

A Study on Supplier Finance Required in Maintaining Active Working Capital Level of Customers: An Example from IDLC Financing Company in Bangladesh

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Received: 8 December 2013 Accepted: 5 January 2014 Published: 15 January 2014

Abstract

Factoring is a simple form of Commercial Finance in which a Small Business which can't qualify for more conventional financing sells its accounts receivable (invoices), representing money due from its business/governmental customers for the sale of its goods and services to a ?Factor? or Factoring company at a discount from face value so that it does not have to wait the normal 30-90 days for its invoices to be paid. In short, Factoring helps a Small Business Speed Up its Cash Flow, thereby enabling it to more readily pay its current obligations and grow. Some people defined factoring as the purchasing of accounts receivable, in the form of invoices, at a discount from their face value. The term ?Factor? has its origin from the Latin word ?facere? meaning to make or do (to get things done). The dictionary defines a Factor as an agent, particularly a mercantile agent. Factoring has a long and fascinating history, which traces back through several centuries. In the early stages, Factors were itinerant merchants who were entrusted with merchandise belonging to others.

Index terms— supplier financing, factoring, supplier loan, customer performance, effective guarantor, active working capital management.

1 Introduction

he growth of factoring, in a fairly recognizable form, took place in the fifteenth and sixteenth centuries, with the advent of the period of exploration and colonization by Great Britain. When the mother countries started shipping goods in ever increasing quantities to the settlements under their control in foreign lands, the Factors arranged for the sale and distribution of these goods and became the local representatives of the manufacturers and merchants from the mother country. Initially, they maintained extensive storage facilities to the merchandise received by them from abroad and made arrangements for the cartage of such merchandise to customers throughout their respective territories; the Factor's principal function then was to sell such merchandise on the best terms. The Factors did not own the merchandise but were responsible for its safekeeping, as well as for the proceeds they received upon its sale. In course of time, the Factors prospered and grew in economic strength. To the earlier services rendered to their foreign principals, they added the practice of making advance payments to their principals against the security of the merchandise in their possession. The Factors also obtained information relating to local customers and assumed the risk of losses (in case they were unable to collect the amounts owing from such customers). Thus, the Factor substituted itself as a debtor of high credit standing for any individual customers of uncertain credit worthiness.

During the later years of the nineteenth century and the early years of the present century, the storage, selling and general merchandising functions performed by the Factors were gradually replaced by financing, credit and collection functions which were found to be of greater value by their various clients.

5 PURPOSE OF THE STUDY

Around the turn of the last century, factoring was also extended to domestic sales and at the same time the role of Factors in international trade became less important. Those Factors who offered financial services came to be known as 'del credere' Factors. Their services involved advancing money on the security of accounts receivable, collecting the debts, and assuming the credit risk. As the actors shed the role of merchandise agents and took on 'del credere' responsibilities, the relationship between the Factors and the parties with whom they dealt also changed in as much as it was no longer one of principal and agent but one of an independent financial organization offering services to manufacturing concerns which were known as 'clients'.

Factors in the U.S.A. have traditionally operated in textile industry and have gradually extended to apparel industry, as also some consumer goods industries. The Factors there rely on their in-depth knowledge of the practices and position of the concerned industries and have been slow to move into new fields. They have also built up, over a period, comprehensive information about credit worthiness, up-to-date financial position, record of dealings, etc., of thousands of sellers/buyers in these industries, which forms the basis for approval of credit limits of various parties. Services rendered by a Factor are tailored to suit the clients' requirements. To some of the clients, the Factors provide only such services as management of sales ledgers, collection of debts and protection against bad debts, without providing any finance.

In the absence of any uniform codified law, the term factoring has been defined in various countries in different ways depending on the discretion of legal framework as well as trade usage and convention of the individual country. Many efforts have been made to arrive at a consensus regarding uniform meaning and defining a well laid scope for such a type of service contract.

However, the first attempt was made in the USA to define the term 'factoring' in a more organized and systematic manner. The definition given by the US laws is as follows:

A continuing arrangement between a factoring concern and the seller of goods or services on open account, pursuant to which the factor performs the following services with respect to the accounts receivable arising from sales of such goods or services: ? Purchases all accounts receivable for immediate cash; ? Maintains the sales ledgers and performs the other book-keeping duties relating to such accounts receivable; ? Collects the accounts receivable; ? Assumes the losses, which may arise from any customer's financial inability to pay (Credit loss) ? Provides further funds on a seasonal and term basis, which are either unsecured or secured, ? Assists in advisory services, marketing surveys, management and production counseling, and data processing services. Westlake (1975, P-1) defined, "Factoring is a device of transforming a nonproductive, inactive asset (i.e. book debts) into a productive asset (i.e. cash) by selling book debts (receivables) to a company that specializes in book debt collection and administration".

Kalyanasundaram Committee (1988), in the report submitted to the RBI defines Factoring as the outright purchase of credit approved accounts receivable with the factor assuming bad debt losses"

A more descriptive definition of factoring is that it is a financing tool that provides the business with immediate working capital, without creating debt or forcing to give up equity in the company.

In another way, Factoring is a process of invoice discounting by which an external Financing/Leasing/Capital market agency purchases all trade debts, offers additional resources to the corporate account and, in turn, takes upon the recovery of trade dues.

Factoring is said to be a continuing legal relationship between a financial institution (the Factor) and a business concern (the client) selling goods or providing services to trade customers (the customers) on open account basis whereby the Factor purchases the client's book debts (account receivables) either with or without recourse to the client and in relation thereto controls the credit extended to customers and administers the sales ledgers.

Factoring a sort of suppliers' credit is understood by the services an agent renders to its principals by managing the letters sales ledger realizing the book debts of bills receivables against a predetermined commission known as commercial charges. For example, the manufacturer or trader sells the goods directly or through agent and advises the details of the sale to the factor to realize the credits. Thus, the factors responsibility is contractual with the privates of contract with the seller. Depending upon the terms of the contract, the factor may assume risk for nonpayment by the customer also. The need for factor services is felt in view of expending sales by the manufacturer supplier so as to manage the sales realization by minimizing risk for non-realization and without waiting for realization of book debts, thus reducing dependence upon bank credit for working capital requirements.

2 II.

3 Statement of the Problem

How customer's performance influence the supplier finance loan through effective guarantor's to keep their working capital active.

