FROM THE PERIPHERY TO THE CENTRE: **AFRICA AS THE GROWTH MARKET FOR FACTORING**

DR BENEDICT OKEY ORAMAH

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Afreximbank Distinguished Lecture Series publishes important papers that address current issues on Africa's economic and trade development. The papers are normally commissioned by Afreximbank and are usually delivered at the Annual Meetings of the Bank's Advisory Group on Trade Finance and Export Development in Africa. This article was first published in the ***2013 World Factoring Year Book*** and a summary was published on the ***African Development Bank***'s blog.

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CONTENTS

LIST OF FIGURES

FOREWORD

Africa had, until recent years, not been an important market for factoring. This was mainly because of the composition and destination of the trade as well as the poorly developed supply chains in the continent. Since the past decade, we have witnessed impressive development in Africa's economic activity; merchandise and services trade, in terms of volume and market destination; and marked improvement in supply chains across the continent, leading to a sustained rise of factoring business in the continent. The changes in Africa's economic growth performance and factoring business we are currently witnessing have led many financial sector players and analysts to consider the continent as a rising star and a fertile ground for factoring in the world.

Since 2008, Afreximbank has been contributing towards facilitating the growth of factoring on the continent. In this paper, Dr. Benedict O. Oramah discusses the evolution of factoring business over the last few years, the challenges and prospects for factoring in Africa. He also highlights the contribution of Afreximbank to the development of factoring business in the continent.

Dr. Oramah is the Executive Vice President in charge of Business Development and Corporate Banking at the African Export –

Import Bank (the “Bank” or “Afreximbank”) and is the Chair of the African Chapter of International Factors Group. He supervises the Business Development, Syndications and Specialized Finance, and Investment Banking operations of the Bank. He also assists the President of the Bank in overseeing the Bank’s Research and Knowledge Management and Strategy and International Cooperation Departments.

Afreximbank has decided to publish this article in order to contribute to wider debate on the prospects of factoring in Africa, challenges before it and the opportunities it offers to practitioners and trade financiers.

I hope that you find the content of this paper as interesting as I did.

Thank you,

Mr. Jean Louis Ekra
President
Afreximbank

1. INTRODUCTION

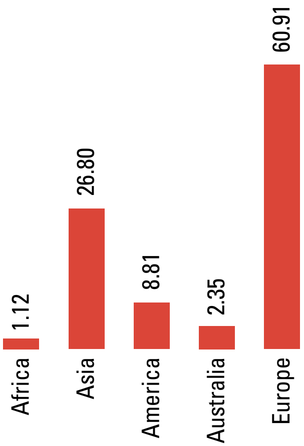
Africa is today at the fringes of global factoring despite the immense advantages factoring offers to small and medium-sized businesses (SMEs) around the world. Recent developments, however, indicate that things are about to change for the better with Africa poised to move from the periphery to the center of global factoring in the no distant future. We discuss briefly in Section 2 of this article the State of Factoring in Africa and the factors that had constrained its adoption across the continent. In Section 3 we give a forward-looking view of Africa's factoring market and factors that will drive the market before concluding in Section 4.

2. STATE OF FACTORING IN AFRICA AND CHALLENGES

THE STATE OF FACTORING IN AFRICA

As mentioned in Section 1, Africa is currently an insignificant player in the global factoring market, more so in international factoring. Of the €2 trillion world factoring transactions recorded in 2012, Africa accounted for a paltry 1.2% (Figure 1), with only four countries in the continent accounting for this share, namely South Africa (largely domestic factoring), Tunisia, Morocco and Egypt. South Africa alone accounted for more than 90% of the total factoring volume of the continent (Figure 2), with domestic accounting for 99.3% versus 0.7% for international factoring.

