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REGULATORY BARRIERS FACING RECOURSE TO FACTORING FOR FINANCING MSMEs IN NIGERIA

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Mutiat Mobolanle Abdulsalam*
Obafemi Awolowo University, Nigeria

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Abstract

In this paper, we examine how factoring can be used to finance businesses and boost Nigeria's economy. We also analyse the legal framework for factoring in Nigeria and identify the regulatory challenges that prevent Micro Small and Medium Size Enterprises (MSMEs) from accessing this financing option. According to a World Bank estimate, MSMEs can contribute up to 60% of employment and 40% of GDP in developing countries like Nigeria. However, there is a $6.17 billion annual deficit in financing businesses, which negatively impacts the country's economy. Factoring can help bridge this gap and facilitate economic growth. To promote factoring in Africa, the African Export-Import Bank (Afreximbank) and other international bodies have committed funds and developed a model law to guide states in maximizing factoring for development. Meanwhile, there is a dearth of literature on the legal framework for harnessing factoring as a business finance tool for MSMEs in Nigeria. Paying attention to this will shed some light on the gap in business financing in Nigeria, the imperative for relying on factoring for business financing, and the regulatory issues inhibiting recourse to factoring by MSMEs in Nigeria. The paper relies on primary and secondary sources of information. The primary source included the Factoring Assignments (Establishment, Etc.) Bill 2017 and the Banking and Other Financial Institutions Act (BOFIA) 2020. While the secondary source included books, journal articles, newspaper publications, periodicals, and the internet. The study found that the lack of existing law governing factoring in Nigeria remains a major constraint. It is thus concluded that the adoption of a sound legal and policy framework is critical to the development of the Nigerian factoring industry and bridging the financial gap of MSMEs to aid development.

Keywords: Economy, factoring, Micro Small and Medium Size Enterprises MSMEs, legal and policy framework

*LL.B (Hons), LL.M, (University of Pretoria, South Africa), M.PHIL, (Obafemi Awolowo University, Ile-Ife, Nigeria), Doctoral Candidate (OAU, Ile-Ife), B.L., Lecturer, Department of International Law, OAU, Ile-Ife, Nigeria. Email mutiatabdulsalami@yahoo.com; Tel: +2348066188201

Introduction

Business is a vital economic activity that propels development. According to the United Nations Business and Sustainable Development Commission, the adoption of a sound business model could generate approximately $12 trillion and create 380 million jobs in developing countries by 2030.[1] The business activities of MSMEs drive massive job creation through the engagement of millions of people. Micro-enterprises are critical drivers of any functional economic system. MSMEs in most developed countries enjoy the conducive environment required for them to thrive; as a result, they are numerous and able to contribute to national income through the payment of taxes and levies.[2] The existence of a favourable business environment for MSMEs is also critical to the achievement of the Sustainable Development Goals (SDGs). They create jobs for the underprivileged and marginalized members of society. In doing so, they help to reduce unemployment and poverty while also advancing private-sector innovation.[3] The definition of micro-enterprises varies by country, depending on the location and economic well-being of the concerned state. Similarly, multilateral organizations such as the World Bank (WB) and the United Nations (UN), use different definitions when interpreting the term MSMEs. Micro-enterprises are the primary vehicles for wealth creation in various climes, accounting for approximately 95% of global GDP. The contribution of MSMEs may be summed up as the development of entrepreneurial skills, industry innovations, and job creation.[4] It is projected that as the global population increase, the number of MSMEs and their economic contribution will continue to

[1] Nazila Vali, 'More than philanthropy: SDGs are a $12 trillion opportunity for the private sector' (United Nations Development Programme 25 August 2017) https://www.undp.org/content/undp/en/home/blog/2017/8/25/More-than-philanthropy-SDGs-present-an-estimated-US-12-trillion-in-market-opportunities-for-private-sector-through-inclusive-business.html accessed 20 July 2022
[2] Tina Highfill *et al*, 'Measuring the Small Business Economy' (BEA Working Paper Series, WP2020-4, March 2020) https://www.bea.gov/system/files/papers/BEA-WP2020-4_0.pdf accessed 15 July, 2022
[3] 'Micro, Small and Medium Sized-Enterprises (MSMEs) And their Role in Achieving the Sustainable Development Goals' (UNDESA – Report on MSMEs and the Sustainable Development Goals, 2020) https://sdgs.un.org/sites/default/files/2020-07/SDO2020_Book.pdf accessed 27 July 2022
[4] Lyndon M. Etale and Opinion Bibiere Light, 'An Evaluation of the Impact of Small and Medium Enterprises (SMES) Development on Economic Growth in Nigeria' (2021) 9(1) International Journal of Small Business and Entrepreneurship Research 54-70

increase. It is projected that by the year 2030, MSMEs could aid the creation of up to 600 million jobs.[5]

According to the National Bureau of Statistics, MSMEs in Nigeria are responsible for 48% of the Gross Domestic Product (GDP), 90% of established businesses, and 84% of job creation between 2013 and 2018.[6] Thus, efforts to eliminate poverty and create jobs in the global south need to incorporate the empowerment and strengthening of micro-enterprises. However, the economic contribution of MSMEs in Nigeria is inhibited by over-taxation and other regulatory challenges.

