

## STUDY ON THE ROLE OF FACTORING IN BUSINESS FINANCING

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### Abstract

*The financial challenges of the last two years generated by the pandemic, military conflicts, etc. have determined Romanian companies to evaluate their businesses and choose the best sources in order to continue their economic activity. The companies' short- and medium-term objectives were shaped according to the new economic and social conditions. Access to financing is a key element for development, to build new jobs, to remain competitive. Consequently, the need for short-term financing increased and was honored by accessing factoring products by companies. Through the conducted study, it was highlighted that for small and medium-sized companies, factoring products are of interest and are very useful. The evolution of the products granted by Romanian financial institutions are in correlation with the international market, but the proportions are different. Developed countries promote financing through factoring, the proof is the volumes reported by factoring companies. At the same time, financial institutions maintain their prudential criteria in conditions where the economy is influenced by social and political factors, some unpredictable and with a high degree of risk*

**Key words:** factoring, financing, business, services

### INTRODUCTION

Factoring represents a combination of financial services that include covering the risk of non-payment, amicable collection, financing, debt management. After the 2008 crisis, many small companies had difficulties in obtaining traditional bank loans [3].

The seller assigns the receivables to a factoring company or banks and immediately receives cash.

Within a factoring contract, the contractual parties are specifically named:

- The adherent is the company that assigns the receivables issued in favor of a trader (debtor)
- The factor is the financial institution that becomes the transferee. The Adherent transfers the receivables of the Factor before they reach maturity.
- The accepted debtor is the commercial partner of the adherent with whom he concludes commercial contracts.

The object of the factoring contract is the totality of the present and future claims that an adherent holds in favour of a debtor, as well as their accessories arising from all

commercial contracts, invoices, orders and any other commercial documents.

The receivables are transferred by assignment to the Factor who becomes the creditor of the accepted Debtor. For the services offered, the factor charges *commissions* that must be specified in the factoring contract:

- the factoring commission calculated flat at the nominal value of the invoices assigned by the Factor to the Adherent plus a fixed amount for each assigned invoice. It is charged at the time of assignment of invoices. By paying this commission, the Adherent accesses the amicable collection services, invoice management and/or covering the risk of non-payment or insolvency of the debtor.
- the debtor analysis commission charged by the bank at the time of concluding the factoring contract
- the financing commission. It represents the price that the member pays if he wants to obtain the financing of certain, liquid, payable debts. The subscriber can request financing at the time of transfer or after this moment, but not later than the due date of the invoices. It is charged throughout the financing period.

The size of commission and size the amount that will be paid immediately to clients depends on the receivables, its quality, business reputation of the debtor etc. [22].

- the commission for granting/ extending/ increasing the financing ceiling and the ceiling for covering the risk of non-payment. It is charged as a percentage of the value of the ceiling approved at the time of the event.

All commissions within the factoring contract are subject to VAT.

The *financing documents* presented by the Adherent in the factoring contract:

- Notification Letter of the accepted debtor issued according to the Factor's instructions
- Commercial contracts concluded with debtors
- The List of the assigned invoices

*Guarantees* requested by the Factor:

- mortgage on all accounts opened with the factor
- money order ticket in white, signed

*Legal aspects of the factoring contract:*

According to the study carried out by the EBRD in 2018, which includes 24 countries, in Romania, the definition of the factoring contract is not specifically mentioned [6].

The Accounting Regulation implementing the relevant European directives, dated 17 July 2015, applicable from 1 January 2016 defines factoring, as a contract concluded between the client named Adherent and a financial institution [4]. The object of the transaction is effected by the transfer the property of its commercial receivables (invoices) to the Factor. During the validity of the agreement, Factor has to ensure the collection of the adherent's receivables. The institution, based on the received documentation, pays the nominal value of the receivables, less agio, either immediately or at their due date or at the contractually due date established with the adherent. A similar definition is provided by the Accounting Regulation according to financial reporting international standards, applicable to credit institutions, dated 16.12.2010 [8].

Debt assignment is regulated by the Civil Code, it does not specifically refer to factoring (with or without recourse).

Based on the Civil Code future receivables can be assigned, provided that the assignment document includes elements that permit the determination of the assigned receivable.

The "true sale" concept is not defined under Romanian law. In practice, from a legal perspective, achieving true sale is often translated into Romanian law concepts as achieving the transfer of the ownership right over the receivables from the patrimony of the assignor to the patrimony of the assignee.

