



Comparison between the legal nature of commercial factoring and similar legal institutions

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ABSTRACT

Objective: Factoring companies are one of the most important modern legal entities to facilitate domestic and international trade-economic relations. Factoring is a short-time funding method and factoring company is responsible for managing, demands collecting or decreasing commercial documents and receivable accounts. Also, the main task of the factoring company is purchasing debt. **Methodology:** Factoring contract is a general agreement between the exporter and operating company which exporter whereby transfer to the factor some receivable amounts arising from the sale of goods between themselves and customers. **Results:** The aim of this study is to review the legal structure of commercial factoring and to compare it with similar legal institutions. In Iran operating entity, despite of practical common, is not benefit of appropriate, clear and decisive legal basis because of having some bugs legal basis and therefore the study is of great significance. **Conclusion:** This study is based on descriptive –analytic method and the information collecting method.

1. Introduction

“commercial relations” and also “contract” are the most important things that are discussed in commercial law and it has a special place among individuals. People do the conclusion of contractor commerce or even in some cases in everyday life and to meet personal needs and to meet personal needs and to achieve the desired goal. Nowadays trading spread, plurality of exchanges and the increasing of amount of contracts cause that people pay more reviews on contract (Spasić et al., 2012).

Factoring contract is rarely sued in our municipal law but it has a Major role and different types in international trade. “factoring” or “setting demands collection and cession of claims is a method of financing that whereby exporter transfer their short-term receivables to a financial and credit institute that the recent institute manage, collection or decrease that debts, regardless of whether the right of recourse to the exporter is reserved or not.

Factoring contract is signed between operating company and exporter whereby an agreement take place between the agent and exporter and the operating company take the responsibility of collection and management of debts of exporter in general and receive the percentage of claims as a wage for it. Available evidence suggests that the factoring goes back a long history of trade and even some people tracked it until the Babylonians and about 5 thousands years ago. However, the new factoring operations that we have it today, formed since the late nineteenth and early twentieth centuries. England is a country of origin factoring (Bonell, 2004).

Since a comprehensive work has not been done in our country regarding the diversity of the legal nature of factoring and comparison with similar legal institutions in Iranian law and international trade regulations until now and some legal scholars have sporadically engaged to this topic, we pay the diversity of the legal nature of factoring and comparison with similar legal entity since it be effective in the improvement of business and the problems of Iranian businessmen in payments and domestic and international debt collection.

1.1 Definitions and idioms

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Here, we pay to lexical and technical meaning of factoring and the definition of key words and also the component of factoring contract

1.1.1 Lexical meaning of factoring, agent and commander

1.1.1.2 Agent

It literally means, operator, worker, workable and one who handles finance or civil affairs of anyone else (Beheshti, 1990).

1.1.1.3 Commander

It literally means “commander, employer” (Beheshti, 1990).

1.1.1.4 Factoring

It literally means” debt collection factoring and cession of claim.

1.2 Technical meaning of agent (factoring)

The legislator has not given a special definition about the concept of agent and who to be an agent. The term agent is used in Iranian trade law about three times and agent commercial law is generally removed in the regulations of new amendment and it is defined as commercial factoring. In the term of civil and commercial law, agent is one who does work on behalf of someone else and in his name and for him, whether he is an attorney or legal representative. Also, independent professional factoring, is permanent and an agent can be a lawyer and a businessman, too there is disagreement among legal experts about this issue, some lawyers comments are:

1-agent is one who does a work on behalf of someone else such as the brokerage fee. The difference is that unlike brokerage, the agent doesn't work for a certain person.

2-agent is one who buys and decreases the receivable amounts and collects them. He is at the disposal of receivable accounts or other guarantees as collateral by paying off the loans to merchants and accept the risk of return damage.

3-agent is a representative who sells a good that is belong to someone else. But agent is different frame representative, because it is necessary that goods to be in possession of agent, while there is on such provision for representative. The relationship is established between the agent and principal by writing the contract. Both parties must comply with the provision of the contract and the termination of contract is possible by agent, principal or by operation of law (Lehman and Phelps, 2004).

