FACTORING AS AN INTERNATIONAL TRADE FINANCE PRODUCT: MAKING A CASE FOR THE ENACTMENT OF A FACTORING ACT IN ZAMBIA

SUBMITTED IN PARTIAL FULFILMENT OF THE LL.M IN INTERNATIONAL TRADE & INVESTMENT LAW IN AFRICA.

BY:

MWENDA HAMANYATI

CANDIDATE No.: 17399263

SUPERVISED BY:

Dr. FEMI OLUYEJU

List of Acronyms

ABFA—Asset Based Financial Association.

AfDB—African Development Bank.

AFI—Alliance for Financial Inclusion.

Afreximbank—African Export-Import Bank.

ASISA—Association for Savings and Investment South Africa.

BOZ—Bank of Zambia.

CBE—Central Bank of Egypt

DFC—Debtor Financing Committee.

EBRD—European Bank for Reconstruction and Development.

EFSA—Egyptian Financial Supervision Authority.

ESD—Enterprise and Supplier Development Fund.

FAPA—Thematic Fund for Private Sector Assistance.

FCA—Financial Conduct Authority.

FCI— (ex-Factors Chain International).

FDI—Foreign Direct Investment.

GDP—Gross Domestic Product.

GRIF—General Rules of International Factoring.

IFC—International Finance Corporation.

IFG—International Factors Group.

NFIS—National Financial Inclusion Strategy.

NPC—Negative Pledge Clause.

SEDA—Small Enterprise Development Agency.

SMEs—Small and medium-sized enterprises.

UK—United Kingdom.

UNCITRAL—United Nations Convention for International Trade Law.

UNIDROIT—The International Institute for the Unification of Private Law.

Contents

List of Acronyms 2
Declaration.......... 5
Dedication.......... 6
Acknowledgements.......... 7
Abstract.......... 8
CHAPTER ONE: GENERAL INTRODUCTION 10
1.1 Background to the research 10
1.2 Problem statement 11
1.3 Research questions 11
1.4 Thesis statement 12
1.5 Objectives and significance of study 12
1.6 Literature review 12
1.7 Research methodology 17
1.8 Limitations of the study 17
1.9 Outline of chapters 17
CHAPTER TWO 19
THE CONCEPT OF FACTORING 19
2.1 Introduction 19
2.2 A Historical overview of factoring 19
2.3 Understanding the concept of factoring on the universal plane 22
2.4 The mechanics of factoring 25
2.5 Classifications of factoring 26
2.6 The three (3) approaches to regulation of factoring 30
2.7 Case Studies 31
2.7.1 Turkey 31
2.7.2 Republic of South Africa 33
2.7.3 Egypt 35
2.8 Conclusion 38
CHAPTER THREE 40
FINANCING OF SMES: FACTORING AS OPPOSED TO TRADITIONAL BANK LENDING 40

3.1 Introduction 40
3.2 Traditional bank lending: overdrafts and terms loans 40
3.2.1 Overdrafts 42
3.2.2 Term Loans 44
3.3 The advantages and disadvantages of factoring as opposed to traditional forms of financing 45
3.4 Conclusion 49
CHAPTER FOUR 50
ZAMBIA'S REGULATORY AND POLICY FRAMEWORK FOR FACTORING: THE INADEQUACIES OF FACTORING LAW IN ZAMBIA 50
4.1 Introduction 50
4.2 The theory of Financial Inclusion 50
4.3 Zambia's National Financial Inclusion Strategy 2017-2022 52
4.4 The existing legal framework governing factoring in Zambia 53
4.4.1 The Banking and Financial Services Act 7 of 2017 54
4.4.2 The Bank of Zambia Act 43 of 1996 56
4.4.3 The common law and doctrines of equity 57
4.5 Shortcomings of the extant Zambian regulatory framework on factoring 57
4.6 Conclusion 58
CHAPTER FIVE 60
THE STATE OF FACTORING IN AFRICA AND AFREXIMBANK'S MODEL LAW 60
5.1 Introduction 60
5.2 The funding gap for SMEs in Africa 60
5.3 The state of factoring in Africa 60
5.4 The Role of the Afreximbank and the African Development Bank in promoting factoring on the continent 61
5.5 History and overview of existing factoring model laws 62
5.6 Afreximbank's Model Law for African States 64
5.7 Justification for a model factoring law in Africa 69
5.8 Challenges in implementing the model law 71
5.9 Conclusion 72
CHAPTER 6 73
CONCLUSION AND RECOMMENDATIONS 73
6.1 Introduction and recap of the problem statement 73
6.2 Summary of findings 73

6.3 Concluding remarks 75
6.4 Recommendations 75
BIBLIOGRAPHY 78

Declaration

I, MWENDA HAMANYATI, hereby declare that this mini-dissertation is my original work and that other works referred to or used are clearly acknowledged. This work has never been submitted to any university, college or institution of learning for an academic or other award.

Signed: ……………………………………

Date: ………………………………………

This mini-dissertation has been submitted for examination with my approval as University Supervisor.

Signed: ………………………………………

Date: …………………………………………

Dr. Olufemi Oluyeju

University of Pretoria

Date: …………………………………………..

Dedication

This work is dedicated to Ashish J. Thakker, Founder of the Mara Group who started his business twenty-one years ago at the age of 15 and today epitomizes the true spirit of entrepreneurship.

Acknowledgements

First and foremost, my gratitude goes to Almighty God for this amazing opportunity to pursue my studies in the Republic of South Africa. I am also grateful to my sponsors ABSA Bank for the award of the scholarship that enabled me to pursue my LL.M studies at the University of Pretoria. I also owe the Centre for Human Rights a debt of gratitude for the invaluable support rendered throughout my stay at the University.

I also extend my profound gratitude to the following people: my supervisor Dr. Femi Oluyeju for the insight and advice to improve this work, Dr. Enga Kameni of Afreximbank who introduced me to the concept of factoring and not only provided useful material but also guidance on the framework of this paper. I acknowledge the assistance of Ms. Rene Swart of the Albert Luthuli Centre for Responsible Leadership for her insights on dissertation writing. I also thank Professors Patricia Michelle Lenaghan and Wandrag of the University of Western Cape for carving out time of their hectic schedules to share their views that tremendously enriched the content of this paper.

My classmates Sarah Oluyeju and Joanita Nampewo were also very instrumental in providing assistance and objective peer review

I would also like to thank my employers from Zambia at the Ministry of Justice who permitted me to take a year off work for the purposes of pursuing my studies. Special thanks go to Mrs. Thandiwe Oteng, Mr. George Zumani and Ms. Maria Santana who worked tirelessly to facilitate my leave from work. I gratefully acknowledge the assistance of my colleagues at the Department of Civil Litigation: Mr. Joe Simachela, Major Constantine Hara and Mrs. Patience Musonda Kalisirira for their assistance.

Special thanks also to Ms. Inonge Mbangweta of the World Bank as well as Advocates Mulambo Haimbe and Comfort Mulenga who wrote letters of recommendation to support my application.

Finally, I wish to thank my parents, Mr. and Mrs. Hamanyati for their unwavering support.

Abstract

It is axiomatic that small and medium-sized enterprises (SMEs) are the lifeblood of most economies across the globe. However, access to finance continues to elude SMEs. This problem has been exacerbated by the global financial crisis of 2008 which triggered the introduction of stricter financial regulation resulting in a drastic slow-down in SME financing.[1] Worse still, SMEs often supply their goods and services on trade credit terms and typically experience late payment from their debtors who often have greater bargaining power. This adversely impacts their liquidity and restricts their growth.[2] As bank lending often requires collaterals and guarantees, the odds weigh disproportionately against SMEs. These small businesses find it difficult to access bank loans because their assets may already be a subject of encumbrance under an existing facility or they simply lack adequate assets to satisfy lenders' requirements. Factoring, as a financial service premised on the sale of accounts receivable to a third-party financier, is a viable option to surmount this cash flow problem. It provides immediate cash to the business in consideration for the accounts receivable often purchased at a discount and takes into consideration other charges as well. Although factoring is a trade finance product that has been used in modern commerce for several decades, this financial tool is gaining unprecedented impetus across the globe. This is partly attributable to the development of more sophisticated legal structures[3] developed by global institutions and adapted by national legislatures. Africa's participation in the factoring industry remains grossly stunted. Some reasons for this are the lack of an appropriate legal structure and lack of awareness of the financial tool in most African jurisdictions. Afreximbank under the auspices of FCI developed a model law on factoring to serve as a prototype for African states to model and enact at domestic level. This paper makes an extensive assessment of the existing legal framework and advocates that Zambia draws important lessons from the Afreximbank Model Law and other jurisdictions to enact its own Factoring Act to ensure that its small businesses can have enhanced access to financing through factoring and can thus operate at their cutting edge.

[1] M Birken 'Boosting Small Businesses: A Legal Affair?' (2015) *Law in Transition* 4 https://www.ebrd.com/documents/comms-and-bis/pdf-law-in-transtion-2015-building-stronger.pdf (Accessed 17 September 2017).

[2] K Goh 'Trading Places: Benefits of Invoice Finance for Small and Medium Sized Enterprises as Opposed to Bank Lending' (2017) 7 Aberdeen Student Law Review 56.

[3] I Istuk and M Labus 'Factoring and Reverse Factoring Reforms in the EBRD Region' (2015) in *Law in Transition* 30 https://www.ebrd.com/documents/comms-and-bis/pdf-law-in-transition-2015-building-stronger.pdf (Accessed 17 September 2017).

CHAPTER ONE: GENERAL INTRODUCTION

1.1 Background to the research

The most debilitating challenge confronting SMEs is lack of access to financing.[4] Banks are averse to finance SMEs and this has exacerbated the 'funding gap' prevalent amongst these small businesses.[5] Stubbs lends support to this view by elaborating that small businesses are confronted by numerous challenges in their quest to access external financing. She illustrates this by stating that they may struggle to provide potential lenders with acceptable collateral. This may arise from limitations in existing collateral systems, which do not provide financiers with a reasonable level of risk mitigation owing to inefficient laws or enforcement procedures) or because the prevailing legal infrastructure does not enable certain types of assets to be used as collateral at all.[6] Factoring has been identified as a viable option to unlocking financing for SMEs across Africa.[7] Factoring is a financial service provided by a third party to an underlying credit sale of goods or services (known as a factor) purchases accounts receivables from the vendor at a discounted price and provides the latter with liquidity enabling the vendor to sustain its business.[8]

In the context of Zambia, the foregoing observations hold sway. The greatest challenge that small businesses grapple with is lack of adequate finance to conduct their affairs. Traditional forms of financing such as bank loans are often inaccessible as interest rates are exorbitant and collateral requirements further compound the problem. Although factoring is extant in Zambia today, it is not widely used. The Banking and Financial Services Act[9] acknowledges factoring as one of the financial tools to be supervised and regulated by the Central Bank but it does not provide a definition of what factoring is nor how it must be conducted. The purpose of this paper is to make an enquiry as to how the law governing factoring in Zambia may be improved with a view to developing the industry to meet international standards.

---

[4] L Klapper 'The Role of Factoring for Financing Small and Medium Enterprises' (2006) Journal of Banking & Finance Volume 30 Issue 11 3111 www.sciencedirect.com/science/article/pii/S0378426606001002 (Accessed 27 April 2017).

[5] Goh (n 2) 60-61.

[6] J Stubbs 'Small Business Finance' (2015) in *Law in Transition* 8 https://www.ebrd.com/documents/comms-and-bis/pdf-law-in-transition-2015-building-stronger.pdf (Accessed 17 September 2017).

[7] Priest-Stephens, L. and E. Kameni 'Building a Model' *Trade and Forfaiting Review 1 June 2016* http://www.tfreview.com/feature/regions/building-model.pdf (Accessed 7 March 2017).

[8] Afreximbank 'Factoring: Financing Solutions for African Trade Integrating African SMEs into the global value chain' www.afreximbank.com (Accessed 19 March 2017).

[9] Act 7 of 2017.

1.2 Problem statement

SMEs are the mainstay of the Zambian economy. However, these small businesses are unable to reach their full potential principally because of lack of access to finance. Bank loans and other traditional forms of financing are often inaccessible to these businesses as most of them do not possess adequate long-term assets to qualify for this type of financing. SMEs have been marginalized as high-risk ventures by most financiers. Notwithstanding this, these small businesses are often required to provide trade credit to their clients thereby limiting their working capital even further, and posing a threat to their ability to settle loans and other liabilities. The regulatory environment in Zambia does not promote entrepreneurship either. It is therefore imperative that an efficacious legal framework that enables SMEs to sell their accounts receivables is put in place with the aim of improving their working capital and liquidity through the short-term financial tool of factoring. Enacting legislation that will regulate and facilitate factoring is both urgent and momentous. Such a step will propel the much-needed financing for SMEs and erase the effects of inequalities attendant to lack of access to capital.

1.3 Research questions

With a view to propose the enactment of a modern and effective legal framework that will regulate and catalyze factoring in Zambia, the study will be anchored on the following overarching question:

Is the prevailing legal infrastructure in Zambia effective to regulate and promote factoring?

In answering this broad research question, the following adjunct questions will also be addressed:

i. What is factoring and what is its importance to the financing of small businesses?

ii. In what ways, and to what extent, is factoring a better alternative source of financing than bank lending?

iii. Does the Zambian legal framework regulating factoring adequately govern this multifaceted trade financing product?

iv. What are some of the international best practices and models that have enabled factoring to flourish in other jurisdictions?

1.4 Thesis statement

This research is premised on the argument that the extant laws underpinning factoring in Zambia are inadequate. The Zambian SME sector has tremendous potential to grow the economy. However, access to quality finance continues to elude most SMEs, thereby limiting their contribution to GDP and their capacity to make any meaningful impact on the economy. Although factoring does exist in Zambia, there is no comprehensive and modern legal framework to regulate it. Factoring is formally recognized in the Banking and Financial Services Act of 2017. However, there are no detailed regulations to adequately develop and promote the industry for the purposes of meeting the needs of SMEs. As a result, most SMEs, who are the predominant users, do not optimally benefit from the service. Therefore, it is envisaged that the enactment of a law on factoring based on the Africa Export Import Bank's Model Law will enhance access to finance, raise awareness of the product and build a solid foundation for the integration SMEs into the formal financial system as well as adequately develop the service to meet both domestic and international factoring.

1.5 Objectives and significance of study

The principal objective of the present study is to propose legal reforms in Zambia pertaining to factoring by building upon demonstrable evidence from other jurisdictions that have developed their entrepreneurial base as a corollary of a conducive legal framework. This study is therefore relevant to entrepreneurs, policy makers and investors as it seeks to provide innovative financing solutions that transcend borders. Equally important, the study will also contribute to the growing need to increase awareness of the concept of factoring and its relevance in today's interconnected business landscape.

1.6 Literature review

Zambia is a least developed country situated in Central and Southern Africa with a geographical size spanning more than 750,000 square kilometers and a human population of 15.5 million.[10] Endowed with abundant natural resources such as rivers, lakes, vast arable land, and minerals, her economic state is inconceivable. Approximately 80% of the labour force is in the informal sector, especially in supply of goods and services to the mines.[11] The Zambian economy has been facing

[10] www.heritage.org/index/country/zambia (Accessed 19 September 2017).
[11] ILO (2016) 'Zambia Human Development Report 2016-' (Last accessed on 15 September 2017 atwww.hdr.undp.org/sites/default/files/Zambia_human_development_report_2016.pdf.

severe economic headwinds resulting from slowing Chinese growth and a slow turnaround in US and European economies. Copper prices have fallen significantly since their 2011 peak. This has had a devastating impact on mining profitability and the economy. At the same time on the domestic front increasing fiscal deficits since 2013 and 'poorly conceived economic policies have added to the waning sentiments about the strength of the Zambian economy as exposed through the significant Kwacha depreciation in 2015.'[12] Poverty is prevalent, with more than 60% of the population living below the poverty datum line.[13] This paper will endeavour to show that this has resulted in the proliferation of informal small businesses that must be attracted into the formal sector by creating a conducive legal framework.

The nation's entreprises continue to grapple with high costs of doing business, lack of access to finance and high interest rates. These are considered as the main factors holding back the country's diversification efforts.[14] In fact, lack of access to financing has been singled out by the World Economic Forum as the most problematic factor for doing business in Zambia. More than 65% of the population is excluded from accessing financial services.[15]

Some of the principal challenges identified as impediments to expanding factoring in Africa are that most businesses in Africa are neither prepared for nor interested in factoring and the 'lack of, or very limited, knowledge of the product across a large swath of the continent.'[16] Equally important, the lack of a specific regulatory framework in most African countries has stunted the growth of this trade finance option. As Oramah points out, the near absence of an adequate regulatory framework and laws on factoring has hindered its growth owing to the attendant uncertainty and risk posed thereby.[17]

---

[12] AfDB Zambia Country Office (2015) 'Annual Report' 3 unpublished.
[13] AfDB (n. 12) 4-5.
[14] WTO 'Trade Policy Review: Zambia 2016' https://docs.wto.org (Accessed 22 March 2017)
[15] ILO (n 14) 17.
[16] Oramah 'From the Periphery to the Centre: Africa as the Growth Market for Factoring' (2014) *Contemporary Issues in African Trade and Trade Finance* Volume 1 Number 1, 5.
[17] (n 16 above) 8.

SMEs play an instrumental role in accelerating economic development.[18] They have been identified as 'engines of growth, jobs and social cohesion'[19]. However, lack of access to quality financing continues to limit their growth and in some cases threatens their survival.[20] Goh observes that SMEs are also negatively affected by delay in settlement of debts due to them, particularly by large businesses who wield greater bargaining power, principally due to the influence reposed in them on the potential growth of an SME as a purchaser of the latter's goods [or services]. Consequently, such customers usually have the power to defer settlement of invoices with impunity. This of course is a grave predicament for SMEs because it constrains the liquidity of their businesses and incapacitates them from promptly paying their own suppliers, leading to strained business relationships.[21] 'Ensuring a healthy cashflow'[22] is therefore a critical imperative for SMEs.

