International Journal of Commerce and Management Research
www.managejournal.com
ISSN: 2455-1627
Received: 26-07-2026, Accepted: 25-08-2026, Published: 09-09-2026
Volume 12, Issue 3, 2026, Page No. 312-316

An analysis of factoring services as a financial mechanism for MSMEs

Gajendra M L
Assistant Professor, DONBOSCO College, Chitradurga, Karnataka, India
DOI: https://doi.org/10.66856/ijcmr.2026.12.3.12235

Abstract
In India, Micro, Small, and Medium Enterprises (MSMEs) serve as the primary pillars of the economy, contributing approximately 31.1% to the national GDP. According to data from the Economic Survey 2025–26, the sector has expanded significantly to encompass over 7.47 crore (74.7 million) enterprises, making it the second-largest source of livelihoods after agriculture by employing more than 32.82 crore (328.2 million) individuals. Beyond their staggering economic metrics, MSMEs are crucial drivers of inclusive regional growth, actively fostering employment and accelerating entrepreneurship across rural and semi-urban areas. However, despite their pivotal macroeconomic role, accessing adequate formal finance—particularly for short-term working capital needs—remains one of the most critical structural challenges facing these enterprises.

The alternate solution available to this issue is factoring of accounts receivables in the business. The problem recognised in the study is less application of factoring service by the MSMEs. Hence, the study undertaken to address the issue of financial crunch faced by MSMEs and factoring service available as an alternative solution to it. The study involves quantitative approach and conducted primary survey by interviewing various manufacturing sectors MSMEs in Peenya Industrial Area, Peenya, Bangalore.

The study concluded that factoring is best alternative compared to private borrowings and other methods of raising finance. This is substantiated with the help of alternative cost comparison. The study analysis resulted in proving that MSMEs need alternative financing in the initial years of establishment and factoring is over all beneficial to MSMEs that improves the efficiency. The study suggests suitable recommendations from the findings and concludes that Factoring Service as a major financial tool to MSMEs of manufacturing sector.

Keywords: Cost, MSMEs, Factoring & Finance

Introduction

1. Factoring Service

The lending policy of banks was very rigid and individual financing was out of reach. New Economic policy lead to a lot many reforms in the banking system and most of the contemporary banking services are a result of the LPG reforms. The above mentioned changes in the economy gave rise to “Retail Banking” which was an outcome of the LPG policies. Retail banking was an initiative taken by the public sector financial institutions. Few of the current banking services introduces were Structuring of financial collaborations, heading of risk due to in-charge risk, planning for merger and acquisition, rendering project services management from preparation to project report, managing the portfolio of large public sector corporations, guiding corporate customers in capital structure, factoring, forfeiting, mutual funds, venture capital, issue of debit and credit cards.

1.1 Meaning of Factoring

Factoring is an arrangement under which the factor purchases the book debts of his client and immediately pays the full amount or a significant part of the debt value to the client (for a consideration). Thereafter the factor collects the debt value from the client’s customer (debtor) on the due dates.

1.2 Functions performed by the Factor are:

- Improves the liquidity position of the clients.
- Credit administration – i.e., collection of book debts of the client.
- Credit projection – i.e., protection of the client against the risk of bad debts resulting from book debts of the clients.
- Credit financing – i.e., providing immediate cash to an extent of the debt value to the client and provision of advisory services.

1. Micro, Small & Medium Enterprises (MSMEs)

The “Micro, Small and Medium Enterprise Development Act, 2006 is the first act for micro, small and medium enterprises, filling of memoranda, measure for promotion, development and enhancement of competitiveness to micro and small enterprise. Micro, Small and Medium enterprises as per MSMED Act, 2006 are defined based on their investment in plant and machinery and on equipment for enterprises providing or rendering services (Vasant Desai,2011) [1].

In February 2018, the Union Cabinet approved changes in the basis of classifying Micro, Small and Medium enterprises from ‘investment in plant & machinery/equipment’ to ‘annual turnover’. The objective of the change is to encourage ease of doing business, collection make the norms of classification growth oriented.