4 III.

5 Purpose of the Study

? To find out the impact of positive customer performance on active working capital. ? To determine the customer performance level to keep active the working capital. ? To find out the role of effective guarantor in order to minimize credit risk.

6 Literature Review a) Supplier Finance Loan

Supplier finance loan is also known as accounts receivable financing or factoring might be an option for suppliers depending on their industry and the nature of their business.

Accounts receivable financing involves borrowing against your receivables or selling your receivables to a company that will pay you an amount equivalent to the invoice amount due you, less a discount. The amount of the discount varies depending on the size of the transaction, the extent of risk that the financing company (sometimes called a "factor") has to take to collect the amount due, and other matters. You'd get more for an invoice payable by a blue chip company that's due soon versus one that's, say, 90 days past due from a weaker payor.

Factoring your accounts receivables means that you actually sell them, as opposed to pledging them as collateral, to a factoring company. The factoring company gives you an advance payment for accounts you would have to wait on for payment. The advance payment is usually 70-90% of the total value of the receivables. After charging a small fee to the company, usually 2-3%, the remaining balance is paid after the full balance is paid to the factor.

Factoring is a relatively expensive source of financing, but the cost is lowered because the factoring company takes on all risk of default by the customer. Factoring is important in the retail industry in the U.S. In fact, the garment industry accounts for about 80% of all U.S. factoring, although many small businesses in a huge variety of industries use this form of financing when they need short-term working capital loans.

Sometimes, using accounts receivable financing is all that stands between your small business and bankruptcy, particularly during a recession or other types of tough times for your business. Don't hesitate to use it for your working capital needs if you need to. It is not acceptable financing, however, for longer term business financing needs.

Need cash? Consider selling your accounts receivable. While approaching a lender is the most common way to raise capital, it's not always the best or most viable solution for a small business. If a bank loan isn't an option for your business, factoring can help.

Factoring is the purchase of a business' accounts receivable. Large corporations have long used this method to increase cash and reduce the management of receivables, but it is now becoming a popular option for small businesses, as well, said (Dave Kurrasch), vice president and general manager of Small Business Payments Company, which develops financial solutions for small businesses. (AccountsReceivableFinancing.com).

Factoring is an alternative to asset-based lending and provides businesses with capital when they need it. It is particularly appealing for businesses that need cash, but have limited sources of credit, he said. "Factoring is a fantastic method to convert inventory or work product into cash to pay vendors, payrolls, taxes or other obligations. (Businessnewsdaily.com) Moreover, because factoring rids small businesses of receivables, it allows them to reduce or completely eliminate collections. "Managing the working capital conversion cycle is crucial for businesses that produce receivables with long collection terms," (Kurrasch) added. "Factoring is a real option for shortening or eliminating collection times."

Factoring has been around at least 500 years, says (Dan Casey). He notes that it involves the: "Process of selling your rights to collect an invoice.

The factor/invoice buyer pays a high percentage of the invoice face value day one. Upon collection, the factor funds the balance of the invoice value less their fees for service. "So with these types of services, you can either borrow against the money you expect to come in soon, or sell the invoice itself at a discount. The net effect in either case is that you get a lot of money a lot sooner.

(Robert Zadek), attorney with (Buchalter Nemer), focuses his practice on factoring. "There's no downside, per se. Like any other product or service you buy in the world, you try to get the best service and best product for the lowest cost," (Zadek) said.

Factoring offers small businesses an alternative to taking out a bank loan, he said.

"If the bank would lend to you, you wouldn't be in factoring. But there are many businesses that don't go to a bank, even if they can. Getting money from a factor is so easy, as long as you're honest with a factor. You don't live in fear of losing your money. There are plenty of factors that can work with you. You're not locked in like you are with a bank," (Zadek) said.

7 b) Benefits of Accounts Receivable Financing

The primary benefit to these financing services is to help small businesses get cash quickly.

It's particularly useful for businesses that get paid large invoices by clients that may pay slowly for one reason or another (such as large corporate clients, or when part of a large multi-phase government contract). Yet, in the interim that small business still has a payroll to meet -putting the business in a cash flow bind. Accounts receivable financing can also help free up working capital. Because so many businesses have funds tied up in inventory, getting paid for invoices quickly is paramount. Getting financing takes that worry out of the equation for small businesses. Factoring, where you actually sell the invoice outright and the factor takes over collection,

can take away the headache of chasing down payments from clients. That alone can save a small business time and money in the form of internal staff resources dedicated to follow-up and collection.

8 c) Customer Performance

More and more businesses are relying upon suppliers to innovate faster, cheaper, and better than the suppliers of its competitors. But, most firms do not routinely evaluate the need to overhaul relationships or intervene to correct performance problems (Ernst and Bamford 2005). Even fewer firms have an adequate understanding of these reciprocating relationships between the buyer and the supplier. Thus, coordinating with trading partners, negotiating terms, monitoring performance, and switching partners is costly (Liker and

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Choi 2004, Hagel and Brown 2005). Alternatively, identifying resilient performance for each dyad member can provide new performance prescriptions for each member during the supplier evaluation process. When firms make sourcing decisions, they should take into account both supplier performance and buyer performance in the relationship as a behaving system by considering exchange cost criteria, technology-based information sharing criteria, order fulfillment and quality criteria, and demand planning criteria. Each of these criteria is directly observable and relates to the performance contribution of both the buyer and the supplier. Buyer and supplier performance examination is of consequence because these relationships enable entry into new markets, provide for deeper penetration into current markets for both suppliers and buyers, and reduce the risk of supplier failure. The present study extends traditional models and approaches to supplier evaluation into the dyadic domain. Our context is post performance supplier evaluation. Using DEA with assurance region formulations, we include and then investigate the effects of buyer performance on supplier performance. To do this, the hybrid DEA approach used focuses on the buyer evaluation team's preference weights for a set of supplier performance factors. These preferences are rooted in the priorities set by different functional areas and are brought to the team evaluation by individuals representing these functional areas. The DEA methodology has a rich 30-year history in the supplier evaluation literature that will be discussed later. However, work that addresses supplier evaluation using performance factors representing both the buyer's behaviour and the supplier's behaviour has yet to materialise. It is within this new paradigm shift that several research issues emerge and, in turn, propositions are formed and analysed.