Figure 1: Percentage Share of Total Factoring Volumes by Region, 2012 (%) Total Global Factoring Volume == €2 Trillion



Source: IFG, 2013

Figure 2: Country Share of Factoring Businesses in Africa, 2011 (%)

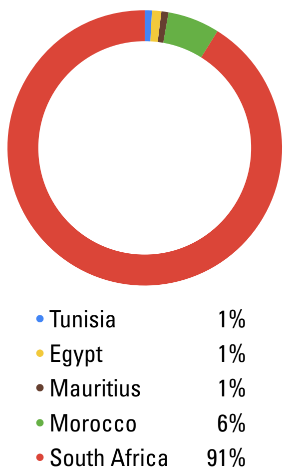
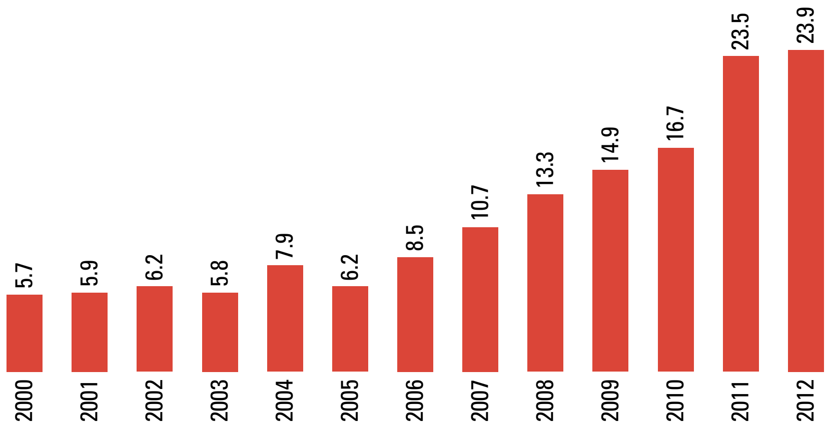


Figure 3: Factoring in Africa, 2000-12 (€ Billion)



Despite its relatively low share of global factoring transactions, Africa is witnessing a quickening in the rate of expansion of factoring volumes. As can be seen in Figure 3, total factoring volume in Africa grew from €5.86 billion in 2001 to €23.93 billion in 2012, representing an average annual growth of approximately 14.2%. This growth is significant, when one considers that the rate of growth in world factoring volumes was at 8.6% and in Europe 9% during the same period.

Another feature of factoring in the continent is that it is largely offered by banks and bank subsidiaries. This is the case in South Africa and Morocco and to a large extent in Egypt. Independent factoring companies are few and far between. This is not unconnected with the fact that an important service offered by factors in Africa is funded credit lines. Affiliation with a bank that can grant a credit limit is therefore a competitive advantage.

On the demand side, the market is narrow. An average of about 80% of the factoring business in the continent is domestic factoring, largely reflecting the dominance of South Africa where over 90% of the factoring volumes is accounted for by domestic factoring. In view of the limited credit insurance capacity, even in markets where factoring has flourished in appetite for risk is limited, with most factors focusing on the risk of governments and blue-chip corporates, especially those in mining, telecom and retail.

Due to limited insurance and reinsurance capacities for African risk and dominance of domestic factoring, the services most offered by factors in Africa are purchase of debtors and Sales Ledger Management. Credit cover is offered selectively, especially in North Africa, subject to availability of insurance cover.

Most factors are relatively small in terms of capitalization and turnover. Average turnover are €880 million in Morocco and €248 million in Tunisia. This is a limitation to the size of business they can write.

It is no wonder then that the factoring industry in Africa is highly concentrated with one country (South Africa) out of 54 accounting for about 90% of the continent's factoring volume; and 4 countries accounting for about 10% of the volume.

5 Companies in South Africa, 4 each in Morocco, Egypt, and Tunisia, and 1 in Mauritius account for the entire volume. Given the high

concentration, the market in various countries is to some extent oligopolistic and therefore inefficient and does not encourage innovation. Market entry is also more onerous.

Let us now examine other challenges factoring face in Africa.

CHALLENGES TO EXPANDING FACTORING IN AFRICA

Why has factoring not expanded across Africa? Why is the factoring industry in the continent so concentrated? To answer these questions one needs to understand the constraints the factoring industry faced in the continent until 7-10 years ago.

