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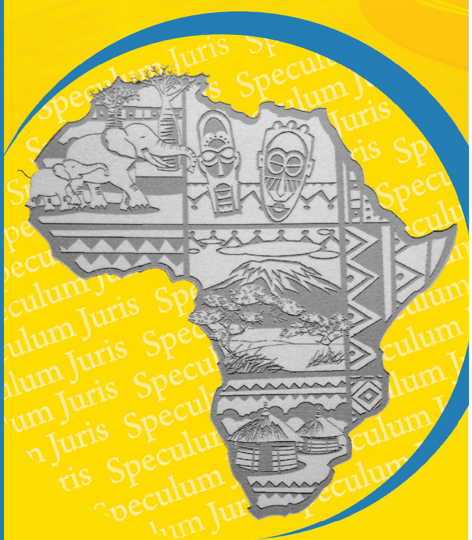

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Sustaining Access to Finance for Africa's Small and Medium Enterprises During and Post COVID-19 Crisis: Factoring to the Rescue

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Abstract

The COVID-19 crisis has caused many problems, one of which is the challenge for African SME's to access traditional debt financing from banks. This situation has made it imperative to explore other alternative forms and sources of financing that SMEs can rely on to sustain their operations. It is in this context that this article examines the useful role that factoring could play in sustaining financing to SMEs in Africa amidst and after the COVID-19 crisis. The article recommends that a multifaceted approach involving the implementation of both legal and other forms of interventions such as digitalisation is imperative for growing factoring as a financing alternative for African SMEs.

Keywords: SMEs; COVID-19 crisis; factoring; open accounts; trade credit; receivables

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1 INTRODUCTION

Globally, small and medium enterprises (SMEs) are among the economic stakeholders that have been most adversely affected by the COVID-19 pandemic.[1] Before this crisis,[2] the yearly unmet financing needs of SMEs in developing countries were estimated at US$5,2 trillion.[3] Amidst the crisis, access to financing for SMEs from internal sources and banks has worsened, thereby threatening their survival.[4]

Closer to home, Africa recorded its first COVID-19 case on 14 February 2020 in Egypt before the virus gradually spread to the rest of the continent.[5] Even before the COVID-19 crisis, SMEs in Africa faced a significant financing gap estimated at over US$ 331 billion each year,[6] chiefly because most of them were (and still are) either underserved or unserved by the banking sector.[7] Apart from leaving a lasting impact on Africa's SMEs and leading to the extinction of quite a few, the COVID-19 crisis is widening the financing gap.[8]

Therefore, it has become critical to broaden the range of financing solutions and sources available to SMEs to help them scale the amplified shortage of finance occasioned by the COVID-19 crisis.[9] This financing intervention is also imperative so that SMEs can support the post-COVID-19 pandemic economic revival of their host African countries.[10] Specifically, there is an urgent need to promote suitable alternative financing solutions and sources that can complement or substitute traditional debt financing from banks. Factoring is one such alternative.

Factoring is an arrangement between a financial institution ("factor") and a business ("seller") that has delivered goods or services to its customer ("debtor") on open account or trade credit terms.[11] Under the arrangement, the factor, for an agreed fee, performs one or more of the following services regarding the receivables (also called book debt) arising from the sales

1 The definition of SMEs varies across countries, international organisations, industries, and policy objectives. However, in most countries, SMEs have been defined as businesses employing less than 250 people and this article follows this definition. For an elaborate discussion on the definition of SMEs see generally Berisha and Pula "Defining Small and Medium Enterprises: A Critical Review" 2015 *Academic Journal of Business, Administration, Law and Social Sciences* 17 17.

2 In business literature, the term "crisis" is used broadly to describe all internal or external events (such as pandemics) that are unexpected and also disrupt the operations and financial conditions of businesses. See generally Kahveci "Surviving COVID-19 and Beyond: a Conceptual Framework for SMEs in Crisis" 2021 *Business: Theory and Practice* 167 167.

3 International Finance Corporation *MSME Finance Gap: Assessment of the Shortfalls and Opportunities in Financing Micro, Small and Medium Enterprises in Emerging Markets* (2017) 28.

4 Hertati and Widiyanti "The Effects of Economic Crisis on Business Finance" 2020 *International Journal of Economics and Financial Issues* 236 236.

5 Anyanwu and Salami "The Impact of COVID-19 on African Economies: An Introduction" 2021 *African Development Review* 1 1–2.

6 International Finance Corporation *MSME Finance Gap* (2017) 31.

7 Quartey and Turkson "Financing the Growth of SMEs in Africa: What are the Constraints to SME Financing Within ECOWAS?" 2017 *Review of Development Finance*18 18.

8 Amoussou and Karagueuzian "African SMEs through COVID-19: Challenges, Policy Responses and Recommendations" 2021 *Africa Economic Brief* 1 2–4.

9 *Ibid.*

10 United Nations Conference on Trade and Development "Supporting Small Businesses is Critical for COVID-19 Recovery" https://unctad.org/fr/node/32737 (accessed 27-02-2022).

11 See generally Moore "Factoring - A Unique and Important Form of Financing and Service" 1959 *The Business Lawyer* 703 706; also see EU Federation *The Glossary on Factoring and Commercial Finance* (2017) 8.

transaction between the seller and debtor:[12] (i) To provide a percentage of the receivables as financing to the seller; (ii) To maintain the ledger and perform other bookkeeping duties relating to the receivables (receivables management); (iii) To collect the receivables from the debtor when it is due for payment (debt collection); and (iv) To assume the losses which may arise from the debtor's inability to pay when the receivables are due for payment (credit risk protection).[13]

Apart from these four primary services, the factor may also provide advisory services, marketing surveys, and production counselling to the seller.[14] In some countries, the provision of factoring services is restricted to either only licenced banking institutions (bank factors) or non-bank financial institutions like finance companies (non-bank factors).[15] In other countries, it can be provided by both bank and non-bank financial institutions.[16]

Notably, over the years, factoring has established a reputation for its cost-effective and convenient financing requirements that allows SMEs to access it and remain solvent during times of crisis.[17] This reputation is resounded in Ivanovic and Baresa's description of factoring as an efficient and effective short-term financing product for SMEs seeking to expand operations but unwilling or unable to access finance from banks, especially in times of crisis when it is more difficult to access financing.[18]

The problem, however, is that the practice of factoring across most African countries is still at a very low level or even non-existent.[19] Recent statistics from Factors Chain International (FCI), the world's largest network of factoring firms, reveal that Africa accounts for less than one per cent of the global factoring turnover.[20] Studies that have investigated the reasons behind the low development of factoring in the continent have majorly attributed it to the lack of facilitative legal frameworks in most African countries.[21] More specifically, this comprises the absence of specific laws on factoring, lack of tax incentives, and unfavourable regulatory regime for non-bank factors.[22] Other obstacles include the general lack of awareness about factoring and the underdevelopment of the credit risk insurance and credit information systems in most African countries.[23]

Because the low development of factoring has been majorly attributed to the lack of facilitative legal frameworks, existing legal scholarship has placed so much emphasis on the need for

12 Receivables means money owed to a seller by its customer following the sale of goods or services to the customer on open account or trade credit terms and which is legally enforceable against such customer. Receivables generally takes the form of an invoice raised by the seller and delivered to the customer for payment within an agreed timeframe. See EU Federation *The Glossary on Factoring* 3.

13 See generally Moore 1959 *The Business Lawyer* 703 706; also see EU Federation *The Glossary on Factoring* 8.

14 *Ibid.*

15 Strauss *Regulatory Framework for Factoring – Egypt Financial Services Project* (2005) 8.

16 *Ibid.*

17 Polak "Addressing the Post-Crisis Challenges in Working Capital Management" 2021 *International Journal of Research in Management* 73 74.

18 Ivanovic and Baresa "Factoring: Alternative Model of Financing" 2011 *UTMS Journal of Economics* 189 196.

19 Tomusange "Factoring as a Financing Alternative for African Small and Medium-Sized Enterprises" (PhD-thesis, WU, 2015) 86.

20 FCI "Industry Statistics" http://www.fci.be/en/statistics/fci.aspx (accessed 24-10-2021).

21 See generally Kameni 2014 *Contemporary Issues in African Trade and Trade Finance* 27 27–40; Korankye-Sakyi *Factoring as a Means of Promoting Small and Medium Scale Enterprises: The Case for a Legal Framework for Credit Factoring in Ghana* (LLM-thesis, UP, 2019) 88–89; Hamanyati "Factoring as an International Trade Finance Product: Making a Case for the Enactment of a Factoring Act in Zambia" (LLM-thesis, UP, 2017) 75–77.

