

Factoring as a means of promoting small and medium scale enterprises: The case for a legal framework for credit factoring in Ghana

By

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Declaration

I, **FRANCIS KOFI KORANKYE-SAKYI**, 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:

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Dedication

I dedicate this work to the whole of my family. To you, my dear wife, Mrs Esther Korankye-Sakyi (Adwoa) and my blessed sons; Clifford Sakyiba-Agyinsam (Faith) and Chasy Sakyiba-Arhin (Judah).

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I declare in the name of our Lord Jesus Christ that, Elohim is the immortal, invincible, the only wise God; my foremost thanks go to Him. He has been my pillar, anchor, protector, provider and the inspiration behind my aspirations in this academic path.

Since my adult life after completing Teacher Training College in 2001, I have always engaged myself in one academic pursuit or the other; working at the same time during all these journeys. I worked full-time while pursuing all my major qualifications: Diploma, Bachelor of Education, Master of Arts, and Bachelor of Laws. This is the only study that engaged me without working. In all these years, my family had to have the patience and understanding to support me with prayers, counsel and finances. It was a sacrifice they had to make while I sojourned on these academic trajectories. I am highly indebted to express my appreciation to the Korkankye family of Jukwa.

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List of acronyms

AfCFTA	-	African Continental Free Trade Area.
AfDB	-	African Development Bank.
Afreximbank	-	African Export-Import Bank.
AU	-	African Union.
BoG	-	Bank of Ghana.
CAR	-	Capital Adequacy Ratio.
CAGR	-	Compound Annual Growth Rate.
CSA	-	Central Statistics Agency.
DTI	-	Department of Trade and Investment.
DFC	-	Debtor Finance Committee.
EBRD	-	European Bank for Reconstruction and Development.
ECOWAS	-	Economic Community of West African States.
ESD	-	Enterprise and Supplier Development.
EU	-	European Union.
EUF	-	European Federation.
FCI	-	Factors Chain International.
FDI	-	Foreign Direct Investment.
GDP	-	Gross Domestic Product.
GRIF	-	General Rules of International Factoring.
HSBC	-	Hongkong and Shanghai Banking Corporation.
IBA	-	International Bar Association.
ICC	-	International Chamber of Commerce.
IFG	-	International Factoring Group.
IFIs	-	International Financial Institutions.
JSE	-	Johannesburg Stock Exchange.
ISSER	-	Institute for Statistical, Social and Economic Research.
MTIC	-	Ministry of Trade, Industry and Cooperatives.
NBSSI	-	National Board for Small Scale Industries.
NCCE	-	National Commission on Civic Education.
OHADA	-	Organisation for the Harmonisation of Corporate Law in Africa.
SDGs	-	Sustainable Development Goals.
SEDA	-	Small Enterprise Development Agency.

SMEs	-	Small and Medium Scale Enterprises.
SSA	-	Sub-Saharan Africa.
UFA	-	Universal Financial Access.
UNIDROIT	-	The International Institute for the Unification of Private Law.
UNCITRAL	-	United Nations Commission on International Trade.
UK	-	United Kingdom.
US	-	United States.
VAT	-	Value Added Tax.
WB	-	World Bank.
WBG	-	World Bank Group.

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Abstract

This research is underscored by the fact that there is a dearth of literature on the legal framework of credit factoring in Ghana. This is despite the reality that factoring provides an opportunity for small and medium scale enterprises (SMEs) to access finance with fewer constraints in promoting the growth of SMEs globally. The financial sector of Ghana has seen major reforms in recent years and, in principle, have the capacity to nurture SMEs to thrive on leading in the expected economic progress of the country. In this regard, the challenge of access to capital to facilitate the activities of businesses surfaces as the critical issue, which must be addressed with a sustainable alternative.

This research examines the legal framework and regulatory protection for credit factoring as an alternative means to access capital in Ghana. It employs qualitative tools by analysing secondary data to conclude that, a well developed factoring framework and legal environment for factoring will adequately protect SMEs and create an alternative pathway to a more sustainable finance source in order to promote and spur the growth of such businesses. Furthermore, factoring has been a significant financing scheme in most developed nations and some African countries, unlike the situation in Ghana, which lacks in legal and institutional provisions on factoring that will adequately regulate the commercial industry in order to promote and actualise SMEs.

The enactment of good factoring law will give impetus to convenient access to finance and broaden the scope of facilitation of SMEs and their activities within the factoring enterprise. This research recommends the adaptation of the Afreximbank's model law on factoring, which is based on the Factoring Chain International standard, as a foundational basis for creating a legal framework on credit factoring in Ghana.

CHAPTER ONE

GENERAL INTRODUCTION

1.1 Background to the study

Cash constitutes the life wire for every business entity¹, especially for Small and Medium Scale Enterprises (SMEs). It is traditional practice for SMEs to rely on sources of finance such as borrowing from banks and credit agencies in the forms of loans and overdrafts characterised with high requirements of guarantees and collaterals,² that are usually almost impossible for these businesses to come by. The contributions of SMEs to national development are enormous and varied. These contributions generally cover ‘employment, Gross Domestic Product (GDP), innovations, human resource development and poverty alleviation, but these enterprises are constrained by access to credit.’³ The challenges for the survival and continued relevance of SMEs cannot be divorced from the supply of reliable financing and sustainable trade credit. It is estimated that in Ghana, SMEs constitute about 92% of all registered companies.⁴ Again, 85% of the SMEs in Ghana offer employment in the manufacturing sector alone to the citizens and contribute 75% to the GDP of Ghana.⁵

In most developed countries, credit factoring has played a critical role in financing SMEs,⁶ and it receives the support of governments and central banks, worldwide⁷. However, few countries in Africa, notably South Africa, Tunisia, Egypt, and Morocco have the legislative and

¹JG Salek *Accounts receivable management best practices* (Wiley & Sons Inc. 2005) at 1, 5th ed. Hoboken, New Jersey.

² The Vienna Initiative Working Group on Credit Guarantee Scheme ‘*Credit guarantee schemes for SME lending in Central, Eastern and South-Eastern Europe*’ November 2014 Report: https://www.eib.org/attachments/efs/viwig_credit_guarantee_schemes_report_en.pdf (accessed 2 May 2019).

³ P Kwashie-Akorsu & D Agyapong ‘*Alternative model for financing SMEs in Ghana*’ (2012) Vol. 1 No. 5/14 International Journal of Arts and Commerce at 136.

⁴E Sacerdoti ‘Access to bank credit in Sub-Saharan Africa: key issues and reform strategies’ (2005) WP/05/166 IMF working paper <https://www.imf.org/external/pubs/ft/wp/2005/wp05166.pdf>(accessed 17 April 2019).

⁵ Daily Guide ‘*The Catalyst of Economic Growth A look at ILO contribution to SMEs’ development*’ Accra April 22, 2017 <https://dailyguidenetwork.com/catalyst-economic-growth-look-ilo-contribution-smes-development/> (accessed 28 April 2019); E Bruce ‘*Let’s position our SMEs to take advantage of AfCFTA-Edward Gomado*’ Graphic online Accra Friday 9 August 2019 13:11 <https://www.graphic.com.gh/business/let-s-position-our-smes-to-take-advantage-of-afcfta-edward-gomado.html> (accessed 9 August 2019).

⁶ S Ivanovic, S Baresa & S Bogdan ‘*Factoring: alternative model of financing*’ (2011) Vol: 2 (2) UTMS Journal of Economics at 189–206.

⁷ Ivanovic et al. (n 6).

institutional framework for credit factoring.⁸ In the Global North, credit factoring has been successfully utilised, especially in the European Union (EU) member states as well as in all five non EU “benchmark” countries considered relevant such as Russia, Switzerland, Norway, United States(US), and Turkey.⁹ This thesis examines how Ghana has used factoring as a credit finance scheme to aid sustainable trade and investment profiles of its businesses. It also proffers suggestions as to how Ghana can make factoring a major system of financing SMEs by adopting a workable model law of factoring to legislate an instrument to regulate that activity.

1.2 Problem statement

The fact that SMEs remain very pivotal in the economy of Ghana cannot be overemphasised.¹⁰ In this age of information and within the ambience of globalisation, the means to get people to be abreast with a phenomenon; and to access its usefulness or otherwise is to get information about such phenomenon. Factoring is an under researched subject for Africa in particular. The extent of awareness is significantly appalling in most countries of Africa, including Ghana. The quest for information is an essential factor in any market economy.¹¹ The demand for information by businesses is understood to be a derived demand for risk management and investment.¹² Even though there are substantial knowledge and writing on factoring and the various aspect of financing SMEs, very few literatures as to how SMEs can be financed through factoring in Ghana exist. Hence this thesis.

⁸ E Kameni ‘An insight into recent legal and regulatory reforms of factoring in Africa’ in M Bickers (ed) (2017) World Factoring Yearbook. ch 3 at 27.

⁹ J Brehcist ‘Fourth EU factoring and commercial finance summit’ (2018) No:18 Athens Greece ,the EU Federation Legal Study 2017 Update <https://fci.nl/en/event/4th%20EU%20Factoring%20Summit%20Athens%202018/4222> (accessed 28 March 2019).

¹⁰ The World Bank ‘Small and medium enterprises (SMEs)finance: improving SMEs access to finance and innovative solutions to unlock sources of capital’ <https://www.worldbank.org/en/topic/smefinance> (accessed 18 May 2019).

¹¹ R Davies, R Madaus, et al. *Micro, small, and medium enterprises insolvency: a modular approach* (Oxford University Press 2018) New York.

¹² BO Oramah ‘Structured trade finance -conceptual foundations, origins and definitions’(2015)ch3 accessed online 15 March 2019 at <https://www.ark-group.com/product/foundations-structured-trade-finance#.XNUxSl4zaM8> .

Factoring in Ghana has not developed an adequate regulatory regime to regulate its practice as compared to other countries across the globe, including some North African countries like Tunisia, Morocco, and Egypt.¹³ It does appear, that, credit factoring is less known to the SMEs as a favourable and an alternative means to financing business transactions in Ghana due to the inadequate access to information on the industry.¹⁴ This research aims at adding to the literature on the challenges and the financial encumbrances inhibiting SMEs and to identifying how factoring can be used to obliterate these challenges through a proper regulatory regime in Ghana for sustainable economic growth and development.

1.3 Aims and objectives of the study

The overarching aim of the study is to identify and analyse how credit factoring has facilitated trade for SMEs in Ghana. An attempt would be made to identify existing laws regulating the factoring industry in Ghana and underline the regulatory gaps if any; make recommendations from the experiences of other nations and underscore how Ghana can learn from those countries. It is also geared towards identifying a workable model law tailored to suit the economy of the country in respect of factoring legislation and regulation. This study will contribute to productive business activities by supplying the needed information and understanding of SME financing in emerging economies, especially Africa. The findings of this work are expected to help increase the knowledge about factoring as a viable means of trade finance. The extent of the awareness, acceptance and patronisation of factoring will ultimately depend on how much awareness is created among African enterprises on the industry through such means as this research aims to do.

1.4 Research questions

This research shall investigate the overarching question:

To what extent do SMEs utilise factoring as an avenue to access finance to promote their businesses in Ghana?

In addition to the overarching question, the following sub questions will be answered:

1. What is factoring and what role does it play in facilitating SMEs' financing in Ghana?

¹³L Priest-Stephens & E Kameni 'Building a model | trade and forfeiting review' (2016) feature I June 2016 at 1.

¹⁴M Hamanyati 'Factoring as an international trade finance product: making a case for the enactment of a factoring act in Zambia' LLM dissertation, University of Pretoria, 2017; E Senzu & H Ndebugri 'Account receivable management across industrial sectors in Ghana; analyzing the economic effectiveness and efficiency' (2017)MPRA Paper No 80014 https://mpra.ub.uni_muenchen.de/80014 (accessed 22 April 2019).

2. What are the benefits and challenges of utilising credit factoring as trade finance product as compared to traditional bank lending?
3. Why does Ghana need a legal framework based on internationally accepted model law for factoring?
4. What role does model laws such as the Afreximbank model law on factoring play in domestic legislation?

1.5 Thesis statement

This research is underscored by the position that, there is not much in the legal literature on factoring in Ghana, although factoring provides an opportunity for access to finance with fewer constraints in promoting SMEs. The financial sector of Ghana has seen significant reforms in recent years and should have the capacity to nurture SMEs to thrive on leading in the expected economic progress of the country. In this regard, access to capital to facilitate the activities of businesses surfaces as the critical issue, which must be addressed with a sustainable alternative. Factoring has not been a critical financing scheme in Ghana, due to lack of governments' foresight to seek the best alternative supports for businesses, the lack of technical capacities of the financial institutions on the product, and the absence of a legal framework to regulate that business. It is suggested that a well developed framework and legal environment for factoring will fortify SMEs and expose them to a sustainable alternative finance source to facilitate their businesses. The enactment of good factoring law will give impetus to convenient access to finance and broaden the scope of facilitation of SMEs and their activities within the factoring enterprise. The proposal to model a future factoring law for Ghana to fit into the African Export-Import Bank's (Afreximbank) model law is informed because of its tried and tested application in some African countries which have already enacted such laws and to meet international factoring legislative standards under the auspices of Factoring Chain International (FCI).

1.6 Literature review

Ghana had a population of approximately 27 410million as at midyear 2015,¹⁵ and with an annual growth rate of 1.4 %, it is expected to increase to about 33 678million in 2025.¹⁶ Ghana is a developing country with the geographical size of approximately 238 533 square kilometres, and it is the first sub-Saharan African (SSA) nation to have its independence in 1957.¹⁷ It is a nation with enormous natural resources like gold, magnesium, bauxite, rivers, lakes, forest

¹⁵ United Nations 'The demographic profile of African countries' (2016) Economic Commission for Africa at 27-28.

¹⁶ UN (n 15).

¹⁷ Central Intelligence Agency 'The world factbook' accessed online 15 April 2019 at <https://www.cia.gov/library/publications/the-world-factbook/geos/gh.html>.

reserves, industrial diamond, petroleum, silver. Its export commodities are gold, cocoa, timber, and crude oil.¹⁸ The GDP growth rate of Ghana as of 2017 was estimated at 8.4%.¹⁹ In 2016, the GDP was recorded at a growth rate of 3.7% and was considered the lowest in two decades from the record high of 14.0% in 2011.²⁰ The outturn of 3.7% growth as experienced in 2016 was comparatively better than the lamentable 1.4% growth rate, achieved by other SSA countries in totality.²¹ According to Alagidede et al., ‘the Ghanaian economy has been on an upward trajectory over the past three decades.’²² Their assertion does not reflect the recent volatility in the Ghanaian economy. The service sector of Ghana with contribution from the financial sector has contributed significantly to the economic performance of the country but more robust attention to other segments of the sector will be an impetus for further and sustained growth. Alagidede et al. reiterate further that the structure of any financial system determines how its monetary administration is carried through.²³ To this extent, the government of Ghana was ubiquitous in the monetary and credit policy directions of the economy before a major financial restructuring in 1988.²⁴ They further postulate that government owned banks dominated the financial system in that period of Ghana's history.²⁵ Their position could explain why there is not much on factoring in the literature of Ghana because the factoring industry is mostly a private sector driven enterprise. Based on these challenges, Alagidede et al. conclude that Ghana decided to reform its financial industry in 1988, which brought about the enactment of the Banking Law in 1989.²⁶ The present exercise to reform the financial sector and the influx of foreign banks into the industry is mainly attributable to these reforms. It is unfortunate to observe that the new paradigm could not take advantage to give space to the viable industry of invoice discounting as a key finance activity of the banking industry.

Furthermore, Alagidede et al. reveal that there is informal evidence which points to the fact that Ghanaian businesses are wary and hesitant to access corporate loans and other long term credit schemes, but retentions of surplus income or profit, family income, minimal equity

¹⁸ CIA (n 17).

¹⁹ CIA (n 17).

²⁰Bank of Ghana ‘Summary of economic and financial data’(September 2017) www.bog.gov.gh (accessed 17 April 2019); ISSER ‘*The state of the Ghana economic report 2016*’ Institute of Statistical, Social and Economic Research <http://isser.edu.gh/index.php/sger>(accessed 17 April 2019).

²¹ ISSER (n 20).

²² P Alagidede et al. ‘*The Ghanaian economy: an overview*’(2013)Vol.1 Ghanaian Journal of Economics at 4 https://www.researchgate.net/publication/260591239_The_Ghanaian_Economy_An_Overview(accessed 15 April 2019).

²³ Alagidede et at. (n 22).

²⁴ Alagidede et al. (n 22).

²⁵ Alagidede et al. (n 22).

²⁶ Alagidede et al. (n 22).

financing are the order of the day for most businesses.²⁷ This malaise is a reflection of the nature of the economy, where SMEs owned by families constitute about 70% of all companies.²⁸

Davies et al. have stated that, in different jurisdictions, different terms are used to describe small scale operators.²⁹ They argue further that, there is no globally accepted definitions of SMEs but listed some of the factors or indicators for the definition of SMEs to include annual gross or net revenue, the value of assets or liabilities, the number of sales, legal structure and number of employees.³⁰ Ardic et al. intimate that players in the industry agree mostly that the number of employees, loan size, and volumes of sales are cardinal variables for defining an SME.³¹ They are convinced that the number of employees and sale volumes are probably ‘the most accurate parameters to define a SME.’³² Agyapong also affirms this position that there is no single definition for the concept of SMEs and explains that the concept is virtually localised by the extent of operation and conditions in a country.³³ In line with Agyapong’s assertion, the National Board for Small Scale Industries (NBSSI), which is the regulator for SMEs in Ghana, defines SMEs based on their fixed assets and number of employees with annual turnover not exceeding US\$200 000.³⁴

The challenges inherent in the classification of SMEs, present managerial and financial road-blocks and access in their activities within a globally competitive trading arena.

According to Davies et al., SMEs are the primary conduits through which entrepreneurs undertake business ventures to the people and to deliver a variety of goods and services to the demand sides of the economies.³⁵ To this end, SMEs make up the most reliable route by which jobs are created for the teeming unemployed folks in the private sector.³⁶ The importance of SMEs to the global economy is keen now because the world will need about 600million jobs to absorb its working force, mainly made up of the youth in the next 15 years, particularly for Asia and

²⁷ Alagidede et al. (n 22).

²⁸ Alagidede et al. (n 22).

²⁹ Davies et al. (n11).

³⁰ Davies et al. (n 11).

³¹ OP Ardic & others ‘*Small and medium enterprises: a cross country analysis with a new data set*’ (2012) Pacific Economic Review 17:4 at 498 in R Davies & others *Micro, small, and medium enterprises insolvency: a modular approach*. (Oxford University Press 2018) New York.

³² Ardic et al. (n 31).

³³ D Agyapong ‘*Micro, small and medium enterprises’ activities, income level and poverty reduction in Ghana-a synthesis of related literature*’ (2010) Vol.5 NO.12 International Journal of Business and Management.

³⁴ Daily Guide (n 5).

³⁵ Davies et al. (n 11).

³⁶ Davies et al. (n 11).

SSA.³⁷ Hruby puts the expected jobs for the youth at a relatively moderate figure of 18million.³⁸ He confirms that to meet the expectation to create the estimated new jobs for the youth, the role of governments to enact policies that are globally competitive and economically stimulating cannot be relegated to the background; and that these efforts are needed to grow SMEs in Africa.³⁹ He has indicated that access to finance has been singled out every time as the biggest impediment to new businesses with a funding gap of about US\$140billion.⁴⁰ Indeed, lack of finance is always present in any discussion that focuses on finding lasting solutions to problems of small businesses in Ghana. To this effect, to identify a workable finance model is not out of place, especially when traditional financial and credit institutions in Ghana are going down as a result of the recent normalisation exercise by the central bank which has affected more than 400 of these institutions in the last two years. What is needed is to utilise an avenue such as factoring through a comprehensive law to guide its operation. To elucidate on what constitutes finance in SMEs management, Bondinuba defines finance as ‘the set of activities dealing with the management of funds and specifically involves the decision of collection and use of funds.’⁴¹ This explanation is in sync with the generic meaning of finance as consisting of the economies of time-how long a borrower keeps a lender’s money-and risk-the interest a borrower is likely to incur and charged on loan-or the money itself.

Since time immemorial, the contribution of SMEs to national development trajectories of nations have been tremendous. The impact on national economies resulting from the activities of SMEs are matters that cannot be underestimated.⁴² The challenge, however, facing these enterprises have been as diverse as their nature. Access to finance, as a key to the survival and competitiveness of these enterprises, has always been a significant obstacle to these SMEs.⁴³ In the absence of concrete measures to shore up SMEs, it has been confirmed that both internal and external risks opposed to SMEs are a going concern and the majority of them do not survive beyond three and half years after commencement of their activities.⁴⁴ According to

³⁷ The World Bank (n 10).

³⁸ A Hruby ‘*Entrepreneurship funds in Africa; distinguishing good from bad*’ The Conversation 29 April 2019 accessed 1 May 2019 at <https://www.moneyweb.co.za>.

³⁹ Hruby (n 38).

⁴⁰ Hruby (n 38).

⁴¹ FK Bondinuba ‘*Exploring the challenges and barriers in accessing financial facilities by small and medium construction firms in Ghana*’ (2012) Vol.2(6) Journal of Civil and Environmental Research.

⁴² Davies et al. (n 11).

⁴³ Sacerdoti (n 4).

⁴⁴ Bureau for Economic Research ‘*The small, medium and micro enterprise sector of south Africa*’ (2016) No.1 Research Note Commissioned by the Small Enterprise Development Agency.