The factoring contract is:

- it is a synalagmatic contract, it generates rights and obligations for the adherent and factor,
- it is a contract with onerous title - the Adherent pays a price to the factor for the services offered
- it is a commutative contract - the extent of the obligations is established from the beginning
- it is a consensual contract - it is concluded with the agreement of the parties
- it is an adhesion contract - the Factor establishes the contractual clauses for the most part, and the Adherent accepts them under the conditions formulated by the financial institution
- it is a commercial contract - the parties are legal entities, merchants, and the effects of the contract are generated by commercial acts concluded by the member with his debtors

Legal aspects regarding international transactions are also generated by the law applicable to contracts. The non-existence of national regulations regarding factoring, the lack of knowledge of the legislation of the debtor's country by the seller, the internal legislative specificities regarding the assignment of debt, the prohibition of assignment, the transfer of ownership led to the idea of standardizing the law of international contracts.

There are two international instruments indented to promote the movement of goods and services across national borders by facilitating increased access to a lower cost credit. The first instrument of unification is the UNIDROIT (International Institute for the Unification of Private Law) Convention on International Factoring (Ottawa, 1988) which

is entered into force in 1995 with the ratification of six countries (France, Hungary, Italy, Lithuania and Nigeria) and became through that ratification a part of the national legislation of those countries. Under auspices of UNCITRAL (UN Commission for International Trade Law) another instrument of unification has been created in the field of receivables financing. It is the United Nations Convention on the Assignment of Receivables in International Trade which is issued in 2001 [31].

The following receivables cannot be the subject of the factoring contract, according to the United Nations Convention on the Assignment of Receivables in International Trade:

- (a) Transactions on a regulated exchange;
  - (b) Financial contracts governed by netting agreements, except a receivable owed on the termination of all outstanding transactions;
  - (c) Foreign exchange transactions;
  - (d) Inter-bank payment systems, inter-bank payment agreements or clearance and settlement systems relating to securities or other financial assets or instruments;
  - (e) The transfer of security rights in, sale, loan or holding of or agreement to repurchase securities or other financial assets or instruments held with an intermediary;
  - (f) Bank deposits;
  - (g) A letter of credit or independent guarantee
- From the specialized literature and banking practice, the receivables that the Adherent can assign to obtain non-payment risk coverage services and financing services must also meet the following conditions:

- To represent firm obligations resulting from commercial facts (sales of goods, provision of services)
- Not to represent sales on consignment, or deposit, in the barter system, or, in general, any sale under a suspensive or resolutive condition;
- Not to represent advance payments, cash-on-delivery deliveries, pay-as-you-go deliveries, sales or services to companies under special administration, in reorganization, in the bankruptcy or preventive composition procedure.
- Their deadline should not be exceeded.

- That they have not already been assigned or encumbered in any way in favor of a third party and that they are freely assignable, without any restrictions;

The debtor's notification regarding the conclusion of the factoring contract and the assignment of receivables was made in writing. Through this document, the accepted debtor is notified of the existence of the factoring contract, receives instructions regarding the account in which he will pay the invoices (in the account indicated by the Factor).

Registration (with the Electronic Registry of Movable Property Collateral- AEGRM) is necessary for making the transfer effective against third parties and for establishing the priority ranking between creditors. The registration of security interests in AEGRM is mandatory for certain types of transactions, such as financial leasing, factoring, and commercial loans secured by movable assets. The electronic registration of movable property collateral in AEGRM provides a more streamlined and secure process for both creditors and debtors.

The notification of the debtor is not required for validity purposes, but rather for making the assignment effective against the debtor.

The assignment does not exonerate the assignor from liability against the debtor as a result of breaching the contractual prohibition. VAT issues - Under the Romanian VAT law, transactions with receivables are VAT exempt, without deduction right, except for the receivables' recovery/factoring operations which qualify as taxable transactions, subject to VAT. Nevertheless, if the aim of the transaction does not consist in receivables' recovery but in a granting of a credit, the transaction would be VAT exempt, not qualifying for the above mentioned exception. Another important legal aspect refers to commercial disputes or disputes that may arise between the member and the debtor during the period of the factoring contract. They are events that lead, until the solution to the suspension of financing, to cover the risk of non-payment for future debts. The adherent remains obliged to continue transferring the Factor's claims. The dispute can be considered

any event that leads to the refusal to pay the debts by the debtor, or by any other party in connection with the assigned debt. If the disputes are not resolved, the Factor can withdraw from the client the claims that are the subject of the dispute, requesting the recovery of the financing.

