

## Factoring České spořitelny, a.s.

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# Czech Republic

### Introduction

The Czech economy continued to prosper in 2018 and grew by 2.9 per cent according to the final statement from the Czech Statistical Office. GDP growth rate slowed down from the previous year (4.5 per cent), but this slowdown constitutes a return to what we regard as a long-term sustainable growth rate of about 2.8 per cent. So the 2018 figure should not be interpreted as something negative.

The Czech banking sector, including the factoring industry, substantially benefited from this economic growth. The Czech factoring market grew both in turnover and in the volume of outstanding financing. The six members of the Association of Factoring Companies (AFS) of the Czech Republic achieved a total factoring turnover of EUR6.8 billion (CZK174.3 billion) in 2018, which represents an increase of 11.7 per cent on 2017.

The volume of outstanding financing grew by 11.8 per cent compared with 2017.

The penetration of factoring contracted to 3.3 per cent of the Czech Republic's GDP. This share is still less than half that of neighbouring countries – Austria and Germany – and less than one third of the EU average GDP penetration ratio of about 10.9 per cent. Consequently, the Czech Republic provides plenty of space for factoring to grow in the future.

### Factoring Industry Environment

The relatively weak koruna and the interest rate increases, orchestrated by the Czech National Bank (CNB), were the main macro stories in 2018. After exiting from the CNB FX commitment regime in April 2017, the koruna started to appreciate. This trend, however, came to a halt in February 2018 due to the worsening global sentiment towards Emerging

Markets' currencies (resulting from the US/China trade war and the slowdown in the global economy). In response to inflationary pressures generated by the combination of a weaker currency and an ultra-tight labour market, the CNB interest rates increased five times in 2018 from 0.5 per cent to 1.75 per cent.

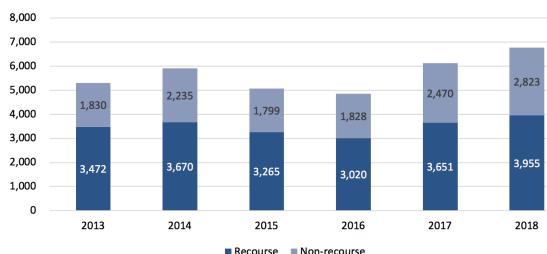
Economic growth, despite the aforementioned slowdown, remained solid in 2018. As in 2017, household and government expenditure contributed positively to the overall growth (the slowdown in the growth of household consumption was compensated for by a significant surge in the growth of government expenditure). The contribution of investments increased in 2018, due to strong fixed capital investments (partly offset by the running down of inventories). The trade balance, which in 2017 made a positive contribution (+1.2 percentage point) was negative in 2018 (-0.7 percentage point), and this change was the key item responsible for the decline in the GDP growth rate. The main cause of this deterioration was a deceleration of exports (primarily due to capacity constraints in the Czech economy) coupled with an acceleration of imports for domestic consumption and investments.

Unemployment rate came in at 2.2 per cent in 2018 while nominal wage growth rose 8.5 per cent. Inflation reached 2.1 per cent (on average) in 2018, compared to 2.5 per cent in 2017. The Czech Republic has the lowest unemployment rate in the EU and the highest job vacancy rate. Labour market shortages are limiting capacity to increase production across all sectors, especially in manufacturing and construction. Mismatches between supply and demand are fuelling rising wages in both the private and public sector.

The average Days Sales Outstanding (DSO) figure in the Czech Republic decreased by two days in 2018 and stands at 44 days. Based on a survey by Atradius

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### Total Factoring Volume (EUR Millions)



### Factoring Products and Services

- Domestic recourse factoring
- Domestic non-recourse factoring
- Export factoring (both recourse and non-recourse)
- Import factoring
- Reverse factoring
- Management and collection of receivables
- Bad debt protection

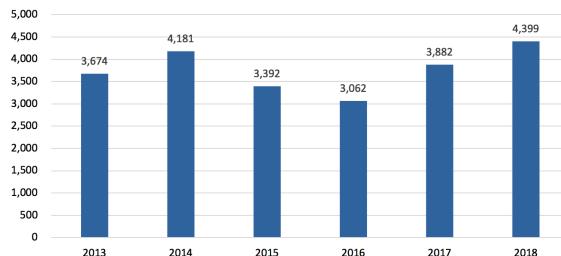
Payments Practices, 89.8 per cent of respondents reported late payments by their B2B customers in 2018. The percentage is stable compared to a year ago. In the year 2018 there was a minor decrease in the proportion of overdue B2B invoices from an average of 36.9 per cent in 2017 to the current 34.1 per cent. There is not much difference in payment delays between domestic and foreign B2B customers. On average late payment among domestic B2B customers is 16 days past the due date (in 2017 it was 15 days), while late payment among foreign B2B customers is 13 days past due (in 2017 it was 17 days). The worst payment discipline remains in the construction and machines sector – on average, these companies settle invoices 15 or 11 days past due date. However, from a long-term point of view, payment discipline has improved and stabilised. Looking at the 12 months ahead, we do not expect to see any changes in payments behaviour by B2B customers.