Swanepoel,⁴⁵ a contributory factor to this situation is the late payment of invoices, which constitutes about 40% of bad debts of these enterprises.⁴⁶

In their quest to meet their objectives, it has been a common marketing feature for SMEs to produce and supply their products and services on credit for later payments.⁴⁷ According to Avevor, in Ghana, SMEs have contributed to playing key role in the reduction of poverty rate from 51.7% in 1993 to 39.5% in 1999.⁴⁸ They have also reduced extreme poverty from 36.4% to 27% over the same period.⁴⁹ Despite the tremendous contributions to the economy, SMEs in Ghana grapple with numerous difficulties when accessing funds from financial institutions.⁵⁰ Despite the general acceptance that SMEs play a very critical function in economies of nations, Agyapong indicates that there is another school of thought that opposes this notion and posits that larger enterprises instead make the chunk of contributions to the national prosperity of economies.⁵¹ Agyapong disagrees vehemently and argues that there cannot be any justification to assert that only larger business ventures constitute the economic pillars of countries and suggests that the means to have robust SMEs sector is to integrate them into the mainstream economic underpinnings of broad governmental policies.⁵² It must be stated that this forgoing disagreement cannot stand the test of time in the face of the preponderance of the economic facts today. At least, the notional and quantitative value of SMEs cannot be lost on any present socioeconomic analysis. SMEs struggle to survive due to the higher sensitive legal architectural regime of the business world in contrast to the larger enterprises that are usually fortified and competitive in such legal and regulatory environment.⁵³ The most harmonious step to actualise this suggestion is to build, promote, and institutionalise a more viable credit scheme that would serve as a livewire for the growth and competitiveness of the SMEs. The connection between SMEs growth and economic advancement, especially in the private sector is incontestable. On this score, it has been recommended that governments' interventions for SMEs are essential to the extent that they are very productive as compared to the bigger businesses because SMEs are fundamentally constrained by the demand and requirements of the financial market and

⁴⁵ Bernard Swanepoel is the Executive Director of Small Business Institute in South Africa.

⁴⁶ B Swanepoel *'Late Payment, the assassin of small businesses'*-SBI FIN24 Newsletter 5 May 2019.

⁴⁷ Hamanyati (n 14).

⁴⁸ EE Avevor *'Challenges faced by SMEs when accessing fund from financial institutions in Ghana-case country'* (2016) Ghana Business Economics and Tourism.

⁴⁹ Avevor (n 48).

⁵⁰ Avevor (n 48).

⁵¹ Agyapong (n 33).

⁵² Agyapong (n 33).

⁵³ Davies et al. (n 11).

other credit organisations for the needed capital injection into their ventures.⁵⁴ Despite the cogent point by Agyapong, as long as there is a neglect to take advantage of a scheme such as factoring with a legal architecture to advance his suggestion, the financial market cannot offer much to suffice the activities of SMEs. The government of Ghana must play an instrumental part to enact laws that bolster the works of SMEs.

SMEs are the engines that drive economic growth and development.⁵⁵ According to Davies et al., they are the bulk and heartbeat of practically all global economies.⁵⁶ Muiruri has corroborated this position and pointed out that the percentage of enterprises that are SMEs in all economies accounts for about 90% by way of employment, taxes, and GDP.⁵⁷ He is, again, convinced that SMEs must be the desired trigger for economic growth in Africa despite the difficulties they face, and challenges African leaders to confront such impediment.⁵⁸ SME businesses account for 99% of all companies in developing countries, thereby signifying their importance to both developing and developed economies.⁵⁹

According to Fjose et al. SMES ‘are the engine that drives world economies and the stepping-stone to industrialisation.’⁶⁰ The industry is particularly important due to their straightforward approach in response to most Africans’ challenges by making goods and services available at less cost besides being a source of income and employment.⁶¹

Table 1: The table below shows the percentages of contributions made by SMEs to employment and GDP in some African countries:

Countries	Contributions to GDP (%)	Contributions to Employment (%)	References
Ethiopia	3.4	90	Central Statistic Agency (CSA),2003; Gebrehiwot,2006

⁵⁴ Agyapong (n 33).

⁵⁵ S Fjose & others ‘SMEs and growth in Sub-Saharan Africa: identifying SME roles and obstacles to SME growth’ (2010) MENON-Publication No 14/2010, MENON Business Economics in S Muiruri (n 57).

⁵⁶ Davies et al. (n 11).

⁵⁷ S Muiruri Muriithi ‘African small and medium enterprises (SMEs) contributions, challenges and solutions’ (2017) Vol. 5 No. 1 European Journal of Research and Reflection in Management Sciences at 36.

⁵⁸ Muiruri Muriithi (n 57).

⁵⁹ Muiruri Muriithi (n 57).

⁶⁰ Fjose et al. (n 55).

⁶¹ C Kauffmann ‘Financing SMEs in Africa’ (2006) Insight No 7 Paris: OECD Development Centre Policy. <https://www.oecd.org/dev/34908457.pdf> (accessed 14 April 2019).

Ghana	70	49	Ghana Bank Doing Business Report,2013, World Bank,2006, Abor & Quartey,2010;
Kenya	40-50	80	Mwarari, Ngugi,2013;
Nigeria	50	70	Ariyo,2011; Kolasin-ski,2012
Rwanda	20.5	60	Mukamuganga,2011
South Africa	50-60	60	DTI,2012; WII-lemse,2010;
Tanzania	60	20	Enchengreen & Tong,2005; Ngasongwa,2002
Uganda	18	90	Uganda Ministry of Trade, Industry and Cooperatives (MTIC),2015
Zambia	8	30	Mbuta,2007
Zimbabwe	40	15	Katua,2014; Zwinoira,2015

Source: S Muiruri Muriithi ‘African Small and Medium Enterprises (SMEs) Contributions, Challenges and Solutions’ (2017) 5(1) *European Journal of Research and Reflection in Management Sciences* 38.

The slow pace at which Ghana is bracing up to the milieu of factoring may be situated in the context of Klapper’s position that factoring is more extensive in practice in countries where economic development is thriving with proper access to credit information.⁶² It is safe to argue from this point that Ghana as a developing country with all the social, legal, economic and infrastructural deficits lacks the capacity and the parity to render such level of factoring services to SMEs.

⁶² L Klapper ‘The role of factoring for financing small and medium enterprises’ The World Bank http://sitere-sources.worldbank.org/INTEXPCOMNET/Resources/Klapper,The_Role_of_Factoring_for_Financing_Small_and_Medium_Enterprises.pdf (accessed 17 April 2019).

On the other hand, according to Klapper, there are studies which reveal the fact that trade credit is available more in nations where SMEs financing is more challenged.⁶³ For example, in a study cited by Klapper,⁶⁴ Demirguc-Kunt and Maksimovic posit that in 39 countries in the world, demand for trade credit for businesses in countries with weak legal systems is higher than those sourced from banks, and that makes contracting with bankers a very arduous task.⁶⁵ This position is reinforced by Ardic et al. who state that SMEs encounter difficulties with efforts to have sufficient financing avenues at the inception of their activities and that to have viable existence will depend on accessing finances from existing and new creditors which are peripheral to the formal banking system.⁶⁶

One reason Klapper advances for this position is that factoring is a very sophisticated model of finance which encapsulates services like ‘credit protection, accounts receivable, bookkeeping, collection services, and financing.’⁶⁷ It, therefore, requires elaborate legislation, regulation, and infrastructure to maximise the full viability of invoice discounting as compared to other credit facilities. He further points out that factoring is a credit model for SME financing available in both developed and developing countries.⁶⁸ Factoring significantly recorded a growth rate of 88% amounting to over US\$860billion in volume across the globe within the period from 1998 to 2004.⁶⁹ This impressive growth lends credence to the rationale for the attention received by factoring in most developed countries. The US, for instance, attaches prominence to factoring as a reliable and primary means of capital finance, though the focus is often on selected industries.⁷⁰ This further advances the position of this paper for deserving attention in Ghana to the factoring product as identified by Bondinuba, who points to several sources of finance for SMEs, including invoice discounting.⁷¹ His argument is that the banks in Ghana provide most of these products very effectively to the SMEs and posits that the non banking sector in Ghana is involved in offering factoring packages to SMEs.⁷² For Ardic et al., the absence of legal framework and requirements such as assets free for collateral or the absence of personal

⁶³ Klapper (n 62).

⁶⁴ Klapper (n 62).

⁶⁵ A Demirguc-Kunt & V Maksimovic ‘Firms as financial intermediaries: evidence from trade credit data’(2002)World Bank Working Paper accessed online 13 March 2019 at <https://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.694.6995&rep=rep1&type=pdf>.

⁶⁶ Ardic et al. (n 31).

⁶⁷ Klapper (n 62).

⁶⁸ Klapper (n 62).

⁶⁹ Klapper (n 62).

⁷⁰ Klapper (n 62).

⁷¹ Bondinuba (n 41).

⁷² Bondinuba (n 41).

guarantee and the passivity of creditors are the most challenging factors haunting the survival of SMEs.⁷³ According to them, the institutional and legal framework will provide the mechanisms to facilitate viable enterprises in difficulties to access credit for their bailout.⁷⁴ They, however, agree that there is no single way out and that there may be other effective strategies for the financing of these distressed enterprises.⁷⁵

Strict requirements of collateralisation and guarantees have always characterised traditional trade finance means such as loans and overdrafts from banks and non banking institutions.⁷⁶ It is estimated that about 70% of small and medium sized businesses in emerging economies lack access to these forms of credit.⁷⁷ The challenge is particularly so for Africa and Asia,⁷⁸ with an estimated credit gap of about US\$1.2trillion.⁷⁹ It is anticipated that this gap can be filled with a well regulated factoring regime as experienced in other developed countries.

Factoring is deemed to be offering considerable assistance to SMEs across the globe, including Africa,⁸⁰ playing a significant role in providing a reliable source of finance and thereby promoting SMEs activities in many countries. Even though legislation and the practice of factoring have not been well developed and explored in Africa, the last years have seen African countries increased their volumes of access to factoring services at an annual average of 14.2% with an expectation to increase in real monetary value to about US\$200billion in 2020.⁸¹ For example, South Africa, which is the leading nation in Africa with relatively thriving factoring services⁸² has over 90% of the concentration of Africa's share of 1% of the global factoring industry.⁸³ It has been observed that as far as financial transactions are concerned, factoring is less known to businesses in the industry,⁸⁴ and Ghanaian enterprises are not an exception.

The expositions above give credence to the unavoidable conclusion that legislating for factoring in Africa, and specifically for Ghana is very pressing at this moment. This paper seeks to identify the legislative gaps in the financial arrangements for SMEs by adding to the diverse work discussed already. The essence is to contribute to the advancement of the legal literature

⁷³ Ardic et al. (n 31).

⁷⁴ Ardic et al. (n 31).

⁷⁵ Ardic et al. (n 31).

⁷⁶ K Awani 'Factoring in Africa; opportunities and challenges' (2014) Seminar Paper. Kanayo Awani is Director for Trade Finance and Branches at the African Export-Import Bank.

⁷⁷ The World Bank (n 10).

⁷⁸ The World Bank (n 10).

⁷⁹ The World Bank (n 10).

⁸⁰ Priest- Stephens & Kameni (n 13).

⁸¹ Kameni (n 8).

⁸² FCI Press Release of 8 April 2014 <http://www.fci.nl/news/detail/?id=502> (accessed on 13 May 2019).

⁸³ Priest-Stephens & Kameni (n 13).

⁸⁴ Newsghana.com.gh 'Finding the right factoring company' News Ghana, Accra 11 April 2012.

with specific attention to highlighting the need for a law that will address the challenges of SMEs through factoring for Ghana. Again, this work will analyse the advantages and the challenges of factoring as against other traditional lending schemes; an exercise which has not been satisfactorily covered in the financial literature. To this end, the set of recommendations that will ensue will focus on the realities of the economic and financial dynamics of the day to have a legal framework that will be effective for Ghana.

1.7 Research methodology

This study uses primary and secondary data analysis of existing data to generate a new hypothesis and find answers to critical research questions from documents and sources pointing in the direction of the information necessary for this study. The research shall employ desktop research and library based methodology by tracking down useful, existing published information and data. It shall analyse the current legal regimes that can facilitate SMEs in Ghana. Primary materials like books, case laws, regulations and legislation as well as secondary sources such as online articles, and journals will be sourced and reviewed.

1.8 Limitation of the study

This research is principally to unearth the challenges that confront SMEs in Ghana and offers solutions from best practices based on model laws and existing legislation under which it can operate. The focus is not on financial or economic analysis even though those factors may play out as well. The research is also limited to only Ghana and not necessarily applicable to all African countries or countries with similar backgrounds and structure. Also taking account of the methodology, which is not empirical, the study may not unearth every problem associated with the industry and that further research is required in one area or the other to supplement what has been done in this study.

1.9 Outline of chapters

This research will primarily be divided into six chapters.

Chapter one will serve as a general introduction to the research. It will be devoted to the background of the study, the problem statement, the significance of the study, aims and objectives of the study, research questions, thesis statement, methodology, the limitations of the research and will also cover the literature review and give an outline of the chapters.

The focus of chapter two will be on the generality of the concept of factoring and related matters; including the historical perspective of factoring, the mechanisms of factoring and the legal approaches to regulating the product. It shall explore factoring as a viable product of trade finance for SMEs in global commerce.

Chapter three will analyse how far Ghana has reached with the use of factoring as an alternative trade finance product against other existing traditional forms of trade finance for SMEs. The chapter will highlight how factoring offers the best and convenient alternative finance model for promoting SMEs. The benefits and challenges of factoring will be dealt with in this chapter. Chapter four will analyse the existing legal and regulating frameworks on factoring in Ghana. The correspondent banking and financial legislation will be analysed to identify the extent to which factoring is covered. Other relevant laws; generally applicable to factoring will be interrogated to justify the theme of this paper for a separate legal framework for factoring in Ghana. Chapter five will be dedicated to looking into the role of key international financial institutions in promoting factoring and various international model laws on factoring and how they can be adapted to formulate better factoring law and regulations for Ghana. It will take a look at the legislative environment for factoring in South Africa and Tunisia as case study and the lessons for Ghana. The Afreximbank model law on factoring will be the focus on this subject matter and to discuss the role of Afreximbank in Egypt, leading the charges in Africa to fashion out appropriate factoring environment to facilitate finance securing for SMEs.

The summary, recommendations and conclusions of this study will be presented in chapter six as the final chapter. The focus will be to establish jurisdictions and the best practices Ghana can learn from in tailoring its future legislation depending on the best international models on factoring. The Afreximbank model law on factoring will highly be recommended.

CHAPTER TWO

UNDERSTANDING THE CONCEPT OF FACTORING

2.1 Introduction

Funding has been a major obstacle to suppliers and other business enterprises in the supply chain, posing as a core factor for most insolvencies.⁸⁵ In Ghana, for instance, it takes between 30 to 300 days for suppliers to get paid for services provided or goods supplied.⁸⁶ This situation, though usually familiar with the business environment, puts SMEs in a position of uncompromising financial stress and competition that typically leave them worse off and distressed. Issues of finance always have been identified as primary impediments to local enterprises despite the agenda of most governments to lean on private enterprises as the engine of growth of their respective economies.

It has been observed that:

Keeping a business going during the time gap between delivering a product or service and getting paid for it is not a new challenge for people in the business. This gap in revenue – and the financial difficulty that it can bring – is as old as recorded business transactions.⁸⁷

In this respect, it has been suggested that the game changer will be factoring in the context of SMEs in Africa.⁸⁸ Given the challenging credit market today,⁸⁹ factoring has become indispensable financing scheme for many enterprises, irrespective of their sizes, and therefore underscores its role in promoting the growth of SMEs in Ghana.

This chapter focusses on the concept of credit factoring. It highlights the history, scope and its role in domestic and international trade as well as the mechanisms and approaches involved in the system.

2.2 The history of factoring

Indeed, it is a business truism that the idea of speeding up businesses' cash flow using factoring is not new.⁹⁰ Factoring is a term which is used synonymously with invoice discounting in some

⁸⁵ Ghana Web 'Invoice factoring, a game changer for suppliers-Lynch Capital boss', Monday 4 June 2018 <https://www.ghanaweb.com/GhanaHomePage/business/Invoice-factoring-a-game-changer-for-suppliers-Lynch-Capital-Boss-657279?gallery=19> (accessed 16 April 2019).

⁸⁶ Ghana Web (n 85).

⁸⁷ <https://www.interstatecapital.com/brief-history-factoring/> (accessed 26 June 2019).

⁸⁸ Ghana Web (n 85).

⁸⁹ 'Accounts receivable factoring history' accessed online on 25 June 2019 at <http://www.promotionalcapital.com/factoring-history.html>.

⁹⁰ A brief history of factoring(accounts receivables financing), accessed online on 26 June 2019 at <https://www.rtsfinancial.com/articles/brief-history-factoring-accounts-receivable-financing>.

literature and context.⁹¹ It has become the term for account receivables financing in general; but in the US, it connotes a specialised form of financing that involves the actual transfer of the ownership of the invoice to the factor. It is a financial undertaking by which an entity discounts its invoices and sells to a factor.

Factoring has been part of the commercial world for over a century now. It is one of the longest standing and proven method by which businesses accessed capital to mitigate their cash flow challenges, dating back to the ancient Mesopotamians.⁹² Whereas it has been suggested that, domestic factoring emerged from the US in the mid 19th century, European countries are considered the pacesetters for international factoring from the 1960s.⁹³

Some rules for invoice discounting are traced to the Code of Hammurabi; the initial set of laws governing trade and commerce in ancient Babylonia.⁹⁴ Its origin is traced to the 1500s in England, where factoring was used as a form of financing commerce and trade.⁹⁵ During the industrial revolution in the 1800s, manufacturers in the textile and apparel factories who needed immediate cash flow to purchase raw materials and to pay other contingencies including workers' salaries relied on third party lenders who offered upfront cash interventions.⁹⁶ For the security of advances, the factors focused on the creditworthiness of a business' debtors before contracting to fund such company, and clients were usually offered non recourse factoring at that time.⁹⁷

In the 1600s the trade was received in America through the pilgrim's contact.⁹⁸ It was a system of finance provided by factors in their journey to the new world.⁹⁹ The concept was used in the textiles industry of the US, first, which was made up of small but fast growing enterprises which were involved in selling their products to more prominent and clothing manufacturers.¹⁰⁰

The role of factors in the US changed significantly, especially in the last half of the 19th century as captured below:

Advances in communication and transportation no longer made it necessary for an exporter to send his goods to someone on consignment and instead, products were sold directly to buyers

⁹¹ J Wilkinson 'History of factoring'(2013) accessed online on 25 June 2019 at <https://strategiccco.com/history-of-factoring/>.

⁹² (n 90).

⁹³ <https://fci.nl/en/solutions/factoring> (accessed online on 7 July 2019)

⁹⁴ Wilkinson (n 91).

⁹⁵ Wilkinson (n 91).

⁹⁶ Wilkinson (n 91).

⁹⁷ (n 90).

⁹⁸ News Ghana (n 84).

⁹⁹ (n 93).

¹⁰⁰ News Ghana (n 84).

by salesmen who were equipped with books and cases of samples. This development essentially eliminated exporters' need for storage, marketing, and distribution services, but they nevertheless remained in need of financing. The legal basis for these financial services had once been the factor's selling goods and being reimbursed from the proceeds of the sale. By now, however, the situation had changed, and that traditional system no longer worked.¹⁰¹

The factor in return for these services was paid part of the value of the goods traded as commission, which was taken out of the seller's payment.¹⁰²

It is, to be expected that the volumes of transactions under factoring in the early periods of its development cannot be compared to today, even though the underlining principles and benefits remain the same. For example, factors in ancient days paid money upfront depending on the worthiness of customers' invoices or receivables, just as it is today.¹⁰³ It originally, and up to today, involved small companies selling goods to large and reputable counterparts and selling the invoices from such contracts to third parties at a discount for prompt and available funds.

The 20th century witnessed factoring become more established and accepted as a major avenue for financing various businesses and industries.¹⁰⁴ Before the 1950s, industries in textiles, transportation and furniture were the principal beneficiaries of factoring services, and it was the period in which SMEs began to use factors to access immediate cash available to run their operations efficiently.¹⁰⁵

Factoring emerged as a modern finance phenomenon in the 1960s, and the system has seen enormous expansion with acceptance, mainly due to the contributions of institutions like Factors Chain International (FCI) which has emerged as an essential element of the trade today.¹⁰⁶

In Africa, the Afreximbank has been a critical facilitator in the modern practice of factoring on the continent. Despite the many years of factoring activities in Africa, the system has received little or no attention in most African countries including Ghana for many reasons which are yet to be investigated.

2.3. Factoring as a concept

The understanding of the concept will be discussed in the following sections to elaborate on how it is conceived by the relevant international legal frameworks and practitioners to shed light on it.

¹⁰¹ 'A brief history of factoring' accessed online 26 June 2019 at <http://www.fibafactoring.com.tr/en/a-brief-history-of-factoring-y-of-Factoring>.

¹⁰² (n 90).

¹⁰³ (n 93).

¹⁰⁴ (n 93).

¹⁰⁵ (n 93).

¹⁰⁶ (n 101).

