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DES CAPACITES EN AFRIQUE



Transforming Africa's Trade

African Export-Import Bank  
Banque Africaine d'Import-Export

# Factoring as a Catalyst for Small and Medium Enterprises Development and Intra-African Trade





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ISBN : 978-1-77933-659-0  
EAN : 9781779336590

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## Foreword

The confluence of global shocks including the COVID-19 pandemic, and the lingering Ukraine crisis have presented significant challenges to African countries, exacerbating existing economic vulnerabilities, and hindering progress towards sustainable development. In this context, the establishment of the African Continental Free Trade Area (AfCFTA) holds immense promise as a transformative force for intra-regional trade, economic integration, and an important insulant for global shocks. However, to fully optimize the potential benefits of the AfCFTA, it is crucial to address the perennial constraints to SME growth and development. In a region where SMEs constitute the largest share of industrial fibre and serve as the backbone of most economies, these obstacles impede their ability to participate effectively in regional and global value chains. Despite contributing significantly to employment, innovation, and income generation, SMEs are confronted with multiplicity of challenges, including, weak institutional framework, inadequate infrastructure, and skills gaps – with the single most important constraint being limited access to finance.

This paper sheds light on the centrality of factoring as a critical alternative financial instrument for SMEs in Africa by highlighting some of the key attributes of factoring including offering immediate working capital and addressing the unique financing needs of SMEs, particularly in contexts where traditional lending methods may not be readily accessible. Indeed, by evaluating the risk associated with accounts receivable rather than relying on fixed assets as collateral, the study demonstrates how factoring provides a lifeline to SMEs, especially in challenging business environments.

The case studies presented in the paper highlight the experiences of South Africa, Tunisia, Namibia, and Mexico, showcasing the potential benefits of factoring for SMEs across diverse domestic contexts. These case studies underscore the need for targeted interventions and policy measures to enhance the enabling environment for factoring and SME development. We are particularly encouraged by the emphasis on digital technology as a catalyst for transforming SME operations and unlocking new opportunities for growth. Digitalization has the potential to boost the competitiveness of African SMEs, facilitate cross-border trade, and foster greater regional and global interconnectedness. It is imperative that policymakers and stakeholders prioritize investments in digital infrastructure and support SMEs in adopting digital technologies.

While factoring holds immense potential for SMEs in Africa, it is crucial to acknowledge and address the persistent barriers to cross-border trade. Incoherent trade policies, complex administrative procedures, inadequate infrastructure, and information and communication technology (ICT) deficits continue to hinder SMEs' ability to participate fully in regional and global markets. Coordinated efforts are needed to streamline trade processes, reduce trade barriers, and enhance trade facilitation mechanisms.

The African Export-Import Bank (Afreximbank) and Africa Capacity Building Foundation (ACBF) recognize the importance of building capacity and promoting knowledge sharing among stakeholders. We commend the recommendations put forth in this study, which emphasize the need for formalization, factoring adoption, financing diversification, credit guarantee schemes, digitalization, infrastructure development, skills development, policy coherence, research and data collection, and public-private partnerships. These recommendations provide a comprehensive roadmap for policymakers, development partners, and practitioners to support SMEs and leverage factoring as a catalyst for inclusive and sustainable economic growth.

ACBF and Afreximbank remain committed to supporting African countries in addressing the challenges and seizing the opportunities presented by SMEs, factoring, and the AfCFTA. Our technical assistance, capacity-

building programs, and knowledge products will continue to focus on building the necessary skills, institutions, and policies to promote factoring, SME development, enhance trade facilitation, and foster regional integration.

We encourage African governments, regional economic communities, development partners, and the private sector to leverage the findings and recommendations of this research paper in their efforts to support SMEs and strengthen the enabling environment for factoring. By working together, we can unlock the full potential of SMEs, promote inclusive and sustainable economic growth, and advance Africa's Agenda 2063 and the United Nations Sustainable Development Goals.

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## **Acknowledgements**

This study was prepared by the African Capacity Building Foundation (ACBF), under the overall guidance of Mamadou Biteye OBE, Executive Secretary of ACBF. The paper is a product of extensive collaboration with Afreximbank. At ACBF, the work was carried out by a team in the Programs and Impact Department, under the general guidance of its Director, Mbacke Niang. The technical team was led by Barassou Diawara and supported by Grand Mutondo, Tsitsi Chakonza, Ruramai Marandu, and Kossi Dwaraga Doukou. At Afreximbank, Lina Iyok and Enga Kameni coordinated the work including inputs from the Afreximbank Factoring Working Group under the supervision of Kanayo Awani (Executive Vice President, Intra-African Trade Initiative) and Nassourou Aminou (FCI Regional Manager Africa) and the insightful feedback provided.

Garth Le Pere, member of the ACBF Strategic Studies Group, led the drafting of the paper. ACBF would like to give special thanks to Afreximbank whose financial support enabled the production of this report.

The views expressed in this paper are those of the author(s) and should not necessarily be considered as reflecting the views or carrying the endorsement of ACBF.

## List of Acronyms

ACBF	African Capacity Building Foundation
AfCFTA	African Continental Free Trade Agreement
AfDB	African Development Bank
Afreximbank	African Export-Import Bank
AU	African Union
CGS	Credit guarantee schemes
EUR	Euro (European Monetary Unit)
FCI	Factors Chain International
GDP	Gross Domestic Product
RECs	Regional Economic Communities
SMEs	Small and medium-sized enterprises
UNECA	United Nations Economic Commission for Africa

# Executive Summary

**Background and Purpose:** African countries face a difficult road to economic recovery because of the effects of the Covid-19 pandemic and the Russia-Ukraine war. Therefore the African Continental Free Trade Area (AfCFTA) is such a significant development in transforming the trading modalities and integration landscape of the continent.

In terms of its letter and spirit, this paper provides an assessment and an evaluation of the SME landscape in Africa, with a focus on the role and functions of SMEs as a force multiplier where factoring serves as an intermediation tool to promote and improve levels of intra-regional regional trade which currently is only 17 per cent of total African trade.

**Method:** The study draws on a wide secondary literature, primary sources, and relevant empirical material. It also includes four case studies that provide insights into the use of factoring in diverse domestic settings. The importance of factoring: Factoring provides SMEs with immediate financing and working capital. Compared to other types of lending such as loans with fixed assets used as collateral, the key advantage of factoring is that it is underwritten based on the risk of the accounts receivable rather than the personal risk profile of the borrower. In Africa's often weak business environments, the factored receivables are owned by the factor and consequently, are not part of the bankruptcy estate of the borrower.

## Main observations of the study:

### 1. SMEs face serious challenges

Besides problems of access to finance because of high levels of informality, fragmented local markets present operational and strategic obstacles. Difficult business conditions for SMEs are further affected by weak enabling and regulatory environments, cash-flow problems, poor infrastructure, deficits in technical and management skills, unstable financial systems, and regressive tax regimes.

### 2. The importance of service sectors

Service sectors will assume greater importance for two reasons: firstly, there will be greater demand for services such as transportation, utilities, digital trade, and personal and business services in which SMEs have a direct stake; and secondly, economic recovery will provide new incentives for SMEs to move out of the informal sector as the potential for new pathways of growth and development beyond local markets are realised.

### 3. The promise of credit guarantee schemes

Credit guarantee schemes (CGS) could contribute complementary and supportive synergies for SMEs. As such, they assist with third-party risk mitigation to lenders so as to improve the credit environment for SMEs. Properly designed and operated, a CGS can be an important policy mechanism for alleviating the financing constraints on SMEs and like factoring, is a critical enabler of economic development and job creation.

### 4. Insights from the case studies

The case studies of South Africa, Tunisia, Namibia, and Mexico highlight the fact that African countries in particular and developing countries in general are still marginal players in the lucrative global factoring market. Africa only accounts for 1.14 per cent of the global market in 2022; and there are only 190 factoring companies in Africa of a total 4193 in the world. In addition, factoring is concentrated in domestic markets, where South Africa is the dominant player, constituting 89 per cent of the continent's factoring business.

## **5. The role of digital technology**

Digital transformation plays a catalytic role in how new business models can improve SME business operations, add value to their products and services, and generate greater revenue. Importantly, the use of digital technology could stimulate increased mobility, cross-border trade, and enhance the interconnectedness with other national and regional SMEs in the context of the AfCFTA's objectives.

## **6. Persistent barriers to cross-border trade**

The potential of SMEs to stimulate cross-border trade are hindered by a range of non-tariff barriers. These include trade policies which are incoherent, inadequate, and inefficient; complex customs and administrative procedures and regulations; economies that are commodity dependent and lack diversification; and inadequate infrastructure in roads, rail, ports, air, and waterways, as well as deficiencies in soft infrastructure, energy, and ICT.

## **7. The need for a continental legal framework**

It is important to improve the legal, policy, and regulatory environment for SMEs to grow and develop from factoring. In this regard Afreximbank's 2016 Model Law on Factoring is particularly instructive for its scope and relevance to Africa. Confidence in the legal framework across factoring jurisdictions will provide greater certainty and reduce risk in cross-border and international transactions, especially for SMEs when it comes to export services.

## **8. The need to raise awareness of factoring**

There is a pervasive lack of knowledge and understanding of the benefits of factoring across African countries. Raising awareness and building capacity are thus at a premium, especially through technical assistance, training, and education.

### **Strategic policy considerations and recommendations:**

In view of the above and in terms of the relevant policy dimensions, the study suggests the following:

#### **▪ The formalisation dimension:**

- » The ACBF and Afreximbank, in collaboration with the AfCFTA Secretariat, the AfDB, the AU Commission, and UNECA, conduct pilot studies using the Afreximbank's data on informal cross border trade to develop a process methodology with incentive parameters on how SMEs can be better integrated into formal domestic and regional economic circuits.

#### **▪ The factoring dimension:**

- » The Afreximbank's Factoring Unit, in close collaboration with the AfCFTA Secretariat, ACBF the AfDB, the AU Commission, and UNECA, should launch a continental campaign for the adoption of the Model Law of 2016.
- » Afreximbank's Factoring Unit and the ACBF, with the support of the AfDB, UNCTAD, the World Bank, and IMF should develop the necessary technical assistance and education infrastructure to promote factoring.
- » Afreximbank's Factoring Unit and the ACBF, in close cooperation with FCI's Education Director and Regional Manager for Africa should institutionalise learning platforms among the 43 African members of FCI but also include non-members, as well as REC, AfCFTA, AfDB, AUC, and UNECA Secretariats. This includes certified courses, seminars, and training material for all stakeholders that examine the process and components of factoring.

- **The financing dimension:**

- » The ACBF and Afreximbank, in close collaboration with the AfDB's Secretariat of Making Finance Work for Africa and its Thematic Fund for Africa Private Sector Assistance should examine diversification, especially through securitisation and forfaiting modalities for mobilising funds to support SMEs and factoring across Africa.
- » Such modalities should be modelled on the Factors Chain International's "Receivables as an Investable Asset Class" to raise capital and trade finance from development finance institutions for SMEs by promoting the establishment of more non-bank factoring companies, especially to expand the geographic scope of factoring.
- » The ACBF and Afreximbank, in close collaboration with the AfDB, the World Bank, and IMF should examine the possibility of issuing "factoring bonds" whose proceeds can be used to support SMEs across a range of sectors, and which are capable of attracting a diverse pool of investors such as hedge funds, sovereign wealth funds, pensions funds, and credit guarantee schemes.

- **The government support dimension:**

- » The Afreximbank's Factoring Unit, in close collaboration with the AfCFTA Secretariat, ACBF the AfDB, the AUC, and UNECA should examine the possibility of turning the SME and factoring interface into a public-private partnership.
- » Such a partnership between governments and the private sector should be based on a clear, manageable, and legitimate institutional framework which defines the principles and practices for establishing dedicated SME and factoring agencies which represent all stakeholders in relevant ministries and across the secretariats of all regional economic communities.

# 1. Introduction

## 1.1 Background

This paper builds on the foundational elements of the ACBF-Afreximbank study (ACBF-Afreximbank 2021). The study provided a broad analytical, conceptual, and empirical assessment of the opportunities and challenges of factoring in Africa. On one hand, it was sensitive to the nexus between factoring and how it could enhance the performance of Africa's Small and Medium Enterprises (SMEs); and on the other, their potential to benefit from and contribute to intra-African trade under the flagship auspices of the African Continental Free Trade Area (AfCFTA). SMEs stand to benefit greatly from the full implementation of the AfCFTA which could increase regional income by 7 per cent or US\$450 billion, lift 30 million citizens out of poverty by 2035, and double the size of the single market to US\$6.7 trillion in the next decade in Africa (World Bank 2020).

Across Africa, the comparative advantages as well as the growth potential and business transactional benefits of factoring remain relatively unknown. South Africa alone accounts for 85 per cent of all factoring business in Africa and it remains a prominent practice in only a few countries, namely, Egypt, Mauritius, Morocco, and Tunisia while slowly taking root among several others such as Cameroon, Zambia, Nigeria, and Zimbabwe (ACBF-Afreximbank 2021, 11). Factoring, therefore, represents an innovative frontier of development finance to be explored, supported, and encouraged at all levels: national, regional, and continental.

