

Impact of Factoring Agreement on Credit Risk and Company Cash Management

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ABSTRACT

The purpose of this study is to analyze: 1) How is the legal basis of factoring agreements in accordance with existing rules according to Indonesian law?; 2) How is the Impact of Factoring Agreements on Credit Risk?; 3) How Does the Factoring Agreement Impact the Company's Cash Management?. The research method used is empirical juridical with a statutory approach, concept approach, and case studies.

The results showed that: 1) The legal basis in factoring agreements is regulated into two types, namely administrative and substantive legal arrangements. Administrative legal arrangements are contained in Article 6 letter l of Law No. 7 of 1992 which has been amended by Law No. 10 of 1998, hereinafter referred to as the Banking Law, Presidential Financing Regulation, and Regulation of the Minister of Finance of the Republic of Indonesia No. 84 / PMK.012 / 2006 concerning Financing Companies. While the Substantive Legal Basis which is divided into Pure Substantive, namely Article 1338 BW is related to the principle of freedom of contract. So that the parties are free to make an agreement provided that they have fulfilled the conditions for the validity of the agreement as contained in Article 1320 BW, namely agreement, competence, certain objects, and permissible causation. In addition, there is a procedural Substantive Legal Basis in article 613 BW related to *cessie* and *subrogation* based on Articles 1400 BW, 1459 BW, 1491 BW, 1493 BW, 1495 BW, 1533 BW, 1534 BW and Article 174 KUHD-Article 177 KUHD. 2) Factoring agreements can have a significant impact on a company's credit risk and cash management. While factoring can increase liquidity and reduce credit risk, companies also need to consider the costs and concentration risks associated with these financial instruments. Therefore, the decision to use factoring must be carefully considered and based on the specific needs and financial condition of the company.

Keywords: Impact, Factoring Agreement, Credit Risk, Corporate Cash.

INTRODUCTION

Background

The background of factoring agreements in Indonesia includes economic development, the need for liquidity, and the role of external and internal factors in corporate decision-making. As a country with a growing economy, Indonesia is experiencing rapid business sector growth, especially in the small and medium sector (SMEs). This growth is often accompanied by an increased need for liquidity for companies, both to support day-to-day operations and to finance business expansion.

In this context, factoring agreements are one of the relevant solutions for companies in Indonesia. Factoring allows companies to convert accounts receivable into cash quickly, thereby increasing liquidity and facilitating smooth operations. In addition, factoring can also help companies manage credit risk by transferring the risk of default or late payment from customers to third parties.

In business activities, many problems arise to require additional capital or capital goods to develop their business activities. Increasing capital in a business activity can generally be done through loans at banking institutions. However, because this institution requires guarantees that must be met by the business entity concerned, other efforts are needed that are without guarantees and easier to process. This effort can be done through a type of business entity called a financing institution.¹

However, when business activities increase, with the rapid increase in sales volume, it will cause a new problem, namely sales administration problems, because in reality many companies only concentrate on efforts to increase production and sales. While having limited ability to manage sales on credit. This causes the company to experience problems with bad receivables so that it will affect the smooth flow of its finances. To anticipate this, the government in 1988 through Presidential Decree NO.61 of 1988 concerning Financing Institutions opened opportunities for various

¹ Wahyu Utami and Yogabakti Adipradana, *Introduction to Business Law in Theoretical and Practical Perspective in Indonesia*, Jakarta: Jala Permata Aksara, 2017, p. 143

business entities to carry out financing activities as another alternative to provide funds to support the growth of the Indonesian economy.²

In overcoming the obstacles experienced by the business world as explained above, it seems that the presence of factoring institutions will provide an alternative solution to the problem.³ Through factoring services, companies will be able to obtain sources of financing easily and quickly up to 80% of the value of their sales invoices on credit. In addition, with the support of experienced personnel and experts in their fields, factoring companies can help overcome difficulties in the field of credit management. Thus clients can be more concentrated on product improvement and sales activities.

