Factoring agreement model as an effort of protection for small business from customers’ bankruptcy

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Abstract. Factoring can be used by small business, as a client, as the alternative of capital source. The parties in factoring are factor, clients, and customer. Legal connection between factor and client is included in an agreement containing their rights and responsibility. One of the rights of the factor is receiving the payment from the customer. The failure of collection to account receivables from customer can be caused by customers’ bankruptcy. If in financing factoring use the clause with recourse; the client is responsible. The aim of this research is to unveil the position of factor and clients in customers’ bankruptcy, and to recommend Factoring Agreement Model which protects clients as small business in customers’ bankruptcy.

This research used socio legal approach with secondary data of legal or non-legal materials from document review. The legal materials are divided into primary, secondary, and tertiary materials. Primary data in this research was obtained by deep interview to informants in Jakarta and Semarang by purposive sampling. The validity of the data was checked using source triangulation which was continued with qualitative analysis.

In this research, the position of factor in customers’ bankruptcy acts as concurrent creditor, while clients do not become the creditor due to the ownership of the debts is transferred to factoring company. However, if using clause with recourse as happened in practice, clients are still responsible to the failure of collection because of customers’ bankruptcy. It harms the clients. Thus, in the future, there should be a regulation for factoring agreement which can secure small business in the forms of authentic deed containing clause without recourse, the collection of account receivable can be done based on the provision of BW. The existence of third party can become the guarantor. Those party can be coming from government or insurance company. Changes in the agreement should be accepted by both parties.

Keyword: Small Business, factoring, customer, bankruptcy

1. Introduction

In Indonesia, there are many small businesses. It is a power which is expected by the government to reduce the number of unemployment. This expectation cannot be met easily based on several factors interfering the business to develop, especially on capital. The source of capital for small business comes from individual or from the cooperation of individual with other party. Individual capital is very limited for sole proprietorship, while the filling from banking credit has the problem from the obligation of giving the guarantee and administrative requirements, such as Business License (SIUP). SIUP is one proof of the legality of business activities which is an operational requirement that must be fulfilled by every company that runs the company. An enterprise shall be deemed to start its business upon receipt of a trading business license from an authorized technical institution.

The concerns of government to the difficulties of the business regarding the needs and capital raised the formulation of Presidential Regulation Number 9 Year 2009 [1] regarding Financial Institution, which mainly focused on factoring. Small businesses with capital problems can sell their short-term account receivables by making the Factoring Agreement. Small businesses who sell their
account receivables are called as clients, company who buys the account of clients is called Factoring Company, while the parties which have debts to the clients are called customer.

From the involvement of clients, factoring agreement can be made by using clause with or without recourse. If the factoring uses recourse, the clients are responsible to pay the bill to the factoring company caused by the bankruptcy of customer. Considering the factoring agreement as the standard, [2] states that all the contents of the agreement emphasize on the responsibility of clients to its rights; thereby, clients can accept or refuse. This is supported by the economic position of small businessmen (clients) which is far below the factoring company; thus, the company formulates the agreement to protect its interest in customers’ bankruptcy to clients by forcing the use of recourse factoring in the agreement even if there is no any specific regulation which regulates factoring agreement. Therefore, this research aims to unveil the position of factor and clients in customers’ bankruptcy and recommend Factoring Agreement Model which protects small business as the clients in the case of customers’ bankruptcy.

2. Methodology

The approach of this research used socio legal research using secondary and primary data. The secondary data was obtained from document study to legal and non-legal materials. The legal materials were divided to primary, secondary, and tertiary materials. The primary legal materials used are the law and regulation, and the agreement related to the research. The secondary data used the publication regarding law with tertiary legal materials of encyclopedia, bibliography, and relevant legal dictionary. The primary data in this research used the deep interview to informants in Jakarta and Semarang determined by purposive sampling which includes the businessmen, the head of finance institution, POJK, and experts. The technique of data validity in this research used triangulation of sources continued by qualitative analysis.