The analytical foundation addresses the appropriateness of using a DEA approach and its suitability in the dyadic domain. This study contributes to past DEA studies by extending the traditional model formulations to include factors of buyer performance. Buyer performance can and does affect supplier performance, which cannot be adequately evaluated without that inclusion (Frazier and Summers 1984). The measurement of supplier performance has two dimensions: historical supplier performance and the perception of that performance. The buyer forms a perception of historical supplier performance based on its own performance attributes, its selection of supplier performance attributes to measure and track, and on the preference weights that it places on these attributes. A hybrid DEA model is specified and used to assess the impact on supplier evaluation resulting from the degree of conformity/disparity among weights or priorities that a diverse evaluation team might apply. An evaluation team, based on its composition, might represent either a wide ranging or a narrow set of viewpoints on supplier performance attributes. This can often arise due to each evaluator's place and responsibility in the procurement organisational hierarchy. As a result, differences in preferences and importance weights placed on supplier performance attributes can vary significantly from member to member (Sarkis 2000). Alternatively, team members with similar backgrounds and responsibilities in the buying organisation might be expected to reflect consistent preferences and assign weights with less variability. The benefit of assigning either consistent or diverse preference weights on the supplier performance attributes is not the focus here. Rather, we explore the impact that the level of variability in preference weights has on the perception of supplier performance, how supplier performance scores are affected, and how the model weighted the supplier performance factors. Thus, our propositions are presented next.

Recent works emphasised that the buyersupplier dyad is an important key to managing the supply chain. For example, ??Chen and Paulraj (2004) highlighted the importance of dyads and concluded that both supplier performance and buyer performance contribute to overall relationship success. Focusing on both buyer and supplier exemplifies the long-term relational view of inter-organizational competitive advantage (Dyer and Singh 1998); and buying firms are advised to take strategic initiatives that nurture relationships to yield long-run mutual benefits ??Hahn et al. 1990, Gadde andHakansson 1994). On the one hand, it is often assumed that good suppliers are agile enough to adapt to the buyer's changes; good suppliers become candidates for additional business because of the supplier's perceived focused commitment. On the other hand, this same agility can drive a supplier away from a volatile buyer, creating the need for the buyer to consider just how good a customer it has been to its suppliers. The dyadic lens emphasises the specific one-to-one performance relationship that the buyer establishes with each of its many suppliers and can provide a starting point for decision makers to develop

valuable insights into requisite levels of focused commitment from both partners (Swink and Zsidisin 2006). Therefore, focused commitment should be operationalised from a dyadic perspective of supplier performance.

11 d) Effective Guarantor

Personal guarantees remain a grey area for most SMEs mainstream lenders remain cautious about whom they issue funds to, expressing specific reluctance towards seemingly 'high risk' clients wanting to obtain funding for SMEs, the requirement for directors to personally guarantee loan repayments is on the rise. A recent survey, conducted by personal asset lender borrow, found that directors of SMEs are now just as likely to turn to secured loans for funding as they are an extended overdraft facility or unsecured bank loan. Even

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Volume XIV Issue VI Version I Year () C more so, when applying for secured credit, one in ten business owners over the past year used their personal property as security on a loan in order to raise capital for their business and continue trading throughout 2011.

A personal guarantee operates as additional pledge of collateral in conjunction with the initial security for the commercial loan. Should the loan go into arrears, the director(s) will make themselves personally liable to repay the debt which may mean their own high valued assets or even their home is at risk if the company defaults.

So, under what circumstances may they be required?

(Jonathan Newman, Senior Partner at Brightstone Law LLP and Chairman of the AOBP), spoke of the growing need for a personal guarantee. He said: "Lenders take more comfort in issuing commercial loans to businesses if directors personally guarantee the loan. There are many instances where a borrowing company is a single purpose vehicle with no filed accounts or trading history so a personal guarantee is widely considered to be essential in these cases.

"For borrowers, there are significant advantages in sitting behind the corporate veil because it protects their individual assets; however, the covenant is more attractive to lenders if directors are willing to stake their own personal assets on the deal."

The types of assets provided as a guarantee are often unspecified, as (Jonathan) further explained: "Technically a personal guarantee isn't a charge on the Director's home -although it can end up that way once pursued, and can also attach to any high value personal property."

As a result of this vague definition, here lies a significant grey area for the guarantor. If a lender does begin foreclosure proceedings on personal assets and they do not cover the shortfall of the loan's initial security, in some circumstances this could mean that the guarantor's home is at risk of repossession.

Furthermore, the FSA offer very little protection to the guarantor in such instances. Stated within the FSA's online information for smaller firms (Mortgage Conduct of Business rules and related matters: Scope of regulation), the Authority provides the following guidelines for firms obtaining commercial funding: "where an individual customer provides a personal guarantee to a bank covering the liabilities of a limited company, this will not be a regulated mortgage contract. This is true even where the individual's guarantee liability is secured by a first charge over his residential property. This is because we think the bank is not providing credit to an individual. (It may be providing credit to the company, but this doesn't satisfy the definition of a regulated mortgage contract)."

And so, the scope of FSA regulatory protection does not extend to those who provide their homes as collateral for a commercial loan. As an unregulated transaction, there is potential for business owners to be hasty in guaranteeing a loan in order to continue trading in tough economic climates -notably, there is no requirement for a 'cooling off period' as with regulated loans. It is therefore vital that the guarantor is fully aware of their contractual obligations to repay the loan on behalf of the firm.

(Jonathan) highlighted the importance of the guarantor in understanding the gravity of such commitments: "The impact of personal guarantee is very strong for any director as enforcement may lead to bankruptcy, which is a very serious prospect for an individual with widespread commercial interests undertaking sophisticated borrowing. Often guarantors have more to lose than the debt on the single property transaction. Such persons cannot entertain bankruptcy as this will have a dramatic impact on their wider business dealings, not to mention reputational risk."

Yet, this may be considered a worst case scenario as lenders will turn to the principal loan security first and will typically look to the guarantee as a last resort. Lessening the adverse associations, we also spoke to (Hinesh Varsani, Partner at Bellevue Mortlakes Chartered Surveyors), who maintained that personal guarantees are very much commonplace and generally limited to 20 per cent of the debt, reflecting the tensions within the current lending market.