As Klapper corroborates: A lot of businesses experience difficulties to finance their production cycle, since most purchasers demand between 30-90 to settle after delivery. During this period, sellers issue an invoice, recorded for the seller as an account receivable and for the purchaser as an account payable, which is an illiquid current asset for the seller until payment is received. Factoring as a type of supplier financing enables businesses to sell their accounts receivable at a discount (generally equal to interest plus service fees) in exchange for instant cash.[23]

It is therefore vitally important to comprehend how SMEs can operate at peak performance and economically to survive and ultimately thrive in the competitive business environment. Governments have an instrumental role to play in establishing policies that bolster the performance of SMEs. For instance, legislative intervention to protect SMEs from protracted settlement of debts, securing markets for goods and services produced and offered by these businesses, and the establishment of specialized financial institutions that offer microfinancing are some of the ways that governments can ensure the growth of these small businesses. [24]

---

[18] A Nuwagaba 'Enterprises in Zambia' (2015) *International Journal of Economics, Finance and Management* Vol. 4 No. 4 September 2015 http://www.ejournalofscience.org (Accessed 28 April 2017).
[19] RB Alarcon 'International Factoring and Development: The Impact of the Factoring Model Law of 2014' (2014) *FCI Newsletter September 2014* https://fci.nl/about-factoring/international-factoring-rosana-bastos-sep2014.pdf .
[20] Alarcon (n 10 above).
[21] Goh (n 2 above) 60.
[22] (n 2 above) 61.
[23] Klapper (n 4 above) 3111-3112.
[24] (n 11) 90-92.

It is evident from the above that one common thread that seems to run through is that access to financing is the most debilitating problem confronting SMEs across the globe. The case of SMEs in Zambia is even more pernicious. This points to the need to modernize the nation's legal framework and enhance it to not reflect present-day needs of SMEs but also be anticipatory of the dynamic and ever-changing business practices evolving around the globe. In this regard, this mini-dissertation proposes that Zambia enacts its factoring legislation in accordance with the principles stipulated in the Model Law on Factoring introduced by the Africa Export-Import Bank on 24th October 2016 in Cape Town, South Africa.[25] The Model Law is aimed at providing a standard for African national legislatures to refer to in the enactment of domestic law with a view to fostering the growth of factoring activities in Africa.

Speaking at the launch of the Model Law, Ms. Kanayo Awani, Intra-African Trade Initiative Department Managing Director and Chairperson of FCI Africa Chapter, optimistically projected that the document would tremendously improve access to financing for SMEs in Africa. 'Its development impact will phenomenal, facilitating access to finance for excluded small and medium-sized business,' she stated. 'We have placed the promotion of intra-African trade on the front burner of our current strategy and recognize the support which SMEs need as indirect exporters of regional value chains.'[26]

Awani proceeded to call on lawmakers and regulatory authorities across Africa to consider the adoption of the Model Law as an urgent matter. She further noted that improving the legislative infrastructure would be instrumental to ease the creation, perfection and enforcement of collaterals as part of the financing provided to businesses through factoring. These measures to strengthen legislation, she emphasized, would provide the much-needed credibility to factoring as well as bolster business assurance to investors.[27]

Oramah notes with optimism that although Africa is presently at the periphery of global factoring, recent developments, however, indicate that change for the better is imminent with Africa poised to move from the fringes to the hub of global factoring in the no distant future.[28] He adds that a

[25] K Awani 'An overview of Factoring Activities in Africa' FCI 'IN-SIGHT Newsletter' 5 November 2016 https://fci.nl/downloads/in-sight-newsletter-november-2016.pdf (Accessed 24 March 2017)
[26] Awani (n 25 above) 29.
[27] (n 25 above) 30.
[28] Oramah (n 16) 1.

‘tail-wind’ is arising in Africa with forecasts of about 90 billion Euros in 2017, with new markets emerging in Kenya, Nigeria, Ghana, Côte d’Ivoire, Tanzania, Zambia and elsewhere. To take advantage of the opportunity will require an active participation of European and American factoring companies in the market to bring expertise and correspondent relationships critical under the 2-Factor framework. ‘Notwithstanding,’ he reiterates, ‘there will be no stopping the tail-wind that has formed and early entrants to the market will make the best for it.’[29]

Echoing Oramah’s confidence that will be instrumental in the financing of SMEs across Africa, Kameni corroborates the former this way: There is a pressing need for an efficient and facilitative legal and regulatory regime for factoring in Africa. To achieve this, regulators and lawmakers must collaborate with factors to identify and address the challenges emanating from the absence of a predictable, certain and clear legal regime on factoring.[30]

In a separate article entitled ‘Building a Model’[31] Priest-Stephens and Kameni re-emphasize that the lack of a legal framework and regulations continues to be a major roadblock to the development of factoring across Africa. The duo suggests that regulators and legislators have a critical role to play in developing such a framework through the development of enabling laws and regulations.

The pertinent issues highlighted by the above exposition lead to the inescapable conclusion that enacting domestic legislation in most African countries is long overdue. The essence of this paper is to attempt to show the lacunae in the Zambian legal system pertaining to financing of SMEs by building upon the works highlighted above. It also seeks to contribute to the development of legislation that will be country-specific and responsive to the ineffective legal infrastructure regulating entrepreneurship in Zambia today. Additionally, this paper will also critically analyze the strengths and weaknesses of factoring as a trade finance mechanism in the prism of other traditional sources of financing, and make recommendations as to the necessary measures to be considered in the proposed legislation. The paper will therefore add a pragmatic dimension as to how the proposed law can sync with the socio-economic realities in Zambia by making recommendations that will be supportive of the legal framework.

---

[29] (n 20 above) 14.

[30] E Kameni ‘An Insight into Recent Legal and Regulatory Reforms in Support of Factoring in Africa’ (2014) 27, 40.

[31] Priest-Stephens & Kameni (n 7 above).

1.7 Research methodology

There is a wealth of literature available on factoring in the international trade finance arena. This proposed study will essentially be desk-top and library-based. In addition, it will be approached from a plethora of research methods and therefore will be theoretical, descriptive, analytical, comparative and prescriptive in nature. In terms of sources, reliance will be on primary and secondary sources such as related laws, regulations, published articles and books.

1.8 Limitations of the study

This paper focuses on and endeavours to provide solutions to this problem by advocating for the adoption of national legislation that will be facilitative to the growth and development of factoring in Zambia with a view to enhance the competitiveness of SMEs both domestically and internationally. This study is not intended to be a comprehensive evaluation of all the issues pertaining to financing of SMEs in Zambia.

1.9 Outline of chapters

This mini-dissertation is divided into six chapters. Chapter 1 provides the background to the study, the problem statement, significance of the study and research questions. It also discusses the research methodology, limitations of the study, literature review and provides an overview of the ensuing chapters.

Chapter 2 will provide a conceptual framework of Factoring in general. Thereafter, an analysis of this trade finance product will be expounded to demonstrate how it can help SMEs to thrive and be competitive. Its history and mechanics will be discussed hereunder. The different types of factoring and models of factoring regulation will also be the subject of this chapter. Case studies of Turkey, South Africa, and Egypt will be presented with a view to underscore the importance of factoring to SMEs and to highlight the various practical aspects of the trade finance product.

Chapter 3 compares factoring with other traditional forms of bank lending in relation to start-ups and SMEs. The theme of the chapter is to reiterate the difficulties of obtaining bank financing for small businesses and how factoring as an alternative source of financing can accommodate small businesses that may not ordinarily qualify for traditional bank lending. The limitations of factoring will also be explored before concluding that factoring presents numerous benefits to SMEs.

Chapter 4 will commence with the policy framework aiming at enhancing financial inclusion in Zambia and its impact on factoring. Thereafter the chapter will render an analysis of the state of factoring in Zambia under the current legal framework. Focus will be placed on the Banking and Financial Services Act. The other laws that have a bearing on factoring will also be studied and it will be shown that the current framework does not facilitate nor promote modern-day factoring. The conclusion of this chapter will signify that the lack of adequate legal milieu to regulate and adequate enhance factoring lies at the heart of financial exclusion of SMEs in Zambia.

A review of international best practices and model laws is the subject-matter of Chapter 5. The history of the model laws will be traced and an overview of the Afreximbank Model Law will constitute the bulk of this chapter. The chapter will also introduce the role played by the Afreximbank and the AfDB to propel factoring on the African continent in recognition of the integral role that SMEs play in economic development.

The final chapter presents conclusions on the findings and makes recommendations on institutional and policy changes that need to be effected with the intent to bring Zambian law and practices with regards to factoring in conformity with the Afreximbank Model Law on Factoring and other international standards that continue to pay dividends the world over.

CHAPTER TWO

THE CONCEPT OF FACTORING

2.1 Introduction

Businesses are often incapacitated by the lack of working capital during their infancy and maturity stages. This problem is universally recognized as Small and Medium-sized Enterprises (SMEs) grapple with securing prompt payment for supplies made to large corporations without damaging the relationship through litigation or other means of debt collection. The position is similar at both international trade and domestic level: businesses may secure a contract for the supply of goods or services with a large prestigious entity for which they will not receive payment until several weeks or months later but the much-needed capital to follow through on the contract or other contracts as well as to settle bills, pay employees and pay for other overheads. This predicament is exacerbated in dealing with foreign customers as the attendant challenges of international trade can undermine the potential of small firms. The evolving nature of the trade finance industry has alleviated the impact of these cashflow challenges by unlocking the value of a businesses' accounts receivables or trade invoices.

This chapter unfolds by describing the concept of factoring, traces its origins, discusses its present form and underscores its contribution to various jurisdictions across the globe through case studies. While acknowledging that an array of trade finance tools is available to small firms, factoring is the focal point of this chapter. The chapter finally provides a synopsis of the trade finance product in selected jurisdictions to illustrate how factoring plays an integral role in both domestic and international trade.

2.2 A Historical overview of factoring

Scholars such as Hoti have traced factoring to as far back as 2,000 B.C. in the early civilization of Mesopotamia, during the reign of King Hammurabi. There is also evidence that it was practised in the ancient Roman Empire. However, the actual use of the term 'factors' as agents first appeared around the 15th century in trade settlement arranged by European merchants in the colonies where they were procuring goods. This primitive form of factoring advanced with the passage of the centuries and by the close of the 19th century, factoring been firmly established to facilitate

international trade between the United States of America and the United Kingdom, particularly in the textile industry.[32]

Spasic and others posit that modern-day factoring evolved from the commission business; in the 19th century, international trade was very risky. Proprietors in the English textile industry had secured market for their products to the United States of America. To mitigate the export risk of non-payment, these businesspeople hired an agent to sell their goods in exchange for a commission. American agents in turn expanded the scope of their services by ascertaining the solvency of the buyers. These agents also performed administrative and other services on behalf of their clients. For instance, they assumed care of the merchandise from the moment it was loaded in some port till the collection of claims. As business operations modernized these agents not only guaranteed the solvency of the buyers, but also at the time of delivery had arranged the payment of selling price less deduction of the agent's commission.[33]

Subsequently debt collection services, irrespective of whether the agent assumed the inherent risks of debt collection and financing the supplier, evolved into a new specific business – factoring.[34]

> Alongside with the transformation of commission into factoring business, the subjects that were performing this business also transformed; instead of trading companies, which were performing commission and other businesses, factoring business was more and more taken over by the banks from which some were specialized for such business.[35]

Alarcon reiterates that from the time that the United States began to export to Europe, American entrepreneurs, with the intention of addressing the problem of lack of understanding of the legal framework which underpinned the receivables procedure in the importer's jurisdiction set up a corresponding factor in the importer's country, thereby triggering the emergence of groups of corresponding factors, called "closed chains". Since their genesis, these chains began to establish uniform rules to regulate the relations between the export factors and the import factors,

---

[32] U Hoti 'Factoring: A Financial Instrument' (2014) *Interdisciplinary Journal of Research and Development* Vol (I), No. 2 www.uamd.edu.al/new/wp-content/uploads/2015/07/2.-Ulpian-Hoti.pdf (Accessed 24 May 2017).
[33] I Spasic *et al.* 'Factoring-Instrument of Financing in Business Practice: Some Important Legal Aspects' (2012) *Economic Research,* Vol.25 No.1 191-211 www.tandfonline.com/doi/abs/10/1080/1331677X.2012.11517502 (Accessed on 31 May 2017).
[34] Hoti (n 32 above).
[35] Hoti (n 32 above).

culminating in the General Rules of International Factoring (GRIF).[36] The GRIF create the underlying legal infrastructure on which virtually all international factoring transactions are carried out.[37]

According to Alarcon, factoring gained much of its traction in international trade. It was replicated also in domestic trading exchange, especially in the USA.[38] In European countries factoring developed much later but has now taken root. Germany paved the way in Europe followed by other developed countries such as Sweden and Italy.[39] Alarcon attributes the impetus of factoring in Asia, South America and Eastern and Central Europe to the events of the last quarter of the 20th century with specific reference to the fall of the Berlin Wall on November 9, 1989. She quotes Thomas L. Friedman who put it so brilliantly:

> 'The fall of the Berlin Wall didn't just flatten the alternatives to free-market capitalism and unlock enormous pent-up energies for hundreds of millions of people in places like India, Brazil, China, and the former Soviet Empire. It also allowed us to think about the World differently—to see it as more of a seamless whole. Because the Berlin Wall was not only blocking our way; it was blocking our sight—our ability to think about the world as a single market, a single ecosystem, and a single community.'[40]

Today, factoring is a reliable and established trade finance mechanism employed all over the world. 'FCI is the representative organisation for factoring and financing of open account domestic and international trade receivables.' With about 400-member companies in about 90 jurisdictions, FCI's influence spans the globe offering a unique network for cooperation and sharing of opportunities in transnational factoring.[41]

Established in 1968, FCI (ex-Factors Chain International) has entrenched its position as the 'Voice of the global open account receivables finance association and network in the world today. The past 49 years of FCI's existence have seen a phenomenal growth as the world economy and global trade have prospered,' observes FCI Chairman Cagatay Baydar in the FCI Annual Review of 2017.

---

[36] RB Alarcon 'International Factoring' (2014) https://fci.nl/about-factoring/international-factoring-rosana-bastos-sep2014.pdf (Accessed 23 May 2017).
[37] Alarcon (n 36 above) https://fci.nl/about-factoring/international-factoring-rosana-bastos-sep2014.pdf
[38] Alarcon (n 36 above).
[39] Alarcon (n 36 above).
[40] Alarcon (n 36 above).
[41] C Baydar 'Welcome Letter from the Chairman' *FCI Annual Review* 2017 https://www.fci.nl (Accessed 15 August 2017).

In the same publication FCI Secretary-General Peter Mulroy points out that the FCI has played an integral role in propelling the factoring industry globally to astounding heights:

> 'When FCI was founded 49 years ago, its mandate was to promote the growth of factoring globally, develop uniform factoring techniques and best practices for cross-border businesses and help solve the legal, regulatory and technical issues arising in international factoring. As a result of the many investments FCI and its members have made over the years, factoring has grown into one of the most sought after financial services today. The industry registered over EUR 2.35 trillion in volume in 2016, and for the past 20 years has grown over 9 per cent per annum on a CAGR basis. This is in part stemming from the many seeds that FCI has planted globally, especially in such developing markets in greater China, Eastern Europe, South and Southeast Asia, MENA and Latin America regions.'[42]

On 1st January 2016, the International Factors Group (IFG) and the Factors Chain International amalgamated as one under the banner of FCI pooling their strengths to form the largest not-for-profit society devoted to the growth of and interests of the receivables finance industry today. The benefits of this union abound. The proliferation in membership and country demographic has conferred unquestionable legitimacy to the association. Additionally, FCI now has more resources to help conduct educational seminars on the infinite value of factoring, particularly in times of economic downturns.

2.3 Understanding the concept of factoring on the universal plane

The term factoring has been defined differently in various jurisdictions. The International Institute for the Unification of Private Law (UNIDROIT)[43] adopted the following definition of factoring:

'Factoring means an arrangement between a factor and his client which includes at least two of the following services to be provided by the factor:

1. Finance
2. Maintenance of Accounts
3. Collection of debts
4. Protection against credit risks'.

---

[42] P Mulroy 'Introduction by the Secretary-General' *FCI Annual Review* 2017 https://www.fci.nl (Accessed 15 August 2017).

[43] http://www.unidroit.org/english/implement/i-88-f.htm#NR 11 (Accessed 15 August 2017).

However, Hoti[44] states that this definition is applicable only to factoring pertaining 'to the supply of goods and services in respect of the following:

1. To trade or professional debtors
2. Across national boundaries
3. When notice of the assignment has been given to the debtor.'[45]

According to Hoti:

> 'Factoring may be defined as the relationship, created by an agreement, between the seller of goods/services and a financial institution called the factor, whereby the latter purchases the receivables of the former and also controls and administers the receivables of the former. Factoring may also be defined as a continuous relationship between a financial institution (the factor) and a business concern selling goods and/or providing service (the client) to a trade customer on an open account basis, whereby the factor purchases the client's book debts (account receivables) with or without recourse to the client, thereby controlling the credit extended to the customer and also undertaking to administer the sales ledgers relevant to the transaction.'

Salinger in his classic work 'Factoring Law and Practice' defines factoring as:

> 'The purchase of debts (other than debts incurred for goods or services, purchased by a debtor for his personal, family or domestic use and debts payable on long term or by instalments) for the purposes of providing finance or relieving the seller from administrative tasks or bad debts, or for any or all of such purposes.'[46]

FCI Secretary-General, Peter Mulroy in the FCI Annual Review 2016 described the concept of factoring in these terms:

> 'Factoring is an alternative and flexible means of finance which is widely used especially amongst SMEs. This is achieved by the supplier assigning and selling its accounts receivables to a bank or non-bank financial institution. The factor will provide a range of services to its clients, including providing capital against the assignment of their receivables, accepting the risk of bad debts and collecting on past due accounts. Factoring has been considered a stable financing alternative by many companies, particularly since the start of the financial crisis [in 2008]. As many SMEs were unable to obtain traditional bank funding during the crisis, due to the fact that SMEs are perceived to have a higher probability of default compared to larger firms,

---

[44] Hoti (n 32 above).
[45] (n 32 above).
[46] F Salinger 'Factoring Law and Practice (1991) 2.