The characteristics of small business are seen from the location, capital, and legal status. Small business is spread in Indonesia, whether in rural area or in urban area. It is established with small capital sourced from self-financing and family helps. The legal status of the business is generally a sole proprietorship, owned by individual or family, developed from home industry, has non-formal status, does not have license, and usually, does not fulfill legal requirement, which becomes the inhibiting factor to formal finance institution, like banking [3].

Small business has problems in limited capital, control of technology, quality of human resources, ability of product marketing, and other ability, like solving the problems of unemployment and creating wide and cheap job fields, has flexible structure, and freedom of action (not bureaucratic and independent), as well as able to adjust with local needs (flexible and responsive), has high resistance (tenacious, hardworking, not wasteful) especially in uncomfortable economic condition [3], as in the crisis time of Indonesia, this business endures in a long time [4].

One of the capital sources which can be used by small business to fulfill its needs is using factoring agreement. In factoring agreement, there are three parties involved.

a) Factoring Company or factor. It is a business entity which can use the funding by buying/accepting the account receivable with becoming the mediator of clients and customer.

b) Client is a company which sells and/or transfers the account receivable from the trading transaction to factor company.

c) Debtors or customer is the debtors who have debts to clients.

From the involvement of clients, factoring is divided into

1) Recourse Factoring is a type of factoring when the factor company does not collect the debts from customer, clients still have the responsibility to repay. There is also a type of recourse factoring giving the option to Factoring companies to sell its account receivable to clients.
2) Without Recourse Factoring is a factoring company which places the burden of debts collection along its risks to the Factoring Company. Thus, the failures of debts’ collection will be the responsibility of the Company where the clients does not have the responsibility unless there is a mistake from the clients.[5].

Customer acts as the debt owner or debtors. There are two requirements which should be fulfilled by debtors to be requested as bankrupt as stated in Article 2 section (1) Law Number 37 year 2004 regarding Bankruptcy and Suspension of Obligation Debt Payment which is then called as Law of UUKPKPU. They are there should be two or more creditors (concursuscreditorium) and there should be one debt which has been in the due time and bale to be collected. This law acknowledges 3 types of creditors: concurrent creditor, preferred, and separatist. The second requirement shows that creditor has the rights to demands the debtors to fulfill their achievement that the debt should come from perfect bonding (schuld and haftung).

Article 1 point 1 of Law No. 37 Year 2004 concerning UUKPKPU provides the definition of Bankruptcy as "a general confiscation of all the wealth of the bankrupt debtor whose management and ordering is carried out by the Curator under the supervision of the Supervisor."

Beside the requirement of bankrupt debtors, UUKPKPU also regulates whoever can become debtors as stated in Article 1 Section 11, that it can be individual or corporation which is included in legal entities or liquidated legal entities. Non-corporate corporations in Indonesia include the Partnership which is governed by the Civil Code (KUH. Perdata). The Firm and the limited partnership are governed by the Commercial Code (KUHD), while corporations with legal entities consist of Limited Liability Companies, Cooperatives and Foundations.

Bankruptcy causes the debtors to be bankrupt under the law making them losing their rights to control and handle their wealth, including the bankrupted wealth from the verdicts of bankruptcy (Article 24 (1)), the wealth is included in general confiscation which handles done by curator under the control of controller judges,[6], which then in the stage of valuation of the property is used to pay debtor debt to its creditors based on the principle of paripassu pro rata parte against the concurrent creditors whereas to the separatist creditor apply the provisions of Article 55 UUKPKPU.