According to the same survey, e-invoicing is used by the majority of respondents in the Czech Republic. 77.9 per cent of them are already invoicing their domestic and foreign B2B customers online and 11.1 per cent plan to adopt e-invoicing in the next year. By contrast, 10.6 per cent of respondents are not using e-invoicing and one per cent have stopped using it.

In 2018, 31,634 new companies were formed in the Czech Republic, the second highest in the history of the Czech Republic. On the other hand, 13,328 companies were dissolved during the year, the highest number in the history of the Czech Republic. The total number of companies in the Czech Republic exceeded 500,000.

Meanwhile, the number of company insolvency proposals decreased for the first time since the creation of the Insolvency Act in 2008. Historically, the highest number of insolvency proposals was in 2013

### Domestic Factoring Volume (EUR Millions)



when the total number stood at 36,909. Since then the percentage of company insolvency proposals has declined. In 2014, insolvency proposals accounted for 20 per cent of company closures, in 2016 10 per cent, in 2017 6.3 per cent and 2018 just 4.9 per cent.

### Market Performance and Supply

Since the second half of 2016, the factoring market has been growing. It achieved the enormous growth rate of 26 per cent in 2017, and the market continued to grow throughout 2018 by increasing by 11.7 per cent.

Domestic factoring formed 65 per cent of total factoring turnover in 2018, growing by 14 per cent to EUR4.4 billion. International factoring formed 35 per cent of total factoring turnover in 2018, with export factoring accounting for 32.5 per cent and import factoring 2.5 per cent. Compared to the previous year, the volume of export factoring grew by eight per cent to EUR2.2 billion and the volume of import factoring fell by six per cent to EUR0.18 billion.

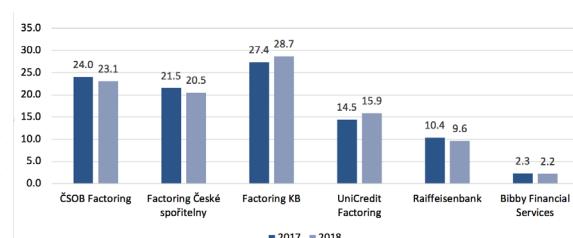
At the end of 2018, total funds in use (the volume of outstanding financing provided to clients) was EUR956 million (CZK24.6 billion), which represents a growth of 11.8 per cent year on year and which is proportionately in line with the increase of the factoring market.

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**International Factoring Volume (EUR Millions)**



**Market Share by Factoring Service Provider (%)**



Statistics are not available for the market sectors nor the number of clients (due to the lower number of factoring companies in the AFS (Association of Factoring Companies) and a possible negative impact on the market if statistics were released which might contravene antitrust law). In general, the key sectors served by factoring – manufacturing, automotive, distribution, FMCG, transport and trading – remain unchanged. However, factoring companies are sufficiently flexible to be able to provide business solutions for other sectors.

Typical clients for factoring services can be divided into two groups. In the first group are the SME clients with an annual turnover in the range EUR two million to EUR20 million. It is in this segment where the banks' efforts to place the maximum volume of liquidity is most apparent. Thus, banks are competing much more with factoring companies for SME clients.

In the second group are larger companies. The key proposition here is advanced factoring products, such as balance sheet factoring, invoice discounting, supply chain finance and reverse factoring which may offer the best in terms of synergy with other banking products. These clients expect tailor-made services with an emphasis on adapting to the electronic systems and the administrative and legal framework in which multinationals operate.

The growth of the factoring industry is partly due to the fact that banks now have a better understanding of factoring products and they have closer cooperation with factoring companies. In the Czech Republic, banks control the main factoring companies or have their own factoring departments. Banks have recognised the importance of receivables management tools in their product portfolio mix and the benefits arising from credit risk protection

(commercial insurance).

The product range of factoring remains basically unchanged, with recourse factoring having the major share of the market amounting to 58 per cent of total factoring turnover, down from 60 per cent in 2017. The increase in the use of non-recourse products (42 per cent, up two percentage points compared with 2017) is mainly due to the usage of commercial insurance protection and balance sheet cleaning. Nevertheless, besides traditional products, there are increasing requirements from clients for less traditional factoring products such as invoice discounting, balance sheet factoring, reverse factoring and supply chain finance.

The Association of Factoring Companies (AFS) of the Czech Republic brings together the six major players in the market: Bibby Financial Services a.s.; ČSOB Factoring a.s.; Factoring České spořitelny a.s.; Factoring KB a.s.; Raiffeisenbank a.s. and UniCredit Factoring Czech Republic and Slovakia a.s. Most of these are members of large banking groups. Almost all AFS companies are members of the Czech Leasing and Financial Association (the Czech Leasing and Financial Association involves other non-banking financial institutions – leasing companies, consumer loan providers). Membership of the Czech Leasing and Financial Association is important for AFS companies as it creates a suitable environment in which they can discuss areas of mutual interest with other institutions.