In Indonesia, the existence of factoring institutions began since the launch of the Policy package of December 20, 1988 or Pakdes 20: 1988 in accordance with Presidential Decree No. 61 of 1988 and Decree of the Minister of Finance No. 1251 / KMK.13 / 1998 dated December 20, 1998 which was later updated with the Regulation of the Minister of Finance No. 84 / PMK.012 / 2006 concerning Financing Companies, the introduction of factoring business is intended to obtain alternative sources of financing outside the banking sector, leasing, venture capital and consumer financing.⁴

External factors such as financial market conditions, government policies, and regulatory developments also influence the trend of factoring usage in Indonesia. For example, regulations that support the development of the factoring industry can encourage the growth of this sector by providing legal certainty and adequate incentives for industry players. On the other hand, stable financial market conditions and low interest rates can strengthen the attractiveness of factoring as an alternative financing.

Meanwhile, internal factors such as company policies, capital structure, and management's awareness of risk factors also play a role in decision making related to factoring. Companies need to consider their own internal conditions, including risk

² Siti Ismijati, "Some Agreements relating to Financing Activities", Paper on Civil Law Lecturer Upgrade, 1996.

³ Dahlan Siamat, Financial Institution Management, first printing, CV. Intermedia, Jakarta, 1995, p 216

⁴ Marzuki Usman, 1987, "Factoring Business", Paper, Jakarta.

profile, liquidity needs, and long-term financial strategy, before deciding to use factoring as a cash management tool. Thus, the background of factoring agreements in Indonesia reflects the complex dynamics between external and internal factors influencing the use of these financial instruments in the emerging economies.

Factoring agreements, or better known as factoring, are one of the financial instruments used by companies to manage their accounts receivable. In the context of the modern economy, factoring has become a significant tool in overcoming the liquidity problems of companies. However, in addition to its obvious benefits, factoring also affects credit risk and company cash management.⁵

In the end, an update was made with the Minister of Finance Regulation No.84 / PMK.012 / 2006 concerning Financing Companies, factoring business activities can be carried out by *Multi Finance Company*, which is a financing institution that can carry out business activities in addition to factoring, also in the fields of business lease, venture capital, credit cards and consumer financing. However, companies can choose one of several forms of activities carried out by *multi-finance companies* as their business specifications by forming a separate business entity. The type of financing business that can be done is influenced by the amount of capital in the deposit. Banks in principle can provide factoring services as part of their products without the need to form a new business entity.⁶

However, because this factoring activity has its own characteristics and is different from the financing process in the form of lending, in addition to the volume of factoring business is usually relatively large, banks generally tend to separate this factoring activity from daily banking operations by forming a business entity even separately, either by establishing a purely factoring company or by establishing a multi-financing company.

Thus, this paper aims to describe the impact of factoring agreements on credit risk and corporate cash management in the current economic context.

⁵ Setiawan, Bambang. (2018). Financial Management: Theory and Practice. Jakarta: Erlangga Publishers.

⁶ Dahlan Siamat, loc.cit

Problem Statement

1. What is the legal basis of factoring agreements in accordance with existing rules according to Indonesian law?
2. How Does a Factoring Agreement Impact Credit Risk?;
3. How Does the Factoring Agreement Impact the Company's Cash Management?

THEORETICAL FRAMEWORK

In accordance with the problems to be discussed in this study, it is necessary to briefly put forward several theories that are used as a theoretical framework.

1. Theory of Legal Protection

Legal interests are concerned with human rights and interests, so that the law has the highest authority to determine human interests that need to be regulated and protected. Legal protection must see stages, namely legal protection born from a legal provision and all legal regulations provided by the community which is basically an agreement of the community to regulate behavioral relations between community members and between the company and the government which is considered to represent the interests of the community. According to Satjipto Raharjo: Legal protection is to provide protection for human rights (HAM) that are harmed by others and that protection is given to the community in order to enjoy all the rights provided by law.⁷

In the opinion of Philipus M. Hadjon that "legal protection for the people as a preventive and repressive government action." ⁸ Preventive legal protection aims to prevent disputes, which directs government action to be prudent in decision-making based on discretion and protection.⁸

2. Law Enforcement Theory

Law enforcement does not solely mean the implementation of laws, although in reality in Indonesia the tendency is so, so the definition of law

⁷ 7 Satjipto Raharjo, Legal Science, PT. Citra Aditya Bakti, Bandung, 2000, p. 53