Compared to other types of lending such as loans with fixed assets as collateral, its key advantage is that factoring is underwritten based on the risk of the accounts receivable rather than the personal risk profile of the borrower. Moreover, in weak business environments such as those that exist in many African countries, the factored receivables are owned by the factor and consequently, are not part of the bankruptcy estate of the borrower should that eventuality occur. Hence, factoring provides SMEs with immediate financing and working capital not only to maintain staff, operations, and liquid balance sheets but also offer strategic opportunities for business expansion and job creation (Klapper 2005, Hamanyati 2017).

A perennial challenge that commonly afflicts Africa's diverse population of SMEs has been access to finance because of their very high levels of informality; for Sub-Saharan Africa only, the financing gap is estimated at US\$331 billion (SME Finance Forum 2022). This has special significance when it comes to funding their business cycles, mainly because of the high risk of default. This challenge has direct consequences for the sustainable growth, economic viability, and business sustainability of SMEs, especially because of the collateral effects on retained earnings which is their main source of capital.

Moreover, Africa's SMEs face serious operational and strategic obstacles because of small and fragmented local markets. This is compounded by difficult non-tariff barriers and obstructive modes in the cross-border flows of goods and services where SMEs could add value and develop economies of scale, given the promise and prospects of the AfCFTA. Problematic business conditions under which SMEs have to operate are further affected by weak enabling and regulatory environments, cash-flow problems, poor infrastructure, technical skills and management deficits, fragmented financial systems, and regressive tax regimes (Fjose, Grünfeld, and Green, 2010).

The far-reaching impacts of the Covid-19 pandemic and the Russia-Ukraine war have exacerbated these raft of challenges and concerns, especially since 2020, when output losses across the continent accounted for up to US\$80 billion and growth contracted to -3.4 per cent from an average of 2.4 per cent in 2019 (AfDB 2020). The impact of the pandemic on Africa's service sectors has been particularly severe and pronounced since 70 per cent of SME activity is concentrated in services (Amoussou, Karagueuzian, and Bah 2021). In addition, SMEs are the economic engines of African countries, accounting for 80 per cent of business activity and employing some 70 per cent of its workforce (ACBF-Afreximbank 2021).

Consequently, the entire SME eco-system in Africa has been at the coal-face of experiencing the damaging effects and consequences of the pandemic, made worse by inadequate government policies to assist them with reducing layoffs, preventing bankruptcies, and mitigating financial risk.

## 1.2 Research Objectives

The paper aims to assess and evaluate the SME landscape in Africa, with a focus on the role and functions of SMEs as a force multiplier by using factoring as an intermediation tool to promote intra-African trade. This takes on added significance against the background of global systemic challenges and impacts, especially climate change which has had disruptive effects on Africa's supply chains and the viability and sustainability of SMEs in industries such as agribusiness and food processing. These challenges have now been further complicated by the effects of the COVID-19 pandemic and the Russia-Ukraine war as will be further elaborated below. As such, the paper will devote special attention to the deficits in the functional efficacy of SMEs with a focus on improving their human capital and institutional capability to take advantage of the multiple benefits that come from factoring.

In addition, the paper will attempt to add value by examining two mutually reinforcing dimensions: firstly, how factoring can promote services trade as a key driver of the letter and spirit of the AfCFTA; and secondly, how SMEs can be positioned legally, operationally, and institutionally to become catalytic agents of improving intra-regional trade through the factoring and services interface. A significant study by the UN Economic Commission for Africa (UNECA 2021) has demonstrated how services and services industries in Africa will be important drivers of growth, economic development, and structural transformation under the AfCFTA, against the backdrop of the impact of the pandemic; and by extension, the Russia-Ukraine War.

The paper will conclude by suggesting a policy and action agenda in which factoring can be used to enhance the productivity of SMEs and promote intra-African trade.

## 1.3 Methodology

This is essentially a qualitative desk-top study whose substantive scope and analytical exploration of the subject matter relies on data and information from secondary sources. Quantitative data and visual material are used insofar as they augment and provide additional support for and insight into the qualitative analysis and its observations. It follows established social science conventions of interpreting these sources for their relevance to the study and producing generative explanations of the issues to be assessed and evaluated. These secondary sources are especially consequential for the conclusions drawn and the recommendations derived.

With regard to the choice of the four case studies of South Africa, Tunisia, Namibia, and Mexico for convenience of comparison and to the extent that they offer instructive lessons and practices, the study adopts a dual approach. The first is to maximise similarity in how the case studies share certain features in policy, legal, and institutional dynamics which have facilitated the adoption of factoring to drive SME growth as an instrumental value. The second is to maximise diversity which is to demonstrate that even though the country cases differ substantially from each other in geographic location, business environments, and levels of development, there are regularities which have shaped the patterns of factoring and SME performance as normative ends and operational goals.

## 1.4 Structure of the Paper

The paper is organised and divided into the following thematic sections:

- **Section 2** focuses on the AfCFTA and global challenges with a focus on regional integration, the impacts of the Covid-19 pandemic and the Russia-Ukraine war, the challenges these pose for economic recovery, and what roles SMEs and factoring can play in that process.
- **Section 3** provides an overview of the different components of factoring, understanding their relevance, and what their benefits might be in the African context.
- **Section 4** examines a few select case studies in terms of how the practice of factoring has affected the business environments of South Africa, Tunisia, Namibia, and Mexico.
- **Section 5** focuses on the SME environment in Africa and the various challenges and problems SMEs have to face but also includes opportunities for SMEs that arise from the AfCFTA's Services Protocol and digital technology.
- **Section 6** casts the spotlight on the prospects and challenges of intra-Africa trade, with an emphasis on how factoring and SMEs could contribute to enhancing intra-Africa trade.
- **Section 7** examines the significance of legal and regulatory frameworks for factoring, their implementation challenges, and opportunities, as well as the need to raise awareness and build skills and capacity.
- **Section 8** offers recommendations in this regard with respect to the policy and legal aspects to promote factoring, develop the institutional infrastructure, and strengthening the operational environment.
- **Section 9** concludes by summarising the key findings of the paper, its implications for the relationship between factoring and SMEs finance, as well as suggesting areas for further research.

## 2. The AfCFTA and global systemic challenges

This section will examine various factors which have an impact on the efficacy of the AfCFTA in the context of a changing African and global landscape. This contextual background is significant since the AfCFTA is a major achievement in its scope, promise, and ambition. However, its adoption occurs at a turbulent and uncertain moment in the global trading system and in transnational economic relations (le Pere 2020). The socio-economic challenges across the global and African landscapes have become more complicated because of the Russia-Ukraine war, now continuing unabated from 22 February 2022, as well as the residual effects of the Covid-19 pandemic over the last two years.

Turbulence and uncertainty threaten the very foundations of the liberal international order where a variety of centrifugal effects are at work. We are witnessing rising military and geo-political tensions, disruptive trade and commercial relations, increasing climate instability and environmental degradation, and growing right-wing populism and forms of nativist nationalism in the West (Frankopan 2018); while in Africa's case, there are unsettling levels of conflict, poverty, insecurity, and religious extremism (Lundsgaarde 2012; Araoye 2014; UNDP 2023).

### 2.1 The AfCFTA and state of regional integration in Africa

The Abuja Treaty adopted in 1991 reaffirms the strategic importance of regional integration and intra-African trade liberalisation for the continent's development as well as defining relevant benchmarks for achieving the Pan-African objectives of unity, self-determination, collective growth and prosperity.

Various initiatives have ensued to give meaning, direction, and content to the acceleration of the Treaty's objectives. A sampling include: the establishment of the AU in 2001 and NEPAD in 2002. In 2009, the Minimum Integration Framework (MIF) sought to promote a conceptual and normative consensus between member states, the Regional Economic Communities (RECS), and the AU Commission to lend greater momentum to integration processes. Then in January 2012, the Action Plan for Boosting Intra-African Trade (BIAT) was adopted; and equally importantly, a decision was made to form the AfCFTA. The following year in 2013, "Agenda 2063: The Africa We Want", emerged as strategic blueprint to further advance integration processes, together with an agenda for 10-year implementation plans and flagship projects (AU 2015).

The AfCFTA, adopted in 2018, represents the first flagship project under the auspices of Agenda 2063. It is the world's largest free trade area in terms of participating countries and provides the basis for a single continental market with a population of 1.4 billion and a total GDP of around US\$3 trillion. A major innovation of the AfCFTA is that it not only seeks to remove tariffs and other barriers to trade in an effort to improve the prospects for intra-African trade, but crucially, it is also concerned with addressing domestic regulatory impediments with regard to services, investment, competition, intellectual property rights, and the digital economy (UNECA 2021). The modalities of expanding trade will be complemented by promoting value-added production across economic sectors and building regional value chains.

### 2.2 The impacts of the Covid-19 pandemic and the Russia-Ukraine war

However, the substantial progress registered in policy and institutional development with the AfCFTA's economic integration endeavours have been affected by both the Covid-19 pandemic; and thereafter, the outbreak of war between Russia and Ukraine, to which we turn next.

## 2.2.1 The COVID-19 pandemic

Critically, the pandemic's effects stretched the already poor and understaffed health systems of most African countries, especially those that are least developed. Infected patients started overcrowding existing health facilities and those who already have high-burden diseases such as HIV/Aids, TB, and malaria suffered further from the lack of access to adequate health care. The malaria burden across Africa's 21 worst affected countries was also affected by the pandemic: according to the WHO, in 2021 there were 235 million malaria cases, representing 96 per cent of the global total; and 594 000 deaths, representing 96 per cent of the global total (WHO 2023). The pandemic further created chronic shortages in medicines, healthcare workers, and protective equipment. On average, it was estimated that African countries each needed an additional \$11 billion for health spending on the pandemic; a total of more than \$600 billion (Schneider, Pivodic and Jison Yoo 2020).

The pandemic has further exposed serious security challenges. Africa's conflict zones have perpetuated the movement of large populations of internal refugees and displaced persons. According to the UN High Commission for Refugees, Sub-Saharan Africa has 26 per cent of the world's refugee population and 12.5 million are internally displaced. Managing Africa's security challenges is variously complicated by state fragility, gender-based violence, youth unemployment, political instability, climate change, and the exponential surge of mostly young migrants attempting the dangerous passage across the Mediterranean Sea in search of a better future. Moreover, ongoing violent conflict in many parts of the continent, and the threat of violent extremism are affecting much of the Sahel, North Africa, the Horn, and even the SADC region, thereby again exposing the weaknesses of Africa's peace and security mechanisms.

## 2.2.2 The Russia-Ukraine war

According to the UN Task Team for the Global Crisis Response Group, the war's ripple effects on global commodity and financial markets will leave 1.7 billion people in 107 countries—41 of which are in Africa—directly exposed to at least one of three impacts, namely, rising food prices, rising energy prices, and increasing financial constraints (UN 2022).

African governments, as well as their citizens and economies, have been experiencing soaring prices in wheat, cooking oil, fertiliser, and energy with serious and direct consequences for global growth so soon after the Covid pandemic (Reuters 2022). The gravity of the situation has far-reaching repercussions since it is worth recalling that combined, Russia and Ukraine account for almost 30 per cent of global wheat supplies. Importantly, both Russia and Ukraine supply about 44 per cent of Africa's wheat consumption and this war-induced shortage exacerbates the continent's worsening food insecurity dilemma (UNCTAD 2022); ironically when the AU's theme for 2022 was "Strengthening resilience in nutrition and food security on the African continent".

In addition, Ukraine is also a major producer and exporter of corn, barley, and sunflower and rapeseed oils; while Russia and its Belarus ally together generate 40 per cent of global exports of crop nutrient potash, which is used for sustainable crop production the world over.

The channels of rising food prices, rising energy prices, and tighter financial conditions have heightened the exposure of African and developing countries to higher levels of fiscal and financial pressure because of the war and its effects. There is a group of "perfect storm" countries where all three channels converge, and this constitutes 69 countries with a total population of 1.2 billion people. Of the 69, 25 are in Africa, 25 in Asia and the Pacific, and 19 are in Latin America and the Caribbean; and 20 out of 46 are UN country groups which are Least Developed Countries (LDCs) and 26 out of 58 are Small Island Developing States (SIDS). Of the 46 LDCs with maximum exposure to all three channels, 25 are in Africa, 9 in Asia and the Pacific, and there is only one in Latin America and the Caribbean (UN 2022).

***Against this background, what are the prospects for economic recovery and growth?***

### **2.3 The challenge of economic recovery and opportunities for growth**

The twin challenges of fixing economies and societies battered by the pandemic and confronting the perilous headwinds of food, energy, and financial shortages caused by the war will demand a carefully calibrated matrix of prudential choices and judicious decisions being made (UN 2022).