(Hinesh) explained: "Personal guarantees are nearly always unsupported and we are unaware of lenders asking for a charge over a director's own home in order to support the guarantee."

The guarantor is thus given a degree of freedom in choosing which of their assets may be used to cover the shortfall of the loan security. Moreover, the guarantee will only be acted upon as a last resort, which may only be a small percentage of the entire loan facility. Providing a personal guarantee will give lenders an increased confidence and only in a small number of cases will this guarantee be detrimental to personal finances. Responsible

lenders will express due diligence by adequately assessing the individuals personal liability and the ability to repay fully, without this being a significant obstacle should the foreclosure process begin.

A personal guarantee, as a supporting assurance to lenders, can often be a huge advantage for small business looking to obtain finance; however, personal guarantees should only be provided subject to extensive and independent legal advice ensuring the individual is fully aware of the implications.

13 e) Active Working Capital

Working capital structure refers to the elements of WC and it shows which of the possible components is responsible for investment in WC. Working capital structure is encapsulated in the concept of working capital management (WCM), which refers to the

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Volume XIV Issue VI Version I Year () C financing, investment and control of the net current assets within the policy guidelines. WC can be regarded as the lifeblood of the business and its effective provision can do much to ensure the success of the business, while its inefficient management or neglect can lead to the downfall of the enterprise.

In many countries, empirical studies have indicated that small business managers experience problems in raising capital for the development of their businesses. Different studies (e.g., ?olton, 1971; ?ilson, 1979; ?olmes & Kent, 1991; ?inborg, 2000) have frequently referred to the concept of a financial gap to explain why many small businesses face this type of problem. Access to finance has been identified as a key element for SMEs to succeed in their drive to build productive capacity, to compete, to create jobs and to contribute to poverty alleviation in developing countries. Despite their dominant numbers and their importance in job creation, SMEs have traditionally faced difficulty in obtaining formal credit or equity.

Working capital is a significant and important issue during financial decision making because it is a part of the investment in total assets that requires an appropriate financing investment (Bhunia, 2010). Generally, working capital (WC) is financed by a combination of long-term and short-term funds. Longterm sources of funds consist of capital (equity from owners) and long-term debt, which only provide for a relatively small portion of the WC requirement (finance theory dictates that only the permanent portion of WC should be supported by long-term financing ?Gitman, 2000)). This portion is the net WC; that is, the excess of the current assets over the current liabilities. On the other hand, the short-term sources of WCF consist of trade credit, short-term loans, bank overdrafts, tax provisions and other current liabilities that can be used to finance temporary WC needs. Sometimes, a WC deficit exists if the current liabilities exceed the current assets. In such a situation, short-term funds are used to also finance part of the non-current assets and the firm is said to be adopting an aggressive WC policy (Bhattacharya, 2001). No doubt, the easy accessibility of finance is an important factor when selecting the source of financing, but its impact on the risks and returns cannot be ignored ?Gitman, 2000). Thus, the working capital management policies are guidelines that are helpful to direct businesses; the policies aim to manage the current assets, generally cash and cash equivalents, inventories and debtors, and to manage the short-term financing so that the cash flows and returns are acceptable (Kumar, 2010).

The financing preferences of firms are often explained using Myers' (1984) pecking order theory. Although this theory was developed for large, quoted companies, it is equally applicable to small firms. Firms tend to use cash credit as a first choice for financing their WC needs. However, the excessive reliance on the banking system for WCF exerts some pressure on the banks, and a significant portion of their available resources are first channeled to the large firms (Narasimhan & Vijayalakshmi, 1999). Narasimhan and Vijayalakshmi also noted that the long-term sources of funds for WC appear to be dominant in many industries and that cash credit is the next major source for financing WC. Another important dominant source for funding the WC requirement is trade credit. Trade credit is usually called a spontaneous source of finance and is normally available as part of the trade terms. Olomi (2008) reported that medium-sized textile firms with limited access to the long-term capital markets tend to rely more heavily on owner financing, trade credit and short-term bank loans to finance their operations.

Working capital is the total of the amounts invested in current assets of the company. Generally, it is assumed that the current liabilities must be met by current assets. Because, maturity date of current assets coincides with maturity date of current liabilities (maximum maturity date is one year). Lack of coincidence between maturity date of current assets and current liabilities leads to liquidity problems of the firms. of course, some of companies may try to secure a part of their current assets through shareholders' rights which is called fixed working capital. Current assets including cash stock, short term investment, claims stock of raw materials and goods, and also current liabilities means accounts and trade bills payable, pre receipts and short term bank credits (Pike and bill, 2006: 337). The working capital management from financial managers' point of view is a simple and clear concept ensuring the firm ability to grasp differences between assets and short-term debts (Yaghob nejad, 2010: 118). Therefore, working capital management is one of the most important problems that firms' managers may face it. Working capital management plays an important role for the firms' maintenance and growth. Working capital management refers to financing methods, investment and control of working capital. In other words, working capital management is practical part of financing which includes all current accounts of firm. Working capital

management relates to adequacy of current assets and risk resulting from current liabilities (Pike and Bill 2006: 338). Working capital management is of particular important due to its impact on risk, returns and shareholders' wealth. Companies by using various strategies related to working capital management can affect the amount of firm's liquidity. These strategies determine their risk level and returns ??Nikoomaram et al, 2004: 8). In other words, firms by using efficient working capital management can facilitate access to different objectives.

Working capital management is an issue in which finance research is scarce. One possible reason behind this fact might relate to the relative ease with which efficient financial markets correct deviations from

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optimal working capital policies. However, in less efficient financial markets, pervasive among emerging economies, working capital management is critical for both firms' performance and survival. The difference in the market's ability for providing immediate assistance to firms might explain the differential consequences on firms' profitability and financial distress. This article explains the fundamentals of working capital management, the importance of its interaction with financial markets, and how this interaction might explain working capital patterns around the world. f) Relationship between Supplier Finance Loan and Active Working Capital

Factoring and commercial financing make the most sense for companies needing an infusion of working capital to produce a steady increase in sales and profit. However, factoring and commercial financing can also give companies that are losing money time to achieve a turnaround. An asset financier can ride a downhill course longer than an unsecured lender and is less reluctant to intervene in such situations; of course, the financier must have confidence in the management and the recovery plan. This assumption of additional risk is, in my opinion, of significant value to the economy because without it many companies, now revitalized, would never have had a second chance.