4-Agent can be a person who attempt to buy or sell the goods and in get a commission in return that is called the factoring right. (Blackwell, 2008).

5-The agent buy receivable accounts less than their nominal value and collects funds and gets the differences between the two as a commission or the factoring right.

The factoring is a bridge that fill the financial flow intervals between the production, sale and flow and provide a smooth functioning for businesses through maintain the balance of liquidity and also factoring is defined as “sale of receivable accounts (receivable documents) to operating company to supply of cash and reduction of credit risk”.

7-Factoring or setting of collection of debts and cession of claim is a method of funding whereby an exporter transfers his short- term receivables to Financial and credit Institute which recent Institute manages collects or decreases that receivables.

8-Factoring is a continuous legal relation between a financial institution (agent) and a businessman (exporter) that sells goods or some services to their customers based on account. The agent buys the sellers' receivable items from customer with or without the right of withdrawal yet controlled Credit that is given to the customer and manage the account history (Tazhibi, 2011).

2. Materials and methods

According to the above definition that was presented about factoring, in the modern factoring gather the demands of sellers of goods from their shoppers and collect Also the main performance of factoring is buying the debts and decreasing them.

Also, general rules governing the international factoring entered into force in July 2002.

1) Receivable documents

It is to demands that it is received some commercial documents such as cheap, promissory note and bill from the debtor and are divided into two forms of short-term (one year) and long-term.

2) Receivable accounts

It is consisting of the claims about the cash which is expected to be received within one year or one operating cycle.

3) Commissioner factor

Commissioner factor is a person who start trading to his name but a different account and receives commission in return.

4) Broker

Broker is a person who become a middle-man for transaction because of the wage, and finds a correspondent for some me who wants to be traded.

5) Buying debt

Buying debt or in the other words “recoupment” is one of the tools that is used for provision of financial resources that are needed for production, Business and service units through commercial papers belonging to these units in the Islamic banking system.

6) Forfeiting

Forfeiting are also the companies such as factoring companies which are mainly active under the supervision of banks or Financial institutions and they attempt to discount commercial papers of some companies which need to receive funds from their export before the importer due date in their international transactions.

7) Leasing

Leasing is a method of financing that it is designed based on “hire –purchase” contract. And the development of leasing activities requires appropriate funding in order to purchase the leased assets.

8) Contract of reward

Contract of reward is the obligation of a person to payment of specified remuneration for an act.

2.1 Factoring contract components

1) Factoring company

factoring company usually act to managing the claims and collecting them to from the factoring. The factoring company may buy exporter receivable accounts (Claims) at the lower price and pay the fund to the exporter by cash. In this method, exporter “receivable accounts” are transferred to the factoring company and the recent company visits the importer in due course and receives it fund. The agent should implement at least two of these functions: Financing for Supplier, including loans and advance payments. Maintenance accounts related to receivable claims. Collection of receivable claims and protection against default on payment by debtors (Reisman, 1974).

2) Exporter

Exporter is a seller who sells a good or some services to the buyer on credit or deferred and transfers the right of receive debt to the agent.

3) Importer

The importer is a buyer who is owed to the exporter because of factoring and should take action toward payment in due course.

4) Applying factoring contract

The factoring should apply the contract about the permission and authority that is guaranteed and this is the main task of agent. nonperformance of the contract by agent, is considered the agent fault. Art ide 220 of the civil code says:

“The contract not only requires the parties to the transaction to implement something that is clear, but also they are required to all results that comes from contract under the common low or legislation.

The agent is required to implement the contract based on agreements and extremes in implementation of the contract causes his or her guaranty. According to article 663 Civil code which is appointed on contract of mandate: “a lawyer can’t perform an action that is outside the scope of his power of attorney”. Although the agent can perform the can treat ads he wants because of independence in business. But any stop in the execution of contract that is inexcusable, provides grounds for agent guaranty (Eskini, 1999).

