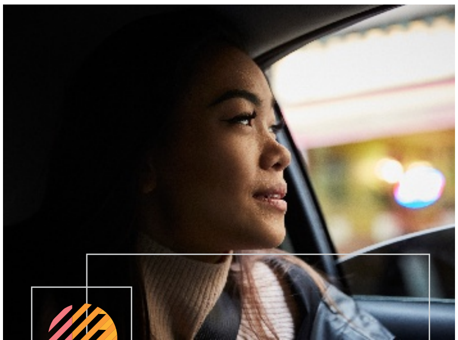
“Factoring” the Gap

Improving Access to Working Capital for MSMEs

Introduction



> ... only 0.3% of total commercial banking credit was availed to small businesses, according to the statistical bulletin from the Central Bank of Nigeria

Micro, Small and Medium scale businesses form the bedrock for most economies globally

Micro, Small and Medium-scale Enterprises (MSMEs) are crucial to economic output (GDP – Gross Domestic Product) and employment in most economies, especially developing/emerging economies. The World Bank estimates that formal SMEs contribute around 40% and 60% of total GDP and employment respectively in developing/emerging economies.

The trend is similar in Nigeria, where SMEs have contributed about 48% of the national GDP in the last five years, and account for over 90% of businesses and 84% of employment, according to the National Bureau of Statistics (NBS).

World Bank estimates that formal SMEs contrinute

40% of total GDP

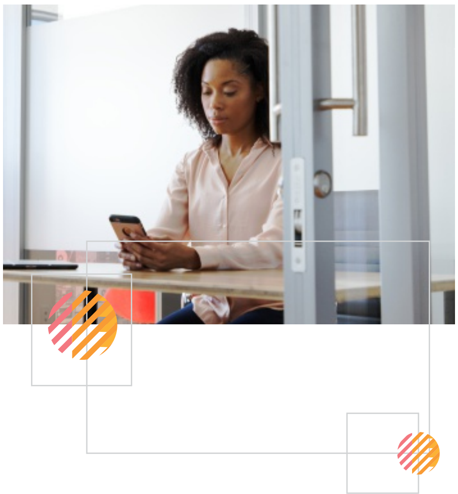
60% of employment

SMEs in Nigeria have contributed about 48%

90% of businesses

84% of employment

About PwC
At PwC, our purpose is to build trust in society and solve important problems. We’re a network of firms in 157 countries with more than 276,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more by visiting us at www.pwc.com/ng



Despite their importance to inclusive economic growth and job creation, SMEs in Nigeria are still plagued with many challenges, especially access to finance

To put this in perspective, only 0.3% of total commercial banking credit was availed to small businesses, according to the 2018 statistical bulletin from Central Bank of Nigeria (CBN). Unavailability of credit, coupled with other peculiar challenges faced by MSMEs in Nigeria, have created a financing gap of about N617.3 billion per annum, based on PwC estimates.

The Federal Government through the CBN, continues to set-up intervention funds aimed at addressing the financing challenges faced by MSMEs. However, we believe that creating frameworks that de-risk SMEs provide a more sustainable means to addressing financing issues, granting MSMEs access to the much-needed capital for daily operations and growth.

Factoring: a veritable and sustainable means of providing access to finance for MSMEs in Nigeria

