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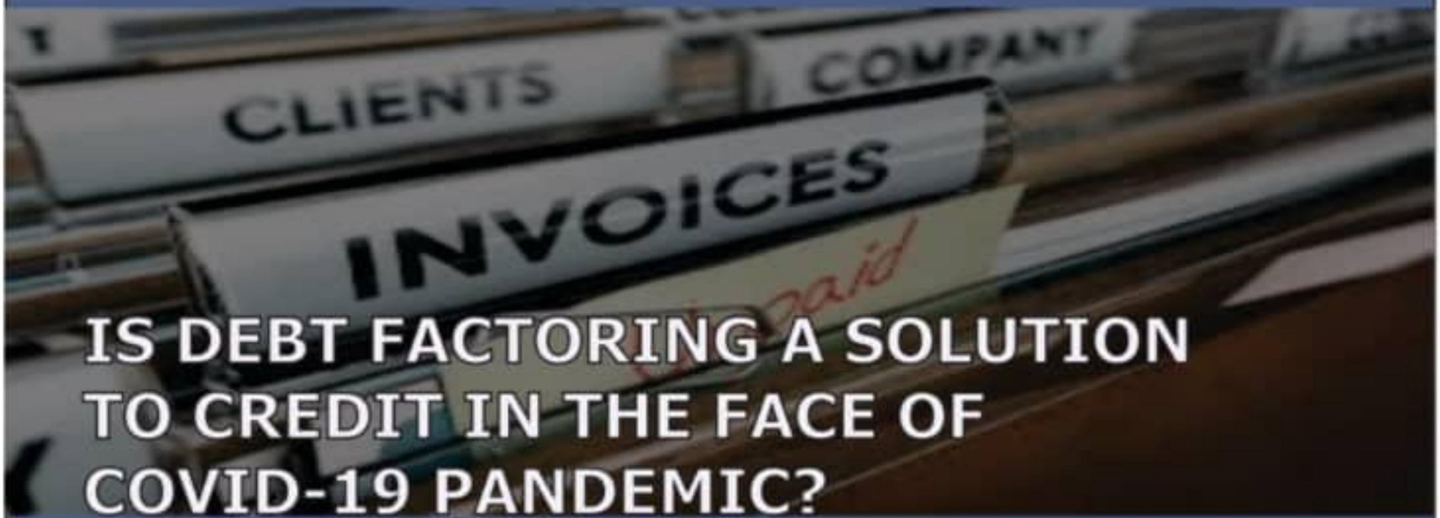

IS DEBT FACTORING A SOLUTION TO CREDIT IN THE FACE OF COVID-19 PANDEMIC?

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The entire world has been greeted with a rude health shock occasioned by the outbreak of the coronavirus (COVID-19) pandemic which started in Wuhan China in November 2019 with increasing number of infections across the globe on a daily basis. This has brought all aspects of human endeavors to a standstill, resulting to a near total collapse of economic, social and to some extent, political activities.

According to the International Monetary Fund (IMF), the coronavirus pandemic will turn global economic growth "sharply negative" in 2020, triggering the worst fall-out since the 1930s Great Depression, with only a partial recovery seen in 2021[1]. In Nigeria, the Minister for Finance, Budget and Planning, Mrs. Zainab Ahmed earlier warned that if the coronavirus pandemic continues for the next couple of months, Nigeria will definitely go into another recession.

There is no gain saying the fact that COVID-19 has become a major concern to businesses and governments across the world. In view of the apparent complex and hazardous economic situation, it is necessary for businesses and most especially those in the financial sector to look inward for possible solutions to cushion the negative effects of the pandemic on businesses and the ability of debtors to meet their debt obligations to creditors. One of the veritable ways of managing credit at this critical stage of dwindling economic activities in the face of COVID-19 is by way of *"Debt Factoring"*.

What is debt factoring?

Factoring is a financial transaction and a type of debtor finance in which a business sells its accounts receivable (i.e., invoices) to a third party (called a factor) at a discount[2]. Factoring could be in the form of accounts receivable factoring, invoice factoring, and sometimes accounts receivable financing. Accounts receivable financing is a term more accurately used to describe a form of asset based lending against accounts receivable[3].

According to the Cambridge English Dictionary, debt factoring is a financial arrangement in which a factoring company takes responsibility for collecting money relating to a business' invoices, and immediately pays that business part of the total amount owed on the invoices[4].

How does debt factoring work?

A company may choose to factor a portion or all of its invoices. First it approaches the 'factor', a financial institution or lender who specializes in accounts receivable finance. The factor assesses the level of risk by looking primarily at the financial health and reliability of the companies owing the invoices. Based on this analysis they then make a quote regarding what percentage of the invoices they can factor (up to 90%), and the terms are drawn up. Once the agreement is signed, the lender advances most of the money straight away with a small proportion held back until the invoice has been paid[5].

Advantages of debt factoring:

- Speeds up the working capital cycle.
- Saves time and administrative resources.
- Can speed up growth.
- Non-recourse factoring protects you against bad debts.

How does debt factoring improve cashflow?

Once the factoring arrangement is in place, businesses no longer need to wait anxiously for each payment cycle for customers to settle their invoices. With the debt factor paying the advance on the same day of each month, businesses can benefit from assured cash flow which leaves more time for them to focus on their core business interests. Especially useful for businesses with a smaller number of invoices at a higher value, and where the profit margin is healthy, factoring can transform the day to day running of a company[6].

What are the Risks of Debt Factoring?

If you have understood the fees (and ensured no hidden costs, charges or exit fees), the

main risk of debt factoring is that when a customer doesn't pay and you have already received the advance, you will become liable for that debt. You can mitigate a lot of these risks by choosing a respected and trustworthy factor and only using it when necessary. Many businesses do run for years with factoring in place without issue[7].

Conclusion

As attractive and effective as debt factoring seems to be, it is unfortunate that its usage is not common in Africa at the moment. Only few countries in Africa have so far embraced this commendable mode of financial transaction. In Nigeria, a bill for an Act to give a legal framework to debt factoring was introduced at the National Assembly in 2016 but it has not been passed into law. Although factoring is a contractual affair between the contracting parties, the lack of any legal legislative backing for it may have been responsible for its low usage in this part of the world. In Nigeria, very few companies are currently engaged in the business of factoring. With the outbreak of the coronavirus pandemic, it is believed that the National Assembly would speed up the process of enacting the current Bill before the National Assembly into an Act for the promotion of high economic activities and also help in the much desired resuscitation of the economy in the face of the current pandemic of COVID-19. It is the opinion of the writer that the use of debt factoring would no doubt prevent unnecessary protracted legal battles that would otherwise occur during or after the pandemic.

References

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