Ministry of Micro, Small, and Medium Enterprises presents ceilings on investment and annual turnover for enterprises to be classified as Micro, Small and Medium enterprises as follows;

Table 1: Shows Enterprises to be classified as Micro, Small and Medium Enterprises

Classification		Micro	Small	Medium
Manufacturing Enterprises and Enterprises rendering Services	Investment in Plant and Machinery or Equipment	Not more than Rs.1 crore	Not more than Rs.10 crore	Not more than Rs.50 crore
	Annual Turnover	not more than Rs. 5 crore	not more than Rs. 50 crore	not more than Rs. 250 crore

Source:https://msme.gov.in/know-about-msme#:~:text=Ministry%20of%20Micro%2C%20small%20%26%20Medium%20Enterprises,-What's%20MSME

MSMEs are as important as Large Scale Industries to the country as their contribution towards economy is considerable. One of the major issues faced by MSMEs is financial crunch due to irregular cash flows in the business. There are certain ways and methods to raise finance using the book debts of the business that eases the cash flow in the industry.

Review of Literature

The factoring service acts as a financial tool and helps an organisation to achieve its primary motive i.e. profit and wealth maximisation. The operating activities in a business do not always facilitates for the above said purpose and at such times the business will be pressurised to fetch sources of funds from elsewhere (Michalski, Grzegorz,) [2]. Hence, factoring of receivables is the best available alternative to raise finance as it involves resources available with the business and cuts the extra cost of borrowing a loan. (Aleknaitė, L) [3].The existing financial institutions fail to provide the necessary financial needs of the institutions due to various reasons like the organisation being too minor for huge loan and many other reasons. During those situations, factoring of receivables is the most feasible option that can be availed by the organisations. The factoring service is the sturdy finance available to MSMEs for resolving short term capital issues for working capital needs (Auboin, Marc & et.all) [4]. Theorganisations that have lesser financing capacities, those with not regular cash inflows into the business will be the main targets for factoring companies. The study says that such kind of organizations require the use of factoring service much in number (Hartmann) [5]. In addition, the reverse factoring mechanism provides more benefit (van der Vliet) [6]. And it was substantiated with the relevant analysis which includes payment period extensions, working capital policies, risk free interest rates etc. (Tanrisever & et.all) [7].

1. Statement of Problem

The growth of small industries is being hindered by their financial needs. One of the ways for the MSMEs to raise short-term finance for meeting the working capital requirement is factoring service. However, most of the industries do not prefer factoring due to high charges compared to other financial aids and improper linkage between factoring companies and MSMEs. Through various data sources, it was found that few numbers of studies were conducted on cost analysis of factoring service and its comparison with other financial alternatives (MILLER, C) [8]. Hence, the study is undertaken to make a comparative cost analysis to find out why factoring is not adhered in the manufacturing MSMEs.

2. Objectives and Methodology

Objectives and methodology are standout amongst the most essential stages in carrying out a research. Any research work majorly depends on the objectives and methodology. For the present study, both primary data and secondary data sources were used.

Primary data is used in research originally obtained through questionnaire survey and secondary data were collected from sources like previous surveys, statistical information from magazines, journals, online indices and abstracts, reference works and analysts' reports.

Table 2: Shows Study Objectives, Methods/Methodology and Resource Used

Objective No.	Statement of the Objective	Method/ Methodology	Resource Used
1	To identify methods of mobilising funds for WCM in MSMEs	Secondary data – The data related to WCM collected in journals and articles Primary data – Some data related to WCM is collected from MSMEs through survey	Journals, Articles, books, research papers etc (EBSCO Host database)
2	To analyze the short term borrowing costs for MSMEs	Primary data – Data related to borrowing costs is collected from MSMEs through survey	Survey Questionnaire, SPSS
3	To study the impact of factoring on operating activities cash flow in MSMEs	Secondary data – The data related to working structure of factoring is collected through journals and articles Primary data – Some data related to working structure of factoring is collected from MSMEs through survey	Journals, Articles, books, research papers etc (EBSCO Host database) Survey Questionnaire, SPSS
4	To analyze the opinion about factoring for WCM in MSMEs	Primary data – Data related to opinion on factoring is collected from MSMEs through survey	Survey Questionnaire, SPSS

Source: Author Developed

Analysis and Interpretation

In order to accomplish the study objectives, the collected data analyzed using different statistical tools.