5) The necessity of the creation of factoring

Nowadays, the train of progress and development moves in all countries with program and passes the progress station quickly. Now, if a country with natural God. Given capacity and educated and empowerment people, as Iran, can’t make a comprehensive plan in this way, for any reason, whether right or wrong, and can’t remove obstacles ahead with an understanding of the realities of the environment, it will be blamed by future generations. Therefore, in this issue which is related to one of the most critical parts of the country’s economic program and that is export promotion and country’s withdrawal from prioritization to import, we should reform current adverse culture and remove theoretical and administrative barriers to the development of export (Goode, 2007).

6) Benefits of factoring services

Same companies that due to the increase in receivable funds, don’t have sufficient funds to meet its working capital; tend to use the agent company services. Using of such company services in order to obtain the cash needed, help them to increase their cash balance.

In general, Vender company can consider with the two following factors, use factoring operations to provide working capital needed.

A) save on administrative costs, the costs that is paid to agent, are a Maximum between 1 and 1.5% more than bank costs. But this increase in cost compensate through saving management.

B) Decrease in time management in order to control arrears and exporter can concentrate on specialized issues of production and sales of the product or services.

C) company cash flow increase (if you use the process of financing)

D) factoring services is more comprehensive than services that banks do for financing receivables (Tazhibi, 2011)

7) Risks related to factoring operations

One of the most important risks that threatens the proper conduct of operations.

A) credit risk: that can reduce the risk of the lack of commitment using new methods validation or abating adequate collaterals and also the entrance of agent banks in importing country.

B) The risk of customer fraud: This risk comes from the cases that the exporter wants to cheat the agent company by providing fake dotcom and collude with a fake importer in another country that this risk is also preventable by adopting appropriate measures and subject field study.

C) Market risk: This risk is providing the existence of competitors in the market.

3. Discussion and results

3.1 The comparison between legal establishment and similar commercial entities.

1) Commission and factoring

Commission is defined in the article 357 of commercial law as follow: "Brokerage is a person who does a work to his name but for someone else and receive commission for it. And in the article 4 off France commercial law, it is also defined as well Brokerage is named merchant in Iran and Franc law. But there is no definition for agent in Iran law we can define agent as follow. He is a person who act in commander name and account and He has no role in the fulfillment of obligations. Factoring has all representation elements and it is the most complete representation (Akhondi, 2005).

2) Brokerage and factoring

According to the article 335 of commercial low, we can define brokerage as: middleman is a person who become mediator to make a deal and receives wage for it or finds a correspondent for one who wants make a deal. And professional brokerage is intrinsically commercial. Middleman is not the party for transaction, He just facilitates the transaction.

Brokerage is one of the oldest commercial actions in France law and has an important role performing business deals. Middleman has different kinds in France Law, such as: commodity brokers, amphibious transport brokers (Rubin, 1996).

3.2 Forfeiting and factoring

forfeiting literally means penalty, compensation, loss, wasting, forfeiting, and recording. For Feting are also of such companies that maturely operate under the supervision of banks or financial institutions. Therefore, Forfeiting is the sale conversion of the product or services to cash sale without recourse to the exporter.

1) Forfeiting and factoring in common

There are many similarities between forfeiting and factoring

A) The existence of contract: in both methods, First the contract is signed between the seller (exporter) and the buyer (importer) in which the buyer agrees that, instead of paying a visit, pays money mort age to seller on credit.

B) assignment to factoring company : n both methods , the seller may assign there from the importer to an factoring company in order to an factoring company in order to provide the necessary liquidity and receive part of it in cash If the claims and " receivable accounts " that are transferred to company don't be valid , it seems like that these documents is fake or it is obtained through fraud.

2) Differentia's between forfeiting and agency

A) factoring is usually appropriate for continuing relationships between an exporter and a factoring company, while forfeiting has more Functionality aspect.

Thus, if an exporter wants to assignee collection of receivables from Various clients continuously to the agent company. The factoring is more appropriate, but if he tends assignee collections only from a specific customer, forfeiting is more suitable.