This strategic calculus could be assisted by promising signals of recovery. According to the African Development Bank's (AfDB 2022) African Economic Outlook 2022, Africa's total GDP has shown strong recovery of an estimated 6.9 per cent in 2021 following the pandemic-induced decline of 1.6 per cent in 2020. While rising oil prices and global commodity demand have contributed to improving macro-economic fundamentals, growth could decline to 4.1 per cent in 2022 and remain there in 2023 due to the post-pandemic effects and the inflationary pressures caused by the war. International efforts such as the AfDB's US\$1.5 billion "African Emergency Food Production Facility", the G20's "Common Framework for Debt Treatment", and the US\$650 billion in Special Drawing Rights by the International Monetary Fund (IMF) are all salutary for the continent's recovery.

However, as the Outlook makes clear, there is still a shortfall of US\$432 billion which the continent does not have to address the lingering effects of the pandemic. This includes 30 million people across Africa who were relegated to poverty while 22 million jobs were lost in 2021 because of the pandemic. The Russia-Ukraine war has contributed to this trend which will push another 2.1 million into extreme poverty by the end of 2023 (AfDB 2022).

### **2.4 The role of SMEs and services in Africa's future growth and development**

While the SME landscape in Africa will be explored and examined in greater detail below, suffice it to say that in light of the considerations above and their far-reaching existential implications for Africa, it cannot be stressed enough how important SMEs will be to the future growth, development, and economic recovery of the continent as a whole. This takes on added significance in light of the fact that their informal nature and the informal sector where the majority of SMEs conduct their business often bely their critical roles, functions, and contributions in the face of serious operational challenges, especially when it comes to finance (Fjose, Grünfeld and Green 2010). This is precisely why factoring is considered to be one of the most innovative instruments of finance for Africa's large segment of SMEs (Hamanyati 2017).

As African economies collectively take the difficult road to economic recovery, service sectors will assume greater importance for two reasons: firstly, there will be greater demand for services such as transportation, utilities, digital trade, and personal and business services in which SMEs have a direct stake; and secondly, economic recovery will provide new incentives for SMEs to move out of the informal sector as the potential for new pathways of growth and development beyond local markets are realised, especially in cross-border trade (Dihel and Goswami 2016).

Moreover, services have been a critical source of employment, accounting for 32.4 per cent and contributing about 50 per cent of Africa's GDP. A vibrant and efficient service sector is thus important for supporting industrial competitiveness, creating new business and employment opportunities, and for realising the advantages in producing goods. SMEs can play a key role in providing a range of services that are important for stimulating intra-regional trade, especially since services trade functions below its actual potential, accounting for only 22 per cent of Africa trade (UNECA 2021).

The impact of digitalisation and technology change on the service sector must also be taken into account since these platforms present a major growth opportunity for SMEs if properly harnessed. Digital technologies and information and communication technology further facilitate trading services across national borders and across regions. The internet's intermediation role has spawned new services avenues such as e-business and e-commerce, thus making services the connecting tissue between national and cross-border markets (African Union 2020).

The turn to services is, therefore, a major development and has become a critical growth and innovation pole in developing and emerging markets. The Chinese economy—once a global manufacturing hub—has shifted to services which now account for 52 per cent of its GDP, driven by the Fourth Industrial Revolution and artificial intelligence. A similar development has occurred in India where services make up 50 per cent of GDP. In Brazil and South Africa, the share is even higher at 63 per cent and 66 per cent, respectively (World Bank 2021).

## 2.5 Factoring as a driver of enhancing business opportunities for SMEs

Africa is a marginal player in the global factoring market, with less than 1 per cent of the market and where six countries represent the most important markets (Table 1). A major impediment and drawback to making factoring more attractive in Africa has been that it remains the preserve of banks and related banking institutions with onerous lending conditions and eligibility criteria, while autonomous factoring entities are few and far between (ACBF-Afreximbank 2022, 11).

According to Jani Moliis, co-founder and chairman of the board of BeneFactors Ltd of Rwanda: “The attractiveness of factoring is increased by the fact that it is a simple asset sale, and contrary to a loan, it does not create a liability for the company in question. This means that financing can be extended quickly, flexibly, and reliably without the need for collateral. All these elements make factoring a much more attractive source of capital for SMEs than a traditional banking loan” (Cited in Making Finance Work for Africa 2022).

In other words, it is the creditworthiness of the SME's customers or clients which determines its access to acquiring working capital rather than its collateral or credit history.

**Table 1: Total Factoring Volume: Country and Africa (EURO million)**

	2018	2019	2020	2021	2022
<b>Egypt</b>	517	589	604	1153	1181
<b>Mauritius</b>	227	230	203	250	144
<b>Morocco</b>	2532	2532	2532	2532	2532
<b>South Africa</b>	18582	20873	21465	27905	37392
<b>Tunisia</b>	316	338	258	311	378
<b>Africa</b>	<b>22174</b>	<b>25562</b>	<b>25062</b>	<b>32151</b>	<b>41627</b>

Source: Factors Chain International Annual Reviews 2022, 2023a

The adoption of factoring as a financing instrument in Africa has been hindered by several contributing factors that must be addressed. The most noteworthy include (Making Finance Work for Africa 2022):

- Knowledge gaps and information asymmetries continue to stifle growth of the product, its uses, and benefits among businesses, especially those that make up the SME sector. Factoring as an alternate source of finance to bank loans crucially depends on relevant financial information and types of economic activity (Alayemi 2017).

- The above knowledge and information limitations about factoring are equally applicable to governments and regulatory bodies which are, by and large, not aware of or show a distinct lack of interest in factoring as means of promoting entrepreneurship but also as a stimulus for overall economic growth and social development in the context of instabilities introduced by the pandemic and Russia-Ukraine war.
- This has perpetuated the cycle of high costs of doing business in Africa, compounded by bureaucratic and red-tape hurdles, a lack of finance, and high interest rates. Hence the reason why many African countries struggle with structural problems and challenges of economic diversification, especially those that add human and capital value (Irungu, Kibuine, and Muhoho 2019).
- These factors converge to underscore the lack of domestic legal and institutional enabling environments which embed the virtues and advantages of factoring activity in the business domain. For instance, where no effective and enforceable factoring laws exist, legal documents such as stamp duties and registration charges involve more and higher costs of between 3 and 5 per cent of the collateral value in some Anglophone African countries (Making Finance Work for Africa 2022, 8).
- In this regard, Afreximbank's 2016 Model Law on Factoring, which contains a basic template of the necessary legal provisions, legislative infrastructure, and regulatory regime, is highly instructive and is to be commended.
- Africa's private sector in general and SMEs in particular still struggle to take advantage of integrating digital technologies into their operations to build and develop resilience. The use of data analytics, digital tools, and automation could significantly contribute to facilitating factoring transactions by reducing the length and cost of processing such transactions (Achieng and Malatji 2022).

These matters are useful and important for understanding the anatomy of factoring, particularly its functional components as a financial service, how it works, and for what purpose as an alternative financing instrument to what is offered by conventional banks. In view of the embryonic nature of factoring in Africa and the constraints identified above, it is important to assess the importance of factoring. This relates not only to how it can enhance the latent and inherent potential of Africa's SMEs; but also, to realising the goals and ambition of the AfCFTA as far as the promotion of deeper and wider intra-regional trade is concerned, especially given the recovery challenges posed by the Covid pandemic and the Russia-Ukraine war.

In this regard, it will be useful to provide an assessment of credit guarantee schemes as mechanisms for SME growth and development in the general context of endemic threats of market failure.

## 2.5 The Promise of Credit Guarantee Schemes for SMEs

According to Tomusange (2015), state-owned banks and a few that are foreign owned dominate the financial sector in Africa. Lack of liquidity and commercial depth tend to be pervasive problems although, as Tomusange notes, there have been some improvements in capitalisation and trading activity due to regulatory and economic reforms that have been introduced. Other than South Africa and Mauritius, the banking systems of most countries are weakly embedded in the economic and commercial spheres and thus, offer few financial services. These endemic weaknesses have led to credit rationing which have direct implications for SME access to external finance (Beck and Cull 2014; IFC 2021).

In the repertoire of financing options offered by factoring, credit guarantee schemes (CGS) could contribute complementary and supportive synergies for SMEs, especially through reverse factoring or supply-chain financing and factoring without recourse. As such, a CGS assists with third-party risk mitigation to lenders so as to improve the credit environment for SMEs. Properly designed and operated, a CGS can be an important

policy mechanism for alleviating the financing constraints on SMEs and like factoring, is a critical enabler of economic development and job creation (IFC 2021; Soumaré 2022).

It further absorbs a portion of the lender's losses on the loans made to SMEs in the event of default in return for a fee. The popularity of CGSs derives from their common combination of a subsidy component with market-based arrangements for credit allocation. There is, therefore, less scope for distortions in credit markets compared to more direct interventions by state-owned banks or interest rate subsidies (Calice 2017).

In countries with weak institutional environments such as many in Africa, CGSs can provide more reliable information on SME borrowers together with credit registries. CGSs can also be leveraged to assist SMEs with countercyclical financing in times of an economic downturn or when there is higher risk aversion and a credit crunch such as occurred during the global financial crisis and the COVID-19 pandemic (Soumaré 2022). Outreach and additionality are basic principles which determine the efficacy of a CGS. Outreach has to do with scalability of the CGS in terms of the number of guarantees which are issued to SMEs which qualify; the logic of outreach dictates that the wider the coverage, the greater the impact which the CGS will have. In addition, economic additionality will result in overall economic improvements because of increased access and availability of capital for SME's (Calice 2017).

However, both additionality and outreach could suffer where SMEs are credit constrained which entails risk-taking and financial losses. It is precisely in this context where governments can play leading roles in the design and operation of CGSs because as a matter of course, their public nature presupposes that they are not profit-driven. Moreover, the inherent advantage of CGSs is their ability to address market failures which make it difficult for SMEs to get quantitative and qualitative forms of credit in a manner that contributes to social and economic development (Soumaré and Raga 2021).

While still in an embryonic stage with capitalisation constraints compared to developed countries such as the USA, the UK, France, and Canada, Africa does have the basic foundations of CGSs at both regional and national levels which provide services to SMEs. The best known at regional level are Afreximbank, the African Guarantee Fund, and the African Fund for Guarantee and Economic Cooperation. These are mainly funded by governments, Pan-African financial institutions, development finance institutions, and external cooperation partners. Most national CGSs are public institutions that receive a combination of government and donor funding. Examples include: the Business Development Fund in Rwanda, the Small Enterprise Development Agency and the Industrial Development Corporation in South Africa, the Small Industries Development Fund in Tanzania, the Agricultural Credit Guarantee Scheme Fund in Nigeria, and the Fonds de Garantie des Crédits aux Petites et Moyennes Entreprises in Côte d'Ivoire (Soumaré 2022).

### 3. Overview of factoring

Historically, factoring originated in the clothing and textile industries of America and Great Britain as a means of providing immediate financing. Factors then in the late 19th century were trading companies in the main, and as such, they handled goods on consignment in exchange for a commission (Hamanyati 2017, 20). Factoring has since evolved to become a major source of alternate finance, especially among developed countries where it is a €3 trillion industry (FCI 2022). European countries such as France, the United Kingdom, Italy, and Germany have become dominant players in the global factoring market, with Europe as a whole holding more than two-thirds of the market share at 68.4 per cent. The Asia-Pacific region, with China being the leading market player, has also shown rapid growth of 24.3 per cent, compared to all of North America at 3.1 per cent. However, as can be seen in Table 2, Africa’s global factoring volume still lags way behind other regions, making up only 1 per cent of the global total. Moreover, of the 4193 companies that operate in factoring markets across countries and regions, there are only 190 in the entire African continent (FCI 2022).

**Table 2: Regional Factoring Volumes (Billions EUR)**

	2019	2020	2021	2022
Africa	24.56	25.24	32.34	41.8
North America	86.70	66.60	97.00	103.00
Asia-Pacific	687.82	697.00	751.09	881.30
Europe	1976.24	1844.72	2118.04	2498.7
Middle East	9.93	9.52	9.17	9.40
South America	132.00	83.56	86.04	124.10
<b>Total</b>	<b>2917.25</b>	<b>2726.64</b>	<b>3093.68</b>	<b>3658.30</b>

Source: *Factors Chain International Annual Reviews 2022, 2023a*

Another relevant consideration is that factoring business in Africa is, by and large, of a domestic nature, thereby highlighting the growth potential for an enabling environment to include the promotion of international factoring where other regions enjoy great competitive edge and advantage (FCI 2022). In this regard, the potential is crucially located within the African circuits of intra-regional trade where factoring could make the difference as a financing instrument in support of expanding SME business operations as well as building their supply chains (Making Finance Work for Africa 2022).

Against this background, we now turn to examining the various conceptual and technical aspects of factoring.

#### 3.1 Definition and components of factoring

The essence of factoring can be understood both as a transaction involving a financial business and as a debtor finance arrangement. Its main function is to enable a business to sell its accounts receivable to a factor at a discount. In constrained and difficult credit market environments such as exist in many African countries, factoring interventions provide immediate solutions to meeting pressing financial needs that enable a business not only to survive in competitive and demanding conditions but also to grow and prosper.

