

- The policy changes: International freight forwarders are mostly undertaken by international trade and international shipping businesses in the process of convergence part and related policy changes which will affect the certainty of recovery of funds.
- Corporate decision-makers cannot control the customer's future state. Because of the complexity of the market economy environment, international trade and shipping businesses contribute to the deterioration of the customer economy. Loss of ability to pay a large number of international freight forwarders, accounts receivable cannot recover in time, leading to financial risk arising.

2.1.1.3 How factoring works

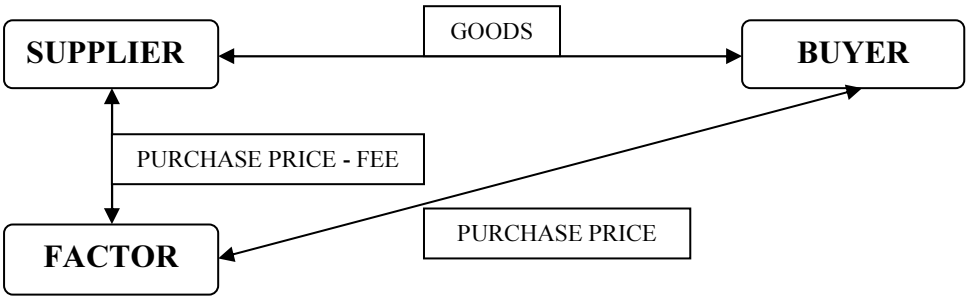
Factoring, also referred to as accounts receivable financing, is the method by which a company sells its outstanding invoices or accounts at a discount to a finance company which then assumes the risks associated with the accounts in exchange for immediate cash. In this instance, companies are effectively trading future earnings potential for the capacity to obtain cash immediately, enabling them to finance different projects or cover different expenses (Bizjak, 1995).

Factoring means an agreement between a factor and his client which includes at least two of the following services to be provided by the factor:

- finance;
- maintenance of accounts;
- collection of receivables;
- protection against credit risks.

Figure 2.3 explains how direct factoring works. As mentioned above, the main characteristics of a factoring agreement are that the exporter assigns the benefit of the sales contract to a financial institution, called the factor, which advances the purchase price for the goods or services provided, less his fee.

Figure 2.3 - Direct factoring



Source: Prvi Factor (2012)

The factor usually instantaneously advances a percentage of the value of the debts assigned, followed by the balance once the debts have been collected. Especially in the context of international trade, it is often useful to introduce, between the exporter and the importer, someone who has experience in commercial transactions in the home jurisdictions of the parties and who is better equipped to assess credit risks and collect funds. The factor may not restrict itself to a price collection service on behalf of the exporter, but may also provide credit management services. According to the provisions in the factoring agreement, the factor may handle the internal credit control and sales accounting of the exporter. These facilities, where agreed, will be included in the factor's charges (Borgio and Burgess, no date).

Factoring is generated by credit sales in the normal course business. The main purpose of factor is realisation of sales. Once the business takes place, the role of factor step in to realise the sales or collect receivables. Thus, factor act as an agent between the seller and till and sometimes along with the seller's bank together.

Factoring accounts receivables involves selling an upcoming payment from a customer to a third party, the factor, at a discount in order to receive immediate payment (Spragins, 1991). The majority of factoring activities are implemented on a non-recourse basis, wherein the factor assumes the majority of the risk, as well as the wait, of collecting the payment. When a business factors its receivables, no money is borrowed, no money is loaned and no interest is paid or earned. The factor earns a fee, which is based upon the amount of the invoices/receivables purchased. This fee, earned by the factor, is based on a percentage of the

face amount of the invoices, which is determined by the quality, quantity, and average turnover of the account.

The particulars of the financial agreement depend on the nature of the account and on the nature of the financing institution's personal policies and guidelines. In most cases, the financing company will charge a 5% fee associated with the proceedings, which may or may not be less than other comparable financing options. Additionally, every account has a value assigned to it on an individual basis. The cost of factoring services primarily includes the following two components: factoring fee and discount charges. Factoring fee is charged to providing various services to the clients namely to the sales ledger administration, credit control including processing, operational costs and collection of debts, providing protection against bad debts (Ravas and David, 2010). The quantum of charged depends upon the following factors: type of industry, financial strength of the client as well as of the debtors, volume of sales, average invoice value, terms of trade, types of services offered, required profit margin to the factor, extent of competition and security to the factor (Potočnik, 1992). Discount charges are imposed to providing immediate credit to the client by way of prepayment. Essentially, the lending institution will assign a higher base value to an account, relative to how recently the account has been opened. For many small businesses, financing of this form offers several advantages (Bogin and Borkowski, 2007).

The factor provides a variety of services at some charge in the form of a fee expressed as a value of debt purchased. It is collected in advance. The fee is in the form of interest charged for the period between the date of advance payment and the date of collection or guarantee of payment date, for short-term financing as advance part payment (Brownstein, 2003).

Hence, SME can take the same advantages of its short-term receivables and sell them to a factor. Factors are purchasing short–term receivables with a certain maturity; the factor is paying to the client, for example 70–90% of the invoice value, less the factoring fee. The remaining unpaid amount of the invoice is paid after the borrower settled the obligations, minus a certain percentage of fees. The fee can represent, and can be charged for services, credit risk and interest from the moment of the repurchase until the time of charging the receivables. Usual deadline for short-term financing through factoring is between 30 and 120 days, depending on the quality of receivables and also on its possible repurchase maturities of 180 days or more. The amount of the commission and the value that will be paid immediately

to the client depend on the quality of the receivables and, for example, on debtor business' reputation (Hussain, 2011).

Factoring is about insurance of receivables and financing the sale with deferred payment deadline. An important task of factoring is to regulate the liquidity situation of the business system that sells receivables and receives an advance on receivables. Advantages of factoring as a service of the future are: consistent cash flow, increase working capital, hedging default, currency hedging and lower administrative costs.

However, because of overtaking the risk, factor also receives - from vendor receivables - a fee, which is generally a percentage of the value of the receivables. Thus, the factors usually check the recoverability of the receivable before it is accepted. This funding model, whereby a SME sells its receivables, for SME represents an increase in current assets. Repurchasing the receivables by a factor allows for an SME to receive an inflow of funds before the maturity of receivables. Hence, SME has the ability to achieve higher productivity of current assets using certain facilities (for example discounts) or the possibility of financing current operations and like this contributing to better business results (Mishkin and Eakins, 2005).

A factor can be:

- a specialised financial organization,
- a company,
- a bank which has a separate department,
- a specialised factoring subsidiary,
- a classic institution of factors,
- a factoring company or
- a factoring–factor–house.

Except for payment of receivables, a factor can charge for receivables themselves, credit control, administrative tasks of monitoring invoices for the clients, the service for providing protection against the risk of non-payment and for monitoring the solvency and credit worthiness of business partners.

2.1.1.4 Types of Factoring

A factoring contract always includes a part of the collection service but may also include other services such as management of credits taken, against the risk of insolvency or

bankruptcy of the debtor and financing to a company member. Throughout history, factoring developed, took different forms and adapted to the needs of the participants in the factoring business (business entities/clients, factors, buyers/debtors and on the international level corresponding factoring companies in the country of the debtors), its special activities, general economic situation and political circumstances, that resulted in different forms and types of factoring, which are applied today.

- **Disclosed and Undisclosed Factoring**

In disclosed factoring the client's customers are notified of the factoring agreement and disclosed factoring can be either recourse or non recourse. In undisclosed factoring, the client's customers are not informed of the factoring agreement. Sales ledger administration and collection of debts are undertaken by the client himself. Client has to pay the amount to the factor irrespective of whether customer has paid or not. But in a disclosed type, the factor may or may not be responsible for the collection of the debts, depending on whether it is recourse or non recourse (Singh and Jatinder, 2005).

- **Recourse and Non-recourse Factoring**

With factoring invoices, there are usually two types of accounts receivable factoring offered by factors - recourse and non-recourse factoring. Recourse factoring is normally more common in most businesses because the client selling the invoice shares the risk with the factor. Factoring with recourse is where the client selling the invoice is required to buy the invoice back from the factor if it goes uncollected for a fixed number of days, thus sharing the risk between the client and the factor. In comparison, non-recourse factoring is where the client sells the invoice to the factor and the factor accepts all the risk of collecting of the invoice. Factoring with recourse is generally a less expensive form of factoring than non-recourse factoring because the factor accepts less risk. Recourse factoring is also easier to manage, the invoice factoring company will tend to have less stringent rules about company's business systems and the payment history of company's clients. In non-recourse factoring the factor assumes responsibility for all bad debts. This means that if a customer does not pay an invoice the company does not have to pay back the amount advanced to the company by the factoring company. The factor legally takes ownership of the debt. It may also be harder for the company to obtain non-recourse factoring services if it has weak financial systems or numerous customers with bad payment histories (Strategy of corporate finance, no date).

- **Full and Limited Factoring**

Full Factoring is the most comprehensive form of factoring combining the features of almost all of the factoring services, especially those of non-recourse and advance factoring. It is also known as old line factoring. Under this system the factor performs almost all of the services: collecting of receivables, maintenance of the sale ledger, credit collection, credit control and credit insurance. The factor also fixes up a draw line based on the bills outstanding maturity-wise and takes the equivalent risk of default or credit risk and the factor will have claims on the debtor as well as on the client creditor. Under limited factoring, the factor discounts only certain invoices on selective basis and converts credit bills into cash in respect of those bills only (Vičič, 2002).

- **Advance and Maturity Factoring**

The factor pays a pre-specified proportion, ranging between 75% - 90%, of the factored receivables in advance, the balance being paid upon collection on the guaranteed payment date. A drawing limit, as a pre-payment, is made available by the factor to the client as soon as the factored debts are approved and the invoices are accounted for. The client has to pay interest on the advance between the date of such payment and the date of the actual collection from the customers' guaranteed payment date, determined on the basis of the prevailing short-term rate, the financial standing of the client and the volume of the turnover.

Maturity factoring is an agreement under which the factor does not make a pre-payment to the client. The maturity factoring is also known as Collection factoring. The payment is made either on the guaranteed payment date or on the date of collection. The guaranteed payment date is generally fixed, taking into account the previous ledger experience of the client and allowing for a period for slow collection after the due date of the invoice.

- **Domestic and Export Factoring**

Considering that factor can purchase receivables in the home country or abroad, basic division of factoring can be made between domestic and foreign (import and export) factoring. International factoring is more complex - legally, politically, and due to the currency risk and the interest rate risk. International factoring is particularly suitable for exporters because they are exempted from, for example, the creditworthiness of the buyer, risk of non-payment, political risk. In domestic factoring, the three parties involved, namely customers (buyer), client (seller supplier) and factors (financial intermediary), are domiciled in the same country.

The mechanics of such a factoring deal is outlined in the prior discussion reacting to different types of factoring. The procedure of export factoring is very similar to domestic factoring except in respect of the parties involved. While in domestic factoring three parties are involved, there are usually four parties to a cross border factoring transaction. These are: exporter (client), importer (customer), export factor and import factor. Since two factors are involved in the deal, international factoring is also called two-factor system of factoring.

- **Direct and Indirect Factoring**

According to a number of factors involved in a business, factoring can be divided into direct and indirect. In direct factoring there is only one factor which is in direct relationship with the buyer/debtor, and in indirect factoring there are two factors, first in the country (exporter) or from the country of the client/assignor of receivables, and other from the country (importer) of the buyer/debtor.

- **Reverse Factoring**

As mentioned above, in traditional factoring a factor only buys accounts receivable from firms that are in their client base, or portfolios of accounts receivable from multiple buyers, in order to diversify the risk of default from one single buyer. The factor then needs to assess the risk of an entire portfolio of receivables which is time consuming and expensive, since the factor needs to collect credit information of many buyers (Klapper, 2006). Factoring has also not been profitable in developing countries since track records and reliable credit rating agencies are missing. Factoring with recourse was presented as a possible solution when the credit worthiness of the buyer was hard to assess. Never the less, when due to the buyer's non-payment the factor turns to the supplier; this supplier might not have enough financial sources to repay the obligation. In case of a buyer default, the factor becomes exposed to the supplier's credit risk, which is generally high.

To overcome all of the mentioned difficulties, reverse factoring was developed. Reverse factoring is a form of supply chain finance which overcomes the problem of information asymmetry between the factors and the suppliers. In a reverse factoring agreement the buyer and the supplier work together with the factor in order to optimise the financial flows (Cetinay, Reindorp and Tanrisever, 2011). Reverse factoring is an effective solution to weakness in credit information, regarding a buyer, which enlarges the difficulty of collecting credit information on a large number of buyers. Thus, there are a number of additional tax,

legal and regulatory challenges to ordinary and reverse factoring in many developing countries (Yasuo, 2006). The principle behind reverse factoring is the same as behind the more traditional factoring. In a reverse factoring transaction the factor only buys accounts receivable from partner companies with a high credit rating. In this case the factor persuades the buyer organisation to participate in the reverse factoring. If this supplier wants to convert his accounts receivable into cash at an exact moment before maturity, the supplier contacts the factor, who then buys the accounts receivables at a discount, which is dependent on the creditworthiness of the buyer. Most importantly, in reverse factoring the buyer is part of the agreement and usually demands a certain advantage as well. This incentive can come in different types, like an extended payment period, a price reduction or a fee from the factor. Usually the payment period is extended or the buyer does not demand a financial benefit at all. An extended payment period will reduce the cash conversion cycle and the net working capital, and therefore reduce the short term financing cost.

The process of reverse factoring starts at the time when the supplier delivers the products to the buyer. The buyer will later send an approval of invoice to the bank, meaning the invoice will be paid within the agreed payment term. If the supplier needs cash between those two moments, i.e. when the buyer has sent the approval of an invoice and the final payment of the buyer, the supplier contacts the factor and sells the accounts receivable against a discount. The risk of these accounts receivable is dependent on the credit worthiness of the buyer, with high credit rating, and not on the supplier, with low credit rating. The supplier gains by this transaction compared to an ordinary bank loan, since they can sell the account receivables at a lower interest rate than their own interest rate. The discount the factor charges for factoring the accounts receivable is the interest rate of the buyer plus some additional factoring fees, times the remaining payment term. This is a reversed process of classic factoring because the first contact of the factoring company is the buyer of goods or services (importer) instead of the supplier (exporter). Therefore the involved factoring company (import factor) does not service the sales side but the purchase side of its client (Mthoko, 2011).

There are two versions of reverse factoring:

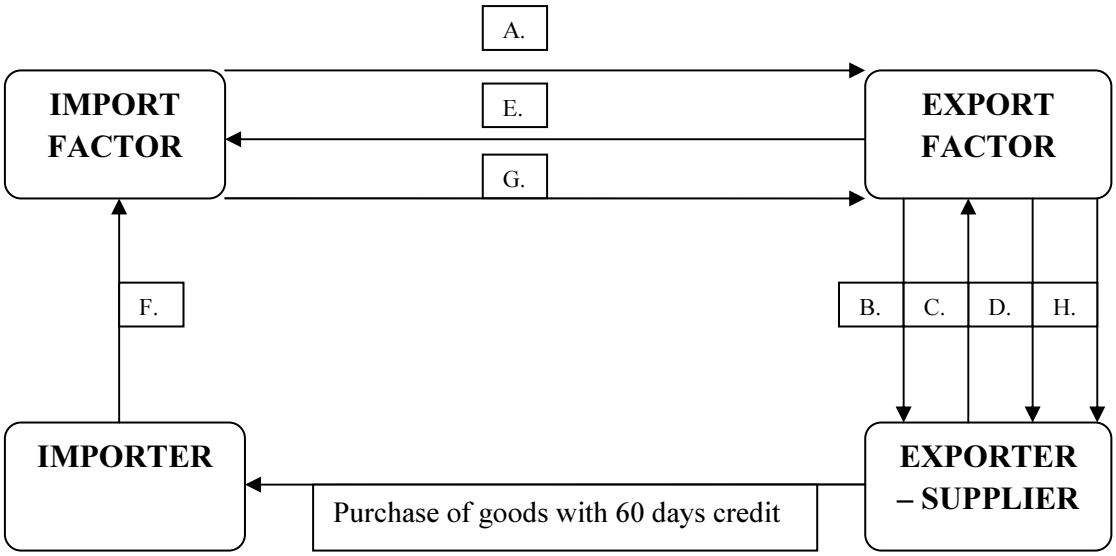
- it can be preceded either by the direct import procedure,
- or by the Two-factor-system (Figure 2.4), which is much more common, using the communication policy and the legal framework of either of the two global factoring

associations - Factors Chain International (FCI) and International Factors Group (IFG).

Firstly the importer authorises the import factor to factor its responsibilities against foreign suppliers. The factor assesses the creditworthiness of the importer up to a limit, which covers the accounts payables. The importer presents the concept to its suppliers and the import factor informs (transition A) the respective local export factor to negotiate a factoring contract with interested suppliers, based on the approved importer's credit line. After the export factor is informed about the credit exposure by the import factor, he can send the approved credit limit to the interested suppliers (transition B), negotiate the pricing and sign factoring contracts with each of them. The supplier sells his receivables against the respective importer to his local export factor (transition C). The export factor normally pays 90 per cent of the invoice amount immediately to the supplier. 10 percent are kept as withholding for possible payment deductions of the importer (transition D). The export factor, in transition E assigns the purchased receivables to the import factor. In transition F the importer pays the full invoice amount on the due date of the invoice to the import factor.

Later on, in transition G, the import factor transfers the payment, reduced by possible invoice deductions of the importer, to the export factor. In the end (transition H) the export factor pays the remaining retention of the 10 per cent to the supplier, reduced by the factoring fees and possible other deductions. In case of the importer's incapacity to pay the outstanding receivables, the import factor is obliged to pay the invoice amount to 100 per cent 120 days after due date of the invoice.

Figure 2.4 - Two – factor-system



Source: Eurofactor (2008)

Both parties gain benefits from reverse factoring. The exporter receives immediate liquidity by the funding of the export factor and is protected against bad debts to 100 per cent within the approved credit limit. Hence, he can export his goods to the importer on flexible open account terms and is able to increase his sales potential. The importer on the other hand can take advantage of the open account terms to improve his liquidity and purchasing conditions. He gains liquidity and improves his working capital ratio. He is able to expand the purchasing volume, profits from resulting discounts and can develop new exporters or increase the loyalty of his strategic important suppliers.

The costs of reverse factoring usually consist of a factoring fee that covers the protection against bad debt and the receivables management by the import factor. Regarding the funding of the receivables, a common interest rate is charged by the export factor. The international reverse solution is interesting for importing companies who want to optimise their trade relations with existing or new exporters. Reverse factoring can be found in nearly all industries that import goods in large quantities and because of the increasing global trade, reverse factoring has an enormous growing potential in countries with high trade level.

Reverse factoring may be useful for SMEs especially because of the following (Klapper, 2006):

- Traditional factoring requires complete credit information on all borrowers' customers, which may be difficult and expensive to determine in countries with poor credit information system.
- Reverse factoring allows companies to transfer their credit risk and borrow on the credit risk of its creditworthy customers. This may allow companies to borrow greater amounts at lower costs.
- Factoring only requires legal environment to sell, or assign, accounts receivables. Factoring does not require good collateral laws or an efficient judicial system.
- Reverse factoring advantage is that it provides benefits to lenders and buyers. Lenders are able to develop relationships with small firms without being exposed to additional risks. This may provide cross-selling opportunities and allow the lender to build a credit history on the small company that may allow additional lending.