> factoring filled the void. Central banks around the world have come to appreciate the product as a safe and secure method of financing trade.'[47]

Factoring is also known as 'debtor financing'. It is used for both domestic and international trade finance. Factoring is essentially a short-term finance facility whereby a business sells the value of its account receivables to a financial institution (commonly referred to as a 'factor') at a discount in consideration for immediate payment, thereby creating an opportunity for the factor to make a profit.[48] The discount is usually between 10 and 20 percent. For instance, if the accounts receivable are valued at US$200,000, the SME might prudently accept immediate cash form the factor of US$175,000 with the view to sustain its business, rather than insist on the full US$200,000 which entails waiting for several months and potentially risk missed opportunities arising from lack of liquidity. The financier or factor purchases the value of the accounts receivable for US$175,000 but must wait until the invoice date matures to receive the full value of US$200,000.

Fairbanks states that invoice factoring is a method of alternative financing wherein a business sells some or all its outstanding invoices to a factor, for an upfront percentage of the aggregate value. Then, as the factor collects the outstanding payments, it remits the remainder (called the rebate) to the business, less a predetermined fee.[49]

According to Goh, the debts are purchased at a discounted price by the factor. The factor can pay the client up to 90 per cent of the discounted debts in advance, while the outstanding balance will only be paid to the client when the debtor has fully settled their debt. Additionally, the factor manages the client's sales ledger and collects the money from the debtor. The debtor must be informed of the agreement between the factoring company and the client.[50]

Invoice discounting works in the same way. However, the fundamental difference between factoring and invoice discounting is that in the latter case the debtor is not given notification.

---

[47] P Mulroy 'Introduction by the Secretary-General' *FCI Annual Review 2016* https://www.fci.nl (Accessed 16 August 2017).

[48] Philip Silitschanu 'Financing International Trade—Factoring v. Forfaiting' Accessed online on 23 April 2017 at https://www.americanexpress.com/us/content/foreign-exchange/articles/financing-international-trade-factoring-vs.forfaiting.

[49] L Fairbanks 'Factoring: What it is and how to choose a service' Business Daily 12 September 2017 www.businessdaily.com/9336-choosing-factoring-service.html (Accessed 24 September 2017).

[50] Goh (n 2 above) 62.

Moreover, ‘invoice discounting’ does not involve the functions of managing the business’ sales ledger nor collecting debts.[51]

Goode defines a ‘factor’ as ‘one who, pursuant to a continuing relationship with a supplier of goods or services to trade customers purchases debts from time to time arising in respect of supplies to those customers.’[52]

2.4 The mechanics of factoring

The basis of factoring is that the seller’s or exporter’s accounts receivables are purchased by a third party, the factor, at a discount. Depending on the agreement, the outstanding balance is paid to the seller when the receivables are settled by the purchaser to the factor, less any interest and service fees. A crucial characteristic of the factoring relationship is that the factor will typically advance less than the full amount of the face value of the accounts receivable.[53]

To satisfy eligibility requirements for factoring services, the business’s customers' accounts must be creditworthy.[54] The factor conducts due diligence to ascertain the creditworthiness of the customers and their capability of settling their invoices on time.[55] After approval, the factor assesses outstanding invoices and inspects them for accuracy and completeness, verifying with the business’s customers that the invoices are genuine, the products or services have been received and accepted, and the invoice dates are correct.[56] If everything is satisfactory, the factoring company as a matter of course usually requests payment from the customers by sending them a notice of assignment that instructs them to send invoice payments directly to the factor. The moment that the customer settles the invoice, the factor forwards the rebate to its client, less its service fee.[57]

The international factoring process as executed by FCI members typically runs as follows[58]:

- The exporter receives the purchase order.
- The exporter sends the importer’s information for credit approval.

[51] (n 2 above) 62.
[52] R Goode *Commercial Law* 4th Edition (2010) 789.
[53] Klapper (n. 4 above).
[54] Fairbanks (n 49 above)
[55] (n 48 above)
[56] (n 48 above)
[57] (n 48 above).
[58] FCI home page https://fci.nl/en/about-factoring/how-does-it-work (Last accessed 18 September 2017).

- The exporter confirms the importer's creditworthiness through FCI partner
- The import factor makes an evaluation of the importer and sets a credit limit
- The exporter makes the shipment to the importer
- The export factor makes cash advance up to 80% of the assigned invoices
- Collections are carried out by the import factor
- The import factor remits funds to the export factor
- The export factor remits the 20% outstanding balance to the exporter's account less any charges.

2.5 Classifications of factoring

'Ordinary (traditional) factoring' entails a continuing business relationship between the factor and its client where the latter sells some accounts receivable or its entire portfolio of receivables due from multiple buyers to one factoring company.[59] The client pays fees and finance charges to the factor who assumes responsibility 'to administer and control a sales ledger as well as collect amounts payable from the debtors.'[60] The factor undertakes to bear financial loss arising from the debtor's failure to pay. To the extent that the factor has given approval of the debts, he purchases the debts without recourse to the client with regards to the debtor's failure to pay owing to insolvency. The client thus receives complete indemnity against bad debts provided he does not sell to any debtor not approved by the factor or to a value over and above the approval given.[61]

Reverse factoring is another important category of factoring. Hereunder, the factor purchases accounts payable without recourse only from well-established, high-quality buyers. The factor thereby limits its credit risk to the more manageable default risk of the stable high-quality debtor, in lieu of the more precarious SME. The supplier and its customer reach an agreement wherein the purchaser accepts the vendor's invoice by confirming that the vendor has performed its obligations under the underlying contract. This may be by acknowledging safe receipt of goods or expressing satisfaction of the services rendered. The customer then forwards the invoice to the financier, who

[59] Salinger (n 46 above) 15-16.
[60] Spasic et al (n 33 above).
[61] Salinger (n 46 above) 16-17.

assumes responsibility to settle the debt under the invoice and subsequently pays the supplier, discounting the invoice for an early payment rate based on the buyer's credit standing.[62]

Efficiency can be enhanced where reverse factoring structures are centralized by the formation of online registries where the purchaser can register its endorsement of the supplier's invoice on an information system that is accessible to all three parties to the transaction (supplier, purchaser and potential financiers).[63] The SME supplier is 'merely one click away from the money being transferred into its account owing to these automatically generated financing conditions.'[64] Modelling the successful scheme of a reverse factoring platform of a development bank called Nacional Financiera (Nafin) in Mexico, the international financial community is currently considering into the possibility of modeling it.[65]

Another important variant of factoring is "factoring with recourse" and "factoring without recourse".[66] An arrangement "with recourse" means that the factor may seek compensation from the business if the accounts receivable are not paid in full. 'Under recourse factoring the factor has recourse against the seller for account payment deficiency.' Conversely, factoring "without recourse" entails that the factor assumes the risk of non-payment and may not be entitled to compensation from the business.[67]

'Maturity' factoring by contrast entails that the factor estimates the time that a debtor will usually take to settle a debt, and then permits the business to draw a percentage of the repayment based on the estimated 'maturity' of the debt. The implication of this is, according to Weaver, that 'the business will not be able to draw the entire amount of the debt it has sold to the factor until the time that the factor estimates it should have been repaid in full by the debtor. Nonetheless, the amount that the business receives at regular intervals will not necessarily be a fixed amount and may vary from time to time depending on the actual period each debtor takes to make its repayments.[68]

---

[62] Istuk & Labus (n 3 above) 33-34.
[63] Klapper (n 4 above) 3117
[64] Klapper (n 4 above) 3118
[65] Klapper (n 4 above) 3118
[66] Goh (n 2 above) 63
[67] Klapper (n 4 above) 3123.
[68] PM Weaver 'Banking and Lending Practice' (2016)174.

Factoring can further be classified into two (2) broad categories: factoring on a notification basis and factoring on a non-notification basis. Notification entails that purchasers are informed that their accounts payables have been procured by a factor. 'Under "notification factoring", the purchasers typically furnish the factor with delivery receipts, an assignment of the accounts and duplicate invoices prepared in a form that indicates clearly to the supplier that their account has been purchased by the factor.'[69]

Fairbanks also distinguishes between bulk (whole-ledger) factoring and spot (single-invoice) factoring. Bulk factoring entails that the business turns over all its invoices to the factor for a set period. Normally the parties are required to execute a contract, and there are typically monthly minimums and additional fees associated with this type of service. However, rates are usually lower. Single-invoice factoring, by contrast, means that the business can choose which invoices to factor with this type of service. Ordinarily no monthly minimum is charged nor is there any contract requirement, but rates are higher. Businesses that plan to use a factoring service intermittently, or only intend to factor invoices from certain customers will normally resort to spot factoring.[70]

Prior to engaging into a factoring contract, factors characteristically assess the creditworthiness of the seller's clients whose accounts the factor intends to purchase. The factor must have an accurate description of the series of the accounts to properly assess the risk and determine the discount rate for their purchase.[71]

Factoring can further be categorized as either 'domestic' or 'international' factoring. This is an important distinction which may overlap with the above types of factoring.[72] A factoring arrangement will be designated as "international" if the supplier of goods or services and the person responsible for payment are situated in different jurisdictions.[73]

The emergence of international factoring gave rise to the use of the two-factor system. By the two-factor system the client enters into a contract, to include its export sales, with a factor in its own jurisdiction so that for purposes of its domestic and export business it deals with that sole factor.

[69] Spasic et al. (n 33 above) 194.
[70] Fairbanks (n 49 above).
[71] Weaver (n 68 above) 175.
[72] Spasic *et al.* (n 33 above) 197.
[73] Salinger (n. 46) 115.

The client's factor ("the export factor") arranges with correspondent factors ("the import factors") in the jurisdictions of the client's customers to accept the credit risk posed by the debtors and to collect, and sub-assigns the purchased debts to the import factors. The export factor at all material times remains responsible to its client for all aspects of the service and will normally provide finance by way of prepayments. The import factor, transacting with debtors within its own country, will assume responsibility for the credit risk in respect of the approved debts and for collection of the debt. As there is no contractual relationship with the export factor's client, it will be responsible for these matters solely to the export factor who in turn will be responsible for them to the client.[74]

Salinger explains the advantages and disadvantages of the two-factor system. The advantages identified are as follows:

1. The client is reassured in dealing with one factor even if its exports may be spread in different countries. This simplifies the factoring service for the client as it will communicate with a factor that is familiar with the business practices of the client's jurisdiction.
2. The export factor is placed in a better position to offer export collection in a wide array of jurisdictions without having to obtain experience of the law and practice in those countries.
3. The debtor can make payment to a person in his own country and to receive communications from his creditor in his own language. It is also beneficial for a debtor to be able to communicate with such a person regarding any disputed item.

However, there are also disadvantages in the two-factor system. Firstly, the total cost will probably exceed the cost of using a single factor because the two factors must share the administration charge and, however efficient the system, duplication of some records is inevitable. Secondly, the transmission of funds may be slower than if the export factor is paid directly by the debtor because the import factor may await cleared funds in his bank account before paying the export factor. For the import factor, such business is often not attractive if the exports of the client are spread across various countries so that the sales volume to each is relatively insignificant and the cost to the import factor of dealing with a client account for such insignificant volume is disproportionate.[75]

---

[74] Salinger (n 46 above) 116.
[75] Salinger (n 46 above) 120

2.6 The three (3) approaches to regulation of factoring

The extent and kinds of factoring regulation vary widely across the different jurisdictions of the world. This classification is important as it will provide clarity as to the overarching theme of this paper. Kara identifies three (3) fundamental paradigms to regulation of factoring.[76] These are firstly, factoring markets with no regulations. Secondly, factoring that is governed by a regulatory authority and finally a factoring sector with regulations.[77] Each one of these will be examined in greater detail.

Factoring markets without regulations are those jurisdictions where there is no specific regulatory body charged to oversee factoring and other non-bank services. Factoring is therefore regulated within the extant legal and fiscal framework. Factors operate in accordance with their corporate governance rules and contractual relationships.[78] Examples of this model are the United States of America, the United Kingdom and several other EU countries, as well as some emerging markets.[79] It is submitted that the Zambian factoring regulatory system falls under this heading.

Under the second model, where a regulatory authority governs factoring, it is usual that the Central Bank of a state is the designated regulator using factoring-specific rules distinct from those regulating commercial banks.[80] Kara points out that there seems to be emerging a trend where some states have established "super" regulators supervising the financial sector. With respect to factoring, the regulatory may be a "super regulator" of non-banking financial business or different from the regulators of the banking and capital market sectors.[81]

The third model Kara expounds is factoring industry with regulations under which the industry is closely regulated by the law, and minimum qualifications are set out as to who qualifies to engage in the service.[82] Membership to a factoring institution that satisfies minimum legal standards and stipulation of capital requirements are hallmarks of this model.[83] Kara cites Russia as a prime example of such a jurisdiction where factoring business is the preserve of commercial banks. He

---

[76] H Kara 'Factoring: To regulate or not to regulate?' *World Factoring Yearbook 2017 Edition* (2017) 4 (Available at www.ebglaw.com/content/uploads/2017/06/Tatge-World-Factoring-Yearboo-2017-eBook.pdf (Last accessed 27 September 2017)

[77] Kara (n 76 above) 4

[78] (n 76 above) 4

[79] (n 76 above) 4

[80] (n 76 above) 4

[81] (n 76 above) 4

[82] (n 76 above) 4

[83] (n 76 above) 4

poignantly observes that such restrictive or detailed laws may have the effect of stifling the development of the industry. He concludes his article by providing analyzing the impact of regulations on the industry. In his view, regulation may have an adverse impact on factoring arising from escalation of costs, tying up resources, creating bureaucracy and becoming too prescriptive.[84] Notwithstanding these negatives, regulation of the industry raises standards, enhances professional conduct and promotes transparency. Furthermore, he adds, regulation also has other attendant benefits such as mitigation of risk and enhanced customer confidence. 'If a regulated factoring environment results in fewer providers for the industry, this can be considered as a negative, but it can also be seen as an advantage because it will create high quality standards for the sector.'[85]

2.7 Case Studies

Three (3) country case studies will be explored hereunder to build upon the three models of regulation. Each of them has unique characteristics that have developed the factoring industry over time to astounding heights. These have been carefully selected to exemplify that certain bold reforms and that public and private sector cooperation are vital to the success of the trade financial tool in emerging markets. Turkey represents a jurisdiction following the strict regulatory approach with a specific piece of legislation while Egypt serves as an example of a country which has a strong regulator but without a specific factoring statute. South Africa will exemplify a jurisdiction without any specific regulator or regulatory framework designated to supervise the factoring industry but having a coherent framework of laws and institutions that operate factoring through their corporate governance structures and related laws. The case studies below will also endeavour to show what other aspects have enabled the factoring industry to thrive in their respective jurisdictions.

2.7.1 Turkey

Turkey is perhaps the epitome of a European country that has harnessed factoring and lifted itself to be an economic powerhouse. A non-member of the European Union, it is the 7th largest economy in Europe and the 18th largest economy in the world. Its Gross Domestic Product (GDP) was an impressive US$ 861 billion in 2015 and per capita income in 2016 surpassed US$11 billion. For

[84] (n 76 above) 4
[85] Kara (n 76 above) 4

27 years factoring has played an integral role in Turkey's business life. Throughout that period, this trade finance product has shown steady growth averaging 20 per cent over the last ten years.[86]

Today, the factoring industry generates an astounding 6 per cent of Turkey's GDP and employs more than 4, 700 people. It comprises 62 factoring companies with 379 branches and representative offices serving around 100,000 customers and roughly 300,000 debtors, mostly SMEs. Although in 2016 Turkey witnessed fluctuations in financial markets, geopolitical problems and domestic uncertainties, the factoring industry has remained a strong pillar of the economy.[87]

SMEs are extremely important to Turkey's economic development. They account for 73.5 per cent of employment and 99.8 per cent of businesses. Notwithstanding their significance, SMEs in Turkey continue to grapple with a myriad of financial problems: difficulty in securing bank credit, higher interest rates with short term maturity, insufficient equity capital, insufficient access to capital market instruments, compounded by lack of professional financial management. Fortunately, there are numerous organisations that address these impediments confronting SMEs. Organizations such as the Credit Guarantee Fund (KGF), the Small and Medium Scale Enterprises Development Organisation (KOSGEB), and the Union of Chambers and Commodity Exchanges of Turkey (TOBB) all provide financial and/or non-financial assistance for SMEs.[88]

The factoring industry provides financing mainly to small and medium sized companies and therefore it is highly sensitive to fluctuations in the economy. By providing financing, payment guarantees and collection services to SMEs, factoring companies contribute significantly to the Turkish economy, particularly during crisis periods when quick and practical solutions are needed to fund companies' working capital requirements. [89]

Turkey's 27 years of factoring experience has set the standard of a factoring industry in emerging markets. This knowledge and experience is not only attributable to its geographical position and

---

[86] F Unal 'Turkey' *World Factoring Yearbook 2017 Edition* (2017) 138. (Available at www.ebglaw.com/content/uploads/2017/06/Tatge-World-Factoring-Yearbook-2017-eBook.pdf (Last Accessed 27 September 2017)

[87] Unal (n 86 above) 138.

[88] (n 86 above) 140.

[89] (n 86 above) 143.

success in export factoring and general global factoring expertise, but also a result of the work it has invested in the legal and regulatory environment. Unal[90] concludes as follows:

> 'Turkey is a great example of how factoring industries can work with governments and governmental organizations successfully. The main reason for this success is that the industry has been able to represent itself with one voice to the executive, legislative and judicial authorities. After the Law on Financial Leasing, Factoring and Financing Companies, we focused on building the future of factoring in Turkey with new innovative IT-based products such as supply chain finance and centralized e-solutions under the Financial Institutions Association. The factoring industry in Turkey is dynamic, has developed itself very rapidly with new IT initiatives and it is very well connected with other countries. All those characteristics coupled with its geographical position make Turkey a bridge between the continents for international trade and factoring, SCF, know-how and Islamic factoring.'