Instant financing or making cash immediately available is facilitated by the factoring transaction and typically occurs when a factoring company or entity buys the accounts receivable (also known as invoices) from an operating business, the creditor (Goodden 2023). The factor could also offer other significant trade-related

services such as collecting the receivables, managing the receivables ledger on behalf of the creditor, and protecting the creditor against bad debts or debt default.

Banks and bank-operated factoring services tend to be the dominant modes as opposed to smaller or independent factoring entities. While qualifying entry, eligibility, and due diligence criteria for banks are quite stringent, banks offer standard factoring fees as well as lower fees for charges-commitment, exit, and delinquency; while also seeking to maintain a relationship culture that promotes future business and other possible transactions and products (Goodden 2023).

As an incentive to the factor, the creditor offers the receivables at 80 to 85 per cent of the cost, with a maturity of 45 days from the date of the invoice. The direct purchase of receivables by the factor does not require collateralisation which is the inherent advantage of factoring for SMEs (Klapper 2005). These basic formulae show how SMEs could mitigate their cash flow and financing challenges in terms of problematic operating matters that they inevitably confront such as high debt leverage, meeting their tax obligations, and being able to finance their payables on agreed terms and conditions (Korankye-Sakyi and Oluyeju 2022).

### 3.2 Types of factoring

The literature on factoring is very informative and useful in describing its scope and function (Klapper 2005, Oramah 2014, Hamanyati 2017, Marchi, Zaroni, and Jaber 2020, ACBF-Afreximbank 2021, Korankye-Sakyi and Oluyeju 2022, FCI 2022, and Goodden 2023). There is a wide and technically complex range of factoring types based on the operational requirements and exigencies of the business. They require expert knowledge, administrative experience, and management skills to ensure a satisfactory outcome for all parties and should be taken into account in the evolving African business environment and especially for their relevance to SME growth and performance as well as for technical assistance considerations. However, drawing on this literature and its vocabulary as well as for purposes of this study, the main features of factoring can be disaggregated as follows:

- Real and quasi factoring: Real factoring refers to all the relevant and conventional aspects of ensuring credit, payment, and providing professional services. Here the factor as the third party takes financial responsibility for the creditor (also variously called the supplier or seller) by:
  - » firstly, purchasing the accounts receivable from the creditor;
  - » secondly, the creditor receiving immediate cash or working capital based on the transfer of the accounts receivable to the factor, which is discounted for fees and commission;
  - » thirdly, the factor as the new owner of the invoice debt claiming payment from the debtor or buyer for the sale of goods or services; and
  - » fourthly, the creditor deriving additional benefits from the transaction such as the factor managing the ledger and administrative matters, but crucially assuming the risk of the debtor's potential insolvency.

**In the case of quasi factoring, not all services in the real transaction loop are rendered such as taking on the risk of insolvency.**

- An important underpinning of factoring is its recourse or non-recourse nature. In recourse factoring, the factoring entity has a claim (in other words, recourse) against the debtor for any default in payment; that is, there is no credit protection for the seller. In non-recourse factoring, by contrast, the factor not only takes on responsibility for the invoices but also most of the default risks since the factor does not have recourse against the supplier in the event of default; that is there is credit protection for the seller.
- A recent innovation has been in supply chain finance, known as reverse factoring. This form of factoring makes working capital available by allowing the business to extend its terms of payment to suppliers with

an option for early payment based on approved invoices. In other words, the factoring company buys the accounts payable without recourse from buyers with an established and credit worthy credentials, thereby limiting the credit risk to more manageable proportions.

- Open or disclosed factoring is another category which could potentially enhance cross-border trade and which SMEs could find attractive because it is intended for exporters and importers. Its open nature involves an exporter who is a client of the factor and a foreign buyer who imports the goods or service. The exporter offers the receivables to the factor who then claims from the foreign buyer. The client informs the foreign buyer about the transaction and the payment demand which is due to the factor.

**There are two types of open factoring:**

- » In the first, the exporting client of the factor transfers claims against the importing foreign buyer to the factor who then becomes the sole claimant. The factor then pays the client the value of the claim, less interest, expenses, and commission. Due to the high risk involved, it is assumed that the factor is fully conversant with the credit worthiness of the buyer.
  - » In the second, the exporting client only assigns the claim to the factor for its collection but does not transfer the claim to the factor. Hence, the factor, based on agreed terms, only collects the claim from the foreign buyer on behalf of the client.
- A final category is factoring with a right to recovery and factoring without such a right. In the case of the former, the factor has a right to the client in the event of being unable to collect the claim from the buyer. In the latter case, should the buyer renege on payment, then the factor has no right of claim from the client.

The above and other types of factoring are summarised in Table 3.

**Table 3: Types of Factoring**

<b>Real Factoring</b>	Involves all the relevant and standard forms of factoring, including ensuring credit payment and rendering professional services. The factor as third party assumes financial responsibility for the creditor as supplier or seller, and takes on the risk of the debtor's potential insolvency.
<b>Quasi Factoring</b>	Some but not all of the above services are rendered such as taking on the risk of insolvency.
<b>Full-Service Factoring</b>	Like real factoring, provides the entire range of services such as ledger maintenance, providing regular accounts statements to the customer, collecting receivables, and credit control. Charges can vary at between 0.5 and 2.5% of receivables.
<b>Recourse Factoring</b>	The factor does not assume the credit risk of default by the customer regarding the payment obligation. The credit risk is borne by the customer.
<b>Non-Recourse Factoring</b>	The factor assumes the credit risk. Even if the customer defaults on due date payment, the factor cannot claim back the amount from the customer; hence, why fees are higher than for recourse factoring.
<b>Reverse Factoring</b>	Also called supply-chain financing, this is initiated by the buyer or importer. Usually conducted where the customer is a large business and the client is a SME. The client gets instant liquidity and the buyer more time to pay the invoice.
<b>Domestic Factoring</b>	Involves three parties in the same geographic area: the client (seller), the customer (buyer), and the factor (the financial entity). This is usually a seamless arrangement since cultural, legal, and trade issues that arise are similar as are related barriers that must be overcome.

<b>Export Factoring</b>	Besides the client and export factor in the same area, involves an import factor located in the customer's area in another country. The import factor helps to determine creditworthiness, collects the money on the due date, and sends this to the export factor.
<b>Maturity Factoring</b>	Also known as collection factoring in wholesale markets. The factor collects money from the customer and remits the amount on the maturity date of each month's sales invoices. Can be with or without recourse depending on the terms and conditions of the contract.
<b>Advance Factoring</b>	An option where the business needs immediate liquidity and can be with or without recourse. In terms of the contract, the factor pays 75-90% of the factored receivables in advance to the client. The balance is due on the agreed payment date on receipt of money from customers. The factor charges an agreed rate of interest, called a discount.
<b>Disclosed Factoring</b>	Also called bulk and notified factoring where the factor immediately discloses the nature of the debt assignment by the client to the buyer or importer. The supplier notifies the buyer or importer to make payment directly to the factor.
<b>Non-Disclosed Factoring</b>	Also known as confidential factoring since the buyer has no knowledge of the vendor's financing arrangement with the factor who only provides an advance against invoices. The customer pays the client directly without being aware of the factoring arrangement. Some businesses prefer this arrangement since it allows them to deal directly with customers and thereby, have good relations.
<b>Bank Participation Factoring</b>	When an exporter or supplier needs access to a wider funding pool beyond the factor's base of 80%, banks can be approached for the unadvanced 20%. A usual resort in times of need of working capital.
<b>Limited Factoring</b>	Also known as selective factoring, the factor will only manage certain invoices or none at all. This is conducted on merit and money is only paid against selected invoices.
<b>Supplier Guarantee Factoring</b>	Also known as drop shipment or vendor guarantee factoring. This is a three-way agreement with the borrower's supplier as the additional party. The supplier could supply raw material for a big order or the client could be a distributor. The factor agrees to pay the supplier once shipped goods are accepted by the borrower's buyer. Money generated from factoring the invoice is paid directly to the supplier. This allows business to enter into new ventures that were not available due to lack of available credit from suppliers.

Source: Parekh 2022

### 3.3 Benefits and disadvantages of factoring for SMEs

On a means-ends continuum, the above categorisation and modalities are suggestive of the benefits which flow from factoring even though the service and discount fees charged for factoring can be prohibitive. Compared to loans, factoring thus offers a financing model for domestic and international transactions which is efficient, effective, flexible, and reliable. It has proven its pedigree as a short-term financing facility the world over (FCI 2022). Moreover, it provides a credit management service which provides greater space for business growth and expansion, especially for SMEs; assists with the expeditious collection of debt which greatly improves cash flow; reduces the risk of bad debts; and can also provide credit protection which eliminates the risk of bad debts (Irungu, Kibuine and Muhoho 2019).

However, we should also be mindful of some of the disadvantages of factoring for SMEs, and in the main, there are four. Firstly, non-recourse factoring and factoring without collateral can be costly, especially regarding mitigating risk and ensuring the agility of the product. Secondly, since the business uses its receivables to secure financing, such receivables do not appear on the balance sheet of the client who then has no control over the book debts; hence, these cannot be used as collateral in other financial services. Thirdly, a successful factoring relationship depends on the creditworthiness of the customer. However, a factor can reject a customer's invoices in an arbitrary manner if the factor considers the buyer's credit profile to be suspect or unworthy. Lastly, the third issue may lead to a certain degree of discomfort or unease as a factoring company assesses the buyer's credit profile, thus affecting the integrity and trust of the buyer and seller relationship (Parekh 2022a).

These main benefits can be tabulated as follows in Table 4.

**Table 4: The Benefits of Factoring**

<b>Immediate cash flow/ liquidity</b>	The factor pays between 80-90% of receivables upon invoice receipt. This leads to improved liquidity and more efficient capital management.
<b>No need for collateral</b>	Banks often require collateral from SMEs. By contrast, most factoring companies do not since the receivables and buyers are audited and the factoring company assumes the risk.
<b>Focus on core activities</b>	SMEs can focus on their core competencies more efficiently since factoring saves time and reduces costs of collecting the customer's receivables. The factor further provides services such as ledger management, collecting the account receivables, as well as credit control and protection
<b>A sale, not loan</b>	Since factoring is not a loan, it does not create any liability on the balance sheet.
<b>Bad debt protection</b>	If a client opts for non-recourse factoring, the factor assumes the risk of bad debts. This allows the business to focus on growth through the unlocked capital. By contrast, non-recourse factoring does compromise the cost competitiveness dimension of the financing mechanism.
<b>Cost competitive</b>	Given the highly competitive nature of the industry factoring, costs are basically reasonable; and importantly, are a more cost-effective means of managing the sales ledger process. This is especially in the case of recourse factoring compared to the higher costs of non-recourse financing.
<b>Fast and easy</b>	The easy and fast methods of factoring are its most significant merits. In addition, the application that is needed to establish a factoring relationship is straightforward. SMEs which are scalable, growing, and profitable benefit from this aspect compared to traditional bank loans.
<b>Higher credit limits</b>	Companies that specialise in factoring services offer higher credit limits based on a peg that SMEs do not exceed. This helps to maximise all the above benefits.

Source: Parekh 2022b

## 4. Select Factoring Case Studies

Notwithstanding the challenging global landscape, FCI's World Statistics Report highlights the remarkable growth of 18.3 per cent (or € 3659 billion) in 2022 in factoring and the receivables finance industry. This surpassed growth of 12.3 per cent in 2021 and has much to do with ongoing recovery from the pandemic as well as the injection of substantial government stimulus packages, growing inflationary pressures, and a surge in pent-up consumer demand. This growth in volume is indicative of the vital role that factoring plays in supporting SMEs in particular and the corporate sector in general (FCI 2023b).

Europe remains the largest contributor with 68 per cent of the global volume in 2022 (€2499 billion). Countries such as Spain (30 percent) and Germany (20 per cent) have registered impressive growth while another group has exceeded expectations and include Lithuania (67 per cent), Serbia (57 per cent), Turkey (51 per cent), Cyprus (50 per cent), and Greece (31 per cent) (FCI 2023a, FCI 2023b).

However, Africa is still a small market in global terms, accounting for only 1.14 per cent of the volume, although the growth rate of 29 per cent in 2022 (€41 billion) is a significant step forward (FCI 2023a, FCI 2023b). Below we showcase four case studies which cast the spotlight on different country factoring regimes. (Other useful case studies can be found in ACBF-Afreximbank 2021, 13-19)



### 4.1 South Africa

As the industry leader in Africa, in 2022 South Africa accounted for 89 per cent (€37 billion) of the continent's factoring business, followed by Morocco (6 per cent), Egypt (3 per cent), and Tunisia 1 per cent. South Africa also has the most factoring companies at 110 compared to 7 in Morocco, 32 in Egypt, and 5 in Tunisia (FCI 2023a). While the factoring is a robust business, South Africa has no relevant legislation or regulatory framework which governs the industry or market. It is left to a competent judiciary to provide interpretive guidance based on applicable legislation such as the Banks Act which regulates deposit receipts from the public but also informs how banking factors should conduct their business. There is also the Consumer Protection Law which regulates how goods and services are provided to consumers and this includes financial services. Then the National Credit Act regulates consumer credit as well as prohibiting reckless granting of credit and unfair credit-marketing practices.