2.2 Factoring over other lending tools for small freight forwarder business

The lending tools have important effects on the access to credit for creditworthy transparent and solid SMEs. The different tools – financial statement lending, small business credit scoring, asset – based lending, factoring, fixed-asset lending, leasing, relationship lending and trade credit – each involves a different combination of primary information source, screening and underwriting procedures, loan contract structure and monitoring mechanisms. The choice of a lending tool for a freight forwarder company depends on the sources of information, as well as on the adaptability and appropriateness of the various screening, underwriting, contracting and monitoring techniques (McDowell, 2007).

From a policy point of view, the significance of these different types of lending stems from the possibility of those SMEs facing significant funding gaps, which would occur if companies encountered significant financial constraints due to systematic credit rationing. The severity of the funding gap problem depends on the magnitude of the information problem in SME financing and the strength of lending technologies to mitigate this problem (OECD, 2012).

Factoring is a wide financial service that includes credit protection, accounts receivable bookkeeping, collection services and financing. Factoring can be a powerful tool in providing financing to high-risk, informational solid sellers. Factoring's key virtue is that underwriting is based on the risk of the receivables rather than the risk of the seller. Factoring may be

particularly well suited for financing receivables from large or foreign companies when those receivables are responsibility of buyers who are more creditworthy than the sellers themselves (Klapper, 2006).

Factoring differs from a traditional bank loan in three main ways. Firstly, the credit assessment is strictly based on receivables rather than other factors, like how long the company has been in business, working capital and personal credit score. Secondly, factoring is not a loan; it is the purchase of a financial asset. Finally, a bank loan involves two parties while factoring involves three – buyer, exporter and factor.

Factoring has advantages and disadvantages when compared to commercial banking. Factors are not subject to the supervision and the regulations imposed on commercial banks unless they are part of a banking holding company. They are able to avoid writing-off loans and absorbing losses that banks would be required to recognise. While this is potentially a source of risk and it also makes it possible for a factor to work closely with its client to solve the problems. Factors enhance the balance sheets of their clients in a way that cannot be duplicated by commercial banks. When the client sells its accounts receivable to a factor, its debt-to-equity and debt-to asset ratios are improved, increasing its credit-worthiness. Thus, use of factor can make it easier for the small business to obtain bank finance. This bundling of services is one of factoring's advantages over other types of lending, particularly for a small freight forwarder company that do not have resources to manage own credit and collection activities.

All technologies can be distinguished based on how they deploy contract features in underwriting and monitoring of the borrowers in a way that addresses problems related with informational opacity, the type of financing needed, and the lending environment of the borrower. Although factoring has some advantages over the other tools, it also has disadvantages. But on balance, the advantages significantly outweigh the disadvantages in developing economies (Berger and Udell, 2004).

2.3 Empirical studies

There are strong indications in previous literature that the use of trade credit and the potential for factoring services is higher in countries with greater barriers to SME financing, mostly during periods of financial distress. Conclusions of International Factors Group's (IFG) Global Industry Activity Report (IFG GIAR, 2011) confirm an important growth of factoring

turnover in 2011 in most parts of the world. Figures from the EU Federation – Factoring and Commercial Finance (EUF) at the end of June 2011 indicated a growth of 19% and a gross domestic product (GDP) penetration of 9,45 % for the most important European markets. These global statistics indicate that during the recession the factoring industry was able to continue to finance businesses all over the world and to achieve this with very low credit losses. Another example is a study by Demirguc-Kunt and Maksimovic (2001) and they find that in 39 countries around the world, trade credit use is higher relative to bank credit in countries with weak legal environments, which makes bank contracts more difficult to write.

However, factoring can be used as a tool for improving the underinvestment problem (Sopranzetti, 1998). The underinvestment problem is more severe for firms that have boundaries on the use of debt in financing new projects, for example when the firm has maximally explored its debt capacity or in cases of financial distress. Hence, under such circumstance firms are more motivated to sell their accounts receivable in order to lessen the underinvestment problem. On the other hand, Smith and Schnucker (1994) took a different approach and provided an empirical assessment of an organizational structure, where the economics of the factoring decision was evaluated. They found that firms factored their accounts receivable in order to manage their credit risk better. They also founds that economies of scale have an impact on the decision to integrate, because credit management internalisation is greater when the selling firm is larger and the percentage of trade credit customers is higher. When the factor cannot assess the level of the seller's credit risk, a rational factor will assume the possibility of a moral hazard problem, which will be included in the equilibrium price of the agreement. Sellers with a high bankruptcy risk may be able to only factor their highest credit quality receivables on a non-recourse basis. The medium quality receivables will have to be factored with recourse, while the lowest quality receivables will not be factored due to high costs of factoring (Sopranzetti, 1997b).

There have been a number of papers which have attempted to examine the reasons why a firm would decide to factor its accounts receivable. Mian and Smith (1992) and Mian, Smith and Spring (1994) provided a comprehensive empirical assessment of numerous cross-sectional explanations of receivables strategy determinants, with a special importance placed upon the arrangement of captive subsidiaries. However, because of insufficiency of factoring explanations, their tests provided only weak data with respect to the variables that motivate a firm’s decision to factor its accounts receivable.

Fisman and Love (2003) highlighted the impact of inter-firm financing by presenting that industries with higher dependence on trade credit financing reveal higher rates of growth in countries with reasonably weak financial institutions. Love, Preve and Sarria-Allende (2006) found that trade credit is an important source of financing, relative to bank lending, during periods of financial distress. Van Horen (2004) studied the use of trade credit in 39 countries and found that trade credit is used as an economical tool, particularly for small and young firms. McMillan and Woodruff (1999) studied the use of trade credit in Vietnam and found that small firms are more likely to both grant and receive trade credit than large firms. This empirical evidence suggests that SMEs in emerging markets are likely to provide trade credit and hold illiquid accounts receivable on their balance sheets.

Using UK data Summers and Wilson (2000) argued that the motivation to use factoring is more related to a demand for asset-based finance from small firms than to firm-level choice about organisational structure. In their recent work they found evidence of a financing demand explanation for the use of factoring, and also some support for the theories which relate the decision to use the services of a factor to the firm's product characteristics and to the preference of the factor.

Looking at the field of transport and logistics, a large number of strategic alliances emerged within the last decades. Many empirical studies have examined the effect of transport costs on trade flows. Hence, Limão and Venables (2001) found a strong statistical connection between transport costs and international trade flows. They also found a clear connection between the quality of infrastructure and transport costs and thus conclude that infrastructure investments are important for export led economic growth.

Subramanian and Arnold (2001) studies find that differences in logistics performance are determined only in part by poor quality of physical infrastructure services such as roads, rail, waterways, port services, and borders. Instead, the insufficiencies are often caused by non-tariff policy and institutional restrictions such as routine red tape, insufficient enforcement of contracts, poor definition and enforcement of rules of engagement, delays in customs, delays at ports and border crossings, pilferage in transit, and highly restrictive protocols on movement of cargo. This decentralised environment also causes strong challenges to developing economies, requiring them to be highly efficient, productive, and capable of providing just-in-time services. Efficient logistics services play an important role in the worldwide flow of goods and services and in the ability of countries to draw and maintain

investment. Inefficiencies in logistics have been highlighted as an important constraint on firms' productivity and competitiveness in developing countries by earlier studies on investment climate and trade facilitation. Similarly, Subramanian, Anderson and Lee (2005) found that long customs clearance times have a significant adverse effect on firms' productivity. Dollar, Hallward-Driemeier, and Mengistae (2003) found that firms in countries with a better investment climate, including better logistics, have a higher probability of exporting to international markets and attracting foreign direct investment.

A study from Taiwan written by Kuo – Chung and Chin (2012) empirically identified customer relationship management and examined its impacts on firm performance in the context of freight forwarder services. Using data collected from a survey of 144 freight forwarding firms in Taiwan, they identified crucial customer relationship management dimensions and their influences on the apparent financial performance. Results pointed out that customer relationship management dimensions, such as customer response and profit interaction, are found to have considerable positive effects on the perceived financial performance aspects of profit and growth rate. This research not only investigated the crucial customer relationship management but also proposed a model for empirical studies to link customer relationship management and firm performance. This study is one of the first to examine customer relationship management in the freight forwarder services. The model may be used as a stepping stone for empirical research in transportation services on customer relationship management. The understanding of relationships between customer responses, information technology, knowledge management application, profit interaction, and organisational performance may provide evidence as to how freight forwarding companies can adjust their customer relationship creation processes to sustain their performance.

Logistics inefficiencies damage the competitiveness of private firms through their effects on both the costs and time. The costs relate not only to the direct costs of transporting products; goods in transit sustain indirect costs such as inventory holding costs. The longer the transit time, the higher are the costs; shippers are willing to pay extra for faster delivery.

Recent research by De Groot et al. (2004) highlights institutional performance as a precise determinant of bilateral trade, recognising that the excellence of institutions can have a considerable impact on transaction costs, which in turn influence trade. To observe bilateral trade, the authors use an increased gravity model that, in addition to distance and the GDP of each country, includes dummy variables for common border, common language, common

trade area, and common religion and a set of variables representing institutional quality (voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and control of corruption). Results show that increasing the overall quality of institutions would significantly increase bilateral trade.

In an empirical study on the role of factoring in financing SMEs, the determinants of factoring in 49 countries were investigated and demonstrated that economic development, growth rate of GDP, the availability of credit information, and weakness in contract enforcement all contribute to the greater use of factoring. However, while bank loans represent the primary source of SME financing in developed economies, they are often unavailable in emerging markets because they require lenders to be able to file liens against all business assets of the firm and require sophisticated technology and full credit information on firms (Klapper, 2006).

2.4 Why study factoring as method of financing for TOP Hrvatin in drugi d.n.o.?

Top Hrvatin in drugi d.n.o (TOP) is a small family-run freight forwarding company which was established in 2003. In the same year the company started with organisation of sea freight and during 2004 together with their partners, went ahead with the organisation of land transport service and air freight. Today TOP offers a full logistic service to their customers.

The company offers services from shipper warehouse to consignee warehouse, including all logistics services such as insurance, custom clearance, transport and cargo manipulation. Sea freight service includes full container load (FCL), less container load (LCL) and convectional transport cargo. Together with their partners, TOP can organise sea freight all over the world. In majority of cases TOP organises sea freights from China, United Arab Emirates, USA and Columbia to Slovenia. Land transport services include, import and export to and out of all European countries, railway transport service and road service. 90% of all services that the company offers are road services, which are:

- Full truck load;
- Less truck load;
- Transport with normal trucks;
- Transport with special trucks – FRIGO;
- Transport with container trucks;

- Transport of oversized cargo;
- Transport of ADR cargo.

TOP also organises air freight all over the world, however only for their most loyal customers.

TOP operates in accordance with the current Standard Trading Conditions of Slovenian International Freight Forwarders, issued by the Slovenian International Freight Association, with the Slovenian Chamber of Economy.

Hence, in 2009 the company started to organise road transports for few internationally recognised companies and the number of arranged transports per year increased drastically. The result of these transports, the quality of services and the professional attitude started to show results also on the Slovenian market. In 2012 TOP was chosen as the fifth fastest growing company in Štajerska region and received also a Certificate Excellent SME issued by the Slovenian Chamber of Economy.

However, the company reached the point where it should consider investing in their own fleet, to have their own trucks, vans, distribution, etc. This investment would influence the growth and the cash flow of the company and that is why the right method of financing has to be selected. Factoring is a fast growing method of financing, it is not affected by the world's current financial distress, it is highly recommended for SME's and because of all mentioned reasons factoring deserves to be considered.

The consideration framework will include the financial state of the company in the last few years, their investment plan, the value of the investment and the future earnings that the investment should bring. However, in order to be able to reach the decision on whether factoring as a method of financing is appropriate, one also needs to consider also how developed factoring is in Slovenia and legal framework of factoring is in Slovenia. However, an investment also has an impact on the choice of the international transport conventions TOP has to consider when organising transport with their own fleet and which when entering the trade as a freight forwarder. Hence, the additional amount of work and the structural changes in the company's working capital also have to be considered.

The following chapters are designed to investigate these issues in details.

CHAPTER 3

LAW REVIEW

3.1. Legal framework of Factoring

International trade, including international factoring, has in the last decade been facing an enormous boom. This required increasing volumes of international transactions unifying legal and other rules in respect of mutual rights and obligations between the contracting clients. Thus, the long-standing international commercial services developed standard legal rules and standardised terminology (Noel, Mills and Davidson, 2006). In fact, unification of substantive rules within international treaties is the most effective instrument to significantly reduce the risks of international transactions, which stem from the diversity of national legal systems. Among the foundations of the international law foundations that regulate international factoring are the International Institute for the Unification of Private Law (UNIDROIT); Convention on International Factoring and United Nations Commission on International Trade Law (UNCITRAL): Convention on the Assignment of Receivables in International Trade. These two conventions designed solutions for key issues related to international factoring.

3.1.1 Factoring worldwide

Convention of International Factoring took place in Ottawa on 28th of May 1988 due to the instituting international rules for factoring. The Convention on International Factoring focused on solving the questions on international factoring because the assignment of the receivables, at the international level, become more accessible and at the same time more powerful form of financing. However, through the Convention on International Factoring all the issues that may arise in international factoring have not been clarified so, according to the 4th article of the Convention on International Factoring all outstanding issue have to be resolved in accordance with the rules of private international law.

Convention on International Factoring is divided into four key chapters. The first chapter explains the range of the convention, its requirements, and in respect of which business the Convention on International Factoring is applicable. The second section highlights the nature of cession and the rights and obligations of the contract parties. The third chapter is devoted to the requirements relating to the further assignment of receivables (indirect factoring), which

allow the realisation of international factoring. The fourth chapter covers the final provisions and details the instruments of accession to the Convention on International Factoring.

Convention on International Factoring can be considered as an important step towards providing a more accessible international factoring as a tool of financing international trade. However, the Convention on International Factoring has its flaws and is limited in its use because it does not cover domestic factoring and relationships between factors and their clients. Nor do we find provisions that would resolve current problems associated with the insolvency of any of the parties. A general observation is that Convention on International Factoring leaves many substantive issues open and leave them to the national regulation, and regulation specified in the contract.

A more widely accepted international agreement is the UNCITRAL Convention on the Assignment of Receivables and International Trade and its extension, which was, addressed by the General Assembly of the United Nations in December of 2001 and is still open for the national governments signature. The main purpose of the Convention on the Assignment of Receivables and International Trade is to promote the practice of international finance receivables as a tool of promoting international trade. Its main objective is to reduce transaction costs, which include international assignment of receivables, international factoring, project financing and other tools of international financing. The core of the problem is in the divergence of national laws and several often conflicting criteria for the assignment of receivables. The Convention on the Assignment of Receivables and International Trade is particularly concerned with issues concerning the validity of the assignment of receivables under derivative foreign jurisdictions and the question of priority in the event of insolvency of the debtor.

Convention on the Assignment of Receivables and International Trade is divided into six chapters. The first chapter is dedicated to the scope of the Convention and clarifies key concepts, definitions and restrictions. The second section covers general requirements, definitions and interpretations of the rules, provisions relating to the parties where it is sub lined relative effect of assignment receivable. Effects of the assignment, with additional provisions relating to contractual restrictions assignment, are explained in chapter three. The fourth chapter is certainly one of the key chapters because the rights and obligations of the parties are explained therein. The fifth chapter provides the rules for the resolution of conflicts. Final provisions are set out in the sixth chapter.

It is worth mentioning that international factoring is supported by a correspondence foundation and on other links. Consequently, international factoring associations were created and they now provide a strong bond between the factors around the world. The most notable association is Factors Chain International (FCI) (The Factor Chain Organisation, 2012) based in Amsterdam. FCI membership is open therefore any factoring organisation can join it at any time. That is why FCI is the biggest factoring association and includes more or less 80% of all factoring organisations around the world. FCIs' legal basis is Code of International Factoring Customs and Statute of FCI - The Constitution of Factor Chain Organisation. Another influential factoring association is the International Factors Group (IFG) with headquarters in Brussels.

In the last years factoring has become well established in developing countries as well as in those that are highly industrialised. According to the Factors Chain International (FCI) Annual Review 2012, the growth of factoring occurred in various Asian countries, Africa, Central Europe, the Baltic countries and the Middle East. Although Latin America also reported growth in the last seven years, financial institutions continue to join the industry.

In 2009 almost all FCI members reported difficulties in respect of the risk management and maintaining pre-crises factoring volumes. Regardless of the world economies problem factoring started evidence profitability and risk control in a record year 2010. Furthermore the year 2011 also confirmed the 21% growth in domestic factoring and 37% in international factoring. Although factoring is still mostly used and suitable for SMEs, the tendency shows that large international corporation also seek factoring services.

The FCI General Rules for International Factoring (GRIF), introduced in July 2002 and developed and monitored by the FCI Legal Committee, have become the world's most widely recognised legal framework for international factoring. The FCI Legal Committee offers a support to the FCI members relating to any legal matters or relating in particular to the FCI GRIF, which is the standard for correspondent factoring relationships and probably close to 95% of the world's cross border factoring volume is governed by those rules. For resolution of disputes between the Export Factors and the Import Factors, a more formal FCI Arbitration process is available.

