

A Supply Side View of Factoring as a Financing Method for SMEs in Kenya

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ABSTRACT

The trade receivables of a typical SME constitute 21%-35% of its assets. Trade receivables provide an opportune alternative from the more traditional borrowing methods that SMEs use to obtain financing. That alternative is factoring. Factoring is a financial service enabling enterprises to sell their accounts receivable to a factoring company in exchange for cash. This study explores the supply side of factoring by banks in Kenya by looking at the profiles of enterprises receiving factoring services and the criteria that banks consider in making the decision to factor receivables. The study establishes that only about a third of banks in Kenya are offering factoring services. The study also finds that factoring services are provided exclusively to SMEs. Using correlation, the study also determines that in arriving at the decision to factor accounts receivable, banks in Kenya consider the creditworthiness of the SME's accounts receivable. Factoring as a financing method draws its security from the receivables of the enterprise and not the financial health of the enterprise itself. Given the growth of factoring in the world, Kenya through its financial intermediaries, government and other agents must exploit the opportunity that factoring provides to drive the rapid growth of SMEs.

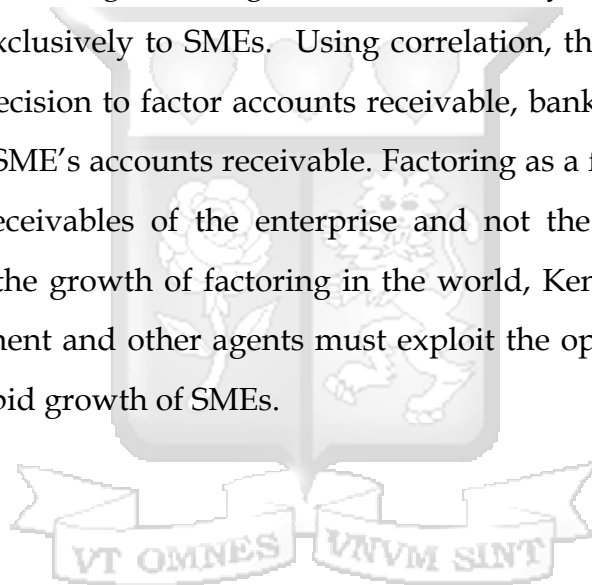
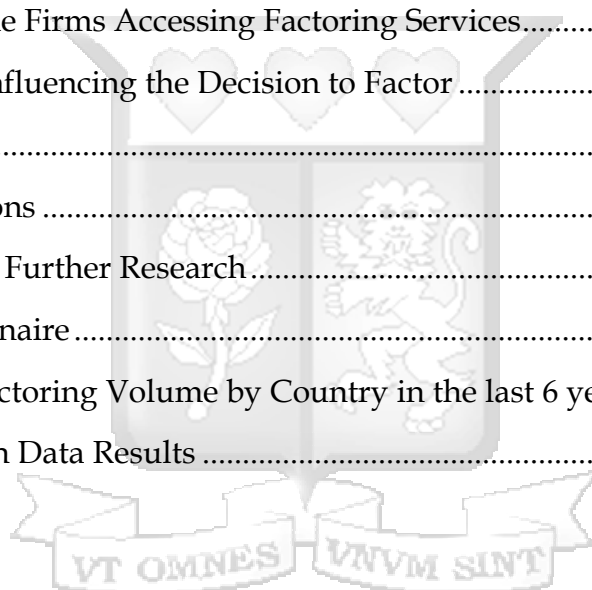


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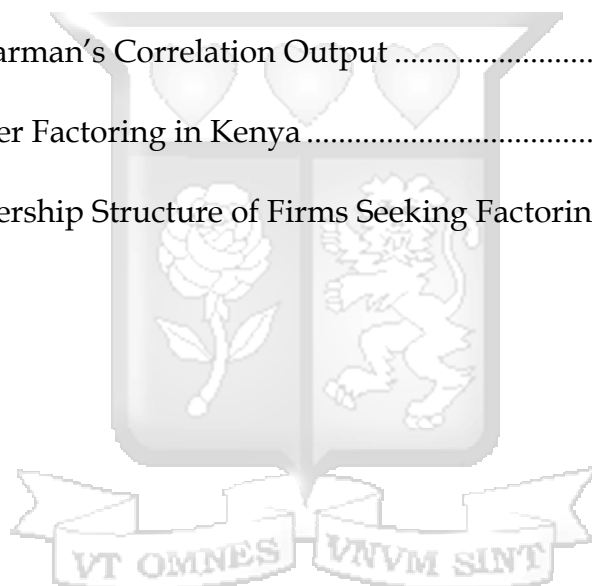
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LIST OF ABBREVIATIONS