2.3.1 The universal understanding of the concept of factoring

In commercial financing, one of the mechanisms that have been misunderstood with misconceptions in the business circus is the concept of factoring and its system of operation.¹⁰⁷ "Factor" as a word comes from the Latin verb "*facio*" which translates to mean "one who does things". In the Roman empire, the practice of entrusting the management of a property to an agent was familiar, with such agents commonly referred to as "factors".¹⁰⁸

The Oxford Dictionary of English defines "a factor" as "a company that buys a manufacturer's invoices at a discount and takes responsibility for collecting the payments due them".¹⁰⁹ This general definition ties into many of the professional and universally accepted meaning adopted by factoring groups and legislation.

For example, the UNIDROIT Convention's understanding of the concept of factoring is:

A contract concluded between one party (the supplier) and another party (the factor) pursuant to which:

(a) the supplier may or will assign to the factor receivables arising from contracts of sale of goods made between the supplier and its customers (debtors) other than those for the sale of goods bought primarily for their personal, family or household use;

(b) the factor is to perform at least two of the following functions:

- i. finance for the supplier, including loans and advance payments;
- ii. maintenance of accounts (ledgering) relating to the receivables;
- iii. collection of receivables;
- iv. protection against default in payment by debtors.

(c) notice of the assignment of the receivables is to be given to debtors.¹¹⁰

The UNCITRAL's model law on factoring does not conceptualise the term "factoring" directly but says, in article 2, that, 'the creation of rights in a receivables as security for indebtedness or other obligation is deemed to be a transfer.'¹¹¹ Tatge and Kameni point out that the UNCITRAL model law only applies to an assignment of international receivables between parties in different states and only if the assignor is contracting.¹¹²

¹⁰⁷ AF Reisman 'What the commercial lawyer should know about commercial finance and factoring' (1974) 79 Com. L.J. 146 Commercial law journal at 146.

¹⁰⁸ Reisman (n 107).

¹⁰⁹ A Stevenson (ed) *Factor* (Oxford University Press. 2010) Oxford Dictionary of English 3rd edition.

¹¹⁰ UNIDROIT Convention on International Factoring (1988) accessed online on 28 May 2019 at <https://www.jus.uio.no/lm/unidroit.factoring.convention.1988/portrait.pdf>.

¹¹¹ DB Tatge and E Kameni 'Afreximbank's model law on factoring' in M Bickers (ed) *Factoring yearbook*(2017) at 9 https://bcrcpub.com/system/files/World-Factoring-Yearbook-2017_0.pdf (accessed on 7 July 2019).

¹¹² Tatge and Kameni (n 111).

Factoring is a financial business and a form of debtor finance scheme where businesses sell their accounts receivables to a factoring entity at a discount.¹¹³ Its essence is for the supplier to meet immediate and pressing cash need and to sustain or take up other business opportunities. It is the purchase of account receivables, also called invoices by a factoring company from an operating company known as the creditor or the exporter to provide instant finance to that business or creditor in the immediate period.¹¹⁴ Usually, the creditor is permitted to offer the qualified receivables at 80% to 85% of the cost to mature within 45 days from the invoice date.¹¹⁵ Sensu et al. explain that invoice discounting is a form of trade credit and continue that it is a credit sale, 'which is the extended term or payment space obtained by a firm to pay for the goods or service acquired from another company.'¹¹⁶ Account receivables are debts owed by customers to the companies resulting from the purchase or supply of goods or services arising from the course of transactions.¹¹⁷ The time value of money is indisputable, and it is often an economic factor for decision making in the business world. This accounts for the reason why a person or business may want to factor its invoices to have access to cash flow for its operations. The various reasons that instigate the reliance on factoring by SMEs include high debt leverage, payroll tax problems, inability to meet payables within their terms with other people or partners.¹¹⁸

Factoring services are not the preserve of the banks or other separate financial institutions, and depending on the jurisdiction and the regulatory framework, different entities may be licensed or registered to offer factoring services. Many businesses would usually choose the bank operated factoring services as against the smaller, independent factoring companies due to such considerations as the lower cost of charges-commitment fees, exit fees, delinquency fees, standard factoring fees-offered by the banks and the quest to maintain banking relationships for future and other transactions.¹¹⁹ Klapper explains that factoring involves the outright purchase of receivables by the factor and does not demand any collateralisation.¹²⁰

¹¹³ Ghana Web (n 85).

¹¹⁴ Wilkinson (n 91).

¹¹⁵ Wilkinson (n 91).

¹¹⁶ E Sensu and H Ndebugri 'Account receivables management across industrial sectors in Ghana; analysing the economic effectiveness and efficiency' (2017) MPRA Paper No.80014 <http://mpra.ub.uni-muenchen.de/80014/>.

¹¹⁷ Business Expenses 'Business bad debts' Publication 535 accessed online 7 July 2019 at <https://taxmap.irs.gov/taxmap2014/pubs/p535-051.htm>.

¹¹⁸ Wilkinson (n 91).

¹¹⁹ Wilkinson (n 91).

¹²⁰ L Klapper 'Export financing for SMEs: the role of factoring' (2006) Trade Note 29, The World Bank Group. International Trade Department.

The Hongkong and Shanghai Banking Corporation (HSBC)¹²¹ Invoice Finance Product Guide distinguishes factoring as a disclosed credit product which allows the debtor to be aware of the purchase of the receivables or the debt from the supplier for the management of the mortgage and to receive payment directly from the debtor by the factor. It, however, considers invoice discounting as an undisclosed arrangement where the debtor is ordinarily oblivious of the contract of assignment of the receivables between the factor and the creditor and thereby allows the creditor to sustain payment to the supplier into an account predisposed to the supplier and the factor.¹²² In this latter arrangement, the supplier is a de facto agent of the factor for the same debt under the agreement.

2.3.2 Features of factoring

Among other characteristics, many factoring dispensations have the following features:

1. Authorisation of factoring companies is an essential feature required to register a jurisdiction as having a vibrant factoring legal milieu. A factoring company is required to register in a country where factoring laws are available. The principle of every business to register before operations apply mutatis mutandis to factoring operators. In Ghana, a company is required to be registered through a due process before it can operate.¹²³ In countries such as France, factoring companies are registered as banks and to operate as such¹²⁴. In other countries such as Bulgaria, Australia, Hungary, however, factoring companies are registered to operate as financial institutions, and do lending but not to take deposits as banks will do.¹²⁵
2. Agreements under factoring, unlike banking, do not necessarily include services, which usually attract charges as Value Added Tax (VAT) in respect of service charges. In working at factoring, any charge on an assignment is deemed as a consideration. Even though the service of discounting is argued to constitute a service and to attract VAT charge,¹²⁶ the assignment of debts does not require such charges on its own.¹²⁷

On the features of factoring, Klapper states:

Factoring can be a powerful tool in providing financing to high risk, informationally opaque sellers. Factoring's key virtue is that underwriting is based on the risk of the receivables (i.e.

¹²¹ HSBC is the Hongkong and Shanghai Banking Corporation which is considered the 4th largest bank in the world with total assets worth about US\$2,374.15Billion.

¹²² HIF Product Guide 'Finance by factoring' (2014) HSBC Global Services.

¹²³ Companies Act of 1963 (Act 179) of Ghana.

¹²⁴ Kameni (n 8).

¹²⁵ Kameni (n 8).

¹²⁶ *Dearle v Hall (1828) 3 Russell 1, 38 ER475.*

¹²⁷ Kameni (n 8).

the buyer) rather than the risk of the seller. Therefore, factoring may be particularly well suited for financing receivables from large or foreign firms when those receivables are obligations of buyers who are more creditworthy than the sellers themselves¹²⁸.

According to Brink, a typical factoring agreement usually must have the following features:

- i. Transfer of the receivable from the supplier (client) to factor.
- ii. Purchase of the receivable by factor including payment of a purchase price by a factor to client.
- iii. Advances in the purchase price.
- iv. Client represents and warrants the legal existence of receivable, assignability, absence of defences or set offs.
- v. The factor takes default risk of the debtor (“non-recourse factoring”) or not (“recourse factoring”).
- vi. The assignment is notified to the debtor (“notified factoring”) or not (“non-notified factoring”).
- vii. Maintenance of accounts and collection either by factor or client (inhouse-factoring).¹²⁹

The key features of the factoring business distinct it from other forms of finance schemes such as forfaiting and securitisation, and must be understood in order to demystify it for the ordinary players required to use and benefit from factoring.

2.4 The mechanisms of factoring operations

The processes to undertaking factoring as an activity involves some established phases and actors which are important to establish in an effort to understanding the phenomenon.

2.4.1 General mechanisms

On the mechanisms of factoring, the FCI explains that:

Factoring is a complete financial package that combines working capital financing, credit risk protection, accounts receivable bookkeeping and collection services. It is offered under an agreement between the so called ‘factor’ and a seller.

Under this agreement, the factor buys the seller's accounts receivable and takes on responsibility for the buyer's ability to pay. If the buyer fails to pay, the factor will pay the seller.¹³⁰

The FCI factoring process by its members internationally operates as follows:

- The exporter receives the purchase order.
- The exporter sends the importer’s information for credit approval.
- The exporter confirms the importer’s creditworthiness through FCI partner.

¹²⁸ Klapper (n 120).

¹²⁹ U Brink ‘*Legal basics of international factoring*’ (2014), International Factoring Group, Bette Wiesenberger Brink.

¹³⁰ FCI home page <https://fci.nl/en/solutions/factoring> (accessed online 7 July 2019).

- The import factor evaluates 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.¹³¹

2.4.2 Subjects in the factoring business

In factoring operations, there are regular players in the business activities; namely, the factor, the client-the exporter, the seller, the creditor, the debtor-the foreign importer, the buyer.¹³² Factoring business is usually practised by specialised firms called factors.¹³³

Three subjects typically take part in a transaction of factoring: Namely, the seller-creditor or customer; the debtor-the buyer; and the factor.¹³⁴ The creditor's customer owes the company in cash, through the sale of tangibles or its products. It is usual in transactional business dealings for a creditor to deliver goods and services to a buyer for terms that permit payment at later date after acceptance of such offer.¹³⁵ Once the debtor agrees and accept the products, the duty to pay the creditor-which is stored in a form of invoice-becomes a negotiable instrument that can be offered for sale to a third party.¹³⁶

In the business of factoring, the third party in this operation purchases the account receivables from the creditor at a discount to give allowance for the factor's returns with a reserve, which is a margin the factor keeps until the value on the invoice is paid by the debtor.¹³⁷ The reserve is paid back to the creditor after the factor had received actual payment of the value of his invoice from the debtor.¹³⁸

¹³¹ FCI home page <https://fci.nl/en/about-factoring/how-does-it-work> (accessed online 7 July 2019).

¹³² I Spasić & others 'Factoring - *instrument of financing in business practice –some important legal aspects*' Vol 25(1) *Ekonomika Istraživanja* at 193-198 <https://core.ac.uk/download/pdf/14447449.pdf>(accessed on 11 July 2019).

¹³³ Spasic et al. (n 132).

¹³⁴ The Strategic Cfo '*History of factoring /factoring history*' accessed online 7 July 2019 at <https://strategiccfo.com/history-of-factoring/>.

¹³⁵ (n 134).

¹³⁶ (n 134).

¹³⁷ (n 134).

¹³⁸ (n 134).

2.4.3 Factoring agreement

Salinger explains that the master factoring agreement usually takes place between the creditor and the factor and can be of three types;¹³⁹

- offer and acceptance type,
- facultative type, and
- whole turnover type.

He explains that the offer and acceptance type takes place any time the creditor or exporter makes the offer of sale through an invoice, and the trade debt is transferred as soon as the offer is accepted by the factor.¹⁴⁰ In the facultative type of agreement, formal acceptance is not necessary, and acceptance of debt is implied to have taken place as long as there is no explicit rejection by the factor and the debt vests in the same.¹⁴¹ In the whole turnover agreement, all the debts remain are taken over by the factor. The factor only continues to make payments as long as the debts are approved based on terms of the agreement, specifically provided to that effect.¹⁴² Salinger recommends that the whole turnover agreement is the most ideal and suitable mechanism for factoring transactions because it is based on prudent financial operation.¹⁴³ The common feature to all the three types is the relationship between the exporter and the factor based on the outright purchase of the actionable claim belonging to the seller, by the factor.¹⁴⁴ The main difference is the time of passing of the ownership right to the factor.¹⁴⁵

2.5 Types of factoring

Factoring can be divided depending on different criteria because factoring has different functions critical to the factoring industry¹⁴⁶. This section is not intended to exhaust all the divisions of factoring which fall under such default criteria, however, such divisions as relevant to the present discourse shall be examined.

1. Factoring can first be divided on its scope of function. According to Spasic et al., an important consideration for the divisions of factoring has to do with the scope of functions which comes under a specific factoring activity.¹⁴⁷ Based on the scope, factoring

¹³⁹ FR Salinger 'Legal issues in international factoring' at ch 8 http://lib.unipune.ac.in:8080/xmlui/bitstream/handle/123456789/3077/15_chapter%208.pdf?sequence=15&isAllowed=y (accessed 16 June 2019).

¹⁴⁰Salinger (n 139).

¹⁴¹Salinger (n 139).

¹⁴²Salinger (n 139).

¹⁴³Salinger (n 139).

¹⁴⁴ Salinger (n 139).

¹⁴⁵Salinger (n 139).

¹⁴⁶ Spasic et al. (n 132).

¹⁴⁷ Spasic et al. (n 132).

can be grouped into “real” factoring and “quasi” factoring.¹⁴⁸ In “real” factoring, the functions of crediting, payment ensuring, rendering professional services are present.¹⁴⁹ In “real” factoring the factor assumes the position of the creditor to claim from the third party-the debtor-the payments for sales of goods or service, undertakes advance payment of the client, does bookkeeping and assumes the risk of insolvency of the buyer.¹⁵⁰ In “quasi” factoring, some of the functions usually associated with real factoring are missing, such as the duty of assuming the risk of insolvency of the debtor.¹⁵¹

2. Another group of division are the “open or disclosed” factoring and “undisclosed” factoring, which is common under Anglo-Saxon law.¹⁵² In “open” factoring, the exporter who is a client to the factor offers his receivables to the factor which claims against the foreign buyer.¹⁵³ In this case, the client is to notify the foreign importer about the claim and demand payment when due to the factor. There are two kinds of “open” factoring. In the first instance, the exporter -client to the factor- transfers its claims against the importer to the factor; the factor then becomes the claimant of the cession.¹⁵⁴ For the assigned claim, the factor pays the client the value of that claim, with the deduction of interest, expenses and commission on the assignment.¹⁵⁵ Due to the risk which the factor undertakes and the high value attached to the transaction paid by the factor on the assignment of claims, the factor is expected to know about the creditworthiness of the foreign buyer.¹⁵⁶ In the other kind of “open” factoring, the exporter assigns the claim to the factor only for the collection but not to transfer the claims to the factor, but only so the factor could collect the claims from the foreign buyer in the name of the client.¹⁵⁷ A variant to the “open” factoring is the “undisclosed” factoring, which is a complex legal business where the presence of the factor in business is not known to the third party-the debtor. In undisclosed factoring, the exporter sells the goods ready for export, for cash. The factor then resells the same goods, on credit, through the exporter, to the foreign buyer. Before the foreign buyer, there appears only the client, who is not the owner of goods since it has been sold to the factor. The client, as a commission agent

¹⁴⁸ Spasic et al. (n 132).

¹⁴⁹ Spasic et al. (n 132).

¹⁵⁰ Spasic et al. (n 132).

¹⁵¹ Spasic et al. (n 132).

¹⁵² Spasic et al. (n 132).

¹⁵³ Spasic et al. (n 132).

¹⁵⁴ Spasic et al. (n 132).

¹⁵⁵ Spasic et al. (n 132).

¹⁵⁶ Spasic et al. (n 132).

¹⁵⁷ Spasic et al. (n 132).

of the factor, appears in his name and on behalf of the factor. This is a complicated transaction which allows the increase in price with the addition of the factor's profit and short term credit given to the exporter.¹⁵⁸ This allows the client to access cash even though the goods are being sold on credit while the factor receives a relatively larger commission.¹⁵⁹ 5

3. Another division of factoring business is the one where we can distinguish factoring between 'factoring with right of recovery' and the 'factoring without right of recovery'. In factoring with the right of recovery, the factor has the right towards the client in case of inability to collect the claim from the buyer, but in factoring without the right of recovery, when the buyer fails to pay, the factor has no right of claim from the client.¹⁶⁰ This latter one comes naturally with a higher commission on the transaction.¹⁶¹
4. Another default criterion is to consider factoring under jurisdictions of agreement or the territorial principle; namely domestic and international factoring. Domestic factoring, as the name itself suggests, takes place within the boundaries of a country where all the participants in factoring business are. The international factoring is intended for exporters and importers and is a kind of instrument for promoting international exchange. The exporter can finance, assure and manage the claims, and makes it easier for the importer to purchase goods from abroad. To the exporter, international factoring is ideal since he is not expected to concern himself with the creditworthiness of the buyer, the risk of non payment and socio political risks.¹⁶² The scope of the article 2(1) of the UNIDROIT Convention applies to international factoring where the client and the customer are in separate jurisdictions but the Convention is in force in both countries as well as the factor's location.¹⁶³ This depends on the territory within which the factoring contract was concluded, whether in the same country or not.¹⁶⁴
5. Factoring can be done either on a "non recourse" or "recourse" basis against the factor's client -the sellers. In non recourse factoring, the factor not only assumes title to the accounts but also assumes most of the default risk because the factor does not have recourse against the supplier if the accounts default.¹⁶⁵ For recourse factoring, however,

¹⁵⁸ Spasic et al. (n 132).

¹⁵⁹ Spasic et al. (n 132).

¹⁶⁰ Spasic et al. (n 132).

¹⁶¹ Spasic et al. (n 132).

¹⁶² Ivanovic et al. (n 6).

¹⁶³ UNIDROIT Convention, art 2(1).

¹⁶⁴ Spasic et al. (n 132).

¹⁶⁵ S Baresa & others '*Specific form of short term financing.*' (2017) UTMS Journal of Economics 8 (2)

the factoring company has a claim-recourse- against the creditor for any payment deficiency.¹⁶⁶

6. Having in mind the number of subject participants in factoring business it is possible to divide into direct and indirect factoring, in the latter, having in mind its international character, two factors appear; the export and import one; some of the divisions mentioned can mutually overlap such as indirect and international factoring.

2.6 Three basic approaches towards factoring regulation

It is important to emphasise that, in the context of the objectives of this research, the understanding of the various approaches is critical to be assessed. Factoring regulations are approached from three spheres across different jurisdiction of the markets and practice.

According to Kara, there are three paradigms to the regulation of factoring, which are outlined below:¹⁶⁷

1. Factoring markets with no regulations. These markets are usually those countries where no specific regulatory entity is mandated to oversee factoring. The factoring industry is thus regulated with the general existing legal and fiscal laws and policies-for common law jurisdictions-or national civil codes-for civil law jurisdictions.¹⁶⁸ Corporate governance rules, regulations and contractual relationships are used to govern operations of factors and their relationships with other parties.¹⁶⁹ In many emerging markets, and countries such US, UK and several other EU countries such as Belgium, Poland, Finland and France, this is the model that prevails.¹⁷⁰ This is also the factoring regulatory approach used in Ghana.
2. Factoring governed by a regulatory authority. Under this second approach, there is an established regulatory regime that governs the factoring activity of such jurisdictions and the authority in charge of that is usually the central or reserve banks of those countries.¹⁷¹ According to Kara, the authorities apply specific rules and regulation to managing the factoring industry of the countries and sometimes are placed under some

¹⁶⁶ Baresa et al. (n 165).

¹⁶⁷ H Kara 'Factoring: to regulate or not to regulate?' in M Bickers(ed) 'World Factoring yearbook' (2017) at 4 www.ebglaw.com/content/uploads/2019/07/Tatge-World-Factoring-Yearboo-2017-eBook.pdf (accessed 8 July 2019).

¹⁶⁸ J Brehcist 'The EUF legal study 2017 update ' (2018)Fourth EU Factoring and Commercial Finance Summit Athens, Greece accessed online 7 July 2019 at https://www.fci.nl/downloads/2018%20EU%20Factoring%20Summit%20Athens%20Master%20presentation_Part2.pdf .

¹⁶⁹ Kara (n 167).

¹⁷⁰ Brehcist (n 168).

¹⁷¹ Kara (n 167).

specific structure usually designated as “super regulator” to oversee the management of non financial operators.¹⁷²

3. A factoring sector with regulations. In this model, the factoring industry is managed with regulations by which it is carefully regulated by the law with some minimum qualifications to qualify an entity or legal person to engage in the industry.¹⁷³ The basic features are the requirements of minimum capital and legal standards to become a provider of the services of factoring. In such jurisdictions, the core business of factoring is preserved for the central banks; as it pertains in Russia.¹⁷⁴ Kara observes that this approach is not friendly to the progress of the factoring industry.¹⁷⁵

According to Kara, some negatives of strict regulations for the factoring system may include an increase in costs of services, tying up resources, creation of bureaucratic tendencies and becoming too prescriptive and therefore cumbersome.¹⁷⁶ Despite these fears, regulating factoring in any jurisdiction like any other financial services presents good advantages to the industry including raising of standards, enhancement of professional conduct, promotion of transparency, mitigation of risk and improvement of customer confidence.¹⁷⁷

2.7 Conclusion

The concept and practice of factoring is not a present day phenomenon, and its implications for business is not in doubt. The evolution of the industry over the decades points to its robustness and tested influences on business development across the globe. The scale of capital involved is way beyond billions of dollars and culminates into supporting arrays of enterprises in various segments of private businesses. The positive impacts of factoring on SMEs far outweigh the negatives. It is obvious in the present socio economic environment that, startups, business innovations, private sectors activities and SMEs drive will continue to dictate the pace of the world’s agenda for transformation to eliminate extreme poverty and inequality issues. The oil that keeps these segments wheeling is the fluid of finance, and any impediment must be treated as an enemy of this progress. To consider factoring as one source of finance that has filled the space of lack of finance for fueling these sectors is not an exaggerated perceptive. Factoring provides the needed cashflows to these enterprises without the traditional deposits of collaterals and third party guarantees that are associated with loans and overdrafts.