First, there was a lack of, or very limited, knowledge of the product across a large swath of the continent. Until the mid-2000s, there was little or no effort to promote factoring in Africa by both the governments and the global factoring industry groups, namely Factors Chain International (FCI) and the International Factors Group (IFG). The industry groups had no interest because they had an erroneous view that, but for South Africa and some countries in North Africa, other countries in the Continent presented unacceptable country risks and would therefore be of no interest to their members. In addition, most of their members did not regard the continent as an economy of any global significance. For instance, as recently as 2012, an economist invited to present prospects for the global economy at the annual meeting of one of the groups did not bother to discuss Africa!

In an environment dominated by a 2-factor mind-set, it was difficult to grow factoring where there is paltering among foreign factors to do business in Africa. Many African governments and regulators on their part had little interest in championing factoring partly due to limited knowledge of the product and partly because they thought that there was little scope for its use firstly because their exporters offered little or no credit to their buyers and second because domestic supply chains were rudimentary and could not sustain a viable factoring in industry.

Second, most businesses in Africa were also not prepared nor interested in factoring. Those involved in international trade exported mostly commodities to OECD countries. The payment terms were usually Cash Against Documents (CAD) and the buyers were largely large credit worthy companies, such as Cargill, ED&F MAN, Glencore, etcetera. Little or no post-export credit is involved creating little incentive for the services factoring offers. Domestic factoring could also not flourish because businesses dealt largely on cash and major corporations relied on international rather than domestic supply chains.

Third, given the lack of interest on the part of businesses and no support from regulators, banks had no incentive to pursue factoring as a line of business whether as a product offering or by way of credit lines to factors.

Another important constraint was lack of facilitating infrastructure by way of:

a) Regulatory framework and laws, and
b) Credit information services and credit insurance.

Across the continent, (excluding Egypt where a factoring law was enacted a few years ago and South Africa) there are no specific factoring laws. The regulatory environment in most countries was uncertain thereby creating risks and uncertainties that hindered the emergence of factoring. In addition, except for a few countries there were no credit insurance and/or credit information services. And until recently, the international credit insurance business had little appetite for African risks. The near absence of these critical instruments raised the risk of offering factoring to unacceptable levels and hindered its expansion in the continent. Finally, the absence of specific factoring laws was compounded by the high cost of perfecting legal documents in the form of stamp duties and registration charges. In some Anglophone African countries, these costs were, and in some cases, still are anywhere between 3-5% of the collateral value. Given that the Assignment of Debtors/Receivables is a plank on which factoring is hinged, this additional cost makes factoring relatively more expensive than other competing products banks offer.

Despite the foregoing challenges, events of the past few years appear to indicate that factoring was in the process of turning the corner. We discuss in Section 3 below why we believe that this is the case by examining the prospects for factoring in Africa.

3. FROM THE PERIPHERY TO THE CENTRE – PROSPECTS FOR FACTORING IN AFRICA

Factoring is beginning to get a powerful trail-wind in Africa. The forces behind this are diverse but in combination, they are beginning to build a foundation for a viable factoring industry spread across the continent.

On account of these forces, one forecasts that factoring volumes in the continent will rise from €24 billion in 2012 to about €90 billion in 2017 and to €200 billion by 2020.

Countries that will drive the growth will be "new" entrants to factoring, namely Kenya, Nigeria, Ghana, Côte d'Ivoire, Zimbabwe, Zambia, Mozambique and Senegal.

We anticipate that domestic factoring will dominate accounting for an average of about 80% of the market, although country situations may vary.

Our forecast is that sectors that will drive the growth will be:

a. Oil and Mining Services in countries heavy on extractive industries, such as Nigeria, Ghana and Zambia. This will be policy-driven through local content promotion and also by the outsourcing policies now embraced by major oil/mining companies;

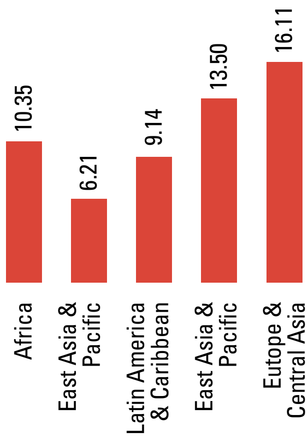
b. Telecommunication Services as a result of a rapid growth of this sector and the tendency of telecom companies to outsource key services;

c. Retail sector as a result of the rapid growth of the middle class in the continent. Figures show that Africa has the fastest growing Middle Class in the world with household consumption rising by 10.4% during 2001-10 compared to 6.2% and 9.1% for East Asia and Pacifica and Latin America respectively (Figure 4).