22 *Ibid.*

23 *Ibid.*

African countries to enact factoring laws, institute tax incentives, and ease the regulatory regime for non-bank factors as ways to promote factoring.[24] However, in the face of how the COVID-19 crisis is redefining how firms of all sizes ought to conduct their business, it becomes germane to consider whether more than these legal interventions are imperative to promote the growth of factoring in Africa.

In particular, the COVID-19 crisis has served as a catalyst and sped up the trend toward digitalisation.[25] There is now an evident shift of commercial activities from predominantly offline and brick-and-mortar outlets (physical stores) to online platforms.[26] This shift benefits businesses in many ways. It improves their productivity, cost-saving, efficiency, and greater reach to more customers.[27] Influenced by the COVID-19 crisis, the digital transformation market size is projected to grow from US$ 521,5 billion in 2021 to over US$1 trillion by 2026.[28] Accordingly, it becomes useful to consider whether and how digitalisation can be employed to accelerate the availability and use of factoring as a financing alternative for SMEs in Africa.

Considering this context, three objectives have been defined for this article. First to explore why and how factoring may be very useful in supporting financing to SMEs in Africa amidst and after the COVID-19 crisis. Second, to understand the extent to which legal interventions impact the growth of factoring using South Africa and Egypt as case studies and focusing on interventions around having factoring laws and introducing tax incentives. Lastly, to explore how, and the forms of digitalisation initiatives that could be employed by policymakers and regulators in Africa to accelerate the availability and use of factoring as a financing alternative for SMEs.

2 THE PROBLEM OF SME FINANCING IN AFRICA: WHAT ARE THE KEY ISSUES?

SMEs contribute tremendously to addressing some of the most pressing challenges confronting the African continent.[29] Apart from their major role of creating jobs, SMEs provide tax revenue to governments and assist in reducing poverty.[30] Statistically, SMEs dominate Africa's private sector as they represent more than 90 per cent of businesses; they also provide an estimated 60 per cent of employment and account for over 50 per cent of the region's gross domestic product (GDP).[31] Unfortunately, SMEs across Africa face a host of challenges that hamper their survival, growth, and expansion. The most significant of these challenges is that they receive a disproportionately insignificant share of financing from banks.[32] The reasons for this are explained in the ensuing subsections.

2 1 The Problems of Cost and Credit Conditions

Banks are the most sought-after source of debt financing (either as term loans, overdrafts, credit

24 *Ibid.*

25 Amankwah-Amoah *et al.* "COVID-19 and Digitalization: The Great Acceleration" 2021 *Journal of Business Research* 602 602.

26 *Ibid.*

27 Bhagat "How Does Digitalization Benefit Your Business- A Quick Overview" https://customerthink.com/how-does-digitalization-benefit-your-business-a-quick-overview/ (accessed 24-10-2021).

28 *Ibid.*

29 International Trade Centre *Promoting SME Competitiveness in Africa: Data for De-risking Investment* (2018) 4.

30 Muriithi "African Small and Medium Enterprises (SMEs) Contributions, Challenges and Solutions" 2017 *European Journal of Research and Reflections in Management Sciences* 36 37–44.

31 *Ibid.*

32 *Ibid.*

lines or guarantees) for SMEs in Africa, especially those that cannot access the stock market for equity financing.[33] Unfortunately, accessing debt financing from banks is both costly and tasking for SMEs as explained below.

Banks regard SMEs as high-risk borrowers because of their vulnerability to market fluctuations, insufficient assets, low capitalisation, and high failure rates.[34] Additionally, SMEs have information asymmetry or opacity because they do not maintain proper business records, accounting records, and financial statements, thus making it difficult for creditors to assess their creditworthiness.[35] As a result of all these, SMEs are "credit rationed" by banks in favour of larger firms.[36] Simply put, banks are more willing to lend to larger firms than SMEs because they have more reliable information, better credit ratings, chances of success, and higher profitability.[37] In occasional circumstances that commercial banks lend to SMEs, they charge higher interest rates to account for the riskiness of lending to SMEs.[38]

It will be thought that non-bank lenders such as finance companies, money lenders, and digital lending firms will provide SMEs with cheaper debt financing than banks. But this has not been the case.[39] The interest rates of commercial banks in Africa are usually in double digits and could sometimes even be higher than 20 to 25 per cent.[40] On the other hand, non-bank lenders could charge higher rates, as much as 40 to 50 per cent.[41] It has been stressed that "high interest rates often deter SMEs from even trying to apply for financing. This lack of affordable financing seriously hinders SMEs in Africa."[42]

Apart from the high-interest charges that SMEs incur to secure debt financing from banks (and non-bank lenders), they are also required to meet other extensive credit conditions.[43] SMEs may be required by banks to provide security or collateral for loans in the form of fixed assets (such as land, buildings, or heavy machinery) and or payment guarantees.[44] Additionally, they could be required to procure insurance policies and make high-equity contributions to the project being financed.[45] Notably, unlike larger firms that have fixed assets, SMEs do not usually have such assets. The bulk of SMEs' assets are constituted as receivables and other movable properties.[46]

33 Ghulam and Iyofor "Bank Credit Availability to SMEs in Nigeria: The Impact of Firm and Owner Characteristics" 2017 *Research Journal of Finance and Accounting* 10 10.

34 Ricupero and Warner *Improving the Competitiveness of SMEs in Developing Countries. The Role of Finance to Enhance Enterprise Development* (2001) 3.

35 Mutezo "Credit Rationing and Risk Management for SMEs: The Way Forward for South Africa" 2013 *Corporate Ownership and Control* 153 155.

36 Domeher and Musah "Micro Determinants of the Extent of Credit Rationing Amongst SMEs in Ghana" 2017 *International Journal of Social Economics* 1796 1811.

37 *Ibid.*

38 Saari *Challenges Faced by SMEs When Accessing Loans from Financial Institutions in Nigeria* (BBA-thesis, HMUAS, 2020) 44.

39 Centre for Strategic & International Studies "Supporting Small and Medium Enterprises in Sub-Saharan Africa through Blended Finance" https://www.csis.org/analysis/supporting-small-and-medium-enterprises-sub-saharan-africa-through-blended-finance (accessed 24-10-2021).

40 *Ibid*.

41 *Ibid.*

42 *Ibid.*

43 Abbadi and Karsh "Methods of Evaluating Credit Risk Used by Commercial Banks" 2013 *International Research Journal of Finance and Economics* 146 146.

44 *Ibid.*

45 *Ibid.*

46 Bazinas "An International Legal Regime for Receivables Financing: UNITRAL's Contribution" 1998 *Duke Journal of Comparative & International Law* 315 315.

2 2 Traditional Debt Financing Model as the Real Issue

The issues around the high cost and challenging credit conditions discussed above partly result from the fact that banks and other non-bank lenders sometimes follow the traditional approach to debt financing. Under this model, debt financing is extended to SMEs primarily based on their overall creditworthiness.[47] The SMEs' expected cash flow is used as the primary source of debt repayment, while the secondary source of repayment is the collateral (preferably fixed assets) and or guarantees provided by the SME to secure the debt.[48]

Traditional lending differs from asset-based financing (ABF), in which financing is extended based on an underlying movable or immovable asset and not the creditworthiness of the borrowing SME.[49] Such an asset is both the primary and secondary source of repayment.[50]

Factoring alongside other ABF solutions like invoice discounting, asset-based lending, warehouse receipts, and purchase order finance are considered more suitable and tailored to SMEs than traditional lending.[51] In capturing their suitability over traditional lending it has been observed that "through asset-based finance, firms obtain funding based on the value of specific assets, including receivables, inventory, machinery, equipment and real estate, rather than on their credit standing. In this way, it can serve the needs of young and small firms that have difficulties in accessing traditional lending."[52]

Banks remain central in the policy agenda of improving access to finance for SMEs in Africa. Accordingly, policymakers and regulators in Africa should take the approach of either encouraging (or preferably, mandating) that specific portions of banks' financing portfolios are channelled to the provision of ABF solutions to qualifying SMEs. Likewise, it is imperative to closely regulate and supervise the rates and fees charged by non-bank financial institutions for their services to SMEs to tackle the problem of high-financing costs.

3 THE PROBLEM OF SME FINANCING IN AFRICA: THROUGH THE PRISM OF THE COVID-19 CRISIS

Eggers identified the shortage of financing as the most obvious challenge that SMEs face in times of crisis.[53] He attributes this challenge to two key reasons. First, SMEs have lower revenues because consumers either reduce or completely stop spending. Second, banks become more careful in lending to SMEs and operate with stricter credit conditions or requirements due to the market's volatility and uncertainty. These predictions highlighted by Eggers reflect the current plights of SMEs in Africa in the context of the COVID-19 crisis.

