

**THE UNIVERSITY OF THE WESTERN CAPE
FACULTY OF LAW**

**THE ROLE OF LEGAL AND POLICY INCENTIVES IN PROMOTING
FACTORING AS A FINANCING ALTERNATIVE FOR SMEs IN NIGERIA**



**A mini-thesis submitted in partial fulfilment of the requirements for the degree of
Master of Laws (LLM) in International Trade, Investment and Business Law**

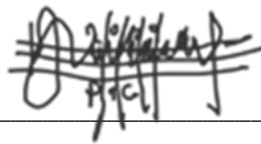
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DECLARATION

I, **Albert Chris PUJA**, declare that the thesis titled '**The Role of Legal and Policy Incentives in Promoting Factoring as a Financing Alternative for SMEs in Nigeria**' is my original work and that all other works used or quoted have been indicated and acknowledged as complete references. This work has not been submitted to any University, College or other institution of learning for any academic or other awards.



Albert Chris PUJA

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



Prof. Riekie Wandrag

July, 2021

DEDICATION

I dedicate this work to all entrepreneurs and small businesses in Nigeria striving to establish, survive, grow and even expand into the international market despite the difficulties in accessing finance that is compounded with the general harsh business environment. Remember this always; today's large corporates and multinational entities were once small businesses. As Jeff Bezos aptly sums it, 'Big things start small.' Therefore, continue seeking out innovative financing options with bells and whistles (like factoring and other asset-based financing options) and employing better business management practices in driving your operations.



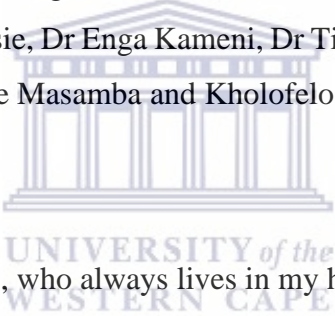
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KEYWORDS

Access to Finance

Agency Theory

Alternative Financing

Asset-Based Financing

Asset-Based Lending

Credit Rationing Theory

Factoring

Invoice Financing

Pecking Order Theory

Small and Medium-Size Enterprises

Trade Finance

Working Capital



ACRONYMS AND ABBREVIATIONS

AfCFTA	African Continental Free Trade Area.
AfDB	African Development Bank.
Afreximbank	African Export-Import Bank.
ASeM	Alternative Securities Market.
BCE	Before the Common Era.
BOFIA	Banks and Other Financial Institutions Act.
BOI	Bank of Industry.
CAC	Corporate Affairs Commission.
CAMA	Companies and Allied Matters Act.
Cap	Chapter.
CBE	Central Bank of Egypt.
CBN Act	Central Bank of Nigeria (Establishment) Act.
CBN	Central Bank of Nigeria.
COVID-19	Coronavirus Disease of 2019.
EBRD	European Bank for Reconstruction and Development.
EFA	Egyptian Factoring Association.
EFSA	Egyptian Financial Supervision Authority.
EU	European Union.
EUF	European Federation.
EUR	Euros.
FCI	Factors Chain International.
FOREX	Foreign Exchange.
GDP	Gross Domestic Product.
GoE	Government of Egypt.
GRIF	General Rules for International Factoring.
Guidelines	Guidelines for Finance Companies of 2014.
HL	House of Lords.
IFG	International Factoring Group.
LFN	Laws of the Federation of Nigeria.
NBS	National Bureau of Statistics.
NCR	National Collateral Registry.
NEPC	Nigerian Export Promotion Council.
Neximbank	Nigerian Export-Import Bank.
NFWG	Nigerian Factoring Working Group.

NICN	National Industrial Court of Nigeria.
NSE	Nigerian Stock Exchange.
PC	Privy Council.
PwC	PricewaterhouseCoopers.
QSC	Queensland Supreme Court.
s	Section.
SC	Supreme Court.
SEC	Securities and Exchange Commission.
SMEDAN	Small and Medium Enterprises Development Agency of Nigeria
SMEs	Small and Medium-Size Enterprises.
SSA	sub-Saharan Africa.
STMA	Secured Transactions in Movable Assets Act.
UNCITRAL	United Nations Commission on International Trade Law.
UNCTAD	United Nations Conference on Trade and Development.
UNIDROIT	International Institute for the Unification of Private Law.
US	United States of America.
VAT	Value Added Tax.
VAT	Value Added Tax.
WBG	World Bank Group.
WTO	World Trade Organization.
\$	Dollars.
₦	Naira.
€	Euros.



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ABSTRACT

Timely, adequate and affordable access to finance is pivotal to bolstering the participation of small and medium-size enterprises (SMEs) in both domestic and international trade. Regrettably, despite their immense contributions to the economy, most SMEs in Nigeria and across Africa find it extremely challenging to access finance from banks and the stock market. As a result, they cannot fund their working capital and trade financing needs conveniently, and this undermines their growth and capacity to contribute even more to the economy. This situation has made it imperative to continue exploring alternative sources of finance that may be more accessible and align better with the peculiarities of SMEs.

Factoring has evolved as an efficient alternative that SMEs can use to complement and or substitute other working capital and international trade finance sources. Factoring is understood broadly to mean a financing arrangement under which a business assigns, either by way of sale or security, its creditworthy accounts receivable to a financing institution called the factor in exchange for immediate cash and other credit management services. Notably, with factoring, SMEs can tackle cash flow problems usually caused by delays from when they deliver goods and services to customers on trade credit or open account and when payment is actually received from such customers. Additionally, just like payment guarantees, letters of credit and documentary collection, factoring can be used by SMEs as a trade finance instrument. Despite the opportunities that factoring presents and its suitability for SMEs, its availability and utilisation in Nigeria remain few and far between.

This study critically examined the extant legal, tax and regulatory frameworks governing factoring in Nigeria to uncover how they have either supported or stood as barriers to the growth of factoring as an alternative source of financing for SMEs in the country. Because Egypt has achieved commendable success in its interventions through legal, tax and regulatory frameworks to promote factoring as an alternative source of financing for SMEs and large corporates alike, the study delved into the Egyptian experience to draw lessons capable of being transplanted in Nigeria. Based on the examination of the extant frameworks in Nigeria and comparative study with the frameworks in Egypt, the study formulated recommendations. These recommendations feature suitable policy, legal, tax and regulatory interventions that can influence the growth of factoring as an alternative source of financing for Nigeria's SMEs.

CHAPTER ONE

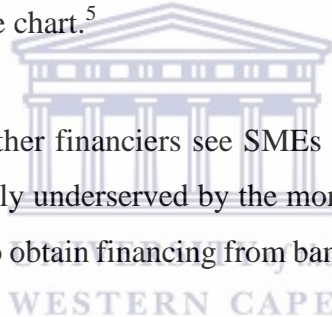
INTRODUCTION

1.1. Research Background

Small and medium-size enterprises (SMEs) dominate the private sector and are an integral part of Nigeria's economy due to their central roles in creating jobs, boosting tax revenues, reducing poverty, promoting exports and fostering entrepreneurship.¹ They contribute to over 50 per cent of the country's Gross Domestic Product (GDP), account for 76.5 per cent of employment and support 7.64 per cent of export activities.²

For SMEs to thrive and participate effectively in domestic and international trade, they need to have sustainable access to finance.³ On the whole, access to finance underpins the formation, survival, growth and development of SMEs.⁴ Unfortunately, despite their immense contributions, SMEs in Nigeria and across other African countries face numerous challenges, with access to finance topping the chart.⁵

Although banks, investors and other financiers see SMEs as a business opportunity, the sad reality is that SMEs remain grossly underserved by the money and capital markets. SMEs are less likely than large corporates to obtain financing from banks and the stock market.⁶ Equally,



¹ As used in this study, small and medium-size enterprises or the acronym SMEs, is broadly defined to include micro enterprise. There is no generally agreed or universally applicable definition of SMEs, both globally and in Nigeria. However, the framework in Nigeria defining SMEs that is commonly used in literature and which is adopted for this study is the National Policy on Micro, Small and Medium Enterprises of 2007. This Policy defines an SME as a firm with less than 199 employees and assets base (excluding land and buildings) valuing less than ₦500 000 000 million (about US\$ 1 260 000). Although the Policy adopts the dual criteria of employment and assets in defining an SME, it clarifies that where there is a conflict between the two, the employment-based criteria shall take precedence.

² Small and Medium Enterprises Development Agency of Nigeria & National Bureau of Statistics *National Survey of Micro Small & Medium Enterprises (MSMEs) Report* (2017) 7.

³ Access to finance is a broad concept describing the availability of financial services like financial capital, savings, payments, insurance and other risk management products to SMEs to facilitate their sustained growth and productivity. However, its usage in this study focuses on financial capital which embraces equity, debt, trade and working capital needed by a business to fund its operations and activities. See generally The World Bank *Policy Research Report on Finance for All: Policies and Pitfalls in Expanding Access* (2008) 21.

⁴ Ahmed S *Strategies to Access Business Loans for Small and Medium Enterprises in Jordan* (unpublished Doctor of Business Administration thesis, Walden University, 2017) 42.

⁵ Muriithi SM 'African Small and Medium Enterprises (SMEs) Contributions, Challenges and Solutions' (2017) 5(1) *European Journal of Research and Reflections in Management Sciences* 40 - 44.

⁶ Taiwo JN, Falohun TO & Agwu ME 'SMEs Financing and Its Effects on Nigerian Economic Growth' (2016) 4(4) *European Journal of Business, Economics and Accountancy* 37.

SMEs are noted to face more obstacles or higher transaction costs than large corporates when seeking financing from banks and the stock market.⁷ Further, SMEs that supply goods or services to their domestic and international customers on trade credit or open account terms face other credit management risks and challenges.⁸ For example, they suffer cash flow shortages or liquidity crisis pending when the customer settles the accounts receivable.⁹ Even worse, the accounts receivable may become bad debt in some cases, thereby causing the SME to suffer a financial loss.

The challenges SMEs face with financing have popularised the terminology 'financing gap'.¹⁰ This terminology can be used to describe a situation where an SME has a profitable business opportunity but is faced with a lack of or insufficient financing from internal or external sources to take advantage of such an opportunity.¹¹ According to a 2017 report by the International Finance Corporation (IFC), the financing gap for Africa's SMEs is about US\$ 331 billion.¹² With particular reference to Nigeria, a recent report by PwC estimated the financing gap for SMEs in the country to be ₦617.3 billion per annum (around US\$1.5 billion) as of 2020.¹³

The unavailability, inadequacy and high cost of accessing financing from external sources make it difficult for SMEs to develop, grow and unlock market opportunities.¹⁴ Further, it limits and cripples their ability to contribute to the economy as much as they ought to.¹⁵ Additionally, it constitutes a significant impediment to the participation of SMEs in

⁷ Saari D *Challenges Faced by SMEs When Accessing Loans from Financial Institutions in Nigeria* (unpublished Bachelor of Business Administration thesis, Helsinki Metropolia University of Applied Sciences, 2020) 13.

⁸ Rawat B & Dave G 'A Conceptual Study of Trade Credit Management on SME's' (2017). 6(4) *Global Journal of Commerce & Management Perspectives* 4.

⁹ Accounts receivable is used to describe money due for goods or services delivered on credit or open account but not yet due and paid for by the customer.

¹⁰ Fowowe B 'Access to Finance and Firm Performance: Evidence from African Countries' (2017) 7 *Review of Development Finance* 6.

¹¹ See generally Goh K 'Trading Places: Benefits of Invoice Finance for Small and Medium Sized Enterprises as Opposed to Bank Lending' (2017) 7 *Aberdeen Student Law Review* 61-2.

¹² International Finance Corporation *Report on MSME Finance Gap: Assessment of the Shortfalls and Opportunities in Financing Micro, Small and Medium Enterprises in Emerging Markets* (2017) 31.

¹³ PwC 'PwC's MSME Survey 2020 Report' (2020) 14 available at <https://www.pwc.com/ng/en/assets/pdf/pwc-msme-survey-2020-final.pdf> (accessed on 22 January 2021).

¹⁴ Osei-Asabi E 'Source of Finance and Small Enterprise's Productivity Growth in Ghana' (2013) 4(3) *African Journal of Economic and Management Studies* 372.

¹⁵ Oliyide O 'Law, Credit Risk Management and Bank Lending to SMEs in Nigeria' (2012) 38(4) *Commonwealth Law Bulletin* 694.

international trade.¹⁶ In exploring solutions to tackle the lingering issue, factoring has been projected as a viable and cost-effective alternative that can promote access to finance for SMEs in Africa to facilitate their participation in domestic and international trade.¹⁷

Broadly defined, factoring is a form of asset-based financing whereby a business assigns (either by way of sale or security) its accounts receivable at a discount to a financial institution called the factor in exchange for immediate cash and other credit management services. These credit management services include credit risk assessment, receivables collection, sales ledger management and credit risk protection in connection with the assigned accounts receivable. As a specialised form of external finance, factoring is provided by banks either directly or through their subsidiaries as well as non-bank financial institutions (sometimes called independent factoring firms).¹⁸

1.2. Problem Statement

Access to finance remains a major obstacle hindering the full-scale development of SMEs in Nigeria, including their increased participation in international trade. Fortunately, factoring has emerged as a highly efficient financing option to assist in tackling these challenges. Factoring can support SMEs in meeting their working capital needs.¹⁹ It can also serve as a flexible form of payment to facilitate the participation of SMEs in international trade, either as exporters or importers.²⁰ In making a case for its promotion in Nigeria, Nevin, Omosomi and Suberu, estimate that factoring could unlock between US\$ one to US\$ two billion per annum in

¹⁶ Africa Development Bank *Report on Trade Finance in Africa: Overcoming Challenges* (2017) 4.

¹⁷ See The African Capacity Building Foundation & African Export-Import Bank *Paper on Factoring in Africa to Support Trade Development: Challenges and Opportunities for Growth through Capacity Development* (2021) 27; also see Awani K 'Factoring: An Alternative SME Financing Instrument for Intra-African Trade Promotion' (2020) 6(1) *Contemporary Issues in African Trade and Trade Finance* 82 -3.

¹⁸ Soufani K 'The Decision to Finance Account Receivables: The Factoring Option' (2002) 23(1) *Managerial and Decision Economics* 23. In Ikechukwu NCN & Chijindu AA 'The Role of Non-Bank Financial Institutions on Financial Intermediation Process in Nigeria (1992-2014) (2016) 14(4) *British Journal of Economics, Management and Trade* 3 non-bank financial institutions are defined to mean 'financial institutions other than deposit money banks that are involved in the mobilization of funds from surplus unit in the economy and making such funds available to deficit unit for investments.'

¹⁹ Onaepemipo E, Zubairu U & Abubakar B et al 'Factoring as an Effective Working Capital Option: A Critical Review' (2019) 5(1) *International Journal of Commerce and Finance* 67.

²⁰ World Trade Organisation *Report on Trade Finance and SMEs: Bridging the Gaps in Provision* (2016) 11.

financing to SMEs in the country to support their working capital needs.²¹ Furthermore, Akintunde observes that factoring can improve access to trade financing for Nigeria's SMEs and facilitate their participation under the African Continental Free Trade Area (AfCFTA).²²

Despite its numerous benefits, factoring remains an unpopular and underutilised alternative source of financing in Nigeria for domestic and international trade, especially among SMEs.²³ Likewise, banks and non-banking financial institutions providing factoring services in the country remain few and far between.²⁴ As a result, although Nigeria boasts as Africa's largest economy, it has constantly missed out on making the list of the countries contributing considerably to the continent's factoring volumes, as evidenced in Table 1 below:

Table 1: Africa's Factoring Volumes for the Last Seven Years: 2013 -2019²⁵

Country	2013	2014	2015	2016	2017	2018	2019
South Africa	19,400	15,898	14,672	16,291	17,117	18, 582	20,873
Morocco	2,755	4,200	2,708	2,708	3,374	2,532	2,532
Egypt	450	435	537	550	418	517	589
Tunisia	373	355	354	373	339	316	338
Mauritius	145	206	235	256	208	227	230
Kenya	NA	NA	215	215	215	NA	NA
Total Billions of Euros	23,123	21,094	18,721	20,393	21,671	22,174	24,562

²¹ Nevin AS, Omosomi O & Suberu M 'Factoring the Gap: Improving Access to Working Capital for MSMEs' (2020) 3 available at <https://www.pwc.com/ng/en/publications/factoring-the-gap.html> (accessed on 14 April 2020).

²² Akintunde J 'Factoring Can Be a Game Changer for Nigerian SMEs and Trade' available at <http://www.financialnigeria.com/factoring-can-be-a-game-changer-for-nigerian-smes-and-trade-feature-317.html> (accessed on 14 April 2020). Akinkugbe OD 'A Critical Appraisal of the African Continental Free Trade Area Agreement in Kugler K & Sucker (eds) *International Economic Law from a (South) African Perspective* (2021) 283, describes the AfCFTA as a 'mega-regional trade agreement that aims to create a single market for goods and services, and to facilitate investment and the movement of persons in order to deepen economic integration in Africa.'

²³ Isern J, Agbakoba A & Flaming M et al *Access to Finance in Nigeria: Microfinance, Branchless Banking, and SME Finance* (2009) 21.

²⁴ Alayemi SA, Oyeleye OA & Adeoye ET 'Factoring as Financing Alternative: Reasons for Non-Patronage in Nigeria' (2015) 1(5) *American Journal of Economic, Finance and Management* 508.

²⁵ Factors Chain International *FCI Annual Review* (2018) 32; Factors Chain International *FCI Annual Review* (2020) 28.

The conspicuous omission of Nigeria from the list of contributors raises an important question: Why has factoring not yet taken off as an alternative source of financing for SMEs in Nigeria? Or, to put it differently, what are the challenges impeding the growth of factoring in Nigeria? This question particularly begs an answer because there have been projections as far back as 2014 that Nigeria is among the countries to lead Africa's factoring volumes.²⁶

1.3. Research Objectives, Hypothesis and Question

Research has been conducted on the likely barriers to the growth of a country's factoring industry. These factors were captured aptly by Klapper, a renowned economist with The World Bank, in his seminal paper on the role of factoring in financing SMEs.²⁷ He highlights that the growth of a country's factoring industry could be hampered by weak contract enforcement institutions and other tax, legal and regulatory impediments.²⁸

In another landmark research paper of The World Bank on financing SMEs through factoring authored by Klapper with two other contributors, Bakker and Gregory, they observe that the tax treatment of factoring can impact its growth in a country.²⁹ According to the trio, imposing stamp duty, value added tax (VAT) and other government levies on factoring transactions could impede its growth in a country.³⁰ They further mention that an overly regulated factoring industry will impede the desired growth.³¹ They advise that independent factoring firms should not be subjected to intense regulation as banks as this will have implications not only for the performance of the factoring industry but also for aggregate macroeconomic performance.³²

Closer home, Kameni observes that the absence of laws and judicial precedence on factoring, lack of tax incentives coupled with excessive capital and market entry requirements have

²⁶ Oramah BO 'From the Periphery to the Centre: Africa as the Growth Market for Factoring' (2014) 1(1) *Contemporary Issues in African Trade and Trade Finance* 14.

²⁷ Klapper L 'The Role of Factoring for Financing Small and Medium Enterprises' 2006 *Journal of Banking & Finance* 3112.

²⁸ Klapper L (2006) 3112.

²⁹ Bakker MHR, Klapper LU & Gregory F *Financing Small and Medium-Size Enterprises with Factoring: Global Growth and its Potential in Eastern Europe* (2004) 21.

³⁰ Bakker MHR, Klapper LU & Gregory F (2004) 21.

³¹ Bakker MHR, Klapper LU & Gregory F (2004) 21.

³² Bakker MHR, Klapper LU & Gregory F (2004) 21.

hampered its growth in most African countries.³³ Other barriers identified in Tomusange's doctoral research include the absence of credit insurance companies, excessive documentary taxes and unfavourable or restrictive foreign exchange regulations.³⁴

Against the above scholarly views, this study is premised on the assumption that the poor performance of Nigeria's factoring industry might have partly resulted from the inadequacy or unsupportiveness of the extant legal, tax and regulatory frameworks. In confronting this hypothesis, the study defines the following objectives:

- a) Examining the advantages of factoring as a working capital and trade financing alternative, including how it compares to other financing sources;
- b) Investigating the legal, tax and regulatory barriers to the growth of factoring in Nigeria;
- c) Assessing if legal, tax and regulatory frameworks indeed impact a country's factoring industry using Egypt as a case study, and
- d) Appraising the proposed legal framework for factoring in Nigeria, the Factoring (Assignment of Receivables) Bill, to uncover its strengths and weaknesses in creating the desired regime for factoring to thrive, especially in the interest of SMEs.

The foregoing objectives are tailored towards resolving the central research question: What legal, tax and regulatory interventions can influence the growth of factoring as an alternative source of financing for SMEs in Nigeria?

1.4. Motivation and Significance of the Study

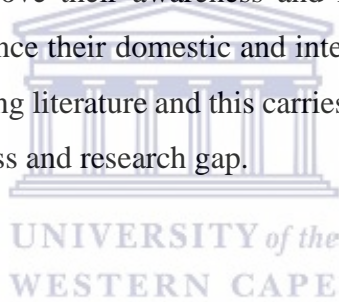
Poor access to finance has remained one of the major factors hampering the growth of Nigeria's SME sector. To make matters worse, in the wake of the coronavirus disease (COVID-19)

³³ Kamani E 'An Insight into Recent Legal and Regulatory Reforms in Support of Factoring in Africa' (2014) 1(1) *Contemporary Issues in African Trade and Trade Finance* 27 – 31.

³⁴ Tomusange RL *Factoring as a Financing Alternative for African Small and Medium-Sized Enterprises* (unpublished Doctor of Business Administration thesis, Walden University, 2015) 132 - 3.

pandemic, the financing gap for SMEs in Nigeria is expected to widen significantly.³⁵ Now more than ever, it becomes imperative to promote alternative sources of financing that can complement or substitute bank and stock market financing. This is also taking into account that Nigeria's SMEs require adequate access to finance to benefit from and participate effectively under AfCFTA which commenced trading on 1 January 2021. Factoring stands out as a unique alternative source of financing that can help in addressing these concerns.

The study is the first of its kind in the Nigerian context and is significant in three key respects. First, it provides policymakers with vital information on how to influence better policy, legal, tax, regulatory and institutional frameworks to facilitate the availability and demand for factoring in Nigeria, especially in the interest of SMEs. Secondly, it will serve as reference material or a handbook for the supply and demand sides of factoring activities. For the supply-side, it is useful to institutions in Nigeria that are already providing factoring services and investors intending to invest in the industry. Regarding the demand-side, which incorporates SMEs, the study will help improve their awareness and knowledge about factoring as an alternative finance option to finance their domestic and international trade activities. Thirdly, the study contributes to the existing literature and this carries with it the benefits of assisting in closing the information, awareness and research gap.



1.5. Research Methodology

The study adopts a desktop research methodology involving a qualitative review of relevant primary and secondary literature obtained from the library and internet databases. Particularly, the study extensively relies on peer-reviewed articles, dissertations, working papers and reports that discussed access to finance, SME financing and factoring. The research also utilised course materials made available for the 'Legal Aspects of Trade Finance' module of the LLM programme.

The study undertakes a comparative analysis of certain crucial aspects of the legal, tax and regulatory frameworks and setup for factoring in Egypt that are capable of being transplanted

³⁵ Amuda YJ 'Impact of Coronavirus on Small and Medium Enterprises (SMES): Towards Postcovid-19 Economic Recovery in Nigeria' (2020) 19(6) *Academy of Strategic Management Journal* 9.

in Nigeria.³⁶ The choice of Egypt as a case study is motivated by the impressive and sustained growth of the country's factoring industry which has supported financing to SMEs and large corporates alike.³⁷ Notably, these impressive and sustained growths have, in part, been credited to the facilitative legal, tax and regulatory interventions that the Government of Egypt (GoE) has put in place.³⁸ Egypt attained the highest growth level in factoring volumes in Africa between 2015 to 2019 with a 14 per cent growth rate.³⁹

In addition to improving an understanding of the law, comparative studies are undertaken to suggest solutions to problems and make proposals for reforms.⁴⁰ In this sense, the impressive growth of Egypt's factoring industry makes it a good choice for drawing adaptable reform initiatives by other African countries like Nigeria seeking to develop their factoring industry. Other reform initiatives were also drawn from international best practices as propagated by Conventions, Model Laws and leading literature on factoring.

1.6. Chapter Outline

This study is divided into six chapters covering the following:

Chapter One: This chapter captures the study's background, problem statement, the study's objectives and the research question. It also presents the motivation and significance of the study, research methodology and an outline of the thesis.

Chapter Two: This chapter examines SMEs in Nigeria by highlighting their numbers and contributions to the economy. The chapter also discusses the common external sources of financing for SMEs, the inadequacies of the sources and why SMEs find it challenging to

³⁶ These aspects mainly cover: (i) The existence of a factoring law, (ii) The existence of a tailored regulatory and supervisory regime for factoring, (iii) The existence of a self-regulatory association for factoring firms, (iv) The treatment of value added tax and stamp duty in factoring transactions, (v) The recognition of non-recourse factoring as a true sale transaction, (vi) The ineffectiveness of ban on assignment clauses, and (vii) The absence of foreign restriction for independent factoring firms.

³⁷ Hamanyati M *Factoring as an International Trade Finance Product: Making a Case for the Enactment of a Factoring Act in Zambia* (unpublished LLM thesis, University of Pretoria, 2017) 35-8.

³⁸ Oramah BO & Dzene R 'Evolution of Factoring in Egypt and Implications for Factoring Development in Africa' (2014) 1(1) *Contemporary Issues in African Trade and Trade Finance* 22 -23

³⁹ Factors Chain International *FCI Annual Review* (2019) 10.

⁴⁰ Okeke CN 'African Law in Comparative Law: Does Comparativism Have Worth' (2011) 16(1) *Roger Williams University Law Review* 345.

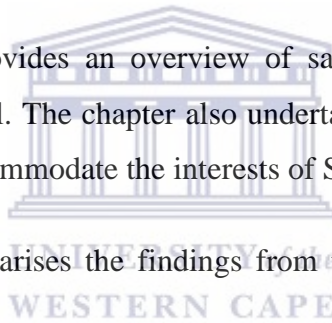
access financing from them. The discussion in the chapter underscores the necessity for promoting asset-based financing alternatives like factoring because they align better with the peculiarities and financing preferences of SMEs.

Chapter Three: This chapter discusses factoring as a financing alternative, outlining its definition, features, history, types as well as its merits and demerits. Conventions and Model Laws on factoring and other key legal aspects of factoring are also discussed in the chapter. The chapter further investigates the numerous areas in which factoring will benefit Nigeria's SMEs to motivate policymakers to institute supportive legal, tax and regulatory frameworks.

Chapter Four: The chapter investigates the likely barriers impeding the growth of factoring in Nigeria. It also undertakes a comparative study of the legal, tax and regulatory frameworks for factoring in Egypt to assess how these frameworks have impacted the growth of the country's factoring industry and draw lessons for Nigeria.

Chapter Five: The chapter provides an overview of salient provisions of the Factoring (Assignment of Receivables) Bill. The chapter also undertakes a critique of the Bill to make proposals on how to make it accommodate the interests of SMEs better.

Chapter Six: The chapter summarises the findings from the study, draws conclusions and makes recommendations.



CHAPTER TWO

CHALLENGES FACED BY SMEs IN ACCESSING FINANCING: TOWARDS ASSET-BASED FINANCING ALTERNATIVES

2.1. Introduction

As a result of the better awareness about the contributions of SMEs to economies, ensuring their sustainable access to financing has increasingly been the focus of policies and interventions by governments in most countries, including Nigeria. Specifically, in Nigeria, these interventions have taken the form of grants, equity schemes, credit guarantees and subsidised loans.⁴¹ At the same time, alternative financial institutions and products, especially outside the traditional funding channels comprised of banks and the stock market, are proliferating financial markets.⁴² These alternatives are helping to broaden the range of funding options available to SMEs.⁴³ One of such alternatives that have come to the forefront is factoring - a variant of asset-based financing.⁴⁴

However, before discussing factoring as an alternative source of financing for SMEs, it is essential first to identify the drawbacks and limitations of other financing channels like banks and the stock market. Such a discussion will provide valuable insights into why numerous alternatives, including factoring, have taken centre stage.

This chapter starts by highlighting the presence and contributions of SMEs in Nigeria to draw attention to why it is crucial to address the challenges they face in doing business. The chapter further examines the drawbacks and limitations of the common traditional and emerging sources of financing for SMEs. This examination aims to underscore the necessity for promoting other alternative sources of financing that align better with SMEs' peculiarities and financing preferences. The chapter's concluding section highlights some of these financing alternatives, including factoring, and explains how they align better with SMEs' peculiarities and financing preferences

⁴¹ Eniola AA & Entebang H 'Government Policy and Performance of Small and Medium Business Management' (2015) 5(2) *International Journal of Academic Research in Business and Social Sciences* 241.

⁴² Rowan P, Miller M & Schizas E et al *Regulating Alternative Finance: Results from a Global Regulator Survey* (2021) 13.

⁴³ Rowan P, Miller M & Schizas E et al (2021) 13.

⁴⁴ Erdoğan EO 'Factoring Application as an Alternative to Financing and Effects of Various Macroeconomic Indicators' (2017) 8(4) *International Research Journal of Applied Finance* 178.

2.2. SMEs in the Nigerian Economy and the Problem of Access to Finance

According to the latest National Survey of Micro Small and Medium Enterprises (MSMEs) Report released in 2019, Nigeria has about 41 543 028 SMEs operating in practically all sectors of the economy.⁴⁵ Earlier surveys completed in 2010 and 2013 pegged the number of SMEs in Nigeria at 17 284 671 and 37 067 416, respectively.⁴⁶ SMEs are assessed to represent about 96 per cent of businesses in Nigeria compared to 53 per cent in the United States of America and 65 per cent in Europe.⁴⁷

Apart from their traditional role of creating jobs at low capital cost, SMEs also contribute enormously to the revenues of governments through taxes.⁴⁸ For example, the study by Ogenyi found that between 2008 to 2012, SMEs operating in Benue State accounted for approximately 79 per cent of the State's internally generated revenue through taxes.⁴⁹ Further, the SME sector has fostered the economy's development through promoting entrepreneurship, capacity building, industrial dispersal and technological development.⁵⁰ In addition, SMEs play other crucial roles, such as improving diversification of the national economy, foreign exchange conservation, poverty reduction, redistribution of income and inclusive growth.⁵¹ These numerous contributions justify why SMEs are described as the engine of economic growth and the backbone of equitable development.⁵²

Despite the immense contributions of SMEs to the Nigerian economy, access to finance from external sources, especially banks and the stock market, remains a critical challenge

⁴⁵ Small and Medium Enterprises Development Agency of Nigeria & National Bureau of Statistics (2017) 8.

⁴⁶ Small and Medium Enterprises Development Agency of Nigeria & National Bureau of Statistics *Micro, Small and Medium Enterprises (MSME) Survey Report* (2013) 6.

⁴⁷ Oyelaran-Oyeyinka B 'SME: Issues, Challenges and Prospects' available at <https://islamicmarkets.com/publications/smes-in-nigeria-issues-challenges-and-prospects> (accessed 26 October 2020).

⁴⁸ Udofot PO & Etim EO 'The Effect of Tax Revenue Components from SMEs on the Economic Growth of Nigeria from 1980-2015' (2017) 8(20) *Research Journal of Finance and Accounting* 120.

⁴⁹ Ogenyi MA 'Small and Medium Enterprises (SMES) and Internal Revenue Generation: Evidence from Benue State - Nigeria' (2020) 22(5) *IOSR Journal of Business and Management* 39.

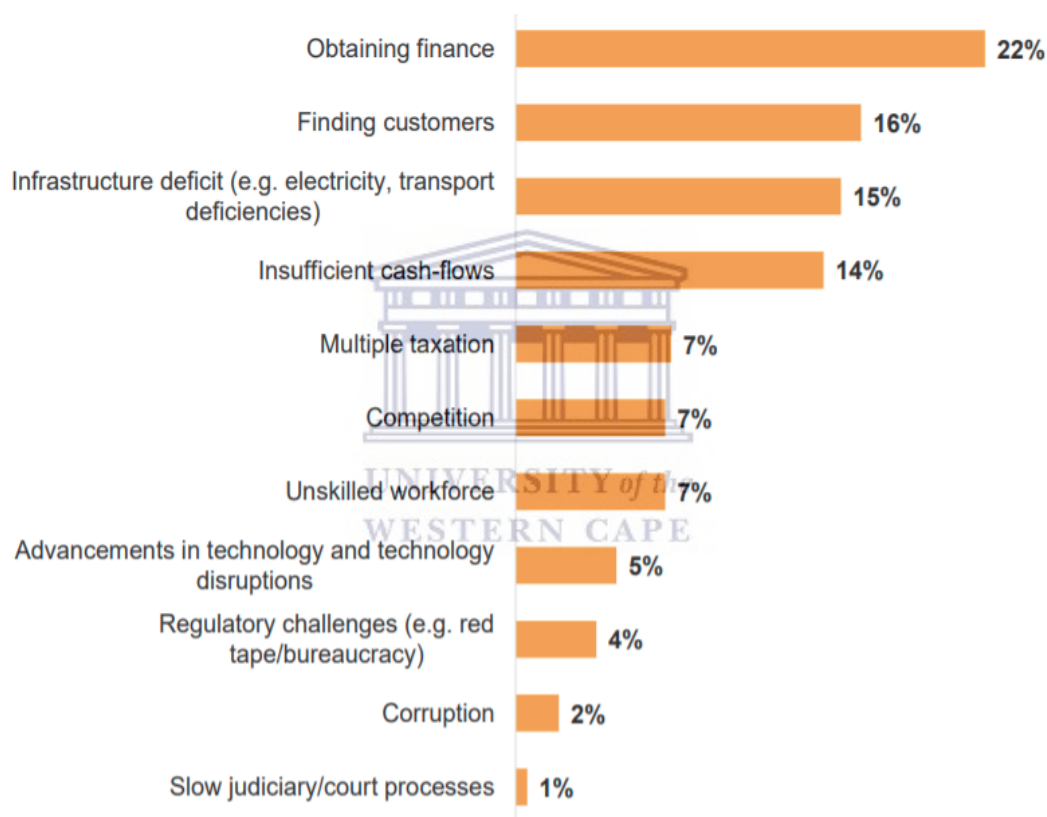
⁵⁰ Oduntan KO 'The Role of Small and Medium Enterprises in Economic Development: The Nigerian Experience (2014) 22(23) *International Conference on Arts, Economics and Management* 76.