Micro-enterprises require coherent legal and policy frameworks that take into account their unique needs to make viable economic contributions to developing economies. This is especially important in this era of digitalization and trade liberalization, as it enables them to capitalize on newly opened domestic, regional, and international markets.[7] In Africa for instance, the adoption of the African Continental Free Trade Agreement (AfCFTA) in April 2019 and its assumption of the force of law in May 2019 opens up new market frontiers capable of enhancing intra-African trade by over 90%.[8] For Nigeria to maximize the market access opportunity of AfCFTA, there is a need to address the problems undermining the performance of MSMEs.[9]

One of the major challenges that undermine the performance of MSMEs in Nigeria is the lack of access to adequate financing. According to the CBN, only a miniature portion of the total available

[5] The World Bank 'Small and Medium Enterprises (SMES) Finance: Improving SMEs' access to finance and finding innovative solutions to unlock sources of capital' (2015) https://www.worldbank.org/en/topic/smefinance accessed 27 July 2022

[6] Andrew Nevin *et al*, '"Factoring" the Gap: Improving Access to Capital of MSMEs' (PWC 2020) https://www.pwc.com/ng/en/assets/pdf/factoring-the-gap.pdf accessed 20 July 2022

[7] Musawenkosi Ngibe, 'A proposed integrated model for innovative business leadership for the attainment of sustainable growth in small and medium manufacturing enterprises in KwaZulu-Natal' (Unpublished PhD thesis, 2020) https://openscholar.dut.ac.za/bitstream/10321/3521/3/Final%20thesis-M%20Ngibe%20-%2029-04-2020_Redacted.pdf

[8] Nwisienyi, Kenechukwu, John Paul and Okonkwo, Ikeotuonye Victor, 'Nigeria's Economy and the African Continental Free Trade Agreement: Issues and Prospects' (2022) 2(2) Contemporary Journal of Banking and Finance 53898-5923.

[9] 'Factoring in Africa to Support Trade Development: Challenges and Opportunities for Growth through Capacity Development' (Africa Portal, 31 March 2021) https://www.africaportal.org/publications/factoring-africa-support-trade-development-challenges-and-opportunities-growth-through-capacity-development/ accessed 25 July 2022

commercial bank credits of 0.03% was available to MSMEs in 2018. The inability of MSMEs to fund their businesses creates a financial gap of about N617.3 billion in the economy annually.[10] Furthermore, the global financial crisis has intensified the problems which small businesses face, as they have experienced the double shock of a credit crunch and a decrease in demand for their goods and services. [11]Since the global economic meltdown of 2008 which caused depression in the Nigerian economy, the economy did not recover fully. Rather, the combined effect of the 2016 economic crisis caused by the sharp fall in global oil prices, the economic problems caused by the COVID-19 pandemic, as well as the Russia-Ukraine war has further depressed the economy, leading to adverse effect trade, and investment, infrastructure, and financial services.[12] These hurt the cash flow and liquidity of micro-enterprises. It has caused the failure of many small businesses and caused an increase in the rate of unemployment.[13] The contraction in fiscal space has also led to the introduction of more stringent conditions by banks and other borrowers, these include high interest rates, credit profiling, and the requirement for collateral security.[14]

Across the globe, factoring is being harnessed for financing MSMEs. Factoring involves sales of business receivables to the third-party entity commonly referred to as the Factor. In 2018, approximately 2.77 trillion Euros were invested in factoring globally, assisting industry growth by 6.49%. It is estimated that factoring could unlock between US$I billion and US$2 bill ion per year for financing micro-enterprises in Nigeria.[15] In Africa, and more particularly in Nigeria, credit factoring is in its infancy. Consequently, there is a paucity of literature on the legal

[10] Zericho R. Marak and Dilip Ambarkhane, 'Determinants of Accounts Receivables Financing: India and Other Asian Economies Perspectives' (2020) 67(1-2) Sage Journals https://journals.sagepub.com/doi/abs/10.1177/0019466220941661?journalCode=ieja accessed 20 July 2021

[11] Sahana Roy Chowdhury, 'Impact of Global Crisis on Small and Medium Enterprises' (2011) 12(3) Sage Journals https://journals.sagepub.com/doi/10.1177/097215091101200303 accessed 25 February 2021

[12] 'Nigeria's Economy Faces Worst Recession in Four Decades, says New World Bank Report' (World Bank Press Release, 25th June 2020) https://www.worldbank.org/en/news/press-release/2020/06/25/nigerias-economy-faces-worst-recession-in-four-decades-says-new-world-bank-report accessed 28 February 2021.

[13] Neil Ford, 'How is the war in Ukraine impacting Nigeria's banks?' (African Business, August 29, 2022) https://african.business/2022/08/energy-resources/how-is-the-war-in-ukraine-impacting-nigerias-banks/ accessed 26 December 2022.

[14] 'Stringent Bank Requirements Challenge To Nigeria's SME Growth – Alakija' (Daily Trust, May 3rd 2022) https://dailytrust.com/stringent-bank-requirements-challenge-to-nigerias-sme-growth-alakija/ accessed 26 December 2022

[15] (n-6 above)

and policy framework for factoring as a viable tool for financing micro-enterprises in Nigeria, prompting this study.

The Concept of Micro-Enterprises

Like any other concept in law, the term micro-enterprises lack a uniform definition as its meaning may be influenced by the economic strength of the concerned state. However, certain factors are put into consideration to ascertain whether or not a firm falls within this category. These include employee strength; value of the business assets and profit being made from the activities of the employee. Hence, the country-to-country variations. In a survey of 132 countries conducted by the IFC, it was found that the most common variable used in defining MSMEs is the number of employees, stated as being less than ten people.[16] Micro-enterprises are defined by the World Bank as individuals or firms with total assets of less than $100,000, total sales of less than $100,000, and fewer than ten employees. Micro-enterprises are defined in the European Union (EU) as businesses with fewer than ten employees, a turnover of less than two million pounds, and a balance sheet of less than two million pounds.[17] The National Policy on MSMEs in Nigeria defines micro-enterprises as business entities employing fewer than ten people and operating on a net asset of less than N5 million, excluding the value of land and buildings owned by the enterprise.[18] A clearer classification was given by the Bank of Industry (BOI), which classify as micro-enterprises, businesses with less than 10 employees, less than 5 million naira in total assets, and less than 20 million naira worth of total turnover. The small enterprises have between 11 and 15 employees, with assets being between 5 and 100 million naira and turnover of less than 100 million naira.