⁸ Philipus M. Hadjon, Legal Protection for the People of Indonesia, PT. Bina Ilmu, Surabaya, 1987, p. 2.

enforcement is so popular. In addition, there is a strong tendency to interpret law enforcement as the implementation of judges' decisions. It should be noted that this rather narrow opinion has weaknesses, "if the implementation of legislation and the decisions of judges disturb peace in society".⁹

Another opinion regarding law enforcement was explained by Sudikno Mertokusumo that: "The law serves as the protection of human interests. In order for human interests to be protected, laws must be implemented. The implementation of the law can take place normally, peacefully but it can occur also due to violation of the law. In this case the law that has been violated must be enforced, It is through the enforcement of this law that the law becomes a reality. In enforcing the law there are three elements that must always be considered, namely: legal certainty (*Rechtssicherheit*), expediency (*Zweckmaasigkeit*) and justice (*Gerechtigkeit*".¹⁰

Furthermore, Selo Sumardjan as quoted by Sidik Sunaryo stated that law enforcement is closely related to efforts to instill the law in society in order to know, respect, recognize and obey the law, community reactions based on the prevailing value system and the period of time to instill hUkum.¹¹ Regarding law enforcement, Leden Marpaung explained that: Law enforcement that contains compliance, arises not suddenly but through a process formed from the awareness of every human being to carry out and not carry out according to existing regulations. The process does not come from top to bottom or vice versa but does not care where it comes from, because the obligation to comply with all forms of laws and regulations belongs to all Indonesians. In everyday reality, there are citizens who uphold the law, there are citizens who mistakenly or mistakenly live up to their rights and obligations so that those concerned are considered to have violated the law. The assumption that someone has violated

⁹ Soerjono Soekanto, Factors Affecting Law Enforcement, Raja Grafindo Persada, Jakarta, 1983, p. 5

¹⁰ Sudikno Mertokusumo, Knowing the Law An Introduction, Liberty Yogyakarta, Yogyakarta, 2007, p. 160

¹¹ Sidik Sunaryo, Criminal Justice System, University of Muhammadiyah Malang Publisher, Malang, 2004, p. 56.

the law must first be proven to be true carefully and thoroughly because of the principle of *presumption of innocence*.¹²

RESEARCH METHODOLOGY

This research is a type of empirical legal research. Empirical legal research is oriented towards primary data (results of research in the field). The approach of empirical legal research is carried out through field research, namely by seeing and observing what happens in the field, and how the application of regulations in practice in society. This research is also used normative research to support empirical research with a legal approach by reviewing laws and regulations related to the role of the Police in securing the execution of fiduciary guarantees.¹³

Normative juridical research refers to legal norms contained in laws and regulations and legal norms that exist in society. In addition, by seeing the synchronization of a rule with other rules in a hierarchical manner.¹⁴ Law that applies at a certain time and place, that is, a written rule and norm officially established and promulgated by the ruler, in addition to written laws that effectively regulate the behavior of members of society.¹⁵

The method of data collection in this study with *library research* or commonly called literature study, this method is carried out to obtain secondary data both in the form of primary legal material and secondary legal material. After being inventoried, a review is carried out to make the essence of each regulation concerned. Data is collected by studying literature sources in the form of literature books, laws and regulations, and collecting existing data in the form of data that is directly related to the research conducted.¹⁶

¹² Leden Marpaung, *Process of Handling Criminal Cases, Investigation and Investigation*, Sinar Grafika, Jakarta, 2009, p.3

¹³ Zainuddin Ali, *Legal Research Methods* (Sinar Grafika, 2021).

¹⁴ Dyah Ochterina Susanti and A'an Efendi, *Legal Research*, Jakarta: Sinar Grafika, 2014, p. 11

¹⁵ Johan Nasution, *Legal Research Methods*, Bandung: Mandar Maju, 2008, p. 81.

¹⁶ Peter Mahmud Marzuki, *Legal Research*, Jakarta: Kencana, 2008, p.141.