B) Unlike factoring, in forfeiting commercial documents such as bill. Promissory note, bank guarantee and documentary credit are shelled at the lower price.

In Forfeiting, receivable deferred documents are transferred to the institute by exporter through endorsements or etc. In factoring the assignment of commercial document is not basically raised, but the receivable accounts of exporter are assigned to the factoring company.

C) Another difference between factoring and Forfeiting is that Forfeiting doesn't allow decreasing company visits exporter in the event of non-payment. according to this, the importer is responsible for payment of documents. If the importer faille's To pay his debt, or has no money to pay, the risk of this failure is the responsibility of discount and he can't visit the exporter. Thus, our demands are removed from the exporter accounts by the conclusion of forfeiting contract whereas in factoring, the agent company may preserve this right for itself which in the event of non-payment visits the exporter (Ayobi, 2014).

D) Another difference between these two methods is that in factoring, the collection of claims and its management to the factoring is very important, while in forfeiting, the issue of financing is more important than the management and collection of the claims. For this reason, factoring is suitable for various claims and forfeiting is suitable for case claims (Ayobi, 2014).

3.3 Leasing and factoring

Leasing is a method of financing which it is based on" it ire-purchase" Contract. The development of Leasing activities needs appropriate funds for buying rental assets. The price is also one of the main factors to determining the demands for leasing products and this matter effects on development of leasing company. Thus, one of the main challenges of leasing companies is funding diversified with appropriate price for development of activities. leasing companies funding mainly contains capital sources, debt financing (bonds or loan), derivative financial resources. And hybrid funds (International contracts such as buyback contracts or international leasing. Leasing companies major financial resources in Iran traditionally contain investment funds and bank facilities.

Leasing companies' problems in sufficient funding cause innovations in the early 1380s. These innovations contain awarding of some contracts as fallow:

A) Factoring contract with manufactures of capital goods:

The first contract of this kind signal between Iran khodro company and leasing mining industry for selling khavar trucks. According to this method, rental assets are owned by leasing companies.

B) Factoring company with holders of funds:

One of the limitations which is barrier to obtaining funding from non0 bank creditors, is the issue of tax.

According to the Direct Tax Law, just the loan interest paid to bank and non- bank institutions, is the acceptable cost. This issue caused increased cost of funding and thus funds wouldn't be justified economically. There are two methods for solving this matter. one is the signing of civil partnership contract and the other one is signing of factoring contract.

C) Factoring contracts with banks

One of the leasing companies' problems in getting bank facilities in the roof of individual and group facilities

Bank leasing companies are designed factoring contracts for overcoming this problem.

According to these contracts, leasing companies act to deal with applicants on behalf bank and receive some wages for rendered services.

3.4 Buying the debt and factoring

Buying the debt or in the other word, recoupment, is among the tools that is used for financing requirements of production, trade and services, through commercial papers belonging to these units. Buying the debt is means of financing which take places through commercial production units and commercial papers. Iranian trade law has expressed the provision related to the bill of exchange, promissory note and cheque but it hasn't introduced these documents

As all business documents. It should be noted that commercial documents is not limited to bill of exchange, promissory note and cheque some , other documents such as warehouse receipt, instruments in order of someone holder, debentures, bill of lading and also credit documents are some papers that are similar to bill of exchange in many ways (Ayobi, 2014).

The features of commercial documents are as follow:

- A) The ability of endorsement.
- B) Involves a cash commitment.
- C) Abstract of the obligations arising from it.

The abstractness is considered as an important feature for commercial documents that the promisor of bill of exchange. Promissory note and cheque undertake for the holder of document by signing the documents and it is not heard the personal relationships after the exportation.

3.4.1 Differentia's between factoring contract and buying debt.

- A) The existence of debt may not be due to the making a deal whereas the factoring contract always is formed for a transaction.
- B) In buying the debt may assigned debt to the debtor but this has never occurred in the factoring.
- C) Buying the debt is a territory contract but factoring is international
- D) Factoring usually offers short-time funding until 180 days but for buying the debt is used for medium or long-term plans (Ayobi, 2014).