A basic rule in selecting a factoring and commercial finance source is the same as for selecting an unsecured financing source: know your lender. Since many of the nation's most respected financial institutions are now engaged in secured financing, taking such an approach is not difficult. And banks without their own secured lending departments or affiliates are likely to be able to recommend sources. The larger factoring and commercial finance companies that remain independent of banks usually have strong national reputations. In dealing with smaller independents, many of which serve regional markets, the borrower will find that most of them will provide references and welcome the opportunity to show how they operate. In negotiating the loan, obtaining the services of an attorney familiar with commercial finance contracts is advisable. A number of conditions are usually involved that are very different from those associated with a promissory note. These special conditions include how the prime rate is to be determined (since interest typically is stated as a percentage above prime), the method of interest charges and collection credits, and the termination clause, which is necessarily different for a revolving loan than for a term loan. Inflation is encouraging more businesses than ever before to seek commercial financing. In the past ten years, many businesses have doubled their sales because of inflation alone and have had no corresponding increase in their working capital or borrowing base. In addition, commercial finance has emerged as a key source of funds for acquisitions and buy-outs. It has helped fill the gap created by a weak market for new equity issues. Most of today's acquisitions are for cash, not stock. Secured financing packages can enable the buyer to borrow on the target company's assets to provide key leverage for meeting the purchase price. Also, the revolving portion of such loans can serve as a substitute for capital, making possible a higher return on investment. Thus it seems clear that the need for specialized lenders is increasing. They can look at more than just the financial statements to help smaller companies uncover ways of obtaining working capital.

There is one key component to all business, and that is liquidity, or cash flow. Businesses need cash to operate as well as to generate additional business. Not all businesses have revolving lines of credit from banks to tap if needed. In fact, companies can have a significant amount of accounts receivables from customers, but fall short in the interim on cash liquidity. One very effective solution for companies in a situation like this is factoring. Factoring is a financial transaction whereby a business sells its accounts receivable (i.e., invoices) to a third party (called a factor) at a discount in exchange for immediate money with which to finance continued business. Factoring differs from a bank loan in three main ways. First, the emphasis is on the value of the receivables (essentially a financial asset), not the firm's creditworthiness. Secondly, factoring is not a loan; it is the purchase of a financial asset (the receivables). Finally, a bank loan involves two parties whereas factoring involves three. "When a business person conducts an analysis on whether to raise equity or monetize their debt, they have to weigh what is more costly, and whether they want to give up part of their company, and that's where we see factoring as being very fitting," said James Connor, cofounder & CEO of Acrecent Financial Corp. Acrecent is a privately held financial services company engaged in the financing and leasing of commercial equipment and factoring of commercial accounts receivable in Puerto Rico and the Caribbean. The company was established in July 2003 by Connor and Raúl Cacho, two highly experienced executives from the commercial leasing and lending industries. "Most companies have accounts receivables on their balance sheet, but many, particularly small and midsize companies have no access, or limited access, to working capital facilities or banks, meaning revolving lines of credit. That's where factoring helps a lot because you can monetize receivables," Connor said. "We have customers, who have millions of dollars in receivables, and for reasons other than Business, for

example, someone who may have had poor credit and the banks don't want to lend to him or her, the only option is factoring," Connor said. "In a situation like that, the financial condition of a company is seldom important; what's really important is the quality of the receivables. In most cases, if a company has a poor

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Volume XIV Issue VI Version I Year () C financial situation, the owner is not financially strong, or may have a weakened credit history, factoring works." g) Relationship between Customer Performance and Active Working Capital Suppliers who have customers with better capital market information quality to make better capacity and inventory management decisions, which in turn will manifest in better performance. Specifically, following Patatoukas (2012), supplier's performance is measured using the DuPont profitability framework wherein the return on assets is decomposed into asset turnover and profit margin ratios. Overall, we hypothesize that the customers' capital market information quality is positively associated with the suppliers' return on assets and its components-asset turnover and profit margin ratios. We consider a sample of publicly listed supplier firms in the United States that provide the names of their major customers. The sample consists of 20,411 supplier firm-year observations spanning from 1994 to 2008, and represents 4818 firms.

Consistent with the hypothesis, we find that suppliers' operating performance as measured by return on assets, asset turnover, property, plant and equipment turnover, inventory turnover, profit margin, and gross margin are all positively associated with customers' capital market information quality score, after controlling for supplier and customer characteristics that have been shown to be associated with suppliers' operating performance in prior studies (e.g., see Patatoukas 2012). We find that this positive relation between suppliers' operating performance and customers' capital market information quality is more pronounced for suppliers that are likely to benefit more from customers' improved information quality.

Specifically, the results are stronger for suppliers with high sales volatility, zero-order backlog, customers that are less dependent on them, and shorter business relation with the customers. In addition, we find that suppliers' operating performance is positively associated with the information content of their customers' information events, including management forecasts, analyst forecasts, and earnings announcements and the sensitivity of the suppliers' market reaction to the customers' information events. Finally, to provide confidence on the direction of the information flow from customers to suppliers, we find that the accuracy of the suppliers' management forecast issued after their customers' management forecast is positively related to the accuracy and occurrence of the customers' management forecast. Collectively, these results demonstrate that the customers' capital market information quality has spillover effects in the input market.