On the issue of a drop in revenues accruing to SMEs, COVID-19's alarming spread forced respective African governments to impose a host of non-pharmaceutical interventions (NPIs), including lockdowns, border closures, and travel bans, as the world eagerly awaited the invention of vaccines. While these interventions were necessary to contain the spread of the virus and reduce the pressure on health care systems, they left the economies of most African countries

47 Bakker *et al. Financing Small and Medium-Size Enterprises with Factoring: Global Growth and its Potential in Eastern Europe* (2004) 4.

48 *Ibid.*

49 *Ibid.*

50 *Ibid.*

51 Cusmano and Koreen *New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Instruments* (2015) 6.

52 *Ibid.*

53 Eggers "Masters of Disasters? Challenges and Opportunities for SMEs in times of Crisis" 2020 *Journal of Business Research* 199 199.

in a comatose state.[54] Particularly, they dealt a heavy blow toSMEs' productivity and financial health as they disrupted supply chains and suffocated cash flows (occasioned by a reduction in sales).[55] Speaking numbers, exporters in Africa were projected to have lost about US$2,4 billion from supply-chain exports due to the shutdown of factories in China, the European Union, and the United States of America.[56] It is further estimated that two out of three businesses in Africa experienced a drop in sales by about 75 per cent and a 54 per cent decline in their ability to access inputs.[57]

With reference to the issue of scarcity of bank financing to SMEs, a recent article posits that "the costs of undertaking credible risk assessment have increased significantly with Covid-19; consequently, local commercial lenders [in Africa] have pulled back on their financing in general, given the higher-risk environment."[58] It has also been predicted that "financial institutions [in Africa] will be more reluctant to provide additional credit to SMEs under the current conditions of COVID-19 given how cumbersome it will be for them to determine the extent and adequacy of collaterals, identify which borrowers are facing longer-term financial difficulties and be able to adequately cover monitoring costs."[59]

Previous research has indicated that another likely offshoot of the crisis is an increased demand for trade credit or open account trade both by and from SMEs. For example, following the 2008–2009 global financial crisis (GFC), many larger firms sought ways to preserve their cash resources, particularly cash constituted as payables (money for goods or services received from sellers but yet to be paid for).[60] This protection was achieved by requesting their SMEs that are sellers to grant them trade credit.[61]

Love and Preve find that there is generally the widespread use of trade credit during an economic or financial crisis.[62] One other study establishes that firms in financial distress (which could result from a crisis such as the COVID-19 crisis) are prone to substitute debt and equity financing with trade credit from their sellers.[63] The study also points out that trade credit is used to substitute financial credit (such as loans from banks) when the latter is unavailable.[64]

Even before the COVID-19 pandemic, there was an increasing appetite for the supply of trade credit or open account trade within domestic markets in Africa as well as for intra-Africa trade.[65] The COVID-19 crisis will only exacerbate this appetite as most businesses will turn to trade

54 Gondwe *Assessing the Impact of COVID-19 on Africa's Economic Development* (2020) 3.

55 Aidoo and Agyapong "The Performance Implications of Strategic Responses of SMEs to the COVID-19 Pandemic: Evidence from an African Economy" 2021 *Africa Journal of Management* 74 74.

56 Muriithi "The Impact of Covid-19 on African SMEs, Possible Remedies and Source of Funding" 2021 *European Journal of Research and Reflections in Management Sciences* 5 6.

57 *Ibid.*

58 Dasewicz and Simon "Financing Small Business is Criticalfor a Strong Post-Covid Recovery" https://www.csis.org/analysis/financing-small-business-critical-strong-post-covid-recovery (accessed 24-10-2021).

59 Amoussou and Karagueuzian 2021 *Africa Economic Brief* 1 4.

60 Caniato and Moretto "A Financial Crisis is Looming for Smaller Suppliers" https://hbr.org/2020/08/a-financial-crisis-is-looming-for-smaller-suppliers (accessed 24-10-2021).

61 *Ibid.*

62 Love and Preve "Trade Credit and Bank Credit: Evidence from Recent Financial Crises" 2007 *Journal of Financial Economics* 453 453.

63 Molina and Lorenzo "An Empirical Analysis of the Effect of Financial Distress on Trade Credit" (2012) *Financial Management* 187 187.

64 *Ibid*.

65 Awani "Factoring: An Alternative SME Financing Instrument for Intra-African Trade Promotion" 2020 *Contemporary Issues in African Trade and Trade Finance* 78 84.

credit as a major source of financing.

Although trade credit or open account trade benefits SMEs that are sellers and buyers (debtors) alike, it presents numerous risks and challenges for SMEs that are sellers. First, there is the risk that the seller may suffer cash flow shortages before the debtor pays. There is also the risk that the debtor could delay or default in settling the receivables when it becomes due for payment (credit risk). Additionally, the trade practice requires other administrative functions like notifying the debtor about the debt, additional bookkeeping, and debt collection.

On the premise of the foregoing, it becomes imperative to look towards alternatives that can complement or substitute traditional financing from banks while also addressing the increasing demand for open account trade or trade credit by customers transacting with SMEs that are sellers. Here lies the benefit of factoring. The ensuing section examines the concept of factoring, focusing on its mechanics, types, merits, and demerits as well as its contractual, legal, and regulatory underpinnings. The section ends by highlighting the justifications factoring will be suited for supporting financing to SMEs during and post the COVID-19 crisis.

4 FACTORING – A CRISIS-TAILORED FINANCING ALTERNATIVE TO THE RESCUE

4 1 Key Dynamics of Factoring

Three key parties are involved in a factoring transaction.[66] First is the seller that has sold goods or supplied services to a debtor on open account or trade credit terms under a contract of sale and thereafter assigns the receivables resulting from such contract to the factor.[67] Second, the debtor who has been delivered goods or services by the seller, and is obligated to settle the receivables (his payables) at a specified future date in accordance with the contract of sale.[68] Lastly, the factor who is assigned the receivables at a discount by the seller and provides a range of services such as financing, credit risk protection, receivables management, and debt collection, as agreed with the seller under a factoring contract.[69]

Before entering a factoring contract, factors are likely to undertake at least two key assessments to determine the viability of the transaction. First, the factor investigates the validity of the receivables sought to be assigned to confirm that it exists and that they are creditworthy and can be enforced against the debtor.[70] In this respect, factors will unlikely undertake factoring transactions for receivables that will not be paid (bad debt), receivables that may likely become bad debt (doubtful debt), or receivables that cannot be legally claimed from the debtor.[71] Second, since the ultimate obligation to pay is on the debtor, the factor assesses the debtor's creditworthiness to assure himself that the debtor can pay.[72] The factor can conduct this assessment by examining the debtor's payment history with the seller or other information available about the debtor from credit bureaus and business registries.[73] This second requirement explains the

66 See generally Nabawanda *Small and Medium-Size Enterprise Owner Strategies for Invoice Factoring Financing* (DBA-thesis, WU, 2018) 36.

67 *Ibid.*

68 *Ibid.*

69 *Ibid.*

70 Klapper "The Role of Factoring for Financing Small and Medium Enterprises" 2006 *Journal of Banking & Finance* 3112 3112.

71 *Ibid.*

72 Strauss *Regulatory Framework for Factoring* (2005) 3–4.

73 *Ibid.*

reason a sound credit information system is critical for factoring to thrive in a country.

Further, there are classes of receivables that cannot be "factored" or subject to factoring.[74] They include receivables incurred by a debtor for goods or services for his personal, family, or domestic use.[75] These classes of receivables are distinguished from receivables arising from business-to-business (B2B) or business-to-government (B2G) transactions.[76] It is widely accepted that factoring is a suitable financing alternative for SMEs that sell B2B or B2G.[77]

4 2 Contractual Aspects of Factoring

Two key contractual arrangements underpin factoring transactions.[78] On the one hand, is the contract of sale between the seller and debtor for the delivery of goods or services.[79] On the other hand, is the factoring contract between the seller and factor for the assignment of receivables and delivery of factoring services.[80]

The contract of sale will typically allow for payment by the debtor on a trade credit or open account basis, thereby giving rise to the receivables that the seller can assign to the factor under the factoring contract in exchange for agreed factoring services.[81] Although the contract of sale and factoring contract are mutually exclusive, the factoring contract takes into consideration key terms and issues arising from the contract of sale. For example, it is more viable to enter the factoring contract if the seller has discharged the delivery of goods or services in accordance with agreed specifications and standards under the contract of sale.[82]

Another major consideration is whether a clause in the contract of sale prohibiting the seller from assigning his receivables arising from the contract to a third party (like the factor) can operate to invalidate a factoring contract. This question was considered in the English case of *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd*,[83] and the court established the rule that an assignment done in breach of a prohibition on assignment clause will render such assignment ineffective against the debtor, but the factor will still be entitled to the proceeds of receivables from the seller. A law could however provide that an assignment of receivables to the factor done in violation of a prohibition on assignment clause will still be binding on the debtor, seller, and factor. In this respect, all the treaties and model laws relating to factoring discussed below contain such provisions overriding prohibition on assignment clauses.[84] If there is no such legal provision, the seller could explore the option of pleading with the debtor to waive the contractual prohibition in the contract of sale.