CBS - Central Bureau of Statistics

D&B - Dun and Bradstreet

GOK - Government of Kenya

ICEG - International Centre for Economic Growth

IFC - International Finance Corporation

K-REP - Kenya Rural Enterprise Program

KYC - Know Your Customer

LPO - Local Purchase Order

MSME - Micro, Small and Medium Enterprise

OECD - Organisation for Economic Cooperation and Development

PIN - Personal Identification Number

RPED - Regional Program on Enterprise Development

SME - Small and Medium Sized Enterprise

SPSS - Statistical Package for Social Sciences

UK -United Kingdom

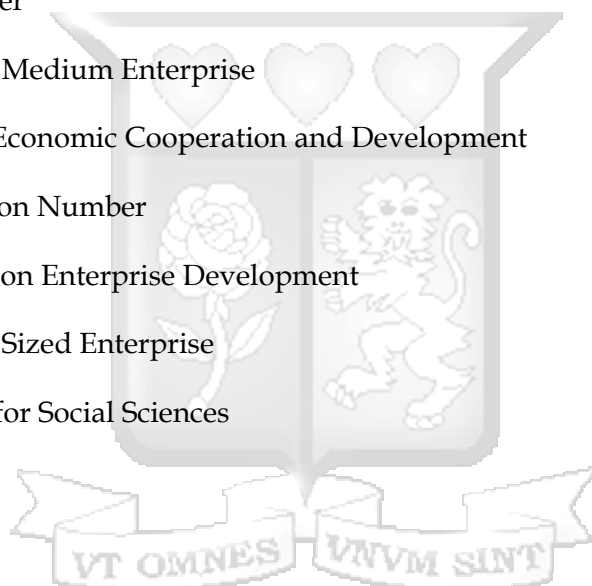
UN - United Nations

UNDP - United Nations Development Programme

UNIDO - United Nations Industrial Development Organisation

USA - United States of America

USAID - United States Agency for International Development



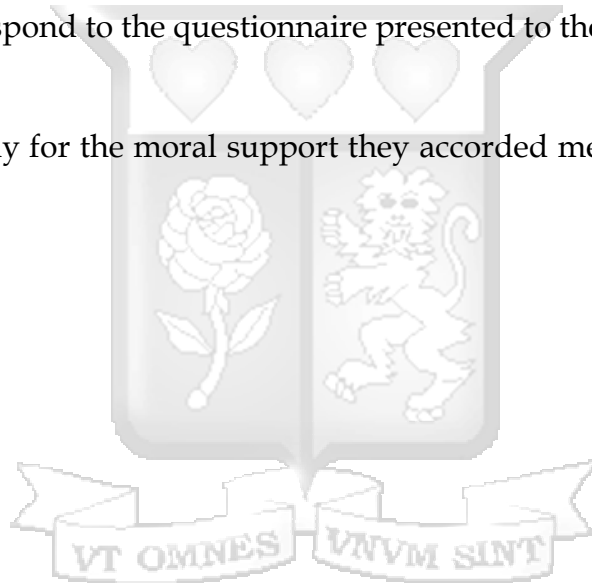
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CHAPTER ONE: INTRODUCTION