⁵¹ Effiom L & Edet SE 'Success of Small and Medium Enterprises in Nigeria: Do Environmental Factors Matter' (2018) 9(4) *Journal of Economics and Sustainable Development* 118.

⁵² Buowari PE *Factors Required for Small Business Sustainability in Nigeria* (unpublished PhD thesis, Walden University, 2015) 26.

undermining their ability to grow and develop.⁵³ It also accounts for SMEs' high failure rate as studies show that 80 per cent of SMEs in Nigeria do not survive past their first five years of existence because of unavailability of financing.⁵⁴ SMEs have underperformed and failed in impacting the Nigerian economy as expected because of the lack of or inadequate access to finance.⁵⁵ SMEs run by women face even more challenges in accessing finance due to socio-cultural peculiarities.⁵⁶ A recent survey report by PwC confirmed that most SMEs in the country consider access to finance as their biggest problem among various other challenges, as shown in Fig 1 below:

Fig 1: Challenges that SMEs in Nigeria Face⁵⁷



⁵³ Imeokparia PO & Ediagbonya K 'Small and Medium Scale Enterprises (SMEs): A Catalyst in Promoting Economic Development in Nigeria' (2014) 5(33) *Journal of Education and Practice* 95.

⁵⁴ Aremu MA & Adeyemi SL 'Small and Medium Scale Enterprises as A Survival Strategy for Employment Generation in Nigeria' (2011) 4(1) *Journal of Sustainable Development* 201.

⁵⁵ Gbandi EC & Amissah G 'Financing Options for Small and Medium Enterprises (SMEs) in Nigeria (2014) 10(1) *European Scientific Journal* 328.

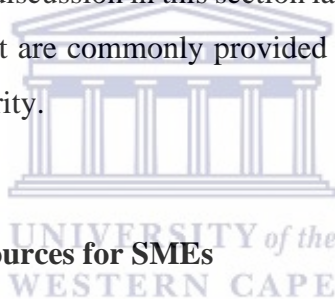
⁵⁶ Zwingin TC, Opusunju MI and Nuhu DG 'Formal and Informal Sources of Financing and Women Entrepreneurship Development in Abuja' (2018) 5(1) *Social Sciences Journal of Policy Review and Development Strategies* 44.

⁵⁷ PwC (2020) 14.

Available data indicate that financing to SMEs from banks in the form of term loans and overdrafts has continued to worsen over the years.⁵⁸ The 2007-2008 Global Financial Crisis (GFC) is considered to have heightened the challenges that SMEs face in accessing financing from banks. The GFC made banks more risk-averse even as the financial regulators upscaled the requirements banks must comply with before extending finance.⁵⁹ Likewise, in the wake of the COVID-19 pandemic, the financing gap for SMEs is expected to widen significantly, particularly in developing countries like Nigeria.⁶⁰ It, therefore, becomes imperative to promote alternatives in terms of financial institutions and products to bridge the SME financing gap.

2.3. Financing Landscape for SMEs

This section discusses the common traditional sources of finance for SMEs, focusing on banks and the stock market, their inadequacies and limitations and why SMEs find it challenging to access financing from them. The discussion in this section lay the foundation for why financing alternatives such as factoring that are commonly provided by non-bank financial institutions are emerging and gaining popularity.



2.3.1. Financing Forms and Sources for SMEs

There are three basic forms of finance available to SMEs: grants, debt and equity. Grants, usually from the government and development institutions, can be likened to free money or a gift given to SMEs to support their financing needs. On the other hand, equity is an investment or funding that is made in return for shares or ownership stake in a company.⁶¹ Apart from owning a stake in the company, equity owners are entitled to dividends when profits are made.⁶²

⁵⁸ Aguwamba SM & Ekienabor EE 'Bank Lending and its Impact on Small Scale Enterprises in Nigeria' (2017) 3(3) *Imperial Journal of Interdisciplinary Research* 64; also see Gbandi EC & Amisah G (2014) 329.

⁵⁹ Ullah A, Bilal A & Hamza A et al 'Revisiting Barriers to External Finance for SMEs' (2018) 11(1) *Journal of Advanced Research in Business and Management Studies* 26.

⁶⁰ Organisation for Economic Cooperation and Development *Paper on Coronavirus (COVID-19): SME Policy Responses* (2020a) 3 – 4; also see Amuda YJ (2020) 9.

⁶¹ Abbasi AW, Wang Z & Abbasi DA 'Potential Sources of Financing for Small and Medium Enterprises (SMEs) and Role of Government in Supporting SMEs' (2017) 5(2) *Journal of Small Business and Entrepreneurship Development* 41.

⁶² Abbasi AW, Wang Z & Abbasi DA (2017) 41.

Equity financing can be sourced by SMEs either privately or from the public. Equity financing can be sourced privately by SMEs from sources such as individuals, other companies, private equity firms, venture capitalists and business angels. Listing on the stock market is how equity financing is sourced from the public. Debt refers to loans, bonds and other credit forms that are borrowed and must be repaid over a specified period, usually with interest.⁶³ Debt often takes the form of cash advances, but they can also be 'in-kind' like trade credit.⁶⁴ Non-financial institutions, including SMEs that are suppliers, typically extend trade credit to their customers.⁶⁵ There is a further classification between short-term and long-term debt.⁶⁶ Short-term debt is required to be repaid within a year or less, while long-term debt has a maturity period of more than a year.⁶⁷

Researchers often use a classification based on internal and external financing in streamlining the sources from which SMEs can access debt and equity.⁶⁸ As the name suggests, internal financing means debt or equity that is obtained from within the business.⁶⁹ This financing source mainly captures personal savings, accounts receivable, retained profits and revenue from selling business assets.⁷⁰ In contrast, external financing cover debt or equity obtained from outside the business.⁷¹ External financing is classified further into formal versus informal sources.⁷² The formal sources of external finance accommodate institutions like banks, non-bank financial intermediaries and the stock market. On the other hand, the informal sources mainly cover financing through the so-called three F's – friends, families and fools.⁷³ It also

⁶³ Abbasi WA, Wang Z & Abbasi DA (2017) 41.

⁶⁴ Cuñat V & Garcia-Appendini E 'Trade Credit and Its Role in Entrepreneurial Finance' in Cumming D (ed) *Oxford Handbook of Entrepreneurial Finance* (2012) 526.

⁶⁵ Cuñat V & Garcia-Appendini E (2012) 526.

⁶⁶ Eniola AA & Entebang H 'SME Firm Performance - Financial Innovation and Challenges' (2015) 195 *Procedia - Social and Behavioral Sciences* 337.

⁶⁷ Eniola AA & Entebang H (2015) 337.

⁶⁸ Ogboru PL *An Evaluation of Funding Arrangements for Small and Medium Scale Enterprises (SMEs) in Nigeria* (unpublished PhD thesis, St Clements University, British West Indies, 2005) 41.

⁶⁹ Abbasi WA, Wang Z & Abbasi DA (2017) 41.

⁷⁰ Abbasi WA, Wang Z & Abbasi DA (2017) 41.

⁷¹ Vasilescu LG 'Factoring – Financing Alternative for SMEs' 2010 *Management of International Business and Economics Systems* 14.

⁷² Nguyen B & Canh NP 'Formal and Informal Financing Decisions of Small Businesses' 2020 *Small Business Econ* 3.

⁷³ Vasilescu LG (2010) 14.

covers financing sourced from moneylenders, trade creditors, cooperative societies, private equity firms, venture capitalists, business angels as well as credit and savings associations.⁷⁴

2.3.2. Financing Patterns and Preferences of SMEs

Using the concept of Financial Growth Cycle, Berger and Udell explain that the financing needs of SMEs and the options they employ to address these needs are influenced by many factors, including the phases of their lifecycle.⁷⁵ They explain that SMEs tend to rely more on insider financing (funds provided by themselves, family and friends), trade creditors and venture capitalists at the start-up and early growth stage.⁷⁶ Factors like informational asymmetry, lack of trading history and high risk of failure contribute to them being confined to these sources of financing at the start-up and early growth stage.⁷⁷ However, as they grow with improved financial records, trading history and proven resilience to market fluctuations, they will consider and become more eligible for external financing, especially from banks.⁷⁸ Eventually, as they become well established and continue to expand, they can access equity from the stock market.⁷⁹



The Pecking Order Theory propagated by Majluf and Myers in 1984 also provides a theoretical framework for understanding the patterns and preferences of SMEs in meeting their financing needs.⁸⁰ The theory is conceived on the premise that business firms finance their needs by following a defined trajectory, from internal to external.⁸¹ As predicted by the theory, business firms prioritise financing their operations using internally available resources (such as accounts receivable and retained earnings).⁸² If this source is unavailable or inadequate, they will have

⁷⁴ Abbasi WA, Wang Z & Abbasi DA (2017) 41; Ekpennyong DB & Nyong MO *Small and Medium-Scale Enterprises in Nigeria: Their Characteristics, Problems and Sources of Finance* (1992) 18.

⁷⁵ Berger AN & Udell GF 'The Economics of Small Business Finance: The Roles of Private Equity and Debt Markets in the Financial Growth Cycle' (1998) 22 *Journal of Banking & Finance* 662.

⁷⁶ Berger AN & Udell GF (1998) 662 - 3.

⁷⁷ Berger AN & Udell GF (1998) 662.

⁷⁸ Berger AN & Udell GF (1998) 662.

⁷⁹ Berger AN & Udell GF (1998) 662.

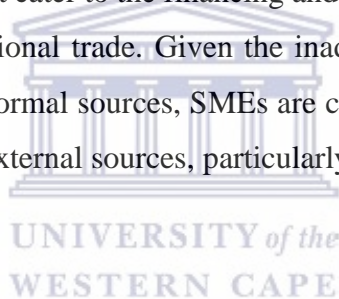
⁸⁰ Majluf NS & Myers SC 'Corporate Financing and Investment Decisions When Firms Have Information That Investors Do Not Have' (1984) 13 *Journal of Financial Economics* 220 -221.

⁸¹ Frank MZ & Goyal VK 'Testing the Pecking Order Theory of Capital Structure' (2003) 67(2) *Journal of Financial Economics* 218.

⁸² Majluf NS & Myers SC (1984) 220.

recourse to external financing, starting with debt and then issuing equity as a last resort.⁸³ The preference of starting with internal financing before debt and then equity is influenced by transaction and information asymmetry costs.⁸⁴ While internal financing comes at no cost, the cost of debt (interest) is considered lower than equity (dividends and ownership dilution).⁸⁵

Affirming the trajectory conveyed in the Pecking Order Theory and the concept of Financial Growth Cycle, SMEs in Nigeria rely heavily on internal financing, especially personal savings in the seed and start-up phase of their lifecycles.⁸⁶ Further, it has also been shown that most SME owners prefer debt over equity so that they can retain full ownership and control of their business.⁸⁷ When resorting to external debt, SMEs prioritise informal sources.⁸⁸ Informal sources of external financing are attractive to SMEs because of their relatively shorter credit process and less stringent collateral requirements compared to formal sources.⁸⁹ However, informal sources can extend only small amounts or short-term credit, which, like internal financing, is insufficient for SMEs that intend to expand their business operations.⁹⁰ Additionally, these sources do not cater to the financing and support services needed by SMEs looking to participate in international trade. Given the inadequacy of internal financing and external financing from other informal sources, SMEs are constrained to seek financing (debt or external equity) from formal external sources, particularly banks and the stock market.



2.3.3. Banks

Banks are the major formal source of external debt financing for SMEs, especially SMEs that do not have access to the stock market or other public segments of the capital market.⁹¹ Banks

⁸³ Majluf NS & Myers SC (1984) 220.

⁸⁴ Frank MZ & Goyal VK (2003) 218.

⁸⁵ Frank MZ & Goyal VK (2003) 218.

⁸⁶ Akingunola RO 'Small and Medium Scale Enterprises and Economic Growth in Nigeria: An Assessment of Financing Options' (2011) 2(1) *Pakistan Journal of Business and Economic Review* 85.

⁸⁷ Watse DU *Sources of Financing for Small and Medium Enterprises in Nigeria* (unpublished PhD thesis, Walden University, 2017) 121.

⁸⁸ Isa KD & Terungwa A 'An Empirical Evaluation of Small and Medium Enterprises Equity Investment Scheme in Nigeria (2011) 4 *International Conference on Economics and Finance Research* 408.

⁸⁹ Isa KD & Terungwa A (2011) 408.

⁹⁰ Mbugua EW *An Investigation into Application of Pecking Order Concept by Companies Listed at Nairobi Stock Exchange* (unpublished MBA thesis, University of Nairobi, 2010) 12.

⁹¹ Ghulam Y & Iyofor B 'Bank Credit Availability to SMEs in Nigeria: The Impact of Firm and Owner Characteristics' (2017) 8(10) *Research Journal of Finance and Accounting* 10; Abdulaziz M, Abdulsaleh I & Worthington AC (2013) 44.

aid in augmenting the financing gap that internal financing and other informal sources of external financing cannot fill by providing SMEs conventional financing products like term loans, overdrafts and credit lines.⁹² Banks also intermediate for SMEs participating as exporters or importers in international trade by providing trade financing instruments like guarantees, letters of credit and documentary collection.

In lending to borrowers, banks usually follow the traditional lending model. Under this model, loans are extended to borrowers primarily based on their overall creditworthiness.⁹³ The borrowers' expected cash flow is used as the primary source of debt repayment, while the secondary source of repayment is the security provided by borrowers to secure debts.⁹⁴ Because banks are very risk-averse, they will normally require either real property or other high-value assets or request for a payment guarantee issued by a person or institution as security against their lending to SMEs and large corporates alike.

SMEs' access to financing from banks in Nigeria is not impressive. According to a 2013 commercial bank survey facilitated by The World Bank, Nigerian banks were least involved in providing credit to SMEs compared to their counterparts in five other Sub-Saharan Africa countries.⁹⁵ The survey results are shown in Table 2 below:

Table 2: Bank Lending to SME in 5 Sub-Saharan African Countries⁹⁶

Country	SMEs' Share of Total Bank Lending
Kenya	17.4%
Rwanda	17.0%
Tanzania	14.0%
South Africa	8.0%
Nigeria	5.0%

⁹² Ghulam Y & Iyofor B (2017) 10; also see Friday IC 'Impact of Microfinance on Small and Medium-sized Enterprises in Nigeria' 2012 *Proceedings of the 7th International Conference on Innovation & Management School of Management* 1865.

⁹³ Cusmano L & Koreen M *New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Instruments* (2015) 18.

⁹⁴ Bakker MHR, Klapper LU & Gregory F (2004) 4.

⁹⁵ Berg G & Fuchs M *Bank Financing of SMEs in Five Sub-Saharan African Countries: The Role of Competition, Innovation, and the Government* (2013) 6.

⁹⁶ Berg G & Fuchs M (2013) 6.

The Credit Rationing Theory put forward by Stiglitz and Weiss in 1981 provides a theoretical framework for understanding why SMEs are constrained in accessing debt financing from banks.⁹⁷ The theory asserts two major propositions based on restriction on the number of loans banks make rather than the size of each loan. First, among loan applicants, some will receive a loan while other applicants are denied, even if they were willing to pay a higher interest rate or provide more collateral. Secondly, there is a certain class of borrowers that are unable to obtain credit even if it is readily available or can only obtain credit at much higher prices. The borrowers denied, restricted or unable to access credit under these propositions are said to have been 'credit rationed'.⁹⁸ Stiglitz and Weiss contend that the major reason certain borrowers are credit rationed is because they suffer from information asymmetry or opacity.⁹⁹

Studies have shown that SMEs are generally more credit rationed than large corporates.¹⁰⁰ Put differently, SMEs are less likely than large corporates to access the credit requested from banks and other credit suppliers. The major reasons banks 'credit ration' SMEs in favour of large corporates in Nigeria are explained below briefly:

2.3.3.1. Information Asymmetry or Opacity

SMEs have a greater degree of information asymmetry or opacity than large corporates because they often lack accounting records, business plans and financial statements.¹⁰¹ The lack of these documents makes it challenging for banks to assess their prospects, risks associated with lending to them or creditworthiness.¹⁰² Most SMEs in Nigeria do not keep accounting records

⁹⁷ Stiglitz JE & Weiss A 'Credit Rationing in Markets with Imperfect Information' (1981) 71(3) *The American Economic Review* 394-5.

⁹⁸ Moyo N (2015) 2; Nabawanda W *Small and Medium-Size Enterprise Owner Strategies for Invoice Factoring Financing* (unpublished Doctor of Business Administration thesis, Walden University, 2018) 5.

⁹⁹ Stiglitz JE & Weiss A (1981) 394-5.

¹⁰⁰ Jin Y & Zhang S 'Credit Rationing in Small and Micro Enterprises: A Theoretical Analysis' 2019 *Sustainability Journal* 13.

¹⁰¹ Emezie S *Prospects and Challenges of SMES in 21st Century Africa* (unpublished BSc thesis, Centria University of Applied Sciences, 2017) 13; United Nations Conference on Trade and Development (2001) 3.

¹⁰² Adekola MJN, Lekan OK & Emmanuel S 'Bank Financing for Small and Medium Enterprises in Nigeria: Mudharabah Vs Usury' (2018) 14(3) *Acta Universitatis Danubius* 24; United Nations Conference on Trade and Development (2001) 3.

and financial statements mainly because of a lack of knowledge and the high cost of getting them prepared.¹⁰³

2.3.3.2. Riskiness and Profitability

Lending to SMEs is considered fraught with various risks and to be non-profitable. Banks regard SMEs as risky borrowers because of their vulnerability to market fluctuations, insufficient resources, low capitalisation and high failure rates.¹⁰⁴ To highlight how some Nigerian banks perceive lending to SMEs, the manager of a leading bank in Nigeria was quoted saying, 'We are not a charity. Why should I take risks with SMEs when I can make good money elsewhere?'¹⁰⁵

2.3.3.3. Credit Conditions

Banks undertake stricter screening measures and impose certain credit conditions that most SMEs are unable to meet.¹⁰⁶ The conditions include imposing higher interest rates, requesting procurement of insurance policy and requiring fixed assets (land, building or machinery) as collateral.¹⁰⁷ Unlike large corporates that have collateralisable fixed assets, SMEs do not usually have such assets. Most SMEs usually have accounts receivable and other movable assets that are usually not attractive to banks as collateral because they need to be constantly monitored.¹⁰⁸ Many SMEs do not even attempt to apply for loans from banks due to insufficient collateral, high interest rates and other excessive credit conditions.¹⁰⁹

¹⁰³ Aladejebi O & Oladimeji JA 'The Impact of Record Keeping on the Performance of Selected Small and Medium Enterprises in Lagos Metropolis' (2019) 7(1) *Journal of Small Business and Entrepreneurship Development* 37.

¹⁰⁴ United Nations Conference on Trade and Development (2001) 3.

¹⁰⁵ United Nations Conference on Trade and Development (2001) 4.

¹⁰⁶ The World Bank Group *Paper on Secured Transactions, Collateral Registries and Movable Asset-Based Financing* (2019) 3; also see Saari D (2020) 13.

¹⁰⁷ Ayuba B & Zubairu M (2015) 2.

¹⁰⁸ Ahmad D 'Can Introduction of Collateral Registries for Movable Assets Spur Firms' Access to Credit in Nigeria? (2018) 5(12) *International Journal of Research and Scientific Innovation* 102.

¹⁰⁹ Saari D (2020) 44.

2.3.4. The Stock Market

SMEs can access equity financing from the stock market.¹¹⁰ The stock market is more favourable to SMEs with high growth potential or that are well-established. The Securities and Exchange Commission (SEC) and the Nigerian Stock Exchange (NSE) have implemented several measures to promote SMEs' access to finance from the stock market.¹¹¹ These measures include setting up the second and third-tier markets under the Alternative Securities Market (ASeM), where the listing and disclosure requirements are less stringent than the first-tier market.¹¹² According to the NSE, the ASeM provides a platform for small and mid-sized fast-growing companies to raise long term capital at a comparatively lower cost to realise their business potential.¹¹³

Despite interventions, the participation of SMEs in the stock market to access equity financing remains very low. A review of the NSE's website shows that there are only eight listed companies on the ASeM platform as of the writing of this thesis.¹¹⁴ This low participation is attributable to various factors, including the legal requirement that only incorporated companies can be listed and the inability of SMEs to fund listing costs and operations on the stock market.¹¹⁵ On the former factor, many SMEs do not operate using incorporated companies but are organised as either sole proprietors or partnerships.¹¹⁶ Other reasons include corporate governance hurdles, information asymmetry, lack of knowledge and poor organisational infrastructure.¹¹⁷

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- ¹¹⁰ Amoako-Adu B & Eshun JP 'SME Financing in Africa: Collateral Lending vs Cash Flow Lending' (2018) 10(6) *International Journal of Economics and Finance* 153.
- ¹¹¹ Oladepo OI & Ajoseh HJ 'Capital Market Operations and SMEs' Financing in a Developing Economy: A Conceptual Evaluation of the Nigerian Stock Market' (2015) 6(10) *Research Journal of Finance and Accounting* 15.
- ¹¹² Nwakoby C & Okoye LU 'Impediments to Capital Market Financing of Small and Medium Enterprises in Nigeria' 2018 1(4) *COJ Reviews & Research* 2; Oladepo OI & Ajoseh HJ (2015) 15.
- ¹¹³ Nigerian Stock Exchange 'Alternative Securities Market' available at <http://www.nse.com.ng/Listings-site/equitylisting-site/aseM-site> (accessed on 13 May 2020).
- ¹¹⁴ Available at <http://www.nse.com.ng/issuers-section/listed-securities/listed-companies?filter=ASEM> (accessed on 13 May 2020).
- ¹¹⁵ Olusoji MO & Enofe EE 'Capital Market and the Development of the Small and Medium – Scale Enterprises in Nigeria' (2012) 5(4) *IOSR Journal of Business and Management* 8.
- ¹¹⁶ Small and Medium Enterprises Development Agency of Nigeria & National Bureau of Statistics (2013) 26.
- ¹¹⁷ Olusoji MO & Enofe EE (2012) 8; Okonkwo NO & Obidike CP 'Small and Medium Scale Enterprises Financing in Nigeria: Problems and Prospects' (2016) 4(1) *International Journal of Innovative Social Sciences & Humanities Research* 84.

2.3.5. Emergence of Alternative Sources of Financing

The numerous restrictions SMEs face in accessing finance from banks and the stock market have instigated discussions on alternative sources of financing. The financing landscape for SMEs is continually changing, with more alternative financial institutions and products. Chambers, Saleuddin and McMahon define 'alternative finance' to mean financial channels and instruments which have grown outside the traditional financial system represented by banks and the traditional stock market.¹¹⁸ Notably, there has been the promotion and utilisation of alternative financing solutions like crowdfunding, venture capital and business angels.¹¹⁹

Crowdfunding facilitates SMEs' access to debt and equity financing through online platforms from the public (crowd-funders) under less stringent conditions than the stock market or other public segments of the traditional capital market.¹²⁰ In addition to extending debt and equity funding to SMEs, venture capitalists and business angels provide management speciality to SMEs in which they invest, participate in strategic planning and are engaged in decision making.¹²¹ These managerial services give them an edge over both bank and stock market financing.

However, venture capitalists and business angels are very selective as they invest only in SMEs with remarkable growth potentials and sound structure.¹²² They are also not very inclusive as they concentrate their funds on SMEs delivering software or technology products similar to crowd funders.¹²³ Not so many SMEs can meet these expectations. There is also the issue of

¹¹⁸ Chambers D, Saleuddin R & McMahon C 'Alternative Finance: A Historical Perspective' (2019) 26(2) *Financial History Review* 109.

¹¹⁹ For more analysis about these financing options see Metelka A *Crowdfunding - Startups' Alternative Funding Source Beyond Banks, Business Angels and Venture Capitalists* (unpublished MSc thesis, Blekinge Institute of Technology, 2014).

¹²⁰ Soreh WC 'Awareness and Attitude Towards Crowdfunding in Nigeria' (2017) 36 *International Journal of African and Asian Studies* 3 – 4.

¹²¹ Tiftik H & Zincirkiran M 'Angel Investors' in Entrepreneurship: An Assessment on Turkey Model' (2014) 6(1) *Journal of Business Research - Turk* 47; Abereijo IO & Fayomi AO (2005) 220.

¹²² Vasilescu L 'Accessing Finance for Innovative EU SMEs – Key Drivers and Challenges' (2014) 12(2) *Economic Review – Journal of Economics and Business* 38.

¹²³ United Nations Conference on Trade and Development (2001) 49.

unwillingness on SME owners to dilute their ownership stake in their business through equity investments by venture capitalists, business angels and equity crowd-funders.¹²⁴

Generally, crowdfunding, venture capitalists and business angels are not yet well-established alternative sources of financing in most developing countries, including Nigeria.¹²⁵ This being the case, internal financing through personal savings remains the major source of financing for SMEs in Nigeria.¹²⁶ PwC's recent survey discloses that contributions from friends and family, trade credit and banks are the most utilised sources of external financing for SMEs in the country, as shown in Table 3 below:

Table 3: Main Sources of External Financing for SMEs in Nigeria¹²⁷

Financing Source	Survey Result in Percentage
Family and friends	48%
Bank credit facilities	15%
Trade Credit	8%
Cooperatives	6%
Government grants	6%
Vendor financing	6%
Private Equity	4%
Others	4%
Venture capital	3%
Listing on the stock market	1%

¹²⁴ Abejiro IO & Fayomi AO 'The Attitude of Small and Medium Industrialists to Venture Capital Financing in Nigeria' (2007) 1(1) *Global Journal of Business Research* 135 – 136.

¹²⁵ Soreh WC (2017) 4-5; Abejiro IO & Fayomi AO (2007) 135 – 136; also see Moses O & Adebisi JF 'Small Business Financing in Nigeria: An Investigation of the Angel Option' (2013) 9(2) *Canadian Social Science* 94.

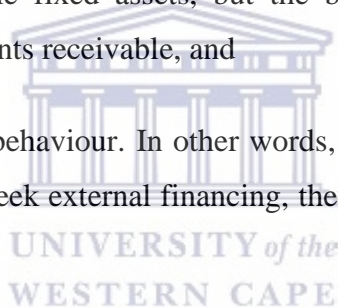
¹²⁶ Saari D (2020) 42; Watse DU (2017) 97.

¹²⁷ PwC 'PwC's MSME Survey 2020 Report' (2020) 34 available at <https://www.pwc.com/ng/en/assets/pdf/pwc-msme-survey-2020-final.pdf> (accessed on 22 January 2021).

2.4. Towards Other Alternatives that Align Better with the Peculiarities and Financing Preferences of SMEs

The literature reviewed so far indicates that accessing financing from traditional sources like banks and the stock market is challenging for most SMEs. It has also been shown that alternative sources of financing like venture capital, business angels and crowdfunding, although having numerous advantages, are yet to be widely adopted. They additionally have their restrictions. These findings motivate the need to look further towards other alternative sources of financing that are more suitable in the sense that they better align with the peculiarities and financing preferences of most SMEs. These peculiarities and preferences include that most SMEs:

- a) Suffer from information asymmetry or opacity because they do not keep proper business and accounting records;
- b) Often lack collateralisable fixed assets, but the bulk of their available assets are movable assets and accounts receivable, and
- c) Have a 'Pecking Order' behaviour. In other words, they prioritise internal financing, and if they ever need to seek external financing, they will prefer to go for debt before external equity.



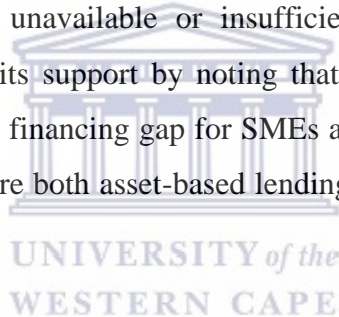
In the context of the above peculiarities and preferences, for a financing alternative to meet the 'suitability test', these conditions will be relevant:

- a) The lender, financier or investor's financing condition must be based on readily available assets of the SME seeking financing;
- b) The lender, financier or investor's financing decision should not be founded on the SMEs' accounting records, financial statements, business plan, credit rating or other superfluous assets or qualities outside the SMEs' reach; and
- c) The financing arrangement will not involve the dilution of the ownership stake in the SME.

Asset-based finance, commonly provided by non-bank financial institutions, including finance companies, leasing companies, independent factoring firms and consumer credit companies,¹²⁸ meets the above suitability criteria. Broadly, asset-based finance is used to describe alternative sources of financing that are built on the value of specific assets and not the credit standing of the borrower.¹²⁹ In capturing the suitability of the financing alternative, Cusmano and Koreen had this to say:

'Through asset-based finance, firms obtain funding based on the value of specific assets, including accounts receivables, inventory, machinery, equipment and real estate, rather than on their credit standing. In this way, it can serve the needs of young and small firms that have difficulties in accessing traditional lending.'¹³⁰

Aligning with the above, The World Bank observes that asset-based finance is beneficial when other sources of financing are unavailable or insufficient.¹³¹ The International Finance Corporation (IFC) also extends its support by noting that creating a space for asset-based finance options can minimise the financing gap for SMEs all around.¹³² Asset-based finance is a collective term used to capture both asset-based lending and invoice financing.¹³³ These two are explained below:



2.4.1. Asset-Based Lending

Asset-based lending (called secured transaction in movable assets sometimes) involves using tangible and intangible movable assets as both the collateral and primary source of repayment for loans.¹³⁴ The classes of assets that can be used as security or collateral for asset-based

¹²⁸ See generally Financial Stability Board *Global Monitoring Report on Non-Bank Financial Intermediation* (2020) 30.

¹²⁹ Organisation for Economic Cooperation and Development *Financing SMEs and Entrepreneurs 2019: An OECD Scoreboard* (2019) 45.

¹³⁰ Cusmano L & Koreen M (2015) 6.

¹³¹ The World Bank Group (2019) 10.

¹³² The International Finance Corporation *Report on Indonesia Market Study: Movable Assets-based Financing to Micro, Small, and Medium Enterprise* (2014) iv.

¹³³ Hewitt A 'Asset Finance' 2003 *Bank of England Quarterly Bulletin* 208.

¹³⁴ Ajala T 'Accessing Finance with Movable Collateral: The Flipside for Micro, Small and Medium Enterprises in Nigeria' (2018) 9(22) *Research Journal of Finance and Accounting* 25.

lending by SMEs include accounts receivable, inventory, intellectual property and equipment.¹³⁵ The amount of credit extended to a borrower under asset-based lending is based primarily on the appraised value of the asset pledged as collateral.¹³⁶ Such an asset is carefully estimated and constantly monitored by the lender throughout the loan's tenor to control and manage the credit risk.¹³⁷ Some specialised forms of asset-based lending include purchase order financing, warehouse receipt, hire purchase and equipment leasing.

Asset-based lending compares to and is more beneficial to SMEs than traditional bank lending in the following ways:¹³⁸

- a) Unlike traditional bank lending, asset-based lending is not based on the SMEs' financial statement or overall creditworthiness but only on the asset pledged as collateral. This way, asset-based lending can help SMEs circumvent the problem of information asymmetry.
- b) Asset-based lending restricts the borrower's exposure because the underlying asset used as collateral is also considered the primary source of repayment. Accordingly, if the borrower defaults on the loan, only the asset used as collateral will be sold to liquidate the debt. However, under traditional bank lending, the asset used as collateral by the borrower is viewed as a secondary source of repayment. Other assets and revenue streams of the borrower are captured as the primary source of repayment and will be targeted if the SME defaults.
- c) Fixed assets such as lands, buildings and heavy equipment are preferred as collateral for traditional bank lending. However, in asset-based lending, movable assets, including accounts receivable, can be used as collateral for a loan. Since SMEs are

¹³⁵ Hewitt A (2003) 208; The World Bank Group (2019) 11.

¹³⁶ Kimathi J *Asset-Based Financing Solutions and the Growth of Manufacturing (SME) in Nairobi County, Kenya* (unpublished MBA thesis, United States International University – Africa, 2017) 14.

¹³⁷ Kimathi J (2017) 14.

¹³⁸ See generally Bakker MHR, Klapper LU & Gregory F (2004) 10; also see Modansky RA & Massimino JP 'Asset-Based Financing Basics' available <https://www.journalofaccountancy.com/issues/2011/aug/20113992.html> (accessed on 24 January 2021); Ahmad D (2018) 102.

known to have movable assets than fixed assets, asset-based lending is advantageous as SMEs can use these readily available assets as collateral for loans.

Asset-based lending is lucrative in countries where the legal frameworks allow a borrower to create an enforceable security interest in the movable asset (whether tangible or intangible) by assigning such asset as collateral or security for a loan.¹³⁹ In Nigeria, this framework is the Secured Transactions in Movable Assets Act, 2017 (STMA). The STMA enables SMEs and other businesses to use tangible and intangible movable property, including accounts receivable, as collateral or security for loans from both banks and non-banking financial institutions.¹⁴⁰ The STMA establishes the National Collateral Registry (NCR) with which security interest created in movable assets used as collaterals can be registered.¹⁴¹

2.4.2. Invoice Financing

The bulk of the wealth of most businesses, including SMEs, is often locked up in accounts receivable.¹⁴² Accounts receivable is associated with invoices for goods or services delivered by a business to a customer under open account or trade credit terms. Under this trade arrangement, the seller delivers goods or supply services to the buyer and grants the buyer (usually another business) anywhere between 30 to 120 days to pay after such delivery.¹⁴³

With invoice financing alternatives like factoring, invoice discounting and reverse factoring, SMEs that are suppliers can quickly convert their unpaid and yet to be due invoices (accounts receivable) into cash by selling them to a financier at a discount. This eliminates the need for the SME to wait for the invoice to mature or borrow pending the invoice's maturity to drive operations. Notably, invoice financing aids SMEs to optimise the use of internal financing (accounts receivable), which is often their preference as predicted under the Pecking Order Theory.¹⁴⁴ Invoice financing is becoming a trending phenomenon in the discourse on SME

¹³⁹ Ahmad D (2018) 106.