South Africa has a Debtor Finance Committee composed of eight banking institutions such as Standard Bank, Nedbank, and First National Bank, and factoring companies such as Merchant Factors, Reichmann, and Grindrod. The four major banks, namely, Standard Bank, Nedbank, ABSA, and First National Bank are members of the Africa chapter of FCI, with 110 active companies as noted above (FCI 2022, FCI 2023a).

Factoring services are offered to both large listed companies and SMEs in sectors as diverse as manufacturing, clearing, and forwarding of imports and exports, food and beverage, wholesale, transport, pharmaceuticals, clothing and textiles, footwear, and steel (Korankye-Sakyi and Uluyeju 2022).

South Africa's SMEs, which account for almost 60 per cent of GDP and 60 per cent of employment, also benefit from the Small Enterprise Development Agency and Association for Savings and Investment in South Africa which are intended to assist with both financial and investment support as well as contributing to building their development capacities.

**Table 5: South Africa**

Number of SMEs*	2.6 million
Factoring Turnover €m**	37352
<ul style="list-style-type: none"> <li>• Domestic</li> </ul>	37272
<ul style="list-style-type: none"> <li>• International</li> </ul>	80
Number of factoring companies**	110

Sources: \*OECD Library 2022; \*\*FCI Annual Report 2023a



## 4.2 Tunisia

This North African country has more than 80 000 SMEs which account for about 40 per cent of GDP and contribute 50 per cent to the country's employment (Zgheib 2019, ACBF-Afreximbank 2021, 18). However, like their counterparts elsewhere in the continent, SMEs struggle to obtain viable forms of finance while maintaining liquidity adds to their challenges. Like South Africa, Tunisia does not have specific legal and regulatory regimes for factoring which rather falls under the purview of the law of contract and laws for the non-banking sector. The Central Bank plays a critical role in controlling the industry and its business operators while approval by the Ministry of Finance is compulsory, especially when it comes to meeting the capital requirement of the equivalent of €4.4 million for the factoring business to operate (Korankye-Sakyi and Oluyeju 2022).

However, over the last decade, the government has augmented legal and regulatory frameworks with the express purpose of establishing systems of public finance, supporting the development of financial markets, and expanding the scope of financial products, all of which are geared to strengthening the economic muscle of SMEs and in recognition of their strategic contribution to society.

These developments were greatly assisted by the European Bank for Reconstruction and Development (EBRD) which, in 2019, made a loan of €24 million to Tunisie Leasing and Factoring (TLF), the country's largest factoring business and the first to venture into leasing operations with a mandate to support SMEs. This loan was advanced against the backdrop of the EBRD's long history of involvement in Tunisia. Since the beginning of 2012, it has invested € 840 million to support 38 projects and provided technical assistance to 800 SMEs (Zgheib 2019).

Tunisia is an interesting and informative case of how financial and technical support for SMEs can be accelerated and better institutionalised through prudential legal and regulatory arrangements, even if these do not exist under one umbrella.

**Table 6: Tunisia**

Number of SMEs*	80000
Factoring Turnover €m**	378
<ul style="list-style-type: none"> <li>• Domestic</li> </ul>	361
<ul style="list-style-type: none"> <li>• International</li> </ul>	17
Number of factoring companies**	5

Sources: \*Zgheib 2019; \*\*FCI Annual Report 2023a



### 4.3 Namibia

Even though Capx Finance is the only factoring company, Namibia has a well-developed financial infrastructure for supporting SMEs which contribute about 12 per cent of GDP and 20 per cent of employment. The limited factoring market has much to do with capital constraints and an absence of relevant legislation, other than the Usury Act of 1968.

The Development Bank of Namibia and the Small Business Credit Guarantee Trust together with units in the Bank Windhoek and First National Bank provide financial services to SMEs. These services take the form of credit lines in low interest accounts, direct lending, and provision of working capital. The Development Bank’s service includes training, mentoring, and financial evaluation. The micro-lending sector has also grown rapidly but has been subject to abuse such that almost 230 000 Namibians are in debt to micro-lenders to the tune of N\$6.8 billion (about US\$37 million). The Micro-Lenders Association of Namibia has therefore stepped in to protect SMEs especially from unscrupulous lenders (Amukeshe 2021).

To protect itself and when buying the accounts receivable, Capx Finance will only deal with high quality buyers which then pay the invoice amount directly to it upon delivery of the goods or service. Capx Finance provides working capital of up to 75 per cent of the SME’s accounts receivable. From the remaining 25 per cent, they deduct the factoring fee and the prime-linked discount fee based on three considerations: the capital needed; the time period for which the capital is needed; and the collateral offered. Those with eligible collateral and lesser amounts with a shorter repayment period enjoy lower rates compared to the opposite situation with larger amounts, longer repayment periods, and no collateral. Other than SMEs, CapX Finance also provides factoring services to clients in the construction industry, general retail dealers, motor repair, and medical practice (Nakusera, Kadhikwa and Mushendami 2008).

**Table 7: Namibia**

Number of SMEs*	40000
Factoring Turnover €m	Data not available
<ul style="list-style-type: none"> <li>• Domestic</li> <li>• International</li> </ul>	
Number of factoring companies	1

Source: \*Namibia Hub 2022

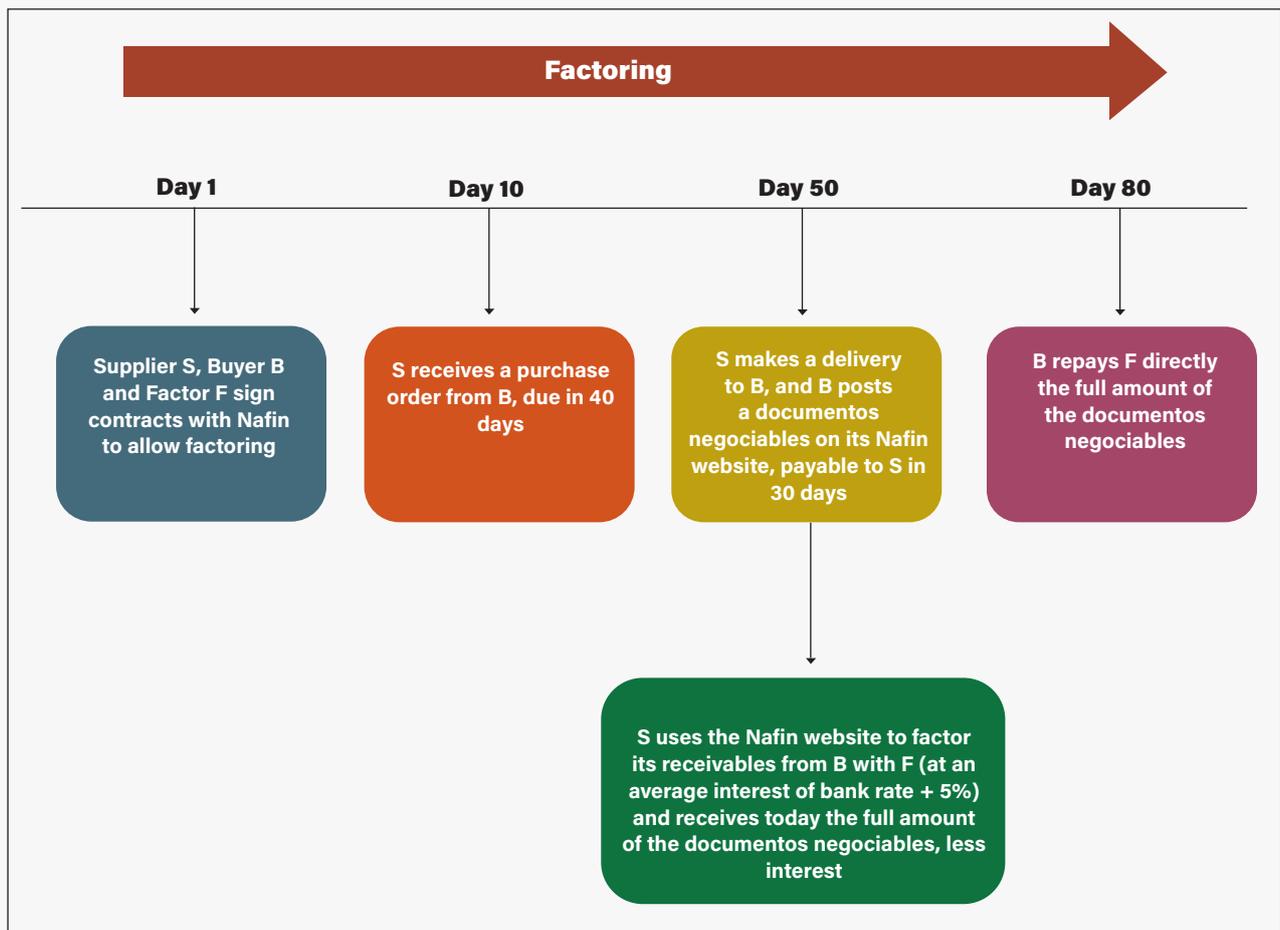


## 4.4 Mexico

Mexican SMEs play a very prominent role in its economy, comprising 42 per cent of GDP and 64 per cent of employment. The case of Nacional Financiera (Nafin) is therefore included since it constitutes a successful study of reverse factoring as well as providing on-line factoring services to SME suppliers. It was established in 1934 as a state-owned development bank to provide commercial banking services. With 32 national branches, since 2000 it has expanded in the direction of using ICT to improve lending to SMEs; and to complement such lending with training and technical assistance. Nafin's operating mechanism of "Productive Chains" establishes chains between big buyers and small suppliers. The former are low credit risk and creditworthy companies while the suppliers are mainly small, at-risk SMEs which do not qualify for formal financing from the banking sector. In terms of "Productive Chains", small supplying SMEs can use their receivables from big buyers to get working capital and finance. This translates into transferring their credit risk to high-quality customers in exchange for higher levels of and less expensive financing (Klapper 2005).

The innovative and noteworthy aspect of Nafin's factoring methodology is its operation as an on-line platform where the *documentos negociables* or the negotiable document which regulates the transaction is posted (see Figure 1). Its most compelling feature as an on-line factoring service is that 98 per cent of all services are provided electronically, thereby greatly reducing costs and improving security.

Figure 1: The Nafin Factoring Agreement



Source: Klapper 2005

An added advantage is that Nafin invites all commercial banks to get involved in the chain such that they have wider national reach through the Internet. This “multi-bank” approach has the added benefit of inviting lenders to compete for suppliers’ receivables by offering the most favourable terms and conditions; and Nafin paying the costs of its electronic factoring platform and associated document preparation, transfers, and signing thus relieving the parties from paying service fees

Nafin also uses the Internet through a network of regional contact centres to both market and provide its factoring services. In addition, all its factoring is conducted on a non-recourse basis which then allows SMEs especially, to improve their liquidity and cash-flow as well as their balance sheets. The success of its factoring programme is attributable to its efficiencies: transactions are quicker and cheaper, usually completed within three hours, and cash received by suppliers by the close of business, thereby enabling immediate liquidity (Klapper 2005).

Nafin thus represents a case where the use of technology has enhanced economies of scale such that its share of the factoring market grew from 2 per cent in 2001 to more than 70 per cent in 2020 (Nafin).

**Table 8: Mexico**

Number of SMEs*	4.86 million
Factoring Turnover €m**	34179
<ul style="list-style-type: none"> <li>• Domestic</li> <li>• International</li> </ul>	33426
	753
Number of factoring companies**	18

Sources: \*OECD Library 2022; \*\*FCI Annual Report 2023a

## 5. SME Growth and Development through Factoring

It is estimated that there are more than 50 million SMEs across the continent with almost 70 per cent operating in the informal sector, making up 58 per cent of the labour force and contributing 33 per cent of total GDP (Hamanyati 2017, 60). As the motor force which drives economic activity, SMEs in Africa thus serve a number of vital functions. They help to diversify a country's economic base, promote innovation in business activity, play a critical role in delivering goods and services to those at the bottom of the social pyramid, and are a potent force for integrating women and youth into the mainstream of economic life (Muirithi 2017).

Yet despite their evident economic, social, and political value and virtues, SMEs across Africa have been neglected by financial institutions such that access to finance remains the most serious binding constraint because of their real and perceived high-risk quotient. Locked out of bank financing, SMEs typically enter the proverbial "Valley of Death" where they are bound to meet their demise (World Bank 2017, 4).

Financial inclusion for SMEs is, therefore, a basic principle of economic growth and job creation and it is because of its inclusionary and non-discriminating ethos that factoring represents such an important source of alternate financing based on the benefits and advantages enumerated above. Factoring and its inherent benefits for SMEs become even more significant in an African credit market which is notorious for market failures and imperfections, including information asymmetries, lack of recognised collateral, and high transaction costs (Beck and Cull 2014, World Bank 2017). The manifest and salutary benefits of factoring for SMEs and the types better suited to the African SME context can only be exploited if attention is paid to the serious and multiple challenges which they have to confront, to which we now turn.