*The services included in the factoring contract:*

- Financing invoices following the assignment of receivables. The customer receives advance payment on the basis of assigned invoices.
  - The financing percentage is usually between 70%-90% of the value of the invoices approved for financing. It is determined by the factor after the analysis of the commercial history between the contractual partners. Elements such as the existence of discounts, scraps, returns, compensations, actual payment terms, commercial disputes are taken into account
- The financing commission has as its component the EURIBOR/LIBOR/ROBOR interest rate chosen according to the currency of the factoring contract and the Factor's margin.
- Invoice management - through the transfer of receivables, the Factor manages the receivables in the portfolio, the client receives reports on the portfolio of assigned invoices
  - Covering the risk of non-payment or insolvency of the debtor. The factor obligates himself if the debtor does not pay the invoices when due or if the debtor declares insolvency to pay the counterparty the value of the invoices.
  - Friendly collection. The factor performs collection services with the debtor for the entire period of validity of the factoring contract for invoices that have not been collected.

Checks with the debtor before the receivables are due, late payment signals can be considered measures to reduce the risk of non-recovery of the receivables and increase the quality of their portfolio.

Romania has transposed the EU Late Payments Directive, which applies to commercial transactions between companies ("undertakings"), as well as between

companies and the public sector [25]. In addition to the default interest, the EU Late Payments Directive provides for fines in case of late payments.

From the Factor's point of view, the moment of closing a transaction is when the sums are collected from the debtor and all the commissions and charges generated by the factoring operation are recovered.

In case of the occurrence of undesirable events of late payment, commercial disputes, insolvency of the debtor, financial difficulties of the Adherent, effective amicable or legal collection actions are required (direct communication with the debtor and the adherent, establishment of a mutually agreed plan with the contracting parties in order to the recovery of receivables and the continuation of the factoring contract).

In specialized literature, several types of factoring are known, the classification criteria being defined below:

Depending on the requested services:

- Factoring without recourse (includes all four financing services, invoice management, amicable collection, non-payment risk coverage). The risk analysis is carried out per debtor. The factor assumes the coverage of the risk of non-payment in case of late payment or insolvency of the debtor.
- Recourse factoring includes three of the four services, namely financing, invoice management, friendly collection. The risk analysis is analysed on Adherent. The Factor is directed at the adherent in the event of a non-payment event on the part of the debtor [23].

"Reverse" factoring, a variation of non-recourse factoring, is useful in case of the financial situations of the Adherent are not the most favourable for obtaining financing, in the conditions in which the risk and creditworthiness of the debtor are analysed. Factoring allows the transfer of credit risk from the member to the debtor when his creditworthiness is high. In reverse factoring (also called "approved payables finance"), the buyer approves the invoice for payment, and finance is raised separately against the accounts payable by the supplier from a bank or other finance provider, who relies on the

creditworthiness of the buyer without recourse to the supplier [5].

The benefits and opportunity of choosing factoring with recourse or without recourse are highlighted by Kouvelis and Xu, 2021 in the form of a study of the characteristics of each type of product [24]. The conclusion shown is in the form of the determining parameters: the credit rate of the member and the risk of liquidity, the credit rate of the debtor, the payment capacity of the debtor.

Depending on the country of the parties:

- International factoring - if the Adherent and the Debtor are from different countries
- Domestic factoring - if the parties are in the same country
- Depending on the number of Factors involved:
  - Factoring in the two-factor system or indirect factoring. In the transaction, there are the Factor of the Adherent and the Factor of the debtor's country. It is used in the case of non-recourse international factoring. In the international factoring business there are four participants: the client-assignor (the Adherent), the Factor, the International Buyer-debtor and Correspondent Factors [22]
  - Direct factoring in which only the financial institution of the Adherent is involved.
  - Depending on the publication of the debt assignment and the client informing the debtor about the conclusion of a factoring contract:
    - Factoring with disclosure
    - Undisclosure factoring

The difference between the traditional short-term credit lines in view of the conditions, procedures and related contracts is as follows:

- Short-term credit is based on the client's financial analysis. The guarantees requested by financial institutions can be real estate, collateral deposits, personal guarantees.
- Banks can request audited financial statements, which leads to additional costs;
- Sustainability and financial analysis of the client's entire business are very important in the case of credit.
- by loan it is very important that the size of asset is bigger than a amount of credit—what can at small and medium companies create a

barrier due relatively high level of risk, because of lack of liquidation

Firms extend trade credit for many reasons, Mian and Smith (1992) identified three main incentives: cost advantage, market power, and taxes [28]. Emery (1984) and other argues that trade credits are extended to avoid financial intermediary “rent” by directly conducting business outside the financial market [7, 27]. Consequently, in general for the firm to adopt the policy of “buy now and pay latter”, credit extension becomes a source of survival and growth [29].