¹⁴⁰ s 1 of the STMA.

¹⁴¹ s 10 of the STMA.

¹⁴² Bazinas S 'An International Legal Regime for Receivables Financing: UNITRAL's Contribution' (1998) 8(315) *Duke Journal of Comparative & International Law* L 315.

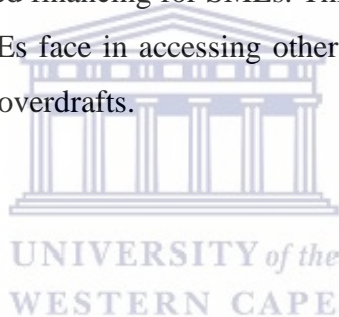
¹⁴³ Marin MJ *Factoring: A Training Guide to Secured Financing* 11 ed (2017) 4.

¹⁴⁴ Chapter 2, Paragraph 2.3.2.

financing because buyers and importers are increasingly pushing to trade with sellers and exporters under open account or credit terms.¹⁴⁵

Similar to asset-based lending, invoice financing can be used to circumvent the challenges of information asymmetry as it also focuses on the quality of the underlying asset rather than the borrower's credit standing.¹⁴⁶ However, unlike both asset-based and traditional bank lending, some invoice financing options like factoring may involve more than just financing. Factoring, in particular, offers other value-added services like receivables collection, credit risk assessment, sales ledger management and credit protection, making it even more attractive and suitable for SMEs that supply goods or services to customers on trade credit or open account terms.¹⁴⁷

Given that banks are one of the most important sources of external financing for SMEs, they should be required by the Central Bank of Nigeria (CBN) to ensure the availability of suitable financing products like asset-based financing for SMEs. This call is particularly motivated by the seeming difficulties that SMEs face in accessing other products of banks like financial-statement backed term loans and overdrafts.



2.5. Conclusion

This chapter has highlighted the contributions of SMEs to Nigeria's economy. It has also examined the major sources of finance for SMEs, the inadequacies and limitations of the sources and why SMEs find it challenging to access some of them. The examination in the chapter conceded that SMEs are the backbone and engine of Nigeria's economy. However, they face many challenges that hinder their growth and development, with access to finance topping the chart.

The chapter has noted that internal financing and informal sources of external financing are often inadequate to facilitate SMEs' expansion objectives. Unfortunately, in their quest to seek

¹⁴⁵ Dewan SK & Zahid JR 'Factoring as an Alternative Mode of International Trade Finance' (2020) 1 available at <https://ssrn.com/abstract=3536156> (accessed on 10 March 2021).

¹⁴⁶ Goh K (2017) 61-2.

¹⁴⁷ Hewitt A (2003) 210.

financing from formal sources, including banks and the stock market, SMEs face numerous requirements they cannot satisfy. Given these issues, the chapter advances asset-based financing as a more suitable alternative to SMEs. It was noted that asset-based financing alternatives are suitable for SMEs because they circumvent financing impediments like information asymmetry, lack of collateralisable fixed assets and weak credit rating often linked with bank financing.

Overall, asset-based financing options prove to be very useful in promoting financial inclusion for SMEs since they align with their peculiarities and financing preferences. The discussion in the chapter has set the stage by recognising the attractiveness and suitability of asset-based financing solutions like factoring. The next chapter will extensively discuss factoring as a financing alternative, outlining its definition, features, history, types as well as its merits and demerits.



CHAPTER THREE

FACTORING AS AN ALTERNATIVE SOURCE OF FINANCING FOR SMEs

3.1. Introduction

The usefulness of accounts receivable in supporting SMEs in sourcing financing from financial institutions was highlighted in the previous chapter. It was disclosed in the chapter that SMEs could use their accounts receivable as security or collateral for loans through asset-based lending. It was also shown that they could even more beneficially, outrightly sell their accounts receivable under invoice financing options like factoring for immediate cash. In the English case of *Chow Yoong Hong v Choong Fah Rubber Manufacturer*, Lord Delvin alluded to the latter option when he observed that ‘There are many ways of raising cash besides borrowing. One is by selling book debts [accounts receivable] and another by selling unmatured bills, in each case for less than their face value.’¹⁴⁸

This chapter undertakes a robust discussion on factoring as an alternative source of financing. The chapter discusses the definition, mechanism, features, history, types, advantages and disadvantages of factoring. The chapter also highlights key legal issues that underpin factoring. Further, the chapter specifically examines the benefits of factoring as an alternative source of financing for Nigeria's SMEs, concentrating on working capital and international trade financing. The chapter also explores how factoring could sustain financing to SMEs during and post the COVID-19 pandemic. These examinations aim to justify why policymakers in Nigeria must ensure that there are facilitative policy, legal, tax and regulatory frameworks for promoting factoring as an alternative source of financing for SMEs.

3.2. Definition, Features and Mechanism of Factoring

The definition and terminology used for describing factoring vary across different countries.¹⁴⁹ The definition of factoring is determined often by the legal system or legal framework where

¹⁴⁸ *Chow Yoong Hong v Choong Fah Rubber Manufacturer* [1962] AC 209 at 216 (PC).

¹⁴⁹ Mizan ANK ‘Factoring: A Better Alternative of International Trade Payment Method’ (2011) 2(9) *Centre for Socio-Economic Research* 249.

it features.¹⁵⁰ Nevertheless, scholars have extended incisive and helpful definitions to facilitate an understanding of the concept.¹⁵¹ Moore's definition of factoring is among the most exhaustive definitions available in literature.¹⁵² He defines factoring as an arrangement between a factor and the supplier of goods or services on open account under which the factor performs certain services connected with the accounts receivable arising from the contract of sale between the supplier and his customer. He lists the services provided by the factor to comprise: (i) Purchasing the accounts receivable for immediate cash; (ii) Maintaining the ledger and performing other bookkeeping duties relating to the accounts receivable; (iii) Collecting the accounts receivable from the customer; and (iv) Assuming the losses which may arise from the customer's financial inability to pay.

The above definition points to the three parties that facilitate a factoring transaction. Going forward in this study, the business selling its accounts receivable (as represented by an invoice) to the *factor* will be understood as the *supplier* or *client*. The term *customer* or *debtor* will be taken to refer to the party that has an obligation to settle the assigned receivables, usually through direct payment to the *factor*. However, it should be clarified at this stage that it is not always the case that the factor will provide all the four services highlighted in Moore's definition. One or a combination of the services could suffice depending on the applicable legal framework and agreement between the supplier and the factor.

Further, it is good to mention that not all accounts receivable can be 'factored'. In most countries, factoring is mainly limited to commercial accounts receivable, that is, receivables from business to business transactions.¹⁵³ Receivables arising from transactions with final consumers (business to customer) could be excluded.¹⁵⁴ Additionally, receivables from sales to government entities may also be prohibited (business to government) from being subjected

¹⁵⁰ Alexander MR 'Towards Unification and Predictability: The International Factoring Convention' ((1989) 27(2) *Columbia Journal of Transnational Law* 358.

¹⁵¹ See Klapper L (2006) 3112; Cusmano L & Koreen M (2015) 24; Giurca VL 'International Factoring – A Viable Financing Solution for Firms' (2010) 8(14) *Young Economists Journal* 28.

¹⁵² Moore CG 'Factoring - A Unique and Important Form of Financing and Service' (1959) 14(3) *The Business Lawyer* 706.

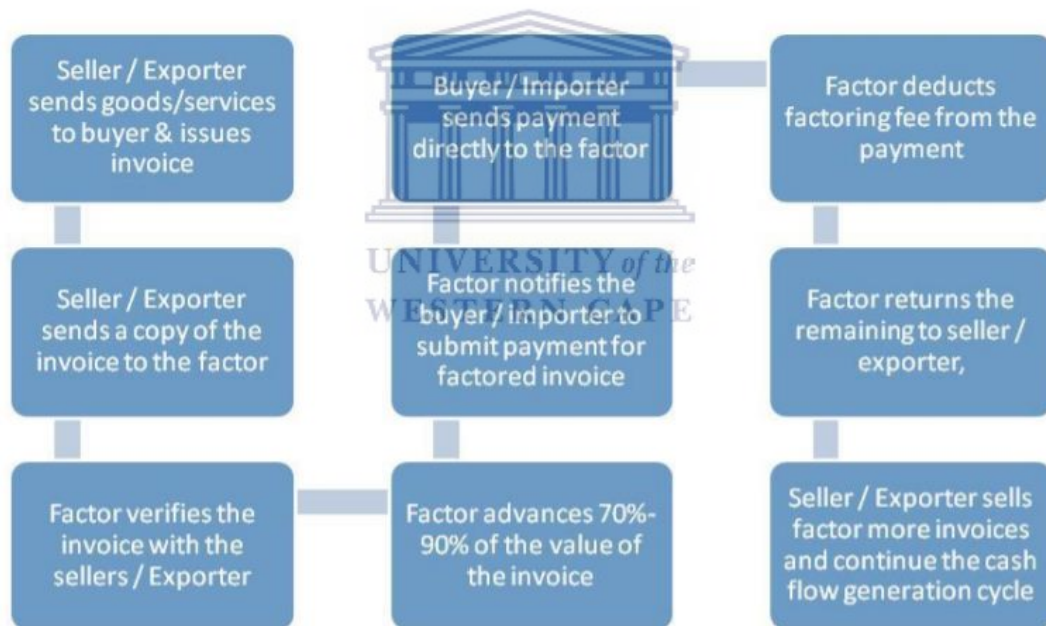
¹⁵³ Strauss S *Regulatory Framework for Factoring Egypt Financial Services: Egypt Financial Services Project, Technical Report No. 27* (2005) 2.

¹⁵⁴ Strauss S (2005) 2.

to factoring.¹⁵⁵ Factors will also not be inclined to acquire any accounts receivable that qualify as doubtful or bad debt.¹⁵⁶

The factor acquires the accounts receivable (as materialised in invoices) from the supplier only after confirming its validity and assessing the customer's creditworthiness, not the supplier's creditworthiness.¹⁵⁷ Given the focus on the customer's creditworthiness, Marin observes that SMEs stand an excellent chance to benefit from using factoring if their open account or credit sales are to high-value businesses (business to business).¹⁵⁸ Nabawanda also recommends that SMEs can improve their eligibility to obtain financing through factoring by dealing with customers that have good credit and by keeping proper business records of their transactions with such customers.¹⁵⁹ Fig 2 below gives further guidance on how the interactions among the supplier, customer and factor could be structured in a factoring transaction:

Fig 2: Factoring Mechanics¹⁶⁰



¹⁵⁵ Strauss S (2005) 2.

¹⁵⁶ A bad debt means accounts receivable that is incapable of being recovered from the customer while doubtful debt is accounts receivable that is likely to become bad debt in the future.

¹⁵⁷ Jayakumar M 'Factoring - Financial Stamina for Working Capital' (2012) 1(12) *Indian Journal of Applied Research* 124.

¹⁵⁸ Marin MJ (2017) 6.

¹⁵⁹ Nabawanda W (2018) 74 -5.

¹⁶⁰ Vaddepalli S 'Factoring: An Alternate Payment Method in International Trade' (2014) 1(3) *International Journal of Business Quantitative Economics and Applied Management Research* 50.

3.3. History and Developments in Factoring

Although factoring started to gain phenomenal growth in the 1970s,¹⁶¹ its origin has been traced to the dawning of trade and commerce.¹⁶² To attest to this, certain factoring rules can be found in the monolithic law book – the Code of Hammurabi, developed by King Hammurabi around 1771 BCE.¹⁶³ Historical records also suggest that merchants in the ancient Roman Empire utilised a form of factoring involving the sale of promissory notes at a discount.¹⁶⁴ The forerunner of modern day factoring developed in medieval England from the 1300s, where it was used in the textile industry.¹⁶⁵ The form of factoring that is closest to what is obtainable presently emerged in the United States of America as it dominated the financing arrangement in the textile industry.¹⁶⁶ But by the 1930s, due to the effects of the Great Depression, factoring spread to other industries beyond textiles.¹⁶⁷

Today, factoring has evolved and is widely accepted as a suitable financing and credit management instrument for businesses, especially SMEs.¹⁶⁸ Available data even suggest that factoring is mainly used by SMEs, not larger corporates.¹⁶⁹ This position strengthens the arguments in the previous chapter that asset-based financing options align better with the peculiarities and financing preferences of SMEs.¹⁷⁰ Although factoring is predominantly utilised by businesses engaged in manufacturing or otherwise selling goods, its use in the services sector is also growing rapidly.¹⁷¹

International Factors Group (IFG) and Factors Chain International (FCI) have been instrumental in promoting factoring and other invoice financing products, including Africa.¹⁷²

¹⁶¹ Giurca VL (2010) 28.

¹⁶² Vaddepalli S (2014) 49.

¹⁶³ Marin MJ (2017) 1.

¹⁶⁴ Jayakumar M (2012) 124.

¹⁶⁵ Hillyer WH 'Four Centuries of Factoring' (1939) 53(2) *The Quarterly Journal of Economics* 305.

¹⁶⁶ Pizar S 'Legal Aspects of International Factoring - An American Concept Goes Abroad' (1970) 25(4) *Business Lawyer (ABA)* 1505.

¹⁶⁷ Jayakumar M (2012) 124.

¹⁶⁸ Milenkovic-Kerkovic T & Dencic-Mihajlov K 'Factoring in the Changing Environment: Legal and Financial Aspects' (2012) 44 *Procedia - Social and Behavioral Sciences* 435.

¹⁶⁹ Auboin M, Smythe H & Teh R 'Supply Chain Finance and SMEs: Evidence from International Factoring Data' *WTO Staff Working Papers ERSD-2016-04* (2016) 7; also see Jayakumar M (2012) 124.

¹⁷⁰ Chapter 2, Paragraph 2.4.2.

¹⁷¹ Milenkovic-Kerkovic T & Dencic-Mihajlov K (2012) 431.

¹⁷² Alarcon RB 'International Factoring and Development: The Impact of the Factoring Model Law of 2014' (2014) 3 available at <https://fci.nl/media/26898/download> (accessed on 6 December 2020).

To solidify their campaign and create a wider pool for factoring service providers, they merged in 2016 with the resulting entity remaining and being called FCI.¹⁷³ FCI publishes an annual review that provides the most authoritative data on the global factoring industry.¹⁷⁴ The latest FCI Annual Review shows that the global factoring industry grew by 5 per cent in 2019 to €2,917 trillion from 2018's €2,767 trillion.¹⁷⁵ In terms of regional distribution, Europe is the biggest factoring market and accounted for 67.7 per cent of 2019's factoring volume, followed by the Asia Pacific (23.57 per cent).¹⁷⁶ At around 0.84 per cent, Africa's share of global factoring was among the lowest, edging over only that of the Middle East (0.34 per cent), as shown in Table 4 below:

Table 4: 2019 Global Factoring Statistics¹⁷⁷

Region	Factoring Volume	Market Share in Percentage
Europe	1,976,239	67.75%
Asia-Pacific	687,594	23.57%
South America	132,031	4.53%
North America	86,742	2.97%
Africa	24,562	0.84%
Middle East	9,937	0.34%
Total in Trillion of Euros	2,917,105	100%

As with other financial services, factoring is also being disrupted by financial technology or Fintech, which simply connotes employing technology to facilitate the use and provision of financial services. There is an increasing move from manual to digitalised platforms through which businesses desiring to sell their accounts receivables and factoring firms can conduct factoring transactions more innovatively and faster.¹⁷⁸ Some of these platforms are run directly

¹⁷³ Factors Chain International 'About FCI' available at <https://fci.nl/en/about-fci> (accessed on 6 December 2020).

¹⁷⁴ Auboin M, Smythe H & Teh R (2016) 7.

¹⁷⁵ Factors Chain International *FCI Annual Review* (2020) 28.

¹⁷⁶ Factors Chain International *FCI Annual Review* (2020) 28.

¹⁷⁷ Factors Chain International *FCI Annual Review* (2020) 28.

¹⁷⁸ Dorfleitner G, Hornuf L & Schmitt M *The FinTech Market in Germany* (2016) 33-34.

by factoring firms. Others are administered by companies that act as intermediaries between businesses seeking to access finance against their accounts receivable (invoices) and factoring firms.¹⁷⁹ In this latter arrangement, the business lodges their invoices on an online portal or digital wallet administered by the intermediary company.¹⁸⁰ The company verifies the authenticity of the invoices before exposing them to a pool of factoring firms that would like to fund against such invoices. Blockchain technology can be deployed to ensure the security and transparency of online or automated factoring transactions.¹⁸¹

3.4. Types of Factoring Arrangements

Various factoring arrangements are possible depending on the agreement reached between the factor and supplier as well as the legal framework applicable to their contractual relationship.¹⁸² However, the most common types of factoring arrangements are explained below:

3.4.1. Advance and Maturity Factoring

Advance factoring involves the factor making an advance payment to the supplier before the assigned accounts receivable matures for collection. The factor will pay the supplier between 70 to 90 per cent of the nominal value of the purchased invoice before it actually matures for collection.¹⁸³ The remaining 10 to 30 per cent of the invoice (less the applicable charges of the factors) is paid over to the supplier after the factor collects the receivables from the customer.¹⁸⁴ Under maturity factoring, the factor pays the supplier only after the accounts receivable has been collected from the customer.¹⁸⁵

Further, in advance factoring, the factor charges interest (discount charge) on the amount advanced to the supplier, but this charge does not apply to maturity factoring.¹⁸⁶ Although

¹⁷⁹ Dorfleitner G, Hornuf L & Schmitt M *The FinTech Market in Germany* (2016) 33-34.

¹⁸⁰ Merchant Factors 'Fintech and the Future of Factoring' available https://www.mfactors.co.za/articles_fintech_future_factoring.php (accessed on 10 April 2021).

¹⁸¹ See generally Guerar M, Merlo A & Migliardi M et al 'A Fraud-Resilient Blockchain-Based Solution for Invoice Financing' (2020) 67(4) *IEEE Transactions on Engineering Management* 1086-1098.

¹⁸² Pizar S (1970) 1506.

¹⁸³ Dimitrova EP (2011) 47.

¹⁸⁴ Klapper L (2006) 3112; Dimitrova EP (2011) 47.

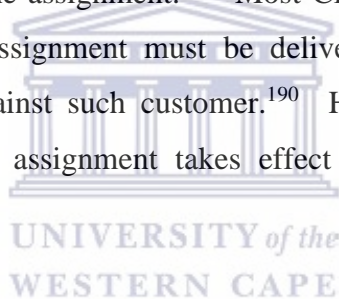
¹⁸⁵ Joubert N (1987) 90.

¹⁸⁶ Milenkovic-Kerkovic T & Dencic-Mihajlov K (2012) 430.

advance factoring is the more expensive arrangement because of the discount charge, it is advantageous to SMEs requiring immediate financing. This is because it helps them to better manage the cash-flow shortages that could result in waiting for the receivables to mature and be paid by the customer. Thus, SMEs that do not require immediate financing can opt for maturity factoring instead of advance factoring to avoid the extra charges. Nonetheless, maturity factoring may be useful if the SME has a large pool of customers to whom they deliver goods or services on credit or open account terms as they can benefit from the other credit management services that factors provide.¹⁸⁷

3.4.2. Notification/Disclosed and Non-notification/Undisclosed Factoring

In notification/disclosed factoring, the customer is notified of the assignment of the accounts receivable to the factor and is usually directed to cooperate with the factor regarding the settlement of the receivables.¹⁸⁸ However, for undisclosed/non-notification factoring, the customer is not notified about the assignment.¹⁸⁹ Most Civil Law practising countries, like Egypt, require that notice of assignment must be delivered to the customer before the assignment can be effective against such customer.¹⁹⁰ However, in most Common Law countries, such as Nigeria, the assignment takes effect without the need to notify the customer.¹⁹¹



3.4.3. International and Domestic Factoring

International or cross-border factoring involves the assignment of receivables arising from a contract of sale for goods or services between a supplier and customer in *different* countries.¹⁹² However, domestic factoring involves the assignment of receivables arising from a contract of sale between a supplier and customer in *the same* country.¹⁹³ Further, domestic factoring usually involves one factor residing in the same country with the supplier and customer.

¹⁸⁷ Chapter 3, Paragraph 3.5.

¹⁸⁸ Vaddepalli S (2014) 50.

¹⁸⁹ Vaddepalli S (2014) 50.

¹⁹⁰ European Bank for Reconstruction and Development *Factoring Survey in EBRD Countries of Operation* 3ed (2018) 39.

¹⁹¹ Milenkovic-Kerkovic T & Dencic-Mihajlov K (2012) 432.

¹⁹² Vasilescu LG (2010) 17.

¹⁹³ Dewan SK & Zahid JR (2020) 4.

However, in some instances, international factoring may involve two factors - the two-factor system.¹⁹⁴ The two-factor system is a type of international factoring that involves the delivery of factoring services through the cooperation between two factoring companies, one operating in the exporter's country (export factor) and the other from the importer country (import factor).¹⁹⁵ International factoring can also be conducted through only one factor (direct factoring).¹⁹⁶ Nonetheless, two-factor system allows for more speed and efficiency in the delivery of factoring services, but it is also costlier as two factors are engaged.¹⁹⁷ Factoring networks like FCI facilitate the two-factor system.¹⁹⁸

3.4.4. Recourse and Non-Recourse Factoring

In non-recourse factoring, which is a more expensive arrangement, the factor assumes the customer's credit risk or risk of non-payment.¹⁹⁹ That is to say, the factor cannot claim against the supplier for the customer's default or failure to settle the assigned invoice by the payment due date due to bankruptcy or illiquidity. However, under recourse factoring, the factor can claim against the supplier for all or any portion of the assigned accounts receivable that the customer is yet to settle by the payment due date.²⁰⁰ Non-recourse factoring is more advantageous for SMEs because it gives them complete protection from the risk of bad debt, thereby helping them to avoid suffering a financial loss. Both non-recourse and recourse factoring can be conducted on either an *advance* or *maturity* basis.²⁰¹

3.4.5. Other Classifications

In addition to the factoring arrangements already discussed, factoring could involve assigning a single invoice or bulk invoices.²⁰² There is also what is termed subsequent assignment of

¹⁹⁴ Strauss S (2005) 4.

¹⁹⁵ Salinger F *Factoring, Law and Practice* (1991) 116-7.

¹⁹⁶ For more analysis on the types of international factoring see Mizan ANK (2011) 247 - 264.

¹⁹⁷ Mizan ANK (2011) 251 - 252.

¹⁹⁸ Mizan ANK (2011) 249.

¹⁹⁹ de la Torre, A, Gozzi JC & Schumukler SL 'An Online Platform for Reverse Factoring Transactions: NAFIN's Experience in Mexico Introduction' in *Innovative Experiences in Access to Finance: Market-Friendly Roles for the Visible Hand?* (2016) 151.

²⁰⁰ Vaddepalli S (2014) 50.

²⁰¹ Joubert N (1987) 90.

²⁰² Milenkovic-Kerkovic T & Dencic-Mihajlov K (2012) 432.

receivables, which involves assigning receivables earlier acquired by the factor to another third party, such as in a two-factor system.²⁰³ Additionally, factoring often involves the assignment of invoices representing goods or services *already* delivered by the supplier to the customer on credit (existing receivables).²⁰⁴ Factoring can also involve the assignment of future receivables - receivables for goods or services that the supplier is *yet* to deliver to the customer.²⁰⁵

Most countries that adopt the Civil Law legal system prohibit or place restrictions on the assignment of future receivables, the bulk assignment of receivables and subsequent assignment of receivables.²⁰⁶ These prohibitions and restrictions are absent in most Common Law countries.²⁰⁷ Notably, international best practices and developed legal principles on the assignment of receivables promote that assignment of future receivables, the bulk assignment of receivables and subsequent assignment of receivables should not be restricted or prohibited.²⁰⁸

3.5. Factoring as a Credit Management Solution for Open Account Trade

As highlighted in Moore's definition cited above, factoring is a settlement method for trade conducted on open account.²⁰⁹ The supply of goods or services on trade credit or open account terms is a prevalent practice among SMEs that are suppliers all over, including in Nigeria.²¹⁰ It is adopted to increase sales and competitiveness, especially when dealing with large corporates or high-quality customers.²¹¹

However, there are risks and challenges associated with open account or credit sales, particularly for SMEs that are suppliers. There is the risk that the SME may suffer cash flow shortages before the customer settles the accounts receivable, thereby making it difficult to

²⁰³ Dewan SK & Zahid JR (2020) 1.

²⁰⁴ Joubert N (1987) 96.

²⁰⁵ Joubert N (1987) 96.

²⁰⁶ Milenkovic-Kerkovic T & Dencic-Mihajlov K (2012) 432.

²⁰⁷ Milenkovic-Kerkovic T & Dencic-Mihajlov K (2012) 432.

²⁰⁸ Fruchtmann RO 'The UN Convention on the Assignment of Receivables in International Trade: Advancing Ratification and What This Means for Trade' (2020) 3-5. available at <https://www.mayerbrown.com/en/perspectives-events/publications/2020/05/the-un-convention-on-the-assignment-of-receivables-in-international-trade> (accessed on 25 November 2020).

²⁰⁹ Chapter 3, Paragraph 3.2.

²¹⁰ Olusola OJ & Olusola OA 'Use of Trade Credit in Nigeria: A Panel Econometric Approach' (2012) 3(2) *Research Journal of Finance and Accounting* 54.

²¹¹ Rawat B & Dave G (2017) 11.

meet its working capital needs.²¹² These cash flow shortages could constrain the SME to take loans or overdrafts from banks, which could be unavailable, as shown in the previous chapter.²¹³ Further, there is also the risk that the customer could delay or default in settling the accounts receivable when it eventually becomes due for payment (risk of bad debt).²¹⁴ Besides these, open account sale or the extension of trade credit requires several administrative functions like assessing the customer's credit risk, notifying the customer about the debt, additional bookkeeping and debt collection.²¹⁵ Most SMEs are ill-equipped to perform these administrative functions efficiently.²¹⁶

Fortunately, factoring is constituted by a package of bells and whistles that provide comfort to SMEs regarding the risks and challenges inherent in open account or trade credit sales. These services (some of which were identified in Moore's definition)²¹⁷ and how they assist SMEs in credit management are highlighted as follows:

3.5.1. Financing Against Accounts Receivable

The supplier can assign its accounts receivable through advance factoring in exchange for immediate cash instead of waiting for the receivables to mature.²¹⁸ This accelerated financing helps to deal with the risk of cash shortages during the credit period. In other words, factoring facilitates SMEs to transform their credit sales into cash sales quickly.

3.5.2. Credit Risk Protection

Under non-recourse factoring, the factor takes over the customer's risk of non-payment.²¹⁹ This protection takes care of the risk of the financial loss the supplier would have suffered due to

²¹² Tomusange RL (2015) 21 – 3.

²¹³ Chapter 2, Paragraph 2.3.3.

²¹⁴ Joubert N (1987) 88.

²¹⁵ Rawat B & Dave G (2017) 3.

²¹⁶ Bakker MHR, Klapper L & Udell GF (2004) 5.

²¹⁷ Chapter 3, Paragraph 3.2.

²¹⁸ Okpala KE, Osanebi C & Irinyemi A 'The Impact of Credit Management Strategies on Liquidity and Profitability' (2019) 1(1) *Journal of Behavioural Studies* 3-4.

²¹⁹ Dimitrova EP (2011) 49.

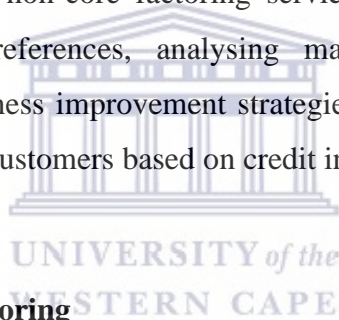
the receivables becoming bad debt or the customer's delay in settling the receivables even when it is due for payment.²²⁰

3.5.3. Accounting and Administrative Roles

The factor performs certain accounting and administrative functions that make it stand out from other types of financing. These functions include collecting the receivables from the customer when they become due, managing the supplier's sales ledger showing amounts paid and owed by the customer and assessing the customer's creditworthiness.²²¹ The factor's assessment of the customer's creditworthiness helps the supplier determine the riskiness of extending trade credit to the customer in the future, including the suitable credit levels for such customer.²²²

3.5.4. Advisory Services

Factors can also perform other non-core factoring services like advising the supplier on business trends, customers' preferences, analysing market performance, management counselling and suggesting business improvement strategies.²²³ Factors could also help the supplier in identifying potential customers based on credit information at their disposal.²²⁴



3.6. Cost Implication of Factoring

There are two main headings of charges that apply to a factoring arrangement. First, in consideration of the services the factor renders, the supplier is charged a service fee or commission.²²⁵ This service fee applies to all factoring transactions. The amount charged as the service fee is determined by considerations including the number of invoices factored, credit risk involved, whether factoring is with or without recourse and the credit period granted

²²⁰ Jayakumar M (2012) 125.

²²¹ Milenkovic-Kerkovic T and Dencic-Mihajlov K (2012) 430; Moore CG (1959) 709 – 711.

²²² Marin J (2017) 7.

²²³ Moore CG (1959) 707; Jayakumar M (2012) 125.

²²⁴ Jayakumar M (2012) 125.

²²⁵ Bakker MHR, Klapper L & Udell GF (2004) 6.

to the customer by the supplier.²²⁶ Secondly, as earlier highlighted, advance factoring attracts an interest (discount charge) on the advance payment to the supplier.²²⁷

Both the service fee and discount charge are deducted (discounted) from the nominal value of the assigned invoice.²²⁸ The factor would usually deduct the applicable service fee and discount charge before paying what is left (if any) to the supplier as a final payment.²²⁹ Apart from these heads of charges paid to the factor, factoring transactions may also attract taxes like stamp duty and value added tax (VAT), including the cost for registering the assignment of the accounts receivable to the factor with a government-administered registry.

3.7. Factoring Distinguished from other Invoice Financing Options

Factoring is sometimes used interchangeably for other variants of invoice financing like reverse factoring and invoice discounting, but they differ in structure. However, it should be clarified that the same legal framework is usually used for the three because the underlying principles are similar despite the structural differences. These structural differences are briefly discussed below:



3.7.1. Reverse Factoring

Reverse factoring, also known as supply chain finance, differs from factoring in terms of the party who initiates the purchase of the accounts receivable. For factoring, the supplier initiates the transaction by requesting the factor to purchase his accounts receivable at a discount. However, in reverse factoring, the customer initiates the factoring arrangement by requesting the factor to settle his accounts payable in advance in favour of the supplier before it matures for settlement.²³⁰ The customer will then settle the payment directly to the factor when the invoice matures. The supplier still receives discounted payments as in factoring. Thus, factoring benefits SMEs that are suppliers of goods and services, while reverse factoring can

²²⁶ Vaddepalli S (2014) 50; Moore CG (1959) 720.
²²⁷ Chapter 3, Paragraph 3.4.1.
²²⁸ Bakker MHR, Klapper L & Udell GF (2004) 5.
²²⁹ Klapper L (2006) 3112.
²³⁰ Tomusange RL (2015) 28.

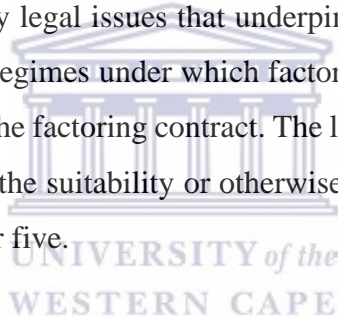
be utilised by SMEs that are buyers. However, to benefit from reverse factoring, the SME acting as the buyer must itself be a high-value customer.²³¹

3.7.2. Invoice Discounting

What distinguishes factoring from invoice discounting is the range of services provided. With invoice discounting, the invoice discounter advances finances against the receivables, but never takes on the function of receivables collection as obtainable under factoring.²³² This means the supplier will collect the debt from the customer and then pay the invoice discounter. In this sense, invoice financing does not require notice of the assignment to be given to the customer since the supplier will still be dealing directly with the customer.

3.8. Legal Aspects of Factoring

This section considers certain key legal issues that underpin factoring. The issues considered include the legal and regulatory regimes under which factoring operates, whether factoring is a sale or lending transaction and the factoring contract. The learning points from the discussion in this section are used to assess the suitability or otherwise of the proposed legal framework for factoring in Nigeria in chapter five.



3.8.1. Domestic and International Regulation of Factoring

The bedrock of factoring in any given country is defined by the legal and regulatory frameworks in which it is practised.²³³ The legal framework (commonly called the factoring law) sets out the definition of factoring, the rights, obligations and defences available to parties connected to a factoring transaction.²³⁴ In addition, the framework answers other questions pertinent to factoring, such as whether recourse factoring constitutes a true sale, must the customer be notified about the assignment and if a ban on assignment clause can invalidate a

²³¹ Klapper L (2006) 3117.

²³² Nabawanda W (2018) 6.

²³³ Strauss S (2005) 7; Brinsley P 'Factoring Legislation and Regulation (2013) 2-3 available at <https://docplayer.net/2509402-Factoring-legislation-and-regulation-douala-cameroon-22nd-november-2013.html> (accessed on 17 June 2020).