### 5.1 Challenges faced by SMEs in Africa

The Covid-19 pandemic and latterly, the Russia-Ukraine war have had a far more pronounced and lasting impact on the viability and sustainability of SMEs. Sectors of SME activity that have been directly affected include hotel and tourism, information technology, retail trade, textile and apparel, social and personal services, financial and business services, food and beverages, transportation services, and crop production and animal husbandry (Amoussou, Karaguezian, and Bah 2021). Moreover, the prolonged lockdown and now the impact of the war on rising food prices, rising energy prices, and increasing financial constraints have affected the supply and demand for labour.

Africa's economic recovery also critically depends on the resumption of traditional trade flows with its largest trading partners, namely, China, the USA, and the EU which together account for almost 50 per cent of its merchandise trade. Africa is especially dependent of China for its manufactured goods, clothing and apparel, vehicles and vehicle parts and accessories and intermediate inputs

The major challenges facing SMEs have been referred to above but further detail can be added here in terms of typical problems which they face:

#### 5.1.1 Problems of access to finance

Africa's financial systems do not have the necessary bandwidth, and therefore, their outreach is limited to a small percentage of the population. It is important to emphasise the robust correlation between financial access and per capita GDP because, in environments where capital is readily available, GDP growth tends to be higher (World Bank 2006). According to the World Bank Enterprise Survey Database (2023) which covers 125 000 enterprises in 146 countries, 48 per cent of the respondents from Africa cited access to finance

as their main challenge compared to 25 per cent in South Asia. Many SMEs have to resort to self-financing or as the World Bank study puts it, they have to depend on “friends, family, or fools” to provide them with the necessary capital (World Bank 2017,4).

### **5.1.2 Problems of informality**

As mentioned, the majority of Africa’s SMEs exist in the informal economy. This can be understood as all economic activity where owners, employers, and employees of the enterprise, both in law and practice, are not covered by formal arrangements or if they are, such coverage tends to be insufficient and inconsequential. The sectoral spectrum of unorganised and informal activities includes commerce, agriculture, construction, manufacturing, transportation, and services which absorb about 60 per cent of the labour force across African countries (UN 2020). Compared to their counterparts in the formal sector who are often protected by labour relations legislation, and thus have regular hours of work, a fixed place of work, and structured benefits, workers in the SME informal sector suffer from insecurity of tenure, with no benefits, welfare protection or union representation (ILO 2018).

Notwithstanding the diversity of Africa’s informal sector, it does come with a range of creative and innovative skills that have been acquired outside the formal economic and education systems; as such its role in income and employment generation cannot be discounted.

### **5.1.3 Problems of Management**

The lack of strategic literacy and tactical intelligence among SMEs points to deficits in relevant training and the absence of the necessary experience to run a business operation. Businesses basically operate by trial-and-error methods, with a premium on short-term gains. The irony is that because of the sheer imperative of survival, SME entrepreneurs instinctively know what they are doing based on effective and workable ideas and have the rudimentary competences to run their business operations. However, deficiencies in managerial skills and financial planning have contributed to the poor performance and long-term stability of SMEs in Africa. In South Africa, 70 per cent fail in the first five to seven years while in Uganda 33 per cent do not survive beyond the first year (Muriithi 2017). However, this is a universal problem that is not unique to the African setting: poor management accounts for 92 per cent of business mortality in the USA and 96 per cent in Canada (OECD 2021a, OECD 2021b).

The stable supply of electricity is another bane of SME management since the business is unable to function at full capacity and alternate means such as generators entail additional capital and fuel costs that most SMEs can barely afford. Besides access to capital (18 per cent of African respondents), the World Bank Enterprise Survey (2020) ranked poor electricity supply as one of the most critical constraints that SMEs in Africa have to confront and deal with (25 per cent).

### **5.1.4 Problems of government support**

The role of government and relevant state agencies is critically important to creating the enabling environment in which SMEs can grow and flourish. SME’s survival imperative can be directly linked to indifference and the uncaring attitude of many African governments towards SMEs although this has to be qualified somewhat since SMEs were given direct support and procurement opportunities during the Covid-19 pandemic.

However, these were crisis interventions and emergency measures due to the effects of the pandemic. Over the long-term, whether or not Africa’s SMEs will enter the “Valley of Death” will crucially depend on how governments, in conjunction and close collaboration with regional economic communities and continental

institutions, establish systems which are geared to directly support the growth of SMEs. This must include appropriate and accessible legal, policy, and regulatory frameworks for wages, taxation, licensing and registration, credit guarantees, as well as technical and technological support.

Obtaining business licenses is of particular concern in the punitive African context: it takes 100 days in Kenya, 220 days in Ghana, and 350 days in Nigeria. Besides such bureaucratic hurdles, SMEs have to further contend with political instability which is often exacerbated by conflict and violence which are often driven by crime, poverty, poor governance, ethnic cleavages, and religious differences.

### 5.1.5 Problems of Corruption

Corruption is another Achilles heel which compounds the effectiveness and vulnerability of SMEs. It erodes trust, impedes economic development, and aggravates inequality, poverty, and social divisions. Due to their informal and often illegal nature, SMEs are subjected to constant harassment and intimidation by legal authorities and law enforcement. Allegations of illegal operations and unpaid licenses can result in the confiscation of goods, equipment, and property unless a bribe is paid. Corruption in this sense constitutes a form of extortion and racketeering Where hard-earned financial gains have to be regularly directed towards such non-financial activities. Consequently, cycles of corruption continue unabated since these practices are considered to be normal by government officials and officers of the law (Muriithi 2017).

According to the World Bank Enterprise Survey (2020), 70 per cent of African respondents saw corruption as the major obstacle to the growth of their enterprises. It is thus not surprising that a host of African countries score very poorly in the Transparency International Corruption Perception Index (2022).

## 5.3 Opportunities for SMEs arising from the AfCFTA Trade in Services Protocol

The importance of services comes into sharper relief when considering the major impact that the COVID-19 pandemic has had globally and from which African countries' service sectors were not spared (Box 1). Many services provide key inputs to almost every major sector of business. For example, infrastructure services are linked to energy, telecommunications, and transportation; financial services facilitate transactions and access to finance for investment; health and education services contribute to a productive and healthy workforce; and legal and accountancy services make up the institutional framework that facilitates market transactions. Crucially and it is worth stressing, trade in services remains largely invisible and intangible, tied as such trade is to the national, regional, and international movement of people, information, money, and goods (UNECA 2021a, UNECA 2021b, Chapter 3).

### Box 1: Services affected by COVID-19 globally

**transport** (air, rail and maritime); tourism (hotels, restaurants, travel agencies); sport and recreation (entertainment, libraries, sporting events); **health** (hospitals, clinics, social services); **environmental** (sewage, refuse removal, sanitation); education (primary and secondary schools, higher education); financial (banking, insurance); **construction** (building, civil engineering, assembly); **communication** (postal, courier, telecommunication, audio-visual); and **business** (professional, computer, research and development, rental and leasing, real estate) (OECD 2020).

In view of the pandemic Africa's structural transformation will in large part depend on how well its countries are able to operate in the context of both regional and global fragmented production chains since trade increasingly occurs through value chains made up of the combined flow of goods, services, investment, and information that are necessary to generate products in different locations. To make this possible, trade in services constitutes the connecting tissue between country, regional, and global markets by providing the essential platforms for broadening participation and improving competitiveness within such value chains (UNECA 2021). The role played by improvements in logistics, ease of travel, and the revolution in ICT and electronic infrastructure has been of critical importance.

The AfCFTA's Trade in Services Protocol is thus a very important development in enhancing the prospects for intra-regional trade, especially in overcoming the structural constraint of informality in the services trade which is a major stumbling block to SME growth and development as explained above. Furthermore, services trade restrictions in African countries remain problematic and could undermine the great promise and potential which services trade holds for the AfCFTA's integration agenda. For example, Africa's aggregate Services Trade Restrictiveness Index is nearly four times that of 19 out of the 36 countries that make up the OECD (UNECA 2021). This is symptomatic of serious impediments in policy, regulation, and competition. The general environment for services trade in Africa is often below standard, costly, and inefficient, with direct consequences for the operational viability of SMEs (Dihel and Goswami, 2016).

The aspiration of the Trade in Services Protocol is, therefore, to create the conditions for more formal trade in services that will encourage both national and cross-border activity, investment, and growth in the services sector. This is in recognition that across African countries and with due regard to the primary role which SMEs can play, services will increasingly become the main fulcrum of productivity, competitiveness, job creation, poverty reduction, and improving living standards.

It is in this strategic context of the synergies between services and SMEs that factoring could unlock the latent potential of intra-regional trade if the appropriate conditions for external financing can be created, especially through modal channels of CGSs. Crucially, factoring will prove salutary under African conditions of weak contract enforcement, poor access to finance, information asymmetries, and inefficient bankruptcy systems.

#### 5.4 The role of digitalisation and technology

When linked to the potential of services in contributing to SME growth and development in Africa with factoring as an intermediation instrument, resilient capability in using technology could assist with rapidly expanding their customer and supplier networks. In this regard, digital transformation plays a catalytic role in thinking about how new business models can improve SME business operations, add value to their products and services, and generate greater revenue. Importantly, the use of digital technology could stimulate increased mobility, cross-border trade, and enhance the interconnectedness with other national and regional SMEs in the letter and spirit of the AfCFTA, whose major objective is market liberalisation and with it, creating opportunities for digitally-driven economic growth (African Union 2020). SMEs could be the key beneficiaries of the AfCFTA's digital ethos and philosophy if properly managed, designed, and promoted.

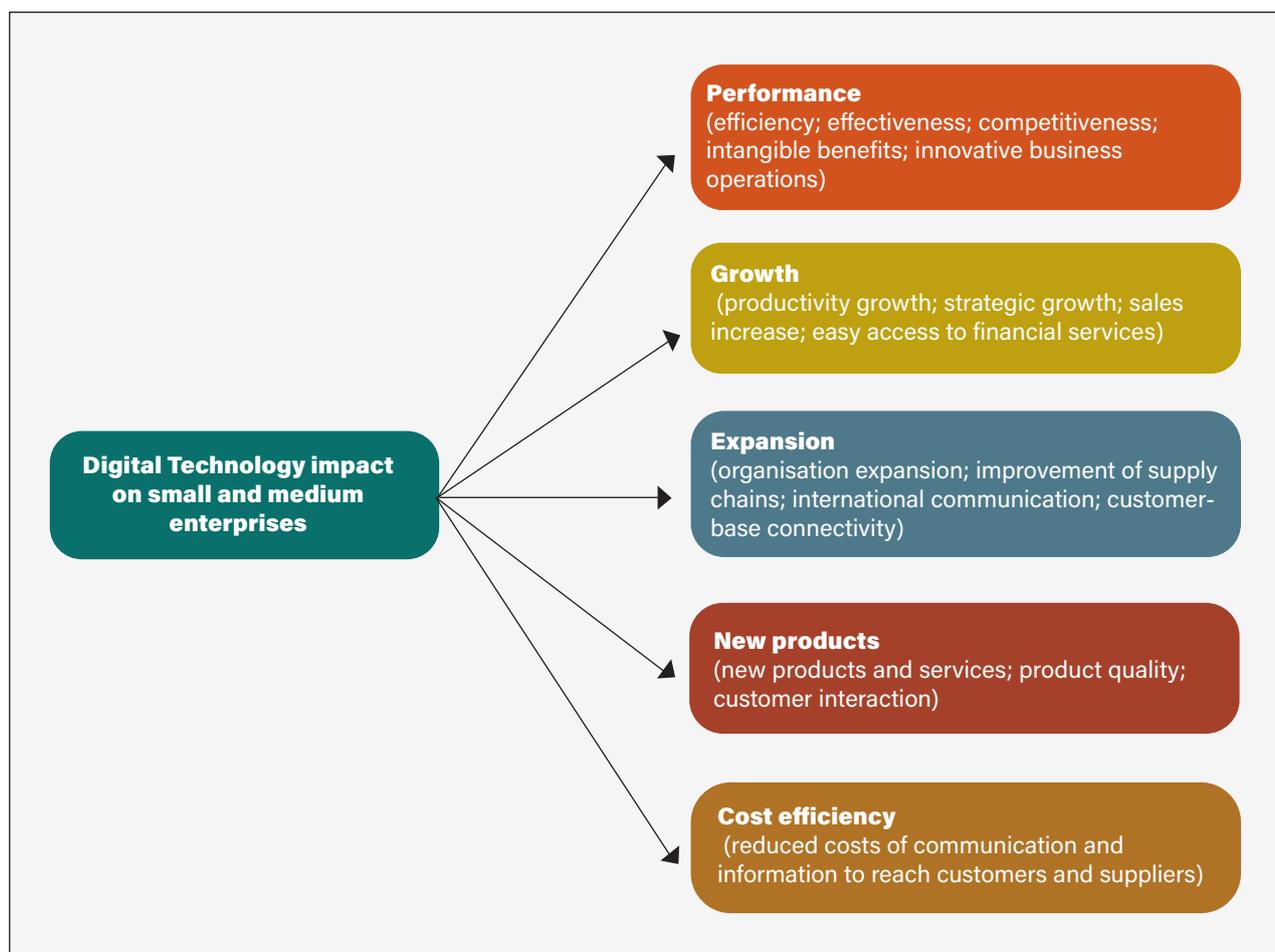
Across Sub-Saharan Africa, there has been an upsurge in digital initiatives because of improved mobile telecommunication infrastructure, Internet-driven mobile broadband networks, and the phenomenal increase in mobile phone ownership. These developments have vastly improved the operating environment for SMEs across a broad activity spectrum which includes the use of information and communication technologies; computer and mobile technologies and applications such as e-mail; electronic commerce websites; cloud computing; electronic payment systems; and social media platforms (Achieng and Malatji 2022). The digital age therefore represents a new developmental frontier for SMEs and can go a long way in helping to contribute to a more stable and productive business environment.