In this study, a statutory approach and a comparative approach were used.¹⁷ Legal research conducted by examining library materials or secondary data.¹⁸ *Statute approach*: an approach taken by examining laws and regulations related to the focus of research. Then, the data collection taken in this study uses literature studies, namely data collection by searching, examining and reviewing secondary data.¹⁹ In this research, document studies will be carried out as a means of collecting data related to the problems raised, namely literature studies / document studies (documentary study), sourced from laws and regulations, books, official documents, publications and research results.²⁰

RESEARCH RESULTS

Legal Basis of Factoring Agreement According to Indonesian Law

Factoring in Indonesian translates to factoring, consisting of 2 words, namely factoring and receivable. Factoring means to move or move. Receivables means money lent (which can be collected from someone), bills of company money to customers that are expected to be repaid within a maximum of one year from the date of issuance of the bill. Factoring means transferred receivables. While the definition of *factoring* according to John Downes and Jordan Elliot Goodman in the Dictionary of Finance and Investment Terms is: "*Type Financial service why a firm sells or transfer title to its account receivable to a Factoring company, which then acts a principal, not as agent. The receivables are sold without recourses, meaning that the Factor can not turn to the seller in the event accounts prove un collectible.*"²¹

Meanwhile, Minister of Finance Regulation Number 84 / PMK.012 / 2006 concerning Finance Companies Article 1 (e) states that *factoring* is a financing activity in the form of purchasing short-term trade receivables of a company along with the

¹⁷ Abdulkadir Muhammad, 2004, *Law and Legal Research*, PT Citra Adiya Bakti: Bandung, p. 113.

¹⁸ Soerjono Soekanto & Sri Mamudji, *Normative Legal Research A Brief Review*, Jakarta: PT Raja Grafindo Persada, 2009, p. 13-14.

¹⁹ Suteki, *Op. Cit*, p 217

²⁰ Zainuddin Ali, *Legal Research Methods*, Jakarta: Sinar Grafika, 2009, p. 105

²¹ Budi Rachmat, *Factoring Cash Flow Problem Solution*, (Cet 1 Jakarta: Gramedia Putaka, 2009), p. 1.

management of these receivables. ²²In Article 1 point 8 of Presidential Decree R.I.No.61 of 1988 jo Article 1 letter 1 of the Decree of the Minister of Finance No.1251/KMK.013/1988 it is stated that *a factoring company* is a business entity that conducts financing business in the form of purchase and/or transfer and management of receivables or short-term bills from domestic and foreign trade transactions.²³

The factoring agreement includes legal documents. This means that factoring as a form of financing business comes from various legal provisions, both agreements and legislation. In addition to including legal documents, factoring also includes special laws. In carrying out its business, factoring institutions need a legal basis that can guarantee legal certainty in carrying out each of their activities. This is needed to ensure the protection of the rights and obligations of parties involved in factoring companies.²⁴

Factoring provides a number of benefits to companies, including:

- **Increased Liquidity:** By selling accounts receivable to financiers, a company can immediately convert its assets into cash that can be used to meet immediate needs.
- **Credit Risk Reduction:** Lenders typically take responsibility for the credit risk associated with receivables, reducing the company's exposure to the risk of default or late payment by customers.
- **Administrative Management:** By outsourcing receivables collection to financiers, companies can reduce the administrative burden associated with monitoring and collecting receivables.

Factoring in the Civil Code and other laws and regulations is not specifically regulated. The regulations that exist until now are only administrative regulations, but their existence is possible in the Indonesian legal system, because Indonesian treaty law adheres to the principle of freedom of contract as threatened in article 1338

²² Muhammad Sutomo Wijaya & Iza Hanifuddin, "The existence of factoring agreements for business actors from the juridical and economic side", *Jurnal Masohi*, Volume 2(1), 2021, p 6

²³ Zaeni Asyhadie, *Business Law: Its Principles and Implementation in Indonesia*, (Jakarta: PT Raja Grafindo Persada, 2008), p. 112.