Soufani (2001) recognized that the use of the financing option such as factoring becomes an important decision to increase the firms liquidity by providing the accounts receivable as the collateral to acquire finance [29].

Ivanovic et al [22] highlights the theoretical advantages of accessing factoring products both from the perspective of obtaining funds and from the financial perspective:

- application process and fund insurance through factoring is much more faster, than a short-term bank credit lines. In this case it takes time to establish it;
- risks are reduced, as debtors with increased financial risk are eliminated from the portfolio, in the case of non-recourse factoring
- factoring is not considered a credit product, it is not registered in the company's accounting, it is highlighted in the balance sheet. Factoring is kept off-balance sheet and may not be disclosed to potential credit institutions
- The exchange rate risks are reduced because the funds are obtained quickly.
- No real estate or personal guarantees are required.
- Reducing costs by the fact that invoice management is carried out by the Factor.
- For companies that need to improve their cashflow in the short term, to sustain their production cycles for periods between 30-180 days, until they collect their receivables, factoring is a product to be taken into consideration.

Factoring is regulated at national level, the National Bank of Romania governs the activities of financial institutions that can grant factoring products to legal entities.

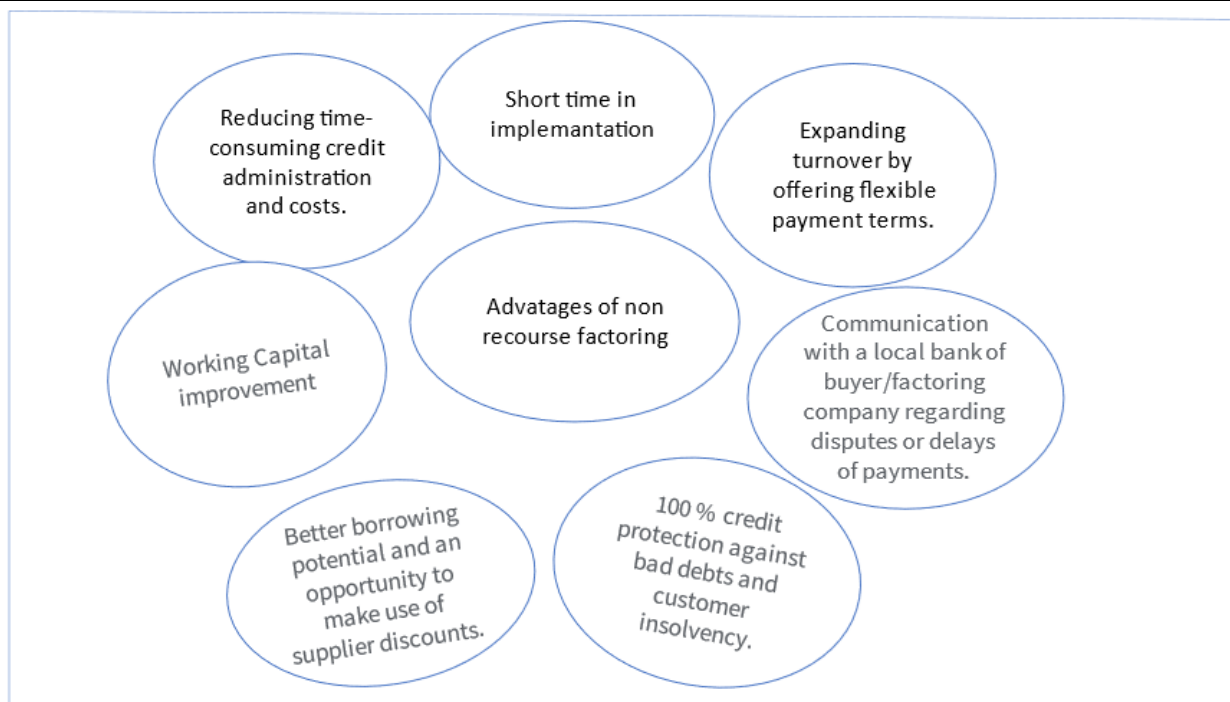


Fig. 1. The advantages of factoring  
 Source: Own processing.