However, the benefits that come with the transformative potential of technology and how it can assist with building SME resilience are often offset by obstacles. Indeed, the road to digital sovereignty for the continent

is one fraught with high internet costs for SMEs, low digital literacy, restrictive laws and regulations regarding equal access, problems of data privacy and data leaks, and increasing incidences of cybercrime.

In this regard governments, in close cooperation and consultation with all officially recognised regional economic communities, and continental organisations, namely, the AfDB, UNECA, the AUC and the AfCFTA Secretariat, should come together to assist SMEs with addressing four digital dimensions that will challenge SMEs in terms of performance, growth, expansion, product development, and cost efficiency (Figure 2).

**Figure 2: Impact of digital technologies on SME business operations**



Source: Achieng and Malatji 2022

## 6. Factoring and intra-African trade

While the AfCFTA constitutes a major milestone in Africa's integration efforts, there are persistent barriers and challenges to enhanced intra-regional trade. It has become something of a cliché that Africa's levels of intra-regional trade are abysmally low given its potential and compared to other regions: 14 per cent for Africa versus 69 per cent for Europe, 59 per cent for Asia, and 31 per cent for North America (Tralac 2021). By removing both tariff and non-tariff barriers as prescribed by the AfCFTA, from its current total value of US\$147 billion (Afreximbank 2020) intra-Africa trade could increase by 15 per cent (US\$50 billion) by 2030 and 25 per cent (US\$70 billion) by 2040 (Mold 2022).

### 6.1 The current state of intra-African trade

The continent's exports to the rest of the world are commodity dependent while trade within the region tends to be more diversified due to a larger share of processed goods and agricultural. However, its trade policy landscape remains fragmented, characterised as it is by multiple regional economic communities, a challenging trade environment, and poor access to finance. Improved intra-regional trade can assist the continent to take advantage of technological change and the demographic dividend, enhance its resilience to climate change, improve its food security, create employment and reduce poverty (IMF 2023). The Table below is indicative of the problematic intra-African trade landscape for exports and imports across the RECs, with only SADC showing appreciable contributions to both categories (UNECA 2021b).

**Table 9: REC Contributions to Intra African Exports and Imports, 2010-2019 (%)**

REC*	Exports			Imports		
	2010	2015	2019	2010	2015	2019
UMU	4.8	4.8	3.9	4.9	4.8	6.5
CEN-SAD	19.7	18.3	20.4	19.8	18.7	19.3
COMESA	13.5	12.7	17.2	13.9	14.0	14.2
EAC	2.9	4.3	3.8	3.2	3.6	4.1
ECCAS	2.7	2.7	1.7	3.3	2.7	1.6
ECOWAS	11.9	11.5	10.9	11.5	11.8	10.8
IGAD	2.3	3.0	4.6	2.2	2.4	2.8
SADC	44.4	49.4	47.0	45.0	49.2	41.5

Note\*: UMU-Arab Maghreb Union; CEN-SAD-Community of Sahel-Saharan States; COMESA-Common Market for Eastern and Southern Africa; EAC-East African Community; ECCAS-Economic Community of Central African States; ECOWAS-Economic Community of West African States; IGAD-Intergovernmental Authority on Development; SADC-Southern African Development Community.

Source: UNECA 2021b

At its 30th Annual Meeting in Accra, Ghana from 18-21 June 2023, Afreximbank announced several important initiatives in support of intra-Africa trade and realising the ambition of the AfCFTA. It will double its assets and guarantee book to US\$60 billion to boost intra-African trade. In the five years leading up to 2021, the bank had disbursed more than US\$20 billion which will be doubled by 2026 to assist with bridging the considerable intra-Africa trade finance gap. In addition, since the COVID-19 pandemic and the onset of the Russia-Ukraine war, the bank has disbursed US\$45 billion to assist governments and businesses to deal with their repercussions as well as their maturing trade debt obligations.

The bank's subsidiary, the Fund for Export Development in Africa, as an equity fund, is making a further difference by providing long-term support for export manufacturing, intra-Africa trade, and value-added services. The meeting also saw the launch of AfrexInsure which will provide insurance for infrastructure projects and export cargo around the continent at rates that are affordable and accessible (Magubane 2023). However, as much as these important dynamics augur well for intra-regional trade and facilitate the core objectives of the AfCFTA, their scope could be undermined by worrisome barriers which have critical implications for SMEs as the main conduits of cross-border business.

## 6.2 Barriers to cross-border trade for SMEs

Higher levels of intra-Africa trade could prove salutary for alleviating the disruptions to the continent's development trajectory caused by the COVID-19 pandemic as well as its food security dilemma as a consequence of the Russia-Ukraine war. This is because, within the AfCFTA ecosystem, it is expected that 90 per cent of tariffs will be eliminated on goods over the next 5-15 years; and trade in agriculture and food products is projected to increase between 20 and 35 per cent by 2040 (Diallo 2022). In addition, the International Trade Centre (ITC)—a joint agency of the World Trade Organisation and the United Nations—has identified 94 value chains in 23 sectors that could materially contribute to greatly enhancing intra-Africa trade with a focus on empowering women and SMEs (ITC 2022).

However, this compelling logic comes up against a number of impediments. The AU Action Plan for Boosting Intra-Africa Trade (BIAT) adopted in 2012 is particularly insightful with regard to the non-tariff factors that inhibit its seven action plan clusters. These are:

- **Trade policies:** for the most part they are incoherent, inadequate, and inefficient.
- **Trade facilitation:** there are complex customs and administrative procedures and regulations as well as inefficient and costly transit systems.
- **Productive capacity:** economies remain commodity dependent and there is a need to diversify in the direction of manufactured goods and services.
- **Trade-related infrastructure:** roads, rail, ports, air, and waterways are inadequate, and there are deficiencies in soft infrastructure, energy, and ICT.
- **Trade finance:** financing mechanisms are weak, compounded by the problem of inconvertible currencies, underdeveloped regional institutions for finance, credit, and guarantee for cross-border trade.
- **Trade information:** there is a lack of relevant information to source products and services.
- **Factor market integration:** there are constraints to the mobility of labour, business, and capital.

If these essentially inhibiting supply-side factors could be assertively addressed, there would be increased volumes of intra-African trade which could help to unleash SME's entrepreneurial dynamism. The net result would be a greater propensity among African countries and SMEs to exchange more manufactured and processed goods, engage in more service-related activity, and create opportunities for the freer movement of people. In addition, such increased volumes would crowd in other advantages such as encouraging economic diversification and knowledge transfer as well as creating more value, especially in those sectors such as services that could promote financial inclusion of SMEs (Songwe 2019).

### 6.3 Role of factoring in facilitating trade finance and integration

While difficult to gauge with precision and well-nigh impossible to control or suppress, it is estimated that informal cross-border trade volumes account for between 30 and 40 per cent of total intra-Africa trade (UNCTAD 2019). Moreover, informal trade through SMEs was an important stabilising factor during the Covid pandemic by contributing to maintaining jobs, incomes, and household consumption as well as developing competitive cross-border value chains in the face of the inexorable destruction of livelihoods and economies caused by the pandemic's multiple impacts (Afreximbank 2020). The challenge then for all strategic AfCFTA stakeholders—governments, regional economic communities, continental institutions, external cooperation and major trading partners, the business community, and the private sector—is how to turn the sow's ear of informal cross-border trade into a silk purse of expansive and formalised SME involvement in regional markets?

While not obviously a panacea, factoring—and to repeat if properly managed and designed as a fit-for-purpose vehicle in an SME environment characterised by informality—could go a long way towards establishing a financial bridgehead for introducing services and manufacturing scale economies in regional and continental markets, especially in the 94 value-adding chains in 23 sectors which the ITC examined in its diagnostic assessment (ITC 2022). In this regard, an area for future research would be to identify regional business circuits that lend themselves to participation by SMEs and how such circuits, on the basis of promoting regional and continental factoring densities, could enhance intra-regional trade through the direct participation of SMEs. Crucially, the recognised international benefits of factoring must weigh into the strategic and policy calculus of promoting it as law, policy, and practice across the continent. A critical underpinning of this promotion must be the express objective of improving the cash flow and working capital of SMEs as they expand the ambit of their business reach beyond their own national borders. It should be axiomatic that factoring offers a more viable alternative to conventional loans since it assists SMEs in managing one of their Achilles heels, namely, achieving liquidity and maintaining solvency.

While there are conditions precedent for borrowers to qualify for factoring services, let us recall and emphasise the fundamental purpose of factoring: firstly, it is less demanding and more supportive in terms of SMEs functional needs; and secondly, it obviates the need for collateral or long-term securities by transforming short-term assets in the form of receivables into cash. Where bad debts and business risks often constitute existential threats to SMEs, as creditors, and because of the factoring arrangement, they are relieved of any risk of insolvency by the factor who assumes full responsibility for receivables payments and their credit management, including non-payment by the debtor (Korankye-Sakyi and Oluyeju 2022).

Therefore, in terms of its value proposition and transactional advantage for advancing intra-regional trade, factoring not only offers an efficient, flexible, and heuristic model to help SMEs in their often limited and constrained domestic environments, but opens new vistas of entrepreneurial opportunity for region-wide and continental transactions where the credit risk is carried by the factor in a win-win type dispensation.

Such a dispensation should be empowered by an ecosystem of affordable finance, training, logistics, and access to markets for SMEs, together with turbocharged institutional capacity to create hubs of factoring expertise across countries, regional economic communities, and continental institutions. This underscores the need, on one hand, for improving the legal, policy, and regulatory environment for factoring in Africa in the context of the AfCFTA's objectives; and on the other, expanding the scope, substance, and reach of national and continental credit guarantee and insurance schemes (Oramah 2014).

## 6.4 Role of SMEs and factoring in enhancing cross-border services trade

On the basis of incisive analyses and persuasive empirical support, the UNECA report (2021) demonstrates that Africa's next phase of growth and development will be driven more by services and less by manufacturing and industrial development where its factor productivity lacks competitiveness both in continental and global terms. From 2000 to 2015, the contribution of services to employment increased from 27.6 per cent in 2000 to 32.3 per cent in 2015 (UNCTAD 2018) while its share of GDP increased from 50 per cent in 2007 to 53.6 per cent in 2017 (UNCTAD 2019a). As of 2018 the total value of services exports and imports in Africa was \$296 billion (UNCTADStat 2019b). Services thus provide a major impulse for the continent's structural transformation, especially with regard to addressing challenges of informality in services trade and promoting greater gender and social equity across its sectors.

Negotiations for liberalising services within the remit of the Trade in Services Protocol have commenced in the five priority areas approved by the African Union Assembly in July 2018, namely, transport, communications, financial services, business services, and tourism. These will be followed by negotiations in seven other sectors, namely, construction, distribution, education, energy, and services related to the environment, health, and social delivery (UNECA 2021). Their outcomes are highly significant for crowding in the roles that SMEs can play and how they may benefit from services trade.

The nexus between liberalising services trade and factoring presents a new opportunity frontier to be explored because the negotiations and their modalities are extremely important for addressing barriers and restrictions in services trade that exist and which inhibit unlocking the potential of services trade among African countries and regions.

The increasing use of digital trade and e-commerce during the COVID-19 pandemic points to the need to promote knowledge-intensive opportunities to enhance SME participation in both regional and global value chains. Factoring and its benefits provide the necessary strategic linkages for developing and expanding digitally-driven economic activity at national, regional, and continental levels. However, the endeavour necessary to realise the benefits of the Protocol on Trade in Services will come with challenges for African governments and SMEs because of its novelty as well as the imperative for deeper governance reforms than those typically associated with merchandise or goods trade. Traditionally, the nature of public ownership and the degree of domestic regulatory intervention have been higher in the services sector than the goods sector. This is because there are serious barriers to services trade in a myriad of domestic regulatory regimes (Brockman 2019).