¹⁷² Kara (n 167).

¹⁷³ Kara (n 167).

¹⁷⁴ Kara (n 167).

¹⁷⁵ Kara (n 167).

¹⁷⁶ Kara (n 167).

¹⁷⁷ Kara (n 167).

In chapter three, the focus will underscore the financial challenges of SMEs and why factoring must be a prudent alternative for trade finance as against loans and overdrafts from the banks. The unique position of factoring in present international trade finance for SMEs will be attended to under the following chapter.

CHAPTER THREE

SMEs FINANCING: FACTORING, LOANS AND OVERDRAFTS

3.1 Introduction

The previous chapter explained factoring as a concept and related features. This chapter will outline some challenges facing SMEs. It will also compare factoring with bank lending avenues commonly available to SMEs as well as the uniqueness of factoring in terms of its flexibility and accessibility. The chapter aims at pointing out the benefits of factoring as well as its challenges as an alternative means of finance in contrast to the traditional lending modes -with emphasis on loans and overdrafts. Due to lack of information and misconceptions, SMEs are still oblivious of the advantages factoring offers as against bank credit facilities that usually come with stringent requirements. Banks are generally reluctant at giving loans and overdrafts to SMEs for various reasons. The contrast must be established to assist enterprises in making timely and conscious option for factoring to access the needed financing.

3.2 Financial challenges of SMEs

Experts have alluded that in most emerging economies, where there are weak financial systems, SMEs are confronted with significant hurdles in accessing capital from financial institutions.¹⁷⁸ Baresa et al. have confirmed that SMEs usually ‘fall short of working capital and cash flows.’¹⁷⁹ They contend that this quagmire pushes even larger enterprises as well as the majority of SMEs to rely on factors for optimum cash supply.¹⁸⁰ Evidence points to the fact that commercial banks will, almost all the time, demand secured collaterals before granting loans to enterprises.¹⁸¹ Kaufman has postulated that:

SMEs are weak in Africa because of small local markets, undeveloped regional integration and very difficult business conditions, which include cumbersome official procedures, poor infrastructure, dubious legal systems, inadequate financial systems and unattractive tax regimes.¹⁸²

Kauffmann continues to point out that SMEs in Africa barely have access to finance, which hampers their growth and expansion.¹⁸³ She argues that this finance gap can be attributed to

¹⁷⁸ D Chardon ‘ICC endorses UNCITRAL Convention on the Assignment of Receivables in International Trade’ Paris 22 December 2014 at <https://iccwbo.org/media-wall/news-speeches/icc-endorses-uncitral-convention-on-the-assignment-of-receivables-in-international-trade/Clio> (accessed on 27 July 2019).

¹⁷⁹ Baresa et al. (n 165).

¹⁸⁰ Baresa et al. (n 165).

¹⁸¹ O Olufunso Fatoki & A Van Aardt Smit ‘Constraints to credit access by new SMEs in south Africa: a supply-side analysis’ (2011), Vol. 5(4) African Journal of Business Management at 420 <http://www.academicjournals.org/AJBM DOI>.

¹⁸² C Kauffmann ‘Financing SMEs in Africa’ Policy Insights No.7. OECD Development Centre. Derived from the *African Economic Outlook 2004/2005*: A joint publication of the African Development Bank and the OECD Development Centre.

¹⁸³ Kauffmann (n 182).

the high default risk associated with SMEs and inadequate alternative financial products on the market.¹⁸⁴

The problem of liquidity and solvency of SMEs is not a current phenomenon.¹⁸⁵ The challenge of business growth to achieve its desired impacts has regularly been reported as access to liquidity and unimpeded finance.¹⁸⁶ The alternative to this challenge to accelerate the opening of new enterprises, develop, upgrade and expand existing ones is through a reliable credit system. Factoring serves as a better alternative to the traditional means of financing by allowing SMEs to achieve liquidity and solvency.¹⁸⁷ Ivanovic et al. has quoted Kallbergh and Parkinson¹⁸⁸ to define liquidity as ‘financial solvency of a company and can be expressed as the liquidity of asset as well as corporate liquidity or solvency.’¹⁸⁹

Insolvency occurs when the company fails as a duty to make payments on its financial obligations when due. Ivanovic et al. defined insolvency as ‘the situation when business entity is unable to settle its financial obligations.’¹⁹⁰ They argue that one crucial indicator of the performance of a business is its liquidity or solvency,¹⁹¹ and explain that a receivable can be liquid if ‘it can be sold in short time without significant loss.’¹⁹²

Generally, it is the duty of the creditor-exporter, client-to realise his payments in debt, but that responsibility shifts to the factor after the purchase of the account receivables (invoices).

In the *Tay Valley Case*,¹⁹³ the issue of whether the export factor has a remedy in the jurisdiction of the exporter in case of insolvency was held on the contrary. Even though the factoring contract provided that the English law was to be the governing law, the lawyers of the parties were unanimous by accepting that the Scottish law must be the law to govern the agreements because most of the debtors to the exporter filing insolvency were Scottish. This judicial outcome was expected to guide future agreements to that effect, especially in respect of the two-factor system, which has become part of the international trade system. This signalled the factor to be up

¹⁸⁴ Kauffmann (n 182).

¹⁸⁵ Ivanovic et al. (n 6).

¹⁸⁶ Ivanovic et al. (n 6).

¹⁸⁷ Ivanovic et al. (n 6).

¹⁸⁸ JG Kallbergh and KL Parkinson *Corporate liquidity: management and measurement* (Richard D. Irwin, Inc 1993) Homewood, Illinois.

¹⁸⁹ Ivanovic et al. (n 6).

¹⁹⁰ Ivanovic et al. (n 6).

¹⁹¹ Ivanovic et al. (n 6).

¹⁹² Ivanovic et al. (n 6).

¹⁹³ *Tay Valley Joinery Ltd v T Financial Services Ltd S.L.T. (1987) 207.*

to date with his knowledge about the legal framework of the importer's country before any such agreement is effectuated.¹⁹⁴

However, the position of the law in the *Tay Valley Case*¹⁹⁵ has been improved, given priority to the location of the exporter to determine the governing law in conflict situations during the making of the agreement under some conditions such as to meet the requirements of some countries where the debtor is located in order to have such priority.¹⁹⁶ The implication is that the cost of the transaction is increased through such processes. It has been intimated that the choice of law of the exporter is to provide 'a single point of reference and one that can be ascertained easily.'¹⁹⁷ This suggests that the law governing the assignment of the receivables and that of the insolvency proceedings must be of the same jurisdiction, basically, of the location of the registered office or residence of the creditor or exporter. The rights of the factor must be protected as against the administrator of the insolvency of the creditor and his judgment creditors.¹⁹⁸

Bazinas has posited that,

meeting the requirements of law of a number of countries for the assignment to be valid inter parte and effective *erga omnes* normally involves considerable time and cost, and may often be impossible- mainly because the identity of a debtor or third -party creditor may not be known at the time of the assignment of future receivables.¹⁹⁹

For example, as he illustrates, an assignment set in country 'A' may not be enforceable against a debtor in country 'B' because the rules of notification in the laws of country 'B' did not adhere.²⁰⁰ He states further that legal regimes governing factoring 'is either uncertain, fragmented or outdated.'²⁰¹ The differences in the laws across various countries and the absence of a compendious and up to date rules to govern factoring have increased the constraints facing the industry and international trade financing.²⁰²

¹⁹⁴ Salinger (n 139).

¹⁹⁵ *Tay Valley Case* (n 193).

¹⁹⁶ SP Bazinas 'An international legal regime for receivables financing: UNCITRAL contribution' (1998) Vol.8:315, Duke Journal of Comparative and International Law at 351.

¹⁹⁷ Bazinas (n 196)351.

¹⁹⁸ Bazinas (n 196).

¹⁹⁹ Bazinas (n 196)320.

²⁰⁰ Bazinas (n 196).

²⁰¹ Bazinas (n 196).

²⁰² Bazinas (n 196).

3.3 Traditional lending terms and conditionalities

Beck and Culld have stated that one of the looming obstacles of SMEs is the difficulty to access lending services on the financial market.²⁰³ The duo argues further that the reason can be attributed to the closed, limited, fewer but expensive financial services available to the enterprises.²⁰⁴ According to Flynn²⁰⁵ and Beashel, at the recent international law conference in Berlin, Germany on 16 May 2019, the difficulty for SMEs accessing finance was a major issue for discussion at the panel discussion by the International Bar Association's (IBA) international financial law conference.²⁰⁶ According to them, the focus of the panel was on alternative financing which was widely interpreted to include 'lending by alternative finance providers such as insurers, pension fund, and lending by non-traditional means such as marketplace lending'.²⁰⁷ The observation of the conference was that there is a movement away from traditional banks by SMEs for financing to other modes of finance, aside factoring.²⁰⁸ The difficulty the conference identified, however, was the fact that those other forms also have challenges because;

they have not a credible history of practice and legal frameworks in the same way as factoring which has been practised for over a century and developed the legal mechanisms and jurisprudence to serve as the best alternative scheme of finance to the traditional sources of finance which is usually taken from the banks.²⁰⁹

This conclusion by the conference of the IBA gives credence to the position that, unlike other alternative financings, factoring holds an excellent record of being the most reliable alternative to traditional lending facilities such as loans and overdrafts. In the estimates of Burns, banks will not distinguish between the terms attached to lending to SMEs and lending to managers of small business owners in their capacities.²¹⁰ The "CAMPARI" as identified by Burns, has become the most used "terms" required by the banks before lending.²¹¹ This concept denotes character, ability, margin, purpose, amount, repayments, insurance and it is exemplified thus:

²⁰³ T Beck and R Culld 'SME finance in Africa' (2014) Vol. 23, number 5, Journal of African Economies.

²⁰⁴ Beck & Culld (n 203).

²⁰⁵ Liam Flynn is a partner of the Matheson Financial Institution Group who co-chaired the panel discussion of the International Bar Association's international financial law Conference held in Berlin, Germany on 16th May 2019.

²⁰⁶ L Flynn & J Beashel 'Germany: International financial law conference, Berlin Germany 2019' 3 July 2019 Matheson Article accessed online 15 July 2019 at <http://www.mondaq.com/germany/x/811816/Financial+Services/International+Financial+Law+Conference+Berlin+Germany+2019> .

²⁰⁷ Flynn & Beashel (n 206).

²⁰⁸ Flynn & Beashel (n 206).

²⁰⁹ Flynn & Beashel (n 206).

²¹⁰ P Burns 'Entrepreneurship and small business start-up, growth and maturity' (Palgrave Macmillan Education 2016) Fourth edition.

²¹¹ Burns (n 210).

- **Character:** Every bank given out a facility will need to know about the credit record and worthiness of the manager of the business as well as his honesty and personal integrity.
- **Ability:** The capacity to repay according to the conditions accompanying the agreement is of utmost interest to the lending bank. The management's profiling is paramount in this case.
- **Margin:** Banks will always assess and consider how much they will make as profit from the processing fee, the interest rate chargeable at the time and how far the prepayment schedule will prevail.
- **Purpose:** The lending financial institution will of necessity require to be convinced that the reasons for the facility align with its mandate and that the loan is for the right course. Every bank will go a step further to be satisfied that the facility is not going to service personal "projects" but to shore up the capital needs of the business.
- **Amount:** The amount of money requested must always be accompanied with a plan or budget that must cover the rationale of the project or programme, the preparations and a contingency plan.
- **Repayment:** The bank's focus when advancing loan is to make sure it is repaid with all the terms met. The project must convince the bank as viable to repay from its proceeds. There must be a realistic proposal for repayment to convince the bank.
- **Insurance:** The bank's utmost security of repayment of money given out is the satisfactory collateral attached to the application. It may demand an additional guarantee in the form of personal security from the borrower. In some transactions, a formal insurance cover may be required from a certified and credible insurance company to take up the risk of non payment of both principal and interest on behalf of the borrower.

3.3.1 Loans

A loan is a financial facility extended by a bank to an individual or business, usually to be repaid with fixed interest later scheduled as part of the agreement.

There are different reasons why SMEs would rely on loans as means of financing their businesses, namely; to acquire additional working capital, for the lease of equipment, for business expansion, to balance their books and for short term financing purposes. Depending on the purpose, loans can be classified as secured or unsecured; the former being the most common form of loans offered by banks which caters for short and long term loans, auto and real estate facilities; and the latter covering credit card, personal loan or short term borrowing.²¹² Both

²¹² DJ Hoare *'The different types of bank loans'* (2013)

secured and unsecured forms of loans demand a personal guarantee from the SME operators to certify that they can repay on schedule²¹³, but a secured loan will require additional security or collateral from the borrower.

The fact is that businesses in Africa generally encounter challenges to access loans as compared to other developing countries in other parts of the world.²¹⁴ The challenge of getting lending services apply to enterprises relative to their sizes and ages. It has been observed that businesses in SSA countries are less likely to rely on bank loans as pertains in other parts of the world.²¹⁵ This explains the reason why most African businesses see limited access to bank loans as a critical barrier to their development and growth.²¹⁶

Beck and Culld argue:

Collateral requirements also seem to be more of an impediment in Africa than in other regions of the developing world. Collateral requirements have been well documented as one of the main impediments that prevent African SMEs from accessing traditional forms of financing needed to acquire machinery and equipment.²¹⁷

Every loan facility requires a loan agreement between the lender-the bank-and the borrower - the customer-which details the terms and schedule of repayment.²¹⁸

According to Merritt, a typical bank loan has the following conditions:

- The principal, or the amount to be borrowed.²¹⁹
- The interest rates the bank will charge on loan.²²⁰
- Whether the borrower is offering any collateral for the loan-collateral is a property that the bank can seize if he fails to repay the loan. With mortgages and auto loans, the collateral is usually the home or car that he borrowed the money to buy.²²¹
- The repayment schedules. Usually, the borrower will make a series of payments over time, with each payment made up partially of principal and part of interest. The repayment schedule could cover just a few months or years, as with a personal loan, or it could last for decades, as with a home mortgage.²²²

Finance <https://businessecon.org/2013/02/19/the-different-types-of-bank-loans/> (accessed on 21 July 2019).

²¹³ Hoare (n 212).

²¹⁴ Beck & Culld (n 203).

²¹⁵ Beck & Culld (n 203).

²¹⁶ Beck & Culld (n 203).

²¹⁷ Beck & Culld (n 203).

²¹⁸ C Merritt 'What is a bank loan?' Sapling accessed online 26 July 2019 at <https://www.sapling.com/4679926/what-bank-loan>.

²¹⁹ Merritt (n 218).

²²⁰ Merritt (n 218).

²²¹ Merritt (n 218).

²²² Merritt (n 218).

These conditions have set factoring apart as being business friendly, less demanding and supportive for SMEs as compared to loans, even though factoring comes with some minimal conditions necessary to qualify a borrower to access the services.

Factoring, on the other hand, presents some economic benefits that give it some advantages over loans. First, factoring provides liquidity to fund business entities by transforming their short term assets in the form of receivables to cash without providing collaterals or long term securities.²²³ Again, the creditor is absorbed from any risk of insolvency from the factor where a factor takes responsibility for receivables payments and disclaims any right to claim a refund to the client in case of non payment by the debtor.²²⁴ All the services and management of receivables of the client become the responsibility of the factor, including contacts to the final debtor, solvency test, testing debtor credibility and creditworthiness.²²⁵

In contrast to loans, factoring is an instrument that offers an efficient and straightforward financing model to assist SMEs in domestic and foreign transactions.²²⁶ It is an effective and reliable intervention as short term financing facility to SMEs which are eager to expand their operations but are incapable of getting credits from a bank.²²⁷

3.3.2 Overdrafts

Overdrafts are soft loan arrangements linked to the customer's current accounts wherein the bank allows the customer to draw on his account over and above his outstanding balance. The condition precedent for this facility is to be an account holder of the bank and have a guarantee of the regular flow of income into the account.

It is defined as ‘a specified amount of money that a bank customer is allowed to owe his or her bank. In most cases, these arrangements are temporary.’²²⁸

Like loans, overdrafts come with some costs, terms and conditions and require a customer to do some careful assessment before using this for long term financing because overdrafts by their nature are interventions for short term necessities when an account is drawn on zero. An overdraft can be classified as (a) authorised (planned) or (b) unauthorised (unplanned). With an authorised overdraft, the amount to access is set and agreed before withdrawal with a fee. An unauthorised overdraft occurs when a customer exceeds the authorised limit and has a

²²³ Ivanovic et al. (n 6).

²²⁴ Ivanovic et al. (n 6).

²²⁵ Ivanovic et al. (n 6).

²²⁶ Ivanovic et al. (n 6).

²²⁷ Ivanovic et al. (n 6).

²²⁸ Market Business News ‘*What is an overdraft? definition and meaning*’ accessed online 28 July 2019 at <https://marketbusinessnews.com/financial-glossary/overdraft-definition-meaning/>.

negative or zero balance but proceeds to draw on the account.²²⁹ It is usually expensive and comes with higher interest and must be avoided.

It is argued that ‘factoring is a suitable alternative to an overdraft facility.’²³⁰ The banks are staying away from offering overdraft facilities because of judicial outcomes on cases involving such transactions.²³¹ Some of the advantages of factoring over overdraft resulting in enterprises resorting to the former are that:

- Factoring is a flexible form of finance that grows in line with a business’ sales.
- Factoring offers a credit management service that frees up valuable time to grow a business.
- Factoring helps to collect debts quickly, which improves cash flow and reduces the risk of bad debts.
- Factoring can also include credit protection, which can eliminate the risk of bad debts.²³²

By overcoming the strict demands of overdraft facilities, factoring is considered as a financial service that can mitigate the difficulties that generally confront SMEs in seeking finances.

Baresa et al. describe factoring as:

A funding model allows inflow of funds before maturity claims, and thus facilitates the increase in current assets, continuous operations, improves cash flow, ensures the smooth functioning, improves competitiveness and collection of receivables and collectability risk as well as exchange rate risk becomes a problem that bears factoring company.²³³

Through factoring companies, many SMEs can enter into international trade arrangements with their credit risk borne by the factor.²³⁴

Reisman concludes that factoring is a century old service that possesses customised characteristics with flexible, adaptable commercial terms helping SMEs to record astounding growth in their operations.²³⁵

3.4 Benefits and challenges of using factoring

In factoring, the factor acquires the client’s receivables, with or without recourse at a discount and takes over the task to collect payments from the debtor.²³⁶ Becks and Cullid posit that both domestic and international factoring has become popular because exporters or creditors are

²²⁹ (n 228).

²³⁰ ‘Factoring vs overdraft facility’ accessed online 28 July 2019 at <http://www.invoicefactoringquotes.co.uk/factoring-vs-overdraft-facility/>.

²³¹ (n 230).

²³² (n 230).

²³³ Baresa et al. (n 165)120.

²³⁴ Baresa et al. (n 165).

²³⁵ Reisman (n 107).

²³⁶ Beck & Cullid (n 203).

relieved from the burden of chasing repayments after sales.²³⁷ Asselbergh asserts that trade credit must be accessed by businesses with little support from the financial markets, meanwhile, the cost of this credit to the supplier is usually unbearable and constrains such access.²³⁸ The solution, according to Asselbergh, is by using factoring;²³⁹ a decision he argues is a ‘pure decision variable from the supplier’s point of view.’²⁴⁰ He concludes thus;

factoring is confirmed to be a real alternative financial resource. Factoring is, indeed, most frequently used by small and medium-sized companies. Also, our findings indicate that younger companies with seasonal sales figures and high capital expenditures use factoring more often. Our research rejects the prejudice about factoring being a last resort means of finance.²⁴¹

Wilde asserts that ‘factoring is recognised as offering significant advantages to small and medium sized businesses around the world, even though the industry is relatively underdeveloped in Africa.’²⁴² He reveals that the use of factoring grew up to about UK£5billion to almost UK£23billion in 2002 on the African continent.²⁴³ This constitutes a trend that can be followed through to encourage stakeholders to enact and fashion out the appropriate legislation and legal environment necessary to develop and expand factoring in trade financing in Ghana.

Priest-Stephens and Kameni have posited that there is an increasing awareness about factoring because traditional finance schemes as a means of trade finance are not able to meet the needs of the growing economies and that leaves businesses to look elsewhere for funding.²⁴⁴ Again, factoring is deemed as offering some critical advantages to SMEs across the globe, even though its prevalence in Africa remains a challenge.²⁴⁵

According to the European Bank for Reconstruction and Development (EBRD);

factoring is particularly useful for providing SMEs with access to working capital. Pricing is usually based on the credit standing of the SME’s biggest customers and is thus insulated from the problems commonly associated with SME finance: information asymmetry and lack of appropriate security.²⁴⁶

²³⁷ Beck & Cullid (n 203).

²³⁸ G Asselbergh ‘Financing firms with restricted access to financial markets: the use of credit and factoring in Belgium’ (2002) *The European journal of finance* 8 at 2-20.

²³⁹ Asselbergh (n 238).

²⁴⁰ Asselbergh (n 238).

²⁴¹ Asselbergh (n 238)18.