1.1. Background to the study

Small and Medium Sized Enterprises (SMEs) worldwide continue to face challenges in raising credit from financial institutions who use various lending methods, a problem triggered by the information opacity and information asymmetry problems characteristic of SMEs (Berger and Udell, 2005; Binks and Ennew, 1998). Some of the lending methods commonly used by financial institutions are: financial statement lending, relationship lending, credit score lending, asset based lending, factoring receivables (Berger and Udell, 2005). Lending methods such as financial statement lending and credit score lending require credible information like financial statements or credit ratings from the SME (Bakker, Klapper and Udell, 2004), while others like asset based lending and factoring require assets to act as collateral in the event of default (Bakker et al., 2004). Factoring is a type of financing in which firms sell their credit worthy accounts receivable at a discount and receive immediate cash (Klapper, 2006). Compared to other forms of lending, factoring emerges as a favourable lending method for SMEs because trade receivables in an SME's balance sheet comprise a major component of its total assets, representing between 21% and 35% of total assets at any one time; these trade receivables can be used as collateral for short term financing through factoring (Wilson and Summers, 1998).

Accounts receivable factoring is globally accepted as a means of raising short term capital for financial needs (Jieh-Haur and Wei-Hsiang, 2012). Factoring is emerging as an alternative for SMEs who face difficulty in obtaining financing because of hindrances that banks face in producing consistently reliable risk assessment processes (Binks and Ennew, 1998). In many instances SMEs use trade credit as a means to grow their size, as a competitive tool or as a price discriminatory tool (Van Horen, 2005; Fisman and Love, 2001; Petersen and Rajan, 1997). Trade credit therefore provides an opportunity for SMEs to use factoring as an alternative to the more traditional borrowing methods that SMEs use to obtain financing, (Jieh-Haur and Wei-Hsiang, 2012).

From a survey done by RPED and the Government of Kenya (GOK, 2005), SMEs in Kenya were found to have difficulty in accessing credit from banks. The survey sampled over 200 manufacturing firms. 50% of the firms surveyed were SMEs. The survey identified a number of factors contributing to the poor business climate for SMEs in Kenya, with 44% of firms in Kenya rating access to finance as a major constraint. The proportion is lower than that in Tanzania and in Uganda, almost equal that in Pakistan, but twice that in China, see table 1.1 below. The RPED survey at the time confirmed that Kenyan banks did not have the tools or capacity to evaluate and monitor loans to small and medium sized enterprises with profitable investment opportunities.

Table 1.1: Share of Firms Rating Access to Finance as a Major Constraint

Country	Kenya	Uganda	Tanzania	Pakistan	China
% of Firms	44%	60%	58%	43%	22%

Source: Investment Climate Surveys, RPED, GOK 2005

To endure this lack of funding, SMEs have had to seek other means of financing. Fafchamps, Biggs and Srivastava (1994), in their study on enterprises in Kenya, stated that the most often cited strategy to deal with financing difficulties is to delay payments to suppliers and speed up payments from debtors. The second strategy was to request help from banks in the form of an extension to an existing overdraft, and the third strategy was to borrow from friends and relatives. “An entrepreneur will use his/her own funds after all other sources have been extinguished” (Fafchamps, et al., 1994). Most large businesses will look for funding from financial institutions using their financial statements as evidence of their profitability and their ability to repay the loan but for many small businesses, obtaining credit based on their balance sheets or anticipated cash flow is difficult (Slater, 1993).

This study seeks to establish whether SMEs are accessing factoring services in Kenya by identifying the profile of the businesses accessing factoring services from banks in Kenya.

Using criteria identified in a similar study by Soufani (2000) in the UK, the study aims at establishing profiles of Kenyan businesses accessing factoring from banks.

Soufani (2002) in a later study, using the same data, carried out a study on the factors determining the decision to finance accounts receivable by factor organisations in the UK. His study (Soufani, 2002) focused on two groups of factoring firms: those owned by banks and those independently owned. Whereas his study aimed at establishing the determinants of the decision to finance accounts receivable by these institutions, his survey was not extended to banks. He states: "it can be argued that identifying the criteria that influence credit through factoring and invoice financing, may help establish a comparative analysis with determinants used by banking institutions." (Soufani, 2002, p. 32) Whereas this study is not intended to establish a comparative analysis between banks and UK factoring companies, Soufani's statement implies that banking institutions may have a different set of determinants from non-bank factoring companies. By focusing on banks in Kenya, the study takes note that banks differ from factoring companies in that they provide other financial services besides factoring services such as: deposit taking services, savings accounts, loans, overdrafts, among others. Banks' activities are also closely regulated in comparison to other financial intermediaries.