The advantages of factoring can certainly enhance the role of services in the structural transformation and overall competitiveness of the continent. The development of synergies between the services sector, one hand; and factoring and reverse factoring as tools of domestic trade finance and supply chain finance, respectively, have important welfare gains for SMEs. These include the reduction of poverty, addressing gender disparities, improving the dynamics of intra-regional trade, developing cross-border networks that benefit consumers and producers, and improving the integration of services and factoring as inputs to other export activities such as agriculture, energy, and manufacturing.

## 7. Regulatory and Legal Frameworks: Implementation challenges

Given its growing importance, relevant studies point to the need to develop factoring laws and regulations that are consistent with and informed by internationally accepted standards (Hamanyati 2017, ACBF-Afreximbank 2021). There are four guiding or paradigmatic frameworks which are often referred to:

- **The Model Law on Factoring of Afreximbank (2016);**
- **The Ottawa Convention on International Factoring of the International Institute for the Unification of Private Law (UNIDROIT) (1988);**
- **The Convention on the Assignment of Receivables in International Trade of the UN Commission on International Trade Law (UNCITRAL) (2001); and**
- **The Model Law of the International Factors Group (IFG) of 2014**

The UNIDROIT Convention recognises the critical role which international factoring can play in promoting global trade across different country jurisdictions by specifying the rights and duties of each party. The UNCITRAL Convention is important because it broadens the scope of factoring by not only covering receivable products and credit factoring but also introduces the concepts of securitisation and forfaiting. Securitisation merges and repackages various financial assets into bonds for sale to potential investors, while forfaiting is a uniquely international trade financing instrument. As such, it is a non-recourse method of payment that allows the trade receivables of exporters to get discounted cash from a finance firm or bank, otherwise known as a forfaiter (Korankye-Sakyi and Oluyeju 2022, 196). For its part, the IFG Model Law brings together best legal practice principles and internationally accepted standards of factoring. Its scope excludes securitisation and forfaiting but covers both domestic and cross-border factoring arrangements where the factor is obligated to provide services such as financing, ledger management, and the collection and protection of bad debts. It might be useful to focus on Afreximbank's Model Law because of its Pan-African ethic and aspiration.

### 7.1 Afreximbank's Model Law

The Model Law integrates the best features of the IFG framework by providing guidance and benchmarks on how factoring and trade finance may be adopted in domestic legislation by African countries. Moreover, the Model Law greatly simplifies the abstruse conceptual vocabulary of the Conventions, such as understanding a factoring relationship as an "assignment". As stated in the preamble, the Model Law aims "...to create certainty and transparency...and ensuring adequate protection for the interests of debtors in order to promote the availability of capital and credit and to facilitate domestic and international trade (Afreximbank 2016).

The Model Law's seven parts include definitions and how it is to be interpreted (Part 1); the scope of its applications and limitations (Part 2); derogation from its provisions except for those that are considered inviolable (Part 3); the validity and effectiveness of assigning trade receivables (Part 4); the rights, obligations, and duties of parties to the assignment (Part 5); the regulation of international factoring transactions (Part 6); and its entry into force, adoption, application and impact of repealing laws that are not consistent with the Model Law's parameters.

At a time when the AfCFTA requires greater momentum after the setbacks caused by the pandemic, the legal basis of factoring must be promoted because it will improve the domestic and regional environments for growth and development. There are several relevant considerations which are particularly germane to SMEs (Hamanyati 2017, 69-71). Firstly, legally sanctioned regulation will define the boundaries in which factors can

conduct their business or assignments. In this manner, the profile, image, and reputation of the factoring industry can be raised and so, inspire confidence in its usage. Secondly, despite different legal traditions, the Model Law is meant to be applicable to all jurisdictions, given its uniformity and universality. Thirdly, confidence in the legal framework across factoring jurisdictions will provide greater certainty and reduce risk in cross-border and international transactions, especially for SMEs when it comes to export services. Fourthly and given the potential growth of factoring in Africa, the continent must have appropriate and relevant legal and regulatory systems to reap the full benefits offered by factoring. And lastly, an enabling, accessible, and user-friendly legal framework could offer an incentive scheme for accelerating the formalisation of the SME sector by being sensitive to their needs.

## 7.2 Awareness and understanding of factoring

While Afreximbank's Model Law is a pragmatic, timely, and valuable contribution to modernising the principles and practices of factoring and receivables financing, its various aspects come up against the pervasive lack of knowledge and understanding. Raising awareness and building capacity are thus at a premium, especially through technical assistance, training, and education. In this regard, the following areas are critical (ACBF-Afreximbank 2021, Çetintas 2023).

- **Enhancing knowledge and awareness:** Many in the African business environment, but especially SMEs are not familiar with the advantages, benefits, and operating mechanisms of factoring. By virtue of technical assistance projects and programmes, these knowledge and awareness deficiencies could be overcome through well-organised professional expertise and educational resources, training sessions, and awareness campaigns. Technical assistance could go a long way to assist in creating an environment conducive to factoring by widely disseminating easy-to-digest information about factoring, especially its benefits and advantages such as improving cash flow, mitigating risks, and supporting business development.
- **Building capacity and developing expertise:** The effective management and operation of dedicated factoring enterprises necessitates the development and presence of skilled managers and professionals. In this regard, technical assistance could be very useful in offering training and capacity-building initiatives to enhance the knowledge and skillset of those involved in the factoring business. Of particular importance are strategic management areas such as risk assessment, credit management, legal and regulatory issues, and the use of technology.
- **Encouraging collaboration and networking:** This is another critical value-added of technical assistance programmes and could take the form of organising national and regional conferences, seminars and workshops, and industry forums which bring together various stakeholders in the factoring community such as experts, companies, financial institutions, policymakers, and regulators. Such platforms could serve as useful clearinghouses that promote innovation, knowledge transfer, information sharing, and best practices.
- **Leveraging technology:** Today's disruptive digital age requires high levels of literacy in the adoption and use of technology in factoring assignments, especially for SMEs. This includes being acquainted with how to use digital platforms for invoice submission, and payment processing as well as using data analytics and artificial intelligence methods for risk assessment and making correct decisions. Traditional infrastructure constraints can be overcome by embracing digital instruments which in turn, helps to improve efficiency and the speed of factoring operations.

## 8. Strategies for Promoting Factoring among SMEs and Intra-Regional Trade

The ACBF-Afreximbank study (2021) identifies key strategic interventions to promote factoring in Africa which, in turn, inform the recommendations for addressing these. The key interventions required are:

- **Institutional:** building operational capacity for ensuring adequate rules, regulations, and standards; and building composite capacity for strategic planning, programme development, and partnerships.
- **Human:** building critical technical skills in trade law, finance, and related areas such as international and reverse factoring; and building transformative leadership skills to understand the concept, have knowledge of its product range, improve “buyer education” among larger and multinational companies in supporting SMEs, and promote factoring at all levels.
- **Data, research, and knowledge sharing:** encouraging countries to become members of FCI which is the main repository of factoring data, promoting factoring as an exciting but under-researched area, and raising awareness of the benefits of factoring.

In Hamanyati’s study (2017), there are four strategic considerations: the first, encourages governments to provide favourable tax treatment and a conducive legal environment to encourage the growth of factoring companies and to attract local and foreign investment; the second, concerns having mandatory but affordable credit insurance schemes to mitigate risk; the third proposes setting up a neutral arbitration tribunal with the necessary expertise to manage disputes that invariably will arise from international factoring; and the fourth proposes establishing a statutory professional factoring body with key functions such as ensuring good and proper conduct of members, promoting a code of ethics as well as putting in place training programmes and industry-relevant publications.

Both studies and their strategic templates are pertinent to this endeavour and are highly relevant for complementing its thematic coverage of the SME ecosystem in Africa in the context of realising Agenda 2063 and in particular, the AfCFTA’s objectives in enhancing intra-regional trade. However, and for the purposes of this paper, the calculus of interventions is directed at the SME and factoring interface in the following strategic and operational dimensions:

- **The formalisation dimension:** While the Afreximbank report proposes that the legitimacy of the informal sector be recognised under the auspices of the AfCFTA, the structural spectre of SMEs constantly facing the “Valley of Death” must be addressed with a sense of moral and practical urgency.

### It is recommended that:

- » The ACBF and Afreximbank, in collaboration with the AfCFTA Secretariat, the AfDB, the AU Commission, and UNECA, conduct pilot studies using the Afreximbank’s data on informal cross border trade to develop a process methodology with incentive parameters on how SMEs can be better integrated into formal domestic and regional economic circuits.
  - » These pilot studies should be informed by the ITC report’s 94 value chains in 23 sectors and the AfCFTA Trade in Services Protocol.
- **The factoring dimension:** The role of factoring in facilitating trade and promoting economic growth is incontrovertible and can provide an important impulse for addressing the multiple supply side constraints identified in the BIAT Action Plan. However, the challenges identified regarding knowledge and awareness, capacity and expertise, legal and regulatory frameworks, and technology must be addressed, with the AfDB Special Purpose Grant for factoring being a useful mechanism.

**It is recommended that:**

- » The Afreximbank's Factoring Unit, in close collaboration with the AfCFTA Secretariat, ACBF the AfDB, the AU Commission, and UNECA, should launch a continental campaign for the adoption of the Model Law of 2016.
- » Afreximbank's Factoring Unit and the ACBF, with the support of the AfDB, UNCTAD, the World Bank, and IMF should develop the necessary technical assistance and education infrastructure to promote factoring.
- » Afreximbank's Factoring Unit and the ACBF, in close cooperation with FCI's Education Director and Regional Manager for Africa should institutionalise learning platforms among the 43 African members of FCI but also include non-members, as well as REC, AfCFTA, AfDB, AUC, and UNECA Secretariats. This includes certified courses, seminars, and training material for all stakeholders that examine the process and components of factoring.

- **The financing dimension:** Access to finance and working capital is the lubricant in the wheels for developing the interface between factoring and enhancing the operational efficacy of SMEs. The role of Afreximbank together with other national and regional credit guarantee schemes and credit lines provide strategic entry points for improving liquidity for SMEs but must be significantly expanded to include modal support that will enable SME's ability to better engage and benefit from international and cross-border trade.

**It is recommended that:**

- » The ACBF and Afreximbank, in close collaboration with the AfDB's Secretariat of Making Finance Work for Africa and its Thematic Fund for Africa Private Sector Assistance should examine diversification, especially through securitisation and forfaiting modalities for mobilising funds to support SMEs and factoring across Africa.
- » Such modalities should be modelled on the FCI's "Receivables as an Investable Asset Class" to raise capital and trade finance from development finance institutions for SMEs by promoting the establishment of more non-bank factoring companies, especially to expand the geographic scope of factoring.
- » The ACBF and Afreximbank, in close collaboration with the AfDB, the World Bank, and IMF should examine the possibility of issuing "factoring bonds" whose proceeds can be used to support SMEs across a range of sectors, and which are capable of attracting a diverse pool of investors such as hedge funds, sovereign wealth funds, pensions funds, and credit guarantee schemes.

- **The government support dimension:** The effectiveness of the above interventions critically depends on how government support for the SME and factoring interface as a strategic priority under the auspices of the AfCFTA can be mobilised and supported both in terms of opening up new business opportunities and promoting greater volumes of cross-border trade.

**It is recommended that:**

The Afreximbank's Factoring Unit, in close collaboration with the AfCFTA Secretariat, ACBF the AfDB, the AU Commission, and UNECA should examine the possibility of turning the SME and factoring interface into a public-private partnership. Such a partnership between governments and the private sector should be based on a clear, manageable, and legitimate institutional framework which defines the principles and practices for establishing dedicated SME and factoring agencies which represent all stakeholders in relevant ministries and across the secretariats of all regional economic communities.

## Conclusion

This paper has examined how factoring can be leveraged to support SME growth and development and stimulate intra-regional trade as mandated by the AfCFTA. It has attempted to demonstrate the extent to which receivables finance and credit factoring could benefit the business landscape of Africa by allowing SMEs to achieve liquidity and maintain solvency. However, the paper has underscored the absence of adequate and facilitative legal and regulatory regimes and government support in the growth and expansion of factoring in Africa compared to other regions and markets.

The continent has now arrived at a challenging juncture and inflection point of anxiety and promise. The anxiety arises from the social and economic fallout caused by the COVID-19 pandemic and the levels of food insecurity that have been propelled by the Russia-Ukraine war. The promise resides in the kinetic energy for growth and development that has been released by Agenda 2063 and the AfCFTA, together with the great potential that SMEs collectively can bring to the coal-face of intra-regional trade through factoring.

If the impact of the pandemic and latterly the Russia-Ukraine war conspired to generate moments of crisis for the continent, it is worth drawing on Milton Friedman, the Nobel Laureate in Economics, regarding how times of crisis can provide great opportunities for systemic change. As he observed to his fellow monetarists: “Only a crisis – actual or perceived – produces real change. When that crisis occurs, the actions that are taken depend on the ideas that are lying around. That, I believe, is our basic function: to develop alternatives to existing policies, to keep them alive and available until the politically impossible becomes the politically inevitable” (1962, 97 emphasis added).

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