From the provision of Article 55 of UUKPKPU, the creditor as the holder of the guarantee can execute the guarantee, which can be done in 90 days after the bankrupt is determined. This suspension does not apply to the guarantee in the forms of cash money (Article 56 section 1 and 2) by curator under the control of controller judges.[6]

The guarantee to creditors’ account receivable is categorized as general and specific guarantee, as well as materials and individual guarantee. The legal foundation of general guarantee is Article 1131 of BW. It is different to general guarantee, specific guarantee is a guarantee published from certain agreement which is given to certain things, like pawning, mortgage, collection, and retention rights. It can also be given to non-materials, like personal and corporate guarantee, or the deed of debts acknowledgment. Material guarantee is directly related to certain goods, Material guarantee is directly related to certain goods. Material Priority Guarantees are prioritized, meaning that anyone who holds a guarantee of material security will first take precedence over the debt repayment compared to the holder of the material rights guarantee then. This warranty exists because it is contracted between the debtor and the creditor, or between the creditor and the third party who provides his property specifically in the form of a fixed item, thereby giving third party the goods to be used as collateral and relinquishing his or her powers by selling, granting or exchanging. like pawning and suspension rights of fields, while personal guarantee is the direct relation to the giver of guarantee, not to certain goods; thus, it can be defended to certain people which is divided in personal guarantee, corporate guarantee, and bank guarantee. The difference of those three guarantees are placed on the subjects giving the guarantee [7].
3. Findings

3.1. The Position of Factor and Clients in Customers’ bankruptcy

Factoring agreement is principally a trade of unpaid account receivables from customer to clients given to factors. A sale and purchase (trade) agreement is an agreement that creates an obligation to the seller which is the buyer's right, and the buyer's obligation which is the seller's right. Seller has a duty to be done for the transfer of property rights that is to give ownership of the goods that the object of the sale and purchase agreement. Thus the risk of goods being the object of the sale and purchase agreement is to the buyer after the goods are delivered. Before the goods are delivered, the risk is on the seller.

There are three kinds of goods arranged in KUH. Perdata (Civil Code) which can be the object of the sale agreement. The goods have their own arrangements in the delivery, namely, Movable Goods, arranged in article 612 KUH. Perdata, Fixed Goods (immovable), set out in clauses 616, and 620 KUH. Perdata. The goods are not bodied, set out in article 613 KUH. Perdata.

Some juridical actions taken after the debtor is declared bankrupt is the suspension of execution of guarantee rights, verification, peace, homo or oversight or insolvency followed by ordering, bankruptcy ends and, rehabilitation.

In general, bankruptcy statements result in

[1] Debtor’s Property Bankrupt

Bankruptcy resulted in the entire wealth of the debtor and everything that was obtained during the bankruptcy was in public confiscation from the moment the decision on bankruptcy declaration was pronounced except:

a) Objects, including animals that are actually needed by the debtor in connection with his work, medical equipment used for health, bedding and equipment used by the debtor and his family, and food for 30 days for the debtor and his family, contained in that place;

b) Everything a debtor obtains from his or her own employment as remuneration of a position or service, as wages, pensions, waiting money or allowances, to the extent prescribed by a supervisory judge; or

c) Money given to borrowers to fulfill an obligation to provide income according to law.

[2] Partner (Husband / Wife) Debtor Bankrupt

The bankrupt debtor who at the time declared bankrupt is bound in a legitimate marriage and the union of property, his bankruptcy can also give legal effect to his spouse (spouse). In the case of a husband or his wife being declared bankrupt, his wife or husband shall be entitled to take motionless and immovable objects which are the property of a wife or husband and the property earned respectively as a gift or inheritance. If the property of a wife or husband has been sold by a husband or wife and the price has not been paid or the proceeds of the sale have not been mixed in the bankruptcy property then the wife or husband is entitled to take back the proceeds of the sale.

[3] All Engagements by Debtor Bankrupt

All of the debtor's engagement published after the decision of bankruptcy, can no longer be paid from bankruptcy property, unless such engagement benefits the bankrupt property (Article 25 of the Bankruptcy Law). Claims concerning rights or obligations concerning bankruptcy property shall be filed by or against the receiver. In the event that such claim is filed or forwarded by or against the insolvent debtor, if such claim leads to a punishment of a bankrupt debtor, the penalty shall have no legal effect on the bankrupt property (Article 26 of the Bankruptcy Law).