3.4.2 Similarities between factoring contract and buying debt

- A) Both of them is used for creditor funding.
- B) The issue of discounting the claim is expressed in both of both them
- C) In the above facilities, material element that are effective are the same. Explaining that in both contracts often their material elements play a role, that are exporter(creditor) importer (debtor) and agent (Ayobi, 2014).

3.4.3 Contract of reward and factoring

The factoring is applicable in Iranian banks by using the reward setting the article of 561 of civil law said reward is the obligation of a person to pay known wage for doing a work. In this method, banks take an action for a certain wage as agent and after the act, receive the wage in cash or installments from the economic client. But the realized profit is determined after spending and doing the act. Banks usually relegate doing the work in contract of reward to the contractor and specialists. Thus, the bank profit will be pay dispute of two rewards. In this case, the bank takes the responsibility of the collection of customer or commander demands for a wage.

This matter has no problem legally and banks also can do that based on the interest-free banking. the important point is that the risk of non-payment of debts is the responsibility of commander and bank will not accept such a risk because only banks take the responsibility of a lawyer in collecting demands Comparison between the legal nature of commercial factoring and similar legal institutions.

3.4.4 Non-interest banking law in Iran

Non-interest banking is the result of Muslim thinking who think that the situation in the banking system in west is cruel. So, the oldest bank that was founded on the principle of the elimination of interest, was the savings bank of Egypt in the early 1960, and in the same way some other banks were funded in Kuwait, Jordan, Sudan and Pakistan Subsequently.

4. Conclusion

1-Nowadays getting the purchase of transaction is out of the traditional mode and the role of the parties to the transaction has extremely weekend. For this reason, commercial factoring has an important role in economical and commercial boom therefore, all kinds of representations is increasing day by day in domestic and foreign trade.

Since the main branch in foreign sales and domestic and foreign trade is "commercial factoring", so commercial factoring has an important role in economic and trade acceleration, facilitation, development and prosperity.

2-Commercial factoring is one the most important commercial agencies and according to this , the factoring has a significant role in settlement of disputes arising from international trade agreements in addition to the application of domestic law and it is a short-term funding with high rate as a legal entity , a commercial practice and financial instrument facilitating global and regional trade. With special services that puts to the disposal of businessmen, has earned a special place world trade.

3-Wxtensive collection services provided by the factoring such as guaranteed payments, loans and advances, accounting and... cause international pay to their business affairs Full freely by entrusting their finances to agents. But the factoring ignored in law and right in Iran and it's used in business and trade and businessmen are also using the traditional methods.

4- Commercial factoring companies had a significant growth in recent years and has notable records compared with the traditional banks, because of using export staff.

Based in the nature of these companies, rendered services are appropriate for medium and small companies.

5-Factoring contract is very similar to forfeiting and purchase contract and all of these facilities are included in contracts. Factoring is used widely in other countries and legislate a special law for factoring in France.

6-Applying factoring tools caused exporter (seller) gets free of problems related to the maintenance of accounts.

4.1 Research proposals

1-It is better that factoring process happens in format of bank activities and non-bank financial institutions. Factoring operations can used in format of debt purchase contract, whether in format of bank operations by bank or for financial operations by independent non-bank institutions.

2-The agent is removed in the new amendment of Iranian trade law, completely and it is defined as commercial factoring and this is a major disadvantage of legislative acts. We should formulate an independent law about factoring in Iran or assign an independent chapter in commercial law, because the factoring is very important in clearance of commodities and collection of debts. Thus, we should convince legislators to change some fundamental laws and formulate an independent law for factoring.

3-International convention is without prejudice to our legal system in most cases and it can be used with the trend of international trade in order to harmonize the Iran trade regulations and help to business development and trade in the international area. It is better to do further investigation in this regard.

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