[16] Parth S. Tewari *et al,* 'Competitive Small and Medium Enterprises A diagnostic to help design smart SME policy' (The World Bank 2013) http://documents1.worldbank.org/curated/en/534521468331785470/pdf/825160WP0P148100Box379861B00PUBLIC0.pdf accessed 10 June 2021

[17] Monika Raczynska, 'Definition of Micro, Small and Medium Enterprise Under the Guidelines of The European Union' (2019) 12(2), Review of Economic and Business Studies 165-190

[18] Ebitu Tom *et al* 'An Appraisal of Nigeria's Micro, Small and Medium Enterprises (MSMES): Growth, Challenges and Prospects' (2016) 5(4) British Journal of Marketing Studies 21-36

While medium size enterprises are those with between 51 and 200 employees, more than 100 but less than 500 million worth of total assets, and a turnover that is less than 500 million naira.[19] The MSMEs are key to driving business innovation and competitiveness while creating jobs to address unemployment, poverty, and underdevelopment.[20] The informal nature of most MSMEs in Nigeria poses a significant challenge to their classification. This makes leveraging available funding opportunities difficult. According to the National Bureau of Statistics data from 2012, of the 17,286,671 MSMEs in Nigeria, micro-enterprises, small enterprises, and medium enterprises account for approximately 17,261,753, 21,264, and 1,554 respectively.[21] Although micro-enterprises constitute the vast majority, they are mostly unregistered and informal in nature. In addition, there is a general lack of adequate data on the number of micro-enterprises and the challenges they face in trying to grow their businesses. This necessitates the law and policy instruments to address the problem of registration using recent data.

The Imperative for MSMEs in Nigeria

Globally, MSMEs are known to be the backbone of the economy contributing an average of 40% of GDP, 50% of employment, and constitutes 90% of businesses.[22] In Nigeria, an estimate of about 96.7% of businesses are within the category of MSMEs, contributing about 50% to the national income.[23] In terms of their legal status, 73% of MSMEs in the country are sole proprietorship businesses while 14% are registered as limited liability companies. The remaining are 6% partnerships, 5% faith-based bodies, 1% cooperative societies, and 1% others. Furthermore,

[19] Sunday Ade Bello, 'Bank of Industry Micro, Small and Medium Enterprises Financing and Poverty Reduction in North-Central Nigeria' *Journal of Global Economics and Business* (2022) 2(8) 1-18

[20] Ardic, Oya Pinar, Mylenko Nataliya and Saltane Valentina, 'Small and Medium Enterprises – A Cross Country Analysis with a New Data Set' (World Bank Policy Research Working Paper 5538, January 2011) https://openknowledge.worldbank.org/handle/10986/3309 accessed 10June 2021

[21] Joseph Babatunde, '17 Million SMEs Not Registered with Corporate Affairs Commission' (Bank of Industry 2020) https://www.boi.ng/17-million-smes-not-registered-joseph-babatunde/ accessed 15 July 2021

[22] Olukayode Pitan, 'MSMEs As An Engine of Growth For Economic Development' (Bank of Industry, 28 October 2021) https://cisinigeria.org/wp-content/uploads/2021/12/MSMEs-as-an-Engine-of-Growth-for-Development.pdf accessed 10 March 2023.

[23] Anthony Otaru, 'Over 39.65m MSMEs operate in Nigeria, says report' (The Guardian, 13January, 2022) https://guardian.ng/business-services/over-39-65m-msmes-operate-in-nigeria-says-report/ accessed 10 March 2023.

MSMEs account for 55% of wholesale and retail trade, 10-15% of manufacturing, and 50% of industrial jobs in Nigeria.[24]

MSMEs are crucial for job creation, elimination of poverty, unemployment, and attainment of the United Nations (UN) Sustainable Development Goals (SDGs) agenda. They encourage innovation and decent work for all. In Nigeria, a large population of women and youths across communities, including the poor communities are engaged as and by MSMEs. As of the year 2021, official figures have the number of MSMEs in Nigeria at 41.5 million, which contributes 50% of the GDP and make-up 86.3% of the workforce.[25] Despite these contributions, MSMEs in Nigeria are not maximizing their potential for economic development. There is a need to further improve their economic performance and drive requisite value addition.[26] This will create a nexus between the increase in the number of MSMEs, their value addition, and economic contributions.[27] There are several challenges inhibiting the performance of MSMEs in Nigeria, these include access to finance, inefficient management capacity, inadequate infrastructure, multiple taxation, corruption, and regulatory challenges. However, access to finance is the most pressing among these problems, hence the study.

Sources of Finance for MSMEs

Among the various challenges facing MSMEs, access to finance remains the most pressing. There are two major sources of finance opened to businesses, they are debt finance and equity finance. Debt finance is crucial to the growth of MSMEs, however in developing economies such as Nigeria, MSMEs are often unable to meet the terms to secure loans. MSMEs in Nigeria are said

[24] PWC MSME Survey, 2020

[25] Chukwuemeka Uwanaka, 'World MSME Day 2021: Enhanced financing for Nigerian small businesses' (The Cable, 8th July 2021) https://www.thecable.ng/world-msme-day-2021-enhanced-financing-for-nigerian-small-businesses#comments accessed 10 March 2023

[26] Oluyemi T Adeosun and Ayodele I Shittu, 'Small–medium enterprise formation and Nigerian economic growth' *Review of Economics and Political Science* (2022) 4(7) 286-301.

[27] Ogunmuyiwa, Micheal Segun, and B. A. Okunleye. 'Small and medium enterprises and sustainable economic development in Nigeria' *Journal of Varna University of Economics* (2019) 63(3) 171-182.

to have an annual finance deficit of N617.3 billion as the number that can access adequate funding is less than 5%.[28]

Debt Finance

Debt financing is a very common method of business finance. It entails access to external finance, whether formally or informally. It includes borrowing loans from banks and other companies or financial institutions to raise capital for business. The principal is repayable at a later time while some interest may be repaid before the loan becomes matured for repayment. Debt financing can be instrumental in facilitating the rapid growth of businesses when loans are obtained at low-interest rates. Frequent borrowing may also be useful for establishing the company's creditworthiness. However, on the flip side, the business must repay both the principal and interest. Another disadvantage is the difficulty of obtaining loans. The common forms of debt financing for MSMEs include overdraft, trade credit, factoring, hire-purchase, leasing, and bank loans. In Nigeria, MSMEs are often viewed as informal and they mostly lack the collateral needed to secure bank loans, as a result, they are often confined to exploring informal sources of finance. The informal debts may be loans from friends, colleagues, associates, relatives, thrift lenders, and cooperative societies. It is found that about 60% of MSMEs in Nigeria rely on informal credit for their financing.[29] Access to bank credit is a major challenge that MSMEs in Nigeria face. In the national arena, only about 4% of the about 40 million MSMEs have access to bank credit. This has adversely affected the ability of MSMEs in Nigeria to drive significant economic growth. Although there are several other problems such as inadequate bookkeeping, lack of a good business plan, corruption, and poor infrastructure, access to finance is the most pressing problem.[30]

Equity Finance

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[28] Green Christopher, Colin Kirkpatrick and Victor Murinde. 'Finance for small enterprise growth and poverty reduction in developing countries' *Journal of International Development: The Journal of the Development Studies Association* (2006) 18(7) 1017-1030.

