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Factoring Services – Practical Way To Overcome Working Capital Problem Faced By Unaided Educational Institutions

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ABSTRACT

Higher education is an area of strategic importance for a country like India with huge share of youth population. Role of private educational institution is critical in meeting the demand for higher education. Institutions face typical cash flow problem in the form of working capital gap due to late realization of fees and as a result staff and eventually students suffer. While there are standard solutions like cash credit for financing the working capital gap they come with their own set of limitations. In such a situation, factoring service can be very handy for the educational institutions. It is much easier to initialize and operate as compared to a loan. With little bit of support from the factoring agencies, educational institutions and the Government, it would not be difficult to resolve the working capital problem.

KEYWORDS : Banks, Cash Credit, Educational Institutions, Factoring

Factoring services – Practical way to overcome working capital problem faced by Unaided Educational Institutions

Introduction –

With the Government suffering from serious funding constraints, private unaided educational institutions have assumed significance. According to Anand Sudarshan and Sandhya Subraminan (2012), over last two decades, a rapidly growing Indian economy has led to a huge demand for an educated and skilled labor force. To meet the manpower needs of a dynamic economy, not surprisingly, private enterprises have cropped up to complement public educational institutions, plagued as they are by capacity constraints. In fact, over the past few decades, it has been the private sector that has really driven capacity-creation in Indian higher education. Private presence in higher education got a fillip starting the mid-1980s, coinciding with the reducing investment by Government of India (GoI) and the states. Two prominent categories of private educational institutions are aided and un-aided. Aided institutions are those that receive funding from the Government whereas un-aided are those that don't receive funding from the Government. There are some Trusts that run educational institutions that fetch Government grants. However, of late most of the Trusts manage educational institutions that are permanently unaided types. Further there are Trusts who have a bunch of educational institutions, some of which are aided and some are non-aided. Share of private un-aided educational institutions is much bigger as compared to private aided institutions. There is another category in the type of private educational institution – fully autonomous. Most of the private un-aided institutes in India are affiliated to some or other Government universities or agency. However there are some institutions that are absolutely autonomous and have no recognition from the Government.

Working Capital problem faced by Unaided Educational Institutions –

As per news in The Indian Express (March, 2013), private college staff runs without pay for months together. Report of research agency India Ratings and Research Private Limited (2014), corroborates the Indian Express news. The research agency report says - "Even though the fee reimbursements scheme (applicable only to Higher Education) propelled enrolments and made education affordable to certain educationally disadvantaged sections of the society, delays in reimbursements by a few states tightened the liquidity for education institutes". It is a matter of common knowledge that a number of private colleges face this problem typically at the end of the academic year when the fee collections either dry-up or are delayed. One peculiar reason is the delay in receipt of scholarship from the Governments Department of Social Welfare. Since more than 25% of the fees are received from the Government by way of scholarship as a part of reimbursement of fees of category students, delay in receipt of such fees create working capital gap. The typical cash flow pattern and the working capital gap is a classical phenomenon peculiar to any seasonal business activity. Cash Inflows are concentrated at the start of the academic year at the time of new admissions. Outflows like salaries, electricity, telephone, water etc are generally fixed costs that are required to be paid every month. As the institutions start approaching 2nd half of the academic year (January to June), there resources dry up and the cash flows move into the deficit zone. This situation is particularly experienced, when the scholarships to be received from the Government for category students get delayed and a working capital gap is created. Educational institutions typically borrow against fixed deposit receipts or break such deposits to meet the working capital crunch. However, this amount on most of the occasions is inadequate to take care of funds requirements of more than a couple of months. As a result several institutions including those of repute are unable to pay their salaries for months together as has been reported in Indian Express dated 27th March, 2013. Due to this problem, educational institutions are not able to attract and retain good staff. Staff in the lower pay category is often the worst hit. Particularly when the salaries are not paid in the months like June when the staff have to pay fees for admissions of their children, they suffer badly. Thus, due to absence of working capital facility like cash credit or a solution like factoring service, lot of operational funding problems are required to be faced.

Factoring Solution –

a. *Nature and scope –*

Specialized services like Factoring can play an active role in not only just financing the receivables but managing the entire fee receivables management portfolio. The nature and operation of factoring is explained below -

- Factoring is a continuing arrangement between a financial intermediary known as the factor and a business concern (the client) whereby the factor purchases the clients accounts receivables/book debts with or without recourse to the client

- In simple words, factoring is a collection and finance service designed to improve the client's (sellers) cash flow by turning his credit sales invoices into ready cash

- A factor, besides purchase of receivables, may provide a wider range of services like –

➢ Credit management

➢ Arrangement for collection of debts

➢ Administration of sales ledger

- Types of factoring

➢ Recourse factoring

- Non-recourse factoring
- Advance and maturity factoring
- Old line factoring
- International factoring
- Invoice Discount

- Factoring charges are of two types –

- Finance charge
- Service Fee

- Popular factoring service providers in India – SBI Factors, Canbank Factors

b. *Modus operandi of the factoring mechanism with reference to unaided educational institutions –*

The factoring mechanism can be implemented through the following steps –

- Institution enrolls the students
- Institution assigns fee receivable to factor
- Factor makes prepayment up to 80%
- Monthly statement of accounts sent to institution and follow-up done
- Student / Government make's payment to factor
- Factor makes balance 20% payment on realization

c. *Advantages of factoring for unaided educational institutions –*

In absence of support from banks in the form of standard working capital facilities like cash credit due to tough credit standards, a service like factoring can still help the educational institution to augment its working capital requirement.

Factoring not being a loan is much simpler to initiate and operate. A standard working capital facility like cash credit on the other hand attracts all the complexities associated with loans. Appraisal process, sanction, permission from legal authorities like Charity Commissioner, mortgage etc are the typical tedious, time-consuming and complicated procedures that are required to be undertaken in respect of a loan.

The educational institutions can concentrate on academics rather than an administrative task of collecting fees. Smaller educational institutions might not be well-equipped to handle the task of receivables management. One needs to have a reasonable system support to manage huge student's databases. Lapses can hamper cash flows which in turn affect's critical aspects like payment of salaries and expenses on time. Factoring agencies on the other hand because of their specialization are experts in receivables management.

d. *Practical implementation* – For successful implementation of factoring facility at educational institutions, support is required from factoring agencies, educational institutions and the Government. Agencies in the first place should come out with an awareness campaign about this service. Financing receivables of educational institutions can be a very big business for the agencies as the working capital problems is a typical cash flow problem faced by a number of educational institutions. At the same time, institutions should look at factoring as a good opportunity of solving the working capital problem. It is a simpler and faster alternative to bank finance like cash credit. Government also should come forward and act as a facilitator. Really speaking it should not have any objection to the scholarships being reimbursed to the factor instead of the institution. Adequate checks and balances can be easily built-in to make the process full-proof. Small support from students would also be required by way of sharing the costs. However, when the cost is distributed over thousands of students, burden per student would not be much.

Conclusion –

Joint efforts on the part of the factoring agency, educational institution and the Government can go a long way in resolving the recurring cash flow problem faced by educational institutions at the end of the academic year. Regular and timely salary payment is a basic requirement to attract and retain good teaching staff. Educational institutions committed to quality education in their own interest will definitely have to take steps to overcome the working capital problem. While there are facilities like cash credit those are not easy to obtain. On the other hand factoring service is simpler and faster. Thus, factoring solution is expected to overcome a major cash flow problem faced by unaided educational institutions. This in turn is expected to result in quality staff and the ultimate beneficiary would be the students at large.

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