²⁴² E Wilde ‘*The Africa Factor*’ in L Priest- Stephens and E Kameni ‘*Prospects for a model law on factoring in Africa*’ (2016) *Building a Model/Trade and Factoring Review*.

²⁴³ Wilde (n 242).

²⁴⁴ Kameni (n 8).

²⁴⁵ Priest-Stephens & Kameni (n 13).

²⁴⁶ European Bank for Reconstruction and Development ‘*Access to finance reforms*’ accessed on 26 June 2019 at <https://www.ebrd.com/what-we-do/legal-reform/access-to-finance/factoring.html>.

Klapper has advanced that, factoring provides essential services to the export sector activities in countries,²⁴⁷ and plays the same role as traditional lending schemes by providing SMEs with working capital financing.²⁴⁸

The EU Federation (EUF)²⁴⁹ for factoring and commercial finance has given the following as the benefits of factoring to all players in the industry:

For SMEs:²⁵⁰

- i. A source of working capital that does not require an established business or significant other assets, the level of funding available is directly proportional to the level of sales the business makes and the debt outstanding. This means that unlike traditional financing, the facility user does not need to be renegotiated in times of growth.
- ii. The opportunity to outsource the labour-intensive administrative functions outsourcing of collection and sales ledger management.
- iii. The opportunity to separate sales relationships from collection activities.
- iv. A form of funding that usually provides a higher level of finance than traditional lending and does not usually require extra security or collateral.
- v. The opportunity to protect against bad debt.

For large corporates and multinationals:²⁵¹

- i. The same finance and outsourcing benefits as for SMEs are enjoyed.
- ii. For large businesses, the finance is generally offered with fewer operating and performance conditions (covenants) compared to other forms of funding. It also allows linking to more extensive asset based lending, where other assets of the business are also included and contribute to the finance package.
- iii. Not based on balance sheet strength, but on current performance.
- iv. It can raise more working capital than traditional lending approaches.
- v. It is an opportunity to protect against bad debt.
- vi. It can help support restructuring, merger and acquisition activity.

For factoring and commercial finance providers:²⁵²

²⁴⁷ Klapper (n 120).

²⁴⁸ Klapper (n 120).

²⁴⁹ The EUF is the representative body for the factoring and commercial finance industry in the EU. It comprises national and international industry associations that are active in the EU accessed online 26 June 2019 at <http://euf.eu.com/glossary-and-translator.html>.

²⁵⁰ EU Federation 'Factoring and commercial finance: an introduction' accessed online 29 July 2019 at <http://euf.eu.com/glossary-and-translator.html>.

²⁵¹ EUF (n 250).

²⁵² EUF (n 250).

- i. Factoring solutions allow the factor to advance relatively more funds, more securely than a traditional lending product.
- ii. Factoring or invoice finance is a low loss given default solution; this improves returns, supports competitive pricing and can reduce the factor's cost of capital.
- iii. The EU Federation's White Paper shows that the losses are around four times lower than traditional financing loan products.

In the view of all stakeholders, the advantages accrued from the uniqueness of factoring solution to businesses are overwhelming.²⁵³

Wilkinson also states that factoring as a form of secured finance scheme is significantly different from a bank loan in three main ways, which make factoring more reasonable and friendlier to businesses and their operations.²⁵⁴

1. First, the contract depends on the worth of the invoices and not on the creditor's creditworthiness.
2. Secondly, it is never comparable to a loan, instead, it is the contract of sale and purchase of the invoice receivables.
3. Lastly, loans from banks have two parties-the banks and the customer, but factoring is an interplay among three parties-the creditors, the factor and the debtor.²⁵⁵

Spasic et al. have posited that:

Apart from financing, an important aspect of factoring organizations' dealings for the client is in the fact that factoring organizations are well acquainted with the state of liquidity of participants in the market, therefore the use of their services (for the client) significantly lowers the risks of claim collection; risks are of course taken over and beard by factoring organizations. Seen from the economic point of view, by taking over the collection of demands (even in the cases when creditors and debtors are barely solvents), factors influence the raising of general liquidity level of commercial subjects and the economy in general where they also improve the security of business, especially when it is a case of international transactions (which are by the way even more complicated).²⁵⁶

Orheian identified some of the benefits of factoring as follows:²⁵⁷

²⁵³ EU Federation (n 250).

²⁵⁴ Wilkinson (n 91).

²⁵⁵ Wilkinson (n 91).

²⁵⁶ Spasić, et al. (n 132).

²⁵⁷ OM Orheian *'The advantages of using factoring, as financial technique on international transaction market'* (2012) Volume IX, Economy, Commerce and Tourism Series.

Factoring requires a small number of procedures in accessing the product through a commercial contract. This demands a standard form completion containing and requiring basic data on the parties and their entities involved in the contract.

Unlike a loan which puts the burden of cost on the facility on the supplier, in factoring, the financing cost of the facility is borne by the debtor as the latter takes up the cost of interest and the commission charged by the factor.

The documentation required in factoring transactions is not nebulous as needed for taking other credit facilities such as loans.

Factoring allows the creditor to get the needed capital to continue his business to reduce the cycle of the *fond de roulement* by the immediate payment of bills by a single financing institution and not by the great number of customers.²⁵⁸ This allows the adherent to pay attention to the running of the business to benefit from the success of the business. The period for getting a funding facility is reduced as compared to a traditional credit period.

There is also the avoidance of risk by the creditor in case of insolvency experienced by the debtor company because all risks in this sense are those of the factor. Orheian intimates that the compelling advantages of factoring cannot be matched with the small proportion of disadvantages associated with the product.²⁵⁹

Indeed, the benefits of factoring far outweigh the challenges associated with factoring. Most importantly, is the fact that there is an improvement of the creditor's cash flow and the reduction of default risk in times of delay or non payment by the debtor.²⁶⁰

To confirm Orheian's position,²⁶¹ Ivanovic et al. identified some challenges associated with factoring that are dwarfed by the numerous advantages,²⁶² but which need mention in this work: First, the overuse of factoring and the reliance on a factor by sellers may cause business partners to lose direct contacts, which may negatively impact on management and trading communications. Businesses are built on trust and confidence. The interventions of middlemen like factors could be reasons to interrupt such relationships if these contacts are not well managed by the parties.

Second, invariably, the costs inherent in factoring services are higher than the costs of the bank loans. Even though it is relatively easier and friendly to get funding under factoring, its cost effects are generally higher as it takes the creditor to accept or forgo substantial sum of his

²⁵⁸ Orheian (n 257).

²⁵⁹ Orheian (n 257).

²⁶⁰ Baresa et al. (n 165).

²⁶¹ Orheian (n 257).

²⁶² Ivanovic et al. (n 6).

income in debt as a discount to the factor. The client may usually also forgo a substantial part of his income, considering all fees and discounting involved.

Third, in a two-factor system, the exporter must ensure that he avoids disagreement with the customer in terms of product quality. This is an undertaking which the exporter must be concerned about to avoid rejection on delivery so that his contract with the factor is honoured.

Fourth, in some instances, some customers of the seller may not want the involvement of third parties-factors- in their transactions, and this can hamper the timely and efficient business flow. Where this occurs, a potential loss of current and future business contacts may be the result for the seller.

Last, it must be noted that the product cannot be a panacea to all business challenges as a form of short term financing. Despite its numerous merits, the contract of factoring is only possible on the assurance that the creditor is solvent on the evidence of the receivables.

3.4 Conclusion

Traditional bank lending services such as loans and overdrafts have always been undertaken with a critical assessment to avoid the risk of losing capitals to unsecured borrowers. Even though loans and overdrafts, among other means of financing SMEs, have long been the readily available options, they have always been characterised by strict terms which prevent most SMEs from accessing. Factoring comes as a less onerous option, which is suitable and friendly alternative to fill the gap created in financing SMEs. The benefits factoring presents, along with the limited challenges, are better option for businesses to rely on promoting and advancing their business concerns. The conditions attached to invoice discounting excludes imposition on how funds are utilised by the client as it is in the case of bank loans or overdrafts.

The inflexibilities occasioned by bank loans and overdrafts affects a business's venture to diversify if the opportunity avails to stay within the agreement of the facility. Factoring improves and supports innovation as the creditor is unrestrained to apply his income in other ventures that may yield better dividends. Unlike traditional lending, factoring application processes are not cumbersome and has less demand for documentations that delay the release of funds eventually.

The underlined challenges of factoring can in no way compare to the ease that comes with the process of securing the needed funding for operations under factoring.

In the next chapter, the existing legal and regulatory framework governing the factoring industry and SME finance will be evaluated. The laws will be analysed to identify where attention

will be required to build a legal environment conducive to support businesses to lead the “Ghana Beyond Aid”²⁶³ policy of the government of Ghana.

²⁶³<http://www.ghana.gov.gh/index.php/news/5410-president-akufo-addo-recieves-roadmap-on-ghana-beyond-aid> (accessed on 29 July 2019).

CHAPTER FOUR

TOWARDS A LEGAL FRAMEWORK FOR FACTORING IN GHANA: THE SHORT-FALLS IN FACTORING LAWS OF GHANA

4.1 Introduction

In Ghana, there is no legal framework for factoring. What is generally applied to activities of factoring is the adaptation of extant banking and commercial laws of Ghana.²⁶⁴

Indeed, in jurisdictions where there is no such factoring law to regulate such activities, there is the certainty of a challenge in defining the concept. For example, in the South African *First Rand Bank Case*,²⁶⁵ the court had to deal with a legal issue on factoring contract but grappled with defining the concept of factoring with no reference to any specific legal framework on factoring throughout the ruling. Ghana has not yet had any reported judicial precedence on factoring dispute in this regard. This presents a challenge to identifying the legal connection between factoring and the general concepts of the laws.²⁶⁶

This chapter will take a theoretical analysis of the various laws, regulations and institutional frameworks that relate to the factoring industry in Ghana and argue that the lack of a specific legal framework for factoring is a setback for the promotion of SMEs. It will propose that in the absence of definite laws regulating factoring, a new legal framework should be the way forward.

4.3 Legal framework governing factoring in Ghana

Salinger argues that the essence of legal framework specific to factoring is to delineate and define the concept and identify the rights, duties of those who engage in such factoring contracts.²⁶⁷ It has been suggested that a detailed and elaborate law is necessary to ‘define the term factoring and establish the rights, duties and obligations of various parties involved in such transactions.’²⁶⁸ Another point of view suggests that in a country where the expectation of an omnibus legal enactment would delay, the industry must be encouraged to function within the ambience of the existing legal architecture to allow the system to evolve naturally.²⁶⁹ It is considered that this later opinion will not help within the space of growing global push for effective

²⁶⁴ The related laws of factoring in the Banking Laws of Ghana: The Company Act, 1963 (Act 179), The Banking Act, The Banking (Amendment) Act, 2008 (Act 738), The Borrowers and Creditors Act, 2008 (Act 773), The Non-Bank Financial Institution Act, 2008 (Act 774), The Banks and Specialised Deposit Taking Institution Act, 2016 (Act 930).

²⁶⁵ *First Rand Bank v Consolidated Timber Exports Close Corporation and Others 2015 2743 (HC) Natal Division.*

²⁶⁶ Salinger (n 139).

²⁶⁷ Salinger (n 139).

²⁶⁸ Salinger (n 139).

²⁶⁹ Kara (n 167).

regulations for trade and business concerns. There is also the need to have the certainty to critical legal issues in unified codes or laws to govern modern finance and business transactions to prevent avoidable litigations and delays that are inimical to the mercantile environment.

Again, factoring is a complicated and a worldwide phenomenon which must be defined to suit a particular jurisdiction and its legal system; either in civil law, common law or other jurisprudence. The assertion leads to the consideration of the principle of conflict of law in the context of international trade practice, where the exporter's home laws are deemed to govern the undertaking with an importer from a different jurisdiction in a dispute situation. This contentious issue of where an export factor and import factor have the appropriate jurisdiction under a conflict of laws has not been settled. The solution to this lacuna was to seek a compromise or to have explicit provisions in the initial agreement between the exporter and the importer when factoring is contemplated as a custom of their trade. According to Salinger, debt has been deemed as an intangible trade object and cannot be confined to a locality, so judicial rules are needed to guide such intangibles.²⁷⁰

Kameni has argued that factoring in Africa generally lacks behind in terms of scope, legislation development and in practice as compared to some countries in the global North.²⁷¹ A country of common law practice such as Ghana will look to the judgments of the courts together with other laws operating to create a regulatory framework in which factoring will survive.

Across the continent, it is estimated that the average growth of factoring stands at about 14.2 % annually.²⁷² The argument has been advanced that this unfortunate trend is due to various factors. According to Kameni, the reasons include the fact that there is not the body of case law for adaption over the last century to guide the factoring product.²⁷³ To Awani, the reasons for this trend can also be attributed to the following:

1. African countries turn to rely on traditional means of finance products for funding and therefore, the release of cash flow from debts has not ordinarily been welcomed as a form of financing.²⁷⁴
2. Another reason is focused on the lack of knowledge on the product by market players. Factoring providers are unwilling to avail their services to companies in Africa due to the challenge of insufficient knowledge on the facility. This situation can be attributed

²⁷⁰ FR Salinger *'Factoring law and practice'* (Sweet and Maxwell 1991), London at 259.

²⁷¹ Kameni (n 8).

²⁷² BO Oramah *'From the periphery to the centre-Africa as the growth market for factoring'* African Development Bank.

²⁷³ Kameni (n 8).

²⁷⁴ Awani (n 76).

to the general lack of a regulatory framework to safeguard such international factoring entities and their investment to avoid the risk associated with it. It is suggested that to remedy this is to partner local organisations with greater awareness of local regulations and customs of trade and finance to gradually integrate the model into the African business environment.

3. It is not common to encounter local factoring lenders in Africa, especially in countries like Ghana, who are willing to and available to make such facilities to SMEs. It is unusual for businesses to look up to factoring as a means of financing their trade.
4. Where there is the minimal sight of credit insurers, the supply of funds under factoring is likely to be remote because factoring providers are not risk averse and will usually seek to secure their investment. By protecting their investments, factors are less attracted to jurisdictions where credit insurance is not available. To a considerable extent, this single reason accounts for a substantial challenge facing the factoring industry in countries such as Ghana.
5. Overdraft and loans facilitation and management are fundamentally difficult, unlike factoring. However, businesses in the traditional African setting are mostly oblivious of the existence of this financing scheme due to the low level of awareness about factoring as a credible resort for distressed companies. That counts for the abysmal patronage of the product.²⁷⁵

Within all these factors, however, people have begun to appreciate the contribution all small firms make to the economies of their countries²⁷⁶ The call has been made for African countries to have robust laws to support the growth of factoring to help access to finance by SMEs much easier.²⁷⁷

The development of factoring occurs in a variety of legal and regulatory environment according to individual countries.²⁷⁸ Ghana has a purely common law legal system with legal pluralism persisting from precolonial times till today,²⁷⁹ which is moderated by an elaborate choice of law rules.²⁸⁰ It has one of the most tested democratic credentials in Africa, and the rule of law

²⁷⁵ Awani (n 76).

²⁷⁶ Burns (n 210).

²⁷⁷ F Tchibota 'Afreximbank ties factoring's growth in Africa to strengthened legislation' Afreximbank Press Release Nairobi 2 February 2017 accessed online 26 August 2019 at <https://www.afreximbank.com/afreximbank-ties-factorings-growth-in-africa-to-strengthened-legislation>.

²⁷⁸ Kara (n 167).

²⁷⁹ V Essien 'Researching Ghanaian law' (2005) Hauser Global Law School Program accessed online 7 June 2019 at <https://www.hyulawglobal.com/index.htm>.

²⁸⁰ Essien (n 279).

is practised. Businesses are governed by various legal frameworks and regulations. Kara has argued that, usually, factoring begins in a country where there is no factoring law, and the existing laws are applied and interpreted.²⁸¹ The challenge, however, is that existing law applied to factoring situations may lack the fundamental concepts and terms such as “receivables”, “assignments”, “the factor’s rights” and so on,²⁸² which terms are so fundamental in understanding the industry to apply to players, their rights and responsibilities.

For this reason, Kara suggests that, where factoring is a new concept, or there are gaps or difficulties within the legal framework for the assignment of receivables, then there is a need for the enactment of a factoring law which defines the product, to raise the profile of factoring and to determine the rights and obligations of the parties.²⁸³ In line with Kara’s recommendation,²⁸⁴ and given Ghana’s standing in the factoring industry,²⁸⁵ enactment of new legislation to govern the industry will be most appropriate because factoring is a complex enterprise that needs to take advantage of the new developments in the industry to meet the exigencies of the times. It is always recommended that existing models such as the International Factors Group (IFG) and Afreximbank model laws inform the development of local legislation and regulations which seeks to raise the profile of such regulations and to define the good practice.²⁸⁶

4.3.1 The Banking Act, (2004) Act 673, amended by Banking Act (2007) Act 738

The banking sector of Ghana is considered the second largest in the West African monetary zone, recording rapid growth within the last few years.²⁸⁷ This has been partly due to the privatisation of the sector which was, until the 1990s, state owned and managed.²⁸⁸ The entry of the private actors has culminated in a well capitalised sector with new minimum capital requirements for new and existing players.²⁸⁹

The Banking Act (as amended), serves as the major legislative framework that governs the operations of the banking sector. The Act was passed to amend and consolidate the laws

²⁸¹ Kara (167).

²⁸² Kara (n 167).

²⁸³ Kara (n 167).

²⁸⁴ Kara (n 167).

²⁸⁵ Ghana Web (n 85).

²⁸⁶ Kara (n 167).

²⁸⁷ Green Climate Fund Readiness Programme ‘Financial sector overview: Ghana’ at 4 accessed online 28 July 2019 at <https://www.gcfreadinessprogramme.org/sites/default/files/Financial%20Sector%20Ghana%20Assessment%20Report.pdf>.

²⁸⁸ (n 287).

²⁸⁹ (n 287).

relating to banking, to regulate institutions which carry on banking business and to provide for other related matters.²⁹⁰ The Act is divided into nine parts:

Part I provides that, the Act shall apply in addition to the Companies Act, 1963 (Act 179) and shall not take away anything from the Companies Act, except when such derogation is specifically provided in this Act. This Act, however, shall have prominence over the Companies Act where there is a conflict or inconsistency in any provision between the two. It also sets out the functions of the BoG in the affairs of the sector to have the total supervisory and regulatory role in all cases relating to banking business.

Part II sets the licensing procedure, regulations, processes and sanctions for the banking industry. It establishes that a person who undertakes any banking business without a license as provided for in the Act shall be liable for an offence punishable on a summary conviction. It outlines the revocation of licenses procedures and the permissible activities of a bank and stresses that a person cannot hold himself out as a bank unless it is otherwise a bank carrying out proper banking business. A bank under the provisions of this part is not allowed to undertake any commercial, agricultural or industrial venture unless it does that with a subsidiary of the bank explicitly registered for such other business.

Part III generally deals with all obligations of the bank in respect of capital adequacy ratio (CAR) set at 10%. The capital adequacy ratio is a measure of the bank's solvency. This part also provides for the guidelines on reserve funds in case of additional risks and penalties for non compliance on the CAR requirements. It also deals with restrictions and formalities with the declaration of dividends. According to the BoG's first quarter of 2019 report, the banking sector's total CAR increased from 18.9% as of April 2018 to 21.4% in April 2019.²⁹¹

Part IV prescribes the maintenance of liquidity of assets, which comprises the specific amount and composition. It also outlines how directors and managers of the bank may have to notify non compliance with the liquidity requirements and the penalties associated with non compliance and those to be held responsible for such inactions.

²⁹⁰ The Banking Act, (2004) Act 673 of Ghana.

²⁹¹ Bank of Ghana 'Banking sector report-May 2019' at 11 https://www.bog.gov.gh/privatecontent/MPC_Press_Releases/Banking%20Sector%20Report%20-%20January%202019.pdf (accessed on 28 July 2019).

Part V makes provisions for ownership and control structures and processes of the banking sector. The sections deal with the transfer of significant shares affecting the shareholders. It requires that direct or indirect disposal of significant shares must seek the approval of the BoG with ample notification. It deals also with the prohibited activities with the transfer of, and discharges in the controlling interests through means such as sales, disposal or transfer of whole or part of businesses, amalgamation, mergers, acquisition or reconstruction of a bank. It outlines the grounds and procedures for disqualification of directors and officers or employees of a bank and the remedies available to such affected persons. The BoG is expected to be notified and approve certain appointments to key positions of the bank, including managing directors and boards of the banks.

Part VI provides for the prohibition of advances against the security of shareholders. In this respect, this part makes provisions to preclude a bank from advances, loans or credit and guarantees against the security of its shares, of its holding company, its subsidiaries. Any breach of these constitutes an offence liable for a summary conviction. It also provides for the limit of financial exposure permissible in respect of a person(s) which shall not exceed 25% of the net fund of the bank. This provision, however, does not apply to exposure between the bank and other non financial institutions, except when the BoG has specified. Under this part, provisions are made on restrictions on the bank's ability to lend to its directors and their relations, associates, the staff and officers. It also covers restrictions on the establishment of subsidiary companies with the approval of the BoG and the ability of the bank to invest in other corporate bodies with equity not exceeding 10% of its net fund.

Provisions under Part VII give the minister in charge of finance, among others, the authority to make regulations in consultation with the BoG through a legislative instrument to give effect to this Act. It gives the BoG the power to issue directives to banks on management structures, conducts detrimental to depositors and on general bank policy. It also gives the power to the BoG to demand on notice, the general information on the bank's operations concerning its assets, liabilities, income, expenditure and accounting procedures.