[29] Mohammed Ibrahim and Ali Ibrahim, 'The effect of SMEs' cost of capital on their financial performance in Nigeria' *Journal of Finance and Accounting* (2015) (3) 8-11

[30] Femi Adekoya, 'Only 4% of MSMEs have access to credit in Nigeria' (*The Guardian*, 1st July 2021).

Equity financing is another method of financing businesses. It involves the sales of company securities such as shares, to investors to raise capital to be invested in the business. Equity financing is crucial for companies that are just starting up. The investors are stakeholders in the company and they make a profit as the value of the shares increases. The investors are entitled to dividends from the company's profit every year. The advantages of equity financing include the involvement of lesser risk compared to debt financing. Also, it is a long-term borrowing and does not involve the actual repayment to shareholders. A major disadvantage is that venture capital issuers may hold such an amount of security that makes them major stakeholders in the business.[31] As far as funding of businesses in Nigeria is concerned, the larger proportion of about 68.3% of businesses are funded through personal savings. Approximately 21.6% of businesses are funded through loans while family sources accounted for the funding of about 14.4%.[32]In 2019, the Development Bank of Nigeria through a World Bank initiative awarded to MSMEs about US$243.7 million in credit, reaching up to 50,000 end borrowers, through 7 banks and 10 Microfinance banks.[33] Meanwhile, across the globe, factoring is a major source of financing for MSMEs, with the factoring market projected to grow by 7.54% between 2022 and 2027. [34]It is therefore necessary for the respective developing state to create the requisite conducive environment for a functional factoring industry. This could boost the performance of MSMEs and aid economic development.

Factoring as a Means of Financing MSMEs

Factoring is a form of debt financing by which companies can improve their cash flow and improve their credit management. It is a supply chain finance method that can help with international trade.

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[31] B.O.Awoyemi, and A.A.Makanju, 'The Growth Prospect and Challenges ofFinancing Micro, Small and Medium Scale Enterprises (MSMEs) in Nigeria' *European Journal of Business and Management Research* (2020) 5(4) 1-6.

[32] Yemi Kale, 'National Survey of Micro, Small and Medium Enterprises' (2017) 31 https://smedan.gov.ng/images/NATIONAL%20SURVEY%20OF%20MICRO%20SMALL%20&%20MEDIUM%20ENTERPRISES%20(MSMES),%20%202017%201.pdf accessed 10 April 2023.

[33] 'Small and Medium Enterprises (SMEs) Finance' (The World Bank) 2022 https://www.worldbank.org/en/topic/smefinance accessed 10 April 2023

[34] 'Factoring Market by Type, Application, and Geography - Forecast and Analysis 2023-2027' (Technavio Report 2022) https://www.technavio.com/report/factoring-market-industry accessed 10 April 2023.

Supply Chain Finance (SCF) refers to instruments used to finance businesses, mitigate risks, and facilitate access to working capital to facilitate supply. They aid in the resolution of financial issues that can stifle demand and supply. Factoring, also known as invoice discounting or account receivable financing, assists the seller in bridging the gap in supply chain logistics caused by a lack of funds by allowing the seller to sell account receivable from the buyer to a third party known as the factor. [35]Recourse to factoring dates as far back as the time of the ancient Mesopotamians who relied upon it in conducting businesses. Likewise, the ancient Babylonian recognized factoring in the Hammurabi Codes. [36]In the modern era, factoring has gained wide acceptance, and it accounted for 80% of SCF transactions in 2019.[37]

A standard definition of factoring was given in the UNIDRIOT Convention on international factoring, in its Article 1(2) (a-c) wherein factoring was defined as:

> *a contract concluded between one party (the supplier) and another party (the factor) under which:*
>
> *(a) the supplier may or will assign to the factor receivables arising from contracts of sale of goods made between the supplier and its customers (debtors) other than those for the sale of goods bought primarily for their personal, family, or household use;*
>
> *(b) the factor is to perform at least two of the following functions:*
>
> *i. finance for the supplier, including loans and advance payments;*
>
> *ii. maintenance of accounts (ledgering) relating to the receivables;*
>
> *iii. collection of receivables;*
>
> *iv. protection against default in payment by debtors*
>
> *(c) notice of the assignment of the receivables is to be given to debtors.*[38]

[35] A brief history of factoring(accounts receivables financing), https://www.rtsfinancial.com/articles/brief-history-factoring-accounts-receivable-financing accessed 26 June 2021

[36]Ibrahim Ahmed Ibrahim Farag, 'Factoring and Accounts Receivable Discounting' (2013) file:///C:/Users/ALHIKMAH/Downloads/RecievableFinancing.pdf accessed 10 June 2021

[37] Peter Mulroy, 'FCI: Confirmed growth in the global factoring volume in 2019' (Trade Finance Global 5 Jun2 2020) https://www.tradefinanceglobal.com/wire/fci-confirmed-growth-in-the-global-factoring-volume-in-2019/ accessed 15 June 2021

[38] UNIDROIT Convention on International Factoring 1988, (online) https://www.jus.uio.no/lm/unidroit.factoring.convention.1988/portrait.pdf accessed 3rd March 2021.