The rapid rise in the Middle Class will create domestic demand and reinforce the expansion of market economy;

Figure 4: Growth Rate of Household Consumption Expenditure, 2001-10 (%)

source: World Bank WDI, 2013

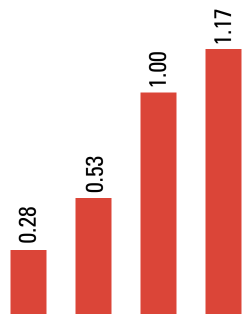


d. Non-traditional export sector to be driven by larger share of the South in Africa's trade forecast to be 45% in 2012 compared to 27% in 2000

Let us now elaborate on the forces behind the tail-wind we mentioned.

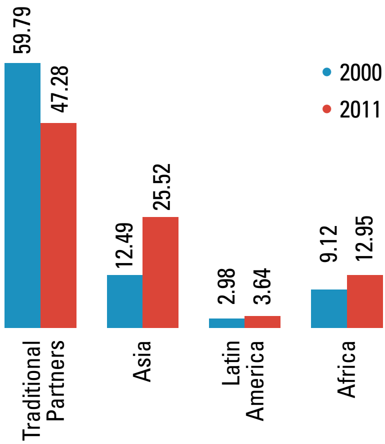
The continent is becoming an economy at last in terms of economic and trade size as well as the emergence of the Middle Class and in the process the market for “factorable” products is emerging. Over the last dozen years, the continent’s merchandise trade has more than quadrupled, reaching approximately US$1.2 trillion in 2011, from US$280 billion in 2000 (Figure 5). This represented an annual average growth rate of about 12.13% during 2000-11. An important characteristic of this growth is the rising share of the South, led by Brazil, India and China, in the trade. The share of developing South economies in Africa’s total merchandise trade rose sharply during 2000-11, from 18% in 2000 to over 45% in 2010 whiles the share of the continent’s traditional trade and economic partners, namely Europe and North America, declined from over 60% in 2000 to 47% in 2010. This trade between the South and Africa has primarily been led by Developing Asia, whose share of the continent’s trade rose from 12% in 2000 to over 25% in 2010 (Figure 6). This is expected to reach about 30% by 2015. The budding trade relations with the relatively risker/unknown markets has created an opportunity for the use of factoring, which is considered one of the most efficient risk mitigation tools for such markets. Another opportunity provided for the expansion of factoring in Africa is the rising volume of intra-regional trade. The trade has more than quadrupled between 2000 and 2011, reaching US$144 billion in 2011. In a context of perceived high risks arising from a lack of knowledge of the markets, factoring is now recognized as a low risk way of facilitating the trade. Further, the products entering the trade with the South are largely manufactures, horticulture and semi-manufactures in addition to commodities. Most of the trade is conducted on open account basis and credit is granted to buyers. The trade items are therefore "factorable" raising interest in factoring.

Figure 5: Trends in African Trade, 2000-11, (US$ Trillion)



source: World Bank WDI, 2013

Figure 6: Regional Distribution of Africa's Merchandise Trade, 2000, 2011



* Traditional Partners include North America & Europe
Source: World Bank WDI, 2013;
IMF Direction of Trade Statistics;
UNCTADstat,2 013

Domestically, credible supply chains are beginning to emerge as a result of rising economic growth and through government regulations. In countries with large extractive industries, such as Nigeria, Angola, Zambia, etcetera, governments are promoting increased local value-added in the industries and this has created a huge market for invoice discounting and factoring. Further, Africa's rapid economic growth of the 12 years is expected to continue over the medium to long-term, despite the lingering adverse effects of the recent global financial and economic crises and the sovereign debt crisis in the Eurozone. In this regard, Africa is expected to experience robust expansion in output at an average annual rate of 6% during 2012-22. The IMF forecasts that 7 of the top 10 fastest growing economies in the world during 2011-15 will be in Africa. Further, opportunities are presented by Africa's rising middle class, which is estimated to be the fastest growing in the world. The continent's middle class, which stood at 60 million in 2011, is forecast to rise sharply to about 100 million in 2015 and to about 1.1 billion by 2060. The implication of this burgeoning African middle class is sustained expansion in demand for consumer goods and services. Additionally, Africa is at last enjoying peace and stable governments reflected by significant and steady transformation of the political landscape for the better. The very recent outcomes of presidential and parliamentary elections in Kenya and Ghana attest to this fact.