Table 3.1 - Total factoring volume by country in the last 7 years

in millions of Euros

	2005	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*
Europe							
Austria	4.273	4.733	5.219	6.350	6.630	8.307	8.986
Belgium	14.000	16.700	19.200	22.500	23.921	32.203	38.204
Bosnia & Herzegovina					35	45	45
Bulgaria	0	35	300	450	340	550	1.010
Croatia	175	340	1.100	2.100	2.450	2.793	2.269
Cyprus	2.425	2.546	2.985	3.255	3.350	3.450	3.758
Czech Republic	2.885	4.025	4.780	5.000	3.760	4.410	5.115
Denmark	7.775	7.685	8.474	5.500	7.100	8.000	9.160
Estonia	2.400	2.900	1.300	1.427	1.000	1.227	1.164
Finland	10.470	11.100	12.650	12.650	10.752	12.400	13.000
France	89.020	100.009	121.660	135.000	128.182	153.252	174.580
Germany	55.110	72.000	89.000	106.000	96.200	129.536	157.260
Greece	4.510	5.230	7.420	10.200	12.300	14.715	14.731
Hungary	1.820	2.880	3.100	3.200	2.520	3.339	2.817
Ireland	23.180	29.693	22.919	24.000	19.364	20.197	18.330
Italy	111.175	120.435	122.800	128.200	124.250	143.745	175.182
Latvia	20	276	1160	1520	900	328	371
Lithuania	1.640	1.896	2.690	3.350	1.755	1.540	2.134
Luxembourg	280	306	490	600	349	321	180
Malta	0	1	25	52	105	136	200
Netherlands	23.300	25.500	31.820	30.000	30.000	35.000	46.000
Norway	9.615	11.465	17.000	15.000	15.100	15.075	16.395
Poland	3.700	4.425	7.900	7.800	12.000	16.210	17.900
Portugal	16.965	16.886	16.888	18.000	17.711	20.756	27.879
Romania	550	750	1.300	1.650	1.400	1.800	2.582
Russia	2.540	8.555	13.100	16.150	8.580	12.163	21.174
Serbia	0	150	226	370	410	500	926
Slovakia	830	1.311	1.380	1.600	1.130	981	1.171
Slovenia	***230***	***340***	***455***	***650***	***650***	***650***	***550***
Spain	55.515	66.772	83.699	100.000	104.222	112.909	122.125
Sweden	19.800	21.700	21.700	16.000	18.760	18.760	29.259
Switzerland	1.900	2.000	2.513	2.590	5.000	4.000	3.450
Turkey	11.830	14.925	19.625	18.050	20.280	38.988	30.869
Ukraine	333	620	890	1.314	530	540	955
United Kingdom	237.205	248.769	286.496	188.000	195.613	226.243	268.080
TOTAL EUROPE	**715.471**	**806.958**	**932264**	**888528**	**876.649**	**1.045.069**	**1.217.811**

Continues

Continuation - Total factoring volume by country in the last 7 years

in millions of Euros

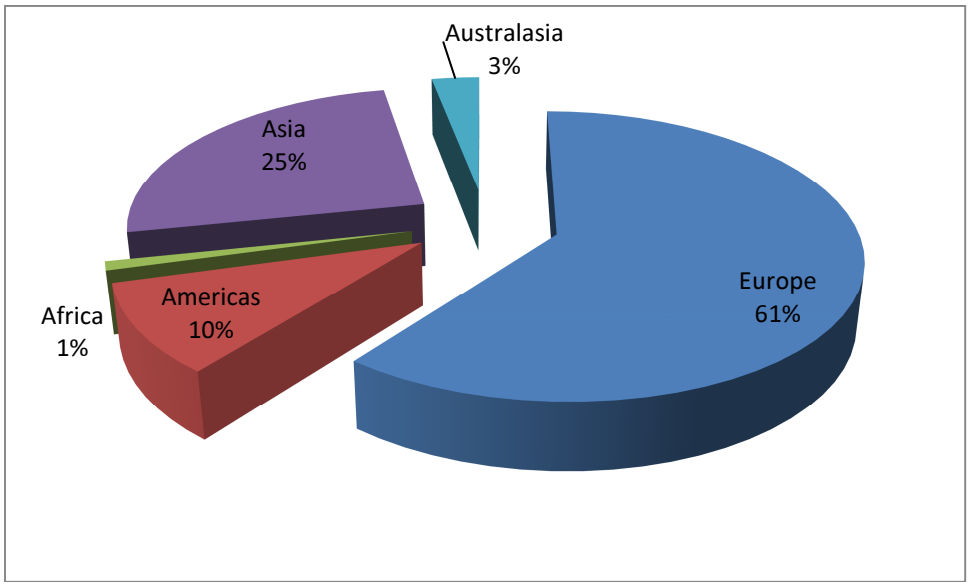
	2005	2006	2007	2008	2009	2010	2011
Americas							
Argentina	275	333	362	355	335	350	475
Bolivia					18	18	35
Brazil	20.050	20.054	21.060	22.055	29.640	49.050	45.623
Canada	3.820	3.386	4.270	3.000	3.250	3.723	5.284
Chile	9.500	11.300	14.620	15.800	14.500	16.422	21.500
Colombia	0	100	2.030	2.100	2.392	2.784	4.990
Honduras						160	30
Mexico	7.100	8.150	9.200	9.550	2.120	14.538	21.074
Panama	240	607	483	460	500	600	700
Peru	95	563	648	875	758	2.712	2.461
United States	94.160	96.000	97.000	100.000	88.500	95.000	105.000
TOTAL AMERICAS	**135.240**	**140.493**	**149.673**	**154.195**	**142.013**	**185.357**	**207.172**
Africa							
Egypt	1	3	20	50	110	200	200
Mauritius					121	125	127
Morocco	430	440	660	850	910	1.071	1.406
South Africa	5.580	7.800	9.780	12.110	13.500	15.120	21.378
Tunisia	226	270	245	253	276	295	340
TOTAL AFRICA	**6.237**	**8.513**	**10.705**	**13.263**	**14.917**	**16.811**	**23.451**
Asia							
Armenia	1	50	50	7	7	14	14
China	5.830	14.300	32.976	55.000	67.300	154.550	274.870
Hong Kong	7.700	9.710	7.700	8.500	8.079	14.400	17.388
India	1.990	3.560	5.055	5.200	2.650	2.750	2.800
Indonesia							
Israel	325	375	800	1.400	1.400	1.650	1.650
Japan	77.220	74.530	77.721	106.500	83.700	98.500	111.245
Jordan					43	43	12
Korea	850	850	955	900	2.937	5.079	8.087
Lebanon	61	95	176	306	420	450	327
Malaysia	532	480	468	550	700	1.058	1.050
Qatar					23	23	75
Singapore	2.880	2.955	3.270	4.000	4.700	5.800	6.670
Taiwan	36.000	40.000	42.500	48.750	33.800	67.000	79.800
Thailand	1.640	1.925	2.240	2.367	2.107	2.095	3.080
United Arab Emirates	440	810	340	1.860	1.910	2.000	1.750
Vietnam	2	16	43	85	95	65	67
TOTAL ASIA	**135.471**	**149.656**	**174.294**	**235.425**	**209.871**	**355.477**	**508.885**
Australasia							
Australia	23.130	27.573	33.080	32.546	39.410	44.915	57.491
New Zealand	600	0	700	700	700	600	600
TOTAL AUSTRALASIA	**23.730**	**27.573**	**33.780**	**33.246**	**40.110**	**45.515**	**58.091**
TOTAL WORLD	**1.016.149**	**1.133.193**	**1.300.716**	**1.324.657**	**1.283.560**	**1.648.229**	**2.015.410**

Source: Factors Chain International: Annual Review (2012)

Total volume of domestic and international factoring by country, observed in a seven year period from 2005 until 2011 is represented in *Table 3.1*. In general, there is a slight decrease in factoring volume during the crisis years of 2008 and 2009. In 2010 and 2011 an increase in factoring volume is noted in a lot of countries which confirms that factoring has not been affected by economic distress. However, Slovenia is one of the few countries where a domestic and international factoring has not increased since 2008, and they even decreased in the last year.

In 2011, similarly to the years before, Europe accounted for the highest percentage of the worldwide factoring volume. Around 61% of the reported global turnover stems from Europe, with the majority stemming from the European Union (EU). The relevant percentages are illustrated in *Graph 3.1.*

Graph 3.1 - Total factoring volume in 2011



Source: Factors Chain International: Annual Review (2012)

A more detailed overview of the domestic and international volumes by country in 2011 is represented in *Table 3.2*.

Table 3.2 - Domestic and international factoring by country in 2011

in millions of Euros

Nr. of Companies		*Domestic Factoring*	*International Factoring*	*TOTAL*
	Europe			
4	*Austria*	7.009	1.977	8.986
6	*Belgium*	28.704	9.500	38.204
1	*Bosnia & Herzegovina*	30	15	45
7	*Bulgaria*	800	210	1.010
20	*Croatia*	2.153	116	2.269
3	*Cyprus*	3.700	58	3.758
8	*Czech Republic*	3.865	1.250	5.115
6	*Denmark*	5.510	3.650	9.160
4	*Estonia*	972	192	1.164
5	*Finland*	11.050	1.950	13.000
12	*France*	141.410	33.170	174.580
100	*Germany*	119.120	38.140	157.260
12	*Greece*	12.685	2.046	14.731
22	*Hungary*	2.455	362	2.817
8	*Ireland*	17.047	1.283	18.330
45	*Italy*	142.686	32.496	175.182
9	*Latvia*	200	171	371
8	*Lithuania*	795	1.339	2.134
1	*Luxembourg*	177	3	180
2	*Malta*	150	50	200
4	*Netherlands*	30.000	16.000	46.000
7	*Norway*	14.334	2.061	16.395
18	*Poland*	14.200	3.700	17.900
15	*Portugal*	24.812	3.067	27.879
13	*Romania*	1.922	660	2.582
33	*Russia*	20.944	230	21.174
13	*Serbia*	726	200	926
7	*Slovakia*	810	361	1.171
4	*Slovenia*	410	140	550
24	*Spain*	109.083	13.042	122.125
40	*Sweden*	28.259	1.000	29.259
8	*Switzerland*	3.352	98	3.450
74	*Turkey*	25.591	5.278	30.869
25	*Ukraine*	933	22	955
42	*United Kingdom*	249.664	18.416	268.080
610	***TOTAL EUROPE***	**1.025.558**	**192.253**	**1.217.811**
	Africa			
4	*Egypt*	100	100	200
1	*Mauritius*	127	0	127
4	*Morocco*	1.226	180	1.406
5	*South Africa*	21.238	140	21.378
4	*Tunisia*	297	43	340
18	***TOTAL AFRICA***	**22.988**	**463**	**23.451**

Continues

Continuation - Domestic and international factoring by country in 2011

in millions of Euros

Nr. of Companies		*Domestic Factoring*	*International Factoring*	*TOTAL*
	Americas			
5	*Argentina*	455	20	475
1	*Bolivia*	32	3	35
1.112	*Brazil*	45.580	43	45.623
51	*Canada*	4.981	303	5.284
148	*Chile*	20.000	1.500	21.500
30	*Colombia*	4.790	200	4.990
1	*Honduras*	0	30	30
11	*Mexico*	21.058	16	21.074
17	*Panama*	700	0	700
9	*Peru*	2.267	194	2.461
300	*United States*	90.000	15.000	105.000
1.685	***TOTAL AMERICAS***	**189.863**	**17.309**	**207.172**
	Asia			
4	*Armenia*	10	4	14
30	*China*	229.952	44.918	274.870
12	*Hong Kong*	15.044	2.344	17.388
12	*India*	2.650	150	2.800
1	*Indonesia*	0	3	3
6	*Israel*	1.300	350	1.650
4	*Japan*	110.195	1.050	111.245
1	*Jordan*	0	12	12
10	*Korea*	0	8.087	8.087
1	*Lebanon*	310	17	327
30	*Malaysia*	840	210	1.050
1	*Qatar*	45	30	75
8	*Singapore*	4.370	2.300	6.670
20	*Taiwan*	76.000	3.800	79.800
13	*Thailand*	3.070	10	3.080
4	*United Arab Emirates*	1.000	750	1.750
7	*Vietnam*	42	25	67
164	***TOTAL ASIA***	**444.828**	**64.060**	**508.888**
	Australasia			
19	*Australia*	57.300	191	57.491
7	*New Zealand*	600	0	600
26	***TOTAL AUSTRALASIA***	**57.900**	**191**	**58.091**
2.503	***TOTAL WORLD***	**1.741.137**	**274.276**	**2.015.413**

Source: Factors Chain International: Annual Review (2012)

International Factors Group (IFG) publishes a Global Industry Activity Report (GIAR) every year, which gives an overview of the activity during last calendar year in the worldwide industry of Factoring, Commercial Finance and Asset Based Lending.

Table 3.3 - Global industry activity report - Slovenia 2011

GDP 2009 (in Millions €)	38.103
GDP 2010 (in Millions €)	33.170
GDP 2011 (in Millions €)	35.807
Number of Companies 2009	6
Number of Companies 2010	6
Number of Companies 2011	5
Total Industry Turnover 2009 (in Millions €)	550
Total Industry Turnover 2010 (in Millions €)	550
Total Industry Turnover 2011 (in Millions €)	600
GDP Penetration 2009	1.44%
GDP Penetration 2010	1.66%
GDP Penetration 2011	1.68%
Total advances (in Millions €)	50
Total number of clients	365
Number of debtors	2.737
Total number of employees	44
Turnover/Employee (in million €)	13,7
Turnover/Client (in million €)	1,6
Clients/Employee	4,2
Non - recourse Factoring (with credit protection)	15%
Recourse factoring (without credit protection)	55%
Invoice Discounting (debtor management stays with the supplier)	25%
Reverse Factoring or Supplier Finance - Volume estimate (in Millions. €)	5%
Turnover in export (direct or 2-factor)	15%
Turnover in import (direct or 2-factor)	4%
Asset based lending Advances €M	n/a
Top 5 combined market share	96%
Top 5 share Division of Bank	9%
Top 5 share Subsidiary of Bank	64%
Top 5 share Independent Company	23%
Newly established factoring companies in 2011	0
Newly established DB	
Newly established SB	
Newly Established IC	
Awareness level	medium
Acceptance level	medium
The level of demand for factoring	positive
Level of turnover	neutral
Industry profitability	neutral
Overall debtor risk	negative
Overall client risk	negative
The future development of the industry in general	neutral

Source: International Factor Group – IFG GIAR (2011)

The report contains information from 62 countries and it provides a distinctive insight into the position of the global factoring and Commercial finance industry. The input from Slovenia is represented in *Table 3.3.* The report considers fundamentals of trade, citing turnover and progress, GDP penetration, market structures and shares, and brings its unique perspective with the analysis of country respondents' opinions on a range of Industry trends and issues.

In Slovenia, awareness and acceptance level of factoring as a financial solution are medium. Demand and turnover in respect of the expected demand for factoring and the associated levels of turnover, are generally positive. Given the prevailing economic climate, this indicates a very high level of confidence. In general, it appears that respondents have become neutral - optimistic so they can translate rising demand and turnover into bottom line profitability. Risk management remains one of the most fundamental operational control challenges for all of the providers in the market.

Regarding industry development prospects, respondents' answers were neutral. However, a clear message from those involved, 2.700 active factoring providers, which at the end of 2011 were advancing around €300 billion to around 485,000 factoring clients and employing around 38,000 staff, is that despite the concerns regarding the global economic situation, this industry is strong, growing and will continue to develop, by providing funding and service solutions that meet the working capital needs of an increasing number of SME and larger businesses worldwide.

3.1.2 Factoring in Slovenia

Factoring market in Slovenia is very young. The first beginnings of the true factoring, with the appearance of all essential functions, we detect in 1994. In this year, the Nova Ljubljanska Bank d.d., together with some foreign partners established the first factoring company in Slovenia, which was called LB Factors. The company initially dealt mainly with export factoring. This development phase is logical, since the beginning of the nineties the Slovenian market was not yet ready for modern, complex financial services; the market was unstable and financial discipline was below a critical value. Factoring can only develop in relatively stable economies with a regulated legal environment and a developed financial market.

Factoring is not specifically regulated in the Slovenian legislation. When looking for factoring solutions, multiple legal sources need to be followed. Nevertheless, it is necessary to consider the basis of the factoring in the Slovenian Code of Obligations, the Banking Act and the Property Code. Factoring contract is literate, durable, nameless and specific bank business. Obligations of the parties, in the case of factoring, are governed by autonomous provisions of commercial law, the contracts and any general terms and conditions of the Code of Obligations. In general, factors are subsidiaries of banks and other domestic and foreign

financial companies, so they accepted account keeping rules in accordance with International Accounting Standards (Van Horen and Wachowicz, 2008).

One of the key elements for the implementation of the factoring agreement is cession. The factoring contract is actually a pre-contract, acting as the first phase of the relationship between the factor and the assignor/client and also the basis for the suppression of its main individual contracts. The second phase of factoring, after the conclusion of a preliminary contract, is an offer from the assignor to factor, to buy individual receivables and factors consent to any such redemption.

The creditworthiness of the debtor plays a decisive role in accepting the main contract or contracts. When deciding, a factor is less interested in the debtor and his ability to pay, rather he focuses on the future of the debtor (Epstein, 2007).

Considering all of its properties, a factoring contract is atypical. It is an agreement drafted by the business world, which means that it is constantly subject to change, development and updating. Within Slovenian legal system, factoring contract is most similar to a sales contract. This is when the factor takes over or not the responsibility del credere. Function guarantees del credere is a typical feature of the factoring contract. The main purpose of the factoring contract is also a need to finance or to guarantee del credere. Legal foundation for transferring receivables to factor is commercial contract, with the difference, that during the transfer in factoring contract apply cession rules (Jerman, 2003).

3.2 Freight forwarding worldwide

Freight Forwarder's tasks arise from their economic functions. It is important to know the role and place of a freight forwarder in organising logistical processes in international trade. Hence, for a freight forwarder to be able to successfully organise physical distribution of goods, he must know the transport markets, the nature of goods, the characteristics of packaging and of the protective materials. He has to be familiar with domestic and foreign legal, financial, insurance, customs and other regulations (Ogorelec, 1999). Forwarding activity is regulated by laws, regulations, customs, usages and jurisprudence. For the purposes of this analysis, the important laws are based on Slovenian, European and Anglo-Saxon system.

The European system is the oldest and explains the basic principles of the work of a freight forwarder as broker. There are different views on the responsibility of the freight forwarder regarding the work of the third party; carrier, sub - freight forwarder, middle - freight forwarder. According to German law, freight forwarder is not responsible for carrier work, but only for his choice, which means that the freight forwarders responsibility is transferred to the carrier at the time of transfer of goods. A freight forwarder is responsible for the work of sub - freight forwarder in choosing services and for his work. In accordance with French law, the freight forwarder has greater responsibilities and is accountable for the carrier work and middle - freight forwarder. In the Anglo-Saxon system – the British and American commercial legal system consider a freight forwarder as an agent, which means that he enters into transport contracts with the carrier on behalf of a third party.

FIATA

International Federation of Freight Forwarder Associations (FIATA) was founded 31 May 1926 in Vienna and is the largest non-governmental organisation on the field of freight forwarding business, with a worldwide impact all over the world. Today FIATA's headquarters are based in Zürich and it governs more than 40,000 forwarding companies in more than 150 countries. FIATA has a consultative role and is acting as a representative of the freight forwarding industry in various organisations, governmental bodies and other international organisations.

FIATA wished to introduce uniform documentation, which allows for easy and smooth document management and goods handling in international trade. Hence, FIATA prepared standardised documents that can be used and issued only by freight forwarders.

Currently, FIATA has the following documents and forms available:

- Forwarders Certificate of Receipt (FIATA - FCR)
- Forwarders certificate of Transport (FIATA - FCT)
- FIATA Warehouse Receipt (FWR)
- Negotiable FIATA Multimodal Transport Bill of Lading (FBL)
- Non-negotiable FIATA Multimodal Transport Waybill (FWB)
- Shippers Declaration for the Transport of Dangerous Goods (FIATA SDT)
- Shippers Intermodal Weight Certificate (FIATA SIC)
- FIATA Forwarding Instructions (FFI)

INCOTERMS

The Incoterms rules or International Commercial terms are a sequence of pre-defined commercial terms published by the International Chamber of Commerce (ICC) and are generally used in international commercial transactions. First published in 1936, the Incoterms rules have been periodically updated, the last version have been published on January 1, 2011. The ICC has over 200 members from 55 countries and its mandate is to support the development of intermodal transport and competitive, efficient transport markets worldwide. These members include executives in charge of transport and logistics for large multinationals, shippers, freight forwarders, carriers, airlines and airports, bankers, insurers, lawyers, industry associations and trade specialists.

The ICC Commission on Transport and Logistics represents all interests in the business of transport and logistics. The commission elaborates global business positions on issues such as the regulation of the environmental impact of transport, including both air transport and vessel emissions, and promotes the liberalisation of all transport modes. The commission also influences new regulations on transport and supply chain security. Additionally the commission contributes to the work of the ICC International Maritime Bureau on combating maritime piracy. Maritime experts include shippers, carriers, intermediaries and ports who maintain that shipping can best serve world trade if allowed to operate on a commercial basis, in a competitive market free from protectionism and other forms of market-distorting government support. Air transport experts include express carriers, intermediaries, and airline and airport representatives. Priority issues include promoting global coordination on issues such as competition, security and the environment. Specifically, the commission presses for a global consensus on new aircraft noise standards with ICAO, the ratification of a draft global convention for aircraft financing and leasing, and the use of information technology for airway bills.

Incoterms is a trademark of the ICC. A series of three-letter trade terms related to common sales practices, the Incoterms rules are intended primarily to clearly communicate the tasks, costs and risks associated with the transportation and delivery of goods. In the latest version of the Incoterms, the rules are only classified into two categories, depending on the mode of transport for which they are intended. Most of the clauses are suitable for all forms of transport: EXW, FCA, CPT, CIP, DAP, DAT, DDP. Only on water transport are intended four clauses: FAS, FOB, CFR and CIF and it does not distinguish between transport by sea

and inland waterway transport. The Incoterms rules are accepted by governments, legal authorities and practitioners worldwide for the interpretation of most commonly used terms in international trade. They are intended to reduce or altogether remove uncertainties arising from different interpretation of the rules in different countries (Appendix I).