According to the convention, large-scale transactions involving the financing of commercial as opposed to individual purchases are anticipated. The seller is safeguarded in this situation from the seller's incapacity to raise finance for the transaction shortly by the factor, who raises funds for receivables. To accomplish this, factoring creates a tripartite structure by transferring the financing liability to the seller's receivables. The supplier is required to give the debtor notice of the assignment of receivables to give sufficient security for the amount owed by the customer to the supplier.

More recently, AFREXIM model law defines factoring in its Part 1 as:

> *a contract concluded between a client and a factor under which:*
>
> *(a) the client assigns or will assign or will offer to assign to the factor trade receivables arising from a supply contract 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 is perceived credit risk at the time the receivable is credited or at any time thereafter; or*
>
> *ii) maintenance of accounts (ledgering) relating to the assigned receivables;*
>
> iii) *collection of assigned receivables and….*[39]

The AFRXIM model legislation on factoring is more modern and comprehensive than the UNIDRIOT model law. The former thinks that factoring covers forthcoming or current assignments. Legislators are expected to adopt domestic factoring legislation that covers a larger range of procedures in addition to ordinary factoring, like reverse factoring and invoice discounting. Besides these functions, it also facilitates the collection of allocated receivables and provides clients with capital via trade receivables. It also serves as a ledger for trade receivables. Another key point is that the supplier is not compelled to give the factoring company such information because the notification of receivables may be seen to be a private document.

[39] AFREXIMBANK Model Law on Factoring 2016. Accessed online elibrary.acbfpact.org>10.dir accessed 25 July 2021

A broader approach is adopted by the UNCITRAL Convention on the Assignment of Receivables in International Trade (2001).[40] Receivables products, such as credit factoring, securitization, and forfeiting, are covered by this Convention. It adopts a wider scope which is necessary to cover all types of factoring. Despite the vibrant and inclusive nature of the convention, the model laws have enjoyed limited reception in the international arena and their effects to date have not been documented.[41] However, some countries have signed the Convention but they are yet to take further steps necessary to make it effective. These include Luxembourg, Madagascar, and the United States.[42]

The definitions of factoring contracts examined above clarify the salient features, quirks, and applications of such agreements. It is thus a long-term agreement between a supplier of goods and a factor, in which the factor purchases accounts receivable from the buyer or debtor from the seller in advance. The factoring agreement drives the supply agreement because the supplier can only finalize the sales contract after the factor has verified the debtor's creditworthiness, established the debtor's credit limits, and expressed the intent to bear such risk. The provider is guaranteed to be paid for the supply as a result of the factoring agreement and has access to liquid cash.[43]

Forms of Factoring Contracts

In general, there are two types of factoring contracts: recourse and non-recourse. In a non-recourse factoring agreement, the risk of the debtor's inability to make payments is assumed by the factor. Recourse factoring, on the other hand, transfers responsibility for payment of the goods to the supplier in the event of a factor's payment default. Additionally, the recourse or non-recourse factoring may be revealed or kept a secret. Undisclosed factoring occurs when the debtor is unaware that the supplier's receivable was assigned to the factor. Contrarily, in the event of

[40] Francis Kofi Korankye-Sakyi, 'Factoring as a means of promoting small and medium scale enterprises: The case for a legal framework for credit factoring in Ghana' (Unpublished LL.M thesis, 2019) https://www.researchgate.net/publication/343988627_ accessed 25 July 2021n

[41] Anjanette H. Raymond, 'Cross-Border Secured Transactions: Ongoing Issues and Possible Solutions (2010) 1(101) Elon University Law Review 102-121

[42] D Chardon 'ICC endorses UNCITRAL Convention on the Assignment of Receivables in International Trade' Paris

[43] Leora Klapper, 'The Role of Factoring for Financing Small and Medium Enterprises' (2005) 30(11) Journal of Banking and Finance 3111-3130.

disclosed factoring, the buyer, who is also the debtor, is informed of the assignment of receivables owing to the supplier from the buyer.[44]

Real factoring and quasi-factoring are two other categories into which factoring may fall. Real factoring includes additional auxiliary services like crediting, ensuring that payments are received, and performing other associated tasks. As a result, in a real factoring contract, the factor assumes the role of the creditor by asserting claims against the supplier's debt, paying in advance for the goods of the buyer, maintaining accounting records, and assuming the risk if the buyer experiences financial difficulty.[45] The terms "factoring with right of recovery" and "factoring without right of recovery" can also be used to categorize factoring. The factoring agreement gives the factor the right to bring claims against the supplier of the products if the buyer is unable to make payment when due. This is known as factoring in the right of recovery. In contrast, factoring without a right of recovery denies the factor the ability to compel payment from the seller if the buyer defaults on a payment.[46]

In addition, factoring can be categorized according to the legal jurisdiction of the contract's parties. In that situation, our options include both domestic and international factoring. Additionally, there are two additional subcategories of international factoring: export factoring and import or reverse factoring. All parties to a domestic factoring arrangement are located within the same country's borders. The parties might, nevertheless, represent a link in a chain of domestic transactions that eventually connect to foreign transactions. International factoring, on the other hand, occurs quickly across international borders. There are importers and exporters involved. Importers and exporters are often the parties to international factoring, which is a tool for facilitating international trade. The UNIDRIOT Convention covers the subject of international factoring.[47]

[44] Cristina Paraschiv, 'Factoring Agreement – Instrument for Credit Institutions' (2013) 7(4) Agora International Journal of Juridical Sciences 10.15837/aijjs.v7i4.824 accessed 28 July 2021

[45] Tamara Milenkovic-Kerkovica and Ksenija Dencic-Mihajlov, 'Factoring in the Changing Environment: Legal and Financial Aspects' (2012) 44 Procedia - Social and Behavioral Sciences 428 – 435

[46]John Velentzas, Nick Kartalis and Georgia Broni, 'The Factoring And Forfaiting Contract As Contemporary Types Of Finance. Especially the Greek regulations' (2013) 5 Procedia Economics and Finance 757-762

[47]Franco Ferrari, 'General Principles and International Uniform Commercial Law Conventions: A Study of the 1980 Vienna Sales Conventions and the 1988 UNIDROIT Conventions on International Factoring and Leasing' (1998) 10(157) Pace International Law Review 157-185; UNDRIOT Convention, Article 2(1)

In exchange for the account receivables from the supply, an exporter who lacks the resources to complete a current supply can receive upfront financial help from an export factor. On the other hand, import factoring, also known as reverse factoring, occurs when the buyer in an international transaction seeks the factoring contract rather than the seller. In a reverse factoring agreement, the buyer can use its resources and credit standing to lend money to a supplier in a developing country with a lower credit standing.[48] Therefore, for international factoring to occur, parties must be located inside the borders of distinct states, each of which is a party to the Convention and has done everything necessary to ratify, domesticate, and give effect to it.

