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Legal and Financial Features of Factoring in Uzbekistan

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Abstract:

this scientific article discusses the importance of financing through factoring and its main advantages as well as legal features of it in the Republic of Uzbekistan.

Key words: factoring, financing, business, property, loan.

Introduction

Factoring is a complete package of services in which companies assign the receivables from their domestic and international sales of goods and services to a factoring company that provides them with guarantee, receivable, collection management, and financing. Factoring makes it possible for a business to finance its operations from its own receivables. Average collection time will be lowered as well commercial payables, which means that company's financial structure will be stronger. This sphere is being improved and supported by the government of the Uzbekistan and this article will discuss the features of the factoring.

Literature Review

Entrepreneurial firms are often characterized as having insufficient acceptable tangible assets, such as buildings, landed property, and others, to offer as collateral. They are also seen as lacking in the track record necessary to establish their reputation. Therefore, factoring is considered more doable for them, as the collateral itself (accounts receivable) is readily available to entrepreneurs, and serves as the primary source of repaying the factor. As such, factoring can be used to complement bank loans, or, as the case may be, substitute them entirely [1]. Like other traditional forms of commercial lending, factoring also provides corporations, especially service companies which grow faster than their credit line, and tend to be payroll intensive, with the funds needed to run their day to day operations [2]. However, unlike most other forms of commercial lending, factoring supplies the needed funds speedily, in such a way that enables the sale of goods and services to continue with minimal interruption, thus encouraging productivity and profitability [3].

Furthermore, financing large scales projects become challenging when there is need to secure and raise capital, as such, contractors use several alternative sources of funding, of which factoring is usually used to get the materials needed, in order to sustain financial flow and avoid any dissatisfaction between collaborated partners[4]. Also considering that, on average, 20 to 40 percent of manufacturers have assets locked as accounts receivables [5], factoring allows the high-risk suppliers among them to mitigate their credit risk level with that of their high-quality buyers, as the decision of a factor to finance the adherent has more to do with the position of the buyers owing, than the supplier owed [6]. In addition to this, the owing buyer's informational asymmetries and risk become the primary concern of the factor, not the adherent, and even those become secondary concerns if the accounts receivable belong to transparent and large companies [1]. As such, manufacturers' abilities to expand operations or change product offerings in response to changing market conditions are unhindered.

Following these, despite the fact that corporate finance sees the protection of the rights of financiers as essential to mitigating agency problems in SME financing and assuring the flow of capital, extant financial literature have stated that not all financial contracts are equally affected by the low quality of laws. Factoring is one of such financial contracts that are less affected by agency problems and inefficiencies in the legal system, regarding the protection of investors, as long as the debtor firms are transparent dealers: this is good news for developing countries which are usually characterized with such inefficiencies. As such, protection of creditor rights and enforcement mechanisms become less important for factors [1].

Results

According to the legislation of our Republic [7], factoring is a type of banking services related to the financing of business entities, in which they are accepted by the payer for the goods, work performed or services provided to the bank - financial agent, but the payment give them the right to receive unpaid payment, without the right of regression, on their applications.

Banks carry out factoring operations on the basis of agreements with customers at the location of the main deposit accounts until their demand is received. The period for fulfillment of a monetary claim by a payer to a financial agent on the basis of the provision of factoring services must not exceed 90 days. Banks must take measures in the manner prescribed by law to recover unpaid liabilities from debtors.

It should be stressed that several improvements have been made to develop factoring operations by supporting private factoring organizations. For instance, the Central Bank hosted a meeting with a delegation led by Amanda Sayeg, Economist of the International Monetary Fund's Public Finance Management Department. The responsibilities of other financial coordinators, in particular insurance, factoring operations and leasing organizations, were also discussed.[8]

Table 1 Outstanding loans of legal entities Factoring and leasing [9]

№	In the beginning of the period	In bln.sum	After a year	In bln.sum	Change, in percenage
1	01.07.2018	1744	01.07.2019	2177	25%
2	01.08.2018	1694	01.08.2019	2103	24%
3	01.10.2018	1733	01.10.2019	2390	38%
4	01.11.2018	1811	01.11.2019	2307	27%
5	01.12.2018	2006	01.12.2019	2111	5%
6	01.02.2019	2225	01.02.2020	2130	-4,3%
7	01.04.2019	2225	01.04.2020	2155	3%

Outstanding Loan means a loan that the consumer is legally obligated to repay, regardless of whether the loan is delinquent or is subject to a repayment plan or other workout arrangement, except that a loan ceases to be an outstanding loan if the consumer has not made at least one payment on the loan within the previous 180 days.

Legislation of the Republic of Uzbekistan also refers that factoring (debt collection) is a type of service of the bank to finance economic entities. According to it, the bank accepts without the right to regress the rights of economic entities to levy payments on goods, works performed and services, which are transferred by the payers.