- EXW – Ex Works (named place of delivery): This term places minimum responsibility on the seller, which has only to make the goods available at their premises. The buyer bears the responsibility of moving the goods to final destination and full costs. The Ex Works term is mainly used when preparing initial quotations for the sale of goods without any costs included.
- FCA – Free Carrier (named place of delivery): The seller delivers the goods, cleared for export, to the carrier chosen by the buyer at the named place. From that point, the buyer bears the risks and costs of transporting the goods to final destination.
- CPT - Carriage Paid To (named place of destination): The seller pays the transportation of goods to final destination. As soon as the goods are transferred to first carrier, so are the risks.
- CIP – Carriage and Insurance Paid to (named place of destination): The sellers assume the costs of transporting the goods over to final destination. As the goods are transferred to the first carrier, so is the risk. The seller however pays for the insurance.
- DAT – Delivered at Terminal (named terminal at port or place of destination): The seller bears all risks and costs involved in moving and unloading the goods at the named terminal, except for costs related to import clearance.
- DAP – Delivered at Place (named place of destination): The seller assumes the costs for transporting the goods to the named place, except for costs related to import clearance. The seller also assumes all risks prior to the point when the goods are ready for unloading by the buyer.
- DDP – Delivered Duty Paid (named place of destination): The seller delivers the goods to the named place of destination, cleared for import, supporting full costs. The DDP term makes the seller bear the maximum obligations and the buyer the minimum.
- FAS – Free alongside Ship (named port of shipment): The seller delivers the goods to the ship at the named port. From then on, the buyer assumes all costs and risks. The seller must clear the goods for export.

- FOB – Free on Board (named port of shipment): The seller loads the goods on the vessel chosen by the buyer and clears them for export. Cost and risk are divided when the goods are actually on board of the vessel.
- CFR – Cost and Freight (named port of destination): The seller pays the costs of delivering the goods to the port of destination and clears the goods for export. The risk is transferred to the buyer once the goods are loaded on the vessel. It doesn't include insurance for the goods.
- CIF – Cost, Insurance and Freight (named port of destination): Exactly the same as CFR with the exception that the seller purchases the cargo insurance.

3.2.1 Freight Forwarding in Slovenia

Freight forwarding law is based on the Law of Obligations, Foreign Trade law and current Standard Trading Conditions of International Freight Forwarders, issued by the Slovenian International Freight Association, with the Slovenian Chamber of Economy. In Slovenia, the legal status of forwarding is defined in the Law of Obligations, where a separate chapter defines the concept of freight forwarding contract and the rights and obligations of the shipper and freight forwarding customer services of this contract. General conditions include detailed provisions on the forwarding business, the freight forwarders status in the Slovenian legal system and freight forwarders responsibilities in a forwarding contract. The customs clearance provisions contain specifically prescribed conditions in relation to the following: professionalism of the shipper, and elimination of space, start-up capital, tariffs, customs forwarding agent services, the license approval process and the process of the license removal. The self-governing law also deserves a mention, as it includes usages, trade practices, terms and conditions, contract clauses and terms, formulated and appropriately applied in business practice. General terms and conditions, which are part of the forwarding contract, take precedence over commercial usage. The Law of Obligations ranks the use of certain rules of contract law.

Freight forwarders have three legal-economic statuses:

- *Freight Forwarder acting on the basis of a commission*: The freight forwarder is an intermediary between exporters and importers, carriers, traffic agents, the financial and other institutions. He performs forwarding work on his behalf and on a third party’s account or on his behalf on order and account of originator.

- *Freight Forwarder as an agent:* The freight forwarder is an intermediary between the exporters and importers, originator and other colleagues, especially customs and insurance. He performs freight forwarding business in the name of and on behalf of another person, or in the name and on behalf of the originator.
- *Freight Forwarder in the status of an entrepreneur* – Freight forwarder is an interface between the originator and his other colleagues of foreign trade structure. He performs forwarding work in his own name and on his account.

One of the major business and performance tasks of a freight forwarder are related to the custom clearance of goods. From private law perspective a freight forwarder represents an originator. From a public law perspective a freight forwarder is not a party in the customs clearance process, but the originator and has the legal status of a customs subject. Freight forwarders and transport insurances represent an important business in relation to the cargo insurance contracts. In this case a freight forwarder is acting on behalf of and on order of the originator, and arranges international transport insurance on his behalf.

According to the Slovenian law the basic characteristics of the forwarding contract are:

- A forwarding contract is a bilateral agreement, with which the freight forwarder undertakes to carry out one or more forwarding tasks of the originators and he undertakes to pay tax on the services, the fees and any subsequent costs.
- Price for forwarding services is determined by the scale of the forwarding service or by a special contract between the freight forwarder and the originator.
- The freight forwarder takes up a contract based on the clients forwarding order (disposition).
- The freight forwarder has the following obligations under a forwarding contract: The obligations are associated with each stage of contract execution. However, one of the obligations of the freight forwarder is to proceed with caution, which means that a freight forwarder always has to proceed in the interests of the originator. A freight forwarder has to proceed according to the instructions of the originator, in other words he has to consider the originators disposition, especially any requirements in relation to the transport route, mean of transport, mode of transport and the transition timeline (Žvikart, 2001).

The relations between the participants in the international transport system are governed by the national and international legal transport regulations; this includes maritime, rail, river, road and air transport. Each method of transport has to operate within the legal framework that is applicable for that specific situation.

- Railway freight: In Slovenia, the railway freight is governed by the Railway Transport Contracts Act, the Law on railway safety and the Convention concerning International Carriage by Rail (COTIF), which applies in the whole Europe. The member states of Intergovernmental Organisation for International Carriage by Rail (OTIF) apply the majority of the appendices to COTIF. There are four basic parts of COTIF; OTIF, being the first part of it, regulates the organisational structure of an intergovernmental organisation for international transport by rail; the second part is the Protocol on the Privileges and Immunities of the inter-state organisation of transport by rail; the third part consists of the single rule of Contract in international rail transport of passengers and baggage (CIV); fourth part consists of Goods transport contract (CIM) and International Rule for Transport of Dangerous Substances by Railway (RID).
- Road freight: Slovenian legal sources are the Law on transport in international traffic, Convention on the Contract for the International Carriage of Goods by Road **(**CMR), the European Agreement concerning the International Carriage of Dangerous Goods by Road (ADR) and The Convention on International Transport of Goods Under Cover of TIR Carnets (TIR Convention).
- Air freight: The national legal sources are the Law of air navigation, Eurocontrol – The European organisation for the safety of air navigation, Warsaw Convention and Montreal Convention.
- Sea freight: Legal sources are Law on safety of maritime and inland navigation, Maritime code, Warsaw convention including Montreal protocol, Hamburg rules, Haag – Visby rules.

CHAPTER 4

CASE STUDY

4.1 Data collection

Data for this study is collected from the financial plan of TOP Hrvatin in drugi d.n.o.

The break-even analysis is one of the possible ways of checking the returns of a business idea. I want to know what profits the company has, but also when do they occur, how long before the company begun to operate profitably and how many services have to be sold in order for a business to still be profitable. In theory, this is called the break-even point. When calculating the break-even point in practice, problems often occur. When calculating the break-even point by considering the turnover, costs are divided into variable and fixed. Profits are what remain after all of the expenses are covered (Steinhoff and Burgess, 1993). Predicting the precise amount of sales or profits is nearly impossible due to the company's many customers (with varying demands for service), and the interaction between price, promotion and the number of units sold. These and other factors will complicate the break-even analysis.

TOP Hrvatin in drugi d.n.o. has three main products: transport of goods in Slovenia, transport of good abroad and sea freight. Selling prices are calculated on an average base of the year 2011 and the first half of the year 2012. Costs per unit are calculated on the same principal. Costs per unit are the average value of the received invoices from the transport companies or, in other words, our partners. The family freight forwarder company is considering investing in fixed assets by buying a new transport fleet.

All of the information is calculated on the base of the break – even analysis and the depreciation is the base for the financial statements, and business and financial indicators. As mentioned above, my key research question has the ability to contribute to greater use of factoring in financing SMEs in a small and young economy like Slovenia. It is especially important to determine how the legal environment is influencing the use of factoring in a freight forwarding company. Balance sheets when using factoring and using bank loan are presented hereafter.

Table 4.1 - The break - even analysis

in €

Product	***Selling price***	***Transport Services Costs***
Transport of good in Slovenia	786 €	665 €
Transport of goods abroad	1.446 €	1.350 €
Sea freight	3.538 €	3.075 €

in €	***Year 1***	***Year 2***	***Year 3***	***Year 4***	***Year 5***
Fixed costs					
Labour	120.000	150.000	160.000	170.000	170.000
Depreciation	5.500	9.100	34.350	34.350	28.350
Rent	4.000	4.500	3.000	2.000	1.000
SUM	**129.500**	**163.600**	**197.350**	**206.350**	**199.350**
Variable costs					
Transport Services	2.686.050	2.896.875	3.215.500	3.523.400	3.684.500
Other variable costs					
Promotional activities	1.000	1.000	1.000	1.000	1.000
Education	1.000	1.000	1.500	1.500	1.500
Maintenance	0	0	20.000	20.000	20.000
Cost of used materials	3.000	20.000	30.000	38.000	38.000
Other costs	11.000	12.000	13.000	14.000	15.000
SUM	**16.000**	**34.000**	**65.500**	**74.500**	**75.500**
Average variable cost per unit	6,72	13,36	23,39	24,60	23,89
SUM	**2.831.550**	**3.094.475**	**3.478.350**	**3.804.250**	**3.959.350**

in €	***Year 1***	***Year 2***	***Year 3***	***Year 4***	***Year 5***
Variable costs per unit product 1	672	678	688	690	689
Variable costs per unit product 2	1.357	1.363	1.373	1.375	1.374
Variable costs per unit product 3	3.082	3.088	3.098	3.100	3.099
Contribution margin per unit 1	114	108	98	96	97
Contribution margin per unit 2	89	83	73	71	72
Contribution margin per unit 3	456	450	440	438	439
Sales mix percentage 1	0,37	0,35	0,34	0,32	0,32
Sales mix percentage 2	0,62	0,63	0,64	0,66	0,66
Sales mix percentage 3	0,02	0,02	0,02	0,02	0,02
Product 1	42	38	33	31	31
Product 2	55	52	47	47	48
Product 3	8	8	8	8	8
Weighted Average Contribution margin per unit	**105**	**98**	**88**	**86**	**87**
Break-even point in units of Sales mix	**1.238**	**1.670**	**2.252**	**2.387**	**2.292**
Product 1 units at break-even point	453	591	764	765	725
Product 2 units at break-even point	765	1.050	1.448	1.577	1.523
Product 3 units at break-even point	21	30	40	46	44
Product 1 sales	355.770	464.159	600.474	601.086	570.012
Product 2 sales	1.105.893	1.518.065	2.093.096	2.280.030	2.202.159
Product 3 sales	73.628	104.465	142.258	161.781	153.947
Break – even point (value)	**1.535.291**	**2.086.690**	**2.835.829**	**3.042.898**	**2.926.117**

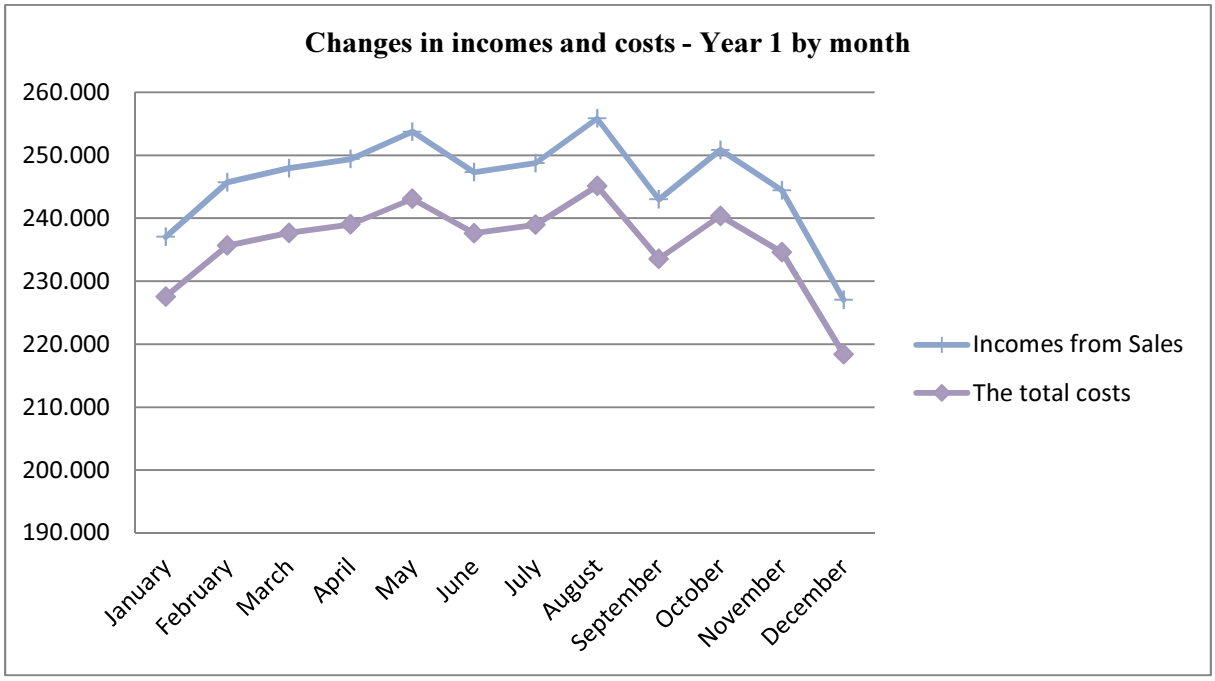
in €

Months Year	*Sold units of Product 1*	*Sold units of Product 2*	*Sold units of Product 3*	*Share of sales in Slovenia*	*Share of sales in EU*	*Share of sales out of EU*	*Incomes from Sales*	*Variable costs*	*A contribution to cover*	*The total costs*	*Profit before taxes - current*	*Profit before taxes - cumulative*
January	72	115	4	38%	25%	37%	237.034	216.764	20.271	227.555	9.479	9.479
February	72	121	4	48%	20%	32%	245.710	224.864	20.847	235.655	10.055	19.534
March	73	122	4	55%	20%	25%	247.942	226.879	21.064	237.670	10.272	29.806
April	73	123	4	49%	35%	16%	249.388	228.228	21.160	239.020	10.369	40.175
May	73	126	4	50%	35%	15%	253.726	232.278	21.448	243.070	10.657	50.831
June	72	127	2	53%	26%	21%	247.310	226.813	20.497	237.605	9.706	60.537
July	72	128	2	54%	27%	19%	248.756	228.163	20.593	238.955	9.802	70.338
August	72	128	4	54%	26%	20%	255.832	234.314	21.519	245.105	10.727	81.065
September	72	124	2	53%	27%	20%	242.972	222.764	20.209	233.556	9.417	90.482
October	73	124	4	51%	25%	24%	250.834	229.579	21.256	240.371	10.464	100.945
November	73	122	3	49%	23%	28%	244.404	223.804	20.601	234.596	9.809	110.754
December	73	110	3	50%	25%	25%	227.052	207.604	19.449	218.396	8.656	119.410
Year 1	870	1.470	40	50%	26%	24%	2.950.960	2.702.050	248.910	2.831.550	119.410	
Year 2	900	1.600	45	50%	33%	17%	3.180.210	2.930.875	249.335	3.094.475	85.735	
Year 3	950	1.800	50	46%	35%	19%	3.526.400	3.281.000	245.400	3.478.350	48.050	
Year 4	970	2.000	58	42%	37%	21%	3.859.624	3.597.900	261.724	3.804.250	55.374	
Year 5	1.000	2.100	60	37%	42%	21%	4.034.880	3.760.000	274.880	3.959.350	75.530	

Growth rate of above mentioned products is calculated on the base of signed new contracts which apply for the next four years. The company also submitted an application for a tender for which it still did not receive the result, however the increased volume of sold units based on this contract is already calculated above.

Both graphs represent incomes and costs from the financial plan.

Graph 4.1 - The break - even analysis - graphical presentation



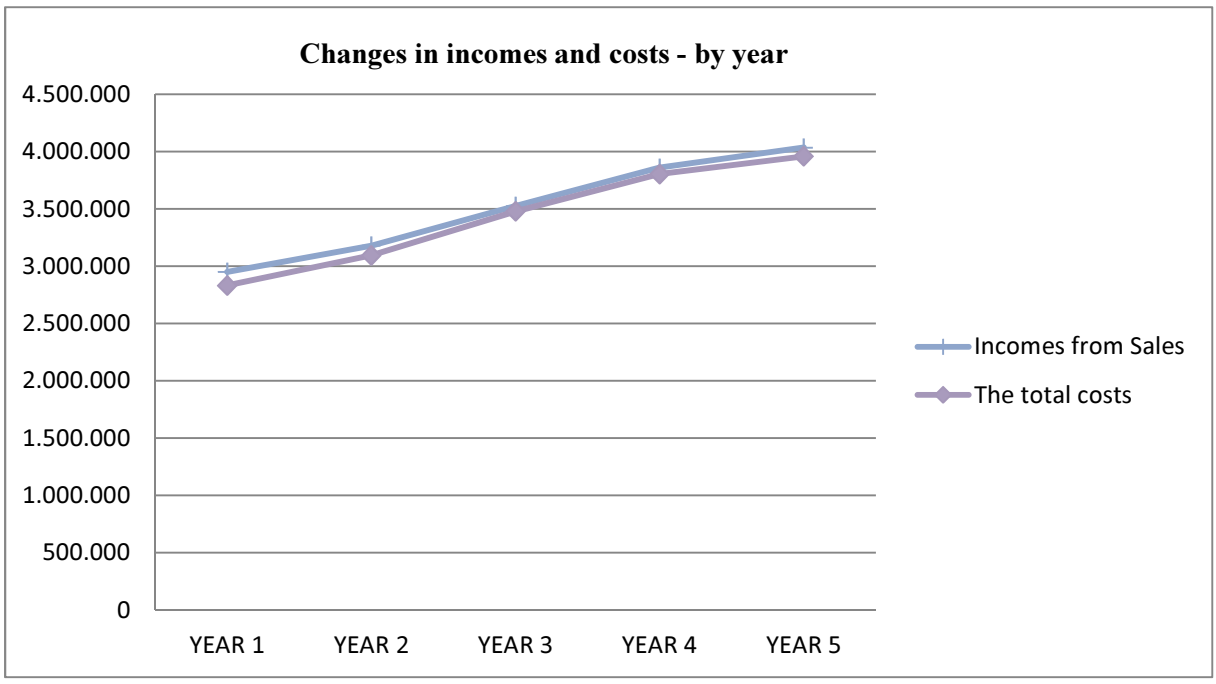


Table 4.2 - Tangible fixed assets and depreciation

in €		*Depreciation entry*		*Purchase price*	*Depreciation rate %*	*Depreciation at the end*		*1*	*2*	*3*	*4*	*5*	*1*	*2*	*3*	*4*	*5*
Fixed assets	*Group of assets*	*Year*	*Month*			*Year*	*Month*	*Write -off*	*Write -off*	*Write-off*	*Write-off*	*Write-off*	*The rest*	*The rest*	*The rest*	*The rest*	*The rest*
Business premises	*2. Business premises*	2	1	120.000	3,00%	35	4	0	3.600	3.600	3.600	3.600	0	116.400	112.800	109.200	105.600
Transport vehicle	*3. Equipment, vehicles, machinery*	3	1	165.000	15,00%	9	8	0	0	24.750	24.750	24.750	0	0	140.250	115.500	90.750
Software	*3. Equipment, vehicles, machinery*	1	1	8.000	25,00%	4	12	2.000	2.000	2.000	2.000	0	6.000	4.000	2.000	0	0
Technical equipment	*3. Equipment, vehicles, machinery*	1	1	7.000	50,00%	2	12	3.500	3.500	0	0	0	3.500	0	0	0	0
Computers	*4. Computers, software, technical equipment*	3	1	8.000	50,00%	4	12	0	0	4.000	4.000	0	0	0	4.000	0	0
2. Business premises								0	3.600	3.600	3.600	3.600	0	116.400	112.800	109.200	105.600
3. Equipment, vehicles, machinery								5.500	5.500	26.750	26.750	24.750	9.500	4.000	142.250	115.500	90.750
4. Computers, software, technical equipment								0	0	4.000	4.000	0	0	0	4.000	0	0
SUM								**5.500**	**9.100**	**34.350**	**34.350**	**28.350**	**9.500**	**120.400**	**259.050**	**224.700**	**196.350**

According to the Article 33 of Corporate Income Tax Act (ZDPRO-2) the maximum depreciation rate for computers, technical equipment, hardware and software is 50%. The company decided that for technical equipment and for computers will apply a 50% depreciation rate, because of the new updates which will be considered in the two years period.