Regulatory Approaches Applicable to Factoring

Practices across climes show three major approaches to factoring among states. These are strict regulation approach, unregulated approach, and mixed approach.[49]

i. Strict Regulation of Factoring Business

This approach involves the enactment of laws designated for the control of factoring. The regulation specifies the standards that business owners in the sector must meet. These financial and regulatory requirements must be met before factoring companies can be accredited. They include monetary requirements such as minimum capital as well as legal requirements that must be strictly adhered to. There are regulations in place for capital sufficiency and prudential risk management in businesses. Implementing the factoring rule is not always the responsibility of a specific government agency; in some countries, such as Russia, it is the responsibility of the Central Bank.

The approach involving strict regulation is common among nations with vibrant and functional factoring industries. For instance in Egypt, the responsibility to regulate factoring is in the hands of the Egyptian Supervision Authority. This institution regulates both banking and non-banking-related factoring companies, financing both domestic and international factoring businesses. Egypt

48 Lucia Cusmano, 'New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Instruments' (2015) OECD https://www.oecd.org/cfe/smes/New-Approaches-SME-full-report.pdf accessed 10 August 2021

49 '*Factoring Survey in EBRD Countries of Operation*' (European Bank for Reconstruction and Development, 3rd ed. 2018) 8-10

has made significant progress since commencing factoring in 2007, by 2019 the factoring industry was valued at 589 million euros, making a significant contribution to the economy.[50] Mauritius is another country with rigid regulation of factoring under the auspices of the Financial Services Commission. [51]

ii. Unregulated Approach to the Regulation of Factoring

In this case, factoring businesses are not regulated expressly, rather, each factoring company is only bound by its corporate policies and the terms agreed-upon, by the parties to the factoring contract. This is due to the lack of extant legal and institutional framework designated to factoring business. Factoring companies must therefore only abide by pertinent current laws in the relevant territory. Other basic rules governing the financial industry and transactions, tax laws, laws requiring the registration of businesses, anti-money laundering legislation, and anti-corruption laws are among them. Within the African Continent, South Africa is an example of a country that adopts the unregulated approach to factoring businesses.[52]

iii. Mixed Approach to the Regulation of Factoring Business

Although factoring is seen as a distinctive financial activity in this context, there are no onerous rules governing the amount of capital that factoring companies must have on hand. Regulators, however, are chosen to carry out supervisory oversight duties, such as issuing operating licenses, examining business plans and financial reports, determining start-up capital, conducting periodic inspections to ensure compliance, and performing other vital ancillary services that must be provided to safeguard stakeholders.

Harnessing Factoring for Financing MSMEs in Nigeria

[50] Factors Chain International Annual Review 2020. Available at https://fci.nl/en/media/26962/download Accessed 25 August 2021

[51] Robert Lumbuye Tomusange, 'Factoring as a Financing Alternative for African Small and Medium-Sized Enterprises' (Unreported PhD thesis, Walden University 2015) https://scholarworks.waldenu.edu/cgi/viewcontent.cgi?article=2577&context=dissertations accessed 22 July 2021

[52] Hamanyati, M, 'Factoring as an international trade finance product: making a case for the enactment of a factoring act in Zambia' (Unpublished LL.M thesis, University of Pretoria, 2017).https://repository.up.ac.za/bitstream/handle/2263/64646/Hamanyati_Product_2017.pdf?sequence=1&isAllowed=y accessed on 25 August 2021

MSMEs would have been the backbone of the Nigerian economy if they had had access to sustainable sources of financing. Due to a lack of funding, the country has been unable to incorporate MSMEs into domestic, regional, and intra-regional trade. Due to a lack of access to capital, many micro-enterprises have shut down. The vast majority of those still in operation lack the resources necessary to operate profitably. They are unable to have a meaningful impact on the economy of the country as a result. As an illustration, MSMEs were in charge of 90% of the nation's employment in 2018. Only 48% of the GDP was contributed to the economy, though. When compared to economic indicators, this is incredibly low.[53]

The lack of sustainable financing is a significant obstacle preventing MSMEs in Nigeria from performing well and growing. The percentage of bank loans to SMEs between 2000 and 2005, according to the CBN, was 6.02%. Over time, this percentage has fallen steadily. Between 2006 and 2011, bank lending to SMEs decreased to 0.41 percent. 2017 saw a 0.1% decrease. Although the government occasionally attempts to intervene by introducing policies to support MSMEs, the majority of these policies fall short over time. The Small and Medium Industries Equity Investment Scheme (SMIEIS), which was introduced in 1999, was one of these regulations. According to this policy, banks had to contribute 10% of their pre-tax profit to the funding.[54]

MSMEs must have access to viable business financing options to effectively contribute to national economic development. In light of this background, factoring emerged as a practical method of financing MSMEs in Nigeria after being tested in other contexts. For instance, studies in China have shown that the development of the micro and macro economies, through digital financial inclusion, which focused on integrating MSMEs into the economy through access to alternative sources of financing like stock financing, prepaid financing, and factoring, is one of the key factors instrumental to the country's exponential economic growth. For instance, the global factoring market increased by 5% in 2019, reaching an estimated 2,923 billion euros. With a growth of 68% and a value of 1,984 billion euros, Europe experienced the highest growth, with Hungary

[53] Factors Chain International, '2019 Preliminary Global Factoring Statistics' https://fci.nl/en/news/2019%20Preliminary%20Global%20Factoring%20Statistics?language_content_entity=en accessed 20 August 2021