Part VIII provides for general guidelines on accounting and audit such as account records, financial statements and audit of bank's accounting records, the appointment of auditors,

BoG's power to appoint auditors, auditor's right to information, audit report, special audit and display of financial statement.

Part IX deals with miscellaneous matters such as the prohibition of a floating charge, the secrecy of customer information, submission of reports on trend and progress, offences and penalties.

From all the sections and provisions of this Act, one finds no mention of factoring and a possible definition in the context of the permissible banking activities of banks in Ghana. The Act does not, also, provide a clue as to how factoring must be regulated and promoted in the banking sector. This reveals how factoring is placed in the scheme of affairs as an alternative banking service to support SMEs. It has already been elucidated that the traditional banking lending schemes have not provided reliable, enough and sustainable finance models to the private sector businesses dominated by SMEs in the country. The BoG reports that by the first quarters of 2017, 2018 and 2019, the private sector credit from the banking sector stood at GH¢31 121.50million, GH¢ 32 842.77million and GH¢34 007.59million respectively.²⁹² The abysmal support from the traditional banks to the private sector is reflected in this report on private sector credit from the banks. The gap in funding SMEs can be filled with a robust factoring industry properly regulated with forward looking legislation.

4.3.2 The Bank of Ghana Act (2002) Act 612

The Bank of Ghana Act is the enabling instrument that established the BoG as the Central Bank. The BoG is an independent institution²⁹³ with the broad objective of maintaining the stability in the general level of prices and supporting the general economic policy of the government for economic growth through effective and efficient banking and credit systems and operations in the country.²⁹⁴ Its general mandates include the following;²⁹⁵

- i. to formulate and implement monetary policies for the country,
- ii. promoting measures to stabilise the value of the currency,
- iii. instituting measures to shore up the balance of payment, public finances and engender national economic development,
- iv. to regulate, supervise and direct the banking and credit system of the country,
- v. to license, promote, regulate and supervise non-banking financial institutions, and

²⁹² Bank of Ghana (n 291)16.

²⁹³ The Bank of Ghana Act (2002), Act 612, sec 3(2).

²⁹⁴ (n 293) sec 3(1).

²⁹⁵ (n 293) sec 4(1).

- vi. to promote as well as maintain relations with international banking and financial institutions.

Factoring businesses come under the direct control of the BoG within these mandates. Therefore, upon the satisfaction of all the requirements of establishing a business as a company in Ghana,²⁹⁶ a factoring company is obliged to be appropriately licensed and certified to operate as a financial institution.²⁹⁷ The mandate of BoG allows it to set regulations and minimum qualification criteria that a company must satisfy to be licensed or to continue operations as such. Over the years, the bank has executed its mandate which has enabled several banks and non banking institutions to render various services and products in support of SMEs in Ghana. In 2018, the BoG undertook some regulatory and supervisory measures within the scope of its mandate by dissolving some five banks on insolvency grounds and turned them to form the Consolidated Bank of Ghana Ltd. Again, the UT and Capital banks were liquidated, placed under receivership and eventually taken over by the GCB bank, which has the government as the majority shareholder. Accordingly, in October 2018, the BoG released the names of 30 banks plus the ARB Apex bank²⁹⁸ with 1 546 branches in April 2018 as licensed banks in good standing to operate in the country. In its first-quarter report for 2019,²⁹⁹ which spells out developments and performance of the banking sector, BoG reveals that the number of licensed banks in good standing have reduced to 23 with 1 225 branches nationwide as at April 2019.³⁰⁰ This reduction is, again, due to the rationalisation of branches under the current reforms.³⁰¹

4.3.2 The Borrowers and Lenders Act (2008) Act 773

Before the coming into force of the Borrowers and Lenders Act, the Companies Act,³⁰² the Mortgages Act,³⁰³ the Land Title Registration Act³⁰⁴ and the Chattel Transfer Ordinance³⁰⁵ were some of the laws of Ghana that governed the creation and registration of securities.

The Borrowers and Lenders Act was enacted to provide a law to regulate the credit market in Ghana. Its major objectives are to improve the standard of disclosure of information by both

²⁹⁶ Any person(s) intending to establish a business as a sole proprietorship, limited or unlimited is (are) required to follow all or some of the provisions under the Companies Act(1963) Act 179, the Registration of Business Names Act(1962) Act 151, the incorporated Private Partnership Act (1962) Act 152, depending on the nature of the business.

²⁹⁷ The Banks and Specialised Deposit Taking Institution Act (2016) Act 930.

²⁹⁸ The ARB Apex bank is the umbrella bank established to manage all rural and community banks in Ghana.

²⁹⁹ Bank of Ghana (n 291).

³⁰⁰ Bank of Ghana (n 291)4.

³⁰¹ Bank of Ghana (n 291 above).

³⁰² The Companies Act (1963) Act 179 of Ghana.

³⁰³ The Mortgages Act, 1972 (NRCD 96) of Ghana.

³⁰⁴ The Land Title Registration Act, 1986 (PNDCL 152) of Ghana.

³⁰⁵ The Chattel Transfer Ordinance, 1951 (No. 12 of 1951) of Ghana.

borrowers and lenders; to prohibit some credit practices; to promote a consistent enforcement framework on credit, and to provide for other related matters.

The general scope of the Act covers seven issues;

- i. application and meaning of various forms of credit,
- ii. supervisory and enforcement role of bank of Ghana,
- iii. borrower rights,
- iv. repayment and recovery of debt,
- v. collateral registry and registration of charges,
- vi. enforcement of borrower's obligations, and
- vii. miscellaneous matters including annual report, regulations and interpretation.

This Act establishes a Collateral Registry under which the BoG is required to register all collaterals and charges; provide information to parties concerned on securities registered with the registry; and promote and support the development of a fair, transparent, competitive and accessible credit market for borrowers and lenders.³⁰⁶ The Act had the effect of guiding businesses and entrepreneurs that undertook to borrow from other avenues other than the traditional banks, but again, it does not address anything to do with invoice discounting.

4.3.4 The position of common law and equity in factoring

Section 14 of the 1876 Gold Coast Supreme Court Ordinance (No. 4 of 1876) which came into force in 1876 stated that,

the Common law, the doctrines of equity, and the statutes of general application which were in force in England at the date when the colony obtained a local legislature, that is to say, on the 24th day of July 1874, shall be in force within the jurisdiction of the Court.³⁰⁷

This Ordinance underpins the historical antecedent of Ghana's legal system. Again, section 19 of the said Ordinance provided for the application of customary law in the colony to conform to the policy of indirect rule which the British had adopted as a policy to rule.

Section 19 of the Ordinance partly, reads, as follows:

Nothing in this Ordinance shall deprive the Supreme Court of the right to observe and enforce the observance, or shall deprive any person of the benefit of any law or custom existing in the said colony and territories subject to its jurisdiction, such law or custom not being repugnant to natural justice, equity and good conscience, nor incompatible either directly or by necessary implication with any enactment of the Colonial legislature.³⁰⁸

³⁰⁶ The Borrowers and Lenders Act (2008) Act 773 of Ghana, Part V.

³⁰⁷ The 1876 Gold Coast Supreme Court Ordinance (No. 4 of 1876), sec 14.

³⁰⁸ (n 307) sec 19.

This legal pluralism under the 1876 Ordinance has manifested in all Ghanaian legal jurisprudence from independence till today. Ghana's law embodies the English Statutes of General Application as provided for under the Courts Act of Ghana, which specifies that:

Until provision is made by law in Ghana, the statutes of England specified in the second schedule to this Act shall continue to apply in Ghana as statute of general application subject to any statute in Ghana.³⁰⁹

Under the current constitution, article 11 provides that the laws of Ghana shall comprise-³¹⁰

- this Constitution;
- enactments made by or under the authority of the Parliament established by the Constitution;
- any orders, rules and regulations made by any person or authority under a power conferred by this Constitution -that will include a subsidiary or subordinate legislation;
- the existing law-comprising the written and unwritten laws of Ghana that existed immediately before the coming into force of the 1992 Constitution; and
- the common law-which include the English common law and doctrines of equity, as well as the rules of customary law.

In effect, since there are no specific regulations in terms of law and equity and practice in Ghana, it is important to enact a new law to regulate factoring in Ghana.

4.4 The shortfalls in existing laws on factoring in Ghana

Even though Ghana's legal system had taken its root from the British practice as illustrated above, it is imperative to note that the written nature of Ghana's jurisprudence requires a major departure from the UK system concerning the rules on factoring which is primarily guided by judicial precedents and established notorious principles. The UK is the leading country in factoring business in the world³¹¹ with regulatory bodies that oversee factoring even though it has no written law as expected in line with its legal system.

Apart from the lack of mention of factoring in any of the laws discussed, Ghana has no record of reported judicial precedent, setting out any regulations or rules on factoring. The evolving and emerging trends in the international financial market make it imperative for Ghana to take up the challenge to institutionalise and regularise its laws to align with international best practices on factoring as a global player to attract the needed investment for SMEs.

³⁰⁹ The Courts Act, 1993 (Act 459) sec 119(1).

³¹⁰ The 1992 Constitution of the republic of Ghana., art 11.

³¹¹M Bickers(ed) 'World Factoring Year Book' (2017) https://bcrrpub.com/system/files/World_Factoring_Year_2017_O.pdf (accessed 7 July 2019).

4.5 Conclusion

Mulroy³¹² has intimated that there is a rise in the factoring laws in the registries to protect factors from fraud and safeguard the industry generally.³¹³ To this end, he opines that more and more central banks realise that ‘factoring has a direct correlation to the accessibility of capital for SMEs, which are the engines of growth and jobs all around the world.’³¹⁴ Central banks are, therefore seeing factoring as a safe and acceptable means of financing open account trade that supports SMEs. In the present state of the laws in Ghana, certainly, factoring is not placed to receive the needed attention and support to thrive. The BoG must initiate the processes to whip up the discussion on the need to have standard legislation to regulate and expand the factoring industry in the country for the benefit of the generality of the economy.

In the next chapter, sections will be devoted to discussing the state of factoring in Africa and how the industry can be harnessed to bridge the funding gaps currently militating against the operations of SMEs across Africa. It shall focus on various model laws and the elements that are impacting on new factoring legal frameworks and how the Afreximbank model has become the ideal model law for Africa.

³¹² Peter Mulroy was the FCI’s Secretary General as at 2017 and authored the introduction to the World Factoring Yearbook for 2017.

³¹³ Bickers (n 311).

³¹⁴ Bickers (n 311).

CHAPTER FIVE

THE STATE OF FACTORING IN AFRICA AND THE ROLE OF INTERNATIONAL AND AFREXIMBANK'S MODEL LAWS IN DOMESTIC LEGISLATION

5.1 Introduction

The lack of a conducive space for the operation of factoring as an impetus for the promotion of SMEs is a real dilemma. This hiatus justifies the struggle of many African countries to meet their financial inclusion targets amid the fast approaches with which other emerging economies are embracing factoring business. The factoring market is currently touted as the “golden age” in the receivable industry.³¹⁵ This is attributed to the increasing pace of the business as compared to other financing services.³¹⁶

This chapter examines the state of factoring in Africa and the international standard model laws, with reference to the Afreximbank Model Law on factoring as meeting the international standard to guide any future factoring legislation for Ghana.

5.2 Factoring in Africa

According to 2017 Factoring Yearbook report, the factoring industry generally increased its volumes of trading marginally on the global scale by 0.35%, amounting to UK€2 376billion in 2016.³¹⁷ Africa's share of the growth was 9% in 2016 led by South Africa, which had the largest share in terms of factoring trading on the continent.³¹⁸ This performance is considered significant due to the general economic performance on the continent. However, Europe grew in the industry in the same period by 7.3% due to the strategies of central banks of member states.³¹⁹ According to Mulroy, for about seven years after the financial crises, banks were slacking in offering financial support for SMEs, but the factoring industry took up the challenge to fill the gap.³²⁰ Mulroy emphasises that ‘receivable finance industry played an important role in the continued health and eventual growth in global trade, particularly by continuing to finance SMEs during this challenging period.’³²¹

Mulroy has identified that some of the factors impacting negatively on the growth of the factoring industry are the archaic regulations such as the use of tax stamp, tax duty, foreign

³¹⁵ Baresa et al. (n 165).

³¹⁶ Baresa et al. (n 165 above).

³¹⁷ Bickers (n 311).

³¹⁸ Bickers (n 311).

³¹⁹ Bickers (n 311).

³²⁰ P Mulroy ‘Introduction’ in M Bickers (ed) ‘World Factoring Yearbook (2017)’ at 1 www.ebglaw.com/content/uploads/2019/07/Tatge-World-Factoring-Yearboo-2017-eBook.pdf.

³²¹ Bickers (n 311).

currency restriction and the laws limiting the rights to assignments.³²² It is also noteworthy that over 70% of the new members of the FCI in the last three years is coming from emerging markets including African countries and the factoring business is anticipated to see a compound annual growth rate (CAGR) of 14.6% to \$9 275.15billion by 2025.³²³ It has been established that the survival of the factoring industry shall depend on the growth of the number of SMEs in the world.³²⁴

In spite of the low volumes of trading in factoring that grew only 2% in 2018 at €2.1billion in Africa,³²⁵ tremendous efforts have been made to develop many areas relating to legal and regulatory interventions to grow factoring businesses.³²⁶ In this regard, Egypt was able to revise its existing Factoring and Leasing Law in August 2018 and grew its factoring volume by 24% year on year.³²⁷ Under the auspices of the Afreximbank, the Nigerian Export-Import Bank (NEXIM) and the FCI, Nigeria also held a public hearing on its factoring bill in July 2018 at the House of Representatives which led to the passage of the bill and awaiting the approval of the Senate.³²⁸

Under the treaty of the Organisation for the Harmonisation of Corporate Law in Africa (OHADA), the 17 countries involved from Central and West Africa have on the basis of the Afreximbank model law on factoring, made strides at having uniform legislation on factoring to be used by member countries.³²⁹ In Kenya and Zimbabwe, bills on movable property security which became laws in 2017 had provisions that effectively impacted on activities of factoring in those countries.³³⁰ To support SMEs financing, the government of Mauritius introduced the SME Factoring Scheme under the Non-Bank Financing Institutions that offer factoring services in that country.³³¹

It is critical to note from the narration above that, Africa is doing something right to take advantage of the prospects that are enhanced under factoring through appropriate legal

³²² Bickers (n 311).

³²³ Adroit Market Research 'Global analysis by trends, size, share, opportunities and challenges' Globe Newswire ET Dallas, Texas, 22 April 2019 accessed online 27 July 2019 at <https://www.globenewswire.com/news-release/2019/04/22/1807305/0/en/Factoring-Market-will-grow-at-a-CAGR-of-14-6-to-reach-9-275-15-Billion-by-2025-Global-Analysis-by-Trends-Size-Share-Opportunities-and-Challenges-Adroit-Market-Research.html>.

³²⁴ (n 323).

³²⁵ K Awani 'Development in Africa' FCI Annual Review 2019 at 10 accessed online 26 August 2019 at <https://fci.nl/downloads/Annual%20Review%202019.pdf>.

³²⁶ Awani (n 325).

³²⁷ Awani (n 325).

³²⁸ Awani (n 325).

³²⁹ Awani (n 325).

³³⁰ Awani (n 325).

³³¹ Awani (n 325).

interventions and thus goes to support the underlining call of this paper to ask Ghana to enact a law for factoring as a necessity to promote its SMEs.

5.3 The role of International Financial Institutions (IFIs) in the factoring industry in Africa.

5.3.1 The African Export-Import Bank

The African Export-Import Bank is a multilateral financial institution established in October 1993 by African governments with some shareholders from the private sector including institutional investors as well as non African investors and international financial institutions under the auspices of the African Development Bank (AfDB).³³² Its major purpose was to serve as the conduit for financing, promoting and expanding intra and extra African trade.³³³ Afreximbank started operations in 1994 and headquartered in Cairo, in the Arab Republic of Egypt, with offices in Abuja, Abidjan and Harare.

The objectives and mandate of the bank include;³³⁴

- i. to extend direct credit to eligible African exporters by providing before and after shipment finance;
- ii. to extend indirect short term credit and medium term loans to African exporters and importers;
- iii. to finance imports needed for export generation such as imports of equipment, spare parts and raw materials;
- iv. to promote and finance the export of non traditional African goods and services;
- v. to promote and provide insurance and guarantee services covering commercial and non commercial risks associated with African exports; and
- vi. to promote development within Africa of a market for bankers' acceptances and other trade documents.

In pursuit of its mandate, the bank has been the foremost champion of factoring on the continent by promoting research and sponsoring African countries to develop an institutional and legal framework for the regulation of factoring. The bank's effort towards factoring is contained in the following news reportage:

Afreximbank had been playing a leading role in facilitating the growth of factoring in Africa through various interventions, including supporting the creation of a facilitative legal and

³³² <http://www.afreximbank.com> (accessed on 14 April 2019).

³³³ http://www.nyuafricahouse.org/?risen_event=special-lecture-with-the-president-of-african-export-import-bank-afreximbank (accessed on 30 July 2019).

³³⁴ <https://www.devex.com/organizations/african-export-import-bank-afreximbank-45335> (accessed on 30 July 2019).

regulatory environment for factoring; provision of finance and guarantees to factoring companies; provision of technical assistance; and formation of strategic partnerships to promote the development of factoring.³³⁵

In 2016, Afreximbank introduced its factoring model law to provide a benchmark for countries in Africa looking forward to legislating laws aimed at fostering the growth of factoring activities across the continent.³³⁶ This law was unveiled in Cape Town in South Africa at the 7th annual meeting of the Africa chapter of FCI to affirm the point that there is progress made in selling factoring as a product on the continent.

The bank in collaboration with the FCI is leading the awareness process to sell factoring in Africa by organising promotional conferences and workshops in different countries in Africa.³³⁷

5.3.2 Factors Chain International

The Factors Chain International is the global constituted body for domestic and international factoring and financing of open account. The FCI has been pivotal in the growth of the industry by helping to double the size of the sector after the financial crisis. The membership of the group comprises 273 factors in 75 countries and contributes more than 80% of the global international factoring volume.³³⁸ The organisation's nature is summarised below:

Founded in 1968, FCI is a global network of leading factoring and receivables finance companies, whose common aim is to facilitate international trade through factoring and related financial services.³³⁹ In 2016 the activities of IFG (International Factors Group) were integrated into FCI. FCI provides four pillars of service; business network, education, advocacy and networking. FCI provides its members with a framework within which to conduct cross-border correspondent factoring. The General Rules of International Factoring (GRIF) form the legal basis under which nearly all cross-border correspondent factoring business transactions are conducted. FCI members also use a proprietary communication system called Edifactoring.com. Like SWIFT does for letters of credit, edifactoring.com provides a sound and secure means by

³³⁵ 'Afreximbank Proffers Factoring to Ease Access to Financing for African SMEs' 18 March 2019, News, Press Release accessed online 29 July 2019 at https://www.afreximbank.com/a_freximbank-proffers-factoring-to-ease-access-to-financing-for-african-smes/.

³³⁶ 'Ghana: Afreximbank introduces new factoring law' accessed online on 7 July 2019 at <https://allafrica.com/stories/201610311234.html>.

³³⁷ Awani (n 325).

³³⁸ Baresa et al. (n 165)121.

³³⁹ 'What is Factors Chain International?' - Comfin, accessed online 8 July 2019 at <http://www.abnamrocomfin.com/corp/en/our-services/export-and-import-factoring/w>.

which members can issue factor guarantees, send invoice data, issue dispute notices, and send payment messages.³⁴⁰

FCI constantly partner Afreximbank to run conferences and workshops for players in the factoring businesses and states institutions. In 2018, in conjunction with the Afreximbank, it run the third edition of its certificate course of finance in international trade at the University of Malta.³⁴¹ It collaborated with Afreximbank recently to organise a two day conference to promote factoring under the theme “Domestic and International Factoring: Alternative tools for SME financing in Africa” from 12-13 March 2019 in Gaborone, Botswana.³⁴²

In 2018, nine new members from Botswana, Cameroon, Egypt, Mauritius, Morocco, Nigeria, Republic of Congo and Zimbabwe registered to join the group which indicates how the impact of FCI is being felt in Africa.³⁴³

5.4 Model laws on factoring

The 21st Century factoring business has been regulated under some international factoring conventions which serve as model laws for the adoption of countries or as guides in making domestic national factoring legislations. This section is relevant to identifying the strengths or otherwise of such laws and how Ghana can adopt same as guides in enacting its own factoring legal framework.

5.4.1 The Afreximbank model law on factoring

Afreximbank’s Model Law was developed on the existing IFG’s Model Law (2014) and the 2001 UNCITRAL Convention.³⁴⁴ The law concedes that it has a limited scope to cover only the assignment of receivables.³⁴⁵ A vital feature of this law from other international models is the simplification of confusing words to make them specific in the document:³⁴⁶ For example, UNIDDROIT and UNCITRAL Conventions’ words like “assignor”, “assignee”, “contract of assignment”, “original contract”, “security rights” and “notification of assignment” are interpreted in the Act as “client”, “factor”, “factoring contract”, “supply contract”, “related rights” and “notice of the assignment” respectively.³⁴⁷

In this law, “assignment” means:

³⁴⁰ FCI ‘Factoring Year Book 2017’ at https://bcrcpub.com/system/files/World-Factoring-Yearbook-2017_0.pdf (accessed on 7 July 2019).

³⁴¹ Awani (n 325).

³⁴² FCI (n 340).

³⁴³ Awani (n 325).