²³⁴ Brinsley P (2013) 3.

factoring arrangement.²³⁵ Some countries have specific laws on factoring.²³⁶ Others have their Civil Code containing certain assignment provisions in support of factoring.²³⁷ There are yet countries, especially developing countries, that do not have factoring laws in any form.²³⁸ However, the consensus is that factoring thrives better and is easier to navigate in countries with legal frameworks taking the form of a statute on factoring or case law (judicial decisions).²³⁹ In the words of Klapper, the factoring law legitimise the factoring industry.²⁴⁰

On the other hand, the regulatory framework looks into the entities that can provide factoring services and how the operations of these entities are regulated.²⁴¹ In some countries, the business of factoring is restricted to licensed banks and their subsidiaries, non-banking financial institutions (independent factoring firms) or both.²⁴² The regulatory framework will typically involve a prescription of the regulatory body overseeing factoring firms, the scope of regulatory oversight, licencing procedures and capital requirement.²⁴³

The legal frameworks and assignment rules for factoring varies from country to country.²⁴⁴ The variations imply that the transacting parties could be confronted by contradictory rules in international or cross-border factoring. This situation has motivated Conventions and Model Laws to be developed for factoring to promote uniformity and certainty in international or cross-border factoring transactions. These instruments and their founding institutions are discussed below:

²³⁵ Strauss S (2005) 11.

²³⁶ Mulroy P & Brink U (2019) 34.

²³⁷ Mulroy P & Brink U (2019) 34.

²³⁸ Mulroy P & Brink U (2019) 34.

²³⁹ Malhotra M, Chen Y & Crassula A et al *Expanding Access to Finance: Good Practices and Policies for Micro, Small, and Medium Enterprises* (2015) 9; Mulroy P & Brink U (2019) 34.

²⁴⁰ Klapper L (2006) 3116.

²⁴¹ Kara H 'Factoring: To Regulate or not to Regulate?' in Bickers M (ed) *World Factoring Yearbook* (2017) 4.

²⁴² Strauss S (2005) 8 -9.

²⁴³ Kara H (2017) 4; Strauss S (2005) 8 -9.

²⁴⁴ Strauss S (2005) 11.

3.8.1.1. Convention on International Factoring, 1988

The Convention on International Factoring of 1988 is the first-ever treaty on factoring.²⁴⁵ The Convention was adopted by the Member States of the International Institute for the Unification of Private Law (UNIDORIT) at a diplomatic conference held in Ottawa, Canada, on 28 May 1988.²⁴⁶ Quite interestingly, in keeping with the requirements of Article 14(1) of the UNIDROIT Convention, it entered into force on 1 May 1995, after Nigeria deposited the third instrument of ratification.²⁴⁷ Eight other countries, namely Belgium, France, Germany, Hungary, Italy, Latvia, Russian Federation and Ukraine, have also ratified it.²⁴⁸ The UNIDORIT Convention is binding only on countries that have ratified it, thereby giving the instrument a plurilateral character.²⁴⁹ Priest-Stephens and Kameni observe that the UNIDROIT Convention has had limited application and impact because it has not been widely adopted.²⁵⁰ They, however, commended the Convention for being the foundation for other factoring instruments.

3.8.1.2. Convention on the Assignment of Receivables in International Trade, 2001

About seven years after the UNIDROIT Convention entered into force, the Convention on the Assignment of Receivables in International Trade was developed and adopted by the United Nations Commission for International Trade Law (UNCITRAL) in 2001.²⁵¹ However, unlike the UNIDROIT Convention that focuses only on factoring, the UNCITRAL Convention generally deals with the broader field of asset-based financing.²⁵² The UNCITRAL Convention covers various transactions, including asset-based lending, forfaiting, factoring, securitisation and invoice discounting. As of the writing of this thesis, the UNCITRAL Convention has been

²⁴⁵ Brinsley P (2013) 4.

²⁴⁶ Brinsley P (2013) 4.

²⁴⁷ Brinsley P (2013) 4.

²⁴⁸ The status of ratification is available at <https://www.unidroit.org/status-1988-factoring> (accessed on 26 November 2020).

²⁴⁹ Eurallyah AJ *Co-Regulation of Cross-Border Factors: Demystifying the Chimera of Free Movement of Capital Within the East African Community Common Market* (unpublished LLM thesis, University of Pretoria, 2019) 41.

²⁵⁰ Priest-Stephens L & Kameni E 'Building a Model' *Trade and Forfaiting Review Feature* 1 June 2016.

²⁵¹ UN General Assembly Resolution A/RES/56/81.

²⁵² Milenkovic-Kerkovic T & Dencic-Mihajlov K (2012) 433.

ratified by only Liberia and the United States of America.²⁵³ Like the UNIDORIT Convention, the UNCITRAL Convention has not had much impact because it has not been widely adopted.

3.8.1.3. FCI Model Law on Factoring, 2014

The FCI Model Law on Factoring was prepared by the IFG's Legal Committee (now constituted under FCI) in 2014.²⁵⁴ The Model Law takes much after the UNCITRAL Convention in terms of both idea and wording.²⁵⁵ However, its scope is narrowed to factoring only.²⁵⁶ Also, unlike both the UNIDROIT and UNCITRAL Conventions, the IFC Model Law is structured to apply to both international and domestic factoring.²⁵⁷ The FCI Model Law was produced to inform and guide national legislators in coming up with factoring laws that incorporate internationally accepted and developed legal principles.²⁵⁸ In addition to the Model Law, IFC has also developed the General Rules of International Factoring (GRIF), edifactoring.com Rules and the Rules of Arbitration.²⁵⁹ These instruments form the binding framework through which FCI members undertake correspondence and the two-factor system factoring transactions.²⁶⁰

Membership of FCI and other similar factoring networks is strongly recommended to factoring firms that offer international factoring services as a core business.²⁶¹ These firms can take advantage of FCI's extensive network of factoring firms.²⁶² However, due to the membership costs and other expenses, joining FCI may be unnecessary for factoring firms intending to focus on only domestic factoring.²⁶³

²⁵³ The status of ratification is available at <https://uncitral.un.org/en/texts/securityinterests/conventions/receivables/status> (accessed on 25 November 2020).

²⁵⁴ Mulroy P & Brink U (2019) 36.

²⁵⁵ Mulroy P & Brink U (2019) 36.

²⁵⁶ Article 1 of the IFC Model Law.

²⁵⁷ Article 1 of the IFC Model Law.

²⁵⁸ Mulroy P & Brink U (2019) 36.

²⁵⁹ Strauss S (2005) 5.

²⁶⁰ Strauss S (2005) 5.

²⁶¹ Strauss S (2005) 5.

²⁶² Mulroy P & Brink U (2019) 36.

²⁶³ Strauss S (2005) 5.

3.8.1.4. Afreximbank Model Law on Factoring, 2016

The Factoring Assignment Act, commonly referred to as the Afreximbank Model Law, is the most recent model law on factoring developed by the African Export-Import Bank (Afreximbank).²⁶⁴ Afreximbank having its headquarters in Cairo, Egypt, is a pan-African international financial institution established in 1993. At the centre of Afreximbank's mandate is the financing, promotion and development of intra and extra African trade. Afreximbank conceived the Model Law in recognition that a significant constraint to the development of factoring in Africa has been the lack of supportive legal frameworks.²⁶⁵ The Afreximbank Model Law was greatly influenced by the IFC Model Law, albeit with certain modifications.²⁶⁶ The Afreximbank Model Law is intended to support the efforts of African countries towards enacting or updating their national laws on factoring.²⁶⁷ Nigeria's proposed legal framework on factoring, the Factoring (Assignment of Receivables) Bill, discussed in the next chapter, takes substantially after the Afreximbank Model Law.

3.8.2. Factoring as a Transaction by Way of Sale or a Lending Transaction

Factoring is described often as a transaction involving the sale and purchase of accounts receivables, not a loan.²⁶⁸ On the surface, this might seem to be the case. However, the distinction between recourse and non-recourse factoring helps determine whether a factoring transaction is, indeed, a true sale transaction or a lending transaction. In this regard, a key learning point from the English case of *Yoong Hong v Choong Fah Rubber Manufactory* is that for a factoring transaction to be characterised as a lending transaction and not a sale, there must exist two conditions that must go hand in hand.²⁶⁹ First, there must be the lending of money by the factor to the supplier. Secondly, the promise of repayment by the supplier to the factor if the customer fails to settle assigned receivables when it matures for payment.

²⁶⁴ Tatge DB and Kameni E (2017) 7.

²⁶⁵ Tatge DB & Kameni E (2017) 7.

²⁶⁶ Tatge DB & Kameni E (2017) 8 – 11.

²⁶⁷ Tatge DB & Kameni E (2017) 8.

²⁶⁸ See generally Klapper L (2006) 3112; Cusmano L & Koreen M (2015) 24; Bakker MHR, Klapper L & Udell GF (2004) 10.

²⁶⁹ *Yoong Hong v Choong Fah Rubber Manufactory* (1962) AC 209 at 215 - 216. The same approach can be deduced from the cases of *Olds Discounts Co. Ltd v John Playfair Ltd* (1938) 2 ALL E.R 275 at 277; *Lloyds & Scottish Finance Ltd v Cyril Lord Carpet Sales Ltd* (1992) BCLC 609 at 613- 616.

For non-recourse factoring done on both *advance* and *maturity* basis, since there is no promise of repayment by the supplier if the customer defaults, the transaction can be characterised as an actual sale. From an accounting point, the asset is derecognised from the supplier's financial records as accounts receivable, and the asset is then recognised as accounts receivable in the factor's financial records.²⁷⁰ However, drawing from earlier explanations, recourse factoring can be characterised as a transaction by way of sale or a lending transaction, depending on whether it is completed on a *maturity* or *advance* basis. This characterisation is clarified below:

- a) If recourse factoring is done on a *maturity* basis, it may only be accommodated as a sale, not a loan. This is because the factor lends or advances no money to the supplier. Additionally, there is no promise of repayment by the supplier to the factor.
- b) Recourse factoring done on an *advance* basis can qualify as a lending transaction because there is both advance financing and a promise of repayment by the supplier if the customer defaults. The advance payment by the factor is perceived technically as a form of credit, with the factored receivables seen as security or collateral for such credit.²⁷¹ In other words, it can, in some sense, be seen as an asset-based lending or secured lending transaction.

Regardless of the distinctions drawn above, a country's legal framework could qualify recourse factoring (whether done on a *maturity or advance* basis) as a sale and purchase transaction, notwithstanding its lending character. A survey conducted by the European Bank for Reconstruction and Development (EBRD) showed that out of the 37 countries surveyed, 24 consider recourse factoring to be a true sale transaction.²⁷² In contrast, 11 other countries consider it a secured lending transaction.²⁷³ The results of the survey are as shown in Fig 3 below:

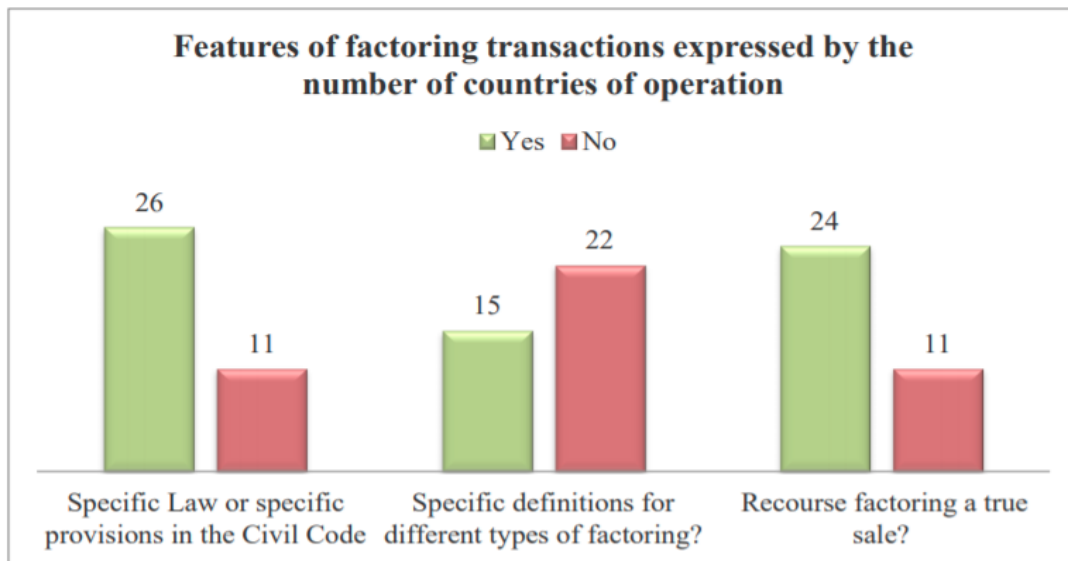
²⁷⁰ Kilian E Merchant *Cash Advances – Investigating the Taxation Consequences in South Africa* (unpublished Mater of Accounting (Taxation) thesis, Stellenbosch University, 2014) 17.

²⁷¹ Kilian E (2014) 20.

²⁷² European Bank for Reconstruction and Development (2018) 4.

²⁷³ European Bank for Reconstruction and Development (2018) 4.

Fig 3: A Survey of Legal Regimes for Factoring in 37 Countries where the EBRD has Operations²⁷⁴



Commenting on the survey results, the EBRD advocates that it is better to qualify recourse factoring as a sale transaction instead of a secured lending transaction because they differ in purpose and character.²⁷⁵ According to the EBRD, the primary purpose of factoring is the sale of receivables for financing and not the use of receivables as collateral for a loan as in a secured lending transaction. The EBRD observes that in factoring, the factor's recourse against the supplier is not the primary obligation; instead, it merely guarantees the value (solvency) of the transferred accounts receivable. In contrast, the fulcrum of a secured lending transaction is the provision of collateral for a loan. Additionally, the primary obligation of the borrower under a secured lending transaction is the repayment of the money lent. Premised on these points, the EBRD concludes that recourse factoring is a form of title finance and should not be re-characterised as a secured lending transaction. It is easy to agree with the EBRD's position, particularly when it is considered that factoring and secured lending are structured differently. In addition to the points mentioned by the EBRD, asset-based or secured lending mainly involves financing only, whereas recourse factoring offers other additional credit management services. Further, asset-based or secured lending may require other supplementary collateral other than just accounts receivable, while factoring does not. These distinguishing features

²⁷⁴ European Bank for Reconstruction and Development (2018) 4.

²⁷⁵ European Bank for Reconstruction and Development (2018) 4.

definitely give recourse factoring the character of more than just a loan. Its designation as ‘title finance’ as proposed by the EBRD is most suitable.

3.8.3. Contractual Arrangement - Factoring Contract

Another critical legal aspect of factoring is the contractual arrangement. Two broad headings of contracts facilitate factoring transactions. First is a contract of sale for goods or services between the supplier and the customer (usually another business), and secondly, a factoring contract between the supplier and the factor.²⁷⁶ Notably, in a two-factor system, there are two separate factoring contracts: one between the exporter and export factor and an inter-factor agreement between the export factor and import factor.²⁷⁷

In terms of what they cover, factoring contracts do not fundamentally differ from other commercial agreements. However, they contain terms that are peculiar to the factoring arrangements. These include the description of the invoices or accounts receivable assigned, services provided by the factor, charges for the factor's services, including whether factoring is on an advance or maturity basis.²⁷⁸ The terms and rights arising from the contract of sale impact the factoring contract. Particularly, the customer could validly raise defences like the right of set-off, non-performance by the supplier, merchandise returns and other rights accruing under the contract of sale to avoid claims made by the factor pursuant to the factoring contract.²⁷⁹

Furthermore, a contract of sale that contains a ban or restriction on assignment (BOA) clause affecting the supplier could create obstacles or render it legally impractical to assign the receivables from such contracts through factoring. A BOA clause may take various forms in constraining the ability of the supplier to assign his rights (also covering the right to receivables) to third parties like factors. This includes an absolute prohibition that the supplier's rights under the contract of sale are unassignable.²⁸⁰ It could also be a conditional restriction,

²⁷⁶ Mizan ANK (2011) 248.

²⁷⁷ Mizan ANK (2011) 248.

²⁷⁸ Bakker MHR, Klapper L & Udell GF (2004) 6.

²⁷⁹ Bakker MHR, Klapper L & Udell GF (2004) 11.

²⁸⁰ Tolhurst GG & Carter JJ ‘Prohibitions on Assignment: Choice to be Made’ (2014) 73(2) *Cambridge Law Journal* 405 – 406.

such as the supplier can assign his rights but with the customer's approval or only to a specified third party.²⁸¹

In the English case of *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd*, the House of Lords established the rule that an assignment in breach of a BOA clause would render such assignment ineffective against the customer, but not the factor.²⁸² This implies two things. If the customer is notified of the assignment of the accounts receivable to the factor, he can refuse to pay directly to the factor and insist on paying the supplier instead. However, the supplier will still be liable to the factor for payments from the customer.

Nonetheless, legal frameworks can override a BOA clause by specifying that assignments done in breach of such a clause will be effective against both the customer and factor, as is the case with all the Conventions and Model Laws discussed above.²⁸³ Thus, this represents the internationally accepted and developed legal principles on BOA clauses. In fact, countries looking at improving access to finance to SMEs through factoring are advised to adopt national assignment rules that override BOA clauses.²⁸⁴ This recommendation is in consideration of the little bargaining power that SMEs acting as suppliers may wield in having such clauses excluded contractually when dealing with large corporates.²⁸⁵

3.9. Merits and Demerits of Factoring

Factoring presents numerous advantages to SMEs, especially compared to traditional bank lending for loans and overdrafts underpinned by financial statements and collaterals. These advantages are enumerated below:²⁸⁶

²⁸¹ Tolhurst GG & Carter JJ (2014) 405 – 406.

²⁸² *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1994] 1 AC 85 at 106-9 (HL).

²⁸³ See Article 6(1) of the UNIDROIT Convention, Article 9 of the UNCITRAL Convention, Article 8.1 of IFC Model Law and Article 7.1 of Afreximbank Model Law.

²⁸⁴ European Bank for Reconstruction and Development (2018) 5.

²⁸⁵ European Bank for Reconstruction and Development (2018) 5.

²⁸⁶ See generally, Nure G *Factoring as a Financial Alternative* (2018) 41 – 43; also see Barbatu N 'Factoring – Alternative of Short-Term Financing for Companies' 2013 *International Conference Risk in Contemporary Economy* 171.

- a) The process for applying for and securing financing through factoring is much faster than for traditional bank lending. Additionally, the credit process requires less paperwork.
- b) Unlike traditional bank lending where the borrower can be restricted or directed on commercial purposes to employ the credit, the factor does not usually mandate the SME to use the funds for a specific commercial purpose.
- c) By improving the overall liquidity of the SME due to faster collection of receivables, the SME is also better positioned to settle its own accounts payable faster.
- d) With the advance payment obtainable under factoring, it ensures the SME can increase sales by trading with customers under open account or trade credit terms. However, an SME that takes on a bank loan does not enjoy the convenience of offering trade credit since it has pending obligations to discharge the principal sum and interest charges for the loan.
- e) Factoring enables SMEs to access financing under more flexible conditions because factoring does not require collateral, guarantees, insurance policies, business plans or financial statements from the SME. Instead, the key documents required are the invoices sought to be assigned and a record of the sale transactions between the SME and the customer.
- f) The advance payment obtained from factoring increases assets and reduces the SME's liabilities. This improves the SME's balance sheet position, thereby increasing the SME's creditworthiness for external financings from banks and the stock market.
- g) Since the factor takes over accounts receivable management responsibilities, it frees up time for the SME to spend more on servicing existing clients or pursuing new ones. This also gives the SME the room to improve its productivity and competitiveness.
- h) Apart from facilitating access to financing, SMEs can enjoy a wide range of specialised administrative, accounting and advisory services through factoring not available under traditional bank lending and other forms of financing.

- i) Independent factoring firms exercise more autonomy than banks in decision making, and this flexibility ensures that they are more receptive to extending financing to SMEs.

However, the undeniable reality is that no financing option is without its shortcomings, and factoring is not an exception. Factoring also has some disadvantages and limitations as a financing option for SMEs. These disadvantages and limitations are enumerated below:²⁸⁷

- a) The fees imposed by factors can sometimes be excessive for SMEs. In addition, factoring transactions also attract taxes like value-added tax and stamp duty usually passed to the SME. These fees and taxes could render the SMEs' credit sales unprofitable. It could also make factoring more expensive than bank lending.
- b) The SME stands the risk of the factor treating the customer harshly or in an uncordial manner, which can have adverse consequences on the SME's relationship with the customer.
- c) Factoring is not available to just any SME. It is likely inaccessible to SMEs with low turnover, inefficient management, numerous debtors, high bad-debt experience or engaged in a speculative business.
- d) Factoring is only available to a going concern business. SMEs seeking start-up capital cannot benefit from factoring.

Nonetheless, while it is accepted that there are some disadvantages and restrictions associated with factoring, these in no way compares to the benefits it presents as an alternative source of financing. For example, despite the considerable cost that non-recourse factoring done on an advance basis may attract, the cash flow convenience, credit risk protection and credit management services it provides make the cost worthwhile. Further, considering the time value of money, the comparative immediacy and ease of accessing financing provided by factoring over traditional bank lending make factoring less costly or at equal cost as bank financing.

²⁸⁷ For further discussion on the disadvantages of factoring, see Mantysaari P *The Law of Corporate Finance: General Principles and EU Law Volume III* (2010) 45; also see Fatima S & Khan A 'Factoring Business in India – A Critical Analysis' (2016) 7(1) *International Research Journal of Commerce Arts and Science* 45.

Factoring stands as a viable complement or substitute for other forms of external financing. More so, it has many advantages in comparison to other forms of external financing.

3.10. Examining the Specific Benefits of Factoring for Nigeria's SMEs

The claim that factoring is a viable alternative source of financing for SMEs in Nigeria has become the boilerplate for the few articles on the subject. Although this claim is not disputed, it is often made without specific discussion on the activities or financing needs that factoring supports. This has contributed to a limited understanding of the financing functions and benefits of factoring. Therefore, this section will attempt to address this gap by exploring the roles of factoring in working capital and international trade financing. The section will also consider the usefulness of factoring in sustaining access to financing to SMEs during and after the COVID-19 pandemic.

3.10.1. Factoring as a Source of Working Capital Financing

Working capital is a term used to describe the capital required by a business to finance its day to day or reoccurring expenses like payments to its suppliers, salaries, rent and rates.²⁸⁸ Given its link with daily expenditure, working capital is described as the lifeblood of any business, particularly those engaging in open account or trade credit sales with their customers.²⁸⁹ A business is considered efficient when it can settle its daily expenses (working capital needs) with ease and timeously.²⁹⁰

Most SMEs in Nigeria, especially those that engage with their customers on open account or trade credit basis, find it extremely challenging to settle their short-term or working capital obligations as they fall due.²⁹¹ This sometimes leads to their untimely demise. According to

²⁸⁸ Kenton W & Mansa J 'Working Capital' *Investopedia* 28 April 2020 available at <https://www.investopedia.com/terms/w/workingcapital.asp> (accessed 14 May 2020).

²⁸⁹ Edwards D, Owusu-Manu D & Baiden B et al 'Financial Distress and Highway Infrastructure Delays' 2017 *Journal of Engineering, Design and Technology* 118.

²⁹⁰ Klapper L (2006) 3122.

²⁹¹ Oladimeji JA & Aladejebi O 'The Impact of Working Capital Management on Profitability: Evidence from Selected Small Businesses in Nigeria' (2020) 8(1) *Journal of Small Business and Entrepreneurship Development* 39; also see Sunday KJ 'Effective Working Capital Management in Small and Medium Scale Enterprises (SMEs)' (2011) 6(9) *International Journal of Business and Management* 278.

the National Bureau of Statistics (NBS), less than 5 per cent of SMEs in the country can access working capital financing from external sources to fund operations.²⁹²

Fortunately, factoring, like traditional bank lending, provides SMEs with working capital financing.²⁹³ As already highlighted, with factoring, SMEs can trade their accounts receivable in exchange for immediate cash, which can be used as working capital. This capital assists SMEs with procuring production inputs, undertaking actual production or service delivery and settling their rent and wages with little or no delay.²⁹⁴ Factoring is an even better source of working capital financing than traditional bank lending because it circumvents information asymmetries, collateral, business plan and credit rating requirements in favour of SMEs. As a working capital solution, factoring helps SMEs increase liquidity and enhance cash-flow patterns, thereby contributing to their competitiveness.²⁹⁵

Cusmano and Koreen observe that factoring is surprisingly advantageous as a source of working capital to SMEs that are high-risk and informationally non-transparent.²⁹⁶ They justify this contention by observing that in factoring, what is primarily evaluated is the validity of the assigned invoices and the customer's creditworthiness, not the supplier.²⁹⁷ They note further that factoring is suitable for SMEs with a solid base of customers or poses high investments in intangible assets, which cannot ordinarily be used to secure traditional bank credit facilities.²⁹⁸

Unlike traditional bank lending that is usually accessible to SMEs on the basis of the availability of fixed assets that can be used as collateral, factoring enables SMEs to access finance through growing their sales. Since SMEs tend to prioritise their investments in growing sales rather than acquiring fixed assets, factoring is a very useful source of working capital for SMEs that engage in large volumes of credit sales. This explains why Ackah and Vuvor describe it as the only source of financing that grows with sales.²⁹⁹

²⁹² PwC (2020) 2.

²⁹³ Milenkovic-Kerkovic T and Dencic-Mihajlov K (2012) 430.

²⁹⁴ Auboin M, Smythe H & Teh R (2016) 2.

²⁹⁵ Milenkovic-Kerkovic T and Dencic-Mihajlov K (2012) 429.

²⁹⁶ Cusmano L & Koreen M (2015) 24.

²⁹⁷ Cusmano L & Koreen M (2015) 24.

²⁹⁸ Cusmano L & Koreen M (2015) 24.

²⁹⁹ Ackah J & Vuvor S *The Challenges faced by Small & Medium Enterprises (SMEs) in Obtaining Credit in Ghana* (unpublished MBA thesis, Blekinge Institute of Technology, 2011) 47.

3.10.2. Factoring as an International Trade Financing Instrument

International trade, an economic transaction involving importers and exporters in different countries, are facilitated by international financial payments. Private banking systems and Central Banks of the trading parties play essential roles in facilitating the payment.³⁰⁰ Alarcon explains that there are two major interests in the choice of payment method under international trade.³⁰¹ First, the exporter prefers a more secure form of payment, guaranteeing that he receives the negotiated price for the sale within the agreed time. On the other hand, the importer would desire not to incur any risk of paying and not receiving the goods or services contracted. There are four major payment methods in international trade: open account, cash in advance, letter of credit and documentary sales.

In the open account method, which has been explained earlier, goods are shipped or services delivered to the importer by the exporter before payment is made by the importer. The payment by the importer could usually be delayed between 30 to 90 days after such delivery.³⁰² The post-payment by the importer is often made through wire transfer, credit card or payment by cheque.³⁰³ International factoring has also emerged as a payment method for open account.³⁰⁴ The cash in advance or prepayment method directly contradicts the open account method as the importer pays the exporter before goods are shipped or services are delivered.³⁰⁵

A letter of credit is a commitment by a bank on behalf of the importer to pay the contract sum to the exporter.³⁰⁶ The importer procures his bank to open the letter of credit for the exporter's benefit by depositing the requisite contract sum with the bank.³⁰⁷ The letter of credit is among the most secured methods of payment. This is because the exporter is assured of payment when the conditions of the letter of credit are met, and the importer is assured of delivery of the goods

³⁰⁰ Allais M, Balassa B & Bertrand TJ et al 'International Trade' available at <https://academic-eb-com.eres.qnl.qa/levels/collegiate/article/international-trade/106321> (accessed on 16 November 2020).

³⁰¹ Alarcon RB (2014) 7.

³⁰² Agbonika JAA 'Methods of International Trade and Payments: The Nigerian Perspective' (2015) 3(1) *Global Journal of Politics and Law Research* 40.

³⁰³ Agbonika JAA (2015) 40.

³⁰⁴ Chapter 3, Paragraph 3.4.3.

³⁰⁵ Agbonika JAA (2015) 37.

³⁰⁶ Alexander MR (1989) 361.

³⁰⁷ Alexander MR (1989) 361.

or services ordered.³⁰⁸ Documentary collection has a similar structure as the letter of credit method as they both involve the use of banks as a channel for exchanging trade documentation and payment.³⁰⁹ However, unlike the letter of credit, neither of the participating banks guarantees payment for a documentary collection.³¹⁰

Open account and letters of credit are currently the most widely used methods of payment under international trade.³¹¹ However, SMEs participating in international trade, either as exporters or importers, face certain challenges in using these payment methods.

Importers are increasingly pushing for international trade to be conducted on open account basis.³¹² Available trade statistics indicate that open account trade comprises around 80 per cent of the total international trade.³¹³ This payment method is advantageous to SMEs that are importers because it sustains their cash flow and gives them more time to source funding. However, open account payment is highly risky for SMEs that are exporters because they are exposed to the risk of non-payment by the importer and could suffer cash shortages because of the extended payment period.³¹⁴ These issues render this payment method very unsuitable for SMEs that are exporters, especially because cash flow and bad debt challenges easily destabilise them and could even lead to their demise. On the other hand, the letter of credit is one of the costliest payment methods for importers.³¹⁵ Therefore, while it will provide adequate protection to an SME that is an exporter, SMEs that are importers may sometimes be unable to source the money that will be deposited in the bank to open the letter of credit.³¹⁶ Moreover, even if finally opened by the SME, the letter of credit can tie up its working capital.³¹⁷

³⁰⁸ Agbonika JAA (2015) 41.

³⁰⁹ Grath A *The Handbook of International Trade and Finance* 2 ed (2012) 42.

³¹⁰ Grath A (2012) 42.

³¹¹ Agbonika JAA (2015) 41; Alarcon RB (2014) 7.

³¹² Agbonika JAA (2015) 40.

³¹³ Dewan SK & Zahid JR (2020) 1.

³¹⁴ Klapper L 'Export Financing for SMEs: The Role of Factoring' 2006b *The World Bank Group (Trade Note No. 29)* 2.

³¹⁵ Alexander MR (1989) 362.

³¹⁶ Alexander MR (1989) 362.

³¹⁷ Alexander MR (1989) 362.

Luckily, international factoring provides a solution to the challenges with open account and letters of credit. As a trade finance instrument, international factoring eliminates both the importer's financial burden of premature payment and the need to open letters of credit while also protecting the exporter's risk of non-payment and cash shortages.³¹⁸ In fact, the emergence of factoring as a payment method under international trade was triggered by two significant factors.³¹⁹ First, the need to promote a more secured form of open account payment in international trade. Secondly, to checkmate some challenges identified with letters of credit.

Through international factoring, exporters can remain competitive, increase sales, and take advantage of all other benefits associated with open account sales without being exposed to non-payment and cash flow risks.³²⁰ The exporter can concentrate on trade, which is his core business and enjoys the benefit of the factor assuming the burden of managing the flow of funds.³²¹ The credit assessment conducted by the factor on the importer helps the exporter evaluate the importer's financial capability and suitability for future business engagements.³²² FCI highlights the numerous benefits of international factoring for importers.³²³ The benefits include eliminating the hassles of opening a letter of credit, managing the cash flow risks that could arise if the importer had to open the letter, and allowing the importer to purchase goods conveniently. It also ensures that the importer still enjoys an extended credit period to pay for the received goods or services. This extended period gives the importer more time to raise funds to pay the factor. Other benefits of international factoring include reducing costs for both exporters and importers and providing a valuable tool for facilitating the better management of foreign exchange fluctuations, differences in the legal system, language barriers and political risks.³²⁴

The numerous benefits of international factoring, as highlighted above, becomes even more relevant in the context of the African Continental Free Trade Area (AfCFTA). The AfCFTA

³¹⁸ Alexander MR (1989) 359; Alarcon RB (2014) 7.

³¹⁹ Girsberger DL (1992) 467.

³²⁰ D'Arcy L, Murray C & Cleave B *Schmitthoff's Export Trade: The Law and Practice of International Trade* 10th ed (2000) 225-6.

³²¹ D'Arcy L, Murray C & Cleave B (2000) 226.

³²² Alarcon RB (2014) 7.

³²³ FCI 'What are the Benefits for Exporters & Importers?' available at https://fci.nl/en/international-factoring-benefits?language_content_entity=en (accessed on 27 November 2020).

³²⁴ Mizan ANK (2011) 263; Klapper L (2006b) 2.

has many ambitious objectives, including creating a single market for goods and services, improving the movement of people and capital and boosting intra-African trade.³²⁵

The trade finance gap in Africa was estimated to be US\$ 82 billion in 2019.³²⁶ It is, therefore, not surprising that the availability of trade finance is said to present a significant challenge to the successful operationalisation of the AfCFTA, particularly for SMEs.³²⁷ The most frequently cited reasons banks in the continent refuse to grant applications for trade financing are the applicant's creditworthiness, insufficient collateral and unavailability of foreign exchange.³²⁸ In fact, Africa's relatively low 3 per cent share of global trade³²⁹ is attributed to factors, including SMEs' restricted access to trade financing.³³⁰ Narrowing it to Nigeria, the story is not any different. SMEs account for barely 7.64 per cent of Nigeria's export value, well below their potential.³³¹ This low level of contribution has been attributed to numerous factors, including restricted access to trade financing.³³² Encouragingly, factoring has been recognised as a vital financing instrument that can support trade financing to SMEs, thereby improving their participation under the AfCFTA.³³³

The prospects of factoring benefiting SMEs under the AfCFTA is strengthened by three key factors. First, sales on open account under intra-African trade are expected to increase significantly.³³⁴ Secondly, with help from Afreximbank, many African countries are putting in place necessary frameworks to improve the practice of factoring.³³⁵ Lastly, factoring firms are increasingly emerging across different African countries, including in Nigeria.³³⁶ Overall,

³²⁵ Abrego ML, de Zamaroczy MM. & Gursoy T et al *The African Continental Free Trade Area: Potential Economic Impact and Challenges* ((2020) 17.

³²⁶ Nyantakyi EB & Drammeh LM 'COVID-19 Pandemic: Potential Risks for Trade and Trade Finance in Africa' (2020) 11(6) *Africa Economic Brief* 4.