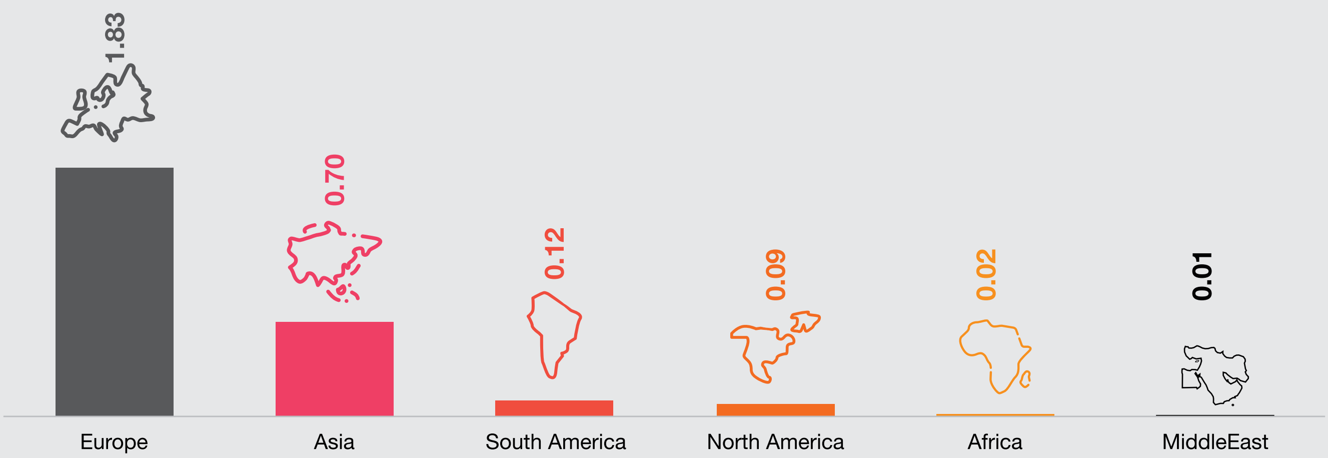
Factoring is the act of selling a business receivable to a third-party entity known as the Factor. The need for easy access to cash supports the necessity of Factoring as it is a short-term resort to financing a business.

Factoring could either be with “Recourse” or without (non) “Recourse. Recourse Factoring involves an agreement in which the client/business owner is required to buy back unpaid debts, which means that the credit risk stays with the business. In non-recourse Factoring, the credit risk stays with the Factor, that is in the event of unpaid debt, the Factor bears the cost. Factoring allows for growth as there is always ready capital to reinvest to make more profit.

Factoring eliminates the 30 to 60-day period lost to waiting for customers to pay their debts or payables. Additionally, it removes the costs to the MSME and eliminates the risks of bad debt. This is usually done at a cost that reflects the risks of the anchor business, (typically the corporates the MSMEs offer services to) which is typically lower than that of the MSMEs. Unlike bank loans, Factoring does not increase the liability of a business (due to interest payments) and does not require collateral or creditworthiness assessment.

Globally, Factoring was estimated at 2.77 trillion Euros in 2018, with an industry growth of 6.49%, according to the Factor Chain Institute (FCI). Europe accounted for about two-thirds (66%) of global Factoring volumes, followed by Asia with 25%, and the Americas with 8%. Five countries - United Kingdom (18.5%), France (18.5%), Italy (14.3%), Germany (14.1%), and Spain (9.6%) - account for c.75% of total value of Factoring in the European market.

Factoring Value by Region (Trillion in Euros)



Factoring in Africa is still in its infancy phase, with a market value of 22.1 billion Euros in 2018. South-Africa remained the dominant market, contributing 85% to total Factoring volumes, followed by Morocco at 15% and Egypt at 2%. Initiatives by the African Export-Import Bank (Afrexim Bank) and the Africa Chapter of FCI (Factor Chain Institute) have contributed to this progress. Additionally, the African Development Bank launched a Fund under the African Private Sector Assistance (FAPA) in 2018 to invest US$500,000 to finance new Factoring firms and to support existing firms, as well as contribute to the learning and development of Factoring in Africa.

In Nigeria, Factoring could unlock between US$1 billion to US$2 billion (€899m–€1.8bn) per annum in financing to MSMEs. Factoring can address most of the constraints to finance faced by MSMEs with respect to traditional banking facility such as high interest rates, credit profile constraints and inadequate collateral. Thus, Factoring provides MSMEs, especially the ones with quality receivables, access to cash-flows and capital that supports their business continuity and growth.

To this end, Afrexim Bank, the Nigerian Export-Import Bank (NEXIM) and FCI are working with regulators like the CBN to ensure that the necessary legal and regulatory framework are in place to support Factoring in Nigeria.