Whether you're a distributor or screen printer, adequate cash flow is the heartbeat of your business. Without it, the life-blood of an organization ceases circulating, and fatal cardiac arrest can ensue. Unfortunately, your required cash stream may, at some point, dilute to a trickle, or simply not be robust enough to help fuel the growth you desire. Sure, options exist: Bank loans, borrowing from family and securing private equity are all examples. Still, these traditional avenues may sometimes be inaccessible. Even if they are available, they may not provide the necessary green as quickly as your company needs it. Fortunately, there is an alternative. It is called invoice factoring, and its advantages include getting cash into your coffers expediently. Put simply, invoice factoring involves your business selling accounts receivables to a factoring company for cash. "With factoring, your receivables become real assets," says Mike Bartels, vice president of Riviera Finance, a factoring provider. In an invoicefactoring transaction, a factoring company pays you an advance of, typically, 75% to 80% of the value of the receivables. Then, the firm buying your invoices seeks to collect the full payment on the receivables from your customers. Once payment is obtained, the factoring company pays you the remaining percentage of the receivables you sold them, minus a fee that generally falls between 2% and 4% -and, as may be the case, interest on the cash advance. Proponents of factoring note that this financing option can typically get working capital to companies quicker than bank loans. "We generally can help within a handful of days, usually within the week," says Robert Cable, a Georgia-based principal with Liquid Capital, a factoring company. Beyond providing fast cash, factoring has other advantages that appeal to business owners. "It's off the balance sheet," says Cable. "There is no debt incurred." Factoring can potentially work for a range of companies. They include plucky start-ups that need cash to grow, successful established firms that have surpassed their bank line but need more capital to fuel greater revenue rises, and companies with a less-than-stellar financial history that may not be able to secure financing from a bank. Within the imprinted apparel industry, factoring can have applications. Perhaps you're a small distributorship with a few big clients on payment terms; the cash from those clients isn't immediately forthcoming and you need money quickly. Factoring may be a viable option. Still, you don't have to be in duress to factor. Perhaps you are a screen printer who wants to free up cash to invest in a new automatic press. Factoring can possibly help. "Sometimes," says Bartels, "you just need the cash flow factoring provides to grow your business." Nonetheless, factoring experts point out that it's pivotal to understand the difference between recourse factoring and non-recourse factoring. In the latter, the factoring company assumes the risk; if your customer doesn't pay, the factoring firm eats the loss. In recourse factoring, you are responsible for buying back invoices that aren't paid by your customers after a pre-determined period of time. So, while rates may be lower in recourse factoring, there is less of a risk with non-recourse. -(Christopher Ruvo)

If the factoring customer pays all the charges and interests on right time and keep a healthy communication with the financial institute then the working capital will be active by getting further factoring facilities.

17 h) Relationship between Effective Guarantor and Active

Working Capital

It is a prudent credit manager that attempts to obtain personal guarantees from the principals of an incorporated entity to which credit is being extended. In today's volatile marketplace, the existence of a personal guarantee may provide the only viable basis of collecting outstanding receivables from a corporate obligor experiencing financial difficulty. However, in the final analysis, the effectiveness of a personal guarantee is directly dependent upon the financial capability of the guarantor.

Guarantees can be classified as being both guarantees of payment or collection, and the distinction is important to recognize. A guarantee of payment is a far more effective tool, as it allows a creditor to proceed directly against the guarantor without the necessity of taking any action against the primary obligor. Conversely, in the case of a guarantee of collection, a creditor must first proceed directly against the primary obligor -and only if the debt cannot be collected after the exercise of due diligence can collection commence against the guarantor. Most jurisdictions have defined due diligence as the commencement of legal proceedings against the corporate guarantor -and the result being the obtainment of an uncollectible money judgment. Therefore, when drafting a personal guarantee, a creditor should specify that the guarantee is one of payment.

A personal guarantee creates a greater potential source of recovery for the collection of outstanding receivables. The guarantee, as an effective tool of collection, can be maximized when proper attention in drafting, execution and monitoring is exercised. The credit manager who is able to obtain personal guarantees from the principals of his incorporated customers has established a greater security and financial advantage in the protection and minimization of future debt liability.

Firms require short-term assets or liabilities in order to facilitate production and sales. Those working capital requirements are often incorporated in macroeconomic models designed to study the impact of monetary or fiscal shocks.¹ they are important for the propagation of those shocks since they abet the marginal cost of funds faced by some set of agents in the economy. If firms require working capital in order to acquire variable inputs, a change in the cost of funds faced by firms translates into immediate changes in macroeconomic activity. ² This article investigates the cyclical properties of the three main components of working capital-inventories (raw materials, work-in-process, and finished goods), cash and short-term investments, and trade credit-aggregated across all firms and with special attention to their correlations across time with output. The key objective is to obtain stylized facts. While theory informs what kind of facts are worth examining, the uncovering of stylized facts also serves as an input for the development of new theories.

The discussion above provides a couple of examples of existing theoretical models that motivate the exploration that follows, but the results stand on their own as useful. If the guarantors are strong enough to play an important role in the agreement of borrowing, then it's become quite easy to get the factoring facility and keep the working capital active.

18 V.

The Conceptual Framework VI.

19 Questions

VII.

20 Hypothesis

Hypothesis-1: Ho1: There is no relationship between supplier loan and active working capital.

Ha1: There is a relationship between supplier loan and active working capital.

21 Hypothesis -2:

Ho2: There is no relationship between customer performance and active working capital.

Ha2: There is a relationship between customer performance and active working capital. Q3: Why Effective Guarantor is so important for Active Working Capital.

Ha3: There is a relationship between effective guarantor and active working capital.

22 VIII.

23 The Research Design

Research can be designed in eight (8) categories. These are described below:

a) The Method of Data Collection In Monitoring, researcher observes the activity of the participants. It is a one way method. But my data collection is 'Communication' where I asked many questions to my participants and they choose the best statement from their own. As a researcher, I have limited control over the participants to change their opinion; which is one of the most important characteristics for the data collection method of communication.

24 b) Researcher Control of variables

In Experiment, researcher can control the variables. But in Ex Post Facto Design, they can't. They can report only what ever happened. I also can manipulate the variables. In my research, the dependent variable likes Active Working Capital can be changed by me. So my research could be stated as Experiment.

25 c) Degree of Research Question Crystallization

Between Exploratory Studies and Formal Study, my research design could be categorized as Formal Study. This is because the purpose of my research is not to develop any hypothesis or question for the further future research. The goal of my research is to test the answer the research questions.

26 d) The Purpose of Study

The purpose of the study could be categorized as Descriptive. I am researching on the supplier finance loan users by dividing them into few demographic sections to determine who more motivated based on some specific criterion.

27 e) Participants' Perceptual Awareness

In my research participants are aware of my presence. Before conducting survey, I have explained my identity and the purpose of the research. Among the three perceptions, most appropriate is 'Participants perceive no deviation from everyday routine'.

f) The Time Dimension Time dimension could be categorized as Cross-Sectional Studies and Longitudinal Studies. Cross-Sectional Studies are carried out once and represented a snapshot of one point in time which is very much similar for my research. I will carry out my survey once. That's why the time dimension should be Cross-Sectional Studies for my research.