Outside the AFS, factoring services in the Czech Republic are also provided by the local branches of international banking groups, i.e., Citi, HSBC, ING, which are targeting their services at multinationals clients.

There are also several independent factoring companies in the market, providing financing to

## Factoring České spořitelny, a.s.

companies that have a turnover of EUR200,000. These are mostly smaller SMEs.

In terms of the published volume of purchased receivables, Factoring KB remains the market leader with a 28 per cent share of total purchased receivables, followed by CSOB Factoring (23 per cent), Factoring CS (21 per cent) and UniCredit Factoring (16 per cent); the ranking is the same in terms of the funds in use.

### Regulatory Treatment of Factoring / Supply Chain Finance

Factoring and SCF services in the Czech Republic do not require a banking licence from the ČNB, hence there are no regulatory obligations imposed on SCF providers. This has given rise to many non-banking players offering various SCF concepts. Some of them provide this under the terms of a "payment institution" licence which allows for the ultimate collection, settlement and FX services to their clients.

It is generally acknowledged, that Basel III will have a positive effect on the development of products and techniques of SCF, because SCF assets are perceived as a trade finance debt which has significantly reduced capital requirements compared to standard debt financing, which is likely to become a more expensive option in the new regulatory environment.

Even after the true sale of the trade receivable by the supplier to the bank, the accounting status remains unchanged, i.e. the trade debtor takes no accounting action, the bank books the item as a client receivable.

### Future Trends

Analysts expect GDP growth to reach 2.5 per cent and 2.8 per cent in 2019 and 2020, respectively. Although the Czech economy has slowed down, the economic story has not changed. Household consumption, driven by a strong labour market, and private investment influenced by the low unemployment rate in the Czech economy, will remain the most important contributors to GDP growth. The labour market remained tight at the turn of 2018/2019, with the lowest EU unemployment rate and sound wage growth. We expect pressure in the

labour market to only gradually reduce during this year and next year.

In 2019, we expect the CNB to make one increase in interest rates. Although the weak koruna and tight labour market are moving the economy in an inflationary direction, the economic slowdown in the euro area, the high risks associated with Brexit plus protectionist trends in world trade will outweigh those factors. In our view, the CNB will wait until the economic situation in the eurozone becomes clear and then increase it after it improves. According to our baseline scenario, we expect the koruna to gradually appreciate trend and to reach approximately EURCZK 24.80 at the end of next year. However, if a hard Brexit occurs, the koruna will depreciate to about EURCZK 26 and only gradually return to current levels.

The major challenge for factoring companies in the near future is going to be embracing digitisation and benefiting from e-Invoicing and Electronical Data Interchange forms (EDI). The Czech Republic's first combined EDI-Factoring solution is currently running, where an EDI form is automatically imported directly into the factoring system and prepared for financing. Electronic transaction channels and digitising of what were originally paper-based instruments (orders, invoices, delivery notes...) will radically change the nature of relationships within supply chains. Supply chain finance services are increasingly supporting the efforts of companies to optimise working capital; minimise risks in supply chains; improve access to liquidity; and enable suppliers to keep pace with buyers' growth.

Factoring in the Czech Republic is a part of the SCF family of products and as in other developed economies it is undergoing a massive improvement and automation as a result of new financial technologies. The digital era enables the automation of factoring services and real-time financing on the one hand and on the other hand the creation of brand-new platforms merging formerly separate routines of supply chain management into one synthesised process running from procurement to payment. Empowering technologies based on DLT (distributed ledger technology) open new untapped territories for further expansion of invoice financing in the Czech Republic.

## Factoring České spořitelny, a.s.

### Legal Framework

In the Czech Republic factoring activities have to be provided in accordance with Act No. 89/2012 Coll., of the Civil Code. According to the law, each person (assignor) is entitled to assign his receivables against the debtor to a third party (assignee), even without the debtor's prior consent. The assignment shall be invalid if the agreement between the assignor and the debtor includes ban of assignment. All rights associated with the claim are also transferred to the new creditor with the assigned receivable.

The Czech law primarily allows the assignment of individually determined receivables. The assignment of a set of receivables arising in the future (so-called global cession) is also possible.

The assignment of a receivable is done by concluding a contract between assignor and assignee (its form does not have to be necessarily in writing). After the assignment of the receivable, the assignment must be notified to the debtor by the assignor or proved by the assignee. If the debtor is not properly notified, he is not obliged to pay to the assignee, but where there is proper notification the debtor can fulfil his obligation solely to the assignee.

In relation to the assigned receivables, the assignor is responsible for and guarantees that the assigned receivables are collectable up to the amount of payments received from the assignee.

After the assignment of the receivable, the debtor may have objections related to the receivables, but offsetting the debtor's and the assignor's reciprocal claims is possible only if the debtor notifies the assignee about his claims without undue delay after the assignment.

### CZECH REPUBLIC

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