1. Reliability Analysis

The most commonly used measure to test the reliability (consistency) of a research questionnaire is Cronbach's Alpha (α). When the questionnaire consists of multiple Likert questions which formulae a scale, Cronbach's Alpha (α) is the best suitable reliability test that can be applied to the survey.

Table 3: Shows Cronbach's Alpha of study

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
.749	.762	13

Source: Field Survey

2. **Interpretation:** The Cronbach's alpha and the standardized Cronbach's Alpha amounts to 0.749 and 0.762 respectively. Mean, Variance and Cronbach's Alpha was further calculated by deleting one item. The Cronbach's Alpha does not change appreciably and remains above 0.7 throughout. This further confirms that respondent's responses are consistent and reliable.

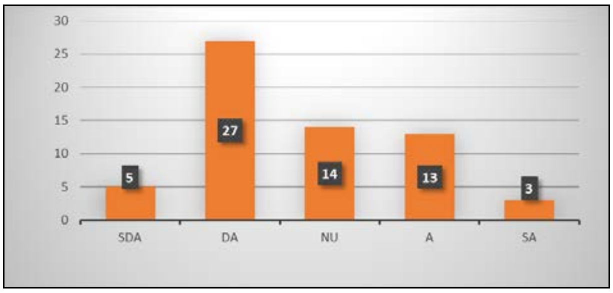
Descriptive Analysis

Descriptive statistics used to describe the basic features of the data collected in a study. They provide simple summaries about the sample. They form basis for every quantitative analysis.

2.1 Opinion on Sufficient cash flow is available for Working Capital Management

Cash flow for WCM	Frequency	%
Strongly Disagree	5	8.1
Disagree	27	43.5
Neutral	14	22.6
Agree	13	21.0
Strongly Agree	3	4.8
Total	62	100.0

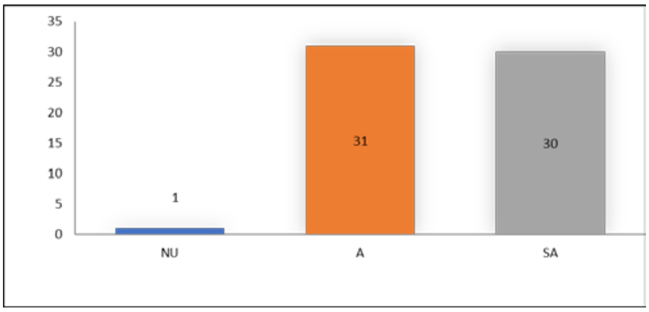
Source: Field Survey



Interpretation: MSMEs were asked to provide their opinion about availability of cash flows for management of working capital. The opinions were analyzed and it is shown that many (51.6%) were unable to manage WCM.

2.2 Opinion about Borrowing Cost Impact on Profits

	Frequency	%
Strongly Disagree	0	0
Disagree	0	0
Neutral	1	1.6
Agree	31	50.0
Strongly Agree	30	48.4
Total	62	100.0



Source: Field Survey

Interpretation: MSMEs were asked to provide opinion about impact of borrowing cost on their business profits. The responses of MSMEs were analyzed and it shows that majority (98.4%) opined that borrowing cost impacts more on business profits.

3. Cost Analysis

Since MSMEs have various alternatives for mobilization of funds to manage their working capital, it is essential to analyse all these alternatives to select the best. One of the major parameter to analyse these alternatives is "Cost of Available Alternatives". Hence, the cost comparison of available liquidity options are shown in the below table 8.