28 g) The Topical Scope

Case Study place more emphasis on a full contextual analysis of fewer events or conditions and their interrelations. But the topical scope for our research is statistical study because it is designed for breadth rather than depth. I attempt to capture a population's characteristics by making inferences from a sample's characteristics.

h) The Research Environment Among Field Setting, Laboratory Research and Stimulation, my research environment was specified as Field Settings. This is because; I will conduct the survey within an original environment where more existing customers are available.

29 i) Sampling

Sampling refers to the act of selecting a specific number of entries from a large set of data for further analysis. Business research often generates vast quantities of data, especially in market-focused research such as demographics.

30 i. Sample unit

The first and foremost question I have been asked that whom should I to survey. To work on this category, I have to know about the demographic information. I have done some categorization based on which I have decided my sample unit. I will do my survey on supplier finance loan's importance using existing customers.

Age: My target customers might be in the age group of 20-70 or above, they will be existing customers of IDLC Supplier Finance Loan.

Income: My target customers would be young, middle aged or aged people. Therefore their estimated income will be 30,000 to 100,000 tk. or above.

Gender: My target sample unit is male or female consumers that mean young, middle aged or aged corporate peoples.

Location: The respondents are only from Dhaka city. Sample Size: To conduct this research, I chose a number of existing IDLC Supplier finance Customers to whom I did questionnaire survey. As I didn't have that much budget, resource and time, I could effectively do my study with fifty (50) customers.

Procedure: Sample procedure is a very important issue of sampling and data collection. By sample procedure, I decided my sample unit and size and how I should choose them. In this case, I have applied the probability sample procedure. Here, I used my Simple Random sample so that every existing customer has a known and equal chance of selection.

31 j) Instruments

A questionnaire was designed for data collection for each of the 4 variables. There are 16 questions excluding demographic in total for measuring all the variables. Each variable is measured by 4 questions.

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Volume XIV Issue VI Version I Year () C A 5 point likert scale was used in the questionnaire and was distributed to the customers of a Financial Company called IDLC Bangladesh..

In "Appendix B" a sample question is been given.

IX.

34 Data Collection

There are two types of data collection:

? Primary Data: Primary data is collected firsthand through experiments, surveys, questionnaires, focus groups, interviews and taking measurements.

? Secondary Data: Secondary data is readily available and is available to the public through publications, journals and newspapers.

In the context of Bangladeshi people, as researchers I used primary data to examine the research problem and verify hypothesis. The questionnaire was distributed among 50 respondents from IDLC Supplier Finance loan's existing customers. Before giving the questionnaire, the purpose of the study and questions were explained to the respondents so they can easily fill the questionnaire with relevant responses.

X.

36 Data Analysis

37 b) Reliability Analysis

The Reliability testing is done through the Cronbach's Alpha; greater value of Cronbach's Alpha indicates more reliability on the items that used in a range of 0 to 1. For this research SPSS version 17 was being used as the statistical data analysis tool as it offers greater flexibility in data analysis and visualization.

Nunnally (1970) suggested that there are at least four methods of estimating reliability coefficient. One of them is internal consistency. The assumption of internal consistency is that a good scale is comprised of items that are homogenous. Hence, methods concerning internal consistency measure inter-item correlation. A scale is considered to have high internal consistency when its items are highly inter correlated for this suggests that the items are all measuring the same thing (DeVelis, 1991). The most highly recommended measure of internal consistency provided by coefficient alpha () or Cronbach's alpha (1951) as it provides a good reliability estimate in most situations. The value of ? range from 0 to 1. The higher the proximity of the value of ? to 1, the better the reliability. If the value is low, either there are too few items or there is very little commonality among the items (Churchill, 1979). For the early stages of any research, Nunnally (1978) suggested that the reliability of 0.50-0.60 is sufficient, although a coefficient of 0.70 or above is desirable. Calculated Cronbach's Alpha is given below for all the variables with the help of SPSS-17:

In this study, the coefficient alphas for the different constructs were computed using the reliability procedure in SPSS. The Cronbach's Alpha of a variable determine the internal consistency among the items used to measure the variables.

The reliability coefficient of the variable supplier loan has resulted in a Cronbach Alpha 0.751 (given in Appendix Table-16 under reliability analysis), which is very high and very desirable. So, supplier loan is defined 75.1% by the 4 questions under it.

The reliability coefficient of the variable customer performance has resulted in a Cronbach Alpha 0.872 (given in Appendix Table-17 under reliability analysis), which is very high and very desirable. So, customer performance is defined 87.2% by the 4 questions under it.

The reliability coefficient of the variable effective guarantor has resulted in a Cronbach Alpha 0.636 (given in Appendix Table-18 under reliability analysis), which is well enough to accept the result.

The reliability coefficient of the variable active working capital has resulted in a Cronbach Alpha 0.778 (given in Appendix Table-19 under reliability analysis), the value is sufficient. So, active working capital is defined 77.8% by the 4 questions under it.

XI.

39 Hypothesis Testing a) Spearman's Correlation

In Appendix Table-20, $\rho = 0.625$ and $\rho = 0.01 < 0.05$

It is clear from the table that, the value of rho is not equal to zero and the value of alpha is less than 0.05. In this condition, alternative hypothesis (H_a) should be accepted. That mean, there is a relationship between Active Working Capital and Supplier Loan. Two stars (**) specifies that the relationship between the variables is 99% true. The value of P is less than 0.05. In this condition, null hypothesis (H_0) should be rejected. That mean, there is a relationship between Active Working Capital and Supplier Loan. Two stars (**) specifies 99%strong relationship between the variables.

In Appendix Table-24, $r = 0.764$ and Probability, $\rho = .001 < .05$

The value of P is less than 0.05. In this condition, null hypothesis (H0) should be rejected. That mean, there is a relationship between Active Working Capital and Customer Performance. Two stars (**) specifies 99%strong relationship between the two variables.

In AppendixTable-25, $r=0.673$ and Probability, $?=.001<.05$

The value of P is less than 0.05. In this condition, null hypothesis (H0) should be rejected. That mean, there is a relationship between Active Working Capital and Effective Guarantor. Two stars (**) specifies 99%strong relationship between the variables.