In Romania, the Romanian Factoring Association (RFA) is the structure that was established in 2011, with the aim of protecting and representing the general interest of the factoring sector and the people involved. The members of the association are financial institutions, most of them being banks (Access Financial Services IFN SA, Banca Comercială Română S.A., BRD – Groupe Societe Generale S.A., Banca Transilvania S.A., EximBank, IFN Next Capital Finance S.A., ING Bank Romania S.A., Intesa Sanpaolo Bank, Patria Bank, Raiffeisen Bank S.A., Unicredit Bank S.A.).

Worldwide, factoring companies and banking institutions that have factoring products in their portfolio are represented by international bodies:

- Factor Chain International (FCI) is the association that governs the activities of factoring companies and the financing of domestic and international commercial receivables in an open account. FCI was founded in 1968 as a global non-profit association, currently headquartered in Amsterdam. With nearly 400 member companies in over 90 countries, FCI offers a unique cross-border factoring cooperation network. Members' transactions account for

almost 60% of the world's international correspondent factoring volume [21].

- The International Factoring Association (IFA) is another international body that unites factoring companies from 12 countries.
- A number of factors can influence the volume of products granted at the level of financial institutions: Credit rate; High transaction costs; Lack of liquidity of financial institutions; Capital constraints; Financial performance of debtors; Country risk rate; BASEL requirements; AML/ KYC requirements.

From the analysis carried out by the EBRD in the 37 countries, it can be seen that the uniformity of the application of the international rules governing factoring and debt assignment is important.

In 70% of the responding countries there are rules to regulate factoring operations (that is, in 26 of the 37 countries), there are capital limits for carrying out financial activities, there is a national body that supervises factoring operations. In 22 of the 37 countries (60%) of factoring companies need an operating license (Table 1).

Table 1. Regulation on factoring operations

Country	Regulated factoring industry	License needed to operate	No capital adequacy requirements	Factoring companies are supervised
Albania				
Armenia				
Azerbaijan				
Belarus				
Bosnia and Herzegovina				
Bulgaria				
Croatia				
Cyprus				
Egypt				
Estonia				
Macedonia				
Georgia				
Greece				
Hungary				
Jordan				
Kazakhstan				
Kosovo				
Kyrgyzstan				
Latvia				
Lebanon				
Lithuania				
Moldova				
Mongolia				
Montenegro				
Morocco				
Poland				
Romania				
Russia				
Serbia				
Slovakia				
Slovenia				
Tajikistan				
Tunisia				
Turkey				
Turkmenistan				
Ukraine				
Uzbekistan				
Yes				
No				

Source: [2].

## MATERIALS AND METHODS

The research methodology assumed the use of time series analysis indicators, both absolute indicators and relative indicators. Starting from the level indicators that show the value of the characteristic at a certain moment in time ( $y_i$ ), and which are results from the primary statistical data, all the other analysis indicators of the time series were then calculated, analysed and interpreted: absolute change with fixed base, the absolute change with a chain base. For the chronological (time) series indicators, data statistics obtained after processing can be absolute, relative and average data which, together, they allow the statistical characterization of the development of phenomena studied by

interpreting the objective trend of their development in any given stage [1].

Absolute indicators:

$Y_i$  - the absolute levels of the terms of the series

$\Delta_i/0$  absolute change (absolute increase or decrease) calculated with a fixed base

$\Delta_{i/i-1}$  - absolute change (absolute increase or decrease) calculated with base in chain.

The methodology for calculating the indicators used to characterize a series it is elaborated on the example of the series of time intervals, which

ensure continuity time variation and can be interpreted as an analytical function of time.

$$y_i = f(ti)$$

$y_i$  - the values of the studied variable

$t_i$  = the numerical values of the time variable.

The absolute indicators are expressed in the concrete units in which they it also measures the phenomenon under investigation.

The absolute change with a fixed base allowed us, starting from the same comparison base, to determine the evolution of the phenomenon between different moments of time, according to the following relationship:

$$\Delta_i = y_i - y_1 \quad (1)$$

where:

$y_i$  – level index

$y_1$  – the value of the characteristic  $y$  at a moment in time.

The absolute change with the base in the chain allowed us to compare each phenomenon in relation to the previous year, using the following formula:

$$\Delta_{i/i-1} = y_i - y_{i-1} \quad (2)$$

where:

$y_i$  – level index

$y_{i-1}$  – the value of the characteristic  $y$  at a moment in time.

The dynamics index with a fixed basis was used in the case of the terms of the time series compared with a single basis, being calculated as follows:

$$\Delta_{i/1} = y_i/y_1 \quad (3) [1]$$

Fixed base growth rate  $x$  is a ratio of fixed base growth  $x$  of each period and year level chosen as a base. It is denoted by  $R_{i/0}$  and is de the rule expressed as percentages.