In terms of their contents, factoring contracts usually contain a description of the receivables

74 Salinger *Factoring Law and Practice* (2004) 2.

75 *Ibid.*

76 Milenkovic-Kerkovic and Dencic-Mihajlov "Factoring in the Changing Environment: Legal and Financial Aspects" 2012 *Procedia - Social and Behavioral Sciences* 428 435.

77 *Ibid.*

78 See generally, Philbrick "The Use of Factoring in International Commercial Transactions and the Need for Legal Uniformity as Applied to Factoring Transactions Between the United States and Japan" 1994 *Commercial Law Journal* 141 142.

79 *Ibid.*

80 *Ibid.*

81 See definition of factoring in paragraph 1 above.

82 Tomusange "Factoring as a Financing Alternative for African Small and Medium-Sized Enterprises" 2017 *Contemporary Issues in African Trade and Trade Finance* 50 53.

83 1994 1 AC 85.

84 See Art 6(1) of the Convention on International Factoring, 1988; Art 9 of the Convention on the Assignment of Receivables in International Trade, 2001; Art 8.1 of IFC Model Law on Factoring, 2014; and Art 7.1 of Afreximbank Model Law on Factoring.

assigned, set out the scope of the services provided by the factor as well as the fees that will be charged on the transaction.[85] The framing of the factoring contract becomes particularly important in jurisdictions that do not have factoring laws, which is the situation in most African countries. The factoring contract must be carefully drafted to cover all key areas and to ensure that the intentions of the parties are given effect in a manner that is legally enforceable.[86] Parties can draw lessons from the model laws highlighted below to have clarity on key issues that should be covered in the factoring contract.[87]

4 3 Forms of Factoring Arrangements

There are different variations of factoring arrangements, and these arrangements are dependent on terms agreed upon in the factoring contract and the law governing such transaction, if any.[88] The common arrangements and some of their legal and contractual underpinnings are discussed below.

4 3 1 International and Domestic Factoring

International factoring involves the assignment of receivables arising from a contract of sale between a seller and debtor in different countries.[89] On the other hand, domestic factoring involves the assignment of receivables arising from a contract of sale between a seller and debtor in the same country.[90] Domestic factoring is typically conducted by a single factor operating in the same country as the seller and debtor.[91] International factoring can also be conducted by a single factor (direct international factoring).[92] Alternatively, and more suitably, the two-factor system, involving co-operation between one factor in the seller's country (export factor), and one in the debtor's country (import factor) may be used.[93] In the two-factor system, there are two factoring contracts — one between the seller and factor and another inter-factor agreement between the export factor and import factor.[94] There are thus two levels to the assignment of receivables.[95]

4 3 1 1 Regulation of Domestic Factoring Transactions

The legal regime for domestic factoring transactions across different countries exists in one of three forms.[96] In some countries, there are specific laws — factoring laws — that regulate factoring transactions.[97] For other countries, their civil codes contain certain assignment provisions in support of factoring.[98] Lastly, some countries do not have rules for factoring transactions in any statutory form, which is where most African countries fall.[99] For countries

85 Alexander "Towards Unification and Predictability: The International Factoring Convention" 1989 *Columbia Journal of Transnational Law* 353 358.

86 Bregmans "Factoring" https://www.bregmans.co.za/factoring/ (accessed 27-02-2022).

87 See paragraph 4 3 1 1 below.

88 Salinger *Factoring Law and Practice* (2004) 15.

89 Strauss *Regulatory Framework for Factoring* (2005) 3–4.

90 *Ibid.*

91 *Ibid.*

92 *Ibid.*

93 *Ibid.*

94 *Ibid.*

95 *Ibid.*

96 European Bank for Reconstruction and Development *Factoring Survey in EBRD Countries of Operation* 3ed (2018) 3–4.

97 *Ibid.*

98 *Ibid.*

99 *Ibid.*

that fall under the third heading, the factoring framework constitutes mainly general contract law provisions, and case laws, if any.[100]

There is generally the consensus that factoring is easier to navigate in countries that have factoring laws.[101] A factoring law answers certain questions that may be subject to controversy if there is no law or if such questions have not been resolved by case law.[102] In essence, factoring laws (and case laws) help to create certainty and predictability in the legal regime under which factoring is practised. It has been stressed that the uncertainties brought about by the absence of factoring laws in most African countries have rendered the financing practice a risky business thereby hindering its growth in the continent.[103]

Model laws have been developed over the years to assist countries in their efforts to update or enact domestic factoring laws that reflect international best practices. The first such model laws were prepared by FCI in 2014.[104] The most recent is the Afreximbank Model Law on Factoring developed and launched by the African Export-Import Bank (Afreximbank) in 2016.[105] The Afreximbank Model Law on Factoring was conceived by Afreximbank in recognition that the lack of factoring laws has been a major constraint to the development of factoring in Africa.[106] Countries like Nigeria are adopting the Afreximbank Model Law on Factoring for enacting their national factoring law.[107] There is a third model law on the way as a Working Group has been set up under the auspices of UNIDROIT to develop a Model Law on Factoring that will help countries in enacting or updating their factoring laws.[108]

4 3 1 2 Regulation of International Factoring Transactions

International factoring transactions are regulated by treaties and these treaties have come about because of the divergencies in rules for domestic factoring transactions across different countries.[109] The first treaty on international factoring is the International Institute for the Unification of Private Law's (UNIDROIT) Convention on International Factoring, 1988.[110] The Treaty entered into force on 1 May 1995 and has so far been ratified by nine countries comprising Belgium, France, Germany, Hungary, Italy, Latvia, Nigeria, Russia, and Ukraine.[111]

The UNIDROIT Convention was followed by the Convention on the Assignment of Receivables

100 *Ibid.*

101 Malhotra *et al. Expanding Access to Finance: Good Practices and Policies for Micro, Small, and Medium Enterprises* (2015) 9.

102 Some of these questions include whether: (i) recourse factoring qualifies as a sale or secured lending transaction; (ii) the debtor must be notified about the assignment of his trade payable to the factor for the assignment to be effective; and (iii) an assignment of receivables in breach of a prohibition of assignment clause will be binding on the buyer.

103 Oramah "From the Periphery to the Centre: Africa as the Growth Market for Factoring" 2014 *Contemporary Issues in African Trade and Trade Finance* 5 8.

104 The Model Law is available at https://fci.nl/en/media/184/download (accessed 24-10-2021).

105 The Model Law is available at https://elibrary.acbfpact.org/acbf/collect/acbf/index/assoc/HASHeeae/afaab6d8/fa9a6668/10.dir/Model%20Law%20on%20Factoring_ENGLISH_final.pdf (accessed 24-10-2021).

106 Tatge and Kameni "Afreximbank's Model Law on Factoring" in Bickers (ed) *World Factoring Yearbook* (2017) 7.

107 *Ibid.*

108 Hameed and Liu "Model Law on Factoring: UNIDROIT's Approach to Receivables Financing" https://www.tradefinanceglobal.com/posts/model-law-on-factoring-unidroits-approach-to-receivables-financing/ (accessed 24-10-2021).