Factoring operations are carried out in accordance with the Regulation "On the procedure for carrying out factoring operations in the territory of the Republic of Uzbekistan by commercial banks" (list of MJ of Uzb. № 953, 03.08.2000).

For the service rendered by the Bank, the period of payment from the borrower is up to 90 days. The factoring services of the bank for export operations are provided only to enterprises and organizations that have a call deposit account in foreign currency. An obligatory condition for the provision of factoring services is the absence of the creditor's debts, which the payer has expired. Mandatory condition for the provision of factoring services for export operations is the absence of overdue debtors on the export contract concluded by the supplier enterprise with a foreign partner.

Conducted studies revealed that the following factoring operations are not carried out by the bank**:**

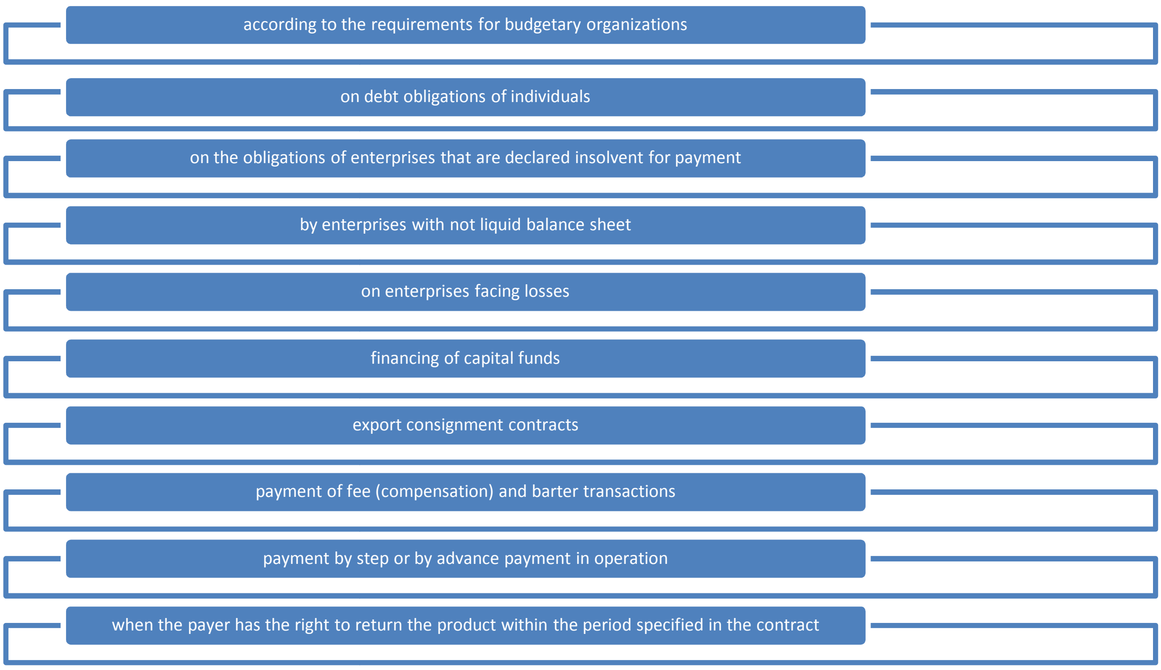

Figure 1 Factoring operations that are not carried out by the bank

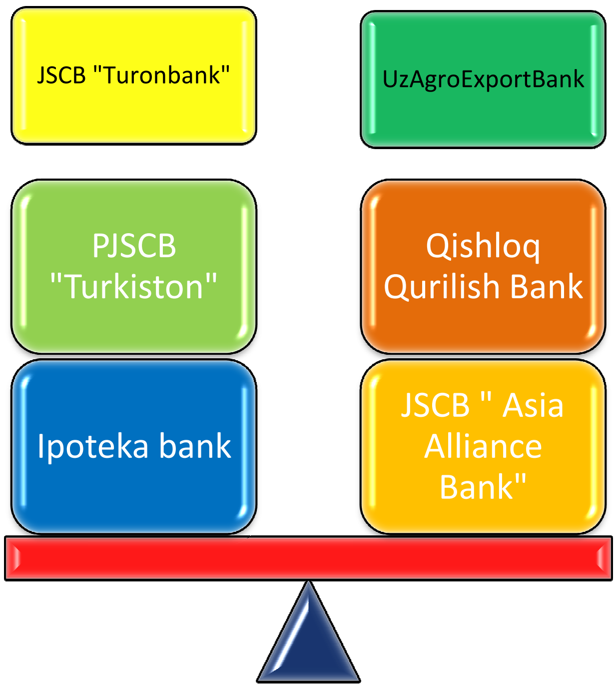

Figure 2 Main banks of the Republic of Uzbekistan that provide factoring services[10]

It should be also noted that commercial banks also provide factoring services in foreign currency for export operations. Factoring services for export products are provided by commercial banks only to enterprises and organizations that have a deposit account before demand in foreign currency, which they serve.