4.2 Financial Statements and Results analysis

In order to take the first step towards a safe business relationship, all of the information in relation to both buyers and suppliers has to be analysed. In today's world of uncertainty, each company is equally dependent on the financial situations of the suppliers and of the buyers. When a business partner's financial state is analysed with caution, this enables on time action to protect a family business. Credit ratings of Slovenian and foreign partners have to be checked and one should not rely solely on personal contacts and feelings.

Credit rating based on the balance sheet analysis provides external and objective estimates, which are often different from just subjective feelings that an entrepreneur or a businessman acquired during business conversations. Ratings of the most rating agencies are based on specific calculations and determine the amount of the company's risk and the possibility that it will become insolvent in the 12 months after the credit rating. This information is extremely important, because it provides information on the company's liquidity, in other words it provides information on whether a firm is able to pay the financial and operating liabilities at any given time. On the other hand, a company that has a poor credit rating clearly does not meet the required ratio, so it is necessary to bear in mind that this also means a low liquidity of the company, which means that there is an increased possibility of a late payment. Credit analyse and assessments will therefore help to set the correct way to do business with the use of the appropriate financial method, the requirement of a bank guarantee or outstanding control of open items and timely payment (Knez et al., 2012).

In case of bad supplier ratings, it is necessary to look at the possibly of working with other suppliers, because of an untimely delivery slip or even service delivery failures, or goods company suffer even greater damage.

Companies that have a lot of funding delays and late payments have to use short-term funding sources. These are usually short-term bank loans. Instead of financing through bank loans the

company may delay payments to its suppliers, which obviously has a negative impact on future operations and cooperation with business partners.

However, factoring as a financial service appears to have a positive impact on the Balance Sheet.

The employment structure of the company: It employs three persons on a full time contract, and three other on a work contract. In the year two and three the company plans to hire one more person full time. Only in the fourth and fifth year is planned an extra employee on a work contract. The company requires extra labour because of the planned investment in motor vehicles so, in the end of year five the company employs four full time contracts and four work contracts. At this moment only one person is responsible for all administrative work in TOP Hrvatin in drugi d.n.o. Increased administrative work regarding the invoice is expected and that is why the company considers factoring. On the other hand, if the company will decide to use a traditional financing instrument to finance its investment, the company will have to consider increasing the labour costs. An optimized solution for the company is to hire a student.

The system of student work in Slovenia is unique in Europe as it enables the student to take care of their financial situation during the study. Student work is one of the flexible forms of work and is typical for the young people who are still involved in education, but still want to join the labour market, either for financial reasons or because of work experience. Student work is occasional or temporary work performed by the student, pupil or other person and carried out through authorized agencies (Student Service and Employment Service of Slovenia) on referral.

Student work can be performed by:

- the pupil's status in the Republic of Slovenia, who have already reached 15 years;
- the student status in the Republic of Slovenia;
- the status of participant in adult education, who are less than 26 years old and study in publicly recognized programs of primary, vocational, secondary and higher professional education.

Temporary and part-time work for pupils and students can be performed also by:

- pupils and students, citizens of the Republic of Slovenia, who have the status of a pupil or a student abroad;
- persons who have completed high school education in the current school year and will receive (based on enrolment in a higher education institution), the status of the student at the beginning of the new school year;
- students from foreign universities, who are within the international exchange programs fulfilling the academic requirements in the Republic of Slovenia.

Table 4.3 - Specification of student work costs

Average working days per month	21	
Average working hours per day	4	
Average working hours per month	84	
Salary cost per hour	4,00 €	
Payout per month	**336,00 €**	According to the Article 36, paragraph 6, of the Value Added Tax Act ZDDV-1 payout of the student work is not calculated in the tax base.
Concession tax ZUJF	77,28€	According to the Article 130 of the Fiscal Balance Act (ZUJF) concession tax of 23% is applicable.
Extra Concession tax ZDKDPŠ	6,72 €	2% extra concession tax is calculated according to the Article 2 of the Act Regulating Additional Concessionary Duty on student' and Pupils' Earnings from Occasional and Temporary Jobs (ZDKDPŠ).
SUM of Concession tax	**84,00 €**	
VAT	16,80 €	VAT is calculated over the total amount of concession tax
Flat-rate contribution ZZVZZ	4,55 €	Flat-rate contribution is obligatory according to the Article 17, paragraph 6 and Article 49, paragraph 2, of the Health Care and Health Insurance Act (ZZVZZ). According to the Article 36, paragraph 6, of ZDDV-1 flat-rate contribution is not calculated in the tax base.
Total monthly cost of a Student work	**441,35 €**	
Annual cost of a Student work	**5.296,20 €**	

It has to be mentioned that because of the generally poor payment discipline in Slovenia a new act has recently been implemented, namely the Act on Prevention of Late Payment (ZPreZP-1). Although pursuant to Directive 2011/7/EU of the European Parliament and of the Council on combating late payments in commercial transactions, the Slovenian legislator's main objectives go beyond those set out in the directive in an aim to:

- strengthen payment discipline and reduce payment delays by inter alia implementing:
  (i) statutory maximum length of payment period (30, 60 and 120 days);

(ii) voidance of grossly unfair contractual provisions;
(iii) a fixed sum of 40 Euros for recovery costs (prior to court enforcement proceeding);
(iv) a debtor's duty to register its due monetary obligations (including those arising from bills of exchange) in compulsory multilateral set-off;

- publicise information on debtors that have not set their obligations arising out of bills of exchange on time (by establishing a register of bills of exchange protested for non-payment);
- sanction violators by imposing penalties ranging from 100 Euros – 10,000 Euros for an undertaking and; 50 Euros – 5,000 Euros for the responsible person within the undertaking.

The scope of the Act is limited to payments made as remuneration for commercial transactions, i.e., delivery of goods or provision of services for remuneration between undertakings or between undertakings and public authorities.

Until the Slovenian government awards a respective concession, the Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES) is maintaining the compulsory multilateral set-offs system. However, the same agency is obliged to establish and maintain a register of bills of exchange, which is in conjunction with Article 66a of the VAT Act and is the main innovation of the law. Duty to notify the multilateral set-off system is mandatory for debtors who fail to settle its outstanding liabilities (i.e. that they are in arrears with payments or to meet their obligations under the agreed payment period).

For economic subjects that are subject to VAT and do not report the off-set, under the new 66a. Article Value Added Tax Act (ZDDV-1) it is necessary to make an adjustment of input VAT on overdue obligations. The right to deduct input VAT for invoices received will no longer be created on the date of receipt, but on the date of payment. If a refund of VAT will not be passed, penalties from 2,000 to 125,000 Euros are foreseen. The ZPreZP-1 should mitigate financial indiscipline and decreasing the amount of outstanding debt.

It should also be mentioned that because of poor payment discipline, especially in a transport industry, payment regulations were add into Law on Road Transport (ZPCP-2C). The most important are Articles 110 and 131.

Article 110 introduces a thirty day payment deadline.

- The fare for the carriage of goods and passengers shall be determined by the carriage contract, General Conditions of Carriage or in any other customary manner.
- The deadline for the payment of the fare is thirty days from the invoice date, but not more than sixty days after the service.
- Notwithstanding the preceding point, the contract of carriage may agree a shorter payment period.
- Consignor or consignee becomes liable for freight within thirty days of receipt of the carrier, which is actually performing transport for fare payment, which he proves by a corresponding document.

Article 131 explains the offences and fines imposed for not complying with the Article 110a.

- A fine between 10,000 Euros and 15,000 Euros shall be imposed on a legal entity, entrepreneur or individual who is self-employed, if he acts contrary to the provisions of the Article 110 and if the contract provides for a longer period.
- A range of fines is between 1,000 Euros and 8,000 Euros for not complying with Article 110a.

According to the offers received on 10.01.2013 by company's financial institutions the following conditions are applicable:

Table 4.4 - Financing conditions

in €	***Year 3*** *Bank loan*	***Year 2*** *Factoring I*	***Year 3*** *Factoring II*	***Year 4*** *Factoring III*	***Year 5*** *Factoring IV*
Amount	60.000	11.765	68.235	11.765	11.765
Loan period	54 months	-	-	-	-
Factoring fee	-	1,85%	1,85%	1,85%	1,85%
Interest rate	8,5% -fixed	8% on 85% of advanced money	8% on 85% of advanced money	8% on 85% of advanced money	8% on 85% of advanced money

in €	***Year 1***	***Year 2***	***Year 3***	***Year 4***	***Year 5***	***Year 6***	***Year 7***
Bank loan	**-**	**-**	**60.000**	**46.667**	**33.334**	**20.001**	**6.668**
Financial expenses - Interest	**-**	**-**	5.100	3.967	2.833	1.700	281
Capital Repayment of the Bank loan	**-**	**-**	13.333	13.333	13.333	13.333	6.668
Long-term financial liabilities	**-**	**-**	46.667	33.334	20.001	6.668	0

in €	***Year 1***	***Year 2***	***Year 3***	***Year 4***	***Year 5***
Recourse factoring	**-**	**11.765**	**68.235**	**11.765**	**11.765**
85% of Factoring contract value	-	10.000	58.000	10.000	10.000
Factoring fee	-	1.119	6.488	1.119	1.119
Financial expenses - Interest	-	800	4.640	800	800
Total factoring expenses	**-**	**1.919**	**11.128**	**1.919**	**1.919**

Table 4.5 - Financing data and Cash Flow

The interest rate on bank loans	8,50%
The interest rate on factoring	8,00%
Average number of days of settlement of liabilities to suppliers	77
Average number of days of payment of invoices by customers	71
Average number of days of the inventory	0
Deposits life time	-6

in €	***Year 1***	***Year 2***	***Year 3***	***Year 4***	***Year 5***
Average annual plywood money in the business process	626.022	670.616	737.957	802.776	836.867
In trade receivables	574.022	618.616	685.957	750.776	784.867
Cash	52.000	52.000	52.000	52.000	52.000
The amount of credit by suppliers	597.341	652.807	733.789	802.540	835.260
The need for financing the current business process	28.682	17.809	4.168	236	1.607
The cost of financing the implementation of the business process bank loan	2.438	1.514	354	20	137
The cost of financing the implementation of the business process factoring	2.295	1.425	333	19	129

In a family freight forwarding company TOP it is especially notable that the difference between the average number of payment days to the suppliers and the average number of payment days by the customers is really low. It is only 6 days.

Tax Procedure Act (ZDavP–2) defines that the income tax has to be paid as an advance payment as followed: one twelfth of calculated income tax for the previous year. All differences have to be reported until 31st of March each year and later on paid or refunded.

Table 4.6 - Financial Forecast

in € **Using factoring**	***Year 1***	***Year 2***	***Year 3***	***Year 4***	***Year 5***
Sources of funds					
Business cash-flow	125.910	94.716	76.912	89.605	103.761
Other cash-flow	410	410	410	410	410
SUM	**126.320**	**95.126**	**77.322**	**90.015**	**104.171**
Applications of funds					
Capital Investment	15.000	120.000	173.000	0	0
Working capital investment	-	-10.873	-13.641	-3.933	1.371
Short-term deferred	-	514	9.466	5.254	960
Income tax	24.164	17.045	7.666	10.973	15.004
SUM	**39.164**	**126.687**	**176.492**	**12.294**	**17.335**
Annual balance	87.156	-31.561	-99.170	77.721	86.836
Initial available cash	-	80.269	57.908	2.098	31.019
Final available cash without external financing	**-**	**48.708**	**-41.262**	**79.819**	**117.855**
New external financing	-	10.000	58.000	10.000	10.000
External financing repayment	-	0	10.000	58.000	10.000
Financial expenses	-	800	4.640	800	800
Final available cash with external financing	**-**	**57.908**	**2.098**	**31.019**	**117.055**

in € **Using Bank loan**	***Year 1***	***Year 2***	***Year 3***	***Year 4***	***Year 5***
Sources of funds					
Business cash-flow	125.910	90.539	78.104	85.428	99.584
Other cash-flow	410	410	410	410	410
SUM	**126.320**	**90.949**	**78.514**	**85.838**	**99.994**
Applications of funds					
Capital Investment	15.000	120.000	173.000	0	0
Working capital investment	-	-10.873	-13.641	-3.933	1.371
Short-term deferred	-	514	9.466	5.254	960
Income tax	24.164	16.370	7.813	9.504	13.762
SUM	**39.164**	**126.011**	**176.638**	**10.826**	**16.093**
Annual balance	87.156	-35.062	-98.124	75.012	83.901
Initial available cash	-	80.269	45.207	1.983	59.695
Final available cash without external financing	**-**	**45.207**	**-52.917**	**76.995**	**143.596**
New external financing	-	0	60.000	0	0
External financing repayment	-	0	0	13.333	13.333
Financial expenses	-	0	5.100	3.967	2.833
Final available cash with external financing	**-**	**45.207**	**1.983**	**59.695**	**127.429**

In the financial statements, accounting of recourse factoring was performed according to the proposed by Gonçalves (2010).

Table 4.7 - Income statements using recourse factoring

in €	***Year 1***	***Year 2***	***Year 3***	***Year 4***	***Year 5***
A. NET SALES REVENUES	**2.950.960**	**3.180.210**	**3.526.400**	**3.859.624**	**4.034.880**
I. Net sales revenues in the domestic market	1.486.261	1.590.105	1.622.144	1.621.042	1.492.906
II. Net sales revenues in the EU market	773.347	1.049.469	1.234.240	1.428.061	1.694.650
III. Net sales revenues outside the EU market	691.352	540.636	670.016	810.521	847.325
B. OTHER BUSINESS REVENUE	**1.000**	**1.000**	**1.000**	**1.000**	**1.000**
C. GROSS BUSINESS INCOME (A+B)	**2.951.960**	**3.181.210**	**3.527.400**	**3.860.624**	**4.035.880**
D. BUSINESS EXPENSES	**2.831.550**	**3.095.594**	**3.484.838**	**3.805.369**	**3.960.469**
I. Costs of goods, materials and services	2.706.050	2.936.494	3.290.488	3.601.019	3.762.119
1. Cost of sold goods and material					
2. Cost of used materials	3.000	20.000	30.000	38.000	38.000
3. Service cost	2.703.050	2.916.494	3.260.488	3.563.019	3.724.119
3.1. Costs of promotional activities	1.000	1.000	1.000	1.000	1.000
3.2. Cost of services in the production	0	0	0	0	0
3.3. Transport services costs in travel expenses	2.686.050	2.896.875	3.215.500	3.523.400	3.684.500
3.4. Maintenance costs			20.000	20.000	20.000
3.5. Rental costs	4.000	4.500	3.000	2.000	1.000
3.6. Education costs	1.000	1.000	1.500	1.500	1.500
3.7. Other costs	11.000	13.119	19.488	15.119	16.119
II. Labour costs	120.000	150.000	160.000	170.000	170.000
1. Payroll costs	120.000	150.000	160.000	170.000	170.000
III. Write-down, depreciation	5.500	9.100	34.350	34.350	28.350
1. Intangible assets	0	0	0	0	0
2. Tangible fixed assets	5.500	9.100	34.350	34.350	28.350
2.1. Business premises / building	0	3.600	3.600	3.600	3.600
2.2. Equipment, vehicles, machinery	5.500	5.500	26.750	26.750	24.750
2.3. Computers and computer equipment	0	0	4.000	4.000	0
2.4. Other	0	0	0	0	0
IV. Other business expenses	0	0	0	0	0
E. BUSINESS PROFIT / LOSS (C-D)	**120.410**	**85.616**	**42.562**	**55.255**	**75.411**
F. FINANCIAL INCOME (INTEREST AND SHARE)	**20**	**20**	**20**	**20**	**20**
G. FINANCIAL EXPENSES (INTEREST AND OTHER EXPENSES)	**10**	**810**	**4.650**	**810**	**810**
H. OTHER INCOME	**1.000**	**1.000**	**1.000**	**1.000**	**1.000**
I. OTHER EXPENSES	**600**	**600**	**600**	**600**	**600**
J. TOTAL PROFIT / TOTAL LOSS	**120.820**	**85.226**	**38.332**	**54.865**	**75.021**
K. INCOME TAX 20%	**24.164**	**17.045**	**7.666**	**10.973**	**15.004**
L. NET PROFIT /NET LOSS	**96.656**	**68.181**	**30.666**	**43.892**	**60.017**

Table 4.8 - Income structure using recourse factoring

in €

Revenues structure	***Year 1***	***Year 2***	***Year 3***	***Year 4***	***Year 6***
Domestic Market	1.486.261	1.590.105	1.622.144	1.621.042	1.492.906
EU Market	773.347	1.049.469	1.234.240	1.428.061	1.694.650
Market outside the EU	691.352	540.636	670.016	810.521	847.325

Graph 4.2 - Incomes structure using recourse factoring

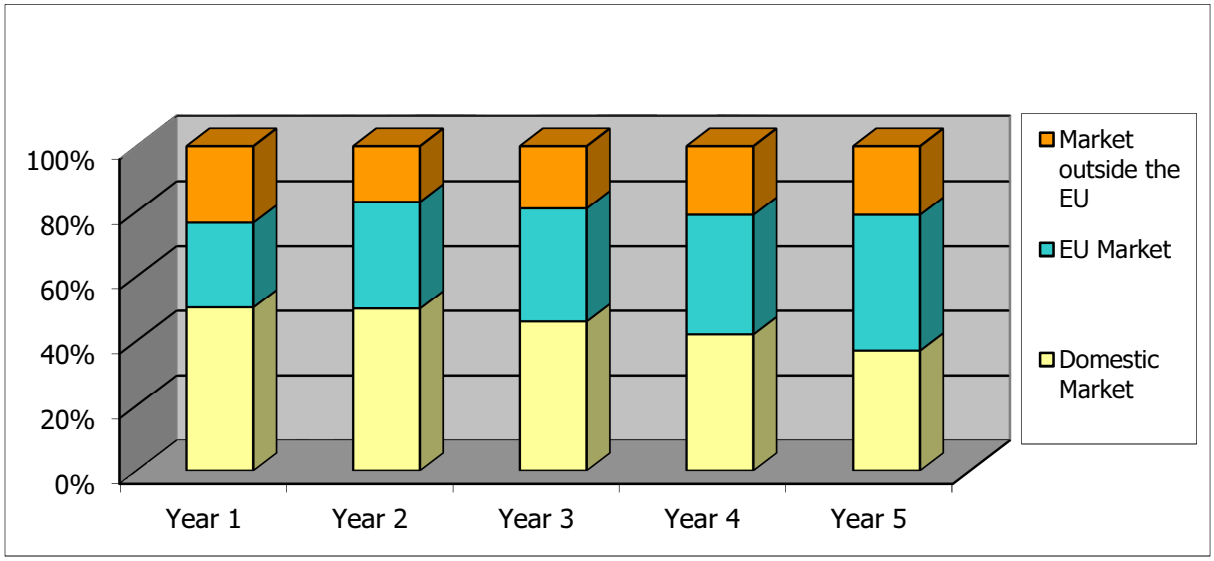


Table 4.9 - Incomes and expenses structure using recourse factoring

in €

Income and expenses	***Year 1***	***Year 2***	***Year 3***	***Year 4***	***Year 5***
Total revenues	2.952.980	3.182.230	3.528.420	3.861.644	4.036.900
Total expenses	2.832.160	3.097.004	3.490.088	3.806.779	3.961.879