[4] All Debtor Act Done before the Decision of Bankruptcy Statement is Spoken
In Article 41 Paragraph (1) of the Bankruptcy Law is explicitly stated that for the interests of bankruptcy property, any legal act of the debtor that has been declared bankrupt, adversely affecting the interests of the creditor, before the verdict of the bankruptcy declaration is pronounced, may be requested for cancellation to the court.

In general, the main consideration of the use of company services factor associated with the cost, namely the extent to which the extra costs to be incurred is still proportional to the profits to be obtained by the presence of factor companies in business client. In addition, there are other considerations that the client should consider in selling his receivables, which is to retain Customer, protection against bad debt, cash flow considerations, comparison with internal costs, comparison with regular financing[7]. Consideration of maintaining this customer regarding the relationship between the customer and the client is likely to be damaged by the transfer of the bill to the factor company. This consideration of bad debt concerns the need to consider the use of credit insurance, while the cash flow consideration is a consideration of the need for factoring services to overcome the difficulties of cash flow problems. The consideration of internal costs is the comparison between the costs incurred by using factoring and the likelihood of its success compared to if the bill is self-directed.[7]

Weaknesses of small businesses include the difficulty of capital, and possibly also the difficulty of collection of receivables. Factoring financing companies can be used to overcome this by selling their receivables. If a small business has receivables, then sell the receivables to the factor companies, then this trade makes the position of creditor changes from clients to factoring company. If customer is stated as bankrupt, factoring company will act as concurrent creditor, a creditor which account receivable is guaranteed with common guarantee as regulated in Article 1131 of BW which is also called as Indonesian Civil Codes (KUH. Perdata).Article 1131 regulates that all existing and outstanding immovable property, whether existing or future, as a guarantee for all engagement

Creditor does not become separatists since there is no any material guarantee given by the customer to factoring company. Creditor is not a preferred one since the account receivables are regulated under Article 1139 of BW (KUH. Perdata). Meanwhile, clients do not become the creditor since its account has been sold making the collection rights transferred to factoring company.

3.2. Factoring Agreement Model Protecting Clients (Small Business) in the Case of Customers’ Bankruptcy

The existence of the Financing institution has long been known, even the embryo has already existed during the Roman Empire. Around 1972 developed in Asia, mostly done by commercial banks. In Indonesia the development of the factoring financing institution started with the issuance of Presidential Decree (Keppres) no. 61 year 1988 about the financing institution which was followed by the decision of finance minister No.1251 / KMK.013 / 1988. In 2009 it was re-arranged in the formulation of Presidential Regulation Number 9 Year 2009 regarding Financial Institution.[5]

The use of Factoring Finance in Indonesia is increasing annually. This increase can be seen from the increasing number of factoring company since 2011 until 2015. In 2011 the number was 68. It increased to 71 in 2012; 72 in 2013 and 2014; and 78 in 2015. The number of debtors to those company were 852 with the details of 320 limited liability companies, 14 Commanditaire Verenidging, and 518 individual company (Interview with OJK staff, 2015). Thus, the most common form of customers’ company is individual company. These companies used individual wealth to guarantee the account receivable of the company. Customer is the party which has debt making them become debtors; thereby, they can be bankrupted if they fulfill the Article 2 UU KP3. Thus, in case of customers’ bankruptcy, the full repayment of the factoring company as concurrent creditor is very small.
A treaty is an agreement between one or more persons with one or more other persons to engage in a legal act in the field of property. Based on its form, it is distinguished in agreements made orally and in writing. Oral agreements are agreements with which the agreement is sufficiently oral whereas written agreements are agreements set forth in the form of writing distinguished in authentic deeds and deeds. The standard agreement is included in the form of a deed or written agreement.