Table 6: Alternative Cost Comparison

Liquidity Option	Amount (in Rs)	Short term Loans	Bill Discounting	Private Borrowings	Co-operative Society	Factoring
Charges (p.a.)		15%	12%	22%	20%	20%
Charges (p.m.)		1.25%	1%	1.83%	1.67%	1.67%
Interest/Charges Payable (p.m.)	10,00,000	1041.67	833.33	1525.00	1391.67	1391.67
Interest/Charges Payable (p.m.)	20,00,000	2083.33	1666.67	3050.00	2783.33	2783.33
Interest/Charges Payable (p.m.)	30,00,000	3125.00	2500.00	4575.00	4175.00	4175.00
Interest/Charges Payable (p.m.)	40,00,000	4166.67	3333.33	6100.00	5566.67	5566.67
Interest/Charges Payable (p.m.)	50,00,000	5208.33	4166.67	7625.00	6958.33	

Source: Author Developed

The above table shows the comparative cost analysis made for the available options to raise finance for short-term working capital in MSMEs. The various options available to raise finance are listed here as shown in the table:

- Short term loans
- Bill discounting
- Private borrowings
- Co-operative Society
- Factoring

The monthly charges for each available option is calculated and shown in the table.

The least charge being bill discounting (1%p.m.) and the highest being private borrowings (1.83%p.m.). The survey result shows that the MSMEs go in for regular borrowings from private lenders (the cost of borrowing remains highest for private lenders).Hence, a comparison of costs is been analysed and proved that factoring service costs lesser than other borrowings to the MSMEs. The above cost analysis shows that factoring cost is less expensive to MSMEs when put into comparison with other borrowings and hence factoring is beneficial to the business.

4. Hypotheses Testing

Hypothesis: 1

H0	Factoring do not facilitates sufficient cash flow (i.e. Working Capital Management) for MSMEs
H1	Factoring facilitates sufficient cash flow (i.e. Working Capital Management) for MSMEs

Source: Author Developed

Table 7: Paired Samples Statistics

		Mean	N	Std. Deviation	Std. Error Mean
Pair 1	Cash flow for WCM	2.71	62	1.046	.133
	Balance in cash flow after factoring	4.32	62	0.566	.072

Source: SPSS Output

Table 8: Paired Samples Statistics

		Mean	N	Std. Deviation	Std. Error Mean
Pair 1	Cash flow for WCM	2.71	62	1.046	.133
	Balance in cash flow after factoring	4.32	62	0.566	.072

Table 9: Paired Samples Test

	Paired Differences					t	df	Sig. (2-tailed)
	Mean	SD	Std. Error Mean	95% Confidence Interval of the Difference				
				Lower	Upper			
Cash flow for WCM - Balance in cash flow after factoring	-1.613	1.219	.155	-1.923	-1.303	-10.415	61	.000

Source: SPSS Output

Interpretation

The variables of cash flow in the business before using factoring and after using factoring is analysed using paired T-test. The significance obtained as results 0.0 as shown in the above table. Hence, the null hypothesis is rejected at 5% level of significance.

The alternate hypothesis to this is "factoring facilitates for sufficient cash flow (for working capital management) in the MSMEs)" is accepted. Therefore, it is proved from the study that factoring eases the cash flow in to the business and hence beneficial to the business.

Note: As the population variance is unknown in the study Z-Test is automatically cancelled and the analysis is conducted by using Paired T-Test as there is comparison to be made between two variables.

Hypothesis 2

H0	Usage of factoring services is not influenced by the year of establishment of the MSME
H2	Usage of factoring services partially influenced by the year of establishment of the MSME

Source: Author Developed

Table 10: Correlations

		Years of Establishment	Not making use of factoring service
Years of Establishment	Pearson Correlation	1	-.755 [**]
	Sig. (2-tailed)		.000
	N	62	62
Not making use factoring service	Pearson Correlation	-.755 [**]	1
	Sig. (2-tailed)	.000	
	N	62	62

Source: SPSS Output

Interpretation

The hypothesis establishes relation between year of establishment and not making use of factoring services and conducted correlation test for the same. The hypothesis says that using of factoring service by the MSME is highly depended on the years of establishment.

The results obtained from the correlation analysis are a negative.75 (-0.75) which shows a strong negative relation exists between the said variables.

The study interprets that as and when the MSME organisation gets older, the requirement and necessity to use factoring service reduces in the organisation.