³²⁷ Awani K (2020) 78; The African Capacity Building Foundation & African Export–Import Bank (2021) 1.

³²⁸ Li G 'How Currency Risk Management Can Boost Access to Trade Finance in Africa' (2020) 6(1) *Contemporary Issues in African Trade and Trade Finance* 64.

³²⁹ The World Trade Organisation Strengthening *Report on Africa's Capacity to Trade* (2021) 13.

³³⁰ Awani K (2020) 84 -5

³³¹ Chapter 1, Paragraph 1.1.

³³² Orighoyegha EU *The Impact of SME Financing Schemes on SME Export Performance in Nigeria* (unpublished Master of Arts thesis, Middlesex University, 2012) 17 – 9.

³³³ Awani K (2020) 85; also see The African Capacity Building Foundation & African Export–Import Bank (2021) 27.

³³⁴ Awani K (2020) 85.

³³⁵ Awani K (2020) 85.

³³⁶ The African Capacity Building Foundation & African Export–Import Bank (2021) 19.

the benefits of international factoring already enumerated evidence that it will be instrumental in addressing the trade finance needs of Nigeria's SMEs under the AfCFTA and other international trade activities.

3.10.3. The Usefulness of Factoring During and Post Covid-19 Pandemic

The COVID-19 pandemic is primarily a health crisis, but it has also triggered an economic crisis in both developed and developing countries. Underscoring its severity, the pandemic is described by the Organisation for Economic Cooperation and Development (OECD) as the largest public health crisis in living memory.³³⁷ The World Bank equally records that it represents the biggest economic shock the world has witnessed in decades.³³⁸ The COVID-19 pandemic has affected all businesses, but SMEs have been more affected due to their size, higher vulnerability levels and lower resilience to shocks.³³⁹

Eggers researched the challenges that SMEs face in times of crisis and spotlighted access to finance as the first and most obvious challenge.³⁴⁰ He explained that this problem is caused by factors like reduced consumption and spending by consumers as well as banks becoming more careful in making credit decisions favouring SMEs. Expectedly, crises such as the COVID-19 pandemic has and will further shrink the ability and capacity of SMEs to access financing from banks and the stock market, just like during and after the 2007-2008 Global Financial Crisis (GFC).³⁴¹ In conditions of crisis, finding alternative sources of financing that can complement or substitute traditional bank lending and stock market financing is critical. Factoring is one of such alternatives.

Factoring has been much-admired for its essential role of sustaining access to finance to businesses through periods of economic and financial crisis. Factoring's usefulness as a

³³⁷ Organisation for Economic Cooperation and Development *Paper on Coronavirus (COVID-19): Joint Actions to Win the War* (2020b) 1.

³³⁸ The World Bank 'The Global Economic Outlook During the COVID-19 Pandemic: A Changed World' available at <https://www.worldbank.org/en/news/feature/2020/06/08/the-global-economic-outlook-during-the-covid-19-pandemic-a-changed-world> (accessed on 15 November 2020).

³³⁹ Organisation for Economic Cooperation and Development (2020b) 3.

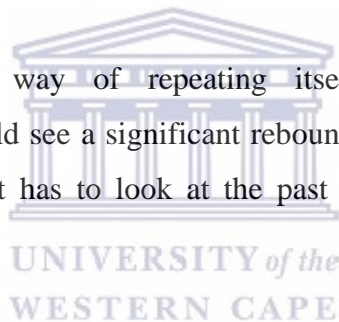
³⁴⁰ Eggers F 'Masters of Disasters? Challenges and Opportunities for SMEs in times of Crisis' (2020) 116 *Journal of Business Research* 200.

³⁴¹ Ullah A, Bilal A & Hamza A et al (2018) 26.

financing alternative in times of crisis has been traced to the time of the Great Depression, which was defined by the collapse of the United States of America's stock market around 1929.³⁴² During and after this period, factoring served to sustain financing to SMEs even as bank financing declined.³⁴³ Also, even with the GFC, there was the continued expansion of factoring volumes and it also served as an attractive substitute for traditional bank lending, which contracted considerably within that period.³⁴⁴ Generally, the factoring industry endured the GFC much better than many other providers in the financial industry.³⁴⁵ The foregoing motivated Ivanovic, Baresa and Bogdan's description of factoring as an efficient short-term financing product for SMEs seeking to expand operations but are unwilling or unable to access finance from banks, especially in times of crisis when it is difficult to get credit.³⁴⁶

In view of the foregoing experiences, there are reasons to project once again that factoring could play a vital role in ensuring liquidity to SMEs during and post the COVID-19 pandemic. On this note, Peter Mulroy, the Secretary of FCI, observes as follows:

'History does have a way of repeating itself and if it is any indication, factoring should see a significant rebound in 2021 and the years that will follow. One just has to look at the past as an indication of the future.'³⁴⁷



Peter Mulroy notes further that banks will be constrained to hold back their credit facilities due to the volatile environment caused by the COVID-19 pandemic. He observes that this decline in the supply of credit by banks will push businesses to seek an alternative source of working capital and look for ways to mitigate the risk of their receivables. He concludes that these

³⁴² Papadimitriou DB, Phillips RJ & Wray LR 'An Alternative in Small Business Finance: Community-based Factoring Companies and Small Business Lending,' (1994) *Public Policy Brief, No. 12, Levy Economics Institute of Bard College* 20.

³⁴³ Papadimitriou DB, Phillips RJ & Wray LR (1994)20.

³⁴⁴ Organisation for Economic Co-operation and Development *Paper on Financing SMEs and Entrepreneurs 2018: An OECD Scoreboard* (2018) 50.

³⁴⁵ Organisation for Economic Co-operation and Development (2018) 50.

³⁴⁶ Ivanovic S, Baresa S & Bogdan S 'Factoring: Alternative Model of Financing' (2011) 2(2) *UTMS Journal of Economics* 196.

³⁴⁷ Mulroy P 'FCI Perspective: 10 Factoring Predictions in a Post-COVID World' available at <https://www.tradefinanceglobal.com/posts/fci-perspective-10-factoring-predictions-in-a-post-covid-world/> (accessed on 7 December 2020).

developments will drive factoring to be in high demand during and after the COVID-19 pandemic. Peter Mulroy's analysis is easy to agree with. Many businesses would need to use open account or trade credit to maintain sales and attract both domestic and international customers who would otherwise be sceptical about spending. As earlier explained, factoring cushions the risks and challenges of open account or trade credit sales and presents a vital asset for working capital financing. In boosting access to working capital and trade financing, factoring could augment bank lending, stock market financing and the government's stimulus packages, which will be inadequate or inaccessible in addressing the financing needs of all vulnerable SMEs. Against the foregoing prediction, a valuable buffer to the liquidity shock posed by the COVID-19 pandemic is for the government of Nigeria and other African countries to implement policies and adopt frameworks that promote factoring as a financing instrument for domestic and international trade.

3.11. Conclusion

The chapter has discussed the definition, features, mechanism, history, types, merits and demerits of factoring. It has also examined the legal environment under which factoring operates. The discussion of the legal environment involved highlighting the Conventions and Model Laws on factoring and critical aspects of the factoring contract. The chapter extensively considered the importance of factoring as an alternative source of financing for SMEs in Nigeria by assessing its usefulness as a source of working capital and trade financing. The assessment showed that factoring has advantages over other sources of working capital and trade financing, especially for SMEs. The chapter also identified the potential of factoring in sustaining financing to SMEs during and post the COVID-19 pandemic. The projection was founded on the roles that factoring played in sustaining financing to businesses during and after the Great Depression and the GFC. The chapter drew attention to some of the disadvantages of factoring. However, it was maintained that the benefits of factoring outweigh its drawbacks, especially when compared to other sources of financing. Having established the numerous benefits of factoring, the next chapter will examine Nigeria's extant legal, tax and regulatory frameworks for factoring. The examination aims to uncover if the frameworks support or stand as barriers to the growth of factoring as an alternative source of financing for SMEs.

CHAPTER FOUR

ANALYSIS OF THE EXTANT LEGAL, TAX AND REGULATORY FRAMEWORKS FOR FACTORING IN NIGERIA AND COMPARATIVE STUDY WITH EGYPT

4.1. Introduction

The preceding chapter examined the numerous benefits of factoring as an alternative source of working capital and trade finance for SMEs in Nigeria, including its advantages over other sources of financing. The reassuring results from the examination justified the need to have favourable legal, tax and regulatory frameworks that will support its growth. Accordingly, it becomes imperative to examine if such favourable frameworks exist currently in Nigeria.

This chapter is divided into three sections. The first section features the development of factoring in Nigeria and assess the performance of the country's factoring industry. The second section examines the extant legal, tax and regulatory frameworks for factoring in Nigeria to uncover if they have supported or stood as barriers to the growth of the factoring industry. The discussion in section two is particularly important because there is a gap in literature regarding the impediments of a legal nature hampering the growth of factoring in Nigeria. The last section of the chapter undertakes a comparative study of certain crucial aspects of the legal, tax and regulatory frameworks for factoring in Egypt. This comparative study aims to underscore the roles of the frameworks in driving the growth of the factoring industry, if any, and also draw lessons that can be adaptable in Nigeria.

The choice of Egypt as a case study is motivated by the sustained and impressive growth of the country's factoring industry, which has supported financing to SMEs and large corporates alike.³⁴⁸ For example, Egypt's total factoring volume grew from €220 million in 2012 to €450 million in 2013, representing over 100 per cent expansion in just a year.³⁴⁹ Egypt's factoring volume as of 2019 stood at €589 million, representing a 13.9 per cent increase from the €517 million achieved in 2018.³⁵⁰ At 14 per cent, Egypt attained the highest growth level in factoring volumes in Africa between 2015 to 2019.³⁵¹

³⁴⁸ Oramah BO & Dzene R (2014) 17.

³⁴⁹ Oramah BO & Dzene R (2014) 17.

³⁵⁰ Factors Chain International *FCI Annual Review* (2019) 10.

³⁵¹ Factors Chain International *FCI Annual Review* (2019) 10.

4.2. Developments and Current State of Factoring in Nigeria

The penetration of factoring in Africa as a whole only started to gain momentum around the 2000s.³⁵² South Africa is the only country in the continent with a formalised factoring industry existing for more than four decades.³⁵³ Factoring has not developed in Africa at the same pace as the rest of the world.³⁵⁴ As disclosed in the previous chapter, Africa is massively trailing behind other regions and had a share of only about 0.84 per cent of the €2.9 trillion global factoring volumes in 2019.³⁵⁵ In addition to South Africa which accounts for more than 80 per cent of factoring activities in Africa, only a handful of other countries comprising Egypt, Morocco, Tunisia and Mauritius have consistently contributed considerably to the continent's factoring volumes over the years.³⁵⁶ In the same vein, the demand for international factoring in Africa remains scarce as over 80 per cent of factoring activities in the continent is domestic factoring.³⁵⁷

Despite the small market share, the growth rate of factoring in Africa has nevertheless been impressive, particularly in countries like Egypt.³⁵⁸ For example, between 2001 to 2012, Africa's factoring volume grew from €5.86 to €23.93 billion, representing an average annual growth of approximately 14.2 per cent.³⁵⁹ Similarly, the factoring volumes grew from €23.1 billion in 2013 to €24.56 billion in 2019.³⁶⁰ The continent's factoring volume is anticipated to exceed US\$50 billion (about €42 billion) by 2025.³⁶¹

Experts project that Nigeria alongside Kenya, Ghana, Cote d'Ivoire, Zimbabwe, Zambia, Mozambique and Senegal, will drive the growth of factoring in the continent.³⁶² The industries

³⁵² Oramah BO (2014) 7-8.

³⁵³ Hamanyati M (2017) 33.

³⁵⁴ Priest-Stephens L & Kameni E 'Building a Model' *Trade and Forfaiting Review Feature* 1 June 2016. Chapter 3, Paragraph 3.3.

³⁵⁵ Oramah BO & Dzene R (2014) 18.

³⁵⁷ Awani K 'Factoring in Africa: Opportunities and Challenges' available at <https://silo.tips/download/factoring-in-africa-opportunities-and-challenges-4#sidebar-close> (accessed on 6 December 2020).

³⁵⁸ Hamanyati M (2017) 35-8.

³⁵⁹ Oramah BO (2014) 6.

³⁶⁰ FCI Annual Review (2020) 28.

³⁶¹ Awani K 'Factoring as an Alternative Tool for Financing SMEs in Africa' available at <https://www.mfw4a.org/blog/factoring-alternative-tool-financing-smes-africa> (accessed on 6 December 2020).

³⁶² Oramah BO (2014) 14.

forecasted to see the most factoring activities include oil and mining, particularly in countries like Nigeria, where such extractive industries dominate.³⁶³ Other projected industries are telecommunications services, retail and non-traditional export, all of which Nigeria is also a dominant player.³⁶⁴

Efforts towards developing Nigeria's factoring industry through initiatives such as advocacy, enlightenment campaigns and enacting a factoring law only became evident from around 2016, when the Afreximbank Model Law was launched.³⁶⁵ These initiatives are being championed by the Nigeria Export-Import Bank (Neximbank)³⁶⁶ with support from Afreximbank and FCI. Notably, the Nigerian Factoring Working Group (NFWG) was commissioned to facilitate the enactment of a factoring law and promote the establishment of an enabling environment for factoring to thrive in the country.³⁶⁷ The NFWG consists of representatives from Neximbank, Afreximbank, the Financial System Strategy (FSS) 2020, factoring companies and a law firm.³⁶⁸

The grossly inadequate commercial credit which Nigerian banks are willing to avail SMEs combined with the high interest rates they charge on their credit facilities, has motivated the promotion of factoring to support financing for the SME sector.³⁶⁹ Additionally, other peculiar challenges such as credit profile constraints and inadequate collateral, which make SMEs ineligible for bank financing, have also influenced the promotion of factoring.³⁷⁰ The promotion of factoring has also been triggered by SMEs' inability and limitations to access the stock market for equity financing.³⁷¹

³⁶³ Oramah BO (2014) 10.

³⁶⁴ Oramah BO (2014) 10.

³⁶⁵ Tatge DB & Kameni E (2017) 11; Factors Chain International *FCI Annual Review* (2017) 12.

³⁶⁶ Neximbank was established in 1991 as an export credit agency. Among other functions, Neximbank has the mandate of providing export credit guarantee and insurance facilities as well as initiating policies to promote non-oil exports.

³⁶⁷ Awani K 'Africa Continues to Outpace Global Factoring' in Bickers M (ed) *World Factoring Yearbook* (2018) 18.

³⁶⁸ Awani K (2018) 18.

³⁶⁹ Nevin AS, Omosomi O & Suberu M (2020) 2.

³⁷⁰ Nevin AS, Omosomi O & Suberu M (2020) 2.

³⁷¹ Onaepemipo E, Zubairu U & Abubakar B et al (2019) 62-63.

In 2016, towards implementing a critical part of its mandate, the NFWG prepared the Factoring (Assignment of Receivables) Bill.³⁷² The Bill adopts the Afreximbank Model Law, albeit with certain additions.³⁷³ The lower chamber of the National Assembly - the House of Representatives, has passed the Bill.³⁷⁴ The Bill is currently awaiting the approval of the upper chamber - the Senate, after which it will be forwarded to the President for his assent.³⁷⁵

There is no available data on the actual volume of factoring activities in Nigeria, even from FCI's database.³⁷⁶ Nonetheless, the fact that Nigeria has never made it to the list of the major countries contributing to Africa's factoring volumes as published by FCI is a likely indication that nothing out of the ordinary has been happening in the country's factoring industry.³⁷⁷

According to findings in a study conducted by Isern, Agbakoba and Flaming et al, commercial banks providing factoring services are majorly willing to make such services available to big oil and gas companies considered to be profitable, not SMEs.³⁷⁸ The study further noted that factoring is generally an unpopular alternative source of financing in Nigeria.³⁷⁹ Equally, in a survey conducted by Alayemi, Oyeleye and Adeoye using data from FCI, they found that companies in the country rarely utilise factoring to finance their operations.³⁸⁰ They also observed that there was no record of firms providing factoring services in Nigeria between 2007 to 2014.³⁸¹ There are now a handful of finance companies that are FCI members and providing factoring services in Nigeria.³⁸² While this is an improvement, the progress is negligible, especially when matched against the massive number of SMEs that will need factoring services and the widening financing gap.

³⁷² Factors Chain International *FCI Annual Review* (2017) 12.

³⁷³ Tatge DB & Kameni E (2017) 11; also see Factors Chain International *FCI Annual Review* (2017) 12.

³⁷⁴ Factors Chain International *FCI Annual Review* (2019) 10.

³⁷⁵ Factors Chain International *FCI Annual Review* (2020) 5.

³⁷⁶ See generally The African Capacity Building Foundation & African Export–Import Bank (2021) 19.
³⁷⁷ Chapter 1, Paragraph 1.2.

³⁷⁸ Isern J, Agbakoba A & Flaming M et al (2009) 21.

³⁷⁹ Isern J, Agbakoba A & Flaming M et al (2009) 21.

³⁸⁰ Alayemi SA, Oyeleye OA & Adeoye ET (2015) 508.

³⁸¹ Alayemi SA, Oyeleye OA & Adeoye ET (2015) 506.

³⁸² These firms include Factoring & Supply Chain Finance Limited, Avuna Limited and Woodhall Capital International Limited. See Factors Chain International 'Overview of Our Members in the World' available at <https://fci.nl/en/members/index?> (accessed on 19 January 2021).

To thrive as an alternative source of financing in a country, factoring requires sound policy accompanied by facilitative legal, tax and regulatory frameworks.³⁸³ It, therefore, becomes imperative to assess the extant legal, tax and regulatory frameworks for factoring in Nigeria to uncover if these frameworks have supported or constituted an impediment to the growth of the country's factoring industry.

4.3. Overview of the Extant Frameworks for Factoring in Nigeria

This section presents an overview of the legal, tax and regulatory frameworks for factoring in Nigeria as they exist at present. Afterwards, the ensuing subsections assess the respective strengths and weaknesses of the frameworks in supporting the growth of Nigeria's factoring industry, including as it pertains to SMEs.

4.3.1. Existence of Factoring Law: International and National

As highlighted in the previous chapter, Nigeria has ratified the UNIDROIT Convention but has neither signed nor ratified the UNCITRAL Convention.³⁸⁴ However, the application of the UNIDROIT Convention in Nigeria is relegated to international factoring transactions involving countries that have ratified it. The UNIDROIT Convention serves no real statutory relevance to domestic factoring transactions. Like in most other Commonwealth countries, Nigeria adopts a dualist approach to the application of international law as part of national law.³⁸⁵ Accordingly, generally, treaties signed or ratified by Nigeria do not automatically become Nigerian law until they have been domesticated, that is, enacted into law by the National Assembly.³⁸⁶ The Constitution of the Federal Republic of Nigeria, 1999 (as amended) in section 12(1), backs the general rule. It provides that 'No treaty between the Federation and any other country shall have the force of law [in Nigeria] to the extent to which any such treaty has been enacted into law by the National Assembly.'

³⁸³ Mulroy P & Brink U (2009) 36; Milenkovic-Kerkovic T & Dencic-Mihajlov K (2012) 44; Oramah (2014) 21.

³⁸⁴ Chapter 3, Paragraph 3.8.1.1

³⁸⁵ Okenwa CA 'Has the Controversy between the Superiority of International Law and Municipal Law been Resolved in Theory and Practice?' (2015) 35 *Journal of Law, Policy and Globalization* 116 – 120.

³⁸⁶ Okeke CE & Anushiem MI 'Implementation of Treaties in Nigeria: Issues, Challenges and the Way Forward' (2018) 9(2) *Nnamdi Azikiwe University Journal of International Law and Jurisprudence* 216; also see Okenwa CA (2015) 121. See also *Abacha v Fawehinmi* (2000) FWLR (Pt.4) 553 at 586 (SC).

However, in accordance with section 254C (2) of the Constitution (Third Alteration) Act 2010, there is only one exception that has been created for the general rule under section 12(1) of the Constitution.³⁸⁷ This exception relates to treaties dealing with labour-related matters that have been ratified but are yet to be domesticated by the National Assembly. In other words, such treaties will be directly applicable in Nigeria even though they have not been domesticated. Even so, the UNIDROIT Convention does not benefit from this exception as it is not a labour-related treaty. Accordingly, given that the UNIDROIT Convention has not yet been domesticated in Nigeria, it does not directly apply to domestic factoring transactions.³⁸⁸

In advancing strategies for developing the legal environment for factoring within a country, Milenkovic-Kerkovic and Dencic-Mihajlov recommend that apart from ratifying factoring-related treaties, it is very beneficial to enact a national law on factoring as well.³⁸⁹ They note that this helps to create certainty and better shape the legal environment for factoring activities. Accordingly, Nigeria's ratification of the UNIDROIT Convention does not serve as a substitute nor eliminate the necessity to have a national law for factoring. Unfortunately, Nigeria does not currently have a national legal framework supporting the sale and purchase of accounts receivable to source financing under factoring and other invoice financing options. Instead, what exists regarding the use of accounts receivable to source financing is the Secured Transactions in Movable Assets Act of 2017 (STMA). As highlighted in chapter two, the STMA deals with creating and enforcing security interests in movable assets, including accounts receivable.³⁹⁰

The STMA could be utilised for recourse factoring transactions done on an advance basis since such transactions, in some sense, involve lending money against receivables.³⁹¹ However, as discussed in the previous chapter, recourse factoring is better characterised as a sale transaction, not a secured lending transaction.³⁹² Furthermore, the STMA does not provide a framework

³⁸⁷ *Aloysius v Diamond Bank Plc* [2015] 58 NLLR 92 (NICN). See also *Duru v Skye Bank Plc* [2015] 59 NLLR (Pt. 207) 680 (NICN).

³⁸⁸ See the legislative brief on Factoring (Assignment of Receivables) Bill available at <https://placng.org/i/wp-content/uploads/2019/12/Legislative-brief-on-Factoring-Assignment-of-Receivables-Bill-2018.pdf> (accessed on 27 November 2020).

³⁸⁹ Milenkovic-Kerkovic T & Dencic-Mihajlov K (2012) 435.

³⁹⁰ Chapter 2, Paragraph 2.4.1.

³⁹¹ Chapter 3, Paragraph 3.7.

³⁹² Chapter 3, Paragraph 3.7.

for the sale of accounts receivable, which is the fulcrum of non-recourse factoring. Additionally, the STMA deals essentially with the lending of money against accounts receivable and neither stipulate the other services associated with factoring nor the mechanism for factoring. These drawbacks make it grossly inadequate as a factoring legal framework.

The legislative gap for a national factoring law is to be filled by the Factoring (Assignment of Receivables) Bill earlier mentioned, which, unfortunately, is still pending before the National Assembly as of the writing of this thesis. Given this gap, as obtainable in other developing countries where laws on factoring are lacking, parties to factoring transactions in Nigeria have to rely on the general contract law provisions instead of a defined legal framework.³⁹³ Kameni cautions that having only contract law regulating factoring could be problematic because contract law neither defines factoring nor recognises international best practices in the field.³⁹⁴ Therefore, the need for a specific national legal framework for factoring cannot be overemphasised. The likely impact of the absence of such a national factoring law on the growth of Nigeria's factoring industry is discussed later in this chapter.

4.3.2. Regulatory and Supervisory Bodies for Factoring

Bakker, Klapper and Gregory observe that the regulatory environment for factoring often exists under two conditions.³⁹⁵ On the one hand, factoring operates entirely outside the purview of any regulatory structure or authority.³⁹⁶ On the other hand, factoring is regulated along with other financial services such as banking.³⁹⁷ The latter conditions reflect the regulatory regime in Nigeria - factoring is a regulated financial service.

There exist two primary laws that provide the regulatory and supervisory framework for entities engaged in the business of factoring. These laws are: (i) The recently re-enacted Banks and Other Financial Institutions Act No. 5, 2020 (BOFIA), and (ii) The Guidelines for Finance Companies, 2014 (hereinafter simply called the 'Guidelines'). These laws identify factoring as a regulated financial activity that licensed banks and non-banking financial institutions

³⁹³ Mulroy P & Brink U (2019) 36; European Bank for Reconstruction and Development (2018) 3.

³⁹⁴ Kameni E (2014) 31.

³⁹⁵ Bakker MHR, Klapper LU & Gregory F (2004) 21.

³⁹⁶ Bakker MHR, Klapper LU & Gregory F (2004) 21.

³⁹⁷ Bakker MHR, Klapper LU & Gregory F (2004) 21.

(specifically finance companies) can provide. Further, the Central Bank of Nigeria (CBN) is designated in these frameworks as having the powers to regulate and supervise banks and non-bank financial institutions providing factoring services. Generally, within the regulatory regime, the CBN issues operating licences, sets minimum capital and prudential requirements and conducts on-site and off-site supervision from time to time for entities providing factoring and other financial services. The specific regulatory frameworks as they pertain to banks and finance companies are briefly highlighted below:

4.3.2.1. Banks

The BOFIA, along with the Central Bank of Nigeria (Establishment) Act, 2007 (CBN Act), are the primary laws dealing with the regulation and supervision of banks and non-banking financial institutions in Nigeria by the CBN. Section 2(1) of the BOFIA provides that no person or entity shall carry on any banking business except it is a company duly incorporated in Nigeria and holds a valid banking licence issued by the CBN. There are essentially three types of banks that can obtain a banking licence: commercial banks, merchant banks and specialised banking licence (which covers non-interest, development and mortgage banks).³⁹⁸ Banking business is defined to cover deposit-taking, paying or collecting cheques, finance consultancy and advisory services relating to corporate and investment matters, as well as making or managing investments on behalf of others.³⁹⁹ Factoring is also mentioned as part of financial services that banks can provide under the BOFIA.⁴⁰⁰ Factoring is defined in the BOFIA to mean the business of acquiring debts due to any person.⁴⁰¹

4.3.2.2. Finance Companies

Section 57(1) of the BOFIA provides that no person or entity shall carry on the business of non-banking financial institutions (which includes factoring business) except it is a company duly incorporated in Nigeria and holds a valid licence issued by the CBN. In keeping with the CBN's powers to regulate non-banking financial institutions, it developed the Guidelines for

³⁹⁸ s 4 of the Regulations on the Scope of Banking Activities & Ancillary Matters No.3 of 2010.

³⁹⁹ s 131 of the BOFIA.

⁴⁰⁰ s 19(8)(a) of the BOFIA.

⁴⁰¹ s 131 of the BOFIA.

Finance Companies. The Guidelines was first issued in 2002 and revised in 2014.⁴⁰² Any entity granted a finance company licence is authorised to provide a wide range of financial services, including factoring.⁴⁰³

Factoring is defined in the Guidelines as the business of purchasing debt (receivables) from suppliers at a discount and making a profit from their collection.⁴⁰⁴ This definition is more detailed than what is contained in the BOFIA. The definition recognises that in factoring, the account receivables are purchased less than their face value (at a discount). Additionally, the definition appears to have qualified factoring as a sale and purchase transaction, not a lending transaction. The Guidelines provides that the minimum share capital for finance companies is ₦100 million (around US\$ 240 000).⁴⁰⁵ In addition, finance companies are prohibited under the Guidelines from undertaking activities like deposit-taking, stockbroking, issuing house business, registrar services and other non-financial activities.⁴⁰⁶ They are also restricted in dealing in foreign transactions except through correspondent banks or authorised dealers.⁴⁰⁷

According to the CBN, finance companies are envisioned to operate within the middle tier of the financial system, focusing on SMEs.⁴⁰⁸ They are expected to complement the roles of banks in bringing the SME financing gap.⁴⁰⁹ Therefore, finance companies are of crucial importance in ensuring the availability and provision of factoring and other invoice financing services to SMEs. The suitability of the Guidelines in advancing the emergence and participation of finance companies to cater to the invoice financing needs of SMEs is discussed later in the chapter.

⁴⁰² s 1 of the Guidelines for Finance Companies.

⁴⁰³ These other services include the provision of consumer loans, local and international trade finance, debt securitization, debt administration, financial consultancy, loan syndication, warehouse receipt finance, etc See s 2 of Guidelines for Finance Companies.

⁴⁰⁴ s 2 of Guidelines for Finance Companies.

⁴⁰⁵ s 3.1 of Guidelines for Finance Companies.

⁴⁰⁶ s 2 of Guidelines for Finance Companies.

⁴⁰⁷ s 2 of Guidelines for Finance Companies.

⁴⁰⁸ s 1 of Guidelines for Finance Companies.

⁴⁰⁹ s 1 of Guidelines for Finance Companies.

4.3.3. The Application of Taxes to Factoring Transactions

In discussing the tax regime applicable to factoring, a core consideration is whether taxes such as value added tax (VAT) and stamp duty apply to factoring transactions.⁴¹⁰

The fiscal laws regulating VAT in Nigeria are the Value Added Tax Act, Cap V1 LFN 2004 (as amended) and the Finance Act of 2020. VAT is a consumption tax paid on the supply of all goods and services in Nigeria, except such goods or services are exempted under the First Schedule of the Value Added Tax Act.⁴¹¹ The tax is levied as a percentage of the value of the goods purchased or services supplied. The current VAT rate in Nigeria is 7.5 per cent which was raised from 5 per cent on 1 February 2020 through the Finance Act of 2020. In accordance with Part 2 of the First Schedule to the Value Added Tax Act, the only financial services exempted from VAT are services rendered by microfinance banks, peoples' banks and mortgage institutions. By implication, other financial institutions like commercial banks and finance companies are required to charge VAT on their factoring services.

In Nigeria, stamp duty is a tax levied on specified written and electronic dutiable documents. The fiscal laws regulating stamp duty are the Stamp Duty Act, Cap S8 LFN 2004 and the Finance Act of 2020. Stamp duty is imposed on dutiable documents on either a fixed or ad Valorem basis (a percentage of the value of the document). Factoring contracts involving the conveyance or assignment of receivables usually attract ad valorem stamp duty on the sum involved.⁴¹² The Schedule to the Stamp Duty Act does not specifically exempt factoring contracts from stamp duty, and the applicable stamp duty rate for conveyance or assignments is 1.5 per cent of the contract sum.⁴¹³ The legal effect of not having a document stamped is that it will not be admissible in evidence in civil proceedings before a court or arbitrator, except the applicable duty is then paid.⁴¹⁴

⁴¹⁰ Strauss S (2005) 8.

⁴¹¹ s 2 of the Value Added Tax Act.

⁴¹² Hans T 'Factoring and Stamp Duty in Singapore and Malaysia' 1994 *Singapore Journal of Legal Studies* 183.

⁴¹³ Updated stamp duty rates available at https://stampduty.gov.ng/stamp_duty_charges (accessed on 8 May 2021).

⁴¹⁴ s 22 of the Stamp Duty Act.

The likely impacts of having VAT and stamp duty applying to factoring transactions will be discussed in the ensuing subsection.

4.4. Barriers to the Growth of Nigeria's Factoring Industry

Alayemi, Oyeleye and Adeoye's 2015 paper titled 'Factoring as Financing Alternative: Reasons for Non-Patronage in Nigeria' reflected on some of the reasons responsible for the poor performance of the factoring industry.⁴¹⁵ They attribute the industry's poor performance to four reasons:⁴¹⁶ The first reason is that Nigeria has an inefficient financial system. Secondly, there is an unfavourable political system that does not promote the operation of financial institutions. The third reason is that the major export of Nigeria is crude oil and the government primarily drives this export activity. This mono-economy renders international factoring irrelevant as there are not so many private businesses exporting other products. Lastly, Nigeria has a weak legal system.

Alayemi, Oyeleye and Adeoye's paper is commended as a pioneering and perhaps the only existing study investigating the impediments to the growth of factoring in Nigeria. However, the findings are not exhaustive, and the reasons which are of a legal nature were not extensively deliberated. In particular, the paper does not assess how the extant legal, tax and regulatory frameworks for factoring may have impacted the industry's growth. Moreover, the authors did not consider how other issues like the lack of awareness about factoring and the absence of facilitative institutions could have impacted as well. This thesis will fill this gap by investigating these other issues.

4.4.1. Legal and Contract Enforcement Environments

A specific legal framework on factoring complemented with an efficient contract enforcement system is critical to support the growth of factoring and other receivable financing solutions.⁴¹⁷

A factoring law that recognises and protects the rights of factors can influence greater investments in the factoring industry. This is because the law helps create certainty about the

⁴¹⁵ Alayemi SA, Oyeleye OA & Adeoye (2015) 503-9.

⁴¹⁶ Alayemi SA, Oyeleye OA & Adeoye (2015) 506 -8.

⁴¹⁷ Mulroy P & Brink U (2009) 36.

environment under which factors purchase accounts receivable from suppliers and how they collect the receivables purchased from the customers.⁴¹⁸ Such certainty impacts the cost and efficiency of factoring in general.⁴¹⁹

The impacts of factoring laws in influencing improved investments in the factoring industry can be better understood using the Agency Theory floated by Jensen and Meckling.⁴²⁰ The Agency Theory inquiries into problems (agency problems) that may arise where one party's welfare - the principal, depends upon the actions taken by another party called the agent.⁴²¹ Agency problems refer to the damages that the principal may suffer if the agent opts to satisfy its interest instead of the principal's interest.⁴²² To check the agent's excesses, the principal may be constrained to expend what is termed agency cost in monitoring the agent as a way of assuring itself that the agent is acting in its best interest at all times.⁴²³

One of the relationships where agency problems exist and may require spending on agency costs is the relationship between creditors and debtors.⁴²⁴ The creditor and debtor relationship is often attributed to bank lending transactions because they are essentially credit transactions. However, they also apply to factoring transactions. In a factoring transaction, the creditor is the factor while the customer obligated to settle the accounts receivable purchased by the factor from the supplier is the debtor. Accounts receivable arise from the supply of trade credit, which is essentially an 'in-kind' form of a loan. Through the assignment of the receivables under factoring, the factor substitutes the supplier as the lender or creditor with the customer remaining the borrower or debtor.⁴²⁵ The agency problem that could arise in factoring is that the customer may act against the factor's interest, thereby preventing the factor from realising the monies that could have already been advanced to the supplier.⁴²⁶

⁴¹⁸ Klapper L (2006) 3116.