[54] Jide Akintunde, 'Factoring can be a game changer for Nigerian SMEs and trade' (Financial Nigeria, 7th February 2020) http://www.financialnigeria.com/factoring-can-be-a-game-changer-for-nigerian-smes-and-trade-feature-317.html accessed 20 August 2021

experiencing the highest growth in Europe at 23%. Factoring expanded at a 23% annual rate in the Asia-Pacific region, 8% in the Americas, and 10% in Africa.[55]

Another important development that necessitates the effectors to advance factoring in Nigeria is the emergence of the African Continental Free Trade Area (AfCFTA). AfCFTA aims to boost intra-African trade by reducing trade barriers, eliminating import duties and non-tariff barriers thereby creating a market of 1.2 billion people. It was projected that upon its full implementation, AfCFTA will stimulate intra-African trade by US$35 billion annually and increase intra-African trade by 52 percent by the year 2022. [56]However, for Nigeria to make the most of the market access opportunity created by AfCFTA, the various problems constituting supply-side constraints must be addressed.[57] Among these supply-side constraints is the access to investment funds for MSMEs.[58]

Legal Framework for Factoring in Nigeria

In Nigeria, factoring is just evolving. As far back as 2017, Nigeria commenced the process of passing into law, the Factoring Assignments (Establishment, Etc.) Bill 2019.[59] However, the bill is yet to become law, it may therefore be said that there is no existing law designated to the regulation of factoring contracts and businesses in Nigeria. Nonetheless, factoring is recognized by relevant institutions of government as a tool for trade financing. The CBN for instance, and the Nigerian Export Promotion Council ("NEPC"), expressly recognize factoring and forfeiting as useful tools for trade financing. To enhance the business prospects of MSMEs, NEPC grants up to

[55] Deepesh Patel, 'NEWS: Global Factoring Industry Grows 5% to €2.9b in 2019' (Trade Finance Global, 10th March 2020) https://www.tradefinanceglobal.com/posts/news-global-factoring-industry-grows-5-pc-2bn-in-2019-fci/ accessed 20 August 2021

[56] Grace Onubedo, 'AfCFTA: What It Means For Nigeria' (Center for the Study of Economics of Africa, May 25, 2018) available at *http://cseaafrica.org/afcfta-what-it-means-for-nigeria/* accessed 10 September 2021

[57] Sean Woolfrey, Philomena Apiko and Kesa Pharatlhatlhe, 'Nigeria and South Africa: Shaping Prospects for the African Continental Free Trade Area' ECDM discussion paper (2019) available at *https://ecdpm.org/wp-content/uploads/DP-242-Nigeria-and-South-Africa-Shaping-prospects-for-the-African-Continental-Free-Trade-Area-1.pdf* accessed 10 September 2021.

[58] Temesgen Woldamanuel Wajebo, 'Micro, Small and Medium Enterprises Access to Finance Challenges in Supply Side Perspective in Ethiopia' (2022) 5(1) International Journal of Small and Medium Enterprises 22-31.

[59] Factoring Assignments (Establishment , etc) Bill, 2019, https://placbillstrack.org/upload/HB292.pdf accessed 20 August 2021

USD 1 billion in loans for factoring yearly.[60] Because of the lack of express legal instruments, factoring provisions are found in various laws, to be examined below.

i. Factoring Assignments (Establishment, Etc.) Bill

The bill set out to enact a law to be applicable to regulate factoring contracts in Nigeria.[61] Structurally, it is proposed that the law be made up of 25 chapters. The bill defines fundamental terms including 'factor' and 'factoring contract'. Here, a factor otherwise known as an assignee is assigned a receivable.[62] A receivable is a right to payment of a monetary sum arising from a contractual agreement.[63] A factoring contract is an agreement between a client and a factor involving an assignment or an offer to assign trade receivables to facilitate a contract of supply between the client and its debtors.[64] The functions of a factor may include provision of funds in the value of trade, to clients, to adsorb credit risk at the time the receivable was created. The factor may also maintain accounts of the assigned receivables related thereto.[65]

The factoring bill when passed into law will be a welcomed development. So far, it covers the fundamentals of a factoring contract. This is to the extent of establishing a legally recognizable creditor-debtor relationship between the creditor and the factor, as well as identifying their respective rights and obligations. However, the bill is not without some obvious limitations. First, it failed to identify a Designated Agency of government for its implementation. Meanwhile, factoring contracts may be resorted to for both domestic and international trade relations, as such the responsibility to implement the law cannot be left in the hands of the NEPC. Another limitation of the bill is the failure to make provision for a receivables registry. This will be a form of account receivable management system to keep central records of factoring contracts and facilitate their success. Although a factoring agreement may run on a notification or non-notification basis, due notification of the assignment of receivables to the client by the factor stating the assignment and

[60] Factor Chain InternationaI, *NEPC adopts factoring for export*, (Nov.10, 2021), https://fci.nl/en/news/nepc-adopts-factoring-export?language_content_entity=en accessed 6 February 2022
[61] Factoring Assignment (Establishment, etc) Bill, 2019, Section 25.
[62] Ibid Section 1(14)
[63] Ibid Section 25
[64] Ibid Section 1(16)
[65] Ibid Section 1(21)

the associated terms and conditions is desirable.[66] Considering the level of development and technological advancement in Nigeria, a system running on a notification basis would give a better sense of security.

ii. Banks and Other Financial Institutions Act 2020 (BOFIA)

The BOFIA is the principal law regulating banking businesses and banks in Nigeria. It sets prudential guidelines to be complied with by banks and other financial institutions in the country. The 2020 BOFIA repealed the 2004 version of the law.[67] A factoring contract involves financial transitions which will be routed through the bank, as such banks are relevant for rendering financial services to which factoring is connected. BOFIA permits Nigerian banks to render the service of debt financing.[68] Further, the CBN is responsible for carrying-out oversight functions over banks and other financial institutions providing debt financing. In its 2014 revised guideline for financial institutions in Nigeria, the CBN expressly recognize debt factoring as one in which financial businesses can be involved. Here debt factoring was described as a business involving the purchase of debt from clients at a discounted rate, with the opportunity to earn profit from the discount.[69] The express recognition of debt factoring in BOFIA is a welcomed development since the services of banks and other financial institutions are needed to complete major transactions in the country. However, the definition of factoring incorporated into BOFIA is quite shallow as it limits factoring contracts to debt acquisition without paying attention to other important aspects including business finance. Also, there is a need for a law designated to regulate factoring business in the country.