109 Marak and Pillai "Relationship Between International Factoring and Cross-border Trade: A Granger Causality Approach" 2021 *The Journal of Applied Economic Research* 320 325

110 The status of ratification and the Convention is available at https://www.unidroit.org/ (accessed 24-10-2021).

111 *Ibid.*

in International Trade developed in 2001 under the United Nations Commission for International Trade Law (UNCITRAL).[112] The UNCITRAL Convention has been ratified by only Liberia and the United States of America and is yet to come into force.[113] However, unlike the UNIDROIT Convention which focuses only on factoring, the UNCITRAL Convention deals with a broad range of ABF solutions.[114] The UNCITRAL Convention covers factoring and other ABF solutions such as asset-based lending, forfaiting, securitisation, and invoice discounting.[115]

Apart from the treaties, international factoring transactions are also contractually regulated by binding rules of international factoring associations such as the FCI.[116] Particularly, IFC has developed the FCI Constitution, General Rules of International Factoring, edifactoring.com Rules, and the Rules of Arbitration which form the frameworks through which its members undertake the two-factor system of factoring transactions[117]

4 3 1 3 Regulation of Factors

How bank and non-bank factors are regulated and supervised, whether they are undertaking domestic or international factoring transactions, is a matter exclusive to national laws.[118] The regulation of factors can exist under either of two environments: Factors are either not regulated; or they are regulated along with other financial services such as banking.[119] Kara notes that the regulation of factors is important to promote high-quality market standards, control unprofessional behaviours, boost transparency, mitigate risk and build customer confidence.[120]

In jurisdictions where factoring can be provided by both bank and non-bank factors, it is advised that the regulatory regime for non-bank factors should not be too stringent so that there is a wider pool of factors that can serve the needs of SMEs.[121] An overly strict regime for non-bank factors could lead to the concentration of factoring services in the banking sector, thereby limiting the sources from which SMEs can access factoring services.[122] It has further been stressed that since non-bank factors do not take deposits as banks, they should not be subjected to excessive capital requirements because they do not pose systemic risks like banks which take deposits.[123] Kameni alludes that the excessive capital requirements for non-bank factors in some African countries might have deterred the emergence of more factoring firms.[124]

4 3 2 Non-Recourse and Recourse Factoring

In non-recourse factoring, which is the more common and expensive practice, the factor takes over the debtor's credit risk such that if the debtor does not settle the receivables by the time it has matured for collection, the factor bears the loss.[125] To mitigate this loss, the factor could procure credit risk insurance from an insurance company. With this, if the debtor fails to pay,

112 The status of ratification and the Convention is available at https://uncitral.un.org (accessed 24-10-2021).

113 *Ibid.*

114 Milenkovic-Kerkovic and Dencic-Mihajlov 2012 *Procedia - Social and Behavioral Sciences* 428 435.

115 *Ibid.*

116 Strauss *Regulatory Framework for Factoring* (2005) 3–5.

117 *Ibid.*

118 *Ibid.*

119 Bakker *et al. Financing Small and Medium-Size Enterprises with Factoring* (2004) 21.

120 Kara "Factoring: To Regulate or Not to Regulate?" in Bickers (ed) *World Factoring Yearbook* (2017) 4.

121 European Bank for Reconstruction and Development *Factoring Survey in EBRD Countries of Operation* 3ed (2018) 3.

122 *Ibid.*

123 *Ibid.*

124 Kameni 2014 *Contemporary Issues in African Trade and Trade Finance* 27 33.

125 EU Federation *The Glossary on Factoring* (2017) 11.

the factor will claim against the insurance company. Accordingly, a sound credit insurance system is important for non-recourse factoring. Awani highlights that the limited credit insurance capacity of most African countries has limited the volume of non-recourse factoring transactions that factors in the continent can undertake.[126] Under recourse factoring, the factor can have "recourse" or claim against the seller for all or any portion of the assigned receivables that it is unable to settle by the payment due date.[127]

Some scholars assert that factoring is not a loan, but a sale of receivables.[128] In other words, factoring is an assignment by way of sale and not an assignment by way of security (secured loan).[129] This assertion is very valid in the context of non-recourse factoring since the factor assumes the debtor's credit risk. However, recourse factoring in which the advance payment structure is adopted could qualify as a secured lending transaction since the debtor's credit risk is not passed to the factor but remains with the seller. The Afreximbank Model Law on Factoring supports this interpretation that recourse factoring can qualify as a secured loan.[130] But some jurisdictions classify recourse factoring as an assignment by way of sale and not a secured loan.[131] The European Bank for Reconstruction and Development however holds the view, which this article endorses, that factoring is very distinct from secured lending in many respects and as such, recourse factoring should not be categorised as secured lending but should be taken as a form of title finance.[132]

4 3 3 Confidential and Non-Confidential Factoring

In non-confidential or notification factoring, the debtor must be notified about the assignment of his payable (the seller's receivables) to the factor, whether as a legal or contractual requirement for such assignment to be effective.[133] Further, in non-confidential or notification factoring, the debtor will usually be required to settle the receivables by paying directly to the factor.[134] However, for confidential or non-notification factoring, the debtor is not required to be notified of the assignment of the receivables to the factor.[135] Also with confidential or non-notification factoring, the debtor will settle the receivables by paying directly to the seller since he is unaware of the assignment of the receivables to the factor.[136] The Afreximbank Model Law on Factoring does not make notifying the debtor about the assignment to the factor a mandatory requirement for the validity of the assignment of the receivables to the factor.[137]

4 3 4 Advance Factoring and Maturity Factoring

In advance or prepayment factoring, which is the more common and expensive arrangement, the factor will pay the seller a percentage of the receivables (between 70 to 80 per cent) before

126 Awani "Factoring in Africa: Opportunities and Challenge" https://silo.tips/download/factoring-in-africa-opportunities-and-challenges-4#sidebar-close (accessed 27-02-2022).

127 EU Federation *The Glossary on Factoring* (2017) 11.

128 See Klapper 2006 *Journal of Banking & Finance* 3112 3112. Also see Bakker *et al. Financing Small and Medium-Size Enterprises with Factoring* (2004) 10.

129 Out-Law Guide "Security in Finance Transactions" https://www.pinsentmasons.com/out-law/guides/security-in-finance-transactions (accessed 27-02-2022).

130 See the Preamble of the Afreximbank Model Law on Factoring.

131 European Bank for Reconstruction and Development *Factoring Survey in EBRD Countries of Operation* 3ed (2018) 4

132 *Ibid.*

133 EU Federation *The Glossary on Factoring* (2017) 11.

134 Bregmans "Factoring" https://www.bregmans.co.za/factoring/ (accessed 27-02-2022).

135 *Ibid.*

136 *Ibid.*

137 See the Preamble of the Afreximbank Model Law on Factoring.

it matures for collection from the debtor.[138] The remaining balance of 20 to 30 per cent of the receivables (less applicable factor's fees and taxes) is paid over to the seller after the debtor has paid.[139] However, in maturity factoring, the seller is paid only after the receivables have been paid by the debtor.[140]

4 3 5 Traditional and Reverse Factoring

Traditional factoring is seller-led as it is the seller that initiates the factoring arrangement by calling on the factor to provide financing against his receivables before they mature for collection from the debtor.[141] Reverse factoring, also called supply chain finance (SCF) on the other hand is debtor-led.[142] It is the debtor (usually a high-credit quality debtor) that requests the factor to settle his payable (the seller's receivables) in advance in favour of the seller (less applicable charges borne by the seller) before it becomes due for settlement.[143]

4 4 Cost of Factoring

In consideration of the functions the factor performs, the seller is charged a service fee or commission by the factor.[144] This service fee, which ranges between 0,2 to 0,5 per cent of the value of receivables, is charged on all factoring transactions and is determined by the complexities of the arrangement.[145] In advance or prepayment factoring arrangement, the factor will additionally charge the seller an interest or discount rate on the advance payment (this ranges between 1,5 to 3 per cent above the base rate).[146] The factor would usually deduct all applicable fees and taxes to arrive at the portion of the receivables that will be paid to the seller.[147]

4 5 Benefits and Challenges of Factoring

Generally, accessing financing through factoring is more convenient for SMEs that are sellers when compared to traditional debt financing from banks.[148] This includes because factoring does not typically require the seller to provide collateral or other forms of security.[149] Additionally, processing financing through factoring is shorter and less rigorous.[150] Further, the factor does not consider the sellers' financial statement, fixed assets or credit history in making its financing decision.[151] Instead, the focus is on the debtor's creditworthiness.[152]

However, this is not to say that factoring does not have its limitations or disadvantages.[153]

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138 EU Federation *The Glossary on Factoring* (2017) 11.

139 *Ibid.*

140 *Ibid.*

141 World Bank Group *Promoting Digital and Innovative SME Financing* (2020) 27.

142 *Ibid.*

143 *Ibid.*

144 Milenkovic-Kerkovic and Dencic-Mihajlov 2012 *Procedia - Social and Behavioral Sciences* 428 430.

145 *Ibid.*

146 *Ibid.*

147 *Ibid.*

148 Vasilescu "Factoring – Financing Alternative for SMEs" 2010 Management of *International Business and Economics Systems* 13 19–20.

149 *Ibid.*

150 *Ibid.*

151 *Ibid.*

152 *Ibid.*

153 For an extensive list of the advantages and disadvantages of factoring see Hoti "Factoring: A Financial Instrument" 2014 *Interdisciplinary Journal of Research and Development* 1 9.