2.7.2 Republic of South Africa

South Africa's factoring volumes represent 85% of the continent's volumes followed by Morocco with 10%, Egypt 2% and then Mauritius, Tunisia and Kenya at 1% apiece of the continent's total factoring volumes.[91] According to Brehcist, FCI Advocacy Director in his article entitled *Global Industry Activity Report for 2016* South Africa's factoring volumes increased from 14, 672 Euros in 2015 to 16,291 Euros representing growth of 11.03%.[92]

The South African factoring industry is approximately 50 years old. Understanding the importance of cashflow for conducting business, some factoring groups formed in the 1960s. These factoring houses eventually amalgamated with and became divisions or subsidiaries of the large banking groups. South Africa has eight (8) members making up the Debtor Financing Committee (DFC). These are Standard Bank, ABSA, Nedbank, FNB, Sasfin, Merchant Factors, Reichmann and Grinrod. Of these, Sasfin, Standard Bank and Nedbank are FCI members.[93]

SMEs are the driving force behind job creation in South Africa. Business and Partners SME Index for the last quarter of 2016 found that 47% of local SMEs had hired new staff members in the preceding one year. Small Enterprise Development Agency (SEDA) adds impetus to this view by

---

[90] Deputy Secretary General, Factoring—Financial Institutions Associations.
[91] K Awani 'Africa on the Rise in 2016' *FCI Annual Review* (2017) 13 https://www.fci.nl (Accessed 17 August 2017).
[92] J Brehcist 'Global Industry Report for 2016' *FCI Annual Review* (2017) 32 https://www.fci.nl .
[93] D Cory 'South Africa' *World Factoring Year Book 2017 Edition* (2017) 166 (Available at www.ebglaw.com/content/uploads/2017/06/Tatge-World-Factoring-Yearbook-2017-eBook.pdf (Last accessed 27 September 2017).

holding that small businesses can act as ‘key drivers of economic growth, innovation and job creation.’[94]

Diverse efforts are being made to unlock the actual growth potential of this sector. In 2013, South Africa’s savings and investment industry, the Association for Savings and Investment South Africa (ASISA) founded the Enterprise and Supplier Development (ESD) Fund in 2013. The Fund aims to ease the development of high potential SMEs through an innovative combination of tailored business acceleration and investment support. Leon Campher, CEO of ASISA, states:

> We understand that SMEs require more than just financial support in order to grow. We also understand that every SME is a unique business with a unique business need. That is why our Fund offers tailored business development support as well as financial support structured according to the specific needs of each SME.[95]

According to Business Partners and SME Index 2015, SMEs doing business with government and private companies identified funding and prompt payment for work done as key requirements for business sustainability. In its official statement highlighting the magnitude of the problem, Business Partners stressed:

> Late and protracted payments by large corporates and state agencies put SMEs under unnecessary pressure. While payment delays can be easily absorbed by large companies…late payments can have potentially devastating consequences for SMEs operating in the private and public sectors.[96]

Business Partners Limited-, formerly the Small Business Development Corporation, founded in the 1980s by the wealthy South African Rupert family, has been one of South Africa’s most influential SME funding and financial training and mentorship bodies, along with corporates in the insurance space such as Sanlam and Old Mutual, which run annual competitions to incentivize and reward outstanding entrepreneurs.[97]

South Africa is a hybrid of Roman Dutch and English Law as the basis of its legal structure. However, there are no specific laws governing Domestic and International Factoring. 'Financing' infers conditional lending. The supplier cedes all current or receivables in favou of the

---

[94] Merchant Factors ‘A Solution to the small business finance gap’ 19 July 2017 www.mfactors.co.za (Accessed 22 September 2017).

[95] https://asisa.org.za.

[96] JSE Quarterly *JSE Supplement September 2016* 39 (Available also at www.jse.co.za).

[97] JSE (n 96 above) 40.

factor by executing the factoring contract or other security document. Banking Factors are regulated by the Banking Act. The Financial Services Board (FSB) oversees the business practices of Non-Bank-owned Factors.[98] Cory states that 'South Africa has a well-established and highly regarded legal framework that does work. The system positively supports the growth of the factoring industry, debts can be recovered and there is rule of law.'

2.7.3 Egypt

The Egyptian economy is heavily dependent on SMEs, which on aggregate account for 80% of the country's GDP. 75% of the nation's labour force are employed in the SME sector. The preponderance of SMEs therefore necessitates the growing need for factoring as a trade finance tool of these SMEs.[99] Factoring facilitates trade on open account terms. It is a very important finance tool in both domestic trade as well as in the international trade space in financing Egyptian exporters. Factoring is equally important in assisting Egyptian importers, particularly manufacturers who procure most of their raw materials from out of the country as it empowers them to negotiate more favourable conditions.[100]

Factoring as a non-banking financial service is conducted by seven companies, namely Coface Egypt, Cairo Factors, Export Credit Guarantee Company of Egypt, QNB Alahli Factoring, Egypt Factors, Tamwel Mortgage and Drive Finance. Egypt Factors was the first to enter the market in 2006 and holds the largest share of the factoring transactions. It is jointly owned by FIMBank Plc and the International Commercial Bank.[101] It offers the full range of factoring products to the market including domestic factoring with and without recourse, export factoring with and without recourse, import factoring and reverse factoring (both domestic and cross border).[102]

A real-life example of how factoring has impacted an Egyptian company is in order. The year 1980 witnessed the founding of a carpet-manufacturing company called MAC Carpet with a capital of US$1million. The company produced an aggregate of a million square meters of carpets and rugs per annum. Despite its steady growth over the years and the establishment of international

---

[98] M Bickers 'A Comparison of Emerging Markets' (2012) unpublished. (Email from M Bickers 28 August 2017)
[99] Oramah & Dzene (n 96 above)17, 21.
[100] G Shams 'Egypt' *World Factoring Yearbook 2017 Edition* (2017) 161(Available at www.ebglaw.com/content/uploads/2017/06/Tatge-World-Factoring-Yearbook-2017-eBook.pdf (Last accessed 27 September 2017).
[101] Oramah & Dzene (n 99 above) 22.
[102] Shams (n 100 above) 162-163.

clientele, particularly in Canada and the United States, MAC Carpet encountered severe financial straits resulting from the 2008 global financial slowdown as its clients either defaulted or reduced their level of imports. Management at MAC made a decision to explore other options to secure financing and safeguard their export business with Egypt Factors, which in turn introduced the company to the numerous advantages of transacting with an FCI member. This, according to FCI resulted in "a one-stop-shop solution for exports to more than 60 countries" with a complete coverage of services ranging from finance to debt collection as well as risk protection.[103]

"Based on credit limits secured by our FCI partners in both Canada (National Bank of Canada) and US (BB&T, UPS and CIT), Egypt Factors was able to offer MAC Carpet a package of full factoring services, of which the most important feature was financing," says Mr Marius Savib, general manager of Egypt Factors.[104]

Today, the business produces an astounding 58 million square meters with 85 per cent of its production being exported to more than 112 countries across the globe. MAC operates twenty-four hours a day, seven days a week and employing over 6,000 people who work in its three eight-hour shifts.[105]

Factoring turnover in Egypt has increased exponentially in the last few years. Shams further points out that: 'Since 2011 it has increased more than 6 times, with turnover rising from EGP 975 million in 2011 to EGP 6.068 billion in 2016. Indeed, in 2016 it increased by more than 32 per cent compared with 2015.'

The Central Bank of Egypt (CBE) is encouraging banks to finance SMEs as they have now been mandated to provide loans to SMEs up to 20 per cent of their total portfolio. However, majority of SMEs still cannot afford this form of financing notwithstanding the fact that the rates being offered are attractive.

The Egyptian Financial Supervision Authority (EFSA) - the authority regulating all the non-bank financial institutions - issued comprehensive factoring regulations at the end of 2010 which clarified most of the regulations with respect to factoring. Further limited amendments ensued in

[103] FCI 'MAC Carpet—FCI on flying carpets around the world' https://fci.nl/en/about-factoring/case-studies/ (Accessed 25 April 2017).
[104] www.sme.egypt.com (Accessed 26 September 2017).
[105] www.maccarpet.com (Accessed 26 September 2017).

early 2012 to facilitate the introduction of factoring for other financial institutions operating under the EFSA. Other changes to the law were included in 2013, 2014 and 2016 adding consumer factoring as a product and to facilitate factoring and the reassignment of debts to banks and other financial institutions.[106]

The EFSA has proposed a new factoring legislation that will amalgamate all existing regulations and amendments into one consolidated statute. It will make reassignment of receivables to another factoring company or bank acceptable. It will also provide enhanced legal protection and enforceability for factoring companies regarding contracts and assignments.[107]

The Department of Exports in Egypt's Ministry of Trade is making tremendous efforts to increase the cognizance of factoring among current and potential exporters of the significant role that it can play in assisting them. The Exports Department has explained that factoring can provide:

- Finance to accelerate their cash flow
- Guarantee against payment default by foreign buyers
- Ledger administration and collection

Membership of FCI accords factoring companies access to insurance cover and debt collection in about 90 countries from more than 400 factoring companies that are members.

New entrants are expected to join the factoring market, since numerous new companies are applying for a licence from the EFSA. The proliferation in the number of factoring companies is likely to increase awareness of the factoring market. It will also inevitably create increased competition between factoring companies which in turn will lead to more attractive services for clients.[108]

Factoring companies are now better equipped and have greater ability to finance SMEs as they grow. Therefore, demand for factoring and related products (vendor finance programs, export, import, domestic factoring and reverse factoring) is expected to grow. To stimulate the economy

[106] Shams (n 100 above) 163.
[107] (n 100 above) 163-164.
[108] (n 100 above) 164.

and expand the sources of foreign currency, the Government is providing additional incentives to Egyptian exporters to increase the country's exports.[109]

The ramifications of Egypt's emerging factoring market for the rest of Africa are insightfully concluded by Oramah and Dzene:

> 'The remarkable growth of factoring business in Egypt in recent years presents some useful lessons for the rest of Africa. First, deliberate policy reforms, particularly those that minimize the stringent entry requirements and improve access to cheap credit, are required to support SME growth and development in Africa. Further, African governments should continue to pursue export-oriented economic growth policies that are conducive to factoring. Last, but not least, appropriate legal, regulatory and institutional reforms are urgently required to create the enabling environment for factoring to flourish…'[110]

2.8 Conclusion

Factoring has evolved over several hundreds of years to its present form. Today, it is a multi-billion- dollar industry that has spread its tentacles to five continents. Its impact is beyond question. Its importance by far outweighs its weaknesses—perceived or otherwise. Entrepreneurship, the role of the private sector and financial inclusion will continue to resonate as key drivers of sustainable economic growth. The ripple effects of delayed payments to those at the base of the supply chain cannot be ignored. Factoring is a proven trade finance tool that promptly provides the much required cashflow to businesses without requiring collateral nor a favourable credit history from the business.

The foregoing case studies have clearly illustrated that that the development of this trade finance tool has been accelerated in jurisdictions with conducive regulatory frameworks as a starting point. Turkey's example has demonstrated how a combination of aspects is important for the development of the industry. South Africa's case study has shown that access to credit information remains a pillar for the optimal performance of factoring. Finally, the Egyptian model has reinforced the fact that SMEs, if supported, are not only an indispensable avenue to ameliorate unemployment in a country but also have the potential to significantly contribute to GDP.

The following chapter attempt to make a case that factoring is a reliable alternative to traditional sources of financing provided by banks. The chapter will focus on overdrafts and term loans on

[109] (n 100 above) 164.
[110] Oramah & Dzene (n 99) 24-25.

the one hand, and factoring on the other, to demonstrate that factoring is a finance technique that is assuming a central position in the financing of SMEs.

CHAPTER THREE

FINANCING OF SMES: FACTORING AS OPPOSED TO TRADITIONAL BANK LENDING

3.1 Introduction

In the previous chapter, the concept of factoring as a trade finance product was explained in detail. The essence of this chapter is to contrast factoring and traditional forms of bank lending. Most SMEs remain unaware of the existence of factoring and almost invariably seek financing from banks and other financiers through loans and overdrafts. Banks are highly risk-averse thereby making it difficult for SMEs to access traditional loans and overdrafts. Equity financing is another option, but this entails losing partial ownership or control of the business.[111] An alternative mechanism is asset-backed financing such as factoring. The theme of this chapter is to showcase the advantages of that factoring presents over various forms of bank lending with specific reference to overdrafts and term loans. It will be necessary therefore to explore these forms of bank lending and demonstrate their inherent disadvantages in the prism of factoring.

3.2 Traditional bank lending: overdrafts and terms loans

Corporate practice shows that SMEs face difficulties with regards to accessing finance through traditional bank borrowing, and to financing the gap between the timing of cash outflows and inflows.[112] Traditionally, external sources of finance, has consisted of overdrafts and bank loans. However, the economic landscape is rapidly changing and asset-based financing has developed tremendously over the last decade.[113]

Burns states that banks perceive lending to SMEs in very much the same way as lending directly to the small business owner-manager. Bankers have coined a few mnemonics to be used as a framework for making lending decisions. For determining whether to lend to small businesses, the most common one employed is CAMPARI.[114]

---

[111] Merchant Factors 'A solution to the small business finance gap' 19 July 2017 www.mfactors.co.za/article.php (Accessed 22 September 2017).

[112] T Milenkovic-Kerkovic & K Dencic-Mihajlov 'Factoring in the Changing Environment: Legal and Financial Aspects (2012) www.sciencedirect.com/science/article/pii/S1877042812011688 (Accessed 23 September 2017)

[113] Milenkovic-Kerkovic & Dencic-Mihajlov (n 112 above)

[114] P Burns 'Entrepreneurship & small business: start-up, growth and maturity' (2011) 268.

Character	The bank will enquire into the business track record of the proprietor/manager and their personal credit history. Honesty and integrity are also factored in.[115]
Ability	The proprietor/manager's capability to execute the plan is also of the essence. This is about their attributes of management's business savvy.[116]
Margin	The bank will assess the cash flow against the interest rate, fees and loan repayment terms.[117]
Purpose	The bank must be satisfied that the purpose of the loan is legitimate and in alignment with bank policy. The bank must be convinced that there is a good case for additional capital rather than simply a case where the borrower will benefit from the increased revenue.[118]
Amount	Is the amount requested matching the purpose? Have all associated costs for the project been included? Has the borrower put in money themselves?[119] Is there a contingency?[120]
Repayment	Will the business generate adequate cashflow to satisfy the interest payments and repay the capital? Is the repayment term realistic?[121]The element of repayment is the key consideration of the bank.[122]
Insurance	The bank first determines whether collateral is required. If so, the bank must be satisfied that the security appropriately evaluated. Additional personal security may in certain cases be necessary. If the amount sought is miniscule, the bank will lend against the business' credit history and require undertakings to be made to ensure that the business retains its capacity to repay the loan.[123]

[115] Burns (n 114 above) 268.
[116] Burns (n 114 above) 268.
[117] Lime Consultancy 'Campari, More Than a 1980s Drink' www.limeconsultancy.net/campari (Accessed 27 September 2017).
[118] https://www.workspace.co.uk/community/homework/business-finance/campari-preparing-a-business-bank-loan-application.html (Accessed 27 September 2017)
[119] Goh (n 2 above) 73.
[120] Burns (n 114 above) 268.
[121] (n 114 above) 268.
[122] Goh (n 2 above) 73.
[123] Goh (n 2 above) 73-74.

3.2.1 Overdrafts

An overdraft is a type of debt financing linked to a client's current account. It is obtained by drawing funds over and above the available bank balance. It is intended generally to cover short-term financing and offers the advantage of flexible borrowing to the precise amount required and prompt availability.[124] This facilitates the seamless operations of SMEs which may require an instant cash injection to meet arising needs. There are essentially two types of overdraft: authorized and unauthorized. An authorized overdraft entails that the limit of the excess amount that is available for withdrawal is ordinarily agreed earlier, and a commitment fee may be required of the business. An unauthorized overdraft by contradistinction is one where the parties do not have such a prior arrangement. Interest rates are higher and further charges will be imposed for unauthorized overdrafts. It is therefore prudent for a business to undertake an authorized facility.[125]

Factoring, on the other hand, is perhaps one of the most effective mechanisms for small businesses to obtain financing. Salinger states that as bank facilities are determined to a large extent by criteria quite distinct from the value of the prospective level of trade debts outstanding from time to time, unestablished growing firms may therefore be unable to obtain adequate finance to realise their optimal productive capacities. A prerequisite that a bank might impose is that its customer must reach a sufficient threshold of trade and thus profitability and thereby produce the profits and the assets to support the required level of finance. However, in the absence of 'availability of the finance to support the required level of trade the business cannot reach it.'[126]

Factoring extricates SMEs from this predicament. The factor's provision of finance is based on the client's sales ledger rather than its balance sheet, and so the facility grows commensurately with the business.[127] This enables the business to prepare for growth in the knowledge that the factoring company will exactly meet the extent of the funds required for the trade credit to be availed for its own customers. This is particularly the case under full service factoring where the factor undertakes to purchase without recourse every debt arising from the sale of acceptable goods

[124] Goh (n 2) 71.
[125] (n 2 above) 71.
[126] Salinger (n 46 above) 35.
[127] Goh (n 2 above) 71.

to creditworthy customers. The client is then required to fund only the differential and the agreed percentage may equal its gross profit margin. [128]

Essentially, since factoring is not a loan no debt is incurred as this is purely a cash advancement predicated on a corresponding current liability in the form of a sales receivable, with no consequent increase to balance sheet liabilities.[129] By contrast, an overdraft is recorded as a liability in the business' balance sheet because it is considered as an expense. The cost could even escalate higher than anticipated if the business overdraws higher than the overdraft ceiling or fails to adhere to the repayment terms.[130]

According to Goh, the requirement that debts be "repayable on demand" under overdrafts poses an added risk to small businesses. "Repayable on demand" refers to a loan made where no period for repayment is specified and the loan can be called in at any moment. To compound the problem even further, even where the set time has been agreed for the overdraft, the bank is still within its rights to make a demand for repayment prior to the expiration of the said period. This heightens the vulnerability of SMEs. [131]