40 b) Regression analysis

Appendix Table-26 shows that R Square value $=0.675$ so dependent variable (Active Working Capital) can be explained 67.5% by independent variable (Supplier Loan, Customer Performance and Effective Guarantor).

41 XII.

42 Limitations of the Report

The main problem faced in preparing the report was the inadequacy and lack of availability of required data. This report is an overall view of Factoring Operations of IDLC Finance Limited SME Division and its Importance from customer's perspective. There were some limitations for preparing this report. These barriers, which hinder my work, are as follows:

? Difficulty in accessing latest data of internal operations. ? Non-availability of some preceding and latest data.

? Some information was withheld to retain the confidentiality of the institution. ? I was placed to this department for only 3 months of time and working like a regular employee hindered the opportunity to put the better effort for the study. ? The personnel of the institution are usually busy with their daily activities and routine tasks; therefore interacting with them during their office hours was difficult sometimes. Although most if the officers were very helpful and friendly but as because they have been busy with their works, they could not give much time to light up my knowledge about the institution's activities. ? Lack of paper books, journals and articles sometimes created limitations for me to understand different terms and conditions. ? The policies and manuals of IDLC Finance Limited are of confidential in nature and thus it is difficult to collect the necessary literature and documents within this short time. With all of this limitation I tried my best to make this report as best as possible. So readers are requested to consider these limitations while reading and justifying any part of my study.

43 XIII.

44 Significance of the Study

My study focuses on exactly how to keep working capital active through supplier finance loan, customer performance and effective guarantor. As I did this research, a lot of learning occurs regarding factoring, learning that does not happen during traditional coursework. Through this study business organization will have an idea about the impact of factoring on their working capital. Moreover they will also have knowledge about the relationship between financial institutes and business organizations. Additionally they will know about the applicability of factoring, bill discounting, receivable financing and supplier financing in Bangladesh as a short term loan to keep the working capital active. 2. The Supplier Finance Loan amount provided by IDLC is enough for a supplier. 3. IDLC charges a fair interest and service rate against the loan. 4. IDLC gives their customers enough time to pay all their dues. 7. Customers must pay all the dues against the Supplier Finance Loan in case of buyers default. 11. Customer should chose guarantors who will be able to perform all terms and conditions given by IDLC Finance. 12. Guarantors must pay all the dues against the Supplier Finance Loan in case of both the buyer and supplier default. 1 2 3 4 5

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Active Working Capital 13. Are you happy with the amount of Supplier Finance Loan IDLC provide against the application? 1 2 3 4 5

14. Are you interested in doing farther business with IDLC Finance to keep your working capital active? ¹

²

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Figure 1: Hypothesis - 3



Figure 2: C

Appendix Table-14: In the Cross Tabulation section shows the frequency of income per month in the possession groups mentioned above. In the income group 30,000-40,000, there are 6Proprietors, 2 Directors and 2 Partners. 15 Proprietors, 1 Chairman, 9 Managing Directors, 5 Directors and 7 Partner from the income group 41,000-50,000 tk. In the income group of 51,000-60,000 tk. there are only 2 managing directors and no Proprietor or Partner. Only 1 Managing Director from the income group of 61,000-70,000 tk.

Appendix Table-15: In the Cross Tabulation section shows the frequency of Business Status in the Possession groups mentioned above. There are 21Proprietors from Proprietorship Concern.1 Chairman, 12 Managing Directors and7Directors from Pvt. Ltd. From Partnership Concern there are 9 partners.

Figure 3:

Year

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b) Pearson's Correlation

In Appendix Table-23, $r=0.689$ and Probability, $p=.001<.05$

[Note: C]

Figure 4:

1
Strongly Agree

2 3 4 5
Agree Neutral Disagree Strongly
Disagree

Year

34

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1

2 3 4 5

[Note: A C 2014 © 2014 Global Journals Inc. (US) 1]

Figure 5:

Appendix Table-1: Under Descriptive Analysis, individual criteria of participants have been analyzed to bring about the result in order of their percentages. The survey has been conducted on 50 existing clients of IDLC Supplier Finance, who are enjoying factoring facility for more than one year. The survey results show that, 46 clients were male where only 4 clients were female. If the result is converted to percentage then 92% of the participants were male and 8% were females.

Appendix Table-2: The data in Table ?? shows that, 20% of the customer belonged to the age group 31-40 years. 8% of the participants were of age in the range of 51-60 years. The rest and biggest size of the participants were from the age group of 41-50 years which is 72% of the whole.

Appendix Table-3: Very large portion of the participants participated in this survey falls under the income group of 41,000 to 50,000 tk. which is 74%. Only 2% participants out of 50 clients have an income of 61,000 to 70,000 tk. Another 20% participant's earn 30,000 to 40,000 tk. monthly. Rest 4% earns 51,000 to 60,000 tk. shows the frequency of male/female in the income groups mentioned above. In the income group 30,000-40,000, there are 6 males but 4 females. 37 males and no females belong to the income group 41,000-50,000 tk. 2 male and no female are from income group of 51,000-60,000 tk. Only 1 male was from income group of 61,000-70,000 tk.

1 Appendix

Appendix Table-8: In the Cross Tabulation section shows the frequency of male/female in the business status mentioned above. In Proprietorship concern, there are 21 males but no females. 18 males and 2 females belong to Pvt. Ltd. Company. And only 7 male and 2 female are from Partnership concern. Appendix Table-9: In the Cross Tabulation section shows the frequency of male/female in the possession mentioned above. In proprietorship concern, there are 21 males but no females were as Proprietor. 1 male and no female as Chairman, 12 male and no female as Managing Director and 5 males and 2 females as Director were from Pvt. Ltd. Company. Only 7 male and 2 female were as Partners from different partnership concern.

Appendix Table-10: In the Cross Tabulation section shows the frequency of age in the income groups mentioned above. In the income group 30,000-40,000 tk. there are 8 persons who fall under the age of 31-40 years, 2 persons under 41-50 years. In the income group 41,000-50,000 tk. there are 2 persons who fall under the age of 31-40 years, 32 persons under 41-50 years, 3 persons under 51-60 years. In the income group 51,000-60,000 tk. there are 2 persons under 41-50 years. In the income group 61,000-70,000 tk. only 1 person under 51-60 years.

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