²⁴ Oktavia Wahyu Utami & Iza Hanifuddin, "Analysis of the Application of *Recourse Factoring* in Factoring Companies and Legal Protection for Clients", *Muamalatuna* Vol. 13 No. 2, December 2021, 9.

paragraph (1) of the Civil Code, that all agreements made validly apply as law to those who make them. This means that the law of agreement gives the widest freedom to the parties to enter into an agreement as long as it does not conflict with the Law, decency, and public order. As long as the factoring agreement meets the requirements for the validity of the agreement as stated in article 130 of the Civil Code, the consumer financing agreement is fully binding on the parties, which must respect the contents of the agreement made and must carry out their obligations and performance. Thus in good faith, as stated in article 1338 paragraph (3) of the Civil Code, basically every agreement must be executed in good faith.²⁵

The legal basis in factoring agreements is regulated into two types, namely administrative and substantive legal arrangements. **Administrative legal** arrangements are contained in Article 6 letter I of Law No. 7 of 1992 which has been amended by Law No. 10 of 1998, hereinafter referred to as the Banking Law, Presidential Financing Regulation, and Regulation of the Minister of Finance of the Republic of Indonesia No. 84 / PMK.012 / 2006 concerning Financing Companies. While **the Substantive Legal Basis** which is divided into Pure Substantive, namely Article 1338 BW is related to the principle of freedom of contract. So that the parties are free to make an agreement provided that they have fulfilled the conditions for the validity of the agreement as contained in Article 1320 BW, namely agreement, competence, certain objects, and permissible causation. In addition, there is a procedural Substantive Legal Basis namely in article 613 BW related to *cessie* and *subrogation* based on Articles 1400 BW, 1459 BW, 1491 BW, 1493 BW, 1495 BW, 1533 BW, 1534 BW and Article 174 KUHD-Article 177 KUHD.²⁶

There are five kinds of elements in the *factoring* agreement, namely²⁷

1. Company *Factor*

²⁵ Siti Hamidah, Juridical Study of Balanced Protection for Factors, Clients and Customers in Factoring Agreements, (Journal. Faculty of Law, Universitas Brawijaya, 2012), p. 2.

²⁶ Fries Melia Salviana & Desy Nurkristia Tejawati, "Legal Protection of Factoring Companies Against Risk Due to Pre Invoicing", *STHG LAW JOURNAL* Volume 2 No. 1 March 2019, p. 113.

²⁷ Munir Fuady. 2006. Theory of Evidence (Criminal and Civil). Bandung : Citra Aditya Bakti, p. 12.

This company is a company that conducts financing by buying and or receiving the transfer of receivables. Factor companies can be companies that are specifically engaged in factoring, *multi-finance* companies, namely companies that in addition to being engaged in factoring are also engaged in other financing, besides that banks are also allowed to enter into factoring agreements, this is as stated in Article 6 letter I of Banking Law No. 7 of 1992 as amended by Law No. 10 of 1998, namely regarding expansion bank services.

2. Client companies

Article 1 letter m of the Presidential Regulation on Financing gives meaning to clients as a company that sells and or transfers its receivables and / or bills arising from trade transactions to *factor companies*.

3. Customer Customer

It is the debtor who owes the client company, which then with *factoring activities*, the receivables issued from the debt are transferred to the *factor company*.

4. Receivables / Bills

Accounts receivable are business bills that are not yet due (*account receivable*), either issued using securities, such as *promissory notes*, or only bills through *ordinary trade invoices*.

5. Transfer of receivables

Transfer of receivables regulated in BW. Client companies that have receivables both existing and non-existent, both maturing and not yet maturing, can transfer receivables to factor companies *either with or without* the knowledge of the debtor on the basis of the principle of freedom of contract contained in Article 1338 BW provided that it has fulfilled Article 1320 BW regarding the terms of validity of the agreement, namely between the two & both parties there has been an agreement, Both parties have met the requirements of proficiency, clarity regarding the object in the form of receivables, and the agreement meets the permissible causation. The factoring

agreement is *short-term financing*, so the transferred bills are relatively short-term bills, ranging from 30 to 100 days.

Transfer of receivables that can be done either by using documentation or evidence related to the transfer of receivables made to *accounts receivables* (not yet due) or through *promissory notes* (securities) to the client company to be *endorsed* to the company *factor* as a link in the process of transferring receivables.²⁸

Impact of Factoring Agreement on Credit Risk

Factoring agreements have become an important strategy for companies in managing their credit risk. One of the main impacts of factoring is the reduction of credit risk faced by companies. By selling accounts receivable to the financier, the company transfers the responsibility of collection and the risk of late or failed payments to the financier. This helps reduce the company's exposure to the risk of default by customers.²⁹

In addition, financiers who typically have more resources and experience in assessing credit risk can help reduce credit risk associated with accounts receivable. They conduct a careful credit evaluation of the company's customers before receiving receivables, thus ensuring that the risk of default can be minimized. Thus, factoring helps companies to manage credit risk more effectively.