The pace of the dynamics allowed us to quantify the change relative to the value we used as the basis for comparisons, being calculated as follows:

$$R_{y/0} = \frac{y_i - y_0}{y_0} \quad (4) [1]$$

## RESULTS AND DISCUSSIONS

The analyzed period included the time period 2009-2021.

The data provided by FCI and the Romanian Factoring Association show that factoring products are increasingly being accessed by companies. The volume of receivables assigned to factoring companies, banks or financial institutions, globally and nationally is increasing [9-20].

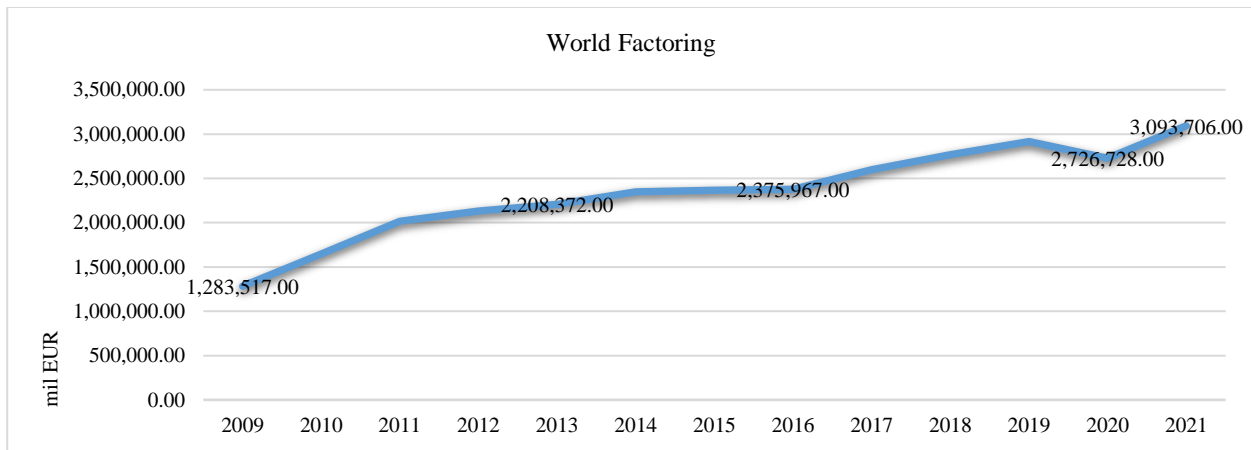


Fig. 2. The evolution of factoring  
 Source: Own processing, FCI [9-20].

The data (Figure 2 and Figure 4) show that international factoring volumes steadily increased between 2009 and 2019 with the important growth in 2010 and 2011. In 2020 the world factoring business was slowly decreased, due to pandemic's influence on the global economic environment. In 2021, the volume of financing through factoring increases again. The volume of the "Top Ten" FCI Members' Total Factoring volume by Country/Territory accounts for 88% of the total, China leading the way with 26%,

followed by Spain (14%), Italy (13%), France (9%), United Kingdom (7%), Japan, USA, Germany, and Taiwan with 4% each and Poland (3%) [8-19].

In 2021, at the level of FCI members, the main clients using factoring are represented by SMEs (44%). Small companies represent 26%, and corporations 30% [8-19].

The industries that access factoring remain the traditional ones, even if technology and digitization are becoming more and more present (Figure 3).