1.2. Problem Statement

According to Dababneh and Tukan (2007), Berger and Frame (2005), GOK (2005) and Binks and Enew (1998) the economic importance of SMEs to a country cannot be overemphasized, and yet obtaining financing continues to be a deterrent to the growth of SMEs. As suppliers of trade credit, enforcing credit terms is troublesome for SMEs, with late payment of such receivables being identified as a factor that precipitates financial distress and hampers growth among SMEs (Wilson and Summers, 1998).

Factoring has been globally accepted as a means for raising short term capital for financial needs (Jieh-Haur and Wei-Hsiang, 2012). Factoring has been cited as a good alternative for obtaining financing for SMEs according to Beecham (1988), Abend (1992), Smith and Schnucker (1994) and Bickers (1994). The study seeks to establish whether SMEs in Kenya

are receiving factoring services from Kenyan banks and what criteria influence that decision.

1.3. Research Objectives

The objectives of this study are:

1. To establish the profile of businesses receiving factoring services from Kenyan banks.
2. To determine criteria that influences the decision by Kenyan banks to factor receivables.

1.4. The Research Questions

The research questions posed in this study are:

1. What is the profile of businesses receiving factoring services from Kenyan banks?
2. What criteria influence the decision by banks in Kenya to factor receivables?

1.5. Scope of the study

The study looks at factoring in its various forms i.e. ordinary factoring, reverse factoring and invoice discounting, which are terms that refer to a range of services offered to businesses involving the release of cash in exchange for accounts receivable.

This study examines factoring in comparison to other lending methods and explores determinants that banks contemplate when factoring accounts receivable.

The study is focused on banks registered in Kenya supplying factoring services to businesses in Kenya. Banks were singled out because of the gap that Soufani's (2002) study presents. Soufani's study only explores factoring companies.

For the purposes of this study, the definition of an SME was that of the IFC from a study carried out in 2004: i.e. an SME is a formally registered business with 5-100 employees, with an annual turnover of between Kshs. 6 million and Kshs. 100 million. This excludes the micro and small enterprises that largely operate informally.

1.1. Justification of the Study

This study is justified by the role that SMEs continue to play in the economic development of a country (Biekpe and Abor, 2007). SMEs play an important role in the industrialisation of any country (The SME Solutions Centre, 2008). SMEs also contribute to improving the economic and the social sectors of a country through the stimulation of large scale employment and investment, the development of indigenous skill and technology, the promotion of entrepreneurship and innovativeness, the enhancement of exports and the building up of an industrial base at different scales (Mandal, 2007). As one author puts it, “It is projected that SMEs will come to be recognised more and more as the engines of employment growth in an economy, and credit institutions will have to be prepared to demonstrate that they are meeting the financing needs of SMEs in their communities” (Dababneh and Tukan, 2007).

Micro, Small and Medium sized Enterprises (MSMEs) in Kenya account for as much as 50% of Kenya's GDP, (GOK, 2005) see Table 1.2 below. 30% of this contribution comes from medium sized enterprises. The small enterprises are largely self-employment activities that operate informally to avoid the cost of compliance with government regulation and they account for two thirds of all non-agricultural jobs in Kenya (Central Bureau of Statistics, 1999).

Table 1.2: Size and Distribution of Enterprises in Kenya

Size of Firm	Estimated No. of enterprises	Estimated Contribution to GDP
Large	1,000	30%
Medium	34,000	30%
Micro and Small	1,679,858	20%
Other (Farm related)	20,142	20%
Total	1,735,000	100%

Source: Estimates based on Central Bureau of Statistics (CBS) Data, National Baseline survey of Micro and Small enterprises 1999 (extrapolated to 2005), CBS, K-Rep, and ICEG, IFC SME survey 2004

Factoring proponents have suggested that factoring is the solution for financing SMEs that are unable to raise collateral or provide pertinent information for lenders. They further

suggest that factoring is suitable for SMEs because the lender assesses the creditworthiness of the trade receivable, and not the SME (Berger and Udell, 2004; Bakker et al., 2004 and Klapper, 2005b, 2006). Studies have shown that other determinants, beyond the creditworthiness of the receivable, are usually considered (Soufani 2000, 2002). This study will inform policy makers whether factoring as a financial service by banks in Kenya is focused on the creditworthiness of the receivable or the SME's financial health.