When providing factoring services by them, the bank's income is a discount in foreign currency, which is the difference between the nominal value of the payment document and the amount of its transfer to the bank in accordance with the contract. Absence of overdue receivables from the supplier on export contracts concluded by the Supplier with the relevant foreign partner, previously included in the Unified Electronic Information System of Foreign Trade Operations, is a mandatory condition for the provision of factoring services for export operations. Commercial banks provide factoring services only on export contracts included in the Unified Electronic Information System of Foreign Trade Operations in the prescribed manner and in the amount not exceeding the amount of letters of credit guaranteed by foreign correspondent banks or not explicitly revoked under these contracts. When conducting factoring operations on export contracts, a commercial bank transfers funds in foreign currency to the customer's transit deposit account upon demand, in the amount waived by the supplier in favor of another person, less the discounted amount agreed in the contract. After signing the contract for the right to demand money, the client must notify the foreign counterparty and his guarantor (guarantor) and provide them with the bank details of the bank-financial agent to make payment on these payment documents. If the letter of credit is accepted as a form of payment, then the client must timely re-issue the letter of credit in favor of the bank-financial agent, and then notify the bank of the status of re-issuance.

In fact, several improvements have been made for further development of factoring sector in the national level of the Republic of Uzbekistan. In order to regulate relations in the field of establishment, implementation and microfinance of non-bank credit organizations, the Central Bank has developed a draft law "On non-bank credit institutions and microfinance activities" and posted it on the portal www.regulation.gov.uz for discussion. The draft law was prepared in collaboration with World Bank experts and on the basis of advanced foreign experience, and defines the procedure for establishing and operating non-bank credit institutions, including microfinance and microcredit organizations, pawnshops, mortgage refinancing, as well as factoring organizations. The draft law also reflects the process of licensing, registration of requirements and conditions for the activities of non-bank credit institutions, including consumer protection and the powers of the Central Bank [11].

Reseraches also showed that factoring operations are actively used in Islamic finance. Optimal Islamic Factoring System enables financial institutions to set up and grow Islamic International Factoring business that is Shariah compliant [12].

It supports both post-financing & pre-financing facilities including :

- Factoring Facility
- Bank Guarantee
- Letter of Credit
- Letter of Undertaking
- Letter of Support.

Optimal Islamic Factoring System is ready, feature-rich and can be deployed quickly. Key features include

- New Facility including generation of legal documentations (such as Letter of Offer, Islamic Factoring Facility Agreement, Sales Agency Agreement, Al Kafalah Letter of Guarantee)
- Document Management (such as upload of board resolutions, paymaster contracts)
- Facility Renewal Management (such as renewal notice / fees / letter / checklist, revised terms)
- Limits Control (such as paymaster limits, client facility limits, client level paymaster limits & recourse periods, sub-limits for bank guarantee / letter of credit / letter of undertaking / letter of support)
- Profit Rate & Fees (such as processing fee, renewal fee, service fee)
- Daily Operations including invoice processing, credit notes/ dispute handling, call/ site visit reports, generation of Schedule of Offer, disbursement of advance, generation of acceptance of purchase request
- Make-checker control & full audit trail

Optimal Islamic Factoring System is built upon our award-winning Optimal PRIME – Digital FinTech Platform. It can be easily extended to add new modules, connects seamlessly with external systems and is cloud ready.

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Conclusion

Despite the fact that the problem of finance is a persistent one in organizations because there are always more needs than available means of meeting them, factoring has been found efficacious as an innovative short-term financing tool that continues to gain grounds as a working capital financing solution, as it enables businesses to keep afloat and maintain competitive advantage in the ever evolving, not-waiting-for-anyone world we find ourselves, by freeing up cash stuck with the organizations' debtors. Nevertheless, it is worthy of note that when it comes to financing businesses, there is no one-size-fits-all. This means that, since strengths, weaknesses, opportunities and threats vary from firm to firm, managers are to be saddled with the responsibility of critically assessing the various means of funding available to their organizations, so as not to adopt just any one, but the one that best suits theirs: what works for company A might not work for company B. However, this paper is limited in that, as opposed to the original intent of the researchers, the paper could not rely on just peer reviewed journal articles as points of reference as the number of scholarly articles specifically discussing factoring are meager, and even some of the available ones are neither comprehensive nor holistic enough. It is therefore proposed that potential researchers seize the opportunity to explore the field of factoring, especially at a time like this when it is still a trending topic in the world of corporate finance.

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