³⁴⁴ Afreximbank ‘Afreximbank Model Law on Factoring’ (2016) accessed online 15 May 2019 at <https://afreximbank.com/wpcontent/uploads/2016/10/Model-Law-on-Factoring.pdf>.

³⁴⁵ (n 344)4.

³⁴⁶ (n 344)8.

³⁴⁷ (n 344)8.

The transfer by agreement from the client to the factor of all or part of or an undivided interest in a receivable payable by a debtor and whether or not notice of the assignment has been given to the debtor. The creation of rights in a receivable as security for indebtedness or other obligations deemed to be a transfer.³⁴⁸

“Factoring contract” is also defined as:

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 after that; or

(ii) maintenance of accounts (ledgering) relating to the assigned receivables; or

(iii) collection of assigned receivables and

(A) unless otherwise agreed any collection is for its 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 financial 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.³⁴⁹

This model law proceeds on the following assumptions:³⁵⁰

- That national laws already provide for the forms and procedures required for the assignment of a receivable and that the model law does not attempt to specify those.
- The model law deems pledge, subrogation, charging, trust, declaration and purchase under various national legal systems as an assignment, whether it supports a purchase or as part of the security for a loan.
- The Act does not define factoring products but left it between the client and the factor to determine as part of their contract agreement.
- The model law does not regulate factors- factoring companies -but the act.
- It does not also regulate fees, interest and discount charges of any particular contract.
- It does not regulate how and manner a company is registered and be called a factor.

³⁴⁸ (n 344)11.

³⁴⁹ (n 344)11-14.

³⁵⁰ (n 344)5-7.

- The law does not regulate tax consequences of assignment such VAT and other taxation treatment of factors fees in any jurisdiction.
- The model law is open to national legislators to add when adopting it as part of its laws.

The Afreximbank model law is divided into seven parts covering:

1. Definitions and interpretation. This part tries to outline the various meanings and interpretations of the words and concepts applied in the law, as well as the rules of interpretation.
2. Scope of application and limitations. It sets the limit of application of the law and exclusions concerning other laws and state laws.
3. Party autonomy. Part three covers party autonomy as a basic principle of contract.
4. Effects of the assignment. Part four deals with effects of assignment, nullification of the prohibition against assignments and transfer of related rights by parties.
5. Rights, obligations and defences. This part covers rights obligations and defences;
 - A. as between client and factor;
 - I. rights and obligations of client and factor,
 - II. representations by the client,
 - III. rights to give notice of assignment,
 - IV. right to payment.
 - B. Position of debtor
 - I. protection for the debtor,
 - II. notice to the debtor,
 - III. debtor discharged by payment,
 - IV. debtor defences and right of set off,
 - V. agreement not to raise defences or rights of set off,
 - VI. modification of the supply contract,
 - VII. non-recovery of payments.
 - C. Position of the third party;
 - I. the law applicable to competing rights in a trade receivable,
 - II. special rules on proceeds,
 - III. subordination,
 - IV. form of a factoring contract.
6. International factoring. This part relates to all that explain and the mechanisms of international factoring. It deals with the relations between factors in international factoring transactions.

7. Entry into force and application. The final part of the scope covers when the model enters into force upon its adoption by member states and application. It also deals with the annexe priority on registration.

It is essential to underline that this model law is not meant to be adopted wholesale for a country's factoring operations but to serve as a guide for adoption or domestic legislation and that it is not binding on any jurisdiction. It is understood that the assumptions are deliberate to allow countries to fashion out where appropriate, provisions that are suited to their respective legal systems and jurisprudence. In order to fill the lacunae in the model law created under the assumptions identified above, it is crucial for national legislation to be designed to cover them if necessary. Since these assumptions are mainly true for Ghana, it justifies the theme of this paper for a new legal framework that will permit the country's financial and economic philosophies. This law is pivotal to the development of national laws on factoring within the continent. To this end, this research adopts the provisions of the model law to the current realities in Ghana in developing a national law on credit factoring.

5.4.2 The UNIDROIT³⁵¹ Convention on International Factoring (Ottawa 1988)

This is the first ever known model law that sought to address factoring regulation in the world. The scope of this Convention applies to international factoring where the client and the customer are in separate countries (jurisdictions), but the Convention is in force in both countries as well as the factor's location.³⁵² An assignment under factoring is deemed international if the creditor and the factor are located in different countries and that if the creditor and the debtor also have their locations in different countries.³⁵³ In this regard, the test considers the location of the registered offices or place of incorporation of parties or the individual residences same.³⁵⁴ It has a limited application as well in scope because it is limited in the adaptation as it requires the supply contract to be governed by the laws of a contracting statute, and the factor must be provided at least two finance such as ledger accounting and collection of debts or bad debt protection only.³⁵⁵ Under this Convention, a notice of the assignment of debt by the supplier must be given to the debtor(customer)by the creditor; which duty is not assigned to the factor. It has been identified that this Convention does not create any new perspective on factoring on an international basis, despite its strength of outlining the duties and rights of each party where

³⁵¹ The International Institute for the Unification of Private Law (UNIDROIT).

³⁵² UNIDROIT Convention, art 2(1).

³⁵³ Draft Convention of UNCITRAL Uniform Law on Assignment, art 3.

³⁵⁴ (n 353) art 5(j).

³⁵⁵ UNIDROIT Convention, art 1.

it applies and again making provisions for prohibitions against assignments to be ineffective against a factor.

In line with article 14(1),³⁵⁶ this Convention came into force on 1 May 1995 after it was adopted in Ottawa, Canada on 28 May 1988. So far, the Convention has seen only 15 countries signed up to it with nine contracting states,³⁵⁷ making its impact in the factoring industry less felt. The Convention has been adopted and passed into law by countries such as France, Germany, Belgium, Italy, Nigeria and Latvia. Other countries like Russia and Lithuania have merely followed the dictates of the Convention to modernise their factoring laws. It allows for the adoption of a part as in the case of Belgium which decided to forgo the provisions related to prohibition of assignment and followed the rest of the provisions of the Convention in enacting its law.

Ghana was one of the first countries in Africa that signed the Convention on 28 May 1988 but has since not ratified it or adopted same. Other countries in Africa such as Guinea, Nigeria, Morocco and Tanzania have signed the Convention, however, only Nigeria has moved on to ratify and adopt it.³⁵⁸ Because this model law is so specific to factoring, it is important that any country seeking to legislate on factoring considers its provisions and relevance to such new law. In this sense, Ghana as a signatory to the Convention will achieve a useful legislative environment to promote factoring if it adheres to the relevant provisions of this model law.

5.4.3 The UNCITRAL Convention on the Assignment of Receivables in International Trade (2001)³⁵⁹

This Convention covers receivable products; not limited to credit factoring but also securitisation and forfaiting. It takes a broader scope to include all forms of factoring. The irony is that this Convention has since its inception seen no country adopting it as part of its factoring legislation, and there is no account of its impact so far.³⁶⁰ So far only Luxembourg, Madagascar and the US have signed to the Convention but have not fulfilled the five actions required to adopt it into force.³⁶¹ In 2014, the Convention received the endorsement of the executive board of the International Chamber of Commerce (ICC) at its world council session held in New York.³⁶² The ICC's support was based on the following purposes of the Convention;

³⁵⁶ UNIDROIT Convention, art 14(1).

³⁵⁷ <https://www.unidroit.org/status-1988-factoring>.

³⁵⁸ (n 357).

³⁵⁹ E Timmermans 'Letter from thoughts from CFA and IFG: the secured lender'.71(7):10.

³⁶⁰ Kameni (n 8).

³⁶¹ <https://www.jus.uio.no/lm/un.conventions.membership.status/doc.html#81>.

³⁶² Chardon (n 178).

- to establish principles and rules to create clarity and transparency in the legal regime applicable to the assignment of international receivables;
- the objective to promote the modernisation of the rules on assignments of receivables;
- Safe guarding and facilitating the development of both current and new assignment practices; and
- to remove obstacles for international trade.

The ICC considered the Convention to be a major step towards a system of globalised asset based lending and hoped that the Convention removed any legal obstacles to receivables financing contracts. The recommendation of the ICC seeks to convince and motivate member countries of the ICC to consider signing, ratifying and adopting the Convention into force. As a member of the African Union (AU) and the Economic Community of the West African States (ECOWAS), Ghana becomes automatic member of the ICC³⁶³ and is expected to take cue from the position of the Chamber. Ghana has not fulfilled any of the actions to adopting the Convention to govern its receivable trading. As a step to creating an enabling environment for factoring by legislation, it is critical for Ghana to ratify and adopt this Convention since its provisions will serve as essential basis for a new legal framework for the country. Due to the wider scope of the Convention, Ghana will stand to benefit as an international trade hub by incorporating relevant provisions of the Convention into the new law on factoring.

5.4.4 International Factors Group model law (IFG) (2014)

In the light of the shortcomings of the UNCITRAL Convention, the IFG in 2014, modelled its factoring law based on this Convention. The IFG model law's objective is to avail legislators, a draft law on factoring that considers and tie in internationally accepted and tested legal principles of factoring. It is developed on a framework that allows for a specific adaptation of legal assignments. The IFG model law excludes securitisation from its scope to narrow it to cover only factoring. It, however, extends its reach to cover both domestic and cross border arrangements and receivables.

In the same way, it includes both present and future receivables. The following are excluded under the IFG model laws;

- assignments to individuals for personal or household purposes;
- sale of a business;
- receivables arising out of financial services transactions such as transactions non-regulated exchange, foreign exchange transactions or netting agreements;

³⁶³ www.iccwbo.org.

- bank deposits;
- letter of credit and other negotiable instruments; and
- the sale or lease of land that is not permitted under the laws of the relevant country.

These are transactions regarded as been regulated by legislation in most countries.

Under the IFG model law, it is required of a factor to perform the following functions;³⁶⁴

- provision of finance,
- ledgering activities, and
- collection and protection of bad debts.

Under this model law, non disclosed factoring is permissible.³⁶⁵

In contrast to the UNIDROIT Convention, the IFG model law allows for more factoring transactions than the former. Whiles the UNIDROIT takes its scope to cover other trade financing schemes, the IFG law exempts activities on forfaiting and securitisation from its scope with a concentration on only factoring. Again, it stretches to cover both domestic and cross border arrangements and receivables which makes it more holistic.

5.5 Case studies

In the attempt to clearly establish the theme of this thesis, which is to argue for a suitable legal environment for factoring in Ghana, it is prudent to identify lessons from other African countries which motivate such a call.

5.5.1 South Africa

South Africa leads the factoring industry in Africa with about a volume of 85%. In order of volumes, Morocco and Egypt follow and account for 10% and 2% respectively; then with Mauritius, Tunisia and Kenya making 1% each with volumes of factoring.³⁶⁶ The factoring industry in South Africa is well established and been in business since the middle of the 1970s.³⁶⁷ According to Brehcist, the volumes of factoring grew at 11.03% in South Africa from €14 672 in 2015 to €16 291 in 2016.³⁶⁸

³⁶⁴ International Factors Group Model law (2014), art 1.

³⁶⁵ (n 364) art 2(1).

³⁶⁶ K Awani 'Africa on the rise in 2016' FCI Annual Review (2017) at 13 <https://www.fci.nl> (accessed 29 June 2019).

³⁶⁷ D Cory 'South Africa' in M Bickers (ed) 'World factoring yearbook' (2017) at 166 https://bcrrpub.com/system/files/World-Factoring-Yearbook-2017_0.pdf (last accessed 7 July 2019)

³⁶⁸ Brehcist (n 168).

The legal systems of South Africa, are based on Roman-Dutch law.³⁶⁹ According to Cory³⁷⁰:

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 the rule of law.³⁷¹

Even though there is a relatively vibrant factoring service in South Africa, no specific legislation regulates domestic or international factoring. Extant laws regulate the sector, but the courts of South Africa are adequately versed with factoring. The Banks Act³⁷² provides for the regulation and supervision of the taking of deposits from the public and serves as the regulating framework for the banking factors. Other vital laws applied in the regulation of factoring include the Consumer Protection Law,³⁷³ which regulates the provision of goods and services - including financial services-to consumers unless exempted³⁷⁴ and the National Credit legislation³⁷⁵ which regulates consumer credit, prohibits certain unfair credit and credit-marketing practices as well as reckless credit granting.³⁷⁶ This regulation regime adequately manifested in the case of *First Rand Bank v Consolidated Timber Exports Close Corporation and Others*,³⁷⁷ where the high court made rulings on issues on factoring based on other legislation other than a factoring law.

The history of South Africa's factoring can be traced to the 1960s when some factoring groups were formed. With the coming in of the banking sector as stronger institutions in the business and finance enterprise, these factoring groups were naturally absorbed by the banks as their subsidiaries or units.

The Standard Bank, ABSA, Nedbank, FNB, Sasfin, Merchant Factors, Reichmann and Grinrod are the eight institutions that make up the Debtor Finance Committee (DFC) of South Africa.³⁷⁸ Sasfin, Standard Bank and Nedbank are the only ones that are members of the FCI. Apart from the official members of the DFC, there are between 20 to 30 business entities that also offer

³⁶⁹ B Lenel 'The history of South African law and its Roman-Dutch roots' (2002) Toeberstrasse 23a, 9425 Thal, Switzerland www.lenel.ch.

³⁷⁰ David Cory is the Head- Debtor Management of Nedbank in South Africa. He is the only contributor from South Africa to the articles in the FCI- Factors Yearbook (2017). Nedbank is a founding member of the FCI in the 1970s. Other members of FCI as at now include the Standard Bank and the Sasfin. The Nedbank has the largest percentage share in terms domestic and international factoring services in South Africa.

³⁷¹ Cory (n 367).

³⁷² Banks Act 94 of 1990 of South Africa.

³⁷³ The Consumer Protection Act 68 of 2008 of South Africa.

³⁷⁴ Banking Laws and Regulations, South Africa, Gli accessed online 26 July 2019 at <https://www.globallegalinsights.com/practice-areas/banking-and-finance-law-and->.

³⁷⁵ The National Credit Act 34 of 2005 of South Africa.

³⁷⁶ Cory (n 367).

³⁷⁷ *First Rand Bank* (n 265).

³⁷⁸ Cory (n 367).

invoice financing in the country. This organised involvement of financial institutions in the factoring business is absent in Ghana. The overall volume turnover from factoring services, made up of invoices received, increase to R229billion in 2016 at 4.5% over that of 2015 but advances were down by 15% on average within the same period.³⁷⁹ This figures, according to Cory, did not take into account, the figures of privately owned debt funding entities that are not members of the DFC.³⁸⁰

Clients-both large listed companies and SMEs-of factoring services are found with various sectors of the economy including manufacturers, clearing and forwarding companies involved in export and imports, foods, wholesaling, transport, automobile equipment supply, pharmaceuticals, clothing, textiles, footwear and steel.³⁸¹ Cory also reveals that the factoring industry in South Africa is not focused even though it has a highly regarded and established extant laws and regulations that work. In line with Kara's first approach, in jurisdictions where the national laws are clear and well tested, as to their applications and enforceability, factoring can develop without any specific legal or regulatory framework.³⁸² This may explain the position of Cory as to the status of South Africa's factoring industry in the absence of a clear factoring legal framework. This admission reinforces the call of his paper for a definite law on factoring in Ghana because even though factoring may survive and do well under subsidiary laws, to give it a focus will require nothing short of a framework to that effect.

The contribution of SMEs in the South African economy cannot be disputed, and they serve as the catalyst for job creation in South Africa. This position was confirmed by the SEDA of South Africa, which posited that small businesses could function as 'key drivers of economic growth, innovation and job creation.'³⁸³ There is every indication that players in the business and finance industries are keen on finding ways of assisting these enterprises in maximising their growth potentials. In 2013, the Association for Savings and Investment South Africa (ASISA) founded the Enterprise and Supplier Development (ESD) fund to assist the development capacities of the SMEs in South Africa by way of an innovative combination of tailored business acceleration and investment support.³⁸⁴ In line with this the CEO of ASISA, Leon Campher, emphasises:

³⁷⁹ Cory (n 367).

³⁸⁰ Cory (n 367).

³⁸¹ Cory (n 367).

³⁸² Kara (n 167).

³⁸³ Merchant Factors 'A Solution to the Small Business Finance Gap' accessed online on 19 July 2017 at www.mfactors.co.za.

³⁸⁴ Hamanyati (n 14).

We understand that SMEs require more than just financial support 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.³⁸⁵

The Business Partners and SME Index 2018 revealed that SMEs in business with government pointed to funding and early payment for completed jobs as critical pointers to business sustainability.³⁸⁶ The official statement of Business Partners, emphasising the seriousness of the challenge stressed:

Late and protracted payments by large corporates and state agencies put SMEs under unnecessary pressure. While large companies can easily absorb payment delays, late payments can have potentially devastating consequences for SMEs operating in the private and public sectors.³⁸⁷

In respect of the challenges that have been identified as inimical to the growth of SMEs in South Africa, factoring has so far intervened with tremendous support which is well acknowledged.

5.5.2 Tunisia

Tunisia's economic growth is slowly picking up after recovering modestly to 2% in 2017. On year on year basis, the economy grew to 2.5% in the first quarter of 2018 and accelerated to 2.8% in the second quarter; supported by agriculture, tourism, and export oriented manufacturing led by the electrical and mechanical industries.³⁸⁸

According to the World Index of Economic Freedom, Tunisia's economic freedom score is 55.4, placing it as the world's 125th freest. This indicates a decrease of 3.5 points because of a slowed down in fiscal health and lower scores for trade freedom, business freedom, labour freedom, and monetary freedom.³⁸⁹ The general economy of Tunisia is characterised with institutional weaknesses due to political instability, burdensome regulatory regime and rigid labour market.³⁹⁰ The combined value of the country's exports and imports is equal to 99.9 % of GDP.³⁹¹ Though there have been some improvements in the regulatory regime, there remain some restrictions that do not encourage dynamic entrepreneurial growth.³⁹² Only about 40%

³⁸⁵ <https://asisa.org.za>.

³⁸⁶ Johannesburg Stock Exchange 'Quarterly JSE Supplement, September 2018' at www.jse.co.za.

³⁸⁷ JSE (n 386).

³⁸⁸ World Bank Group 'Overview' (9 October 2018) accessed online 14 July 2019 at <https://www.worldbank.org/en/country/tunisia/overview>.

³⁸⁹ The Heritage Foundation 'World index of economic freedom: 2019' accessed online 14 July 2019 at <https://www.heritage.org/index/country/tunisia2019>.

³⁹⁰ (n 389).

³⁹¹ (n 389).

³⁹² (n 389).

of the adult population of Tunisians have access to an account with a commercial bank.³⁹³ A large share of the working age of the population is without jobs, and in 2014, around one-third of the youth population was categorised as unemployed.³⁹⁴

Tunisia's legal system is made up of a fused legal system that is mainly based on the French civil law system, with some influence from Islamic law in the areas of personal status and property.³⁹⁵ The success of Tunisia's economy is largely dependent on the success of its small businesses.³⁹⁶ It is estimated that there are over 80 000 SMEs in Tunisia which contributes approximately about 40% to the GDP of the country's economy at the time and offers jobs to more than half of the country's population, but access to funding and liquidity remains a serious predicament on the growth of these businesses.³⁹⁷

Against this background, the government of Tunisian has seen the need to support companies in their search for financing.³⁹⁸ In the past ten years, the government has strengthened legal and regulatory frameworks in the financial sector, by putting in place public financing systems, supporting the development of financial markets and helped to expand the supply of financial products, especially those targeted at SMEs.³⁹⁹

According to the World Bank:

SMEs play a vital role in Tunisia because at least 97.8% of Tunisian firms (across all sectors) fall into this category. The main consequence of the prevalence of SMEs in Tunisia's economic landscape is that all economic development strategies are de facto based on the performance of this category of companies. SMEs ability to obtain financing for their business operations and investments is therefore crucial to Tunisia's future economic development.⁴⁰⁰

This year, the European Bank for Reconstruction and Development (EBRD) advanced a loan of €24million to the country's largest factoring company, Tunisie Leasing and Factoring, to facilitate access to finance for SMEs in Tunisia.⁴⁰¹ This comes at the backdrop of robust factoring regulations integrated into the enactments of Tunisia to regulate the budding industry of factoring in that country. Tunisie Leasing and Factoring Company was the first company to

³⁹³ (n 389).

³⁹⁴ World Bank Group (n 388).

³⁹⁵ *Commercial Laws of Tunisia March 2013: An Assessment* by the EBRD.

³⁹⁶ N Zgheib '€24 million EBRD loan to Tunisie Leasing and Factoring' (27 march 2019) <https://www.ebrd.com/news/2019/24-million-ebrd-loan-to-tunisie-leasing-and-factoring.html> (accessed 13 July 2019).

³⁹⁷ Zgheib (n 396).

³⁹⁸ World Bank. 'Policy note on SMEs access to finance in Tunisia' (2009) Washington, DC. <https://openknowledge.worldbank.org/handle/10986/12951?locale-attribute=fr>.

³⁹⁹ World Bank (n 398).

⁴⁰⁰ World Bank (n 398).