Graph 4.3 - Changes in incomes and expenses using recourse factoring

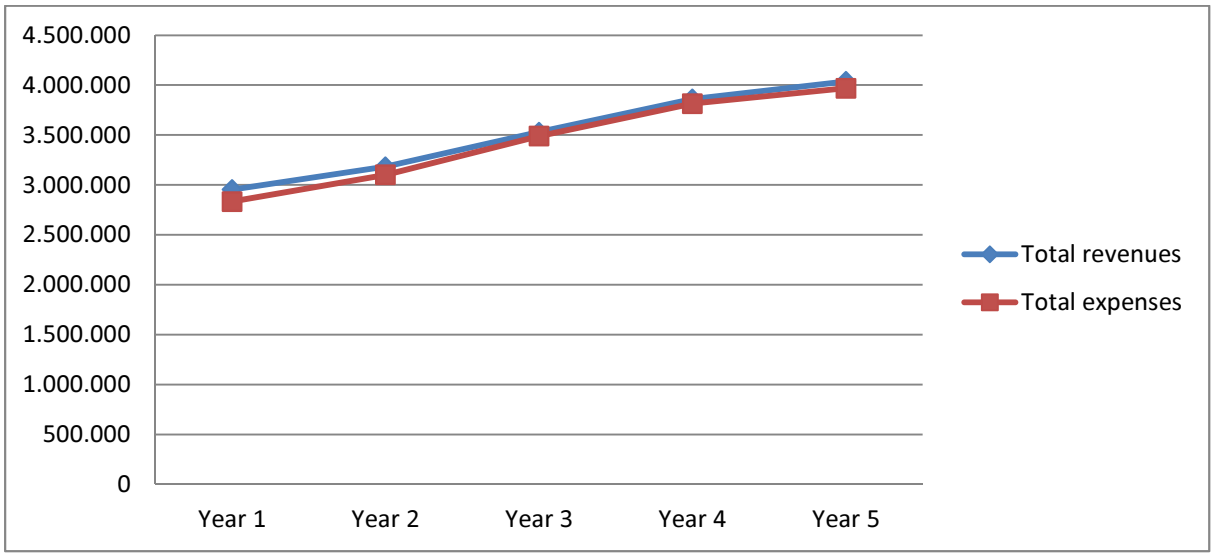


Table 4.10 - Balance sheet using recourse factoring

in €	***Year 1***	***Year 2***	***Year 3***	***Year 4***	***Year 5***
ASSETS (A+B+C)	**716.597**	**850.244**	**1.009.891**	**1.074.535**	**1.167.271**
A. FIXED ASSETS	9.500	120.400	259.050	224.700	196.350
I. Intangible assets and deferred costs	0	0	0	0	0
II. Tangible fixed assets	9.500	120.400	259.050	224.700	196.350
1. Business premises / building	0	116.400	112.800	109.200	105.600
2. Equipment, vehicles, machinery	9.500	4.000	142.250	115.500	90.750
3. Computers and ducks. Equipment	0	0	4.000	0	0
III. Property investment	0	0	0	0	0
IV. Long-term investments	0	0	0	0	0
1. Long-term financial investment, excluding loans	0	0	0	0	0
2. Long-term loans	0	0	0	0	0
V. Long-term receivables	0	0	0	0	0
VI. Deferred tax assets	0	0	0	0	0
B. CURRENT ASSETS	706.291	728.524	740.055	833.795	953.921
I. Assets held for sale	0	0	0	0	0
II. Stocks	0	0	0	0	0
III. Short-term investments	0	0	0	0	0
1. Short-term financial investments, except loans	0	0	0	0	0
2. Short-term loans	0	0	0	0	
IV. Short-term receivables	574.022	618.616	685.957	750.776	784.867
V. Cash	132.269	109.908	54.098	83.019	169.054
C. SHORT-TERM DEFFERED	806	1.320	10.786	16.040	17.000
EQUITY AND LIABILITIES	**716.597**	**850.244**	**1.009.891**	**1.074.535**	**1.167.271**
A. CAPITAL	119.156	187.337	218.002	261.894	321.911
I. Call-in capital	7.500	7.500	7.500	7.500	7.500
1. Share capital	7.500	7.500	7.500	7.500	7.500
II. Capital reserves	0	0	0	0	0
III. Reserves from profit	0	0	0	0	0
IV. Revaluation surplus	0	0	0	0	0
V. Net business loss (gain / loss)	15.000	111.656	179.837	210.502	254.394
VI. Net profit for the year	96.656	68.181	30.666	43.892	60.017
B. LONG-TERM LIABILITIES	0	0	0	0	0
I. Long-term financial liabilities	0	0	0	0	0
II. Long-term operating liabilities	0	0	0	0	0
III. Deferred tax liabilities	0	0	0	0	0
C. CURRENT LIABILITIES	597.341	662.807	791.789	812.540	845.260
I. Liabilities included in disposal groups	0	0	0	0	0
II. Short-term financial liabilities	0	10.000	58.000	10.000	10.000
III. Payables	597.341	652.807	733.789	802.540	835.260
D. ACCRUED TIME ITEMS	100	100	100	100	100

Table 4.11 - Assets structure using recourse factoring

in €

Assets	*Year 1*	*Year 2*	*Year 3*	*Year 4*	*Year 5*
Long-term assets	9.500	120.400	259.050	224.700	196.350
Current assets and short - term deferred income	707.097	729.844	750.841	849.835	970.921

Graph 4.4 - Assets structure using recourse factoring

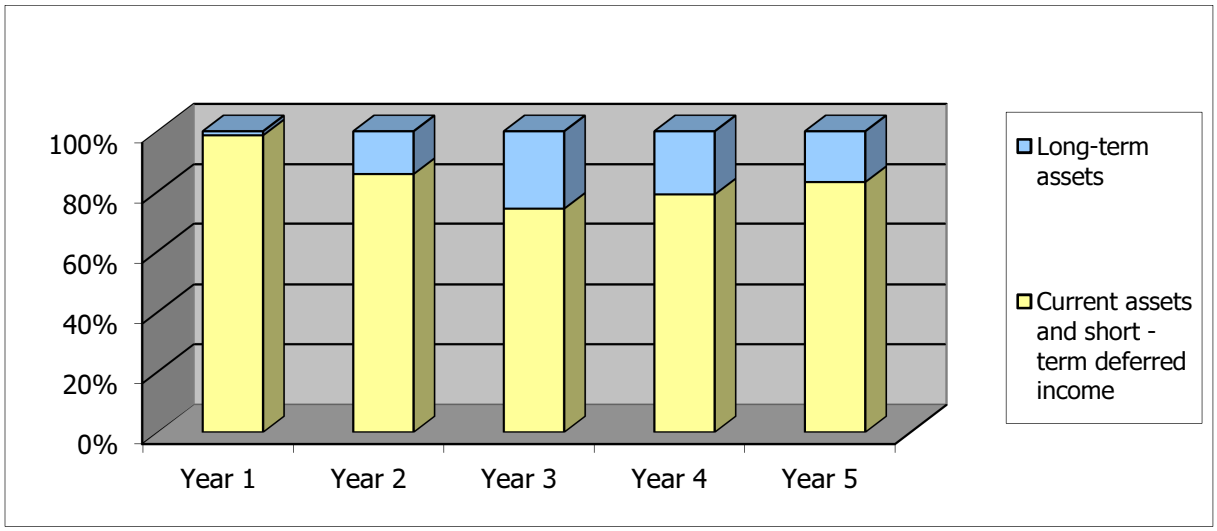
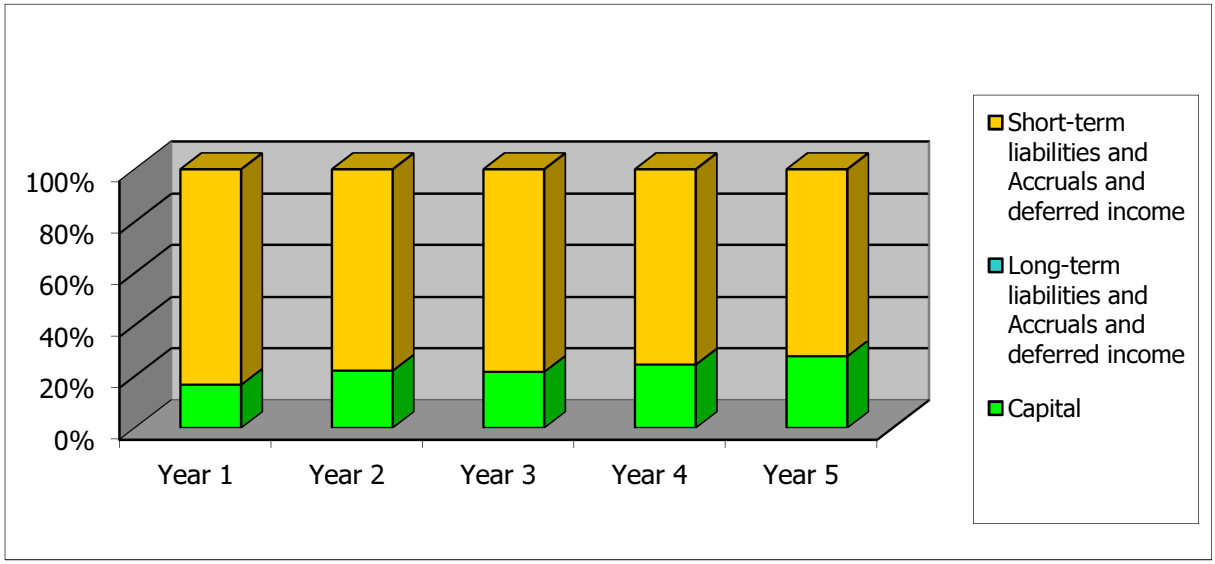


Table 4.12 - Equity and liabilities structure using recourse factoring

in €

Equity and Liabilities	*Year 1*	*Year 2*	*Year 3*	*Year 4*	*Year 5*
Capital	119.156	187.337	218.002	261.894	321.911
Long-term liabilities and Accruals and deferred income	0	0	0	0	0
Short-term liabilities and Accruals and deferred income	597.441	662.907	791.889	812.640	845.360

Graph 4.5 - Equity and liabilities structure using recourse factoring



The impact of factoring on a balance sheet may be stated in terms of:

- Improvement in Current Ratio;
- Reduction in Current Liabilities;
- Off-Balance Sheet finance: Since the client's debts are purchased by the factor and the amount is paid to the client, it serves as off the balance sheet finance and appears in the balance sheet only as a contingent liability in the case of recourse factoring. In case of default by the buyer, the client will have to refund the finance amount to the factor. But in case of non-recourse factoring, it does not appear anywhere in the financial statement of the borrower. Thus factoring helps the client to improve the structure of their Balance sheet. As non-recourse factoring is an off balance sheet finance, it does not affect the financial structure. This helps in increasing the efficiency ratios and returns on assets, saving management time and effort in collecting the receivables, and in respect of sales ledger management. Where credit information is also provided by the factor, it helps the company to avoid bad debts. It ensures better management of receivables as factor firm is a specialised agency for the same. The factor also considers the debtor's business nature, the vulnerability of his operations, the history of his operations, the term of sales, the track record and the bank report available on the past history.

Table 4.13 - Income statement using bank loan

in €	***Year 1***	***Year 2***	***Year 3***	***Year 4***	***Year 5***
A. NET SALES REVENUES	**2.950.960**	**3.180.210**	**3.526.400**	**3.859.624**	**4.034.880**
I. Net sales revenues in the domestic market	1.486.261	1.590.105	1.622.144	1.621.042	1.492.906
II. Net sales revenues in the EU market	773.347	1.049.469	1.234.240	1.428.061	1.694.650
III. Net sales revenues outside the EU market	691.352	540.636	670.016	810.521	847.325
B. OTHER BUSINESS REVENUE	**1.000**	**1.000**	**1.000**	**1.000**	**1.000**
C. GROSS BUSINESS INCOME (A+B)	**2.951.960**	**3.181.210**	**3.527.400**	**3.860.624**	**4.035.880**
D. BUSINESS EXPENSES	**2.831.550**	**3.099.771**	**3.483.646**	**3.809.546**	**3.964.646**
I. Costs of goods, materials and services	2.706.050	2.935.375	3.284.000	3.599.900	3.761.000
1. Cost of sold goods and material					
2. Cost of materials used	3.000	20.000	30.000	38.000	38.000
3. Service cost	2.703.050	2.915.375	3.254.000	3.561.900	3.723.000
3.1. Costs of promotional activities	1.000	1.000	1.000	1.000	1.000
3.2. Cost of services in the production	0	0	0	0	0
3.3. Transport services costs in travel expenses	2.686.050	2.896.875	3.215.500	3.523.400	3.684.500
3.4. Maintenance costs			20.000	20.000	20.000
3.5. Rental costs	4.000	4.500	3.000	2.000	1.000
3.6. Education costs	1.000	1.000	1.500	1.500	1.500
3.7. Other costs	11.000	12.000	13.000	14.000	15.000
II. Labour costs	120.000	155.296	165.296	175.296	175.296
1. Payroll costs	120.000	155.296	165.296	175.296	175.296
III. Write-down, depreciation	5.500	9.100	34.350	34.350	28.350
1. Intangible assets	0	0	0	0	0
2. Tangible fixed assets	5.500	9.100	34.350	34.350	28.350
2.1. Business premises / building	0	3.600	3.600	3.600	3.600
2.2. Equipment, vehicles, machinery	5.500	5.500	26.750	26.750	24.750
2.3. Computers and computer equipment	0	0	4.000	4.000	0
2.4. Other	0	0	0	0	0
IV. Other business expenses					
E. BUSINESS PROFIT / LOSS (C-D)	**120.410**	**81.439**	**43.754**	**51.078**	**71.234**
F. FINANCIAL INCOME (INTERESTAND SHARES)	**20**	**20**	**20**	**20**	**20**
G. FINANCIAL EXPENSES (INTEREST AND OTHER EXPENSES)	**10**	**10**	**5.110**	**3.977**	**2.843**
H. OTHER INCOME	**1.000**	**1.000**	**1.000**	**1.000**	**1.000**
I. OTHER EXPENSES	**600**	**600**	**600**	**600**	**600**
J. TOTAL PROFIT / TOTAL LOSS	**120.820**	**81.849**	**39.064**	**47.521**	**68.811**
K. INCOME TAX 20%	**24.164**	**16.370**	**7.813**	**9.504**	**13.762**
L. NET PROFIT /NET LOSS	**96.656**	**65.479**	**31.251**	**38.017**	**55.049**

Table 4.14 - Income structure using bank loan

in €

Revenues structure	***Year 1***	***Year 2***	***Year 3***	***Year 4***	***Year 5***
Domestic Market	1.486.261	1.590.105	1.622.144	1.621.042	1.492.906
EU Market	773.347	1.049.469	1.234.240	1.428.061	1.694.650
Market outside the EU	691.352	540.636	670.016	810.521	847.325

Graph 4.6 - Incomes structure using bank loan

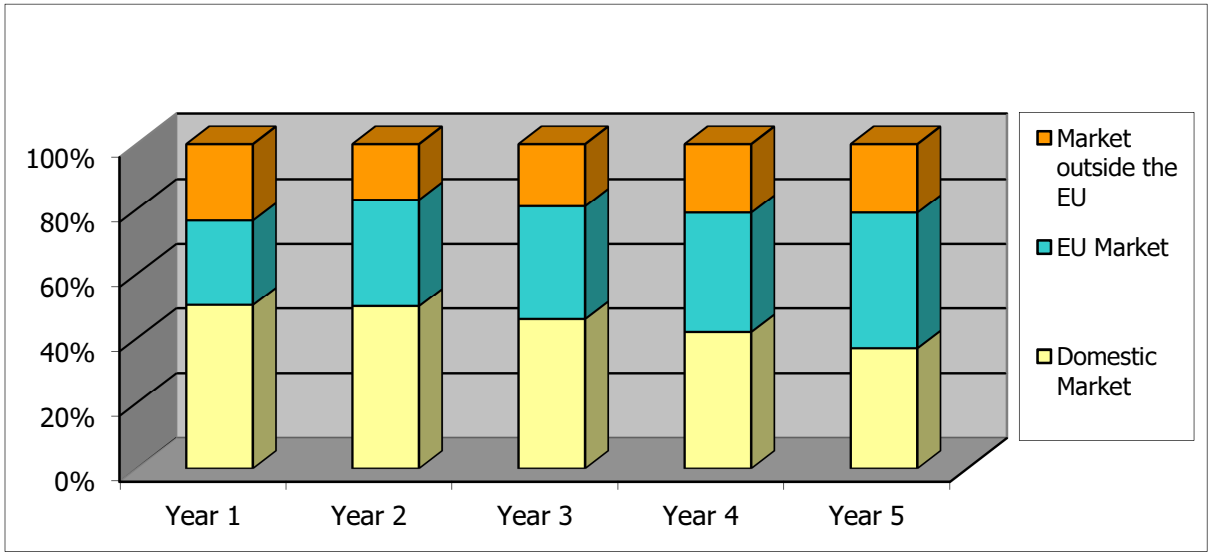


Table 4.15 - Incomes and expenses structure using bank loan

in €

Income and expenses	***Year 1***	***Year 2***	***Year 3***	***Year 4***	***Year 5***
Total revenues	2.952.980	3.182.230	3.528.420	3.861.644	4.036.900
Total expenses	2.832.160	3.100.381	3.489.356	3.814.123	3.968.089