A disadvantage of factoring that is often highlighted is that it can be costly, particularly for non-recourse factoring that adopts the prepayment structure.[154] This problem of cost becomes exacerbated if factoring transactions attract value-added tax (VAT) on the portion of the factor's fees and stamp duty on the factoring contract.[155] It is for this reason that it has been recommended that factoring transactions should be excluded from VAT and stamp duty.[156]

Nonetheless, despite the significant cost of non-recourse factoring that adopts the advance payment structure, the cash flow convenience, credit risk protection, and receivables management services it provides make the cost worthwhile.[157] This combination (non-recourse and advance factoring) is, in fact, most suitable for SMEs.[158] Overall, factoring aids SMEs that are sellers to optimise their readily available internal resources (receivables) to source financing.

4 6 Factoring Through the COVID-19 Crisis

Given the various services available under factoring and its usefulness in addressing SMEs' access to finance challenges, factoring has experienced remarkable expansion over the years.[159] For example, the global factoring volume in 1998 was €500 billion (euro) and rose to €2,76 trillion at the end of 2018.[160] The global factoring volume stood at €2,72 trillion by the end of 2020.[161] Regionally, Europe was the biggest factoring market in 2020 holding 67,65 per cent of 2020's €2,72 trillion factoring volume, followed by the Asia Pacific (23,57 per cent), South America (3,06 per cent) and North America (2,44 per cent).[162] At around 0,93 per cent, Africa's share of global factoring volume was among the lowest, topping only that of the Middle East (0,35 per cent).[163]

It has been earlier noted that open account trade or trade credit sales surge during times of crisis.[164] Apart from its financing aspect, factoring is constituted by other credit management services provided by the factor that can serve as safeguards to SMEs that are sellers against some of the risks and challenges inherent in open account trade or trade credit sales.[165] For example, the seller may be able to receive immediate cash and not be exposed to a possible cash flow shortage if the arrangement entered is advance factoring.[166] Also, with non-recourse factoring, the SME enjoys full protection against the debtor's credit risk.[167] Further, the factor performs credit management services to the seller such as bookkeeping, credit risk assessment, and debt collection typically unavailable with traditional bank lending.[168]

The promotion of factoring as a financing alternative for SMEs in Africa is motivated by the huge costs and herculean credit conditions they encounter in accessing traditional debt finance

154 *Ibid.*

155 Klapper 2006 *Journal of Banking & Finance* 3112 3116.

156 *Ibid.*

157 European Bank for Reconstruction and Development *Factoring Survey in EBRD Countries of Operation* 3ed (2018) 1

158 *Ibid.*

159 Mahmudah and Susilowati "Factoring Agreement Model as an Effort of Protection for Small Business from Customers' Bankruptcy" 2018 *IOP Conference Series: Earth and Environmental Science* 102 102.

160 FCI 'Industry Statistics' http://www.fci.be/en/statistics/fci.aspx (accessed 24-10-2021).

161 *Ibid.*

162 *Ibid.*

163 *Ibid.*

164 See paragraph 3 above.

165 See paragraph 3 above.

166 See paragraph 4 3 4 above.

167 See paragraph 4 3 2 above.

168 See paragraph 4 above.

from banks.[169] Its promotion is also necessary given SMEs' limitations in accessing the stock market for equity financing.[170] The COVID-19 crisis is yet another justification for the promotion of factoring in Africa. In addition to factoring's suitability for open account trade or trade credit transactions, this justification lies in the fact that in previous crises like the Great Depression and GFC, factoring served to sustain financing to small businesses even as financing from banks declined.[171]

Admittedly, the global factoring volume declined by 6,5 per cent from 2019's €2,91 to €2,72 trillion in 2020, stemming from a reduction in domestic and international trade.[172] Nonetheless, with the NPIs having been lifted in most countries and trade gradually picking up, a bounce-back is anticipated in 2021 and the years going forward. This was also the case with the GFC.[173] Although the factoring volumes dropped in 2009 at the height of the GFC, the volume of 2010 far exceeded that of 2008.[174]

There are, therefore, reasonable grounds to project that factoring could, once again, play a vital role in ensuring liquidity to SMEs during and post the COVID-19 crisis. Many sellers would need trade credit to grow sales and attract buyers or importers that would otherwise be sceptical about spending.[175] Factoring cushions the risks and challenges of open account transactions or supply of trade credit. Having established the utility of factoring as a crisis-suitable financing solution, the ensuing section will consider the current state of factoring in Africa and discuss initiatives towards promoting factoring in the continent, especially in the context of the COVID-19 crisis.

5 CURRENT STATE OF FACTORING IN AFRICA AND THE WAY FORWARD

Over the years only a handful of African countries comprising South Africa, Egypt, Morocco, Tunisia, and Mauritius have consistently contributed significantly to Africa's factoring volumes.[176] Factoring thrives on the volume of trading activities in the economy. Since Africa accounts for roughly three per cent of global trade,[177] it should therefore not come as a shock that its market share of the factoring market is also low at barely one per cent.

Despite Africa's less than one per cent of global factoring activities, factoring has developed at an impressive pace in the continent.[178] Africa's factoring volume grew from €5,86 to €23,93 billion between 2001 to 2012.[179] Further, despite the COVID-19 crisis, Africa's factoring volume increased from €24,56 billion in 2019 to €25,56 billion in 2020, representing a growth of 2,8 per cent.[180] The continent's factoring volume is anticipated to exceed US$50 billion (about €42 billion) by 2025, especially in light of the African Continental Free Trade Area Agreement

169 See paragraph 2 above.

170 Olusoji and Enofe "Capital Market and the Development of the Small and Medium – Scale Enterprises in Nigeria" 2012 *IOSR Journal of Business and Management* 8 8.

171 See generally, Papadimitriou and Phillips *An Alternative in Small Business Finance: Community-based Factoring Companies and Small Business Lending* (1994) 20; also see Organisation for Economic Co-operation and Development *Financing SMEs and Entrepreneurs 2018: An OECD Scoreboard* (2018) 50.

172 FCI "Industry Statistics" http://www.fci.be/en/statistics/fci.aspx (accessed 24-10-2021).

173 Milenkovic-Kerkovic and Dencic-Mihajlov 2012 *Procedia - Social and Behavioral Sciences* 428 429.

174 *Ibid.*

175 See paragraph 3 above.

176 FCI "Industry Statistics".

177 World Trade Organisation Strengthening *Report on Africa's Capacity to Trade* (2021) 13.

178 Oramah "From the Periphery to the Centre: Africa as the Growth Market for Factoring" 2014 *Contemporary Issues in African Trade and Trade Finance* 5 14.

179 *Ibid.*

180 FCI "Industry Statistics".

(AfCFTA).[181]

In all, the African continent shows prospects of emerging as a huge market for factoring. However, for this to become a reality, the several legal and other roadblocks that currently stand in the way of the growth of factoring in most African countries as earlier highlighted must be addressed.[182]

5 1 Whether More than Legal Interventions are Imperative

The legal interventions that are necessary for the development and growth of factoring in Africa such as enacting factoring laws, introducing tax incentives, and promoting a conducive regulatory regime, have been extensively documented in legal scholarship.[183] However, the extent to which these interventions contribute to achieving these objectives has not been clarified. The assumption appears to be that factoring will thrive in African countries that have these legal interventions in place while in African countries where these legal interventions are yet to be implemented, the growth of the factoring industry will be hardly achieved.

However, certain studies, outside the African context, which have investigated the determinants of the growth of factoring suggest that factoring may still thrive in markets without facilitative legal interventions. For example, empirical research conducted by Klapper on 48 countries made the finding that factoring could still thrive in countries without factoring laws or that have weak contract enforcement systems.[184] The author notes, however, that factoring will hardly succeed in countries with weak credit information systems.[185] Another empirical research conducted on 15 developed and 10 emerging European countries, shows that factoring could still thrive and be utilised in countries with weak legal systems for the protection of creditors, political instability, and high enforcement costs.[186] The study explains that factoring could still thrive in these circumstances because in such countries bank financing could be more restricted and factoring would be viewed as a less stringent complementary financing option, thus leading to its increased patronage.[187] A similar conclusion was reached in another study by Borgia *et al*., in which the authors analysed data for a panel of 59 countries, over the period 1995 to 2005.[188]

With this view in mind, case studies of two leading factoring markets in Africa, South Africa, and Egypt, are undertaken in the ensuing subsections to deduce whether the growth of factoring in these countries is associated mainly with legal interventions.

5 1 1 South Africa

The legal system of South Africa is a hybrid of Roman-Dutch Law and English Law.[189] South Africa is the only country in Africa with a formalised factoring industry existing for more than four decades.[190] But still, South Africa does not have a factoring law.[191] The country has also

181 Awani "Factoring as an Alternative Tool".

182 See paragraphs 1 and 4 above where the various obstacles to the growth of factoring in Africa have been highlighted.

183 See generally paragraphs 1 and 4.

184 Klapper 2006 *Journal of Banking & Finance* 3112 3112.

185 *Ibid.*

186 Mol-Gomez-Vazquez and Hernández-Cánovas "Legal and Institutional Determinants of Factoring in SMEs: Empirical Analysis Across 25 European Countries" *Journal of Small Business Management* 312 326–327.