In the practice of protecting the interests of factoring company, there is a formulation of factoring agreement in standard of clause with recourse Standard Agreement because it is arranged unilaterally by the factor company. Client does not participate in compile and has no right to change the contents of the agreement that has been provided by the company internal factor form factoring or factoring agreement form. Client faced with two options refuse or accept. If the client signs the form then the client is considered to have agreed. Thus the use of standard forms in the practice of implementing the financing of factoring does not meet the elements of the agreement set forth in Article 1320 KUH. Perdata. The use of clauses with recourse in factorin financing agreements in standard form is very detrimental to the client because,

Clients have the responsibility if the factoring company fails to collect the debts of the customer. There is also an agreement including the guarantee and rights of factoring company to do the collection with all ways as well as changing the funding of the factoring company without the agreement of clients. The condition of factoring agreement is harming the clients, as clients are small businesses not individual. Thereby, there should be a formulation of factoring agreement which is beneficial to all parties.

According to Article 1338 of Indonesian Civil Codes, valid agreement is made as the regulation for the involved parties. In Article 1320, the validity of the agreement is divided into objective and subjective requirement. Subjective requirement is the prowess and deal, while the objective requirement is certain thing with agreeable causes.

The Agreement implies that the parties mutually declare their own intention to conclude a treaty or statement of the other party “match” or match with the other party [8], which contains two elements of supply and acceptance. Skills in the provisions of Article 1320 of the Civil Code, the Civil Code is the ability to perform certain independent legal acts which bind themselves without being inviolable.[8]

The provisions of Article 1338, in addition to containing the principle of the binding power of a treaty, also contain the principle of freedom of contract. Based on the principle of freedom of contract, a person is free to engage in or not to enter into a contract, free of who he or she has entered into, free of contract and free to set terms of agreement [9]. Related to factoring agreement, the agreement should be made on the deal of all parties in an authentic deed. Without the deal, the agreement can be cancelled. Thus, if the accepted factoring has changed, the changes to the content of factoring agreement should be based on the agreement of both parties.

The agreement uses clause without recourse, and the collection done by factoring company should be in accordance with the debts collection in Indonesian Civil Codes, where there is an existence of guarantors: such as government or insurance company. Government as corporate guarantee is represented by related State-Owned Enterprises, if the financing factoring is a model of small business development. Meanwhile, insurance company is needed as principally, every individual takes their own risks to the harms happen to them, unless if the harms can be blamed to other people by paying certain amount of money to insurance company as this company is a company which accepts the transfer of risks.
Risk is a condition that contains the possibility of a deviation that is worse than expected [10]. Efforts that humans can take to overcome a risk are to avoid, to withdraw or to distance, to prevent, to transfer, to receive. What is meant by divert is someone who is at risk of asking others to accept the risk [11]. The other person in question can be an insurance company. Risk is a condition that contains the possibility of a deviation that is worse than expected [10]. Efforts that humans can take to overcome a risk are to avoid, to withdraw or to distance, to prevent, to transfer, to receive. What is meant by divert is someone who is at risk of asking others to accept the risk [11]. The other person in question can be an insurance company.

An insurance company is a company that is located as a risk insurer directly related to the insured or through an insurance broker, as the basic function of insurance is an attempt to overcome the uncertainty of loss, specifically for pure losses rather than speculative losses[12]. The relationship between the insurer and the insured is set forth in the insurance agreement, where the insured is obliged to pay the insurance premium, while the liability of the insurer is to indemnify the losses arising from the occurrence of the risk. The risk in factoring financing for factor companies is the collapse of receivables to customers, which among other things is due to bankruptcy of the customer. This risk can be transferred to an insurance company by paying a premium by the factor company.

4. Conclusion

Factoring company becomes the concurrent creditor in case of customers’ bankruptcy, while clients do not play as the creditor since their account receivables has been transferred to factoring company.

The Recommended Factoring Agreement Model is an authentic deed. The changes of the agreement should be accepted by both parties in which should be existed the clause without recourse. The collection of the account receivable should be under the provision of Indonesian Civil Codes. The third party as the guarantor can be coming from government or insurance company.

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