⁴¹⁹ Klapper L (2006) 3116.

⁴²⁰ Jensen MC & Meckling WH 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305 -310.

⁴²¹ Armour J, Hansmann H & Kraakman R 'Agency Problems, Legal Strategies and Enforcement' 2009 *Harvard Law and Economics Research Paper (Series No. 644)* 2.

⁴²² Jensen MC & Meckling WH (1976) 308.

⁴²³ Matei Z *Identifying and Addressing the Agency Problems in the Financial Turmoil* (unpublished LLM thesis, Tilburg University, 2013) 6.

⁴²⁴ Armour J, Hansmann H & Kraakman R (2009) 2.

⁴²⁵ Milenkovic-Kerkovic T & Dencic-Mihajlov T (2012) 428.

⁴²⁶ Armour J, Hansmann H & Kraakman R (2009) 2.

A factoring law can play an essential role in mitigating agency problems by setting out rules and procedures that facilitate enforcement of rights against the dishonest or opportunist customer.⁴²⁷ The factoring law dictates and guides judges and arbitrators on how they must rule in the factor's favour in the case of unjustifiable default of the supplier or customer.⁴²⁸ This helps to create certainty on the factor's right to redress. Further, a factoring law that recognises and protects the rights of factors to enforce debt obligations can dissuade customers from defaulting. This can aid the factors to dispense with the need to expend agency costs to monitor the customer's activities. Altogether, these create an environment that does not scare investors.

Although the focus has been on statute or legislation, it is important to note that established and published court practice can compensate for the lack of a specific national legislation on factoring. Put differently, developed case law on factoring can also help in mitigating agency problems. This has precisely been the case with South Africa. The country, which leads factoring activities in Africa, does not currently have a specific law on factoring but has established and published case laws on the field.⁴²⁹

Mulroy and Brink observe that investors seldom have confidence in markets that neither have factoring laws nor developed case law on the subject.⁴³⁰ They explain that the absence of these institutions makes investors worried if their efforts to seek redress in court to recover their monies from customers will be productive.⁴³¹ This assessment supports Oramah's position that the uncertainties created by the lack of factoring laws in most African countries rendered factoring a risky venture, which hindered its growth.⁴³² In Klapper's analysis, available statistics support that markets with specific factoring laws outperform those without laws.⁴³³

⁴²⁷ Armour J, Hansmann H & Kraakman R (2009) 3.

⁴²⁸ Klapper L (2006) 3116.

⁴²⁹ Korankye-Sakyi FK *Factoring as a Means of Promoting Small and Medium Scale Enterprises: The Case for a Legal Framework for Credit Factoring in Ghana* (unpublished LLM thesis, University of Pretoria, 2019) 74.

⁴³⁰ Mulroy P & Brink U (2019) 34.

⁴³¹ Mulroy P & Brink U (2019) 34.

⁴³² Oramah BO (2014) 8.

⁴³³ Klapper L (2006) 3116.

Relating the above to Nigeria, the country does not currently have a national law on factoring. In the absence of a factoring law, established and published case laws on the subject could have been helpful. However, a review of popular electronic law reporting platforms shows that the Nigerian courts have not decided on factoring disputes. This is not surprising given that there are not many factoring transactions going on. Further, the judicial system for enforcement of contracts in Nigeria is equally marred with numerous inefficiencies. Particularly, the settlement of contractual disputes through the court system is usually very lengthy. Collectively, the highlighted issues may have invariably rendered factoring unattractive, especially for investors, thereby discouraging the factoring industry's growth.

Given the foregoing, it becomes imperative for the National Assembly to expedite action in passing the Factoring (Assignment of Receivables) Bill. In addition, to assuage the weak contract enforcement regime under the court system, it is desirable to promote alternative dispute resolution mechanisms for factoring related disputes.

4.4.2. Regulatory and Policy Environments

There are pros and cons to regulating factoring. According to Kara, having a regulatory authority to oversee the activities of factoring firms can have some negative consequences.⁴³⁴ The consequences include increasing costs, tying up resources, creating bureaucracy and making the market too prescriptive.⁴³⁵ He, however, observes that regulation offers numerous benefits that outweigh these consequences.⁴³⁶ He notes that the regulation of the factoring industry serves different objectives, including promoting high-quality market standards, controlling professional behaviour, boosting transparency, mitigating risk and building customer confidence.⁴³⁷ On this premise, it is commendable that there is a regulatory regime for factoring in Nigeria.

However, besides having a regulatory authority, the frameworks through which factoring firms are regulated should be well structured and facilitative. It is desirable that a country should

⁴³⁴ Kara H (2017) 4.

⁴³⁵ Kara H (2017) 4.

⁴³⁶ Kara H (2017) 4.

⁴³⁷ Kara H (2017) 4.

have a specific or tailored regulatory framework for factoring.⁴³⁸ Additionally, the regulatory framework must not prescribe requirements capable of dissuading investments or creating unnecessary obstacles to factoring transactions.⁴³⁹ There are no significant benefits in prescribing an excessive capital requirement framework for finance companies providing factoring services since they do not take deposits like banks and therefore do not pose systemic risk comparable to the banking business.⁴⁴⁰ Further, regulatory frameworks that enable finance companies to hold and directly access foreign currency is instrumental for increasing their participation in cross-border factoring transactions.⁴⁴¹ It has generally been observed that the overregulation of finance companies could lead to the concentration of factoring services in the banking sector, which may not be entirely beneficial to SMEs.⁴⁴²

Considering the foregoing, there are certain aspects of the Guidelines for Finance Companies of 2014 that may not be suited for growing the factoring industry. These areas are highlighted below:

First, the Guidelines applies to a variety of financial services, not only factoring. However, factoring and other invoice financing services constitute a specialised business. They require a regulatory framework that is specific or tailored to their peculiarities. Accordingly, it is proposed that a stand-alone regulatory framework should be developed for invoice financing. Such a regulatory framework should also specify a reasonable timeline within which applications for licences will be issued to applicants to checkmate unnecessary delays.

Secondly, the minimum capital requirement of ₦100 million specified for finance companies in the Guidelines seems to be on the high side. Perhaps the CBN placed the minimum share capital so high because finance companies can provide a wide range of services, including factoring. CBN may need to revise the share capital requirement, specifically for companies providing only factoring and other invoice financing services. In doing this, different capital

⁴³⁸ Strauss S (2005) 8.

⁴³⁹ Strauss S (2005) 8.

⁴⁴⁰ European Bank for Reconstruction and Development (2018) 2.

⁴⁴¹ Klapper L (2006) 3116.

⁴⁴² European Bank for Reconstruction and Development (2018) 1.

requirement thresholds should be set for entities providing only domestic factoring and those performing domestic and international factoring. The latter should be higher.

Lastly, the Guidelines restricts finance companies from dealing with foreign exchange transactions except through correspondent banks or authorised dealers. This restriction implies that independent factoring firms in Nigeria participating in international factoring would have to co-opt either bank or authorised foreign exchange dealers in dealing with such transactions. This could impact the flexibility of independent factoring firms conducting international factoring and hamper the use of factoring as an open account settlement method in international trade among SMEs. Afeximbank and Neximbank have engaged with the CBN to advocate for a more favourable regulatory environment and admit independent factoring firms as foreign exchange dealers.⁴⁴³ However, there is no indication that these recommendations have been implemented as of the writing of this thesis.

Implementing the recommendations highlighted above will contribute to increasing the emergence of additional finance companies as factoring firms. This becomes even more critical when it is considered that finance companies are more accessible to SMEs than banks.



4.4.3. Tax Treatment and Transaction Cost

It has been observed that factoring could be rendered unattractive by VAT and stamp duty, especially for SMEs, because they increase the cost of finance.⁴⁴⁴ It is also proposed that the registration of assignments of accounts receivable under factoring transactions should not be a mandatory requirement.⁴⁴⁵ Exempting factoring from these taxes and mandatory registration helps to ensure a level playing field between finance companies and other financiers like banks.⁴⁴⁶ Unfortunately, under Nigeria's extant tax regime, factoring transactions attract both VAT and stamp duty. Such a tax regime neither make factoring an appealing financing option

⁴⁴³ Factors Chain International *FCI Annual Review* (2019) 10.

⁴⁴⁴ Klapper L (2006) 3116; Bakker MHR, Klapper LU & Gregory F (2004) 21.

⁴⁴⁵ Oramah BO (2014) 9.

⁴⁴⁶ Bakker MHR, Klapper LU & Gregory F (2004) 21.

nor encourage its utilisation. Consequently, it is advisable to exempt factoring and other invoice financing transactions from both VAT and stamp duty.

Further, there is no maximum level on the interest (discount charge) that finance companies can charge under the Guide to Charges by Banks, Other Financial and Non-Bank Financial Institutions of 2020. The Guide specifies that the interest rate for loans and advances by finance companies is subject to negotiation between the finance company and supplier. The Guide also does not explicitly mention the service fee for factoring services. To avoid SMEs being subjected to excessive and arbitrary charges, the Guide should set out the maximum levels for discount charges, service fees and other charges of factors. Nevertheless, these thresholds should be competitive to attract investors.

4.5. Other Barriers: Outside Legal, Tax & Regulatory

Beyond the legal, tax, regulatory and policy issues spotlighted above, other issues have been found to inhibit the growth of a country's factoring industry. These issues and their application in Nigeria are discussed below:



4.5.1. Lack of Awareness About Factoring as a Financing Product

The extent of utilisation and adoption of factoring as a financing alternative is impacted by the degree of knowledge, awareness and information that potential users like SMEs have.⁴⁴⁷ One of the notable findings in Nabawanda's doctoral study is that most SMEs in sub-Saharan Africa are not aware of factoring as an alternative source of financing.⁴⁴⁸ Similar findings were made in Tomusange's doctoral study.⁴⁴⁹ This is not unconnected with the fact that it is only recently that policymakers and stakeholders started to promote factoring in the continent. Oramah observes that until the mid-2000s, there was little or no effort by both governments in Africa and global factoring networks like FCI and IFG to promote factoring.⁴⁵⁰

⁴⁴⁷ Tomusange RL (2015) 11; Kameni E (2014) 27.

⁴⁴⁸ Nabawanda W (2018) 64.

⁴⁴⁹ Tomusange RL (2015) 11.

⁴⁵⁰ Oramah BO (2014) 7-8.

The views on lack of or limited knowledge of factoring also reflect Nigeria's position. Factoring is an unpopular source of financing in the country.⁴⁵¹ The absence of a specific law on factoring compounded with the dearth of case laws on the subject may have contributed to the lack of awareness. Given this situation, policymakers need to intensify efforts in creating awareness about asset-based financing as a whole to users and investors.

4.5.2. Inadequate Government Support Programmes and Policy Incentives

The actions of policymakers through advocacy, awareness campaigns and policy incentives play a huge role in growing the interest and confidence of investors to invest in the factoring industry. Oramah explains that given the lack of support by African governments and regulators, banks had no incentive to pursue factoring as a business line, whether as a product offering to SMEs or by credit lines to factors.⁴⁵²

The delay in enacting the Factoring (Assignment of Receivables) Bill into law does not speak volumes to the national government's commitment to seeing through the development of the country's factoring industry. Further, the national government is yet to issue its policy framework and incentives for growing factoring business in Nigeria. The CBN's major move regarding instituting supportive policies for factoring is communicating its plans to assist with developing a trade receivables portal.⁴⁵³ According to the CBN, the portal will facilitate the trading of SMEs' receivables with financial institutions.

Undoubtedly, the inactions and passive implementation approach of policymakers in Nigeria are likely to have slowed the growth of the factoring industry. There is, therefore, the need for more commitment by these actors towards developing the factoring market. Notably, Nigeria could learn lessons from the Cadenas Productivas (Productive Chains) scheme in developing

⁴⁵¹ Isern J, Agbakoba A & Flaming M et al (2009) 21.

⁴⁵² Oramah BO (2014) 6.

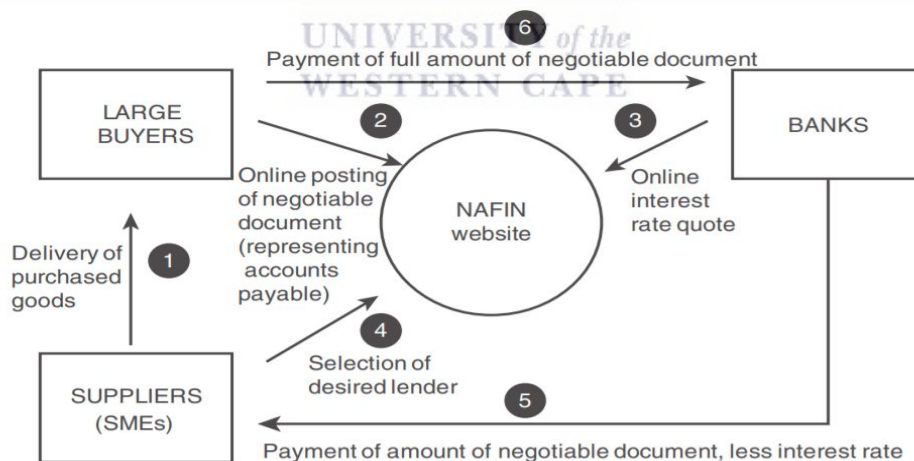
⁴⁵³ This is contained in a press briefing delivered by the Governor of the Central Bank of Nigeria, Godwin Emefiele and titled '5 year Policy Thrust of Central Bank of Nigeria. Available at <https://www.cbn.gov.ng/Out/2019/CCD/Five-Year%20Policy%20Thrust%20-%20CBN.pdf> (accessed 23 December 2020).

the proposed trade receivable portal. The scheme is a receivables platform administered by the Nacional Financiera (NAFIN) - a development bank in Mexico.

Launched in 2001, the Cadenas Productivas (Productive Chains) scheme aims to facilitate factoring services through an electronic portal where big buyers, small suppliers (SMEs) and financial institutions are linked.⁴⁵⁴ Through the scheme, SMEs ordinarily unable to access bank credit could use their accounts receivable from the big buyers to receive working capital financing.⁴⁵⁵ At the request of the big buyers or companies, designated financial institutions or factors in the scheme provide financing to the SMEs against their receivables in advance (less interest).⁴⁵⁶ The financial institutions are then repaid by the big buyers or companies when the receivables mature.⁴⁵⁷

The NAFIN does not finance receivables under the scheme; it only coordinates the online factoring platform.⁴⁵⁸ The scheme has been hailed to improve access to working capital to SMEs and this has motivated some regions and countries to want to replicate it.⁴⁵⁹ Fig 5 below provides a snapshot of the participants in the programme and how it functions:

Fig 5: NAFIN Cadenas Productivas Programme⁴⁶⁰



⁴⁵⁴ de la Torre A, Gozzi JC & Schumukler SL (2016) 158.

⁴⁵⁵ Klapper L (2006) 3124.

⁴⁵⁶ Klapper L (2006) 3124.

⁴⁵⁷ Klapper L (2006) 3124.

⁴⁵⁸ de la Torre A, Gozzi JC & Schumukler SL (2016) 158.

⁴⁵⁹ de la Torre A, Gozzi JC & Schumukler SL (2016) 161 – 2; Klapper L (2006) 3125.

⁴⁶⁰ de la Torre A, Gozzi JC & Schumukler SL (2016) 159.

4.5.3. Absence of Facilitative Institutions

Credit insurance companies and credit information registries/bureaus are other critical facilitating structures for factoring as they support the operationalisation of the factoring industry, efficiency of the factoring firms and overall output of the industry.⁴⁶¹

According to Awani, Africa's limited credit insurance capacity has restricted the quantum of services factors in Africa can offer.⁴⁶² Oramah explains that due to limited insurance and reinsurance capacities, most factoring firms in Africa do not undertake non-recourse factoring, and they also focus on servicing governments and blue-chip companies instead of SMEs.⁴⁶³ Nigeria has an underdeveloped insurance industry, and the points made by Awani and Oramah represent the state of affairs in the country. The limited capacity of the country's credit insurance industry has restricted the expansion of factoring activities and constrained the few factoring service providers to focus on large corporates. As a result, the handful of factoring transactions in Nigeria are done primarily by banks in favour of big oil and gas companies, not SMEs.⁴⁶⁴ This is understandable because, in the absence of credit insurance protection, factors would prefer to focus on industries and firms with lesser credit risk.

Further, a weak credit information reporting system can discourage factoring while also imposing excessive burdens on factors for collecting information about debtors' creditworthiness and assessing credit risk.⁴⁶⁵ In fact, while the factoring industry could thrive in the absence of a factoring law or where the credit enforcement institutions are weak, access to credit information is a critical predictor for the factoring industry's success.⁴⁶⁶ Factors need information about the customer's creditworthiness in deciding whether to enter a factoring transaction with the supplier. Nigeria's credit information system is driven by the Credit Reporting Act, 2017. The Act provides for the licencing of credit bureaus or registries that

⁴⁶¹ Klapper L (2006) 3116.

⁴⁶² Awani K 'Factoring in Africa: Opportunities and Challenges' available at <https://silo.tips/download/factoring-in-africa-opportunities-and-challenges-4#sidebar-close> (accessed on 6 December 2020).

⁴⁶³ Oramah BO (2014) 6.

⁴⁶⁴ Isern J, Agbakoba A & Flaming M et al (2009) 21.

⁴⁶⁵ Klapper L (2006) 3116.

⁴⁶⁶ Mol-Gomez-Vazquez A, Hernandez-Canovas G & Koeter-Kant J 'Legal and Institutional Determinants of Factoring in SMEs: Empirical Analysis Across 25 European Countries (2018) 56(2) *Journal of Small Business Management* 316; Klapper L (2006) 3112.

maintain a database of credit information about debtors.⁴⁶⁷ Although Nigeria's credit reporting system does not prohibit non-bank financial institutions (like factoring firms) to obtain credit information about potential debtors, the system faces other challenges regarding capacity and efficiency.⁴⁶⁸ There are very few private credit bureaus/registries in Nigeria, and the credit information reporting system is still evolving.⁴⁶⁹

Finance companies in Nigeria are hesitant to go into factoring because they have limited tools for credit risk assessment.⁴⁷⁰ These conditions do not support large scale factoring activities and may have also contributed to the negligible volume of factoring activities in the country. The foregoing all point to the need for Nigeria to boost its credit risk insurance and credit reporting capacities. This can be achieved by introducing incentives and policies that attract more investors to boost the financial industry's credit risk insurance and credit reporting capacities.

4.6. Frameworks for Factoring in Egypt: A Comparative Analysis

Discussions in the preceding section identified the favourable legal, tax, regulatory and policy frameworks that stimulate the growth of the factoring industry. The absence of most of the highlighted frameworks in Nigeria unveiled the barriers likely to have hindered the growth of the country's factoring industry. This section now examines Egypt's factoring industry to ascertain if the industry's impressive growth has been influenced by such favourable legal, tax, regulatory and policy frameworks.

4.6.1. Economic Profile, SME Presence and Highlights of Factoring in Egypt

The Egyptian economy recorded a nominal GDP of US\$ 303,175 billion in 2019, making it the third-largest economy in Africa behind South Africa (US\$ 351,432 billion) and Nigeria (US\$

⁴⁶⁷ s 2 & 3 of the Credit Reporting Act.

⁴⁶⁸ s 27 of the Credit Reporting Act.

⁴⁶⁹ Proshare 'All You Need To Know About Credit Bureaus in Nigeria' available at <https://www.proshareng.com/news/Credit%20Services%20&%20Registry/All-You-Need-To-Know-About-Credit-Bureaus-in-Nigeria-/38833> (accessed on 6 January 2021).

⁴⁷⁰ Isern J, Agbakoba A & Flaming M et al (2009) 62.

448,120 billion).⁴⁷¹ Like Nigeria, Egypt's private sector is dominated by SMEs. In Egypt, SMEs represent about 90 per cent of private enterprises, account for about 80 per cent of the country's GDP and employ about 75 per cent of the total workforce.⁴⁷²

Access to finance has consistently featured as one of the critical factors responsible for the failure of SMEs to contribute to the Egyptian economy as expected.⁴⁷³ Having acknowledged the value of factoring in improving access to finance to SMEs in the country, the Government of Egypt (GoE) channelled extensive efforts towards promoting it.⁴⁷⁴ Laudably, initiatives targeted at growing the factoring industry have yielded remarkable results for the Arab nation. As of 2020, there are about 11 factoring firms that are FCI members operating in the country.⁴⁷⁵ The country's domestic and international factoring volumes have been impressive over the years, as shown in Fig 6 below:

Fig 6: Egypt's Factoring Volumes from 2015 to 2019⁴⁷⁶

Year	Domestic Factoring	International Factoring	Total Factoring Volumes (in millions of Euros)
2019	464	125	589
2018	428	89	517
2017	367	51	418
2016	476	74	550
2015	452	85	537

The sustained growth of Egypt's factoring industry makes the country a good reference point for other African countries seeking to develop their factoring industry. It also sparks inquiries on the legal, tax and policy interventions that could have supported the growth of the country's factoring industry.

⁴⁷¹ The World Bank 'World Development Indicators 2019' available at <https://databank.worldbank.org/data/download/GDP.pdf> (accessed on 23 October 2020).

⁴⁷² El-Said H, Al-Said M & Zaki C 'Small and Medium Enterprises Landscape in Egypt: New Facts from a New Dataset' 2014 5(2) *Journal of Business and Economics* 142; also see The African Capacity Building Foundation & African Export-Import Bank (2021) 15.

⁴⁷³ El-Said H, Al-Said M & Zaki C (2014) 142.

⁴⁷⁴ Nasr S *Access to Finance and Economic Growth in Egypt* (2010) 76.

⁴⁷⁵ The African Capacity Building Foundation & African Export-Import Bank (2021) 15.

⁴⁷⁶ Factors Chain International *FCI Annual Review 2015 – 2020* available at https://fci.nl/en/annual-review?language_content_entity=en (accessed on 8 May 2021).

4.6.2. Overview of the Frameworks for Factoring in Egypt

Egypt's financial regulatory structure is housed in two main regulatory authorities: The Central Bank of Egypt (CBE) and the Egyptian Financial Supervisory Authority (EFSA).⁴⁷⁷ The CBE regulates and supervises all commercial and specialised banking institutions, in addition to setting and driving the country's monetary policies.⁴⁷⁸ On the other hand, the EFSA is the regulatory and supervisory authority for all non-banking financial institutions in Egypt.⁴⁷⁹

Unlike in Nigeria where the CBN is responsible for licensing and regulating non-bank financial institutions (finance companies) offering factoring services, these functions are not similarly performed by the CBE.⁴⁸⁰ Instead, the EFSA is the regulatory and supervisory authority for entities providing factoring services.⁴⁸¹ An overview of the EFSA's regulatory and oversight functions includes issuing operating licences, investigating the activities of factors and sanctioning defaulting factors.⁴⁸²

The Financial Lease and Factoring Law No. 176 of 2018 is the consolidated legal framework regulating factoring transactions and factoring institutions.⁴⁸³ Before the enactment of this Law, the factoring industry was regulated by ministerial decrees and other guidance frameworks issued by the EFSA.⁴⁸⁴ The first of such ministerial decrees was issued in 2010.⁴⁸⁵ Within the Egyptian legal system, built on a combination of Islamic Law and Civil Law systems, ministerial decrees are subsidiary legislations issued by government officials and public law entities.⁴⁸⁶ In Nigeria, they are called subsidiary legislation. The use of ministerial decrees to regulate factoring before the enactment of the Financial Lease and Factoring Law is a good learning point for Nigeria. Since it is common knowledge that the National Assembly

⁴⁷⁷ Ghebrial F *Financial Inclusion in Egypt: Challenges and Opportunities* (unpublished Master in Public Administration thesis, American University in Cairo, 2019) 38.

⁴⁷⁸ Ghebrial F (2019) 38.

⁴⁷⁹ Ghebrial F (2019) 38.

⁴⁸⁰ Nasr S (2010) 76.

⁴⁸¹ Ghebrial F (2019) 38.

⁴⁸² European Bank for Reconstruction and Development (2018) 38.

⁴⁸³ Since the law is in Arabic language, the study relies on the survey of Egypt's legal and regulatory framework for factoring facilitated by the EBRD. See generally European Bank for Reconstruction and Development *Factoring Survey in EBRD Countries of Operation* 3ed (2018) 36 -40.

⁴⁸⁴ Nasr S (2010) 76.

⁴⁸⁵ Shams G 'Africa – Egypt' in Bickers M (ed) *World Factoring Yearbook* (2017) 161.

⁴⁸⁶ Abdel-Wahab MSE 'An Overview of the Egyptian Legal System and Legal Research' available at <https://www.nyulawglobal.org/globalex/Egypt1.html#:~:text=Egypt's%20supreme%20law%20is%20its,legal%20rules%20applicable%20to%20contracts> . (accessed on 24 December 2020).

delay in passing laws, the CBN can deploy its powers under the BOFIA and CBN Act to issue regulations for factoring transactions as an interim measure.

Egypt's Financial Lease and Factoring Law primarily aim to accelerate SMEs' access to finance while cushioning the need for expensive and lengthy banking facilities.⁴⁸⁷ The Law recognises both recourse and non-recourse factoring as a true sale transaction.⁴⁸⁸ This classification aligns with the arguments in the preceding chapter that both recourse and non-recourse factoring should be characterised as a sale transaction, not a lending transaction.⁴⁸⁹ The Law distinguishes between domestic and international factoring.⁴⁹⁰ It is further specified to apply to the assignment of both commercial and consumer invoices.⁴⁹¹ The Law, however, provides that assignment in breach of a ban or restriction on assignment (BOA) clause shall be ineffective against the customer unless the customer agrees to such assignment.⁴⁹² Additionally, parties to a factoring arrangement must enter into a written factoring contract that complies with the template contract developed by the EFSA.⁴⁹³ In all, as opposed to Nigeria's situation where the legal framework for factoring transactions remains fragmented and uncertain, Egypt's Financial Lease and Factoring Law has created a defined legal regime for factoring transactions.

In terms of the tax treatment of factoring transactions in Egypt, according to the Value Added Tax Law No. 67 of 2016, all non-banking financial services (which includes factoring) subject to the supervision and regulation of EFSA are exempt from VAT. Further, no registration is required for the validity of the assignment of accounts receivables under factoring transactions.⁴⁹⁴ Additionally, Law No. 143 of 2006 amended the Stamp Duty Law No. 111 of 1980 to exclude factoring companies from paying stamp duties.⁴⁹⁵ By implication, Egypt has a more friendly tax regime for factoring than Nigeria where the current tax legal frameworks

⁴⁸⁷ Shahid Law Firm 'Highlights on the Newly Enacted Financial Lease and Factoring Law no. 176 of the Year 2018' available at <http://shahidlaw.com/2018/09/07/highlights-on-the-newly-enacted-financial-lease-and-factoring-law-no-176-of-the-year-2018/> (accessed 24 December 2020).

⁴⁸⁸ European Bank for Reconstruction and Development (2018) 38 -9.

⁴⁸⁹ Chapter 3, Paragraph 3.7.

⁴⁹⁰ European Bank for Reconstruction and Development (2018) 38.

⁴⁹¹ European Bank for Reconstruction and Development (2018) 38.

⁴⁹² European Bank for Reconstruction and Development (2018) 40.

⁴⁹³ European Bank for Reconstruction and Development (2018) 39.

⁴⁹⁴ European Bank for Reconstruction and Development (2018) 40.

⁴⁹⁵ Nasr S (2005) 76.

impose VAT and stamp duty on factoring transactions. Further, in contrast to Nigeria, in Egypt, independent factoring firms can undertake transactions denominated in foreign currency across the border without any special restrictions.⁴⁹⁶

Another unique aspect of the Egyptian factoring industry is the existence of a self-regulatory factoring association, the Egyptian Factoring Association (EFA). As of the writing of this thesis, there is no record of such a self-regulatory association in Nigeria. The EFA was licensed in 2014 and primarily functions to serve the interest of member companies involved in factoring in Egypt.⁴⁹⁷ The activities of the EFA include promoting factoring, resolving disputes between members and non-members as well as managing interactive activities between members and other local and international factoring institutions. In consideration of these, among other functions, it can be said that Egypt has its own 'mini-FCI' that facilitates activities of factoring firms and promotes factoring services.

Quite interestingly, unlike Nigeria that has ratified the UNIDROIT Convention, Egypt is neither a signatory to the UNIDROIT Convention nor the UNCITRAL Convention.⁴⁹⁸ But seeing the volumes of international factoring that Egypt has recorded over the years, it goes to show that a country has to do more than just ratifying treaties related to factoring. Factoring grows from bottom to top (domestic to international), not the other way round. If there are no supportive frameworks to promote domestic factoring, international factoring would likely also suffer.

4.6.3. Impacts of the Frameworks on the Growth of Egypt's Factoring Industry

It has been recognised that the growth of Egypt's factoring industry has been influenced by the passing of the Financial Lease and Factoring Law No. 176 of 2018.⁴⁹⁹ The growth is also backed by recently activated structures like the Egyptian Collateral Registry.⁵⁰⁰ Shams observes that self-regulatory entities like factoring associations play an essential role in

⁴⁹⁶ European Bank for Reconstruction and Development (2018) 40.

⁴⁹⁷ Egyptian Factoring Association 'The Association's Objectives' available at <https://factoregypt.org/index.php#who> (accessed on 21 December 2020).

⁴⁹⁸ European Bank for Reconstruction and Development (2018) 38.

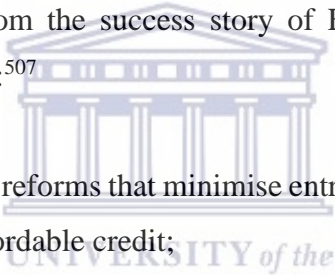
⁴⁹⁹ Factors Chain International *FCI Annual Review* (2019) 10; also see The African Capacity Building Foundation & African Export-Import Bank (2021) 15.

⁵⁰⁰ Factors Chain International *FCI Annual Review* (2019) 10.

markets, particularly those where factoring has been recently introduced.⁵⁰¹ She notes that this has been the case with the EFA, which has been instrumental in the growth of Egypt's factoring industry through its various activities.⁵⁰²

According to Fawzy, the growth of factoring in Egypt can be credited to increased awareness about the product as an efficient finance source for domestic and international trade, thereby substantially improving its demand by users.⁵⁰³ He notes further that factoring has become the fastest-growing segment of the non-banking sector due to the solid legislative framework and interventions by the EFSA and the GoE.⁵⁰⁴

In Oramah and Dzene's view, the enactment of Law No. 143 in 2006, which removed stamp duty on factoring companies, contributed to developing a more favourable environment for factoring to thrive in Egypt.⁵⁰⁵ They further observed that the growth of Egypt's factoring industry has also been triggered by other policy reforms and interventions by the GoE to address SMEs' access to finance challenges.⁵⁰⁶ The duo aptly narrowed three key lessons other African countries could learn from the success story of Egypt's factoring industry over a relatively short period, as follows:⁵⁰⁷

- 
- a) The introduction of policy reforms that minimise entry requirements for factoring firms and improve access to affordable credit;
 - b) The promotion of export-oriented economic policies; and
 - c) The implementation of appropriate legal, regulatory and institutional reform that support factoring.

While the performance of Egypt's factoring industry over the years is enviable and very commendable, the industry is not bereft of flaws. There still exists room for improvement in the industry as studies have shown that there are some challenges to factoring activities in the country, especially international factoring. In this respect, researchers and experts have

⁵⁰¹ Shams G (2017) 163.

⁵⁰² Shams G (2017) 163.

⁵⁰³ Fawzy K 'Africa – Egypt' in Bickers M (ed) *World Factoring Yearbook* (2018) 130.

⁵⁰⁴ Fawzy K (2018) 132.

⁵⁰⁵ Oramah BO & Dzene R (2014) 21.

⁵⁰⁶ Oramah BO & Dzene R (2014) 21.

⁵⁰⁷ Oramah BO & Dzene R (2014) 24 -5.

advocated that improving regulation, strengthening the credit information system, expanding the credit insurance market and increasing awareness about factoring are all crucial to further improving the efficiency and output of Egypt's factoring industry.⁵⁰⁸ Further, the Egyptian factoring law's stance on not overriding BOA clauses is likely detrimental to SMEs with little bargaining power to have such provisions contractually excluded. It also does not align with international best practices.⁵⁰⁹ The provision, therefore, needs to be revisited, particularly considering the interest of SMEs.

4.7. Conclusion

This chapter has provided an overview of the development of Nigeria's factoring industry and discussed the extant legal, tax and regulatory regime for factoring in Nigeria. The chapter has also examined the barriers that have likely hindered the growth of Nigeria's factoring industry. The barriers identified include the absence of a factoring law and tax incentives, low awareness and knowledge about factoring and the underdevelopment of credit information and credit insurance institutions. Other barriers identified are inadequate government support and the non-existence of policy incentives, particularly in connection with foreign exchange access restrictions. The chapter undertook a comparative study of certain crucial aspects of the legal, tax and regulatory frameworks for factoring in Egypt. The comparison demonstrated that most of the barriers identified in Nigeria's factoring industry were absent in Egypt's factoring industry. Efforts in creating awareness about factoring, the institution of a factoring law and tax incentives, including the existence of favourable foreign exchange policies, were identified as some of the factors responsible for the sustained growth of Egypt's factoring industry. The industry's enviable performance was also credited to the regulatory interventions of the EFSA and activities of the EFA. The next chapter will critique Nigeria's proposed legal framework for factoring, the Factoring (Assignment of Receivables) Bill. The learning points from this chapter will be used to make proposals on how to improve the Bill, especially with regards to entrenching the interest of SMEs.

⁵⁰⁸ Oramah BO & Dzene R (2014) 23; Fawzy K (2018) 132; Shams G (2017) 163-4.
⁵⁰⁹ Chapter 3, Paragraph 3.8.2.