There is also evidence that the policy-makers and regulators are taking notice and doing something about factoring. Some are beginning to organize awareness seminars and are discussing possibilities of enacting factoring laws.

Afreximbank, the pan-African trade finance bank is adding impetus to the rise of factoring since the mid-2000s, the Bank has been promoting factoring in various ways namely:

1. As member of IFG and as Chair of Africa Chapter of IFG, the Bank has, and continues to facilitate, the sharing of experiences between local members in Africa; report on such experiences to the worldwide IFG Members; advance the best interests of African members and partners; lobby ministers, legislators, government officials and others whose decisions or advice may influence the success or otherwise of members' and partners' businesses; engage in public relations activities designed to raise local awareness of the benefits of factoring; develop the skills of IFG members' on Factoring in Africa through educational activities and staff exchanges; attracting new members, partners and sponsors; and offer networking opportunities for members, partners and sponsors through seminars, meetings and other functions. Through the work of Afreximbank, a few factoring companies have been created in Ghana, Kenya, Nigeria and elsewhere. Two have started operations and others are expected to start very soon.

2. Introduced/Launched the Factoring Facility to Support African Trade

   Apart from acting as the chair of the Africa Chapter of the IFG, the Bank in 2009 launched a Factoring Facility to support intra- and extra-African trade as well as domestic factoring targeted at export supply chains (e.g. Mining Services). The purpose of this facility is to provide liquidity and payment risk protection to factors.

3. Noting that one of the constraints to the deployment of factoring in Africa has been inadequate knowledge and skill on the use and benefits of factoring, the Bank working closely with IFG, has since 2011 been organizing series of seminars/ workshops on key elements of factoring for participants from factoring and finance companies as well as commercial banks.

   Finally, the global factoring industry has taken note and has proactively started promoting factoring and sourcing membership in Africa. This is the case with FCI and IFG. This new interest is bound to have positive repercussions on the industry.

4. Conclusions

Until recently factoring had been of little or no importance in Africa, with only 4 countries accounting for 100% of the factoring volume. Many factors created this situation including near absence of factorable products. Country risks limited effort at promoting the product by governments and the global factoring groups as well as the structure and direction of Africa's trade. Since about 10 years ago changes favourable to factoring are beginning to occur.

Since Open Account Terms have become standard practice in many markets, Factoring offers an instrument to African exporters to have access to financing by means of advances against outstanding accounts receivable. If only 50% of the 80% of trade currently done under L/Cs are done on Open Account basis, the market for factoring can be as high as USD139 billion for exports and USD158 billion for imports. Market forces are beginning to gradually force that switch from L/Cs.

Domestically, the rise of the middle class and government regulations are creating important opportunities for factoring. In Nigeria, for example, the oil service industry is a market of USD8-10 billion per annum. Currently most of that market is supported by invoice discounting.

Adding impetus to these factors is the support Afreximbank is providing to promote the product which ranges from awareness promotion, credit lines, lobbying etcetera.

The tail-wind arising from the foregoing makes us forecast that factoring volumes will rise from €24 billion in 2012 to about €90 billion by 2017, with new markets opening in Kenya, Nigeria, Ghana, Côte d'Ivoire, Tanzania, Zambia and elsewhere.

To take advantage of the opportunity will require an active participation of European and American factoring companies in the market to bring expertise and correspondent relationships critical under the 2-Factor framework. Notwithstanding, there will be no stopping the tail-wind that has formed and early entrants to the market will be the best for it.

END

FROM THE PERIPHERY TO THE CENTRE:
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