Graph 4.7 - Changes in incomes and expenses using bank loan

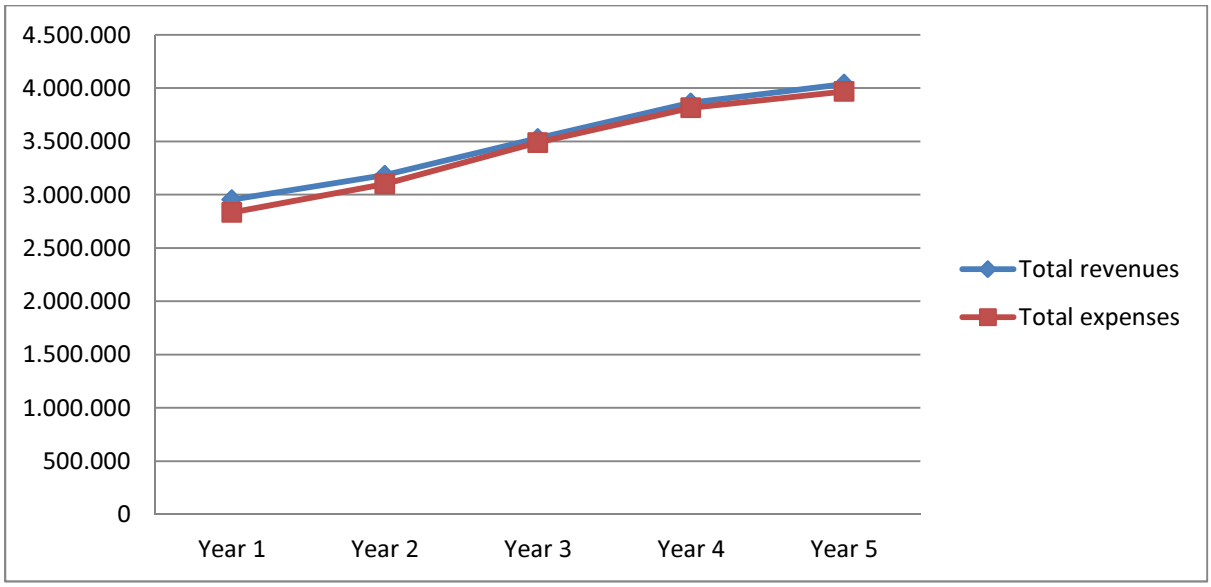


Table 4.16 - Balance sheet using a bank loan

in €	***Year 1***	***Year 2***	***Year 3***	***Year 4***	***Year 5***
ASSETS (A+B+C)	**716.597**	**837.542**	**1.009.775**	**1.103.211**	**1.177.646**
A. FIXED ASSETS	9.500	120.400	259.050	224.700	196.350
I. Intangible assets and deferred costs	0	0	0	0	0
II. Tangible fixed assets	9.500	120.400	259.050	224.700	196.350
1. Business premises / building	0	116.400	112.800	109.200	105.600
2. Equipment, vehicles, machinery	9.500	4.000	142.250	115.500	90.750
3. Computers and ducks. Equipment	0	0	4.000	0	0
III. Property investment	0	0	0	0	0
IV. Long-term investments	0	0	0	0	0
1. Long-term financial investment, excluding loans	0	0	0	0	0
2. Long-term loans	0	0	0	0	0
V. Long-term receivables	0	0	0	0	0
VI. Deferred tax assets	0	0	0	0	0
B. CURRENT ASSETS	706.291	715.822	739.939	862.471	964.296
I. Assets held for sale	0	0	0	0	0
II. Stocks	0	0	0	0	0
III. Short-term investments	0	0	0	0	0
1. Short-term financial investments, except loans	0	0	0	0	0
2. Short-term loans				0	0
IV. Short-term receivables	574.022	618.616	685.957	750.776	784.867
V. Cash	132.269	97.206	53.982	111.695	179.429
C. SHORT-TERM TIME DEFFERED	806	1.320	10.786	16.040	17.000
EQUITY AND LIABILITIES	**716.597**	**837.542**	**1.009.775**	**1.103.211**	**1.177.646**
A. CAPITAL	119.156	184.635	215.886	253.903	308.952
I. Call-in capital	7.500	7.500	7.500	7.500	7.500
1. Share capital	7.500	7.500	7.500	7.500	7.500
II. Capital reserves	0	0	0	0	0
III. Reserves from profit					
IV. Revaluation surplus	0	0	0	0	0
V. Net business loss (gain / loss)	15.000	111.656	177.135	208.386	246.403
VI. Net profit for the year	96.656	65.479	31.251	38.017	55.049
B. LONG-TERM LIABILITIES	0	0	46.667	33.334	20.001
I. Long-term financial liabilities	0	0	46.667	33.334	20.001
II. Long-term operating liabilities	0	0	0	0	0
III. Deferred tax liabilities	0	0	0	0	0
C. CURRENT LIABILITIES	597.341	652.807	747.122	815.873	848.593
I. Liabilities included in disposal groups	0	0	0	0	0
II. Short-term financial liabilities	0	0	13.333	13.333	13.333
III. Payables	597.341	652.807	733.789	802.540	835.260
D. ACCRUED TIME ITEMS	100	100	100	100	100

Table 4.17 - Assets structure using a bank loan

in €

Assets	***Year 1***	***Year 2***	***Year 3***	***Year 4***	***Year 5***
Long-term assets	9.500	120.400	259.050	224.700	196.350
Current assets and short-term deferred income	707.097	717.142	750.725	878.511	981.296

Graph 4.8 - Assets structure using a bank loan

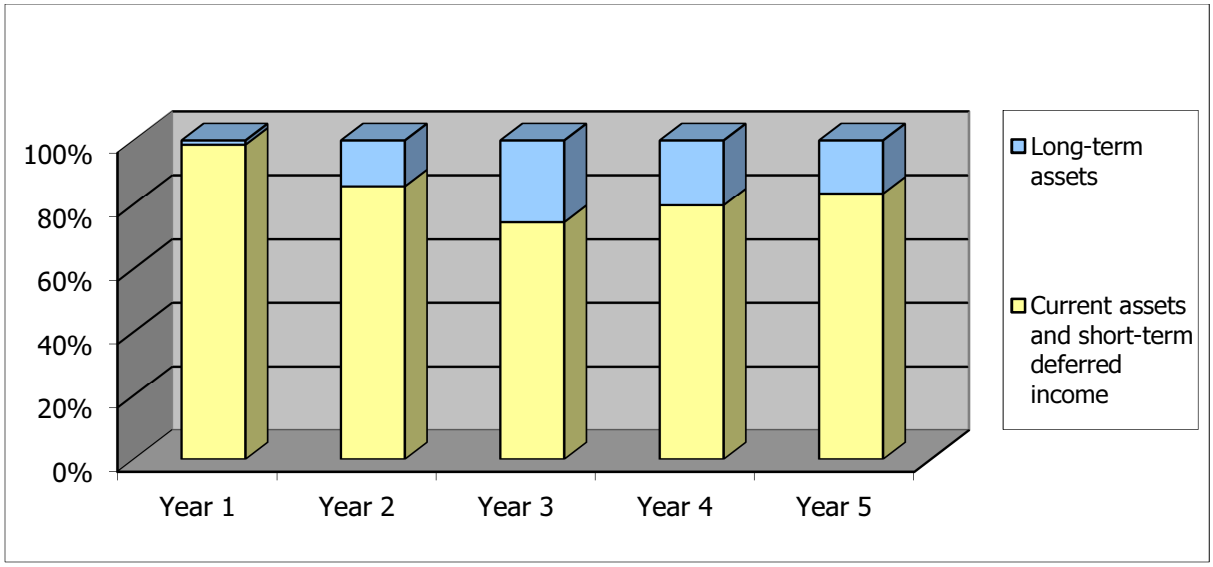
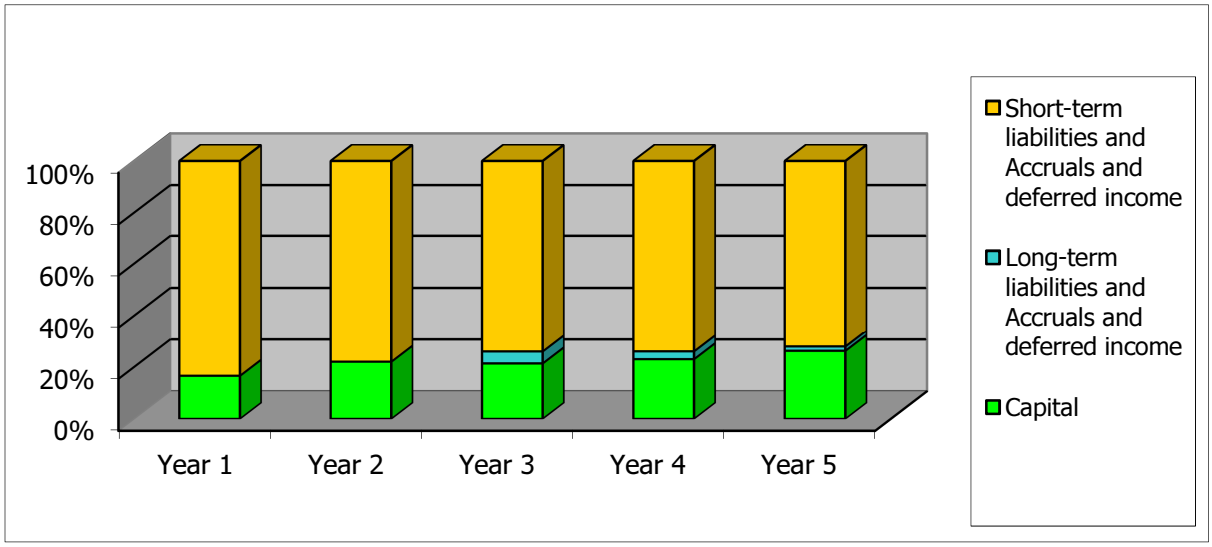


Table 4.18 - Equity and liabilities structure after the bank loan

in €

Equity and Liabilities	***Year 1***	***Year 2***	***Year 3***	***Year 4***	***Year 5***
Capital	119.156	184.635	215.886	253.903	308.952
Long-term liabilities and Accruals and deferred income	0	0	46.667	33.334	20.001
Short-term liabilities and Accruals and deferred income	597.441	652.907	747.222	815.973	848.693

Graph 4.9 - Equity and liabilities structure after the bank loan



BUSINESS AND FINANCIAL INDICATORS

- EQUITY RATIO

$$Equity\ Ratio = {Shareholders\ funds}/{Total\ assets}$$

The equity ratio throws light on a company's overall financial strength. Besides, it is also treated as a test of the soundness of the capital structure. A higher equity ratio or a higher contribution of shareholders to the capital indicates a company's better long-term solvency position. A low equity ratio, on the contrary, includes higher risk to the creditors. Companies having a lower equity ratio have to pay less interest thus having more free cash on hand for future expansions, growth, and dividends. On the contrary, a company with a higher equity ratio is more prone to losses for a large portion of its earnings is spent in paying interests. Besides a lower equity ratio provides a freer access to capital at lower interest rates. A higher equity ratio, on the other hand, makes it difficult for a company to obtain loan from banks and other financial institutions.

- LIQUIDITY RATIO

$$Liquidity\ Ratio = \frac{Stocks + Short\text{-}term\ investment + Short\text{-}term\ receivables + Cash}{Short\text{-}term\ financial\ liabilities + Payables}$$

Liquidity ratio is the ratio that measures the ability of a company to meet its short term debt obligations. These ratio measures the ability of a company to pay off its short-term liabilities when they fall due. The liquidity ratio is a result of dividing cash and other liquid assets by the short term borrowings and current liabilities. They show the number of times the short term debt obligations are covered by the cash and liquid assets. If the value is greater than 1, it means the short term obligations are fully covered. Liquidity ratio greater than 1 indicates that the company is in good financial health and it is less likely fall into financial difficulties.

- FIXED ASSETS TO NET WORTH RATIO

$$Fixed\ assets\ to\ net\ worth\ ratio = \frac{Fixed\ assets}{Assets - (Long\text{-}term\ liabilities + Current\ liabilities)}$$

Fixed assets to net worth is a ratio measuring the solvency of the company. This ratio indicates the extent to which the owners' cash is frozen in the form of fixed assets, such as property, and equipment, and the extent to which funds are available for the company's

operations. Fixed assets to net worth ratio 0.75 or higher is usually undesirable, as it indicates that the firm is vulnerable to unexpected events and changes in the business climate. In both cases, using factoring or a bank loan, the third and the fourth years are critical because fixed assets to net ratio is higher than 0.75.

- RETURN ON SALE

$$ROS = {}^{Profit\ after\ tax}/_{Revenue}$$

Return on sales is a ratio widely used to assess a company's effective performance. It indicates how much profit a company makes after paying variable costs, such as wages and raw materials, but before interest and tax. Return on sale is usually expressed as a percentage of sales (revenue). Return on sales can be used both as a tool to analyse a single company's performance against its past performance, and to compare similar companies' performances against one another. The ratio varies widely by industry but is useful for comparing different companies in the same business. An increasing ROS indicates the company is becoming more efficient, while a decreasing ratio could signal looming financial troubles.

- RETURN ON EQUITY

$$ROE = {}^{Net\ income\ after\ tax}/_{Shareholder's\ equity}$$

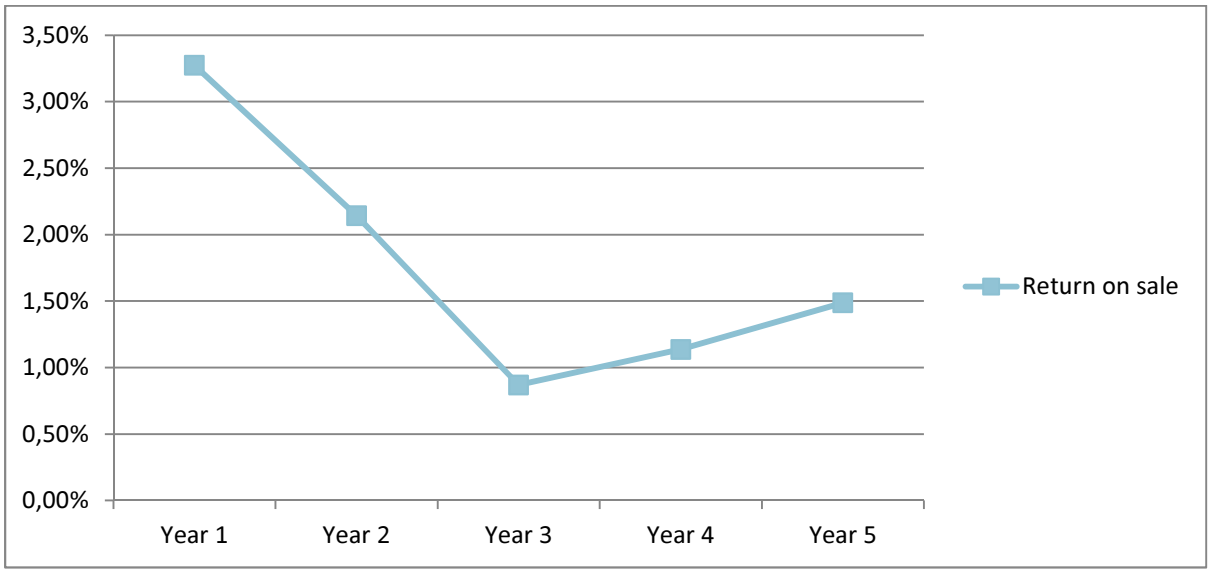
Return on equity (ROE) is the amount of net income returned as a percentage of shareholders equity. It reveals how much profit a company earned in comparison to the total amount of shareholder equity found on the balance sheet. It measures how profitable a company is for the owner of the investment, and how profitably a company employs its equity. For stable economics, ROEs more than 12-15% are considered advantageous. But the ratio strongly depends on many factors such as industry, economic environment, inflation, macroeconomic risks, etc.

Table 4.19 - Business and financial indicators using recourse factoring

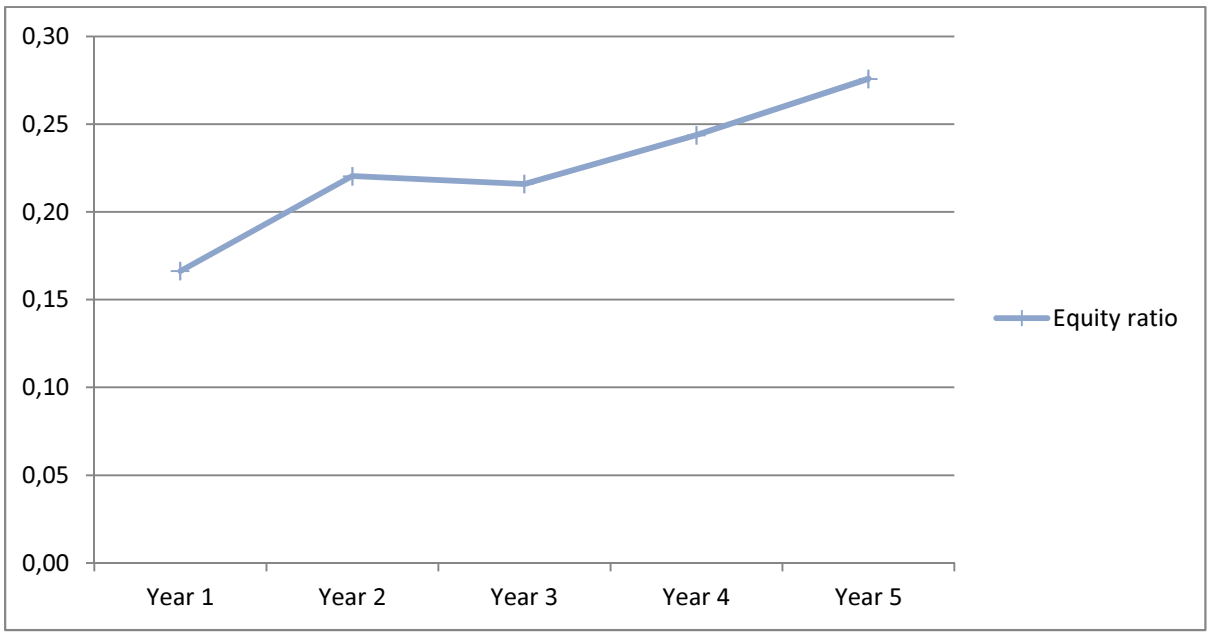
in €	***Year 1***	***Year 2***	***Year 3***	***Year 4***	***Year 5***
Revenue	2.952.980	3.182.230	3.528.420	3.861.644	4.036.900
Expenses	2.832.160	3.097.004	3.490.088	3.806.779	3.961.879
Profit	120.820	85.226	38.332	54.865	75.021
Profit after tax	96.656	68.181	30.666	43.892	60.017

Equity ratio	0,17	0,22	0,22	0,24	0,28
Return on equity	81,12%	36,39%	14,07%	16,76%	18,64%
Liquidity ratio	1,18	1,10	0,93	1,03	1,13
Return on sales	3,27%	2,14%	0,87%	1,14%	1,49%
Fixed assets to net worth ratio	0,08	0,64	1,19	0,86	0,61