CHAPTER FIVE

OVERVIEW AND CRITIQUE OF THE FACTORING (ASSIGNMENT OF RECEIVABLES) BILL

5.1. Introduction

In investigating the likely barriers to the growth of factoring in Nigeria in the preceding chapter, the absence of a national law on factoring was highlighted as a major impediment. However, it was disclosed that there exists a draft law being considered by the National Assembly - the Factoring (Assignment of Receivables) Bill. It is commendable that a proposed framework is on the way. Nevertheless, it is not just enough to have a legal framework. Since factoring has grown to become an SME-focused product, any proposed legal framework on the subject should be tailored to entrench the interests of SMEs. Further, with SMEs assessed to account for over 90 per cent of businesses, any legal framework targeted at businesses should accommodate the interests of the SME sub-segment.

Against this background, this chapter examines the Factoring (Assignment of Receivables) Bill to identify its strengths and weaknesses in creating the desired legal regime for factoring to grow in Nigeria, especially in the interest of SMEs. This examination further aims to propose legal interventions to promote factoring as an alternative source of financing for SMEs. The examination undertaken in this chapter is particularly important because there is a paucity of articles critiquing the draft contents of the Bill.

5.2. Overview of the Bill

The Factoring (Assignment of Receivables) Bill has emerged in response to the clamour for the enactment of a national law on factoring. The Bill substantially copies the Afreximbank Model Law, with minor additions. Notably, the Afrexim Model Law is presented as a Parliamentary Act, thus making its adoption by common law jurisdictions, of which Nigeria is, much easier.⁵¹⁰ The Bill primarily covers the regulation of factoring transactions and not the regulation of factoring firms.

⁵¹⁰ Preamble of the Afreximbank Model Law (Page 5).

Consistent with the Afreximbank Model Law, in describing the parties involved in a factoring transaction, the Bill uses the following terminologies – the *client* (supplier), the *debtor* (customer) and the *factor*. Regarding the scope of its application, section 3(1) of the Bill provides that it applies to domestic and international factoring transactions made under a factoring contract.⁵¹¹ However, it should be clarified that whilst the Bill is audacious in its claim of applying to international factoring transactions, such an application is not automatic. Certain conditions must exist before Nigeria's national law or, indeed, the national law of another country can validly apply to an international commercial contract.⁵¹² The first of the conditions is that contracting parties must have either expressly or impliedly chosen the national law to apply.⁵¹³ But even in such instances, the choice of law is not conclusive. The choice of law will only be effective if it is real, genuine, bona fide, legal and reasonable to be applied in the circumstance.⁵¹⁴ To meet these requirements, the national law chosen as the proper law of the contract must have some relationship to and be connected with the realities of the contract.⁵¹⁵ The other condition is where the parties have not chosen any law to apply to their international contract, but the national law has the closest and most real connection with the contract.⁵¹⁶

The Bill defines a factoring contract as a contract between a supplier and the factor under which the supplier assigns to the factor trade receivables arising from the supplier's supply contract with a customer for the factor to perform *any* or *all* of the following functions:⁵¹⁷

- a) Providing financing against the receivables to the supplier, *including by way of loans, advance payment or otherwise*;
- b) Maintenance of accounts (ledgering) relating to the assigned receivables; or

⁵¹¹ See s 3(1) of the Bill.

⁵¹² Bonell MJ 'The Law Governing International Commercial Contracts and the Actual Role of the UNIDROIT Principles' (2018) 23 *Uniform Law Review* 16-17.

⁵¹³ Bonell MJ (2018) 16-17.

⁵¹⁴ *Sonner (Nig) Ltd v Partnereedn M.S. Nordwind* (1987) 4 NWLR (Pt. 66) 520 (SC).

⁵¹⁵ *Queensland Estate Ltd v Collas* (1971) St. R. Qd 75 (QSC).

⁵¹⁶ *Bonython v Commonwealth of Australia* [1951] A.C. 201 (PC).

⁵¹⁷ See s 3(1) of the Bill. The definition in the Bill deviates from that contained in the UNIDORIT Convention in which the factor must perform *at least two* out of the following four functions to the client/supplier: finance against receivable, ledger accounting, debt collection or bad debt protection.

c) Collection of the assigned receivables.

In addition to ordinary factoring, the definition broadly accommodates other asset-based financing solutions, including asset-based lending or secured lending, reverse factoring and invoice discounting.⁵¹⁸ Further, as with the Afreximbank Model Law, the Bill accommodates that factoring can be characterised as a sale transaction or a lending transaction depending on the circumstance.⁵¹⁹ However, as highlighted in the previous chapter, the Secured Transactions in Movable Assets Act of 2017 (STMA) already provides a legal regime for the use and assignment of accounts receivables as collateral or security for loans. Therefore, by implication, in a given case, more than one domestic law may be applicable where receivables are being used as security for loans. To avoid this confusion, parties would then need to indicate in their contract if they would want the STMA or the Bill to apply.

Bulk assignment of receivables, subsequent assignment of receivables as well as the assignment of future receivables are all recognised and permitted under the Bill.⁵²⁰ The Bill does not also exclude consumer receivables and receivables owed by government institutions.⁵²¹ However, the Bill does not apply to receivables arising from transactions on the stock exchange, insurance policies, sale or lease of property, letters of credit, as well as business sales, mergers or acquisition transactions.⁵²² Parties to a factoring transaction are allowed under the Bill to derogate or vary their respective rights and obligations set out in the Bill.⁵²³ However, certain warranties and representations will be read into every factoring contract, except they are expressly excluded.⁵²⁴

Unlike Egypt's factoring law, the Bill provides that the assignment of receivables shall be effective even if there exists a ban on assignment (BOA) provision in a contract of sale or in another law.⁵²⁵ This provision is commendable as it protects the interest of SMEs dealing with

⁵¹⁸ s 1 of the Bill. See also Preamble of the Afreximbank Model Law (Pages 3-4) and also explanatory note 7 of the Afreximbank Model Law.

⁵¹⁹ See s 1 of the Bill. See also the Preamble of the Afreximbank Model Law (Page 6).

⁵²⁰ s 3 & 7 of the Bill.

⁵²¹ s 4(1)(a) of the Bill.

⁵²² See generally s 2 & 4 of the Bill for other excluded transactions.

⁵²³ s 6 of the Bill.

⁵²⁴ s 11 of the Bill.

⁵²⁵ s 1 & 8 of the Bill.

large corporates and government institutions. It is also good to mention that the STMA equally overrides BOA clauses.⁵²⁶ Another point of difference with Egypt's factoring law is the requirement of notice. The Bill provides that notification to the customer is not a mandatory requirement for the effectiveness of the factoring transaction on the customer.⁵²⁷ However, Egypt's factoring law provides that the factoring contract will only become effective against the customer when he has been served the notice of assignment.⁵²⁸ Nigeria's position on notification of assignment creates more flexibility, especially for invoice financing transactions like invoice discounting, which do not require notice.

The CBN is empowered to regulate and supervise all factoring activities or any other transaction covered under the Bill.⁵²⁹ The Bill further sets out an alternative dispute resolution mechanism to be administered by a panel of adjudicators constituted by the CBN.⁵³⁰ Although not specially stated, the mechanism is essentially arbitration.

5.3. Critique of the Bill

The Bill offers a laudable step in creating a supportive legal framework for domestic and international factoring transactions in Nigeria. In fact, provisions of the Bill overriding BOA clauses favour international best practices than what is specified in Egypt's factoring law. Nevertheless, the Bill is not without its drawbacks. Some of the drawbacks could undermine the framework's objectives in promoting factoring as an alternative financing source for SMEs and the emergence of more finance companies providing factoring services. Additionally, they could create confusion and hamper the factoring industry's growth. These drawbacks are discussed below as follows:

5.3.1. Recourse and Non-Recourse Factoring

The Bill does not distinguish between factoring with recourse and factoring without recourse. This is particularly reflected under the definition of 'factoring contract', which omitted to list

⁵²⁶ s 4 of the STMA.
⁵²⁷ s 1 of the Bill.
⁵²⁸ European Bank of Reconstruction and Development (2018) 39.
⁵²⁹ s 5 of the Bill.
⁵³⁰ See s. 29 of the Bill.

credit risk protection (non-recourse factoring) as one of the core functions of the factor. The Afreximbank Model Law deliberately omitted credit risk protection as a core service because some European countries view such service as an insurance product that can only be offered legally by a factor having an insurance licence.⁵³¹

However, in Nigeria's context, the consideration ought to be is credit risk protection a vital service that factors should provide, especially with SMEs in view? This question is best answered in the affirmative. As highlighted in the previous chapter, SMEs stand to benefit more from non-recourse factoring than recourse factoring.⁵³² Therefore, the Bill should be updated to list credit risk protection as one of the core services of the factor in the definition of factoring contract. Further, to avoid complicating the regulatory environment, the Bill should specify that credit risk protection services of factors are not an insurance product subject to regulation by the insurance regulator - the National Insurance Commission (NAICOM).

5.3.2. Factoring as a Sale or Lending Transaction

The Bill broadly qualifies factoring to either be an assignment by way of sale or an assignment by way of security for a lending transaction. However, as discussed in chapter three, factoring (whether recourse or non-recourse) is best characterised as a sale transaction.⁵³³ Classifying factoring as a sale transaction is beneficial and serves to clarify the following issues that would otherwise be subject to controversies.

First, if classified as a sale transaction, if the supplier or debtor becomes bankrupt, the factored accounts receivable would not be considered part of their bankruptcy estate but will be taken as the factor's property.⁵³⁴ This gives better protection to the factoring firms and encourages them to undertake non-recourse factoring. Further, if the supplier is a company, it excludes the transaction from being seen as a charge over its assets that would be required to be registered with the Corporate Affairs Commission (CAC) for the factor to enjoy priority. More specifically, pursuant to section 222(1)(2)(e) of the Companies and Allied Matters Act of 2020, every charge created over the book debts (accounts receivable) of a company to provide

⁵³¹ See explanatory note 14 of the Afreximbank Model Law.

⁵³² See Chapter 3, Paragraph 3.4.4.

⁵³³ Chapter 3, Paragraph 3.7

⁵³⁴ Klapper L (2006) 3116.

security for a loan must be registered with the CAC within 90 days of the charge being created. The registration fee is not to exceed 0.35 per cent of the value of the charged asset.⁵³⁵ Failure to register renders the security void against a liquidator or creditor of the borrower even though the borrower is not thereby discharged from its payment obligation to the lender.⁵³⁶ Accordingly, recognising factoring as a sale transaction helps to reduce transaction costs by removing the requirement of registering the charge with the CAC. Lastly, the transaction will fully be recognised as an off-balance sheet transaction as no liability whatsoever will be recorded in the supplier's books.⁵³⁷ This recognition is particularly instrumental in making the financial records of SMEs more attractive for other forms of financing.

5.3.3. Financing Objectives of the Factoring Framework

The promoters of the Bill, Neximbank, have reiterated time and again that the framework's primary objective is to improve access to finance, especially for SMEs.⁵³⁸ However, the lax approach used in outlining the core functions to be performed by factors under the definition of 'factoring contract' in the Bill does not align with this core objective. The function of providing financing against the assigned receivables by the factor to the supplier is optional, not mandatory.⁵³⁹ It is good to mention that even the drafters of the Afreximbank Model Law implore national legislators to set out mandatory functions of the factor to align with desired objectives. The Model Law specifies as follows:

'It is up to national legislators to consider the qualifications for a factoring contract. There is an argument that a factor must provide finance, and/or in some jurisdictions, there is a requirement that the factor must provide credit protection, in which cases this definition will need adjusting.'⁵⁴⁰

It is contended that to improve access to finance to SMEs through the framework, financing should be made a mandatory service of the factor while the other services remain optional.

⁵³⁵ s 222(12) of the Companies and Allied Matters Act.

⁵³⁶ s 222(1) of the Companies and Allied Matters Act.

⁵³⁷ Goh K (2017) 64.

⁵³⁸ See Emejo J 'NEXIM Boss Urges National Assembly to Pass Nigerian Factoring Bill into Law' *Thisday* 29 January 2020 available at <https://www.thisdaylive.com/index.php/2020/01/29/factory-bill-will-to-boost-financial-inclusion-job-creation-says-nexim-bank-boss/> (accessed on 3 May 2021).

⁵³⁹ s 1 of the Bill.

⁵⁴⁰ See explanatory note 10 of the Afreximbank Model Law.

5.3.4. Registration of Assignments

In the Bill, references are made to a 'registry' where the assignments of receivables can be registered by either the supplier or factor.⁵⁴¹ It is laudable that the Bill did not make the registration of assignment a mandatory requirement factoring transactions to be effective as this could render such transactions costly, complex and susceptible to bureaucratic inefficiencies. Nevertheless, the Bill neither establishes a registry nor refers to an existing registry where the registration will occur. This omission has created a lacuna. In any case, there may not be a need to create another registry. The National Collateral Registry (NCR) established under the STMA can be used. The Bill should therefore be updated to specify the NCR as the applicable registry. Luckily, the STMA provides that registrations done at the NCR do not attract stamp duty,⁵⁴² which is a good incentive for factoring to grow.

5.3.5. Template Factoring Contract or Minimum Contract Requirements

The Bill stipulates that factoring contracts are expected to meet formal validity; that is, the contents of the contract must meet certain requirements in accordance with the Bill.⁵⁴³ Unfortunately, the Bill neither proposed a model contractual framework that parties could adopt nor set out the minimum requirements that should be contained in factoring contracts. Since factoring is still at an early stage of development in Nigeria, the Bill should address either of these issues to make it easier for SMEs to navigate the contracting pitfalls. Alternatively, similar to what is obtainable under Egypt's legal regime, the Bill can provide that the CBN will clear template contracts used for factoring services.⁵⁴⁴

5.3.6. Dispute Resolution Mechanism

The mandate on disputing parties to explore an alternative dispute resolution mechanism under the Bill is commendable, especially given Nigeria's slow judicial process. However, the dispute resolution regime under the Bill is faced with some drawbacks as streamlined as follows:

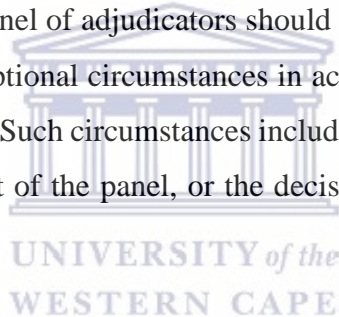
⁵⁴¹ s 12(2) of the Bill.

⁵⁴² s 54 of the Secured Transactions in Movable Assets Act of 2017.

⁵⁴³ s 24 of the Bill.

⁵⁴⁴ Chapter 4, Paragraph 4.6.2.

- a) The Bill fails to stipulate a timeline within which the CBN will constitute the panel of adjudicators. Equally, no timeline is set within which the CBN will issue rules of procedure that will guide the conduct of hearings by the adjudicators, place of sitting, fees payable for adjudication and remuneration of adjudicators. The concern here is that if a timeline is not set, these structures may never be set up, or it could take so much time before they are eventually put in place. Whichever happens, it will undermine the alternative dispute resolution process.
- b) The dispute resolution process may be expensive for SMEs, particularly because the panel of adjudicators is to be constituted by three members and, in some instances, two.⁵⁴⁵ Therefore, it may be more suitable for the Bill to specify one arbitrator.
- c) The Bill also fails to restrict the conditions under which a disputing party could subject the decision of adjudicators to judicial review.⁵⁴⁶ This could create room for abuse by a party seeking to delay the performance of its obligation. Accordingly, it is proposed that the decision of the panel of adjudicators should be final and only be set aside by a Court under limited exceptional circumstances in accordance with the Arbitration and Conciliation Act of 1988. Such circumstances include the decision exceeding the scope of arbitration, misconduct of the panel, or the decision being improperly procured or tainted by fraud.⁵⁴⁷



5.3.7. The Priority of Competing Claims

On the subject of resolving competing rights over assigned receivables among factors, the Bill has conflicting provisions. In one instance, it provides that priority will be determined by who registered the assignment first.⁵⁴⁸ However, another section of the Bill provides that general rules of law will determine priority, and in the absence of such rules, the first factor that gave notice to the debtor shall have priority.⁵⁴⁹ Therefore, the Bill should simply clarify whether

⁵⁴⁵ s 26(5) of the Bill.

⁵⁴⁶ s 26 of the Bill.

⁵⁴⁷ s 29 & 30 of the Arbitration and Conciliation Act. See also *Taylor Woodrow (Nig.) Limited v S.E. GmbH* [1993] 4 NWLR (Pt 286) 127 (SC).

⁵⁴⁸ s 12(2(3) of the Bill.

⁵⁴⁹ s 21(1) of the Bill.

priority will be based on registration or notification. In any case, using the 'first to notify the debtor' criteria will be a more flexible and cost-effective determinant of priority.

5.4. Drawbacks in the Adoption of the Afreximbank Model Law

Some of the drawbacks discussed above are attributable to how the Afreximbank Model Law has been adopted. In adopting the Afreximbank Model Law, the Bill was somewhat slavish as some provisions were lifted and replicated verbatim even though they may be erroneous or leave room for confusion. For example, 'factoring' is listed as part of the banking and other financial services to which the Bill's provisions do not apply.⁵⁵⁰ Expectedly, this is also to be found in the Afreximbank Model Law.⁵⁵¹ However, such exclusion should not even arise in Nigeria's case since banks can undertake factoring business and should not be subjected to a different legal framework. In other instances, Bill's provisions were not modified to suit the Nigerian context. For example, in several instances in the Bill, the word 'State' is mentioned. However, it is not clarified that it is used in relation to a sovereign State and not to a State within the Federation of Nigeria. The Bill reads like a treaty instead of a national law.

While the Afreximbank Model Law is undoubtedly a laudable template, it is vital to note that because of the divergent legal systems within Africa, the drafters of the Model Law were very broad in their approach.⁵⁵² Given this generic nature, a country's legal, social and economic dynamics must be considered in adopting the Afreximbank Model Law.⁵⁵³ Unfortunately, there is a sense that certain legal and economic dynamics applicable to Nigeria were disregarded in adopting the Model Law.

Notably, there seems to be a divide between what the promoters of the Bill are looking at achieving with the proposed legal framework and what the Model Law actually serves to promote. For example, Neximbank has always presented that the objective of the proposed framework is to promote conventional factoring transactions involving the sale and purchase

⁵⁵⁰ s 1 & 2 of the Bill.

⁵⁵¹ Article 1.1. of the Afreximbank Model Law.

⁵⁵² Korankye-Sakyi FK (2019) 80.

⁵⁵³ Korankye-Sakyi FK (2019) 81

of accounts receivable.⁵⁵⁴ However, the Afreximbank Model Law tilt more towards promoting the assignment of receivables generally, not fundamentally conventional factoring transactions. In the exact language of the Model Law, 'It must be emphasised that this is primarily a law about the assignment of receivables.'⁵⁵⁵ In this sense, it is akin, to some extent, to the UNCITRAL Convention that applies to a broad range of transactions involving the assignment of receivables, including factoring.

In comparison to the legal framework on factoring in Egypt discussed in the previous chapter,⁵⁵⁶ there are apparent differences with what is being proposed in Nigeria under the Bill. Particularly in the case of the Egyptian framework:

- a) It is tailored towards factoring and not the broad field of assignment of receivables;
- b) It distinguishes between recourse and non-recourse factoring;
- c) Both recourse and non-recourse factoring are recognised as a true sale; and
- d) It specifies all typical core functions of the factor, including credit risk protection.

Perhaps there is such clarity in Egypt's framework because a policy document preceded it.⁵⁵⁷ The policy document considered and addressed critical questions regarding developing an appropriate regulatory framework to encourage the development of factoring in Egypt. India had a similar policy document that preceded its factoring law.⁵⁵⁸ Unfortunately, there seems to be no such policy document on factoring for Nigeria or at least one that has been made public. Therefore, the country has jumped the policy stage and went straight to developing a framework through adopting the Afreximbank Model Law. By failing to start with a policy document, the country missed the chance to define a clear path on how it would like to design and structure its factoring regime, especially to suit the interest of SMEs. Such a policy document would have also helped set out what the proposed legal framework should cover. This would have given proper guidance on how the country should have adopted the

⁵⁵⁴ See Emejo J 'NEXIM Boss Urges National Assembly to Pass Nigerian Factoring Bill into Law' *Thisday* 29 January 2020 available at <https://www.thisdaylive.com/index.php/2020/01/29/factory-bill-will-to-boost-financial-inclusion-job-creation-says-nexim-bank-boss/> (accessed on 3 May 2021).

⁵⁵⁴ s 1 of the Bill.

⁵⁵⁵ Preamble of the Afreximbank Model Law (Page 4).

⁵⁵⁶ Chapter 4, Paragraph 4.6.

⁵⁵⁷ See Strauss S *Regulatory Framework for Factoring Egypt Financial Services: Egypt Financial Services Project, Technical Report No. 27* (2005).

⁵⁵⁸ Strauss (2005) 1.

Afreximbank Model Law. Nevertheless, since the Bill is yet to be passed into law, a policy document for factoring can still be developed.

5.5. Conclusion

The chapter has extensively discussed the proposed legal framework for factoring in Nigeria, the Factoring (Assignment of Receivables) Bill. The chapter summarised the Bill's salient provisions, followed by a critique of the Bill. The chapter also made proposals capable of making the Bill more tailored towards serving the financing and credit management interests of SMEs and the overall growth of the factoring industry. The proposals in the chapter draw the curtains on the discussion regarding the legal intervention that will facilitate the growth of Nigeria's factoring industry. The next chapter will summarise the findings from the study, draw conclusions and make final recommendations.



CHAPTER SIX

CONCLUSION AND RECOMMENDATIONS

6.1. Introduction

This chapter concludes this thesis and makes recommendations. The chapter is divided into two sections. The first section summarises the findings of the study. The findings mainly relate to results for the four research objectives defined for the study in chapter one. These objectives are reiterated as follows:

- a) Examining the advantages of factoring as a working capital and trade financing alternative, including how it compares to other financing sources;
- b) Investigating the legal, tax and regulatory barriers to the growth of factoring in Nigeria;
- c) Assessing if legal, tax and regulatory frameworks indeed impact a country's factoring industry using Egypt as a case study, and
- d) Appraising the proposed legal framework for factoring in Nigeria, the Factoring (Assignment of Receivables) Bill, to uncover its strengths and weaknesses in creating the desired regime for factoring to thrive, especially in the interest of SMEs.

The second section of the chapter outlines the study's recommendations. These recommendations aim to resolve the central research question: What legal, tax and regulatory interventions can influence the growth of factoring as an alternative source of financing for SMEs in Nigeria?

6.2. Summary of Findings

Chapter two made a case for the promotion of asset-based financing solutions – including factoring because they align better with the financing peculiarities of SMEs compared to other traditional and emerging sources of financing. These peculiarities found include that:⁵⁵⁹ (i)

⁵⁵⁹ Chapter 2, Paragraph 2.4.

The financing alternative is based on assets readily available to the SME such as movable properties and accounts receivable; (ii) The financing alternative is not based on conditions like the SMEs' financial records, collateralisable fixed assets, credit rating or other superfluous assets or qualities outside the reach of the SME, and (iii) The financing alternative aligns with SMEs' preference for debt instead of equity so that their ownership stake is not diluted as predicted under the Pecking Order Theory.

In addressing the first research objective and further supporting the findings from chapter two, chapter three argued that factoring is a better working capital financing alternative for SMEs compared to traditional bank lending.⁵⁶⁰ Some of the reasons given for the suitability of factoring over traditional bank lending include: (i) In addition to financing, factoring offers other credit manager services not available under traditional bank lending, (ii) Processing financing under factoring is faster, more flexible and requires less documentation compared to traditional bank lending (iii) Factoring circumvents challenges like information asymmetry, weak collateral base and low credit rating associated with traditional bank lending.

The findings in chapter three also supported that international factoring is a more favourable payment method that SMEs can use compared to letters of credit and other payment forms of international trade.⁵⁶¹ Additionally, it was projected that factoring could facilitate and sustain SMEs' access to financing during and after the COVID-19 pandemic, even as bank lending is likely to decline during the crisis period.⁵⁶² This projection was premised on how factoring sustained financing to SMEs and large corporates during and after the Great Depression and the GFC.⁵⁶³

The study's second objective was addressed in chapter four. The assessment in the chapter showed that the likely barriers inhibiting the growth of factoring include:⁵⁶⁴ the absence of a factoring law, lack of favourable tax incentives and the inadequate regulatory framework for finance companies. Other barriers identified include the poor awareness and knowledge about

⁵⁶⁰ Chapter 3, Paragraphs 3.10 & 3.11.1.

⁵⁶¹ Chapter 3, Paragraph 3.11.2

⁵⁶² Chapter 3, Paragraph 3.11.3.















⁵⁶³ Chapter 3, Paragraph 3.11.3.

⁵⁶⁴ Chapter 4, Paragraphs 4.4 & 4.5

factoring, the underdevelopment of Nigeria's credit information and credit insurance institutions, inadequate government support as well as the non-existence of supportive policy frameworks.

Chapter four further analysed the role of legal, tax and regulatory frameworks in influencing the growth of factoring using Egypt as a case study - the third research objective. The assessment of Egypt's factoring industry showed that some of the legal, tax and regulatory barriers identified in Nigeria's factoring industry were absent in that of Egypt.⁵⁶⁵ The results from the comparative examination are streamlined in Table 5 below:

Table 5: Comparison between Key Frameworks for Factoring in Nigeria and Egypt

#	QUESTION No  Yes 	NIGERIA	EGYPT
1.	There is a regulatory and supervisory authority for entities providing factoring services		
2.	There is a registered self-regulatory association for factoring firms		
3.	There is a specific national law on factoring		
4.	Value added tax does not apply to factoring transactions		
5.	Stamp duty does not apply to factoring transactions		
6.	There are no FOREX restrictions for independent factoring firms		
7.	The number of factoring firms that are FCI members in the country as of 2020	3	11
8.	The total volume of domestic factoring transactions recorded in 2019 (millions of Euros)	0	€464 million
9.	The total volume of international factoring transactions recorded in 2019 (millions of Euros)	0	€125 million

⁵⁶⁵ Chapter 4, Paragraph 4.6

By assessing and comparing the frameworks in Nigeria with that of Egypt, the study made two key findings:

- a) It found evidence supporting that the existence of favourable legal, tax and regulatory frameworks are likely to influence the growth of the factoring industry. This is demonstrated in the sustained growth of Egypt's factoring industry, where some of these favourable frameworks exist.
- b) It found evidence supporting the study's hypothesis that the inadequacy or unsupportiveness of the current legal, tax and regulatory frameworks on factoring in Nigeria might have fostered the poor performance of the country's factoring industry. The absence of the supportive frameworks is likely to have obstructed the emergence of more finance companies providing factoring, restricted the availability/supply of factoring services, and restrained SMEs' utilisation/demand of factoring in Nigeria.

The fourth and last research objective was addressed in chapter five through critiquing the Factoring (Assignment of Receivables) Bill. It was observed that the Bill offers a laudable step in creating a supportive framework for domestic and international factoring transactions in Nigeria. However, the study identified certain drawbacks that could undermine the framework's objectives in promoting factoring as an alternative source of financing for SMEs and generally weaken the factoring industry's growth.⁵⁶⁶

Some of the drawbacks identified in the Bill were attributed to the slavish adoption of the Afreximbank Model Law.⁵⁶⁷ It was observed that Nigeria's legal and economic objectives were not well considered in adopting the Model Law.⁵⁶⁸ Proposals were nevertheless made on how to improve the legal framework.⁵⁶⁹ In comparison to Egypt's factoring law, the following similarities and differences were noted, as shown in Table 6 below:

⁵⁶⁶ Chapter 5, Paragraphs 5.2 & 5.3

⁵⁶⁷ Chapter 5, Paragraph 5.4.

⁵⁶⁸ Chapter 5, Paragraph 5.4.

⁵⁶⁹ Chapter 5, Paragraphs 5.3 & 5.4

Table 6: Comparison between Nigeria's Proposed Factoring Law and Egypt's Factoring Law

#	QUESTION <i>No</i> ✗ <i>Yes</i> ✓	NIGERIA	EGYPT
1.	There is a clear definition of a factoring contract	✓	✓
2.	There is a definition and distinction between recourse and non-recourse factoring	✗	✓
3.	Credit risk protection is recognised as one of the core services that the factor can provide	✗	✓
4.	There is a definition and distinction between domestic and international factoring	✓	✓
5.	Both recourse and non-recourse factoring is recognised as a true sale transaction	✗	✓
6.	Contractual ban on assignment clauses are ineffective	✓	✗
7.	It is possible to assign future receivables	✓	✓
8.	Notification is not required for the effectiveness/validity of the assignment	✓	✗
9.	There is a guide for the form/contents of the factoring contract	✗	✓
10.	Registration is not required for the effectiveness/validity of the assignment	✓	✓

Overall, the study's arguments and findings are not intended to support a conclusion that factoring alone can solve SMEs' access to finance challenges. Such a conclusion is not only flawed but also unrealistic. Like other financing sources, factoring has its demerits and

limitations, which were highlighted in chapter three.⁵⁷⁰ This being the case, it cannot be projected as having the magic wand effect of overturning the SME financing gap in Nigeria. Instead, the favoured conclusion is that factoring can *complement* and *substitute* other financing sources, particularly for SMEs that engage in credit sales with high-value customers. If the SMEs cannot meet the credit conditions or approval requirements of banks and other formal external financing sources (credit rationed), they can explore factoring as a substitute. SMEs that can meet these requirements could still utilise factoring as a complementary financing alternative. To improve their chances of being financed through factoring, SMEs are advised to keep proper records, maintain good relations with their customers and source high-value domestic and international customers they can trade with on open account or trade credit terms.

6.3. Recommendations

Given the above findings, the study makes the following recommendations towards improving the availability and utilisation of factoring as an alternative source of financing for SMEs in Nigeria:



6.3.1. Policy, Legal and Tax Interventions

A national policy on factoring should urgently be developed by NFWG, Neximbank or the CBN. The policy should define the strategy for growing factoring and other invoice financing solutions in Nigeria and outline a mechanism for tracking the industry's progress. Along with developing a policy framework for factoring, the Factoring (Assignment of Receivables) Bill should be updated to address its current drawbacks. In particular, the Bill should be updated to reflect the following:

- a) The definition of a factoring contract should be updated to include credit risk protection (non-recourse factoring) as one of the core services of the factor;

⁵⁷⁰ Chapter 3, Paragraph 3.10.

- b) Clarify that credit risk protection services by factors shall not be considered an insurance product subject to the regulation of the National Insurance Commission (NAICOM);
- c) Distinguish between recourse and non-recourse factoring;
- d) Recognise both recourse and non-recourse factoring as a true sale transaction, while maintaining that for recourse factoring, the supplier shall remain liable to the factor for default by the customer.
- e) Recognise financing as a mandatory function of the factor.
- f) Identify the National Collateral Registry (NCR) as the registry for the optional registration of assignments.
- g) Clearly specify that registration of assignments is not mandatory for the effectiveness of the assignments of receivables.
- h) Specify that priority in the case of conflicting claims over assigned receivables shall be based on the first to notify the customer.
- i) Set out a template or minimum requirements for a factoring contract.
- j) Exclude the application of stamp duty and value-added tax to factoring transactions.
- k) The dispute resolution provision should be updated to (i) Stipulate the timelines for the CBN to constitute the panel of adjudicators and issue their rules of procedure (ii) Indicate that one adjudicator shall resolve disputes, and (iv) Maintain that the decision of the panel of adjudicators shall be final and only subject to judicial review in accordance with the Arbitration and Conciliation Act.

Following the Bill being updated, the National Assembly should expedite actions in passing the Bill into law. However, if this process remains protracted at the National Assembly, the CBN should, as an interim measure, proceed to issue a subsidiary legal framework for factoring transactions pursuant to its powers under the BOFIA and CBN Act. Most of the proposals mentioned above can be replicated in such a subsidiary legal framework, except regarding the exclusion of VAT and stamp duty. This is because a subsidiary legislation cannot override principal laws (Value Added Tax Act and Stamp Duty Act). In any case, the Finance Act, which has become a yearly omnibus legislation used to effect amendments to various tax laws, can be used to achieve this exclusion if the National Assembly continues to delay the passage of the Bill into law. The Value Added Tax (Modification) Order, a subsidiary legal framework issued by the Minister of Finance, can also be used to exclude the application of VAT to factoring transactions.

6.3.2. Regulatory Interventions

The following regulatory interventions are instructive:

- a) The CBN should issue a tailored or standalone regulatory framework for finance companies engaging in factoring and other invoice financing business as the Guidelines for Finance Companies of 2014 is an inadequate regulatory framework. In developing such a framework, the following should be taken into account: (i) The minimum capital requirement of ₦100 million should be reduced to ₦50,000 for finance companies that will only be engaging in domestic factoring, (ii) Timelines for the issuance of licences should be set out.
- b) The CBN should introduce specific foreign exchange access policies, platforms or window to improve foreign exchange access to finance companies engaged in international factoring.
- c) The CBN should expedite steps in instituting the receivables portal. As highlighted in the study, the proposed trade receivable portal can be structured similar to the Cadenas Productivas (Productive Chains) scheme administered by the Nacional Financiera (NAFIN).⁵⁷¹
- d) The CBN should look towards constituting a grant or finance support scheme for emerging factoring companies in Nigeria.

6.3.3. Institutional Interventions

The following institutional interventions are proposed:

- a) To boost both microcredit and factoring activities, efforts should be made to improve the credit reporting system. In this regard, the CBN should introduce policies or incentives to encourage more private companies to participate in the credit reporting system as credit registries.

⁵⁷¹ Chapter 4, Paragraph 4.5.2.

- b) The CBN, Neximbank and NAICOM should collaborate towards developing credit risk insurance products by operators in the insurance industry to support factoring activities.
- c) The Nigerian Factoring Working Group (NFWG) should coordinate and facilitate the establishment of a factoring association.