However, factoring agreements can also lead to increased concentration risk. Companies are becoming more reliant on a few large customers who may be the subject of factoring. If one of those key customers experiences financial difficulties and defaults on payments, the impact can be very significant for the company. Therefore, companies need to carefully consider the impact of this concentration factor in their factoring strategy.

²⁸ Ari Nugroho, *Getting to Know Factoring Companies*, (Jogjakarta: CV Applied competence of Sinergi Pustaka, 2019), p. 2.0

²⁹ Suharnomo, Satrio. (2020). *Liquidity Management and Factors Influencing Factoring Decisions in Indonesia*. Yogyakarta: Publisher: Gramedia. p 67

In addition, factoring agreements can also provide additional benefits in managing credit risk by providing access to more accurate information about a customer's credit profile. Lenders often have sophisticated risk analysis systems in place and can provide valuable insights to companies about potential credit risks they may face.

Thus, although factoring can help reduce the credit risk faced by companies, companies also need to consider the concentration risks and costs associated with using these financial instruments. The decision to use factoring should be carefully considered and based on a thorough analysis of the company's specific needs and financial condition.³⁰

Broadly speaking, the following is the impact of Factoring on Credit Risk: ³¹

1) Credit Risk Reduction

By receiving cash payments from lenders, companies can reduce the credit risk associated with their accounts receivable. Funders who typically have more resources and experience in assessing credit risk can help reduce a company's exposure to default risk.

2) Increased Risk of Concentration

However, factoring agreements can also increase concentration risk as companies become more reliant on a few large customers who may be the subject of factoring. If one of those key customers fails to pay, the impact can be very significant for the company.

Impact of Factoring Agreement on Company's Cash Management

The impact of factoring agreements on the company's cash management is significant. First of all, factoring provides direct access to liquidity by converting accounts receivable into cash. This allows companies to meet immediate financial obligations and manage their operations without having to wait for payment from

³⁰ Bachsan Mustafa, 2003, *Integrated Indonesian Legal System*, Bandung: PT Citra Aditya Bakti.

³¹ Wibowo, Slamet. (2017). *Corporate Finance: Analysis and Management*. Jakarta: Salemba Empat Publishers. p 45

customers. Thus, factoring can be an effective tool to overcome liquidity problems that may be faced by a company, especially in situations where working capital becomes limited.³²

In addition, factoring can also reduce the risk of delayed payments or defaults from customers. By selling accounts receivable to a financier, the company transfers the credit risk associated with the receivables to another party. This provides additional protection for the company against potential financial losses due to late payments or customer bankruptcy.

However, it is important to remember that the use of factoring also presents costs and interest that need to be considered in the management of a company's cash. Lenders usually charge an administration fee as well as interest on their factoring services. Therefore, companies need to carefully evaluate whether the liquidity benefits derived from factoring outweigh the costs associated with it.³³

In addition, companies also need to consider the long-term implications of using factoring on their overall capital and financial structure. Although factoring can provide a quick liquidity solution, relying too much on this factor can also reduce a company's financial flexibility and increase dependence on external financiers.

Thus, it is important for companies to conduct a thorough evaluation of the benefits and costs of using factoring in their cash management. This decision should be carefully considered in accordance with the specific needs and financial condition of the company, as well as taking into account its long-term impact on the capital structure and overall financial health of the company.³⁴

CONCLUSION

The results showed that;

³² Triyono, Budi. (2019). Factors Influencing Factoring Selection in Manufacturing Companies in Indonesia. Surabaya: New Library Publisher. p 73

³³ *Ibid*, p 75

³⁴ Y. Sogar Simamora, 2000, "Insurer Liability of Personnel Guarantee and Corporate Guarantee; in Puspa Variety of Intorination and Legal Problems, Karya Aditama, Surabaya, p.68.

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