ALTERNATIVE FINANCING SERIES: DEBT FACTORING

INTRODUCTION

Capital has been defined as the blood of a business entity. A business entity without capital is a dead entity. Every business across the world is always seeking to minimize cost and maximize value after all that is the reason why the business was set up in the first instance.

The rising cost of obtaining debt capital couple with its attendant risk is fast making debt capital a less fanciful option for a company to use to raise debt. Since the global meltdown of 2008 and the Nigerian banking/financial crisis of 2009 equity raise is no longer considered as a viable means of capital raise. The implication is that businesses are forced to seek alternative methods of raising capital.

One form of this alternative means is debt factoring.

WHAT IS FACTORING?

The Factoring (Assignment of Receivable) Bill 2016[1] did not define the term but it defined the word *factoring contract* as:

> *a contract concluded between a client and a factor pursuant to which:*
>
> *(a) the client assigns or will assign or will offer to assign to the factor trade receivables arising from supply contracts between the client and its debtors; and*
>
> *(b) the factor is to perform at least one of the following functions:*
>
> *i. providing or procuring finance for the client, including loans and advance payments that are directly related to the value of each trade receivable and its perceived credit risk at the time the receivable is created or at any time thereafter; or*

[1] See Section 1 Factoring (Assignment of Receivable) Bill 2016

ii. maintenance of accounts (ledgering) relating to the assigned receivables; or

iii. collection of assigned receivables and

A. unless otherwise agreed, any collection is for its own account and not as agent for the client; but

B. any collection made by the client for the benefit of the factor is deemed to be made by the factor; and

(c) notice of the assignment of the receivables may or may not be given to debtors.

The term was defined by the Continuous Cash flow LLC as:

> *the outright purchase and sale of accounts receivable (A/R) invoices at a discount from their face value*

The term factoring has also been defined as:

> *a business involving a continuing legal relationship between a financial institution(the factor) and business concern (the client) selling goods or providing services to trade customers (the customers) whereby the factor purchases the client's accounts receivable and in relation thereto, controls credit, extended to customers and administers the sales ledger* [2]

At the risk of over simplifying, factoring is a kind of business arrangement whereby a company with account receivables (debt) sell such receivable to another company. The new company would now step in the shoes of the company.

How does factoring work?

In factoring, a company (factor) acquires the debt of another company. A factoring transaction could be with recourse where the debt is sold and the factor can have recourse to the client, in the event where it is unable to recover the debt. A good example of this could be seen in the purchase of bad loans from financial institutions by the Asset Management Corporation of

[2] Biscoe, P. N. (1975). Law and practice of credit factoring. Butterworth & Company, 5

Nigeria (AMCON). Despite the purchase of these debts, AMCON reserves the right of recourse to these financial institutions. A factoring transaction could also be done without recourse. This is where the factor purchases the debts from the client and does not have the right or recourse in the event that the debt is not recovered.

Benefits of factoring

Factoring is quite beneficial to both the customer and the factor and we have highlighted some of the benefits:

1. Eliminates bad debts: this is the most important benefit of factoring. When a client sells its existing liability (especially when such liability is a sold by way of a non recourse factoring, the liability is eliminated from the books of the client thus giving the Client's a healthy statement of financial position.

2. Unlimited Capital: because of the way factoring is structured, it is a form of financing that grows with your sales while financing like loans are limited to what is in the loan account, factoring, grows with your sales because the more sales a client makes, the more cash that would be available to the client should the client seeks factoring.

3. Factoring provides a non debt solution to funding. Unlike loans, where factoring is sought as a means of finance, the client does not incur any debt as the client is only getting paid earlier than expected.

Recent happenings in the Nigerian economy, makes factoring to be a viable option for financing in Nigeria. We urge clients who have heavy invoices to begin to consider this method as a means of financing.