Regulatory Challenges Inhibiting the Recourse to Factoring in Nigeria

The regulatory landscape for factoring in Nigeria is not viable enough to support a viable factoring industry. A host of legal and institutional challenges inhibit the development of factoring in Nigeria. These include lack of factoring law, failure to cater for regulation and supervision of

66 Jeffrey Alpert, 'Canada: Notice Of Assignment Of Accounts Receivable Under The PPSA: What Every Factor Should Know' (Mondaq, April 2017) https://www.mondaq.com/canada/asset-finance/583854/notice-of-assignment-of-accounts-receivable-under-the-ppsa-what-every-factor-should-know accessed 6 February 2022

67 Banks and Other Financial Institutions Act, 2020 Section 1(1)

68 Ibid Section 19

69 Ibid Section131

factoring services, lack of requisite designated institution, restrictive definition of assignment of receivables, failure to provide notice of assignment and recognize the right of the parties.

i. Weak institutional structure

In Nigeria, the regulatory framework for factoring is underdeveloped. The Central Bank of Nigeria (CBN), which serves as the sole regulatory body for all non-banking financial institutions in the nation, is responsible for a lot of things. The CBN enforces its rules for Nigerian finance companies.[70] Another implication is that the factoring industry is seen as a subset of traditional finance businesses, subject to the requirements of the CBN's revised guidelines, which stipulate that the start-up capital for such a business must be at least N100 million.[71] This has a significant drawback in that the CBN might not be able to effectively address the issues that might prevent the debt factoring industry in Nigeria from operating. Therefore, it is essential to appoint a designated institution for this purpose.

ii. The Lack of Factoring Law

In Nigeria, factoring services are subject to general rules and regulations, just like other non-banking financial services. Because of the absence of a specific law on factoring, it can be said that there is no definition of factoring under Nigeria’s current legal framework. Although a proposed law is in the process of being passed as a bill, the passage has not enjoyed an accelerated process at the national assembly. A look at the factoring bill shows that it is comprehensive, as it defines factoring to include both the assignment of receivables and other factoring services like debt collection and ledger management.[72] Despite the laudable nature of the regulation, it cannot be relied upon until it is passed into law.

iii. Gaps in the Factoring Bill

The Factoring Bill presents an important guideline for the regulation of factoring business in Nigeria once it is passed into law. However, the proposed law has some obvious limitations,

[70] Central Bank of Nigeria guidelines for finance companies in Nigeria, art 2
[71] Ibid
[72] Ibid (n-45), sec 1.; Ibid, art 2.

fundamental among which is the adoption of a restrictive definition that excludes credit protection as one of the functions to be performed by a factor.[73] Thus, the definition of factoring under the Bill is restrictive when compared to other international law instruments such as the AFREXIM model law on factoring. Another obvious limitation or gap in the bill is the failure to provide for the creation of a registry for keeping the records of factoring contracts. The receivable register constitutes (s) a permanent record of transactions. It also creates an avenue for detecting [possible errors in a transaction.

Although the CBN guidelines prescribe the minimum capital for establishing a factoring business, several other issues call for further clarification. These include issues relating to lending and credit exposure ratios, ownership and management of factoring companies, management expertise, and tax and accounting issues. The institutional landscape for factoring may be the same as the one regulating non-bank financial transactions, which is often the Central Bank.[74] However, clarity of applicable rules which prescribes the criteria, is a crucial aspect that cannot be compromised.

Conclusion

In this study, we analysed the role of MSMEs in Nigeria's economic development and the challenges they face. The biggest challenge identified was the lack of funding, with an annual financing deficit of about N617.3 billion. Experts suggest that factoring could free up between US$1 billion and US$2 billion annually for microenterprises. Additionally, the implementation of AfCFTA could provide market access and help MSMEs grow their businesses. However, a strong legal framework for factoring is crucial for success. Therefore, it is necessary to establish a sound legal and policy framework in Nigeria to develop a thriving factoring industry and bridge the financial gap of MSMEs for economic development.

[73] Ibid (n-45), sec 1.

[74] 'Regulatory Framework for Factoring: Egypt Financial Services Project Technical Report NO. 27' (USAID Egypt 2005) https://www.land-links.org/wp-content/uploads/2018/03/USAID_Land_Tenure_FSP_Technical_Report_Regulatory_Framework.pdf accessed 20 August 2021

Recommendations

It is recommended that the Factoring Assignments (Establishment, Etc.) Bill 2017 is passed into law, with a review of the proposed provisions to ensure necessary safeguards for the rights, obligations, and remedies of all parties involved in a factoring contract. These parties include the Assignor, Assignee, customer, and Surety or Guarantor. It is also crucial to appoint a government agency as the Designated Agency (DA) to implement the factoring Act and increase awareness of factoring among MSMEs and other businesses. This agency can also help settle disputes arising from factoring contracts. The act should also provide for quick recovery of debts incurred from factoring contracts, with clear options available for receivable recovery. As the factoring industry in Nigeria is still in its early stages, regulations need to be put in place to outline the necessary clauses that should be included in a factoring agreement. These clauses include the advance fee clause, termination clause, provisions on commission and fees, approval of the debtor, and dispute resolution clause. Additionally, it is important to clarify the taxation of factoring contracts and determine the appropriate form of tax payable, such as Capital Gain Tax (CGT), Value Added Tax (VAT), and other forms of taxes. It is recommended that the relevant provisions of other applicable laws be reviewed to create a favourable environment for MSMEs to utilize factoring as a financing option. A review of investment policies that apply to MSMEs is also suggested.