Graph 4.10 - Return on sale using recourse factoring



Graph 4.11 - Equity ratio using recourse factoring



Graph 4.12 - Liquidity ratio using recourse factoring

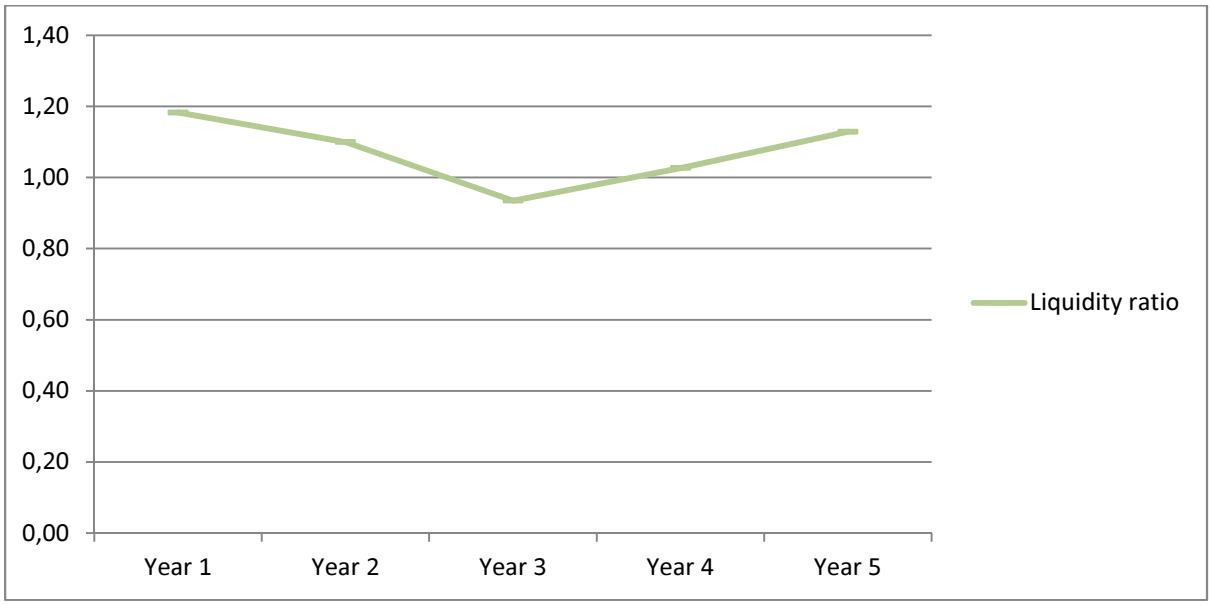
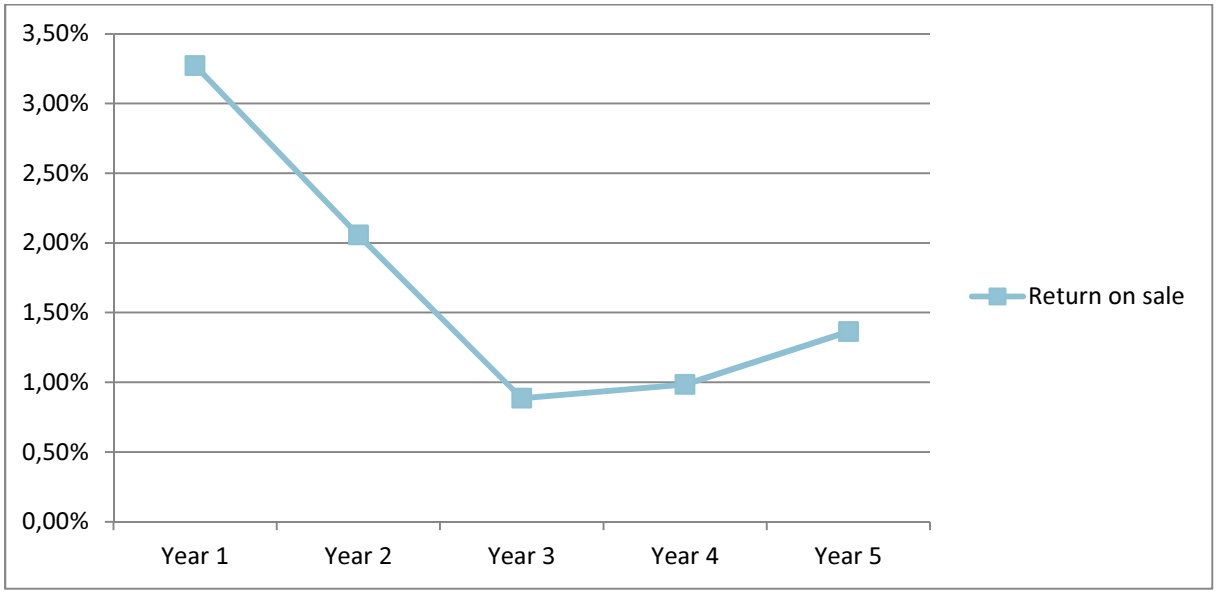


Table 4.20 - Business and financial indicators using a bank loan

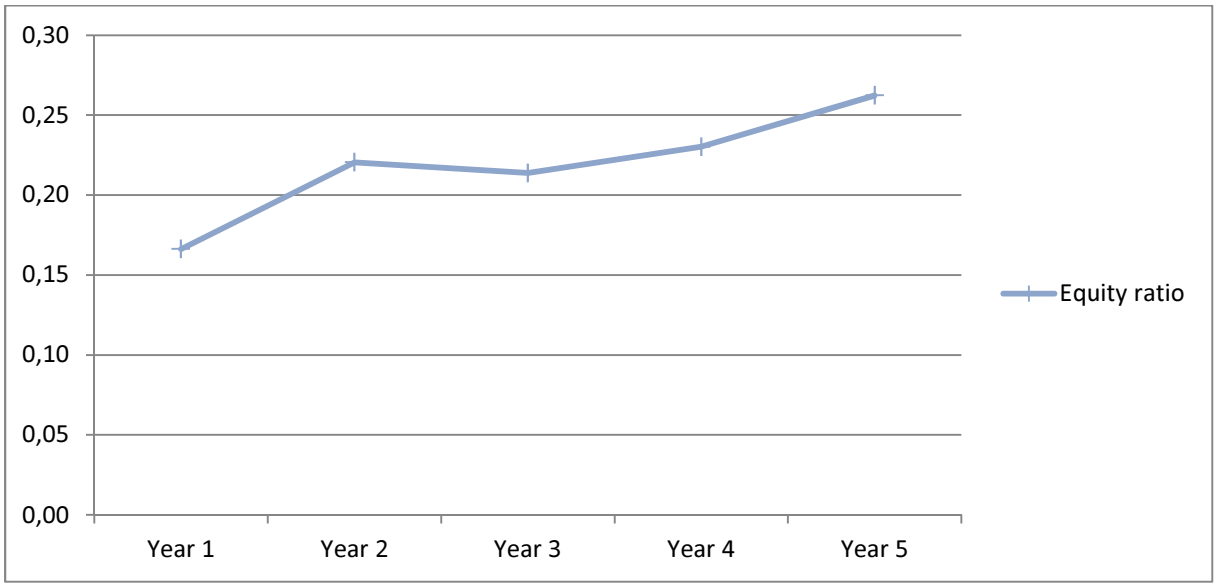
in €	***Year 1***	***Year 2***	***Year 3***	***Year 4***	***Year 5***
Revenue	2.952.980	3.182.230	3.528.420	3.861.644	4.036.900
Expenses	2.832.160	3.100.381	3.489.356	3.814.123	3.968.089
Profit	120.820	81.849	39.064	47.521	68.811
Profit after tax	96.656	65.479	31.251	38.017	55.049

Equity ratio	0,17	0,22	0,21	0,23	0,26
Return on equity	81,12%	35,46%	14,48%	14,97%	17,82%
Liquidity ratio	1,18	1,10	0,99	1,06	1,14
Return on sale	3,27%	2,06%	0,89%	0,98%	1,36%
Fixed assets to net worth ratio	0,08	0,65	1,20	0,88	0,64

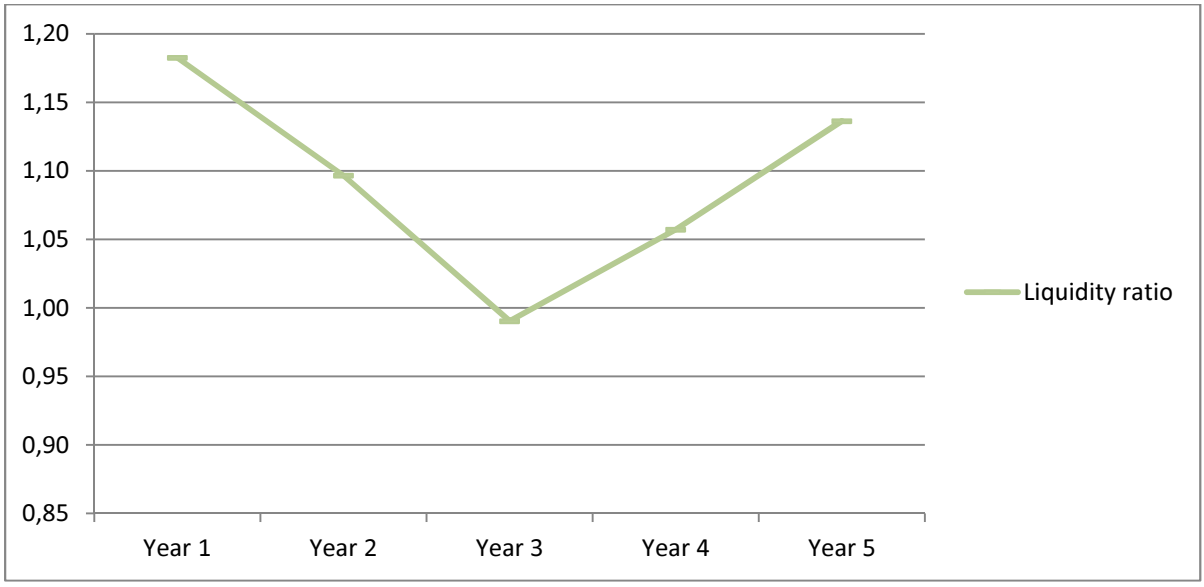
Graph 4.13 - Return on sale using bank loan



Graph 4.14 - Equity ratio using bank loan



Graph 4.15 - Liquidity ratio using bank loan



Liquidity ratio of both financing methods, recourse factoring and bank loan, indicates that the critical year is year 3 because short-term obligations are not fully covered. In both cases, the third and fourth year are critical because fixed assets to net ratio is higher than 0.75 and this means that the family business is vulnerable to unexpected changes in business environment. Comparing return on equity and return on sales higher returns are evident in recourse factoring. All of the ratios and indicators show that the critical years are year 3 and year 4 when the major investments occur. However, in year 4 some improvements on ratios and indicators are noticeable.

CHAPTER 5

CONCLUSION, LIMITATIONS AND FURTHER WORK

Nowadays the competition in the international trade is becoming more and more severe and the markets have become very buyer-oriented. In the emerging markets of many countries it is often the case that a contract can only be won through extended payment terms. Trade finance has long been an important component of the international financial flows, as firms rely heavily on bank financed trade credits to support their export and import activities. Although optimising the invoicing process will definitely help, and most small and medium sized transportation companies will ultimately need business financing to be able to grow and succeed. However, getting a business loan in the transportation industry can be very difficult for small and medium sized enterprises, especially for freight forwarders, carriers and brokers.

However, in recent years an alternative way to finance freight forwarder companies has been gaining grip. It is called freight bill factoring. Factoring accelerates the cash that is due to a company from slow paying freight bills. It also provides the quick liquidity needed to pay for company expenses.

Factoring is a very flexible financial method and it has developed into several forms. The fundamental forms are the non-recourse factoring and the recourse factoring. In Slovenian market the recourse factoring dominates in comparison to the non-recourse factoring, mainly due to the severity of the market situations. Nowadays the business practice, especially in the current distressed environment, highlights the economic aspect of factoring, because it contributes to higher and better liquidity of the company.

In particular, my dissertation is a case study and explains the choice of using recourse factoring as a financing source in a small family run freight forwarding company. A challenge for many small businesses is access to bank financing, and factoring can in many cases provide the solution that helps a business owner to get through tough times or through times of rapid growth and expansion. The study is interesting due to several reasons; firstly because recourse factoring is explained from the company's point of view, secondly because it represents direct comparison with the bank loan, and thirdly, because the study can be used in the studied company.

5.1 Summary and implications

A company that enters into a factoring agreement is at an advantage in a number of ways. The factor provides specialised services with regard to sales ledger administration and credit control, and relieves the client from debt collection. So, the company can concentrate on the other major areas of its business and improve efficiency. Secondly, the advance payment made by the factor to the client in respect of the bills purchased increases their liquid resources. They are able to meet their liabilities as and when they arise, thus improving their credit standing position in respect of suppliers, lenders and bankers. Further on, factoring provides flexibility to the company to decide whether to extend better terms to their customers. The company itself is in a better position to meet its commitments more promptly due to an improved cash flow. Although factoring is widely used in many activities, there are companies for which this business is unattractive. These are the companies that sell mainly for cash, companies selling at very short payment periods, companies selling their total production to a single or a few customers and companies with poor financial condition (Potočnik, 2000).

Recourse factoring include adopting stronger credit practices when reviewing customers, negotiating specific terms regarding the factoring process and selling only receivables accounts with high collection possibility. Recourse factoring can have more restrictions on the type of accounts purchased by the factor company. Companies who always attempt to factor receivables accounts with a poor collection history may pay higher fees or receive less money from the factoring company for these accounts.

All the results indicate what the prevailing literature has already pointed out. Factoring is in many ways a much better financing method than a bank loan but, as many researches discussed, factoring is influenced by a lot of external factors. In the freight forwarder business in the Slovenian economic environment, factoring would not appear to be the right choice. Firstly, because there is almost no legal base for factoring and the one that does exist mentions factoring as an irrelevant financing method. There are also a lot of legal limitations from the factors point of view, especially in accounting and tax aspect. Nevertheless even if the company would decide to use factoring to guarantee the future growth and to invest in fixed assets, the negative aspect of transportation business would occur. The payment deadline limitations and the high penalties indicate that selling account receivables may provoke payment delays. Recourse factoring appears to be a better, cheaper choice of

financing, especially because of extra labour cost in the bank loan treatment, the cost of growing non-payment discipline is much higher. And that is why one of the most important features that the company has to maintain is an excellent credit rating, especially because it guarantees beneficial bank loan conditions.

The main limitations of factoring are that factoring can lead to over-confidence in the behaviour of the client, resulting in over-trading or mismanagement. Secondly, the risk element in factoring gets accentuated due to possible fraudulent acts by the client in furnishing the main instrument to the factor. Later on, the lack of professionalism and competence, underdeveloped expertise and resistance to change are some of the problems which have made factoring services unpopular. The rights of the factor, resulting from the purchase of trade debts, are uncertain, not as strong as those in bills of exchange and are subject to settlement of discounts, returns and allowances. Small companies with a smaller turnover, companies with a high concentration on a few debtors, companies with speculative business, companies selling a large number of products to general public or companies having a large number of debtors owing small amounts may not be suitable for entering into factoring agreements.

5.2 Further work

To conclude, I can safely say that the lack of the payment discipline among Slovenian companies is not solely to be blamed on the current economic crisis. The reason is especially evident in institutional frameworks, and in bad business moral need that is becoming almost habitual. Nevertheless, I can say that inside the studied family freight forwarding company the payment discipline is well supervised. However, it is notable that although the payments from our international clients are received on time, our Slovenian clients are getting more and more behind. Clearly, we need to confront the poor payment discipline situation and seek appropriate solutions. Among some of the fundamental and radical changes are certainly the changes in the legal system. All of the above leads to the search and development of new financing methods.

Hence, all the effort to legally control the non-payment discipline, especially in the transport area, has not yielded positive results. There are a lot of legal acts but no one is controlling their correct implementation.

Given that the factoring is a complex legal transaction, it is difficult to govern it by regulated contractual provisions. Given the fact that factoring is still not legally governed, a key question arises whether the absence of such regulation is an alternative to the release of the designing, developing, modifying and updating of such financial method, to the constantly evolving business environment.

There are several ways to develop and continue my dissertation. A starting point should be based on the 'Basel III' regulations that will be gradually implemented between the years 2013 and 2019. An important part is that the proposed regulation is likely to result in significantly higher trade financing costs and a more restricted access to traditional trade financing instruments. Companies might find it more convenient to use other forms of trade financing, such as overdraft, factoring, cash-in-advance terms and export credit insurance. Further on, as the trade financing costs are liable to rise, country risk information and market intelligence will play an essential role for companies that aim to minimise costs and risks when dealing with foreign counterparties. That is why an empirical research of a company's credit rating could be one of the possible developments of my dissertation.

But any thinking in this direction is certainly an option for the future.

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Zakon o uravnoteženju javnih financ (ZUJF).

Zakon o zdravstvenem varstvu in zdravstvenem zavarovanju (ZZVZZ).

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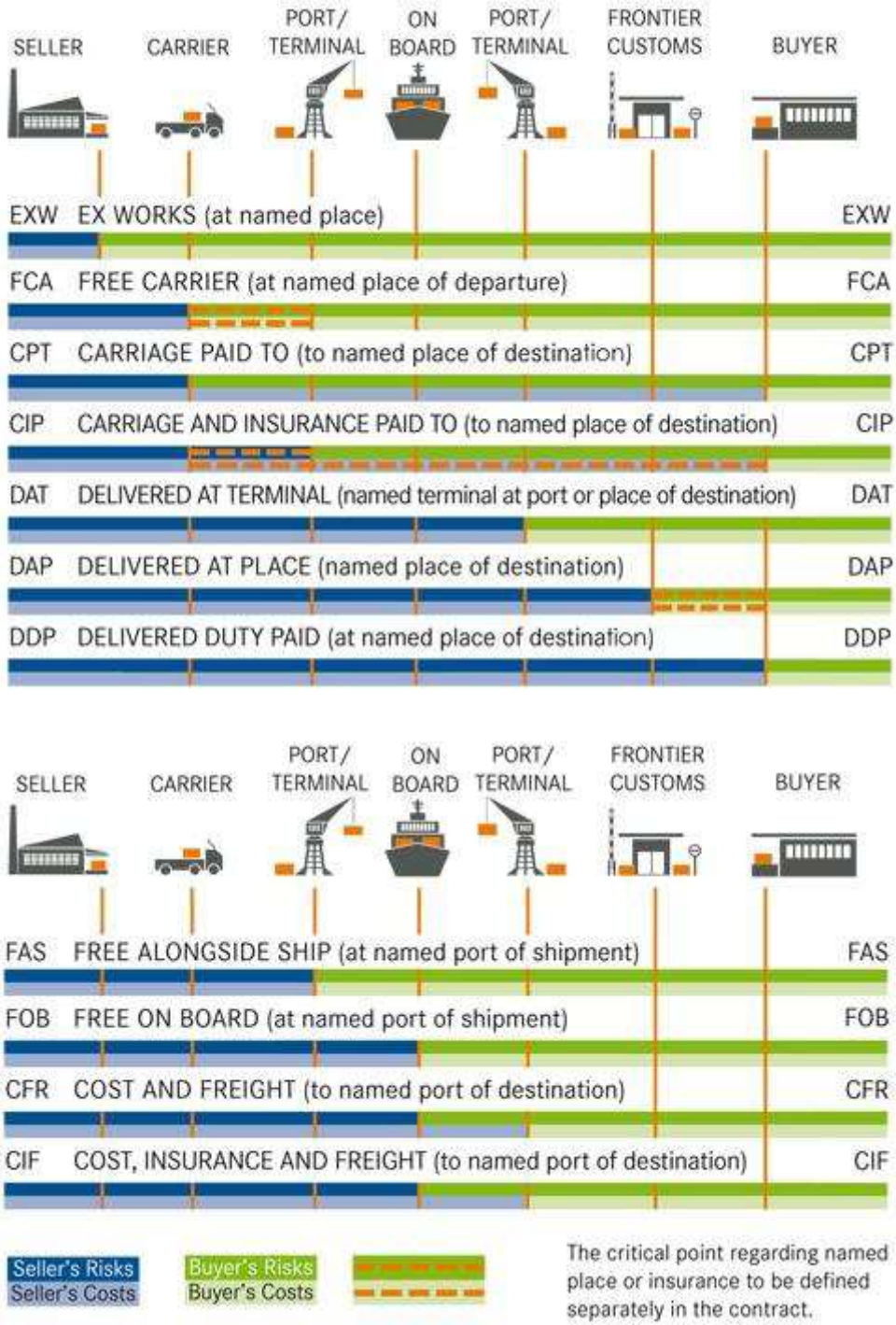
Appendix I: Incoterms



Source: Incoterms 2010