6.3.4. Capacity Building, Awareness and Knowledge Gap Interventions

There should be continuous capacity building for key stakeholders in the factoring industry, including factoring firms and relevant regulatory authorities. Additionally, all government parastatals and agencies interfacing with SMEs, including Neximbank, the Bank of Industry (BOI) and the Small and Medium Scale Industries Development Agency of Nigeria (SMEDAN), should intensify efforts in creating awareness among SMEs about factoring by organising seminars, sensitisation workshops and lectures.

Besides the foregoing factoring specific interventions, the Federal Government, through relevant agencies, including the Ministry of Industry Trade and Investment, the CBN, Neximbank, the BOI, the SMEDAN, and the Nigerian Export Promotion Council (NEPC), should continue to push policies and initiatives that promote non-oil exports.

Experts confirm that Nigeria has prospects for factoring. Implementing the above-listed proposals will go a long way in creating an enabling environment for factoring to thrive as an alternative source of financing for SMEs. Improving access to financing to the SME sector, whether through factoring or other cost-effective financing interventions, enables them to grow and develop. This growth and development are central to achieving numerous socio-economic objectives in Nigeria, including job creation, increasing tax revenues, poverty alleviation, and reducing Nigeria's overreliance on oil revenues. Centrally, it is critical for bolstering domestic and international trade, which is what Nigeria needs towards full economic recovery after the shocks caused by the COVID-19 pandemic.

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APPENDIX

FACTORING (ASSIGNMENT OF RECEIVABLES) BILL, 2016

Sponsored by: (Please insert if any)

A BILL

FOR

AN ACT TO PROVIDE FOR FACTORING TRANSACTIONS AND THE ASSIGNMENT OF RECEIVABLES, AND OTHER RELATED MATTERS.

PART I: DEFINITIONS AND INTERPRETATION

1. Definitions

In this Act, unless the context otherwise requires, -

"Assignment" means the transfer by agreement from the client to the factor of all 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 obligation is deemed to be a transfer;

"Access to Factor Financing Market" means the opportunity for a client or factor or debtor or credit insurer to participate or benefit from factoring contracts or related financial services under this act;

"Administrative Enforcement" means powers conferred on the bank by this act to regulate, supervise or sanction parties who have access to the factor financing market;

"Client" (in business sometimes called an "assignor" but not in this Act) means the person who assigns/transfers a trade receivable to the factor, whether or not the trade receivable was initially payable to that person;

"Competing Claimant" means:

- a. a creditor of the client prior to the assignment of the deliverable; or
- b. an insolvency administrator.
- c. another factor or assignee of the same trade receivable from the same client, including a person who, by operation of law, claims a right in the assigned trade receivable as a result of its rights in other property of the client;

"Domestic Assignment" means an assignment where the client and the factor are located in Nigeria at the time that the factoring contract is concluded between them;

- "Domestic Trade Receivable"** means a trade receivable where, at the time entering into the supply contract, the client and the debtor are located in Nigeria when the supply contract is concluded between them;
- "Existing Trade Receivable"** means a trade receivable that arises upon or before the factoring contract is concluded between the client and the factor;
- "Factor"** means the party to whom a receivable is assigned to in a factoring agreement;
- "Factoring Contract"** means a contract concluded between a client and a factor pursuant to which:
- a. the client assigns or will assign or will offer to assign to the factor trade receivables arising from supply contracts between the client and its debtors; and
 - b. the factor is to perform at least one of the following functions:
 - i. providing or procuring finance for the client, including loans and advance payments that are directly related to the value of each trade receivable and its perceived credit risk at the time the receivable is created or at any time thereafter; or
 - ii. maintenance of accounts (ledgering) relating to the assigned receivables; or
 - iii. collection of assigned receivables and
 - A. unless otherwise agreed, any collection is for its own account and not as agent for the client; but
 - B. any collection made by the client for the benefit of the factor is deemed to be made by the factor; and
 - c. notice of the assignment of the receivables may or may not be given to debtors.
- "Financial Contract"** means any spot, forward, future, option or swap transaction involving interest rates, commodities, currencies, equities, bonds, indices or any other financial instrument, any repurchase or securities lending transaction, and any other transaction similar to any of these transactions entered into in financial markets and any combination of these;
- "Financial Services"** means any service of a financial nature, including (but not limited to)—
- a. transactions on a regulated exchange;
 - b. insurance-related services consisting of—
 - i. direct life assurance;
 - ii. direct insurance other than life assurance;
 - iii. reinsurance and retrocession;

- iv. insurance intermediation, such as brokerage and agency;
- v. services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services;
- c. banking and other financial services consisting of—
 - i. accepting deposits and other repayable funds;
 - ii. lending (including consumer credit, mortgage credit, factoring and financing of commercial transactions);
 - iii. financial leasing;
 - iv. payment and money transmission services (including credit, charge and debit cards, travellers' cheques and bankers' drafts);
 - v. providing guarantees or commitments;
 - vi. financial trading (as defined in this Act)
 - vii. participating in issues of any kind of securities (including underwriting and placement as an agent, whether publicly or privately) and providing services related to such issues;
 - viii. money brokering;
 - ix. asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depository and trust services;
 - x. inter-bank payment systems, inter-bank payment agreements, settlement and clearing services for financial assets (including securities, derivative products and other negotiable instruments);
 - xi. providing or transferring financial information, and financial data processing or related software (but only by suppliers of other financial (f)services);
 - xii. providing advisory and other auxiliary financial services in respect of any activity listed in sub-paragraphs (i) to (xi) (including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy).

“Financial Trading” means trading for own account or for account of customers, whether on an investment exchange, in an over-the-counter market or otherwise, in—

- a. money market instruments (including cheques, bills and certificates of deposit) and other negotiable instruments and financial assets (including bullion);
- b. foreign exchange;
- c. derivative products (including futures and options);
- d. exchange rate and interest rate instruments (including products such as swaps and forward rate agreements);

e. transferable securities;

"Future Trade Receivable" means a receivable that arises after the factoring contract is concluded between the factor and the client;

"Insolvency Administrator" means the person or body, including one appointed on an interim basis, authorized in an insolvency proceeding to administer the reorganization or liquidation of the client's assets or affairs;

"Insolvency Proceeding" means a collective judicial or administrative proceeding, including an interim proceeding, in which the assets and affairs of the client are subject to control or supervision by a court or other competent authority or person for the purpose of reorganization or liquidation;

"International Assignment" means an assignment of a trade receivable where the client and the factor are located in different countries at the time of conclusion of the factoring contract;

"International Trade Receivable" means a trade receivable where, at the time the supply contract is concluded, the client and the debtor are located in different countries;

"Netting Agreement" means an agreement between two or more parties that provides for one or more of the following:

- a. the net settlement of payments due in the same currency on the same date whether by novation or otherwise; or
- b. upon the insolvency or other default by a party, the termination of all outstanding transactions at their replacement or fair market values, conversion of such sums into a single currency and netting into a single payment by one party to the other; or
- c. the set-off of amounts calculated, as set forth in subparagraph (b) immediately above in this definition, under two or more netting agreements;

"Notice of the Assignment" means a communication in writing which reasonably identifies the assigned receivable and the factor and states expressly that the receivable has been assigned to the factor;

"Priority" means the right of a person in preference to the right of another person and, to the extent relevant for such purpose, includes the determination whether the right is a personal or a property right, whether or not it is a security right for indebtedness or other obligation, whether the assignment accomplishes a true-sale of all right, title and ownership interest of the assignor in the receivable to the assignee, and whether any requirements necessary to render the right effective against a competing claimant have been satisfied;

"Proceeds" means whatever is received in respect of an assigned trade receivable, whether in total or partial payment, discharge or other satisfaction of the receivable; the term includes whatever is received in respect of proceeds; the term does not include returned goods;

"Prohibition against Assignment" means

- a. that part of any agreement between the initial or any subsequent client and the debtor or any subsequent factor which;
 - i. prohibits, restricts, or requires the consent of the debtor to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a right or interest in the receivable; or
 - ii. provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of set-off, claim, defence, termination, right of termination, or remedy under the supply contract; and
- b. any rule of law, statute, order or regulation which, in respect of the assignment of, or the creation, attachment, perfection, or enforcement of a right or interest in the receivable which:
 - i. prohibits, restricts, or requires the consent of the government, a governmental body or official, or debtor or
 - ii. provides that the same may give rise to a default, breach, right of set-off, claim, defence, termination, right of termination, or remedy;

"Receivable" means a contractual right to payment of a monetary sum conferred on the Factor by the Client;

"Regulatory Body" means the Central Bank of Nigeria (hereinafter referred to in this Act as "the Bank")

"Related Right" means a personal or property right which follows the receivables and in most cases are transferred alongside the receivable to the Factor by the Client. Where related rights are restricted by any law validly made, the Client shall hold same as a bare trustee and in favour of the Factor as the sole beneficiary. Provided such right is dealt with in a way so directed by the Factor and shall, where necessary turn all proceeds received therefrom to the Factor and shall, without prejudice to the generality of the foregoing include:

- a. rights of lien and stoppage in transit;
- b. guarantees and indemnities;
- c. documents of title;
- d. credit and other insurances;

- e. evidence of the amount and existence of a receivable;
- f. right to compromise disputes and issues receipts.

"Subsequent Assignment" means a further assignment of a receivable by the initial or any other factor to another person, including an assignment of a receivable back to the client;

"Supply Contract" means a contract between the client and the debtor from which an assigned receivable arises,

"Trade Receivable" means any of the following receivables:

1. a receivable representing the payment obligation for a credit card transaction; or
2. a receivable representing the amount owed to the client upon net settlement of payments due pursuant to a netting agreement involving more than two parties;
3. a receivable arising from a supply contract that is:
 - i. for the supply or lease or licence of goods or services, other than for financial services; or
 - ii. for a construction; or
 - iii. for the sale or lease of real property; or
 - iv. for the sale, lease or licence of industrial or other intellectual property or of proprietary information or of intangibles.

"Explanatory note:" Trade receivable does not include a receivable arising out of any transactions specifically excluded from the ambit of this Act by sections 4.1 and 4.2 (exclusions and limitations).

"Writing" means any form of information that is accessible so as to be usable for subsequent reference and where this Law requires a writing to be signed then that requirement is met if, by generally accepted means or a procedure agreed to by the person whose signature is required, the writing identifies that person and indicates that person's approval of the information contained in the writing;

2. Rules of Interpretation

- 1 A person is located in the state in which it has its place of business.
 - a. If the client or the factor has a place of business in more than one state, the place of business is that place where the central administration of the client or the factor is exercised.
 - b. If the debtor has a place of business in more than one state, the place of business is that which has the closest relationship to the supply contract.
 - c. If a person does not have a place of business, reference is to be made to the habitual residence of that person.
 - i. In the case of an individual, this is his principal residence.
 - ii. In the case of a person registered under law to undertake business, this is the place shown in such registration as its address.
- 2 Unless the context otherwise provides, the singular includes the plural and vice versa and a reference to any gender includes any other gender;

- 3 The headings to any section or part of this Act are for convenience only and are to be ignored in its interpretation;
- 4 Any reference to a "person" is to any individual, firm, company, unlimited partnership, limited liability partnership, corporation or partnership, unincorporated body, government, government agency or public authority, as the case may be;
- 5 The meaning of general words either introduced or followed by the words "other" or "including" is not to be limited by reference to any preceding word indicating a particular class of acts, matters or things;
- 6 Reference to a section or to a part is to the appropriate section or part of this Act.

PART II: SCOPE OF APPLICATION AND LIMITATIONS

3. Scope of Application

- 1 This Act applies to domestic and international assignment of domestic trade receivables or international trade receivables made under or pursuant to a factoring contract.
- 2 This Act also applies to subsequent assignments of the receivables referred to in subsection 1 of this section, provided that either:
 - a. the initial assignment was made under or pursuant to a factoring contract; or
 - b. any prior assignment is governed by this Act or Common Law.

4. Exclusions and Limitations

- 1 This Act does not apply to assignments made:
 - a. to an individual for his or her personal, family or household purposes; or
 - b. as part of the sale or change in the ownership or legal status of the business out of which the assigned receivables arose.
- 2 This Act does not apply to assignments of receivables arising under or from:
 - a. transactions on a regulated exchange;
 - b. financial contracts governed by netting agreements, except a receivable owed on the termination of all outstanding transactions;
 - c. inter-bank payment systems, inter-bank payment agreements or clearance and settlement systems relating to securities or other financial assets or instruments;
 - d. the transfer of security rights in sale or loan or holding of or agreement to repurchase securities or other financial assets or instruments held with an intermediary;
 - e. a letter of credit or independent guarantee;
 - f. financial services, including financial trading;
 - g. security interests created by other statutes;
 - h. landlord's liens except as to fixtures;
 - i. receivables arising from the sale or lease of real property;
 - j. transfer of interests in or a claim under a policy of insurance,
 - k. transfers of claims for wages or compensation by employees,

- l. the sale of a business,
 - m. set-off claims;
 - n. claims in court proceedings.
- 3 Nothing in this Act affects the rights and obligations of any person under the law governing negotiable instruments.
- 4 Nothing in this Act affects the rights and obligations of the client and the debtor under laws governing the protection of parties to transactions made for personal, family or household purposes.
- 5 Nothing in this Act:
- a. affects the application of the laws of any state, in which real property is situated, to either:
 - i. an interest in that real property, to the extent that the assignment of a receivable confers such an interest under that law; or
 - ii. the priority of a right in a receivable. to the extent that an interest in the real property confers such a right under that law.
 - b. makes lawful the acquisition of an interest in real property not permitted under the law of the state in which the real property is situated.

5. Regulation and Supervision

The activities of all factoring transactions or any other transaction envisaged under this Act shall be regulated and supervised by the Bank who also, pursuant to this section, is empowered to make regulations, policies and guidelines to ensure transparency, credibility and fairness of the activities of all parties participating in factoring transactions.

PART III – PARTY AUTONOMY

6. Party Autonomy

The client, the factor and the debtor may derogate from or vary, by agreement between them, any or all provisions of this Act relating to their respective rights and obligations except that the client and the debtor may not derogate from the provisions of sections 8(1) and (2) (nullification of prohibitions on assignment) or 9(2) (assignment of rights securing payment). Such an agreement does not affect the rights of any person who is not a party to the agreement.

PART IV – EFFECTS OF ASSIGNMENT

7. Effects of Assignment

- 1 Assignments of trade receivables are valid and effective unless stated otherwise in this Act.
- 2 An assignment is still effective as between the client and the factor or as against the debtor or as against a competing claimant, and the right of a factor may not be denied priority on the grounds that it is an assignment of more than one receivable, or of future receivables

or of parts of a receivable or of an undivided interest in receivables, provided that the receivables are described:

- a. individually as receivables to which the assignment relates; or
- b. in any other manner, provided that they can be identified as receivables to which the assignment relates either at the time of the assignment or, in the case of future receivables, at the time the supply contract is concluded.

3 Unless otherwise agreed, an assignment of one or more future trade receivables is effective without a new act of transfer being required to assign each receivable.

4 This Act does not affect any limitations on assignments arising from any other laws except as stated in subsection 1 of this section, section 8.1) and 8.2) (nullification of prohibitions against assignment) and section 9 (9.2) and (9.3) (transfer of related rights).

8. Nullification of prohibitions against assignments

1 An assignment of a receivable is effective notwithstanding a prohibition against assignment. The debtor may not avoid the supply contract or its payment obligations on grounds that the client is in breach of such a prohibition.

2 Neither the client nor the factor shall have any liability to the debtor for breach of a prohibition against assignment nor may the same be raised by the debtor as a defence or set-off to any claim for payment of an assigned debt.

3 Neither the Government, nor any governmental body or official may take any action against the client or the factor for an assignment of a receivable in breach of any prohibition against assignment.

9. Transfer of related rights

1 Upon the assignment of a receivable, its related rights are also transferred to the factor without any new act of transfer. If such a right is transferable only with a new act of transfer, under the law governing it, the client is obliged to transfer such right and any proceeds to the factor.

2 A related right is transferred under sub-section 1, of this section, even though there may be an agreement between the client and the debtor, or some other person, granting that right which prohibits, limits, makes impossible or imposes a condition or other restriction on the client's right to assign either the receivable or the right securing payment of the assigned receivable.

3 The client shall have no liability to the debtor or other person, referred to in sub-section 2 above, for breach of any agreement referred to in the sub-section (2) of this section. The other party to that agreement may not avoid the supply contract or the assignment contract or the right securing payment on the sole ground of such breach. The debtor may not raise the same as a defence or set-off to any claim for payment of an assigned debt.

- 4 The transfer of a possessory property right under sub-section 1 above does not affect any obligations of the client to the debtor or the person granting the property right, with respect to the property transferred under any existing law governing that property right.
- 5 where the related rights are restricted by any law validly made, the Client shall hold same as a bare trustee and in favour of the Factor as the sole beneficiary. Provided that such right is dealt with in a way so directed by the Factor and shall turn all proceeds received therefrom to the Factor; and
- 6 Provided that section 9 (1) does not affect any requirement under rules of law, other than this Law, relating to the form or registration of the transfer of any rights securing payment and/or evidencing ownership of the assigned receivable.

PART V – RIGHTS, OBLIGATIONS AND DEFENCES

10. Rights and obligations of client and factor

The mutual rights and obligations of the client and the factor arising from their agreement are determined by the terms and conditions set forth in that agreement, including any rules or general conditions referred to therein.

11. Representations by the client

- 1 Unless otherwise agreed between the client and the factor, the client shall be deemed to represent and warrant to the factor that at the time of conclusion of the factoring contract and in respect of each trade receivable to which the factoring contract applies:
 - a. the client has and will continue to have the right to assign each existing trade receivable and each future trade receivable free of all encumbrances including prohibitions on the assignment of the receivable and its related rights; and
 - b. the client has not previously assigned any existing trade receivable or future trade receivable to another person; and
 - c. the debtor does not and will not have any defences, rights of set-off and of the nature referred to in section 17 (1) or counterclaims;
 - d. there are no prohibitions against the assignment of the receivable.
- 2 Unless otherwise agreed between the client and the factor, the client does not represent that, in respect of any receivable to which the factoring contract applies, the debtor has, or will have, the ability to pay or otherwise discharge any receivable.

12. Right to give notice of the assignment

- 1 Unless otherwise agreed between the client and the factor, notice of the assignment and a payment instruction may be sent to the debtor by either the client or the factor or both.

However, after notice of the assignment has been sent, only the factor may send a payment instruction.

- 2 Without prejudice to the provisions of subsection (1) of this section or any other provision in any law relating to grant of notices, registration of the assignment by the client or the factor shall constitute proper notice to the debtor under this Act and to every other party whether or not such party received or had actual notice. Provided that the registry shall immediately send out a notice of registration of same to the debtor.
- 3 Pursuant to subsection (2) above, the date of registration shall be the determining factor in ascertaining priority over the interest accruable to any factor(s) over receivables derived from any factoring agreement.
- 4 Notice of the assignment or a payment instruction sent in breach of any agreement referred to in section 12 (1) is still effective for the purposes of section 16 (debtor discharged by payment).
- 5 However, nothing in 12 (1) or (2) affects any obligation or liability of the party in breach of such an agreement for any consequent damages.

13. Right to Payment

- 1 As between the client and the factor, unless otherwise agreed and whether or not notice of the assignment has been sent:
 - a. if payment in respect of the assigned receivable is made to the factor, then the factor is entitled to retain the proceeds and any goods returned in respect of the assigned receivable; and
 - b. if payment in respect of the assigned receivable is made to the client, then the factor is entitled to payment of the proceeds and also to any goods returned to the client in respect of the assigned receivable; and
 - c. if payment in respect of the assigned receivable is made to another person over whom the factor has priority, then the factor is entitled to payment of the proceeds and also to goods returned to such person in respect of the assigned receivable;
 - d. however, the factor may not retain more than the value of its right in the receivable.
- 2 **Misrepresentation, Fraud by client:**
 - a. A client who knowingly or recklessly represents or delivers an invoice to a factor or a debtor containing materially false statements as to identity, quantity, pricing or any other misrepresentation as evidencing his correct receivables from the debtor with a view to accessing any facility from the factor on the assignment of receivables under the invoice, commits an offence of fraudulent invoicing and shall be liable; if a company, to an amount in fine that is three times the value of the amount represented by the invoice; and if a person other than a company, to imprisonment for a term 2 years and a fine of two times the value of the invoice in

addition to other sanctions authorised by this act to be imposed by way of administrative enforcement.

- b. In the case of a company, where the offence was knowingly facilitated by a director or officer of the company, the director or officer shall be separately liable to imprisonment for a term of 2 years and a fine of two times the value of the invoice in addition to other sanctions authorised by this act to be imposed by way of administrative enforcement.
- c. where the offence committed under sub-section (1) involves unjust enrichment of the party charged but at the expense of another party in the transaction, proceeds of the fine imposed as punishment, shall be applied in the first instance as restitution to the innocent party to the extent of his loss and the balance, if any, shall be forfeited to the Government of the Federal Republic of Nigeria.

3 Misrepresentation, Fraud by Factor:

- a. A factor who knowingly presents instrument of assignment of receivables to a credit insurer for the purpose of procuring the credit insurer to underwrite his risk under factoring contract with the client with a view of obtaining unsecured facility or defrauding the credit insurer commits an offence of fraudulent underwriting and shall be liable; if a company, to an amount in fine that is three times in value of the amount represented by the invoice.
- b. In the case of a company, where the offence was knowingly facilitated by a director or other officer of the company, the director or officer shall be separately liable to imprisonment for a term of 2 year and a fine of two times the value of the invoice in addition to other sanctions authorised by this act to be imposed by way of administrative enforcement.
- c. where the offence committed under sub-section (1) involves unjust enrichment of the party charged but at the expense of another party in the transaction, proceeds of the fine imposed as punishment shall be applied, in the first instance, as restitution to the innocent party to the extent of his loss and the balance, if any, shall be forfeited to the Government of the Federal Republic of Nigeria.

4 Misrepresentation, Fraud by Debtor

- a. A debtor who knowingly issues a purchase order to assist a client to represent or deliver an invoice to a factor, containing materially false statements as to identity, quantity or pricing, as proof of his true indebtedness constituting receivables due to the client with a view to accessing any facility from the factor on the assignment of receivables under the invoice, commits an offence of fraudulent invoicing and shall be liable; if a company, to an amount in fine that is three times the value of the invoice; and if a person other than a company, to imprisonment for a term 2years and a fine of two times the value of the invoice in addition to other

sanctions authorised by this act to be imposed by way of administrative enforcement.

- b. In the case of a company, where the offence was knowingly facilitated by a director or officer of the company, the director or officer shall be separately liable to imprisonment for a term of 2 years and a fine of two times the value of the invoice in addition to other sanctions authorised by this act to be imposed by way of administrative enforcement.
- c. where the offence committed under sub-section (1) involves unjust enrichment of the party charged but at the expense of another party in the transaction, proceeds of the fine imposed as punishment shall be applied, in the first instance, as restitution to the innocent party to the extent of his loss and the balance, if any, shall be forfeited to the Government of the Federal Republic of Nigeria.

14. Protection for the debtor

- 1 Except as otherwise provided in this Act, an assignment does not, without the consent of the debtor, affect the rights and obligations of the debtor, including the payment terms contained in the supply contract.
- 2 This Act does not affect the rights and obligations of the debtor unless, at the time of conclusion of the Supply Contract, the debtor is located in Nigeria or the law governing the supply contract is that of Nigeria.
- 3 A payment instruction may change the person, address or account to which the debtor is required to make payment, but may not change:
 - a. The currency of payment specified in the supply contract; or
 - b. The state or country specified in the supply contract where payment is to be made to a state or country other than that in which the debtor is located.

15. Notice of the assignment to the debtor

- 1 Notice of the assignment or a payment instruction is effective when received by the debtor if it is in a language that is reasonably expected to inform the debtor about its contents. It is sufficient if notice of the assignment or a payment instruction is in the language of the supply contract.
- 2 Notice of the assignment or a payment instruction may relate to trade receivables arising after such notice or instruction has been issued.
- 3 Notice of a subsequent assignment shall be deemed to constitute notice of all prior assignments.

16. Debtor discharged by payment

- 1 Until the debtor receives notice of the assignment, the debtor is entitled to discharge a trade receivable by paying in accordance with the supply contract

- 2 After the debtor receives notice of the assignment then, subject to sub-section (3) to (8) of this section, the debtor can only discharge the trade receivable by paying the factor. However, if there are alternative payment instructions in either the notice of the assignment or in a writing received by the debtor subsequent to the notice of the assignment, then the debtor is discharged by making payment in accordance with such instructions.
- 3 If the debtor receives more than one payment instruction relating to a single assignment of the same trade receivable by the same client, then the debtor is discharged by paying in accordance with the last payment instruction received from the factor or client before payment.
- 4 If the debtor receives notification of more than one assignment of the same trade receivable made by the same client, then the debtor is discharged by paying in accordance with the first notification received.
- 5 If the debtor receives notice of one or more subsequent assignments, then the debtor is discharged by paying in accordance with the notice of the assignment in respect of the last of such subsequent assignments.
- 6 If the debtor receives notice of the assignment of one or more trade receivables, then the debtor is discharged by either paying in accordance with such notice or in accordance with the provisions of this section 16 as if the debtor had not received the notice. If the debtor pays in accordance with the notice, then the debtor is discharged only to the extent of the amount paid.
- 7 If the debtor receives a notice of the assignment from the factor, then the debtor is entitled to request that the factor provide, within a reasonable period of time, adequate proof of the assignment from the initial client to the initial factor and of any intermediate assignments that may have been made. Unless the factor does so, the debtor is discharged by paying in accordance with section 20 (non-recovery of payments) as if notice of the assignment from the factor had not been received. Adequate proof of an assignment includes but is not limited to any writing emanating from the client and indicating that the assignment has taken place or authorising payment to the factor.
- 8 Section 16 (1) to (7) do not affect any other ground upon which payment by the debtor to the person entitled to payment or to a competent judicial or other authority or to a public deposit fund discharges the debtor.

17. Debtor's defences and rights of set-off

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

- 2 The debtor may raise against the factor any other right of set-off, provided that it was available to the debtor at the time notice of the assignment was received by the debtor.

18. Agreement not to raise defences or rights of set-off

- 1 The debtor may agree with the client in writing, signed by the debtor, not to raise against the factor any defences and rights of set-off that it could raise pursuant to sections 17(1) and (2). Such an agreement precludes the debtor from raising against the factor such defences and rights of set-off. Such an agreement may be modified only by an agreement in a writing signed by the debtor. The effect of such a modification as against the factor is determined by section 19 (2) (modification of the supply contract).
- 2 The debtor may not waive defences or rights of set-off:
 - a. arising from fraudulent acts on the part of the factor; or
 - b. based on the creditor's incapacity.

19. Modification of the supply contract

- 1 An agreement between the client and the debtor concluded before notice of the assignment is received by the debtor, which affects the factor's rights, is also effective as against the factor whose rights are correspondingly affected.
- 2 An agreement between the client and the debtor concluded after notice of the assignment is received by the debtor, which affects the factor's rights, is ineffective as against the factor unless:
 - a. the factor at any time consents to it; or
 - b. the trade receivable is not fully earned by performance and either:
 - i. the modification is provided for in the supply contract; or
 - ii. in the context of the supply contract, a reasonable factor would consent to the modification.
- 3 Section 19 (1) and (2) do not affect any rights or obligations of the client or the factor arising from breach of any agreement between them.

20. Non-recovery of payments

Failure of the client to perform the supply contract does not entitle the debtor to recover from the factor a sum paid by the debtor to the client or the factor. However, the rights of the debtor against the client in respect of such sum paid are unaffected.

21. Law applicable to competing rights in a trade receivable

- 1 If more than one assignment is made by the same client of the same trade receivable, then priority amongst the factors, with regards to their entitlement to the trade receivable, will be determined by general rules of law and in the absence thereof then the first factor to give notice to the debtor shall have priority.

- 2 With the exception of matters that are settled in sub-section 1, above, and elsewhere in this Act, the law of the state in which the client is located governs the priority of the right of a factor in the assigned trade receivable over the right of a competing claimant.

22. Special rules on proceeds

- 1 If proceeds are received by the factor, then the factor is entitled to retain those proceeds to the extent that the factor's right and interest in the assigned trade receivable, however arising, has priority over the right of a competing claimant in the assigned trade receivable.
- 2 If proceeds are received by the client, then the right of the factor in those proceeds has priority over the right of a competing claimant in those proceeds to the same extent as the factor's right had priority over the right in the assigned trade receivable of that claimant if:
 - a. the client received the proceeds under instructions from the factor to hold the proceeds for the benefit of the factor; and
 - b. the proceeds are held by the client for the benefit of the factor separately and are reasonably identifiable and segregated from the other assets of the client, such as in the case of a separate deposit account containing only proceeds consisting of cash or.
- 3 Nothing in sub-section 2 above affects the priority of a person having, against the proceeds, a right of set-off or a right created by agreement and not derived from a right in the trade receivable.

23. Subordination

A factor entitled to priority may at any time subordinate its priority unilaterally or by agreement in favour of any existing or future factors.

24. Form of a factoring contract

- 1 A factoring contract concluded between persons who are located in the same state is formally valid as between them if it satisfies the requirements of either the law which governs such contract or the law of the state in which it is concluded.
- 2 A factoring contract concluded between persons who are located in different states is formally valid as between them if it satisfies the requirements of either the law which governs such contract or the law of one of those states,

PART VI – INTERNATIONAL FACTORING

25. Relations between factors in international factoring transactions

Relations between factors concerning the assignment between them of international trade receivables in international factoring transactions and which are commonly known as:

- a. export factoring; and

b. import factoring shall be governed by the rules, if any, of an association established for such purposes of which the factors are both members and in the absence of such rules, by the law agreed to between them. Unless agreed otherwise by the factors involved or regulated by the rules of an association of which the factors are both members, the law set out in Parts 1 to 5 of this Act shall apply accordingly. To the extent that any of the same shall not apply to any aspect of their relationship then the applicable law shall be that of the country in which the factor giving the assignment is located.

PART VII – JURISDICTION AND ALTERNATIVE DISPUTE RESOLUTION

26. Alternative Dispute Resolution

- 1 Any civil dispute, claim or disagreement arising out of or relating to the operations of, or obligations created pursuant to a factoring activity or transaction governed or permitted by this Act between a client, debtor factor, or credit insurer shall, in the first instance, be subject to alternative dispute resolution by presentation of complaint to a body of adjudicators which the Bank may empanel to review and resolve such matters.-
- 2 Unless the parties had agreed to a different alternative dispute resolution mechanism or where the Bank considers the dispute only amenable to adjudication under this act..
- 3 A pool of body of adjudicators shall be maintained by the Bank from which an ad hoc panel shall be drawn to hear each complaint.
- 4 The qualification of members in the pool shall be determined by the Bank, due regard being had to cognate experience, relevant expertise and reputational distinction equivalent or comparable to that of a senior management cadre officer in the banking and finance industry.
- 5 The quorum of adjudicators to constitute a panel shall be three members but two of the number may conduct proceedings in case of casual vacancy of a member, provided that where the panel is constituted of 2 members only, decisions of the panel on final award shall be unanimous.
- 6 The right of parties to fair hearing on any complaint before the panel of adjudicators shall be respected including legal representation by counsel if they so wish.
- 7 Pending final award, the panel of adjudicators may make interim orders to protect or preserve the subject matter or undisputed rights of the parties.
- 8 The panel shall have the power to interpret any law rules or regulations as may be applicable to the complaint brought before it.
- 9 The decision of the panel of adjudicators shall be binding on parties and enforceable by the Bank administratively where it is within its supervisory and regulatory authority (that is administrative enforcement); or otherwise by an application to a High Court vested with jurisdiction under this Act.
- 10 For the purpose of the foregoing subsections the Bank shall issue Rules of Procedure for the conduct of hearing of complaints by the body of adjudicators, the place of their sitting, fees payable for adjudication and remuneration of adjudicators.
- 11 The powers exercisable and reliefs which the panel may make in their final or interim award may include payment of money, adjustment of accounts by set off, directions to parties on performance of their outstanding contractual obligations, sanction by way of public apology, recommendation for prohibition or suspension from accessing the factor

financing market either for a definite period, in a certain sum or absolutely where the complaint adjudicated is shown to be capable of bringing the market into disrepute or impairing its credibility on account of the conduct by the party at fault.

- 12 Any grievance with the proceedings or award of the panel of adjudicators shall be reported to the Bank for redress; and only thereafter shall a party who remains unsatisfied, be at liberty to invoke the jurisdiction of the appropriate court for judicial review by giving 14 days' notice the other party and the Bank.
- 13 The bank shall maintain a register for administrative enforcement actions imposed under this act stating the party and the nature of sanction, which shall be accessible to industry players and credit bureau for the purpose of credit reading and due diligence in respect of parties accessing the Factoring Finance market on such terms as the bank may prescribe including payment of reasonable fees.
- 14 A suit arising from the proceedings before the panel or pursuant to unsatisfied report to the Bank shall only be as between the parties to the complaint, without the need to make the panel members or the Bank a party;
- 15 In all other respects, acts or omission of both the panel and the Bank done in good faith shall enjoy the protection conferred on the Bank by extant laws.

27. Jurisdiction & Dispute Resolution

- 1 Subject to Section 1 of this act, the Federal High Court or the State High Court, depending on the subject matter of the suit, shall have jurisdiction to hear and determine any civil dispute, claim or disagreement arising out of or relating to the operation of, or obligations created pursuant to, a factoring activity or transaction governed or permitted by this Act between a client, debtor, factor, or credit insurer, and shall be entitled to exercise all the powers vested in the panel of adjudicators and other provisions of this act.
- 2 The Federal High Court or the State High Court shall have jurisdiction to try all offences created under this Act.

PART VIII – ENTRY INTO FORCE, APPLICATION AND REPEALS

28. Commencement, short title etc.

- 1 This Act shall come into force on201...
- 2 This Act may be cited as the Factoring Assignments Act (please insert date).
- 3 This Law applies only to assignments if the factoring contract is concluded on or after the date when this Law comes into force.
- 4 The enactments and regulations specified in Schedule 1 are repealed or revoked to the extent specified.