Goh illustrates this quite vividly by citing the case of Cripps (Pharmaceutical) Ltd v Wickenden[132] where the Court of Appeal upheld the appointment of a receiver by a bank to enforce its rights less than two hours after it had placed a demand for repayment. The bank was held to be well within its rights even though there was no doubt that the borrower did not have the capacity to pay at that precise time.[133]

In Bank of Baroda v Panessar[134], a delay of merely an hour between the bank's demand for payment and unleashing the receivers on the borrowers was held to be justified.[135]

The two decisions above are eloquent testimony that reliance on an overdraft facility could potentially lead to the abrupt winding up of an SME. Where the small business is not presently liquid to settle the overdraft on demand and a receiver is appointed to sell the business' assets to

---

[128] Salinger (n 46 above) 35.
[129] Milenkovic-Kerkovic & Dencic-Mihajlov (n 112 above).
[130] Goh (n 2 above) 71.
[131] (n 2 above) 71.
[132] [1973] 1 WLR 944.
[133] Goh (n 2 above) 71.
[134] [1986] 3 All E.R. 751.
[135] Goh (n 2 above) 72.

recover the moneys due to the appointing bank, it can safely be deduced that the business is at the brink of insolvency. A factoring contract, by way of distinction, reassures the business owners that the liquidity of the business will not be at risk of such abrupt adverse shocks because 'a proper notice period is required by both sides.'[136]

3.2.2 Term Loans

Term loans are also frequently offered by banks as a lending facility wherein a lump sum is advanced to the borrower for a designated timeframe, and repayment is required at the expiration of that period, or even during the currency of the designated timeframe in accordance with the set repayment schedule. Term loans are classified into three (3) broad categories: short-term loans, intermediate term loans and long-term loans.[137] Short-term loans are not difficult to obtain and are often unsecured. They must be repaid within 12 months at much higher and more frequent payments. Intermediate term loans range from 1-3 years and have a lower interest rate than short-term loans. Long-term loans can have a maximum period of up to 20 years and interest rates tend to be low. They are often secured by the borrower's fixed assets.[138]

Naturally, the bank's primary concern is to ascertain that the business is capable to repay the loan.[139] Therefore, banks will conduct thorough credit assessment as a condition precedent before disbursing the funds. The lender may subject the business' operations and financial documents to rigorous scrutiny at their infancy, and as a result most SMEs fall by the wayside. Most small businesses almost invariably fall short of certain prerequisites at this evaluation phase.[140]

Factoring also imposes minimum conditions precedent to satisfy the factor that the business is worthy of financing. The factor will assess the business' operations by scrutinizing audited accounts, status reports and making enquiries about the proprietor's experience within the sector. However, in this case, the debtor's capacity to repay is the overarching issue unlike under bank lending where the primary concern is the business' financial position.[141] Salinger postulates that

[136] Goh (n 2 above) 72.
[137] Bond Street Market Place Inc. 'What is a term loan (and how it can unlock growth for your business)' https://bondstreet.com/blog/term-loan (Accessed 26 September 2017)
[138] Bond Street Market Place Inc. (n 137 above)
[139] Goh (n 2 above) 74
[140] (n 2 above) 74
[141] (n 2 above) 74

this is a potential disadvantage of factoring in that the factor is unlikely to accept a transaction in which the expectation of bad debts is exceptionally high.[142]

3.3 The advantages and disadvantages of factoring as opposed to traditional forms of financing

Like other traditional forms of commercial lending, factoring provides SMEs with much-needed working capital financing. Factoring confers the benefit of improving the financial competitiveness of a business through enhanced availability of cash. SMEs are constantly confronted with liquidity risk, which reduces their ability to settle their obligations at their expiration. Factoring assists small businesses to manage their required level of liquidity and their suppliers may offer them price discounts because of prompt payment for supplies.[143]

Fairbanks is of the view that factoring enables SME prompt access to capital and is best used as a short-term solution that assists in keeping the business running while awaiting payment on outstanding invoices. It also allows a business to take advantage of time-sensitive opportunities that help the business develop.[144] For instance, if the business is waiting to receive payment on several large invoices but needs money immediately because one of its suppliers is offering a significant discount if it can purchase a certain monetary value of products within a specific time frame, a factoring advance may be a good solution. This is best illustrated by a real-life story:

Eco Nuts, an organic soap nut retail company, received a huge purchase order from one of its clients. However, as it initially lacked working capital, it was unable to secure this investment deal. It decided to seek the services of the factoring company Blue Vine. Blue Vine assisted Eco Nuts to successfully fill the order. At the time Eco Nuts had numerous outstanding invoices from a reputable company, but it did not have sufficient liquidity to procure the supplies and settle other overheads. This placed its growth trajectory at risk. Eco Nuts successfully used Blue Vine's "invoice financing solution to unlock the cash trapped in their invoices to fulfill new orders and maintain their growth trajectory", narrates Fairbanks.[145]

---

[142] Salinger (n 46 above) 29
[143] Milenkovic-Kerkovic & Dencic-Mihajlov (n 112 above)
[144] Fairbanks (n 49 above)
[145] (n 49 above)

It bears repeating that bank financing inordinately exposes the entrepreneurs' personal property to risk. Goh points out another advantage of factoring over term loans: 'a factoring agreement does not require security in terms of corporeal moveable or heritable property.'[146] This frees up the businesses assets from the exposure attendant to foreclosure or receivership linked to mortgages and debentures. The business is then at liberty to use its assets such as real estate and machinery as collateral from other financiers.[147] Moreover, the bank will normally approve an amount on a line of credit that is significantly lower than the value of the pledged assets. Ultimately, therefore, invoice financing protects the business' assets whereas they exposed are under bank lending.'[148]

Banks, on the other hand, may require global collateral on all the assets that the business owns. Worse still, this usually includes all future assets acquired for the duration of the line of credit.[149] In such a case, the proprietors or even the directors may be required to provide personal guarantees for the bank to grant the loan. While acknowledging that a company is a separate legal entity from its shareholders and capable of pledging its own property as collateral, banks will almost invariably require personal guarantees as a prerequisite to finance SMEs.

The heightened risk of losing personal assets for the entrepreneur becomes even more acute in the case of multiple business owners as a call on the loan may be joint or several and the bank will not concern itself with the inner arrangements amongst the business owners. This may lead to strained relationships within the business, especially if the parties are not forthright with one another. Factoring, on the other hand, does not usually require personal guarantees as the factor provides financing on the strength of the validity of the receivables recoverable from the purchaser.[150]

A further difficulty posed by bank lending to SMEs is the bank's constant involvement even after the loan has been disbursed. The bank requires that it must be updated regularly as to any changes to the business. This can be time-consuming and burdensome on the small business-owner. Any failure to disclose will entitle the bank to demand for repayment of the entire loan immediately and to sue for the outstanding amount if the borrower fails to pay.[151]

---

[146] Goh (n 2 above) 73
[147] M Mandula 'Why factoring is often the astute solution for the SME entrepreneur' (2017) *Trade & Receivables Finance News 6 October 2017* www.bcrpub.com (Accessed 9 October 2017)
[148] Goh (n 2 above) 74
[149] Mandula (n 147 above)
[150] Mandula (n 147 above)
[151] Goh (n 2 above) 75

Perhaps even more disturbing are the covenants under loan agreements that weigh disproportionately in the interest of the bank and at the expense of the borrower. The purpose of covenants is to delineate the activities that a business can undertake to ensure that its credit-rating does not weaken during the currency of the loan, thereby guaranteeing full repayment of the loan, which is the bank's priority.[152] Where breach of a covenant occurs, this is tantamount to an event of default that empowers the bank to terminate the loan agreement.

Goh argues that while restrictive covenants can on the one hand be beneficial to the business by ensuring that it remains focused, covenants may also on the other hand stifle the growth thereof, specifically the covenant that restricts the change of business.[153] By way of illustration, an established SME may conceive a viable business solution that will overcome a problem in the market. However, the bank still retains the power to unilaterally consider this as a "material adverse change". A "material adverse change" is one where the change is of such consequence that it impacts the borrower's capability to perform its obligations under the contract. This may prohibit the business from pursuing a potentially profitable idea, which might have enhanced its revenue.[154]

Such a restrictive covenant will not be found in a factoring contract. The obligation of the client is solely to adhere to certain financial covenants that inherently advance business expansion and its relationship with the factoring company, rather than limit its own economic growth.[155]

No doubt, a certain extent of control is traceable in some factoring contracts. However, unlike a bank loan contract, this kind of control is sought by the client, who does this by electing to include as an integral part of the contract the ancillary functions of factoring, being the collection of debts and administration of the sales ledger. With respect to the sales ledger administration, the factoring company 'ensures that the sales ledger is kept on an "open item" basis, which allows all respective invoices, unpaid parts of invoices and unallocated credit notes and payments to be listed in the sales ledger'.[156]

---

[152] (n 2 above) 75
[153] (n 2 above) 75
[154] (n 2 above) 75
[155] Goh (n 2 above) 75.
[156] (n 2 above) 75.

Goh argues that factoring without recourse is the most important advantage of factoring as hereunder the factoring company assumes the risk of unpaid debts thereby insulating the client from the adverse effects of bad debts and guaranteeing the projected profit margin. Hence, the ancillary services that the factor offers are advantageous to the business as the proprietor can then concentrate on the main aspects of the business such as production, sales and planning. Bank lending, by way of contrast, may add to the stress where the business is unable to repay its loan or overdraft promptly by imposing further charges on top of the debt.[157]

Salinger notes that it is quite common for lenders to companies to include an undertaking from the borrower that it will not, prior to the discharge of the loan, create any form of security over it assets.[158] Goh elaborates on this point by bank may include a 'negative pledge covenant' (NPC) in a loan agreement whereby the business is proscribed from creating additional security over its assets unless the bank grants its consent.[159] A business that requires additional funds in order to implement a project or a purchase may be prejudiced by an NPC because the bank may draw an inference that the business is not financially sound and decline to extend the loan.[160]

A disadvantage of factoring is that it tends to cost more than bank lending. Interest is charged on the funds advanced at a rate of about 2-4% over and above the base rate coupled with administrative charges depending on the service required, turnover and average value of invoices.[161] Goh argues that these additional expenses arising from factoring are amply justified where prepayment of debts allows the business to seize new opportunities and sustain its daily obligations as they arise rather than wait for several weeks or months before invoices are settled.[162] Moreover for an SME experiencing rapid growth it may be the only way to raise funds.[163]

An additional benefit that factoring has over bank financing is that of expeditious approval. Where a business relationship already exists between the factoring company and the client an upfront payment of up to 90 % of the debts can be funded within twenty-four hours. Although an overdraft application can take only three days to be approved, bank loan approval is usually a protracted and

---

[157] (n 2 above) 75.
[158] Salinger (n 46 above) 164.
[159] Goh (n 2 above) 76.
[160] (n 2 above) 76.
[161] Burns (n 109 above) 261.
[162] Goh (n 2 above) 77.
[163] Burns (n 109 above) 261.

burdensome process, particularly for customers who may have a high credit risk.[164] This has the potential to be injurious to businesses that require immediate cash.[165]

3.4 Conclusion

Banks are highly averse to risk and as such subject applications for financing to rigorous scrutiny. Term loans and overdrafts are the two most common forms of traditional bank lending sought by SMEs. Because of stringent criteria set out by the banking industry, most SMEs do not qualify for financing. Invoice financing, and specifically factoring, is on the rise as a flexible alternative to finance SMEs and other businesses. Factoring differs from traditional lending in that it is more accessible to businesses with credit histories that may not be satisfactory to bankers. Additionally, it does not impose restriction on how the business elects to use the funds as it is not a loan. By contrast, overdrafts and loans are liabilities for the business and can restrict the borrower's ability to seize opportunities for growth through covenants. Factoring also yields quicker results: applications are shorter and require less documentation, approvals tend to be quicker, and funding is provided promptly.[166] Although factoring may in certain instances be more expensive than bank lending, the immediate availability of cash enables seamless business operations and possible expansion.[167] Factoring certainly confers a myriad of comparative benefits that may not be available under traditional bank lending. As this trade finance tool ameliorates the financing problem confronting SMEs in Zambia, it must be given credence and full support.

The following chapter appraises Zambia's policy and legislative framework that govern factoring and the financing of SMEs in that jurisdiction. An analysis will ensue under the prism of extant laws and the efforts to advance financing for all sectors of the economy.

[164] Goh (n 2 above) 78.
[165] (n 2 above) 78.
[166] Fairbanks (n 49 above).
[167] (n 49 above).

CHAPTER FOUR

ZAMBIA'S REGULATORY AND POLICY FRAMEWORK FOR FACTORING: THE INADEQUACIES OF FACTORING LAW IN ZAMBIA

4.1 Introduction

SMEs have become increasingly important in the global economy. Most jurisdiction across the globe have implemented policies and strategies to spur optimal performance of these 'engines of growth'. The Government of Zambia formally recognised this in the early 1980s by enacting the Small Industries Development Act of 1981. This Act was repealed and replaced by the Small Enterprises Act of 1996. The Zambia Development Agency Act of 2006 in turn repealed the Small Enterprises Act. Zambia's investment landscape has consequently witnessed accelerated growth principally resulting from the favourable legal milieu to attract foreign direct investment. However, domestic direct investment remains stunted as competition from highly supported and capitalized foreign firms is stiff. SMEs remain at the end of the investment spectrum. This is due to the high cost of doing business and the lack of adequate financing.

In this chapter, the various pieces of legislation, declarations and policy frameworks that have a bearing on the factoring industry will be explored with a view to demonstrating that the lack of a regulatory framework has impeded the growth of factoring in Zambia. A plethora of statutes will also be dissected as there is an obvious interrelationship between the legal infrastructure and the proposed law. Acknowledging that the current regulatory framework is ineffectual is the first step towards reform.

Preceding this exposition, the chapter articulates the theory of financial inclusion as the hallmark of a functional economy. In the light of the growing realisation that improved access to finance is a catalyst to economic growth, the theory merits elaborate discussion hereunder.

4.2 The theory of Financial Inclusion

Triki and Faye[168] define financial inclusion as 'all initiatives that make financial services available, accessible and affordable to all segments of the population.' The duo posit that this includes a seamless financial infrastructure that accommodates individuals and companies to engage more

---

[168] T Triki & I Faye (eds.) 'Introduction' (2013) *Financial Inclusion in Africa* 25 https://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/Financial_Inclusion_in Africa.pdf (Accessed 22 September 2017)

actively in the economy. Globally there are more than 2.5 billion people who are excluded or underserviced by financial systems. These are primarily the indigent or underserved populations that depend upon a combination of formal or informal financial services, neither of which is capable of adequately meeting their diverse financial needs.[169] The World Bank Group in its text 'Finance for All? Policies and Pitfalls in Expanding Access'[170] espouses the notion that financial inclusion lies at the heart of the development process:

> 'Finance is at the core of the development process. Backed by solid empirical evidence, development practitioners are becoming increasingly confident that efficient, well-functioning financial systems are crucial in channelling funds to the most productive uses and in allocating risks to those who can best bear them, thus boosting economic growth, improving opportunities and income distribution, and reducing poverty. Conversely, to the extent that limited access to finance and the available range of services are limited, the benefit of financial development is likely to elude many individuals and enterprises, leaving much of the population in absolute poverty.'[171]

Enhanced access to finance therefore becomes a critical imperative in promoting trade. According to the narrative:

> 'Without inclusive financial systems, poor individuals and small enterprises need to rely on their personal wealth or internal resources to invest in their education, become entrepreneurs, or take advantage of promising growth opportunities. Financial market imperfections, such as information asymmetries and transaction costs, are likely to be especially binding on the talented poor and the micro- and small enterprises that lack collateral, credit histories, and connections, thus limiting their opportunities and leading to persistent inequality and slower growth…Services need to be available when and where desired, and products need to be tailored to specific needs…'[172]

Zambia has also demonstrated her renewed desire to enhance financial inclusion through active participation in the Alliance for Financial Inclusion (AFI) from its inception in 2011. She was among the first countries to sign the Maya Declaration, which was launched in Riviera Maya, Mexico in 2011.

---

[169] Mercy Corps *Financial Inclusion: Approach and Principles* (2014) https://www.mercycorps.org/sites/default/files/Financial%20Inclusion%20Approach%20Principles%20_20June%202014.pdf (Accessed on 6 September 2017)
[170] World Bank Group 'Finance for All? Policies and Pitfalls in Expanding Access' (2008) World Bank Policy Report. Washington DC www.openknowledge.worldbank.org/handle/10986/6905 (Accessed on 10 August 2017)
[171] World Bank Group (n 160 above)
[172] (n 160 above)

> 'The Maya Declaration is an initiative to unlock the economic and social potential of the 2 billion unbanked population through greater financial inclusion. It represents the world's first commitment platform which enables AFI member institutions to make concrete financial inclusion targets, implement in-country policy changes, and regularly share progress updates. A public commitment to the Maya Declaration is a means to champion financial inclusion.'[173]

Studies show a strong correlation between financial inclusion and the establishment of robust economies: it is smaller businesses that are often the most innovative and dynamic. Countries that stifle this potential with financial barriers lose the growth potential of such businesses.[174] Movement toward greater financial inclusion therefore lies at the heart of overcoming the intractable problem of access to finance. From the governmental point of view, financial inclusion can bolster macroeconomic stability while from the financial sector perspective, enhanced financial inclusion equates a wider client base.[175] In this regard, Zambia has adopted a financial inclusion strategy in effort to finding solutions to the challenge.

4.3 Zambia's National Financial Inclusion Strategy 2017-2022

The conundrum of lack of access to capital for most SMEs in Zambia triggered the formulation of a five-year strategy by the Zambian Government aimed at addressing this challenge effectively. Zambia's National Financial Inclusion Strategy (NFIS) was adopted by the Zambian Government in June 2017. The vision of the NFIS is to create a conducive environment where Zambian have access to a wide 'range of quality and affordable financial products and services.' Part of the Action Plan of the NFIS is to develop leasing and factoring instruments in conjunction with the International Finance Corporation (IFC). This is in response to the burgeoning need for financial inclusion in a more cross-cutting manner.