⁴⁰¹ Zgheib (n 396).

venture into leasing operations in Tunisia with a strategic mandate of supporting small businesses.⁴⁰² Since it started operations in Tunisia in 2012, the EBRD has invested €840million in support of about 38 projects and provided technical assistance to nearly 800 SMEs.⁴⁰³

Even though there is no specific legislation on factoring governing the system in Tunisia, the industry is regulated under the general contract laws under the contract code of 2010. The legal regime places factoring activities under the non banking sector of the country. The law No.2001-65⁴⁰⁴ and Law No. 2006-19⁴⁰⁵ provide some legal impetus for the regulation of factoring in Tunisia. The connection between the law and factoring has given factoring activities in Tunisia some miles of advantages in terms of attracting international financing support in the industry to boost SMEs access to finances as against other African countries without such enactment.⁴⁰⁶ Apart from being controlled by the central bank, the requirement for the approval from the Ministry of Finance to the operator of a factoring business in Tunisia is compulsory.⁴⁰⁷ The capital requirement for the operation of a factoring business in Tunisia is not less than 10million Tunisian Dinars-approximately €4.4million-as provided.⁴⁰⁸ Tunisia was one of the countries in Africa that reported on factoring activities in 2012 as well as Mauritania, Mauritius, Morocco and South Africa.⁴⁰⁹

The robustness of the factoring industry also received a positive rating by Fitch. Fitch Ratings affirmed the Tunisie Factoring's national long term rating at BBB(tun) and upgraded the national short term rating to 'F2(tun)' from 'F3(tun)'.⁴¹⁰ The outlook on the long term rating has been reviewed to positive from stable.⁴¹¹ According to Reuters, Tunisie Leasing is known as a leading provider of non bank financing services in Tunisia and factoring products are an increasingly strategically important product within the group.⁴¹² The specificity of provisions in the laws of Tunisia which directly deal with factoring activities is positive development in that

⁴⁰² Zgheib (n 396).

⁴⁰³ Zgheib (n 396).

⁴⁰⁴ No.2001-65 of 2001 of Credit Establishments, art 4.

⁴⁰⁵ Law No.2006-19 amending and supplementing Law No. 2001-65 of 10 July 2001.

⁴⁰⁶ Zgheib (n 396).

⁴⁰⁷ Kameni (n 8).

⁴⁰⁸ Law No. 2006-19 of 2 May 2006 as amending and supplementing Law No. 2001-65 of 10 July 2001 on Credit Establishments, art 13.

⁴⁰⁹ RL Tomusange 'Factoring as a financing alternative for African small and medium scale enterprises' in m Bickers(ed) World Factoring Yearbook (2013) at <http://www.semanticscholar.org/paper/Factoring-as-a-Financing-Alternative-for-African-Tomusange/294f736886477bce364510250911fe3e9d43083e> (accessed on 15 May 2019).

⁴¹⁰ Reuters 'Fitch affirms 2 Tunisian factoring companies' London 14December 2017 accessed online 25 July 2019 at <https://af.reuters.com/article/africatech/idaffit1qlpz8>.

⁴¹¹ Reuters (n 410).

⁴¹² Reuters (n 410).

country which reinforces the core objective of this paper proposing a legal framework to govern factoring in Ghana.

5.6 Reasons for a factoring model law for Africa and challenges

Many reasons would inform the adoption of a model law on such a complex international financial industry like factoring.

First, the passage of the Afreximbank model law was aimed at promoting the unification of factoring laws across the continent due to the various legal systems and the peculiar nature of specific country's socio cultural underpinnings of laws.⁴¹³ It was also expected that such a model law would assist national legislators in making rules compatible with the trends and practices of international trade and finance.⁴¹⁴

Again, a model law helps states thriving to align their national laws with international best practices to have a model to follow.⁴¹⁵ This model law is recommended to be adopted wholesale for common law jurisdictions as it is fashioned on such legal system, but it is convertible into civil code for such countries under civil law jurisdictions.⁴¹⁶

Kayanula and Quartey have rightly noted that,

the dynamic role of small and medium enterprises (SMEs) in developing countries as engines through which the growth objectives of developing countries can be achieved has long been recognised.⁴¹⁷

The concern, however, of authorities of developing countries has been the inability of the banking sector to make credit available on demand to entrepreneurs and SMEs.⁴¹⁸ Priest-Stephens and Kameni have cited the UK as a country where due to absence of legal framework regulating factoring, subjects depend on drafting lengthy contracts to be satisfied that likely expense of disputes are elucidated and exhausted in the documents to avoid judicial interventions.⁴¹⁹ Factoring has for decades been identified as the panacea to the limitations associated with trade finance. It is suggested that Africa cannot be left behind in this journey of finding the appropriate means of financing SMEs or economic growth especially when there is a need to equip and fund these enterprises to take advantage of the African Continental Free Trade Area (AfCFTA) platform.

⁴¹³ Afreximbank Model Law (n 344)4-5.

⁴¹⁴ Afreximbank Model Law (n 344 above).

⁴¹⁵ Afreximbank Model Law (n 344 above).

⁴¹⁶ Afreximbank Model Law (n 344 above).

⁴¹⁷ D Kayanula and P *Quartey* 'The Policy Environment for Promoting Small and Medium-Sized Enterprises in Ghana and Malawi' (2000) Working Paper Series, Paper No 15 Finance and Development Research Programme Idpm, University of Manchester.

⁴¹⁸ Sacerdoti (n 4).

⁴¹⁹ Priest-Stephens & Kameni (n 13).

Despite the potent reasons for a model law to guide a domestic legislation, it can also present some challenges:

To begin, adopting a model law informed by different consideration might not necessarily be the best to suit a country in enacting specific legislation. It is conceded that adopting a model law as the Afreximbank one may pose some challenges depending upon the legal, social and economic dynamics of that country. Again, funding has also been the reason for many delayed projects and initiative, especially in Africa. Most African government resort to donor funding for projects including soft projects on law and development. An enactment involving all facets and processes would have cost implications and would need a dedicated budget for that.

Furthermore, in most African countries such as Ghana, bills for legislation are solely sponsored by the executive. Private bills are expensive and almost inconceivable to sponsor in such jurisdictions. It will, therefore, require a government with the political will and understanding of the implications of such enactment to give attention to promulgating any law on factoring. This demands regular engagements by players and experts in the financial market to draw governments' interests to the law.

Additionally, there will also be the need to get stakeholders' interests and give them a clear understanding of such laws. Even though factoring is well conceived in developed countries, it seems to be a new area in the financial sector in Africa, even among seasoned bankers. The complex nature of the concept requires that both practitioners and citizens are educated and oriented on the need for such law and the benefits thereof to business activities in terms of helping to expand and grow SMEs to create jobs, increase GDP and eradicate poverty.

5.7. Conclusion

The Afreximbank intervention in promoting a model law on factoring has come at the rightful time when the industry is gaining grounds and acceptability across many jurisdictions including Ghana. The leadership role assumed by the Afreximbank in engaging stakeholders across Africa on the need to follow its model law, which is based on the internationally accepted standards of UNIDROIT, UNCITRAL and IFG, is a welcome gesture. Ghana must take advantage of this to enact a factoring law to position its SMEs in order not to be left out of the projected windfalls of the AfCFTA being headquartered in that country. The capacity of factoring to finance a whole supply chain without the usual intricacies associated with traditional finance like loans and overdrafts must be the incentive to provide the needed legal milieu for it to thrive. A regulated environment delineates rights, obligations and prohibitions, and presents an atmosphere of orderliness and development. Having a legal framework to govern factoring

activities in Ghana would make the business environment competitive and attractive for foreign direct investment (FDI), that would propel growth and prosperity for the citizens.

The cases alluded to from South Africa, and Tunisia is to emphasise the following points:

1. Factoring has developed in countries where there have been some efforts to put in place a legal milieu that set the basis for the industry.
2. Even though South Africa has no specific factoring law, the regulatory frameworks that create access to information on credit activities are essential for the factoring industry.
3. Despite the present challenges of Tunisia's economy, it continues to attract positive investments into the factoring industry and receives high ratings because it has made efforts to incorporate factoring provisions into their general business and contracts laws.

The overwhelming evidence from these scenarios is that these two countries have leapt in supporting their SMEs through the activities of factoring through conducive regulatory and legal arrangements.

CHAPTER SIX

RECOMMENDATIONS AND CONCLUSION

6.1 Introduction and recap

The final chapter of this research will proffer recommendations to the effort at legislating a framework for Ghana in future on factoring and conclude on the theme for new factoring law in Ghana. The international trade environment is fast changing across countries, regional and multinational boundaries. In the same vein, the facilitation mechanism for trade and finance is also running with the times. The expectation is that these recommendations would be best suited and instigate the need to enact legislation for factoring in Ghana to promote the activities of SMEs.

The contribution of SMEs to the general economy of Ghana has long been acknowledged by scholars and successive governments. Jackson⁴²⁰ succinctly summarised the contribution of SMEs to the Ghanaian economy and their financial constraints as follows;

...the commercial banks we are talking about that we've secured don't lend to the groundnut seller in the streets. They've never lent to the groundnut seller. That is why we have micro-finance; that is why we have money lenders; that is why we have non banks. Because we admit that, on a very real level, the engine of growth, and we love to talk about the fact that SMEs being the engine of growth; we love to talk about the fact that more jobs are created at the SME level than would ever be created at the large corporate level. No nobody is lending to them. If you are an advertising company today and you get a contract, who is going to get you money to finance that contract before you get paid? You are to go to the good old friends, families etc.⁴²¹

These businesses contribute about 60% and 70% to the GDP and employment avenues of emerging economies respectively,⁴²² which impact on the poverty alleviation efforts of the countries.

Over the years, interventions from the banking sector to finance these SMEs through traditional modes such as loans and overdrafts have not yielded the desired result due to some demand and supply factors. Collateralisation, securitisation, formalities and the rigorous scrutinisation of documents have always been cited as the worst characteristics of these traditional financing. The challenge of most SMEs is that they operate as informal businesses, often working under sole proprietorships.

⁴²⁰ Mr Joe Jackson is the Director of business operations at Dalex Finance in Ghana.

⁴²¹ J Jackson "Banks collapse-recovering what is lost?" Joy FM Ghana, Newsfile Saturday 1 June 2019 at 9 A.M.

⁴²² Agyapong (n 33)201.

It is imperative, therefore under these circumstances, to demand an intervention that is focused on giving protection and guidance to players and parties in a scheme of financing like factoring by way of legislation. This research aimed at arguing for a legal framework on factoring in Ghana that follows the best principles from internationally accepted Model Laws, such as those of UNIDROIT, UNCITRAL, IFG and, Afreximbank.

6.2 Summary of findings

Chapter one of this paper laid the structure of this dissertation; the background to the study, the problem statement, aims and objectives, research questions, thesis statement, literature review, research methodology, limitations of the study and the outline of the chapters. The various works reviewed and analysed revealed the extent to which SMEs support different sectors of economies through their contributions. It identified the lacuna in literature covering factoring in Ghana and the need to undertake this research to help fill the gap. It also identified the challenges of these small scale businesses and how the best alternative financing scheme like factoring can be promoted to address such shortfalls, which addressed the overarching question posed by this research as to what extent SMEs utilise factoring as an avenue to access finance to promote their businesses in Ghana.

Chapter two was devoted to examining factoring as a concept of trade finance, tracing its historical route, the mechanisms of factoring agreements and the legal approaches for regulating factoring business. The support from the FCI through its members in these countries have been encouraging as well as those received from the Afreximbank. As a result, chapter two effectively answered the question one raised, as to what factoring is and what role it can play in facilitating SMEs' financing in Ghana.

Chapter three identified the financing challenges facing SMEs and the fact that loans and overdraft have not adequately and conveniently offered the needed funding for SMEs in Africa. It established the other benefits factoring can bring as a critical financial scheme for promoting the activities of these enterprises. It was established that though there are some challenges associated with factoring, its benefits extend beyond accessibility and affordability, but it is also flexible and a convenient means of sourcing capital. The critical appraisal of the alternative financing models effectively addressed the issue of the benefits and challenges of utilising factoring as trade finance product as compared to other traditional bank lending raised in question three.

In chapter four, the laws and regulations currently providing the legal milieu for the banking sector, which serves as the extant laws for factoring in Ghana were critically examined. The

theme of this chapter was to vigorously defend the argument of this paper for proposing a separate law for factoring to answer the question four of this paper. This proposal was justified by establishing that the policy and legal framework in Ghana do not sufficiently cater for factoring to allow it to thrive to promote the SME sector.

Chapter five emphasised that funding SMEs in Africa remain a dilemma to governments and stakeholders given the challenges of access to liquidity. Except for a few countries, this research established that factoring is not up to speed in most African countries, coupled with the lack of awareness about the product among the citizens. The role of IFIs such as the IFG and the Afreximbank under the auspices of the AfDB; such as providing organisational, research and legal assistance to African countries to develop their local laws on factoring based on the model laws they have promoted was established. The details of the scope of the Afreximbank Model Law on factoring was examined. It also identified specific dynamics inherent in the international model laws of UNIDROIT, UNCITRAL and IFG, which served as the foundations for Afreximbank's Act. The legal approaches and the institutional arrangements for factoring in South Africa, as the leading factoring market in Africa, and Tunisia which have put the two countries in better positions to serve as an excellent example for any country hoping to leverage on factoring to promote its SMEs, were examined. The final question of the research, which asked about the role of model laws such as the Afreximbank model law on factoring play in domestic legislation was sufficiently answered. The conclusion of this chapter reechoed the purpose of this research for a law on factoring in Ghana fashioned in the manner of the Afreximbank model, which syncs with provisions of international model laws.

6.3 Recommendations

A good law is deemed to have such characteristics such as popularity among the citizens, acceptability in the jurisdiction, enforceability, stability, amenability, consistency; without prejudice to existing laws (my emphasis), and mechanisms for dispute resolution.⁴²³ In line with the foregoing arguments in this paper, the following are the recommendations made in support of a legal framework on factoring for Ghana:

First, Ghana must look forward to enacting a law that is consistent with the characteristics of its economic, business and financial environment and culture. As postulated earlier, laws are for a purpose and must seek to serve and elevate that purpose. In order to have the acceptability

⁴²³ The Law Society of Western Australia '*Characteristics of an effective law: year 11 teacher and student resource*' (February 2015) Francis Burt Law Education Programme at 1-5 accessed online 1 August 2019 at <https://www.lawsocietwa.asn.au/wp-content/uploads/2015/09/2015-FBLEP-Characteristics-of-an-Effective-Law.pdf>.

of the players and the citizenry, this proposed law must be well advertised to inform its inputs as well as conforming to the international models in order not to become redundant and unacceptable to the industry players. To achieved this, the following steps must be taken by the government to create the needed awareness among all interested sections of the public before, during and after the passage of the law:

- Public forums at all available avenues must be exploited to bring the citizens and stakeholders up to speed with the scope, the benefits and obligations under the law. The mandate of the National Commission on Civic Education (NCCE) can, therefore, be utilised in this sense.
- High level seminars and workshops are therefore essential for the top level management and practitioners in the financial and non financial sectors of the economy as direct implementors and beneficiaries of the law.
- An effective tool for sensitisation on the law at all times will be the use of the media- print, electronic and social- through paid and sponsored advertisements on the law for the general awareness of the public.
- There must also be an effort to place copies of the law at the disposal of the citizens, and especially SME operators in public and public institutions, where necessary in order not to obscure the benefits of the law.
- Regular monitoring and evaluation on the implementation of the legislation would help receive the appropriate feedback to inform future amendment or improvement of the law in order to maximise the importance of such law on factoring to the growth of the SMEs sector.

Second, because the Afreximbank model law deliberately leaves issues of taxation as national issues for individual countries, it is recommended that the new law must create a congenial business environment by not imposing harsh tax measures to dissuade prospective factoring investors. To facilitate the flow of investment in this industry, factoring companies can have initial tax incentives or packages, especially when it is certain that the benefits of such respite will accrue to the small businesses with a rippling effect on the national economy.

Third, technology is at the background of economic and financial systems today. An up to date law must address this with provisions to address money laundering, cybercrimes, graft and corruption. It is recommended that given the modern trend and practice in business, the law must anticipate providing for financial technology and programmes that might be necessary for

the business. In many advanced nations, platforms have been developed to provide electronic factoring as a convenient means of offering services to the clientele. The financial sector is advancing with the latest technology, such as the Blockchain to provide efficient factoring services in other jurisdictions.⁴²⁴ It is therefore expected that the legislation would provide a mechanism to cater for this new area.

Fourth, it is also recommended that the new law must encourage the formation or grouping of industry players as professionals to take up the mandate of getting the public on board and facilitating the implementation of the law. The benefit of professional bodies in legal architecture is enormous. They serve as a rallying point for advocacy and education. They can mobilise resources to complement government's efforts at sustaining its programmes under any sector. Moreover, as key players and actors in the lawmaking process and implementation, they will be required to make inputs into any amendment that may be contemplated. Indeed, the acceptability of the industry by others will depend mainly on such bodies. The provisions must, therefore, encourage players to belong to international bodies like the FCI and its local and regional affiliates. Like associations of bankers in Ghana, who are supervised by the BoG, a factoring association overseen by the BoG will be a milestone at institutionalising the industry for smooth regulation by the central bank.

Fifth, the factoring industry involves both international and local actors. In this regard, it is recommended that provisions are made to address the dynamics of containing such complex industry to conform to international standard as well as maintaining the local prospects of the industry. In 2017, the domestic factoring contributed more than 80.0% to the world's factoring market and has sustained this growth up till today.⁴²⁵ On the international front, about 7 000 banks and companies are into the business of offering factoring service to varied clientele globally.⁴²⁶ These statistics must inform the consultation, scope and inputs of the law to help Ghana put out a law that will satisfy stability and consistency.

Sixth, like all other financial and banking services, factoring industry is not risk averse. Because of the vast number of international and cross border transactions involved, factors usually seek cover under insurance to secure their investments. Exporter insolvency is possible all the time, and so the industry will encourage domestic and international insurance and reinsurance companies to troop in as another windfall of a booming market. This should call for provisions

⁴²⁴ 'The global factoring market research report' accessed online 1 August 2019 at <https://www.adroitmarket-research.com/contacts/request-sample/837>.

⁴²⁵ (n 424).

⁴²⁶ (n 424).

in the law to explicitly guide how foreign insurance companies can be incorporated in line with the Companies Act 179 and establish the requirements for certifications as a prerequisite for registration under the law.

Finally, a good law anticipates disputes and provides elaborate mechanisms for resolution. In commercial contracts, disputes are likely to emerge on parties' rights, duties and obligations arising out of the terms and sanctity of such contracts. The law must provide specific forums, procedures and mechanism to address the nature of disputes that are likely to arise. The factoring industry is fragmented with both domestic and international actors. This paper recommends that consultation, mediation, good office, conciliation, arbitration and litigation are all considered as possible means of resolving disputes, depending on the nature and parties involved. The principle of party autonomy in private contract must always prevail to offer unlimited options to parties in disputes situations. Avenues for international dispute settlements involving international factoring disputes must be specified in the law. It is suggested that as domestic disputes are specified for settlements in the domestic, commercial courts, international disputes are provided for in the law to be adjudicated with a panel of expert arbitrators or mediators, as the case may be, selected with the approval of the parties in line with the UNCITRAL Model Law on Arbitration.⁴²⁷

6.4 Conclusions

The position of factoring in international trade and finance is unquestionable. Its history and practice amplify why it is regarded globally as a better means of alternative trade finance for the capitalisation, expansion, and growth of small enterprises. The complex and sophisticated nature of factoring makes it challenging to confine it to a single and straightforward definition. Like SMEs, both concepts can only be described than defined. SMEs remain as the backbone of many economies, and that role is profound in the African context. In their varied nature and sizes, SMEs provide employment to most of the population, contribute significantly to GDPs of economies, help alleviate poverty and remove inequality. To emphasise that access to finance is the bane of these enterprises is an understatement. In most African countries including Ghana, where the economies are unable to offer the needed financial support and bailouts for distressed businesses, it is crucial to encourage interventions such as factoring to offer the needed assistance for these businesses. It is essential to put the light on factoring and popularise it through legal framework and policies to make it accessible to the citizens. Ideally,

⁴²⁷UNCITRAL Model Law on International Commercial Arbitration (1985)<https://uncitral.un.org/pdf/english/texts/arbitration/> (accessed 1 August 2019).

international and domestic investors are always attracted to safe, predictable and regulated business environments in order not to risk losing their investments. Factoring companies and importers in other countries willing to use factoring for their transactions will require the same atmosphere. Many African countries are moving towards having their domestic legislations to regulate factoring in line with Afreximbank model law. The need for Ghana to have a legal framework to govern the activities of factoring and its players will ultimately inure to the benefit of the nation as it sustains its SMEs to anchor its agenda on Ghana beyond aid.

A pragmatic legal framework on factoring, proposed to be known as “The Factoring Act” of Ghana with the objects of creating the enabling environment to regulate and facilitate the factoring business will make the country competitive and put the nation in good stead amongst its peers. In line with international best practices, it is submitted that any legislation contemplated must cater for the following rudiments as required of the Afreximbank Model Laws on factoring as well as the three conventions of IFG, UNCITRAL and UNIDROIT;⁴²⁸

- definition of factoring,⁴²⁹
- the right of the factoring company to his payments- “debts”,⁴³⁰
- the rules on assignment of invoice receivables,⁴³¹
- the requirement to make any factoring contract in writing,⁴³²
- rules on international factoring⁴³³ and
- harmonisation of the law with international best factoring practices.⁴³⁴

Ghana hosts the administration of the AfCFTA and must set the pace for all other countries in creating the regulatory environment for all segments of trade and investment.

⁴²⁸ Kameni (n 8)27, 40.

⁴²⁹ Kameni (n 8).

⁴³⁰ Kameni (n 8).

⁴³¹ Kameni (n 8).

⁴³² Kameni (n 8).

⁴³³ Kameni (n 8).

⁴³⁴ Kameni (n 8).

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