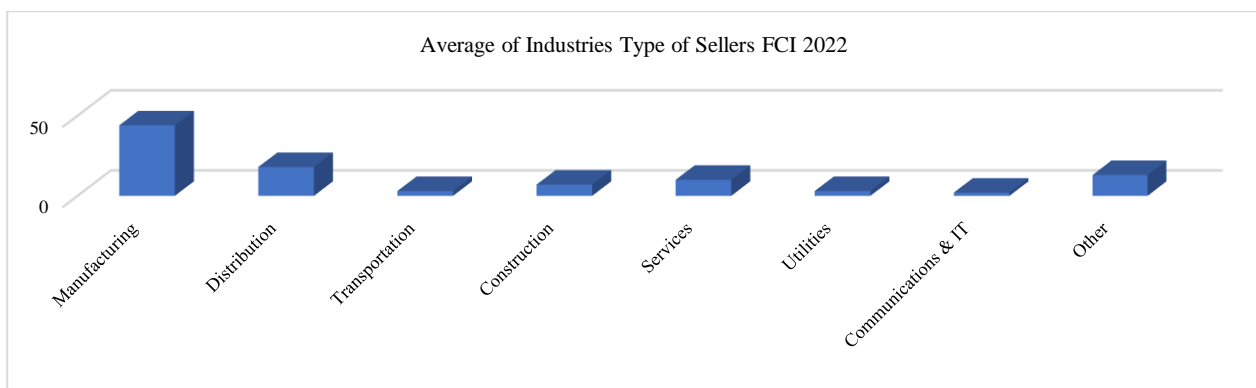


Fig. 3. Average of Industries Type of Sellers FCI 2022  
 Source: FCI [9-20].



Thus, it can be seen that Manufacturing, Distribution, Other categories of activities and Services are on the first places, otherwise

respecting the same structure of businesses registered at the global level.

Table 2. Evolution of World Factoring

Evolution of World Factoring Products (mil EUR)	2015	2016	2017	2018	2019	2020	2021
Invoice Discounting	310,313.00	333,544.00	333,544.00	266,606.00	263,236.00	189,095.00	192,244.00
Recourse Factoring	301,948.00	236,611.00	231,270.00	245,583.00	191,167.00	143,882.00	138,914.00
Non-Recourse Factoring	434,456.00	481,172.00	478,640.00	482,885.00	474,564.00	494,366.00	554,512.00
Reverse			50.01	89,482.00	139,358.00	76,305.00	151,344.00
Total Domestic Factoring FCI	1,104,441.00	1,098,800.00	1,104,058.00	1,141,741.00	1,122,019.00	953,682.00	1,107,887.00
Export Factoring	261,211.00	256,551.00	292,408.00	211,195.00	216,721.00	15,899.00	139,332.00
Import Factoring	66,612.00	63,441.00	55.46	31.72	28.46	18,095.00	21,753.00
Total International Factoring FCI	424,697.00	428,035.00	458,469.00	310.12	298,727.00	217,249.00	216,841.00
Grand Total FCI	1,529,138.00	1,526,836.00	1,562,527.00	1,451,861.00	1,420,746.00	1,170,931.00	1,324,731.00
World Domestic Factoring	1,838,366.00	1,868,855.00	2,078,758.00	2,244,214.00	2,375,406.00	2,206,000.00	2,496,438.00
World International Factoring	529,371.00	507,112.00	519.54	522,852.00	541,699.00	520,728.00	597,268.00
World Total	2,367,745.00	2,375,967.00	2,598,298.00	2,767,067.00	2,917,105.00	2,726,728.00	3,093,706.00

Source FCI [9-20]

The evolution of factoring products in Romania (Figure 4) is in the same ascending manner as the international one. The volumes

declared by Romanian Association of Factoring (RAF) demonstrate this evolution.

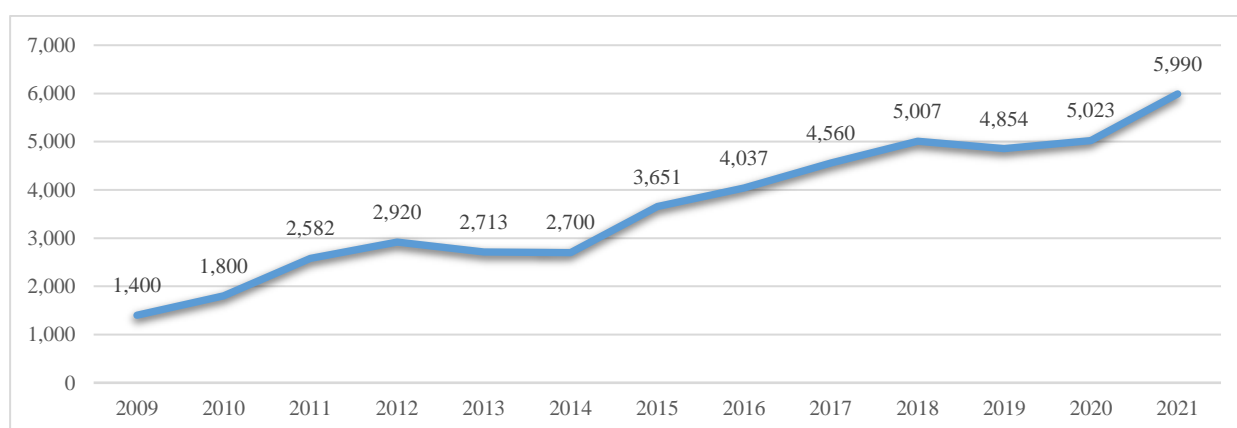


Fig. 4. The evolution of factoring in Romania  
 Source: Own processing, FCI [9-20].