In the Zambian context, financial inclusion is defined as follows: 'Access and informed usage of a broad range of quality and affordable savings, credit, payment, insurance, and investment products and services that meet the needs of individuals and businesses.'[176] This entails that SMEs also fall within the purview of this definition.

---

[173] www.afi-global.org/maya-declaration (Accessed 10 August 2017)

[174] World Bank (n 160 above)

[175] A Hurtado et al. 'Financial Inclusion: Lessons from Latin America and Caribbean' (2013) *Financial Inclusion in Africa* 139

[176] 'National Financial Inclusion Strategy 2017-2022' www.boz.zm (Accessed 18 August 2017)

SMEs are largely excluded from the formal financial sector. This is principally due to factors such as stringent collateral requirements, inadequate bank lending tools and informality of SMEs in Zambia. Most SMEs in Zambia are not registered because of poor access to registration centres as well as the desire to avoid tax[177] and other levies.

The Central Bank of Zambia has tightened monetary policy in its efforts to control inflation, and this has in turn constricted bank liquidity and access to credit. The inter-bank lending rate rose to over 27% in May 2016, and credit has been declining since the last quarter of 2015. There has also been a proliferation in non-performing loans as a corollary of the economic downturn. Three non-banking institutions and one small bank collapsed in 2016.The growth of SMEs in Zambia continues to be hampered by a lack of alternative sources of funding in lieu of traditional bank loans. Existing providers of working capital such as microfinance institutions also face liquidity problems. Low levels of 'awareness of relevant products all constrain the current availability and uptake of working capital financing instruments such as factoring.'[178]

This chapter now discusses the legal framework regulating factoring in Zambia.

4.4 The existing legal framework governing factoring in Zambia

Zambia is a former British colony and as such has a legal system predicated on English common law. Similar to its colonialist, Zambia does not have a specific statute that regulates factoring. However, in the United Kingdom, there are three (3) bodies that are dedicated to regulating factoring companies in the UK: the Financial Conduct Authority (FCA), the Asset Based Financial Association (ABFA) and Her Majesty's Treasury (The Treasury). The FCA is 'an independent, non-governmental body that regulates the UK financial services industry.'[179] It sets regulatory standards to safeguard fair dealing for parties in the industry. It also receives complaints and assists in resolving disputes concerning financial services, including factoring.[180] ABFA was established forty-one years ago as a trade association for factoring businesses in the UK and Ireland. It has forty-one members representing 95% of all invoice finance companies in the UK. The Treasury is the UK's finance and economics ministry overseeing all financial and economic matters.

---

[177] (n 171 above) 21
[178] (n 171 above) 22
[179] S Elaine 'How are factoring companies regulated?' https://www.companeo.co.uk/factoring/guide/how-are-factoring-companies-regulated#0 (Accessed 27 September 2017)
[180] Elaine (n 174 above)

The laws that have a bearing on factoring are discussed below:

4.4.1 The Banking and Financial Services Act 7 of 2017

The Banking and Financial Services Act 7 of 2017 repealed and replaced the Banking and Financial Services Act, Chapter 387 of the Laws of Zambia which was enacted in 1994. It was enacted by the Parliament of Zambia on 13th April 2017.[181] It provides a new roadmap to regulate financial services in Zambia and contains cardinal provisions that impact the financing of SMEs in Zambia. In its definition section, factoring is identified as one of the financial services to be regulated by the Central Bank. Financial institutions that offer factoring services in Zambia are supervised and overseen by the Central Bank.

In granting a licence, the Central Bank takes into consideration, inter alia, capital adequacy requirements of an applicant, financial position, and the experience and character of the directors, significant shareholders, beneficial owners, founders or persons proposing to be concerned in the management of the financial service. Section 17 provides for instances that may warrant the suspension or cancellation of a licence. That section also details the ramifications of a cancellation or suspension.

Part IV of the Act is concerned with Corporate Governance. Every financial institution must have a Board of Directors charged with the responsibility ensure corporate governance of the service provider, warrant that the business is carried out in accordance with all applicable laws as well as to provide direction of the business. Disclosure of interests in contracts is mandatory.[182] Section 39 of the Act criminalises the making of false statements in books of account or reports. Obstruction or attempts to obstruct an authorised audit or inspection of the financial service provider is also criminalised.

Part VI of the Act spells out the Central Bank's Prudential Regulation and Supervisory powers. Section 52 empowers the Bank of Zambia to 'prescribe the minimum paid up capital, minimum common equity tier one, minimum primary capital and minimum regulatory capital requirements for financial service providers.' Section 53 is elaborate as to the creation of a 'capital conservation buffer'. By section 57, financial institutions are required to maintain adequate and appropriate

[181] https://www.parliament.gov.zm (Accessed 11 August 2017)
[182] Section 38 Banking and Financial Services Act

forms of liquidity as recommended by the Central Bank. The Central Bank may initiate an examination of a financial service provider's financial state, its compliance with the Act and any other relevant written law. It can also direct the financial service provider to refrain from adopting or continuing any unsound or unsafe business practices.[183]

In the exercise of its supervisory powers, the Central Bank has robust authority to impose sanctions on a non-complaint or under-capitalised financial institution. This includes taking corrective action, restricting, suspending or cancelling the financial service provider's licence or taking possession of the financial service provider.[184] Section 75 permits a financial service provider to challenge the taking of possession by the Central Bank. This is by way of instituting legal proceedings before the High Court for Zambia within 21 days of the possession. Section 76 underscores the consequences of possession and adequately illustrates the evolving nature of the law to curb fraudulent transfers and transactions.

Part VII of the Act relates to restrictions on transactions of financial service providers. This is with a view to minimise risk of failure. Section 83 prohibits a financial institution such as a factoring company from involving itself in any business or trade for which it is not licensed, unless prior written consent has been secured from the Central Bank. Sections 84-87 also set out that parameters under which financial institutions are to operate.

Part VIII of the Act concerns financial statements and accountability. Section 88 obligates the board of a company to make sure 'that proper books of account and other records relating to the operations of the financial service provider are kept.' Additionally, every financial year it must prepare financial statements, accounts and reports that satisfy international accounting standards. Section 90 is integral to factoring. It states: 'A financial service provider's annual financial statements shall comply with the regulatory statements, issued in accordance with this Act, for creation or variation of appropriate reserves for bad and doubtful debts.'

Part IX of the Act pertains to anti-competitive activities and consumer protection. Of particular relevance to factoring is section 104 (1) which enacts: 'A financial service provider shall not harass, oppress or abuse a person in the collection of a debt.' Equally important to factoring is

[183] Section 63 Banking and Financial Services Act.
[184] Section 67 banking and Financial Services Act.

section 107 which mandates a financial institution to 'apply for the prior written approval of the [Central] Bank' before increasing tariffs or introducing a new charge for SMEs. Section 109 criminalises the imposition of penal interest except for instances specifically permitted under the Act.

Parts X to XII provide for other generic regulations that all financial service providers must adhere to including transition provisions and the repeal of the Banking and Financial Services Act, 1994.

The Banking and Financial Services Act creates a regulatory framework for the conduct of financial institutions in Zambia. Micro-financial institutions and specialised companies that render factoring services must adhere to the provisions of the Act. This means that they must first qualify to obtain a licence and throughout their lifecycle abide by the generic compliance code under the Act.

It is curious to note that the Banking and Financial Services Act does not define what factoring is. Neither does the Act elaborate how factoring is to be regulated or promoted. This poses a risk to those seeking financing as the law does not stipulate what their rights and duties are. It bears repeating that factoring has developed to be a cardinal trade finance tool used in both domestic and international transactions. It was stated earlier in this paper that existing financiers on the domestic level also face liquidity challenges. It is important therefore that foreign investment in the form of factoring companies can be attracted into the jurisdiction. With the lingering uncertainty of how factoring operates in Zambia, investors may lack the confidence to venture into the market. A robust legal framework that addresses its multifaceted nature is therefore crucial to enhance its operations, use and enhancement.

4.4.2 The Bank of Zambia Act 43 of 1996

The Bank of Zambia Act establishes the Bank of Zambia, which is the central bank. One of its core functions is to 'license, supervise and regulate the activities of banks and financial institutions so as to promote the safe, sound and efficient operations and development of the financial system'[185]in Zambia. Factoring companies fall within the purview of financial institutions. The

[185] Section 4 (2) Bank of Zambia Act https://www.zamlii.co.zm (Accessed 12 August 2017)

Bank of Zambia also has the authority to determine the minimum ration of liquidity which every financial institution must maintain with the central bank.[186]

4.4.3 The common law and doctrines of equity

Zambia is a former colony of England and her laws have been influenced by the legal system of the latter. English common law applies by default under the Zambian legal system. This entails that where Zambia legislation or jurisprudence does not address a legal issue, English common law is applicable. Section 2 of the English Law (Extent of Application) (Amendment) Act[187]

'Subject to the provisions of the Constitution and to any other written law-

(a) the common law;

(b) the doctrines of equity;

(c) the statutes which were in force in England on 17th August, 1911, being the commencement of the Northern Rhodesia Order in Council 1911; and

(d) any statutes of a later date than that mentioned in paragraph (c) in force in England, now applied to the Republic, or which shall apply to the Republic by an Act of Parliament, or otherwise;

shall be in force in the Republic.'[188]

4.5 Shortcomings of the extant Zambian regulatory framework on factoring

The foregoing entails that decisions passed by English courts provide guidance as to what the law on factoring is. It is submitted that this is an anomalous position for the law to take because as demonstrably evidenced above, the United Kingdom has in place bodies that set out regulations and conduct oversight for factoring in the light of their law. Zambia cannot therefore purport to fall back on English common law which is constantly evolving and is interpreted in accordance with the changing policy and legislative framework that inform business and finance in that jurisdiction. It is immediately obvious that there exists uncertainty as to the exact nature of a factoring contract in Zambia. The Zambian courts have not had occasion to adjudicate over a

---

[186] Section 41 Bank of Zambia Act https://www.zamlii.co.zm (Accessed 12 August 2017)
[187] Act 6 of 2011
[188] www.saipar.org (Accessed 27 September 2017)

factoring dispute. Moreover, the various intricacies of the financial service are not adequately covered in the existing framework.

There is also a need to harmonize the factoring law with generally accepted international standards if Zambia is to be a player in the factoring space and attract foreign factoring companies to operate in the jurisdiction. Aligning legislation with the international model laws will no doubt also facilitate international trade as the factoring sector will be predictable and stable.

The proposed law for Zambia must address some pertinent issues such as:

- defining factoring[189]
- the right of the factor to collect funds[190]
- the law on assignment of receivables[191]
- factoring contracts must be evidenced in writing[192]
- international factoring
- harmonization of the law with international best practices as enshrined in the UNIDROIT, UNCITRAL and Afreximbank Model Laws on Factoring.[193]

4.6 Conclusion

Zambia's regulatory regime on factoring is fraught with glaring shortcomings as it does not address the intricacies of the industry. The Banking and Financial Services Act of 2017 acknowledges factoring as one of the financial services where the Central Bank has ultimate oversight. The Act does not elaborate on the regulations of factoring. In its present form, the law on factoring is not adequate to facilitate nor promote this all-important trade finance tool. This is particularly the case with regards to international factoring. In today's world, businesses are interconnected across the globe and economies of those nations that have positioned themselves well by creating a conducive business environment have thrived. There is a pressing need for factoring legislation to be specific, comprehensive and modern to reflect the ever-evolving and dynamic information age.

[189] Kameni (n 30 above)
[190] (n 30 above)
[191] (n 30 above)
[192] (n 30 above)
[193] (n 30 above)

The following chapter explores the proposed Model Law in sufficient depth and it will be argued that it is designed to engender closer cooperation and integration of factoring amongst states as well as to upgrade and modernise the trade finance product of factoring in Africa. It also clarifies what constitutes factoring as well as the rights and duties of the parties involved.

CHAPTER FIVE

THE STATE OF FACTORING IN AFRICA AND AFREXIMBANK'S MODEL LAW

5.1 Introduction

This chapter builds upon the assertion that financial exclusion has hampered economic emancipation in Africa and that factoring has not achieved its full potential. The reasons for this stagnation and the response of the Afreximbank will be explored. It will be demonstrated that the lack of a regulatory framework to govern factoring in most jurisdictions on the continent lies at the heart of the problem. The genesis of the Afreximbank's Model Law will be tracked for the purposes of understanding the import of the provisions as well as to showcase the importance of factoring to both domestic and international trade. An in-depth study of the salient parts of this Model Law will constitute the bulk of this chapter. The justifications for a uniform law across Africa will precede the concluding remarks.

5.2 The funding gap for SMEs in Africa

Demirguc-Kunt and Klapper postulate that businesses in Africa are more likely to lack access to bank credit than their counterparts in other developing economies. The duo argues that this predicament is more acute for SMEs.[194] Africa has more than 50 million SMEs, 69% of which operate in the informal sector. These small businesses comprise 58% of the labour force and 33% of the continent's GDP. Despite their astounding contribution to value creation, the majority of SMEs in Africa do not have access to credit. This funding gap is prevalent in sub-Saharan Africa with a paltry 29% of formal SMEs having access to a loan, line of credit or overdraft.[195]

The monetary value of this credit gap for formal SMEs exceeds US$100 billion, out of which 70-90% applies to SMEs in Sub-Saharan Africa alone. 'To close this credit gap, Sub-Saharan Africa, for example, would need to increase the provision of credit (including loans, overdraft, leasing factoring and trade finance) to the unserved formal SME market by 270-320 percent.'[196]

5.3 The state of factoring in Africa

Lack of access to financing continues to inhibit the growth of trade in Africa. Statistically, Africa's share in global aggregate factoring volumes merely comprises between 1-2%. Awani identifies a

---

[194] A Demirguc-Kunt & L Klapper 'Financial Inclusion in Africa: A Snapshot' (2013) *Financial Inclusion in Africa*
[195] P Stein et al. 'Fostering Financing for Africa's SMEs' (2013) *Financial Inclusion in Africa* 65
[196] Stein et al. (n 185 above) 66

myriad of reasons for this: firstly, lack of acceptance of factoring as businesses tend to gravitate towards familiar forms trade finance products. This in turn has its roots in weak or unavailable legal and regulatory framework to advance factoring as a mainstream source of financing in Africa. Consequently, potential lenders perceive Africa as a poor market for the financial product. Foreign currency shortages and the poor state of most African economies are some of the other reasons pointed out.[197]

Priest-Stephens and Kameni echo this position:

> The lack of knowledge has also affected the willingness of factoring providers from elsewhere in the world to make facilities available to companies incorporated in Africa. Such countries are often perceived as carrying an unacceptable risk due to the lack of a regulatory framework around the provision of facilities.[198]

Aside from this has been the lack of credit insurance in most jurisdictions until relatively recently. This absence of reliable credit information and protection heightens the risk on the part of factors thereby making it unattractive to provide facilities. The problem is accentuated when this is added to the perception of factoring as a last resort form of funding only employed by distressed companies.[199]

5.4 The Role of the Afreximbank and the African Development Bank in promoting factoring on the continent

Afreximbank is a pan-African Multilateral Financial Institution founded in 1993 under the auspices of the AfDB.[200] The AfDB's shareholding structure comprises all 54 African countries plus 26 non-African countries.[201] AfDB President Dr. Akinwumi Ayodeji Adesina eloquently stated his Bank's vision for Africa:

> 'This is the mission to which I pledge myself to dedicate myself as President of the African Development Bank: expanding opportunities and unlocking potentials—potentials for countries, for women, for the youth, for the private sector, for the continent. As we unlock these potentials we will unleash a new wave of growth and development shared by all. While Africa's economies are growing, inequality is increasing all over our continent. The sparkle in the eyes of the fortunate few is drowned by a sense of exclusion of the majority. Hundreds of millions of people are left behind. Most of them of them are women and are young people. They

---

[197] K Awani 'Africa on the Rise 2016' FCI Annual Review 2017 https://www.fci.nl (Accessed 31 May 2017).
[198] Priest-Stephens and Kameni (n 7 above).
[199] (n 7 above).
[200] https://www.afreximbank.com (Accessed 31 August 2017).
[201] AfDB Group *Annual Report 2016* (Available at https://www.afdb.org) (Accessed 23 August 2017).

> do not feel the impact of economic growth in their lives. Our collective challenge is to drive inclusive growth—growth that will lift millions out of poverty.'[202]

In furtherance of this pursuit for financial inclusion, the AfDB as shareholder of the Afreximbank has collaborated with the latter through its Thematic Fund for Private Sector Assistance (FAPA) to support factoring companies across Africa. Grants under FAPA are used to promote innovative programs that specifically support SMEs. More importantly, the AfDB approved funding for the purposes of drafting of the African Model Law on Factoring.[203]

It bears repeating that Afreximbank launched a Model Law on Factoring tailored for Africa in Cape Town, South Africa on 24th October 2016.[204] The Afreximbank has long intended to promote factoring as a financial tool which can facilitate the provision and growth of trade finance in Africa to and amongst SMEs and larger companies as well. The Bank poignantly noted that the absence of factoring laws and regulations in most African states posed a challenge to the growth of the product. It therefore drew important lessons from the existing model laws and tailored its own to meet the needs of the states on the African continent.[205] It is therefore imperative to begin with brief overview of the model laws promulgated by UNIDROIT, UNCITRAL and IFG before delving into the targeted law.