Blockchain Technology is crucial in extracting the inherent value of Factoring in the Nigeria market particularly with respect to invoice financing

A blockchain is a decentralised ledger of all transactions in a network. Using blockchain technology, participants in the network can confirm transactions without the need for a trusted third-party intermediary. Thus, blockchain is an essential technology that is gradually disrupting the landscape for invoice finance owing to its decentralized and transparent features as highlighted below:

- Blockchain helps to streamline processes in invoice financing, ensures data validity, reduces risks incurred and gives access to real-time information.
- By using invoice tokens in blockchain, fraudulent incidences will be reduced. This is because the information is available on a decentralized database, which will lead to greater transparency and better security among Factoring companies and lenders.
- Blockchain also enables international transactions. By using tokens, value can be shared rapidly and across borders. It also limits the barriers to entry for smaller companies that have access to tokens and want to buy invoices.

Interswitch and Microsoft partnership is a classic use case of blockchain technology in invoice financing in Nigeria. Interswitch and Microsoft Azure launched the Interswitch Blockchain Service which enables SMEs to access supply chain finance more efficiently in Nigeria. On the service, participating banks can reduce the risks incurred when providing loans to smaller companies. This shortens the delivery timeframe to SMEs to about 3 weeks.

Similar use cases can be found in other developed and emerging economies across the globe. In Australia, Invox Finance is a decentralised invoice lending platform built on blockchain for solving cash flow problems for businesses. Populous World, a UK based firm, aims to use blockchain technology to "disrupt the invoice finance industry". PayPie, based in Canada, also uses blockchain technology to perform risk assessments, bringing a higher level of trust and transparency to business financing.

In the Philippines, Acudeen, a technology company, facilitated the first blockchain invoice discounting transaction, in partnership with OpenPort Technology in 2018. In testing the new system, a blockchain-enabled invoice of 377,384 pesos was uploaded by an OpenPort user on the Acudeen platform. Within two hours, the invoice was purchased at a competitive price; highlighting the increased efficiency that the blokchain contributes to the Factoring industry.

"In Nigeria, Factoring could unlock between US$1bn-US$2bn per annum in financing to MSMEs"

Conclusion

Factoring provides a sustainable funding mechanism that enhances access to finance for MSMES compared to Government intervention funds. With proper regulations in place to provide guidance, and emerging technologies like blockchain to optimize transactions for businesses, Factoring should reduce the need for intervention funds and allow the government to utilize its limited resources to intervene in other key areas of the economy like education and health care.

Sources

- https://fci.nl/downloads/Annual%20Review%202019.pdf
- https://www.tralac.org/news/article/12730-afreximbank-urges-use-of-factoring-to-expand-africa-s-regional-value-chains.html
- http://www.cweic.org/factoring-supply-chain-finance-limited-granted-central-bank-of-nigeria-operating-licence/
- https://allafrica.com/stories/201903220086.html
- https://www.afdb.org/en/news-and-events/african-development-bank-and-afreximbank-sign-strategic-factoring-project-to-support-african-smes-18324
- https://allafrica.com/stories/201811020300.html
- https://www.afreximbank.com/afreximbank-proffers-factoring-to-ease-access-to-financing-for-african-smes/
- http://sme.ebi.gov.eg/Documents/A%20paper%20on%20SMEs%20Landscape%20in%20Egypt.pdf
- https://mpra.ub.uni-muenchen.de/93034/1/MPRA_paper_93034.pdf

Contacts

Andrew S. Nevin Ph.D
Partner and Chief Economist
andrew.s.nevin@pwc.com

Omomia Omosomi
Manager
omomia.omosomi@pwc.com

Mustapha Suberu
Senior Associate
mustapha.suberu@pwc.com

We would like to acknowledge Yemi Akoyi, Oyindamola Oladosu and Oyinkansola Ilupeju for their contribution to the development of this publication.