Compared to 2009, the value of factoring products increased in 2021 by 4.27 times. However, the highest growth rates from one year to another were recorded in 2010 and

2011, which were 29% and 42%, respectively. The next rate of growth was recorded in 2021 when compared to 2020 the increase was 19%. It is also noted that there have been

periods of decline in the rate of use of factoring (in 2013, the decrease compared to the previous year was 7% or in 2019 when the

decrease compared to 2018 was 3%) (Figure 5).

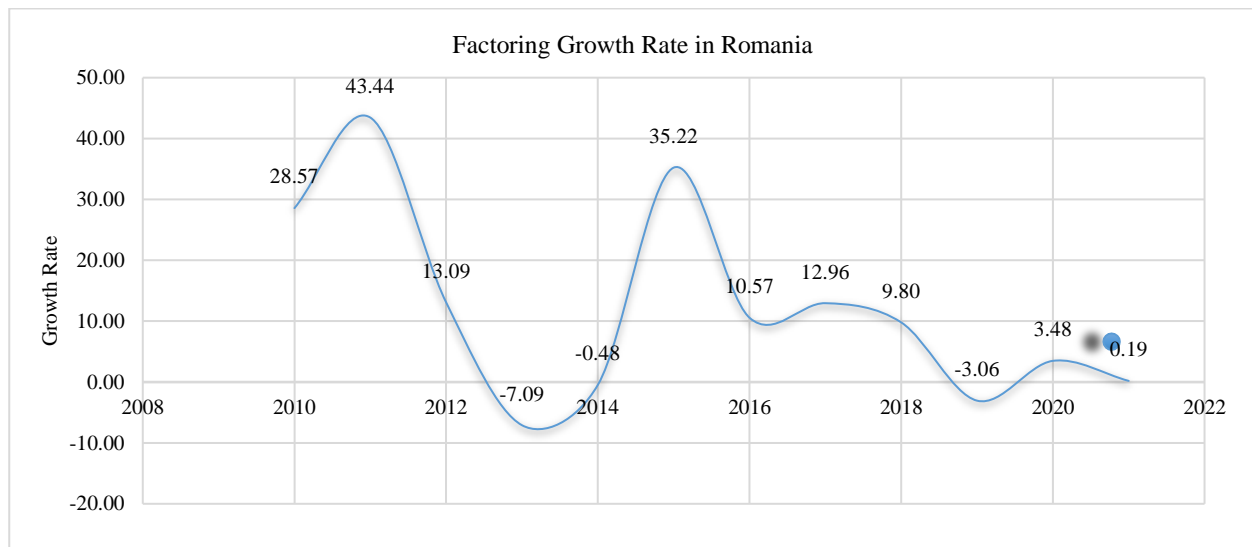


Fig. 5. Factoring Growth Rate in Romania  
 Source: Own processing: FCI [9-20].

The factoring market in Romania experienced steady growth during the period under consideration (Figure 5), with factoring volumes increasing every year except for 2013 and 2019. The highest growth rates were recorded between 2010 and 2012, and in 2015 and 2016, indicating an increasing demand for factoring services during these periods.

In 2021, the best represented sector of activity is represented by FMCG, with a weight of 19.5% and a total volume of 592.5 million euros, followed by the field generically titled "metals, chemicals, water, recycling", with a total value of receivables 527 million euros and a share of 17% in the total market, followed by the "vehicles, machines, equipment" sector, with a share of 14%, the Electronics, IT&C sector with a volume of 392 million euros, the share being 13% [30].

The companies in their turn became more responsible, they started to think much better about their investment strategy or making investments [23].

## CONCLUSIONS

Internationally, there is a growing interest in factoring products. Small and medium-sized companies can access short-term financing much more easily by assigning or transferring

certain liquid and payable receivables to factoring companies (banking or non-banking financial institutions).

As regards the Factor, the one who takes the risk of non-payment, there is an increase in prudence in assessing the creditworthiness of debtors in unstable economic conditions determined by the pandemic and political factors [26]. In the 2020-2021 period from the point of view of risk, the factoring companies have adopted management measures for the existing portfolio, the appetite for new business being less than in previous years. The factoring market in Romania is also maturing, which could lead to further growth in the coming years as businesses become more aware of factoring services and Factors become more willing to provide such services in the country.

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