5.5 History and overview of existing factoring model laws

The Institute for the Unification of Private Law (UNIDROIT) completed the Ottawa Convention in 1988. In its Preamble, international factoring is recognized as having an instrumental 'role to play in the development of international trade' and to that end 'the importance of adopting uniform rules to provide a legal framework that will facilitate international factoring…'[206]. It has been

---

[202] AA Adesina 'Inaugural Speech' 1 September 2015 (Accessed 5 September 2017 https://www.afdb.org/fileadmin/uploads/afdb/Documents/Generic-Documents/SPEECH_PRST_Akinwumi_A_Adesina_Inaugural_Speech_FINAL.pdf)
[203] BO Oramah 'The Role of Afreximbank and IFG Africa Chapter in the Development of Factoring in Africa' Presentation at the First Symposium and Academy on Factoring in Africa held on 11 March 2015 (Available at https://www.afreximbank.com) (Accessed 15 July 2017)
[204] C Nelson 'Afreximbank harps on strong legislation to boost factoring' *The Guardian* 6 February 2017 https://guardian.ng/business-services/money/afreximbank-harps-on-strong-legislation-to-boost-factoring
[205] D Tatge and E Kameni 'Afreximbank's Model Law on Factoring' *World Factoring Yearbook 2017 Edition* (2017) 7 (Available at www.ebglaw.com/content/uploads/2017/06/Tatge-World-Factoring-Yearbook-2017-eBook.pdf)
[206] https://www.unidroit.org/instruments/factoring (Accessed 1 September 2017).

enacted into law in several jurisdictions including Germany, France, Belgium, Latvia, Ukraine and Nigeria and has been used as the prototype for modernizing the law in Russia and Lithuania.[207]

In 2001, the United Nations Committee on International Trade Law (UNCITRAL) finalized the United Nations Convention on the Assignment of Receivables in International Trade. The purpose of the 2001 Convention on Assignment of Receivables "is to promote the movement of goods and services across national borders by facilitating increased access to lower-cost credit."[208] This Convention covers a wide spectrum of receivables products, including forfaiting, securitization and factoring in its various forms. Nonetheless, the impact of the UN Convention is minimal as no single jurisdiction has passed it into law. The most useful effect of this Convention is anchored on the fact that it formed the basis of the International Factors Group (IFG) Model Law on Factoring of 2014.[209]

The IFG 2014 Model Law aims to provide legislators with a draft law on factoring that incorporates internationally accepted and developed legal principles. It is shares remarkable similarities with the Afreximbank Model Law's philosophical underpinnings. These words are present in both Model Laws:

> The Model Law is designed for adoption in more than one country, and should not be changed in substance. Thereby, a unification of national private law can be achieved. Therefore, in the interpretation of this Law, regard is to be had to its object and to the need to promote uniformity in its application and the observance of good faith in trade…National legislators, with the assistance of national or international advisors, may wish to consider the implementation of the rules suggested into the national law. Some rules may be incompatible with national law as it exists; however, for the benefit of promoting finance and trade, national law should be reconsidered and modernized pursuant to the suggestion in this Model Law.[210]

---

[207] Priest-Stephens & Kameni (n 7 above).

[208] https://www.uncitral.org/uncitral/en/uncitral_texts/security/2001Convention_receivables.html (Accessed 1 September 2017).

[209] Priest-Stephens and Kameni (n 7 above).

[210] https://fci.nl/about-us/model-factoring-law-cv-140221.pdf (Accessed 1 September 2017).

5.6 Afreximbank's Model Law for African States

Afreximbank's Model Law is founded upon the IFG's Model Law and acknowledges the contribution that the IFG made in developing its law.[211] The 2001 Convention also tremendously influenced the provisions of Afreximbanks Model Law. Tatge and Kameni in reiterate this fact by stating that the Bank, working under the tutelage of these institutions, prepared its own model law with the aim of enhancing the profile of factoring and trade finance on the continent and to create a benchmark that would inspire African countries to enact their own legislation.[212]

However, Afreximbank's Model Law departs from previous Model Laws in by simplifying the terminologies used. Instead of the term 'assignor' the word 'client' is used while 'factor' replaces the word 'assignee'. 'Factoring contract' is the expression that is employed in lieu of 'contract of assignment' and 'supply contract' replaces 'original contract'. The rationale for these changes is to make the Model Law specific to factoring. States that seek to harmonise their factoring law with international standards are encouraged to adopt the Model Law.[213] It is showcased as a Parliamentary statute in a form akin to those of jurisdictions that have the English legal system as their heritage.[214]

The Model Law is divided into seven (7) parts. The Preamble preceding these parts states as follows:

> An Act to establish principles and to adopt rules relating to the assignment of receivables in order to create certainty and transparency and to promote the modernisation of the law relating to assignments whilst protecting existing assignment practices and facilitating the development of new practices and ensuring adequate protection for the interests of debtors in order to promote the availability of capital and credit and to facilitate domestic and international trade.

Part 1 covers definitions and interpretation of the Model Law. Some important definitions are worthy of regurgitation. The African Model Law's definition of an 'assignment' is predicated on the UNCITRAL and the IFG's model law broad definition as follows:

---

[211] Afreximbank 'Afreximbank Model Law on Factoring' (2016) https://afreximbank.com/wp-content/uploads/2016/10/Model-Law-on-Factoring.pdf (Accessed 21 May 2017).
[212] Tatge & Kameni (n 200 above) 8
[213] Afreximbank (n 206 above).
[214] (n 206 above).

'assignment' means the transfer by agreement from the client to the factor of all or part or an undivided interest in a receivable payable by a debtor and whether or not notice has been given to the debtor. The creation of rights in a receivable as security for indebtedness or other obligation is deemed to be a transfer.[215]

Tatge and Kameni posit that that this wide ambit encompasses types of receivables finance transcending old-line factoring, as well as beyond recourse factoring and invoice discounting, if the domestic legislation of a given African jurisdiction does recognize a 'sale' of accounts.[216]

The Afreximbank Model Law has adopted the following definition of 'factoring contract' to mean:

'a contract concluded between a client and a factor pursuant to which:

(a) the client assigns or will assign or will offer to assign to the factor trade receivables arising from supply contracts between the client and its debtors; and
(b) the factor is to perform at least one of the following functions:
    i. providing or procuring finance for the client, including loans and advance payments that are directly related to the value of each trade receivable and its perceived credit risk at the time the receivable is created or at any time thereafter; or
    ii. maintenance of accounts (ledgering) relating to the assigned receivables; or
    iii. collection of assignment receivables and
        A. unless otherwise agreed any collection is for its own account and not as agent for the client; but
        B. any collection made by the client for the benefit of the factor is deemed to be made by the factor; and
        C. protection against default in payment by debtors solely because of their inability to pay may or may not be given; and
        D. notice of the assignment of the receivables may or may not be given to debtors.'[217]

[215] Section 1.1 Model Law.
[216] (n 200 above).
[217] Section 1.1 Model Law.

The Model Law therefore clarifies that for its purposes, a factor is required to carry out only one of the first three services outlined above.

A 'future trade receivable' is a receivable arising after the conclusion of the factoring contract while an 'international assignment' is defined as a trade receivable where the factor and the client are situated in different jurisdictions at the time of the conclusion of the factoring contract. A 'notice of the assignment' must be reduced into writing and communicated as such to the debtor. Furthermore, it must also reasonably identify the factor and the assigned receivable expressly stating that the receivable has been assigned to the factor. The meaning 'writing' is also clarified as 'any form of information that is accessible so as to be usable for subsequent reference…'

Part 2 pertains to scope of application and limitations. Section 3 is unequivocal that the Act applies to internal and cross-border factoring contracts.[218] However, it 'does not apply to assignment made:

(a) to an individual for his or her personal, family or household purposes; or

(b) as part of the sale or change in the ownership or legal status of the business out of which the assigned receivables arose.'[219]

Further the Act has no application to 'assignments' of receivables arising under or from:

(a) transactions on a regulated exchange;
(b) financial contracts governed by netting agreements, except a receivable owed on the termination of all outstanding transactions;
(c) inter-bank payment systems, inter-bank payment agreements or clearance and settlement systems relating to securities or other financial assets or instruments;
(d) the transfer of security rights in, sale, loan or holding of or agreement to repurchase securities or other financial assets or instruments held with an intermediary;
(e) a letter of credit or independent guarantee;
(f) financial services, including financial trading;
(g) security interests created by other statutes;
(h) landlord's liens except as to fixtures;

[218] Section 3.1 Model Law.
[219] Section 4.1 Model Law.

(i) receivables arising from the sale or lease of real property;
(j) transfer of interests in or a claim under a policy of insurance;
(k) transfers of claims for wages or compensation by employees;
(l) the sale of a business;
(m) set-off claims
(n) claims in court proceedings.[220]

If only some accounts are purchased, the non-purchased accounts can be pledged by the client to the factor as collateral security for the client's obligations to the factor under the contract.

Similar to the UNCITRAL and IFG model laws, the Bank's model law recommends the establishment of a centralized system for security interests in accounts. This will have the effect of mitigating the problem of information asymmetry and fraud.

Part 3 grants liberty to the parties to the factoring agreement to derogate from or vary the provisions of the Model Law save the inviolable provisions expressly identified in the Act.[221]

Part 4 provides for effects of assignment. Section 6.1 states that: "Assignments of trade receivables are valid and effective unless stated otherwise in this Act." An assignment remains effective as between the factor and the client or as against the debtor or as against a competing claimant, and the right of a factor may not be denied priority on the basis that it is an assignment of more than one receivable, or of future receivables or of parts of a receivable or of an undivided interest in receivables, providing the receivables are described:

(a) individually as receivables to which the assignment relates; or
(b) in any other manner, provided the same can be identified as receivables to which the assignment relates either at the time of the assignment or, in the case of future receivables, at the time the supply contract is concluded.[222]

Section 7 of the Act is sacrosanct. A state cannot purport to prohibit assignments. An assignment of a receivable shall remain valid notwithstanding any proscription against assignment. This means that a trade debtor will no longer be in a position to prohibit the assignment of debts by a supplier to a third party such as a factor. Moreover, the debtor may not avoid its obligations under the

[220] Section 4.2 Model Law.
[221] Section 5 Model Law.
[222] Section 6.2 Model Law

supply contract on account that the client has acted in contravention of such a proscription.[223] Neither the client nor the factor shall be liable to the debtor for contravening a prohibition against assignment nor may the same be relied on by the debtor as a defence or set-off to any claim for payment of an assigned debt.[224] Section 7.3 enacts: "Neither the Government, nor any governmental body or official may take any action against the client or the factor for an assignment of a receivable in breach of any prohibition against assignment."

Part 5 is concerned with rights, obligations and defences available to the parties. Section 9 recognises the autonomy that the factor and its client possess to determine their mutual rights and obligations emanating from terms and conditions enshrined in the factoring contract, including any rules or general conditions contained therein. By section 10.2, in the absence of an agreement between the client and the factor, the factor does not signify that the debtor has, or will have, the capacity to settle the debt or otherwise discharge any receivable. Section 11 encapsulates the right to give notice: 'Unless otherwise agreed between the client and the factor, notice of the assignment and a payment instruction may be sent to the debtor by either the client or the factor or both.'[225] However, after notice of the assignment has been sent only the factor may send a payment instruction.[226]

An assignment does not, without the consent of the debtor, affect the debtor's rights and obligations, including the payment terms contained in the supply contract. However, this position can be overridden by provisions to the contrary enshrined in the Act.[227] Notice of the Assignment or an instruction to pay issued to the debtor becomes effective upon the latter's receipt thereof in a language that is reasonably expected to inform the debtor about its contents. It is sufficient if the notice or payment instruction is in the language of the supply contract.[228] Section 15 states that the debtor is entitled to discharge a trade receivable by paying in accordance with the supply contract. However, when it receives notice of the assignment, the debtor can only discharge the trade receivable by settling the debt in accordance with the stipulations in the notice.

---

[223] Section 7.1 Model Law.
[224] Section 7.2 Model Law.
[225] Section 11.1 Model Law.
[226] Section 11.2 Model Law.
[227] Section 13 Model Law.
[228] Section 14.1 Model Law.

Section 16 provides for debtor's defences and rights of set-off. Sub-section 1 is couched in these words:

> '16.1 In a claim by the factor against the debtor for payment of the assigned trade receivable, the debtor may raise against the factor all defences and rights of set-off arising from the supply contract, or any other contract that that was part of or closely connected with the same transaction, of which the debtor could avail itself, as if the assignment had not been made and such claim were made by the client.'

Section 16.2 entitles the factor to raise against the factor any other right of set-off, provided it was available to the debtor at the time the notice of the assignment was received by the debtor while section 17 confers a right on the debtor and the client to contract out of the right to raise against the factor any defences and rights of set-off that it could raise pursuant to sections 16.1 and 16.2 However, the debtor cannot waive defences or rights of set-off:

(a) arising from fraudulent acts on the part of the factor; or

(b) based on the debtor's incapacity.

Part 6 of the Model Act is on International Factoring. It is very brief and contains only one section. It provides that international factoring transactions shall be regulated by the rules (if any) of an association to which the factors are both members and if no such rules exist, by the law agreed to between them. In the absence of a contrary agreement by the factors involved or regulated by the rules of an association to which both factors belong, the law set out in Parts 1-5 of the Model Act shall apply in default.[229]

Part 7 of the Model Act provides for entry into force, application and repeal of statutes. It makes provision for partial or total repeal.[230]

5.7 Justification for a model factoring law in Africa

The reasons for promulgating factoring law on the continent abound. To begin with, regulation will generally delineate the parameters within which factors can conduct their affairs and set a minimum standard that is to be maintained. These standards will raise the profile of the industry and inspire confidence in factoring business, thereby enhancing the image of the industry. Equally important, the model law is designed to operate uniformly in various jurisdictions. This will

[229] Section 24.1 Model Law.

[230] Section 25.4 Model Law.

facilitate the product internationally as factors in one jurisdiction can have the confidence that the legislative framework regulating the factoring contract will be the same or similar in another.[231]

This will be particularly important in trans-border transactions where uncertainty and risk are especially heightened. International factoring plays a catalytic role in bolstering export trade for businesses by surmounting the attendant challenges confronting SMEs such as low credibility and increased costs of alternative forms of financing. Klapper expresses herself this way:

> 'Factoring can provide important export services to local SMEs. For example, an obstacle for firms in emerging markets to sell into export markets is overseas customers' reluctance to work on letters of credit. Firms in developed countries refuse to pay on receipt to firms in emerging markets since they need time to confirm the quality of the goods. They also know that it could be very difficult to receive a refund on returned or damaged goods from firms in countries with slow judicial systems.'[232]

Priest-Stephens and Kameni emphasize that where there are no specific laws or regulations on factoring, extant laws are applied or interpreted to resolve disputes. In common law jurisdictions, this jurisprudence can build up a corpus of judge-made law pertaining to factoring. This may result in uncertainty.[233] The duo cite the UK as an example where due to the lack of specific laws governing factoring the parties resort to drafting lengthy factoring contracts in an effort to ensure that potential areas of dispute are clarified and covered by the documents in order to avert the need for judicial interpretation of the contract.[234] The enactment of an Act of Parliament informed by the Model Law would lessen this uncertainty. A sound legal framework is a precursor of an effective judiciary.

Awani projects that Africa's factoring volume is anticipated to reach an astounding 200 billion Euros by the year 2020. The continent must therefore position itself by implementing the appropriate legal and regulatory framework to enable it benefit from the myriad of advantages that factoring presents.[235] This is momentous because factoring business was at a comparatively

---

[231] Priest-Stephens and Kameni (n 7).
[232] Klapper (n 4).
[233] Priest-Stephens & Kameni (n 7 above).
[234] (n 7 above).
[235] K Awani 'Africa needs facilitating infrastructure to tap 200 billion Euros factoring growth' www.biznisafrica.com 7 July 2016 (Accessed 10 September 2017).

miniscule 5 billion Euros in 2000 and at 23 billion Euros in 2012.[236] This progression is undeniable testimony that factoring is here to stay.

5.8 Challenges in implementing the model law

Despite the numerous advantages that the Afreximbank Model Law presents, there are certain challenges inherent in regulation. Firstly, regulation has cost implications. The regulatory body that will enforce the proposed law will need to be financed.[237] Funds may be raised through membership fees from factoring companies who may in turn pass on the cost to their clients by an extra charge.

A further concern is the prevalent lack of understanding of factoring. The regulators must possess the requisite knowledge of the industry. Most African jurisdiction do not have sufficient jurisprudence on the various facets of factoring and receivables financing. There will thus be need for training of professionals from diverse fields in order to raise awareness levels.

A common challenge that confronts the factoring sector is the issue of prohibition of assignments in the underlying contract.[238] The validity of such prohibitions varies from one jurisdiction to another on a continuum of nullifying the assignment in its entirety to restricting the rights of the factor to action against the client, rather than the end customer. Essentially, this entails that the debt cannot be the subject of factoring.[239]

Insolvency and the effect that it has on the factor's rights is another issue worthy of consideration. Under the legal regimes of most jurisdictions, the commencement of insolvency proceedings entails that no security holder may enforce security interests granted by the insolvent company. The position of the factor, however, is not unambiguous. Considering that the client's operational cash flow will often flow through trust accounts held or controlled by the factor, it may be preferable for the factoring facility to continue, particularly if the client is entering into rescue procedure. This must be weighed against the factor's reluctance to continue disbursing funds if there is no prospect of such funds being recovered.[240]

---

[236] Priest-Stephens and Kameni (n 7).
[237] (n 7 above).
[238] (n 7 above).
[239] (n 7 above).
[240] (n 7 above).

5.9 Conclusion

The Afreximbank's creation of the African Model Law on Factoring is a pragmatic step towards making the continent competitive in international trade on the global arena. The Model Law aims to stimulate factoring which remains a relatively underutilized form of financing by setting a benchmark for African states to enact legislation that is modern, harmonious and facilitates both domestic and international factoring. This Model Law is premised on the corpus of world-class model laws built by UNIDROIT, UNCITRAL and IFG. The legal infrastructure that it builds upon is engineered to facilitate international trade and provide access to finance throughout the supply chain strata. Its provisions therefore inextricably replicate those of prior model laws. However, an innovation introduced in the African Model Law is that it overrides restrictions on assignment imposed by law. Those African states that will promptly act upon it stand to bolster their private sectors and turn around decades of slow progress.[241]

Lack of access to financing is the common thread that continues to militate against the unlocked potential of SMEs in the great majority of African states. These small businesses largely remain in the informal sector as there are few incentives for formalization. The introduction of a facilitative legal framework that addresses their needs is likely to attract entry into the formal sector as factoring services will be a professionally regulated. Factoring may not be a panacea but it certainly has tremendous potential to unlock financing for SMEs across Africa. The lack of legal infrastructure on the continent continues to impede its growth. The advent of the Afreximbank Model Law is therefore not only commendable but also complementary to other pan-African efforts to stem the growing tide of inequalities and financial exclusion that have inhibited the potential of SMEs in Africa.