187 *Ibid.*

188 Borgia *et al.* "Trade Receivable Factoring as a Response to Weak Governance: Panel Data Evidence 2010 *International Business & Economics Research Journal* 11 11.

189 Hamanyati "Factoring as an International Trade Finance Product" (LLM-thesis, UP, 2017) 33–37.

190 *Ibid.*

191 *Ibid.*

neither signed nor ratified both the UNIDROIT Convention or the UNCITRAL Convention. Factoring transactions in South Africa are mainly regulated by the factoring contracts signed between factors and sellers.[192] While there is no factoring law in place, there exists a regulatory regime for providers of factoring services. Bank and non-bank factors fall under regulation and supervision of the Prudential Authority and Financial Sector Conduct Authority[193] as well as the National Credit Regulator.[194]

With regards to the tax treatment of factoring, stamp duty was abolished in South Africa with effect from 1 April 2009 following the repeal of the Stamp Duties Act 77 of 1968. However, in accordance with South Africa's Value Added Tax Act 89 of 1991, VAT is charged on any financial service for which the provider of such service is paid a fee, commission, merchant's discount, or similar charge.[195] VAT is thus chargeable on the service fee (but not on the interest or discount rate on advance payments to the seller) charged by both taxable bank and non-bank factors at the rate of 15 per cent.[196]

Although South Africa does not currently have a specific law for factoring and VAT exemption for factoring transactions, it is nonetheless the biggest market for both domestic and international factoring in Africa.[197] The country has consistently accounted for more than 80 per cent of Africa's factoring volumes over the years.[198] South Africa also accounts for about 100 factoring firms out of over 150 companies operating in Africa.[199]

However, it is good to clarify that whilst South Africa does not have a factoring law, the country has case laws on it and this may have augmented the absence of a factoring law.[200] It has been observed that South Africa's legal system "positively supports the growth of the factoring industry, debts can be recovered and there is rule of law."[201] Further, South Africa is commended for having a sound credit information system that allows factors to access data on the creditworthiness of debtors.[202]

5 1 2 Egypt

Egypt's legal system combines elements of both Islamic Law and Civil Law.[203] Similar to South Africa, Egypt has also neither signed nor ratified the UNIDROIT Convention or the UNCITRAL Convention.[204] But, unlike South Africa, which does not have a national factoring law, Egypt

192 *Ibid.*

193 See generally Financial Sector Regulation Act 9 of 2017.

194 See generally National Credit Act 34 of 2005.

195 Section 2 of the Value Added Tax Act.

196 Section 7 of the Value Added Tax Act. For an extensive analysis of the application of VAT to financial services such as factoring see generally Lebos "Value-Added Tax and Financial Services" (MSc-thesis, UW, 2017).

197 The African Capacity Building Foundation & African Export–Import Bank *Factoring in Africa to Support Trade Development: Challenges and Opportunities for Growth through Capacity Development* (2021) 13–14.

198 *Ibid.*

199 *Ibid.*

200 See for example the following cases: *Merchant Commercial Finance (Pty) Ltd* v *Katana Foods CC* 2017 ZASCA 191; *FirstRand Bank v Consolidated Timber Exports Close Corporation and Others* 2016 ZAKZPHC 31; *Standard Bank of South Africa Ltd v Fakier* 2008 ZAWCHC 291.

201 Cory "South Africa" in Bickers (ed) *World Factoring Yearbook* (2017) 167.

202 Mbatha "Risks and Rewards of Providing 'Reverse Factoring' as a Financing Technology for Small and Medium-Sized Enterprises in South Africa" (MBA-thesis, UP, 2012) 24.

203 Abdel-Wahab "An Overview of the Egyptian Legal System and Legal Research" https://www.nyulawglobal.org/globalex/Egypt1.html#:~:text=Egypt's%20supreme%20law%20is%20its,legal%20rules%20applicable%20to%20contracts (accessed 24-10-2021).

204 See paragraph 4 3 1 above.

has a law by way of the Financial Lease and Factoring Law 176 of 2018.[205]

Further, tax incentives through exemptions for both VAT and stamp duty have also been instituted for factoring in Egypt. Specifically, in accordance with the amendment to Egypt's Stamp Duty Law 111 of 1980 by Law 143 of 2006, stamp duty is not charged on factoring contracts. Additionally, by the Value Added Tax Law 67 of 2016, factoring services are exempted from VAT.[206] In terms of the regulatory regime for factors, factoring is reserved for non-bank factors, and they are regulated by the Egyptian Financial Supervisory Authority (EFSA).[207] The regulatory regime for factoring is also covered under the Financial Lease and Factoring Law 176 of 2018.

Egypt's total factoring volume grew from €220 million in 2012 to €517 million in 2019, representing over 100 per cent expansion.[208] Egypt attained the highest growth level in factoring volumes in the African continent between 2015 to 2019.[209] Researchers have concluded that the series of legal interventions introduced by the Government of Egypt have contributed to the growth of factoring in the Arab nation.[210] The industry's growth has also been attributed to the promotion activities of the EFSA and the Egyptian Factoring Association.[211]

5 2 A Multifaceted Approach Remains the Best Approach

Drawing from the performance of Egypt's factoring industry, it is most likely the case that well-implemented legal interventions such as enacting factoring laws and instituting tax incentives could encourage the growth of factoring. However, it can also be deduced from South Africa's experience that factoring may still thrive in an environment where there are no specific factoring laws or exemptions for all possible taxes. However, in both cases, certainty and predictability of the legal environment in which factoring is practised, whether based on statute or case law, has a huge impact in creating the enabling environment for factoring to thrive.

The key learning point from the case studies is that African countries should still pursue legal interventions to facilitate the growth of factoring. But at the same time, they should not lose sight of other forms of interventions that may not essentially be legal in nature but are nonetheless critical for the factoring industry's growth. As such, setting up factoring associations, strengthening the credit risk and credit information systems as well as creating awareness about factoring are all policy interventions that can be deployed to support the growth of factoring. In the same breath, the ensuing sub-section considers the demands of digitalisation accelerated by the COVID-19 crisis to highlight other interventions that could also be useful in promoting factoring in Africa.

5 3 Factoring and Digitalisation Interventions

The COVID-19 crisis has brought digitalisation to be in sharp focus. Digitalisation denotes "partially or fully converting elements of a firm's value-chain activities and business models to digital platforms through emergent digital technologies such as mobile and visual connectivity,

205 For an overview of the law see European Bank for Reconstruction and Development *Factoring Survey in EBRD Countries of Operation* 3ed (2018) 36–40.

206 *Ibid.*

207 Ghebrial "Financial Inclusion in Egypt: Challenges and Opportunities" (MPA-thesis, AUC, 2019) 38.

208 Oramah and Dzene "Evolution of Factoring in Egypt and Implications for Factoring Development in Africa" 2014 *Contemporary Issues in African Trade and Trade Finance* 17 17–26; also see FCI "Industry Statistics" http://www.fci.be/en/statistics/fci.aspx (accessed 24-10-2021).

209 *Ibid.*

210 *Ibid.*

211 *Ibid.*

cloud computing, robotics, artificial intelligence (AI), blockchain, additive manufacturing, 3-D printing, and Internet of Things (IoT)".[212] The pandemic has finally laid to rest any doubts that may have existed regarding the necessity of digital transformation. The place for human-to-human physical interactions, including commercial engagements, is increasingly diminishing, and the vast majority of interactions now take place through digital connectivity. As things stand, digitalisation is no longer a strategy but a necessity for governments and businesses alike. In this sense, there is a need to also focus on digitalisation interventions that could facilitate the large-scale availability and utilisation of factoring as a financing alternative for SMEs across African countries. These interventions are discussed below.