Study Findings and Recommendations

1. Findings

- Study shows that comparatively a larger number of industries (35%) fall in the average profit earning capacity (i.e., between 10% to 15% p.a.) but they are unable to fetch funds for WCM from those profits which makes large portion of manufacturers (up to 64%) to go for regular loans and borrowings for WCM.
- It was evident from the study results that loans and other source of finance impact more on MSMEs profitability since borrowing cost is high. Therefore, the residual profit earning capacity of the business falls down.
- The study results shows that large portion of MSMEs (84%) are clueless about methods for raising finance using accounts receivables (the only popular method is Bill Discounting).
- The study shows that amongst opined MSMEs who are aware of factoring service, only half (51%) of it make use of the service. The reason listed for avoiding factoring is lack of awareness.
- The study shows that 95% of MSMEs who are using factoring service agreed that their business has seen balance in their cash flows after using factoring. Also

the business is able to make retained earnings and increase their profit earning capacity after using factoring.

- The study shows that factoring fees does not have a negative impact on the business (as mentioned in the existing literatures) and factoring fees is not the major reason to avoid factoring.
- Manufacturers often go in for borrowings from private lenders as it is easier and the lenders are familiar to them. In addition, these borrowings do not have any paper work indulged and hence easier to fetch funds.

2. Suggestions and Recommendations

- For the industries to increase their profit margins, they have to concentrate more on curbing the cost of borrowing expenses so that residual profit margins will increase. Private borrowings are much suitable for long-term loans and hence the industries should concentrate on other options of raising funds for WCM.
- Increasing the usage of banking services will aid the industries to be more profitable in terms of residual profits as the additional borrowing expenditure will be reduced. When banks make an attempt to improve their commercials and ads related to all their services it reaches out to all scale of businesses and hence it would be easy for MSMEs to avail the banking services.
- The MSMEs should make an attempt to widen their views about raising finances and should make an effort to maximum utilize banking services rather than borrowing from private lenders.
- The study gives detailed reports associated to use and benefits of factoring over other means of finances. Also live examples of the ones using factoring motivates non users of factoring to try using factoring for better results in the business
- The study strongly recommends MSMEs to come out of their regular financing means and take up factoring service so that they themselves can find out what the reality exists with reference to factoring and can decide if factoring is favorable to the business or not.

Conclusion

The study concludes that MSMEs can see sustainability and raise their profitability with usage of factoring services. Factoring service acts as an efficient tool/mechanism to improve the progress of MSMEs with reference to their residual profit earning capacity. MSMEs have ample facilities to raise short-term finances and have a minimal profit margin that helps the MSMEs sustain in their market. However, these methods of raising finance do not use the resources available within the business. By making use of these receivables the additional expense of borrowing the funds, making on expenditure on borrowings and time expended on making all the paper works related to loans and borrowings can be condensed.

As factoring becomes a legal procedure when compared to private borrowings, a hesitation would build up among the manufacturers to opt for factoring service. In addition, the wrong notion about highly charged factoring fee is one of the reasons to avoid factoring. The study shows that lack of awareness is the major reason that industries do not make use of factoring service. By making a comparative cost analysis of the available means of raising finance the research is been able to prove that factoring service is beneficial for manufacturing MSMSEs and hence the efficiency of the MSMEs will be amplified.

References

1. Desai V. Small-Scale Industries and Entrepreneurship. 9th ed. Himalaya Publishing House; 2011. ISBN: 978-9350248621.
2. Michalski G. Factoring and the Firm Value. FACTA Universitatis Series: Economics and Organization. 2008;5(1):31-38.
3. Aleknaitė L. Receivables Financing in Lithuania: Is the Legal Regulation Suited to Accommodate the Practical Needs of Industry? Review of Central & East European Law. 2009;34(3):255-285.
4. Auboin M, Smythe H, Teh R. Supply Chain Finance and SMEs: Evidence from International Factoring Data. CESifo Working Paper Series No. 6039. 2016.
5. Hartmann-Wendels T, Stöter A. Accounts Receivable Management and the Factoring Option: Evidence from a Bank-Based Economy. 2012.
6. Tanrisever F, Cetinay H, Reindorp M, Fransoo JC. Reverse Factoring for SME Finance. 2015.
7. van der Vliet K, Reindorp M, Fransoo JC. Improving Service Levels through Reverse Factoring. 2015.
8. Miller C. Factoring can be an option when traditional financing isn't. Hudson Valley Business Journal. 2009;19(10):18.