[241] Oramah (n 16 above) 14.

CHAPTER 6

CONCLUSION AND RECOMMENDATIONS

6.1 Introduction and recap of the problem statement

This concluding chapter provides some recommendations to the proposed law that may assist in making the legal framework workable and versatile to meet the ever-changing landscape of international trade. These recommendations are primarily gleaned from best practices in the jurisdictions preceding discourse and adapted to align with the socio-economic realities in Zambia. It is hoped that the findings and recommendations of this paper will spark the necessary steps for the enactment of the proposed law.

SMEs contribute more than 80 % of the GDP in Zambia. However, lack of access to finance remains the principal limiting factor to their business pursuits. The traditional forms of finance such as term loans and overdrafts are often inaccessible to SMEs because these small businesses almost invariably lack adequate assets to provide as collateral or for other reasons such as lack of credit history do not satisfy the rigours of bank financing. Moreover, the majority of SMEs in Zambia are not formally registered, thereby compounding the problem. Innovative ways of attracting SMEs into the formal sector therefore requires thoughtful attention and sustainable measures such as the enactment of legislation that keeps abreast with the modern trends of doing business. The central theme of this paper was to propose the enactment of a Factoring Act in Zambia that replicates and builds upon the existing Model Laws such as the Afreximbank, IFG, UNCITRAL and UNIDROIT.

6.2 Summary of findings

The present study examined the concept of factoring, traced its origins and development, its impact on trade and economies of some jurisdictions where it is practiced. Statistics and case studies from Turkey illustrated how government can enhance the performance of SMEs through the enactment of facilitative legislation and the founding of institutions to oversee and promote the industry are crucial. It was established that as a corollary of a supportive and facilitative framework for factoring, the industry constitutes 6% of Turkey's GDP. A practical example was drawn from Egypt to demonstrate how factoring can revive a business and expand its clientele through FCI.

It was established under chapter three that factoring is a practicable alternative to traditional forms of bank lending such as overdrafts and loans. Principally, it was found that factoring presents numerous benefits over these traditional forms of lending and that although it may, on the face of it, be more expensive than bank lending, it has the advantage of flexibility and accessibility that negate its disadvantages.

Chapter four introduced the theory of financial inclusion at the global level and provided a brief synopsis of Zambia's framework for expanding financial inclusion. The chapter proceeded to appraise the constellation of statutes that Zambia has in place presently in relation to factoring. The laws were dissected for the purposes of providing an appreciation of the legal milieu within which the proposed factoring law may have to align. Importantly also, it was shown that the extant laws do not adequately create a facilitative framework to regulate the intricacies of modern factoring. The chapter arrived at the finding that the law as it stands in Zambia today is inadequate to regulate factoring.

Chapter five reiterated the importance of financial inclusion with exclusive focus on the efforts made by the AfDB and Afreximbank to counter the appalling inequalities prevalent on the continent. The chapter also extracted important lessons from the international models on factoring with heightened emphasis on the proposed Afreximbank Model Act in detail. Suggesting that the Afreximbank Model Law on Factoring is unassailable would be to grossly underestimate the dynamics of Africa's economic turbulences. However, it is positive step towards ameliorating the challenges that have impeded the optimal performance of the private sector. The suggested law does recognize that jurisdictions may deviate in some provisions but any such divergence must be carefully evaluated in order not to depart from its core principles. This echoes the wording found in the forerunner Model Law produced by IFG in 2014. The chapter proceeded to provide an overview of factoring on the African continent.

Chapter five concluded with the recurring tenet of this paper for the enactment of legislation anchored on the provisions of the Model Law citing compelling reasons such as the need to harmonize the law with international standards and creating a legal infrastructure that will facilitate the anticipated 200 billion Euros by the year 2020 on the continent.

6.3 Concluding remarks

Factoring has been identified across the world as an effective and viable finance product that offers a wide array of benefits to small businesses that may not qualify for traditional forms of financing. In recent years, the recognition of this trade finance product has been triggered by the need to redistribute resources to all sectors of the economy. SMEs are major contributors to job creation and to the GDP of both developing and developed countries all over the world. Lack of access to finance is the common denominator that imperils the survival and growth of these small businesses.

On the African continent, the problem is even more acute. Zambia's fledgling economy has exacerbated this problem for small businesses in that jurisdiction. Factoring as a trade finance tool remains obscure. Promulgating a piece of legislation that will specifically regulate factoring is likely to not only clear uncertainty about the product but also enhance its status as an alternative source of financing. Importantly, Zambia will serve as an exemplar of a state that has aligned its factoring legislation with international standards and will thus position herself to attract factoring companies from abroad.

As a final word, the nation of Zambia must therefore position herself by enacting the appropriate legal and regulatory framework to enable her benefit from the myriad of advantages that factoring presents. SMEs are the lifeblood of the Zambian economy and must therefore be nurtured through sustainable mechanisms such as facilitative legislation.

6.4 Recommendations

The following are the recommendations to support the enactment of the law on factoring in Zambia. A good piece of legislation must provide a healthy balance the interests for all parties concerned and ensure that society's interests are safeguarded. In this connection, the following suggestions are made as to what must be included in the proposed Act:

Firstly, government must incentivize factoring companies by providing favourable tax treatment and other incentives with a view to accelerate the growth of the industry. The case studies of Egypt and Turkey revealed that one of the elements that has accelerated the factoring industry in that jurisdiction is the supportive governmental treatment that factoring businesses enjoy. A conducive legal environment is likely to attract both local and foreign investors to consider factoring as a lucrative industry.

Secondly, the law must ensure mandatory credit insurance for factors at affordable rates. The use of the credit insurance (CI) industry is very important to mitigate the risk of those offering of factoring services.[242] The risk of factoring services is especially highest in the export industry. Across the globe it is used to safeguard factoring arrangements in all kinds of receivables finance backed deals.[243] The law must also permit foreign credit insurance companies to be incorporated in Zambia as well as recognize credit insurance certificates obtained from outside the jurisdiction if prima facie authenticated and notarized. This will have the effect of generating confidence and willingness to assume risk amongst factoring companies.

The fact that international factoring has firmly secured its position in five continents makes a strong case for an efficient, predictable and independent dispute resolution system. It is proposed that rather than resolve international factoring disputes in the domestic courts, matters be resolved by a neutral arbitral tribunal comprising three experienced and technically qualified arbitrators to be nominated in accordance with the contract signed by the parties or in the absence of such agreement in accordance with the UNCITRAL Model Law on Arbitration. However, party autonomy as to dispute settlement must still prevail although as a starting point the law must encourage the amicable settlement of disputes through the tier system of adjudication and mediation to arbitration or litigation. It is envisaged that an international arbitral system will have the effect of inspiring confidence among investors as well as lead to quality decisions.

The benefits of establishing a professional body by way of legislative enactment are numerous. A professional body oversees the conduct of its members, creates a code of ethics and provides an opportunity for its members to initiate and sustain close business relations. Publications, trainings and seminars as well as other forms of outreach are also some other activities that professional associations usually engage in. Buy-in from various sectors of the economy is likely to be realised if there is a body that spearheads the importance of the industry.

All financial services in Zambia are regulated by the Central Bank. A factoring association would therefore play a complementary and specialized role in regulating the affairs of its members.

[242] M Best 'The Role of Trade Credit Insurance in Risk-Weighted Asset Optimisation' *In-Sight FCI Newsletter August 2017 Edition* (2017) 36 http://www.fci.nl (Accessed 1 September 2017)
[243] P Mulroy '49th Annual Meeting: The Symbiotic Relationship between Factoring and Credit Insurance' (2017) *In-Sight FCI Newsletter May 2017 Edition* (2017) 7 http://www.fci.nl (Accessed 1 September 2017)

Empirical evidence has shown that proactive factoring institutions have been the centrepiece behind the remarkable growth of the industry in their countries.

It is therefore recommended that the law to be enacted makes provision for the creation of a factoring association which will have the mandate to promote the growth of factoring in Zambia and ensure that the service meets international standards. The proposed factoring association can also serve as a liaison association with its international counterparts and the FCI.

BIBLIOGRAPHY

BOOKS

Burns, P (2011) *Entrepreneurship & small business: Start-up, growth & maturity* London: Palgrave Macmillan www.palgrave.com (Companion website)

Goode, R (2010) *Commercial Law* London: Butterworths

Salinger, FR (1991) *Factoring Law and Practice* London: Sweet & Maxwell.

Weaver, PM (2016) *Banking and Lending Practice* Pyrmont: Thomson Reuters (Professional) Australia Limited

JOURNAL ARTICLES

Birken, M 'Boosting Small Businesses: A Legal Affair?' (2015) *Law in Transition* London: European Bank for Reconstruction and Development https://www.ebrd.com/documents/comms-and-bis/pdf-law-in-transtion-2015-building-stronger.pdf (Accessed 17 September 2017)

Cory 'South Africa' *World Factoring Year Book 2017 Edition* (2017) 166 (Available at www.ebglaw.com/content/uploads/2017/06/Tatge-World-Factoring-Yearbook-2017-eBook.pdf (Last accessed 27 September 2017).

Goh, K 'Trading Places: Benefits of Invoice Finance for Small and Medium Sized Enterprises as Opposed to Bank Lending' 7 *Aberdeen Student Law Review* (2017) 56 www.abdn.uk

Hoti, U 'Factoring: A Financial Instrument' (2014) *Interdisciplinary Journal of Research and Development* Vol (I), No. 2 www.uamd.edu.al/new/wp-content/uploads/2015/07/2.-Ulpian-Hoti.pdf

Istuk, I & M Labus 'Factoring and Reverse Factoring Reforms in the EBRD Region' (2015) *Law in Transition* 30 https://www.ebrd.com/documents/comms-and-bis/pdf-law-in-transition-2015-building-stronger.pdf (Accessed 17 September 2017)

Kameni, E 'An Insight into Recent Legal and Regulatory Reforms in Support of Factoring in Africa' (2014) 27 *Contemporary Issues in African Trade and Trade Finance* Volume 1 Number 1 Cairo: Afreximbank

Kara, H 'Factoring: To regulate or not to regulate?' *World Factoring Yearbook 2017 Edition* (2017) 4 (Available at www.ebglaw.com/content/uploads/2017/06/Tatge-World-Factoring-Yearboo-2017-eBook.pdf (Last accessed 27 September 2017)

Nuwagaba, A 'Enterprises in Zambia' (2015) 4 *International Journal of Economics, Finance and Management* http://www.ejournalofscience.org (Accessed 28 April 2017).

Oramah, BO 'From the Periphery to the Centre: Africa as the Growth Market for Factoring' (2014) 5 *Contemporary Issues in African Trade and Trade Finance* Volume 1 Number 1 Cairo: Afreximbank

Oramah, BO and R Dzene 'Evolution of Factoring in Egypt and Implications for Factoring in Africa' (2014) 1 *Contemporary Issues in African Trade and Trade Finance* Cairo: Afreximbank

Shams 'Egypt' *World Factoring Yearbook 2017 Edition* (2017) 161(Available at www.ebglaw.com/content/uploads/2017/06/Tatge-World-Factoring-Yearbook-2017-eBook.pdf (Last accessed 27 September 2017).

Spasic *et al.* 'Factoring-Instrument of Financing in Business Practice: Some Important Legal Aspects' (2012) *Economic Research,* Vol.25 No.1 191-211 www.tandfonline.com/doi/abs/10/1080/1331677X.2012.11517502

Stubbs, J 'Small Business Finance' (2015) *Law in Transition* 8 https://www.ebrd.com/documents/comms-and-bis/pdf-law-in-transition-2015-building-stronger.pdf

Unal 'Turkey' *World Factoring Yearbook 2017 Edition* (2017) 138. (Available at www.ebglaw.com/content/uploads/2017/06/Tatge-World-Factoring-Yearbook-2017-eBook.pdf (Last Accessed 27 September 2017)

NEWSLETTERS

Awani, K 'An overview of Factoring Activities in Africa' *FCI IN-SIGHT Newsletter* November 2016 https://fci.nl/downloads/in-sight-newsletter-november-2016.pdf (Accessed 1 May 2017)

Best, M 'The Role of Trade Credit Insurance in Risk-Weighted Asset Optimisation' (2017) *In-Sight FCI Newsletter August 2017* 36 http://www.fci.nl (Accessed 1 September 2017)

Baydar, C 'Welcome Letter from the Chairman' *FCI Annual Review* 2017 https://www.fci.nl (Accessed 15 August 2017)

Brehcist 'Global Industry Report for 2016' *FCI Annual Review* (2017) 32 https://www.fci.nl

Mulroy 'Introduction by the Secretary-General' *FCI Annual Review* 2017 https://www.fci.nl (Accessed 15 August 2017)

Mulroy, P '49th Annual Meeting: The Symbiotic Relationship between Factoring and Credit Insurance' (2017) *In-Sight FCI Newsletter May 2017* 7 http://www.fci.nl (Accessed 1 September 2017)

LEGISLATION

Arbitration Act of Zambia, 19 of 2000

Bank of Zambia Act, 43 of 1996

Banking and Financial Services Act, 7 of 2017

English Law (Extent of Application) (Amendment) Act, 6 of 2011

Zambia Development Agency Act, 11 of 2011

NATIONAL POLICIES

Zambia National Financial Inclusion Strategy 2017-2022 www.boz.gov.zm

REPORTS

African Development Bank 'Zambia Country Office 2015 Annual Report'

AfDB Group *Annual Report 2016* (Available at https://www.afdb.org)

ILO (2016) 'Zambia Human Development Report 2016'. Published by the United Nations Development Programme (UNDP). Lusaka, Zambia

JSE Quarterly *JSE Supplement September 2016* 39 (Available also at www.jse.co.za)

World Bank Group 'Finance for All? Policies and Pitfalls in Expanding Access' (2008) World Bank Policy Report. Washington DC www.openknowledge.worldbank.org/handle/10986/6905 (Accessed on 10 August 2017)

WTO 'Trade Policy Review: Zambia 2016' https://docs.wto.org (Accessed 22 March 2017)

ONLINE SOURCES

Adesina, AA AfDB President's Inaugural Speech 1 September 2015 Abidjan , Ivory Coast https://www.afdb.org/fileadmin/uploads/afdb/Documents/Generic-Documents/SPEECH_PRST_Akinwumi_A_Adesina_Inaugural_Speech_FINAL.pdf)

African Export-Import Bank 'Afreximbank Model Law on Factoring' (Available at https://www.afreximbank.com)

Alarcon, RB 'International Factoring' (2014) https://fci.nl/about-factoring/factoring/international-factoring-rosana-bastos-sep2014.pdf

ASISA https://asisa.org.za (Accessed 20 August 2017)

Awani, K 'Africa needs facilitating infrastructure to tap 200 billion Euros factoring growth' www.biznisafrica.com 7 July 2016 (Accessed 10 September 2017)

Elaine 'How are factoring companies regulated?' https://www.companeo.co.uk/factoring/guide/how-are-factoring-companies-regulated#0 (Accessed 27 September 2017)

Fairbanks, L 'Factoring: What it is and how to choose a service' Business Daily September 12 2017 www.businessdaily.com/9336-choosing-factoring-service.html (Accessed 24 September 2017)

FCI home page https://fci.nl/en/about-factoring/how-does-it-work (Last accessed 18 September 2017).

FCI 'MAC Carpet—FCI on flying carpets around the world' https://fci.nl/en/about-factoring/case-studies/ (Accessed 25 April 2017).

Heritage www.heritage.org/index/country/zambia (Accessed 19 September 2017).

Klapper 'The Role of Factoring for Financing Small and Medium Enterprises' (2006) Journal of Banking & Finance Volume 30 Issue 11 3111 www.sciencedirect.com/science/article/pii/S0378426606001002 (Accessed 27 April 2017).

Lime Consultancy 'Campari, More Than a 1980s Drink' www.limeconsultancy.net/campari (Accessed 27 September 2017).

MAC Carpets www.maccarpet.com (Accessed 26 September 2017).

Mandula www.bcrpub.com (Accessed 9 October 2017.

Merchant Factors 'A Solution to the small business finance gap' 19 July 2017 www.mfactors.co.za (Accessed 22 September 2017).

Mercy Corps 'Financial Inclusion: Approach and Principles' (2014) https://www.mercycorps.org/sites/default/files/Financial%20Inclusion%20Approach%20Principles%20_20June%202014.pdf (Accessed on 6 September 2017)

Milenkovic-Kerkovic & K Dencic-Mihajlov 'Factoring in the Changing Environment: Legal and Financial Aspects (2012) www.sciencedirect.com/science/article/pii/S1877042812011688 (Accessed 23 September 2017)

Nelson, C 'Afreximbank harps on strong legislation to boost factoring' *The Guardian* 6 February 2017 https://guardian.ng/business-services/money/afreximbank-harps-on-strong-legislation-to-boost-factoring

Priest-Stephens, L. and E. Kameni 'Building a Model' *Trade and Forfaiting Review* 1 June 2016 http://www.tfreview.com/feature/regions/building-model.pdf Accessed 7 March 2017

Silitschanu, P 'Financing International Trade—Factoring v. Forfaiting' Accessed online on 23 April 2017 at https://www.americanexpress.com/us/content/foreign-exchange/articles/financing-international-trade-factoring-vs.forfaiting.

Triki, T and I Faye (eds.) 'Financial Inclusion in Africa' (2013) African Development Bank https://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/Financial_Inclusion_in_Africa.pdf (Accessed 15 August 2017)

https://www.parliament.gov.zm (Accessed 11 August 2017)

https://www.uncitral.org/uncitral/en/uncitral_texts/security/2001Convention_receivables.html (Accessed 1 September 2017)

https://www.unidroit.org/instruments/factoring (Accessed 1 September 2017)

https://www.workspace.co.uk/community/homework/business-finance/campari-preparing-a-business-bank-loan-application.html (Accessed 27 September 2017)

https://zamlii.co.zm