5 3 1 Government-Administered Online Factoring Platforms

One of the ways in which policymakers in Africa can "digitally" intervene to promote the growth of factoring is through the establishment of government-administered online platforms for reverse factoring. Mexico is one jurisdiction that has achieved success with such an online platform through the Cadenas Productivas (Productive Chains) launched in 2001.[213] The Nacional Financiera (NAFIN), a development bank in Mexico, administers the platform to which creditworthy debtors, sellers (SMEs), and factors (both bank and non-bank factors) can sign up.[214] How the platform works is that debtors with a contract of sale with sellers request factors to settle their payables arising from such a contract in advance.[215] The factor that takes up the request pays the seller in advance (less applicable fees of the factors and taxes) and collects the receivables from the debtor when it matures for settlement.[216] Through the platform, SMEs that are sellers that would typically be unable to access loans from banks can obtain financing against their receivables to fund their working capital needs and production cycles.[217]

As of the writing of this article, no government-administered online factoring platform is known to exist at a national or regional level in Africa. Encouragingly though, the Central Bank of Nigeria (CBN) recently announced plans to establish a receivables portal to facilitate the trading of SMEs' receivables with financial institutions.[218] As more African countries consider setting up online factoring platforms, they can draw lessons from the structures and mechanisms in Mexico's Productive Chains. Optionally, other relevant stakeholders that could be onboarded to the online factoring platforms are credit bureaus and credit risk insurance companies. To make the platform even more attractive, governments can institute a guarantee scheme to cover peculiar instances where factors cannot recover from debtors. Blockchain, a form of distributed ledger technology, can be deployed to the online factoring platform to prevent fraud and ensure the security and transparency of transactions on the platform.[219]

However, the implementation of a government-administered online factoring platform will require careful planning if it is to achieve the intended objectives. As such a good starting point will be to set up a Technical Working Group comprising key stakeholders from both the

212 *Ibid.*

213 Klapper 2006 *Journal of Banking & Finance* 3112 3124.

214 *Ibid.*

215 *Ibid.*

216 *Ibid.*

217 *Ibid.*

218 This is contained in a press briefing delivered by the Governor of the Central Bank of Nigeria, Godwin Emefiele and titled "5 Year Policy Thrust of Central Bank of Nigeria" https://www.cbn.gov.ng/Out/2019/CCD/Five-Year%20Policy%20Thrust%20-%20CBN.pdf (accessed 24-10-2021).

219 For further discussions on the usefulness of blockchain technology for such platforms see Fabrizio and Rossi "Invoice Discounting: A Blockchain-Based Approach" 2019 *Frontiers in Blockchain* 1 1. See also Guerar and Merlo "A Fraud-Resilient Blockchain-Based Solution for Invoice Financing" 2020 *IEEE Transactions on Engineering Management* 1086 1086.

public and private sectors to develop a sound policy framework that will guide implementation. The need for a sound policy framework becomes even more imperative because although digitalisation comes with numerous benefits, it also poses risks and challenges, particularly in relation to data protection, cybersecurity, money laundering, and fraud.[220] A sound policy framework should therefore consider how these risks and challenges should be addressed while setting out the legal, regulatory, economic, and financing dynamics to the implementation of the factoring platform.

5 3 2 Supporting Fintech Factors and Factoring Brokers

Factoring is a type of financial service and, as such, can also leverage financial technology (Fintech) — another form of digital technology. Fintech is simply the use of technology to facilitate the use and provision of financial services. In most markets where the practice of factoring has advanced, there is an increasing move from manual to technologically enabled platforms through which businesses that are sellers and factoring firms can conduct factoring transactions more innovatively and faster.[221] Some of these platforms are operated by licenced factors themselves (Fintech factors).[222] Others are operated by intermediaries or brokers that are not themselves factors, but intermediate between sellers, debtors, and factors (intermediation factoring platforms).[223] The intermediation factoring platforms run by factoring brokers or intermediaries are similar to government-administered online platforms discussed above, save that they are operated by private companies and not government institutions.[224]

The eFactor Network in Mexico operated by eFactor Network S.A.P.I. de C.V. (EFN) is a good example of a private-sector-led intermediation factoring platform that has been successful in driving the large-scale use and availability of factoring to SMEs.[225] EFN provides an internet platform that enables electronic factoring services for participating sellers that are SMEs located in 20 countries across North America, Europe, South America, and Asia that wish to obtain financing against their receivables.[226] Other participants in the platform are factors that deliver factoring services and approved corporate debtors which provide payments of receivables on maturity.[227] There are currently over 10,000 participants in the EFN.[228] One of the value propositions of the platform is that it allows SMEs to operate on a single, multi-region, multi-currency, multi-institution solution.[229]

Fintech factors and intermediation factoring platforms are gradually springing up in Africa. Three are reported to be operating in South Africa: Nisa Finance; ImaFin; and Invoice Worx.[230] There is also GetCapsa which operates in Nigeria.[231] Respective governments in Africa and international development institutions can support the emergence of more Fintech factors and

220 See generally Chernyakov and Chernyakova "Technological Risks of the Digital Economy" 2018 *Journal of Corporate Finance Research* 99 99–109.

221 Dorfleitner and Hornuf *The FinTech Market in Germany* (2016) 33–34.

222 *Ibid.*

223 *Ibid.*

224 See paragraph 5 3 1 above.

225 World Bank Group *Promoting Digital and Innovative SME Financing* (2020) 27.

226 *Ibid.*

227 *Ibid.*

228 *Ibid.*

229 *Ibid.*

230 Genesis Analytics "Fintech Scoping in South Africa" http://www.treasury.gov.za/comm_media/press/2020/WB081_Fintech%20Scoping%20in%20SA_20191127_final%20(002).pdf (accessed 24-10-2021).

231 Okeke "Nigeria's First Digital Invoice Factoring Platform Processes N300m Payment in 30 Days" https://businessday.ng/news/article/nigerias-first-digital-invoice-factoring-platform-processes-n300m-payment-in-30-days/ (accessed 24-10-2021).

intermediation factoring platforms through conducive regulatory regimes, take-off grants, technical assistance, and project financing.

5 3 2 Digitalisation for SMEs

According to Ackah and Vuvor, factoring is the only source of financing that grows with sales.[232] One of the ways through which SMEs can increase their sales is by adopting digital technologies.[233] In this respect, supporting the digital transformation of SMEs will not only assist them in increasing their sales but will also nurture the environment in which factoring will thrive.

6 CONCLUSION AND RECOMMENDATIONS

This article has identified two environments created by the COVID-19 crisis that makes a case for it to be aggressively pursued as an alternative source of finance for SMEs in Africa.[234] First, funding from banks will become increasingly scarce or very costly to access, leaving room for non-traditional financing options like factoring to thrive. Second, open account trade or trade credit sales will be the most preferred form of purchasing among buyers or importers from sellers or exporters. Such trade practice is also imperative for sellers or exporters to maintain their competitiveness and increase sales. On this latter point, it has been shown that factoring is one of the most cost-effective and convenient methods of facilitating open account trade or trade credit sales and benefits both sellers and buyers alike.

Following the case studies of South Africa and Egypt, the article submits that a multifaceted approach involving the implementation of both legal and other forms of interventions is imperative for promoting factoring in Africa.[235] It has further been contended that in the same way that the COVID-19 crisis has underpinned the adoption of digitalisation for customer engagements and internal operations by businesses to be competitive, policymakers and regulators in Africa also need to explore digital interventions for growing factoring.[236]

Based on the foregoing findings and submissions, the article notes the following recommendations, particularly for policymakers and regulators in Africa. First, banks should be encouraged (or preferably, mandated) to ensure that specific portions of their financing portfolio are channelled to the provision of asset-based financing (ABF) solutions like factoring to qualifying SMEs.[237] Second, the interest rates and fees charged by non-bank lenders and non-bank factors for their services to SMEs should be pegged at commercially viable thresholds to tackle the excessive cost of financing suffered by SMEs at their hands.[238] Third, government-administered online factoring platforms similar to Mexico's Productive Chains operated by the NAFIN should be set up by African countries as a way to promote the large-scale availability and utilisation of factoring by SMEs.[239] Importantly, however, the implementation of such a platform should be based on and backed by a sound policy framework with inputs from key stakeholders from the public and private sectors. Lastly, a conducive regulatory regime, financing support, and technical assistance should be extended to Fintech factors and factoring brokers operating

232 Ackah and Vuvor "The Challenges faced by Small & Medium Enterprises (SMEs) in Obtaining Credit in Ghana" (MBA-thesis, BIT, 2011) 47.

233 See paragraph 1 above.

234 See paragraphs 3 and 4 above.

235 See paragraph 5 2 above.

236 See paragraph 5 3 above.

237 See paragraph 2 2 above.

238 See paragraph 2 2 above.

239 See paragraph 5 3 1 above.

intermediation factoring platforms.[240] The digitalisation transformation of SMEs should also be supported through financing.[241]

By and large, the article posits that factoring is a useful buffer for the liquidity shock posed to Africa's SMEs as a result of the COVID-19 crisis. However, the extent to which factoring will become more available and utilised as a financing alternative for SMEs depends on the proper implementation of both legal and other forms of interventions by African countries. Further research could be undertaken to investigate the safeguards and other key considerations that should drive the implementation of digital technologies for factoring in Africa. Such research could consider how issues of data protection, cybersecurity, money laundering, and fraud, which are the downsides to digital technologies, should be tackled.

240 See paragraph 5 3 2 above.

241 See paragraph 5 3 3 above.