The study will also inform what criteria the banking industry has been using in making the decision to factor receivables. The absence of research on factoring in Kenya cannot be overemphasized and also constitutes a justification for this study.



CHAPTER TWO: LITERATURE REVIEW

2.1. Overview of the Chapter

The chapter opens with a theoretical framework upon which the study is based. It explores the work of Stiglitz and Weiss (1981). An outline of what factoring constitutes is then given, distinguishing it from other forms of lending. This is followed by a brief history of factoring. The growth of factoring worldwide follows. The chapter then looks at the necessity of trade credit as a tool of trade and the vulnerability that SMEs face as a result. A discussion ensues on the importance of receivables factoring to SMEs, developing into a comparison with other lending methods. The study then identifies two other factoring determinants beyond the underlying receivables themselves. The chapter closes with a formulation of the conceptual framework.

2.2. Theoretical Framework

One of the reasons why SMEs find it difficult to grow is due to the limitation they face in obtaining credit or credit lines with banks. This limitation is the result of information opacity and information asymmetry problems which are characteristics of SMEs (Berger and Udell, 2005; Binks and Ennew, 1998). Information opacity refers to the lack of credible information about an enterprise either due to the lack of credible audited financial statements or the lack of a public rating. Information asymmetry occurs when information is costly to obtain and lenders cannot freely observe all relevant aspects of a firm's investment projects and are therefore unable to evaluate creditworthiness (Fafchamps, Biggs and Srivastava, 1994). These two obstacles lead to credit rationing by financial institutions.

Credit rationing will arise due to possible adverse selection and moral hazard problems suffered by financial institutions. Adverse selection occurs because a weak firm will mimic a strong firm to obtain more favourable financing, e.g., in the manipulation of financial ratios. Moral hazard will usually occur after financing has been obtained - an entrepreneur may shift from low to high risk strategies or exhibit expense preference behaviour (Bakker, Klapper and Udell, 2004). The diagram 2.1 on the next page summarises the predicament SMEs find themselves in.

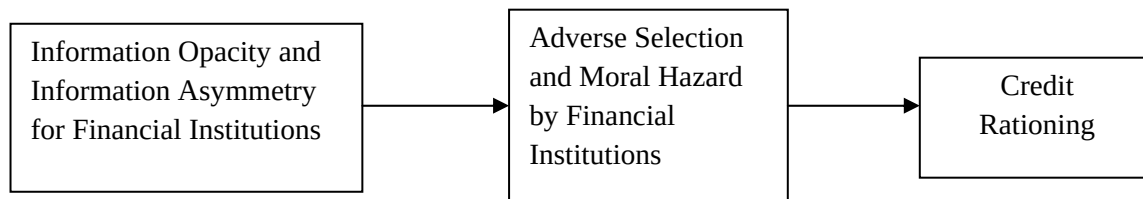


Figure 2.1: Credit Rationing

Stiglitz and Weiss (1981) offered a theoretical explanation for the existence of credit rationing in which some applicants obtain loans while others are rejected. Some authors have defined credit rationing as unsatisfied institutional finance where finance is not only not obtained by some firms, but in addition, some firms obtain only a fraction of what they need (Summers and Wilson, 1998). Stiglitz and Weiss (1981) use the term credit rationing for circumstances in which either:

- a) Among loan applicants who appear identical, some receive a loan and others do not, even if they offered to pay a higher interest rate; or
- b) There are identifiable groups of individuals in the population who, with a given supply of credit, are unable to obtain loans at any interest rate, although if the supply of credit was larger in the market, they possibly would obtain loans.

Stiglitz and Weiss (1981) propose that the interest rate that a bank charges may increase the risk element in a loan advanced. This could happen in two ways: by way of adverse selection and/or by moral hazard.

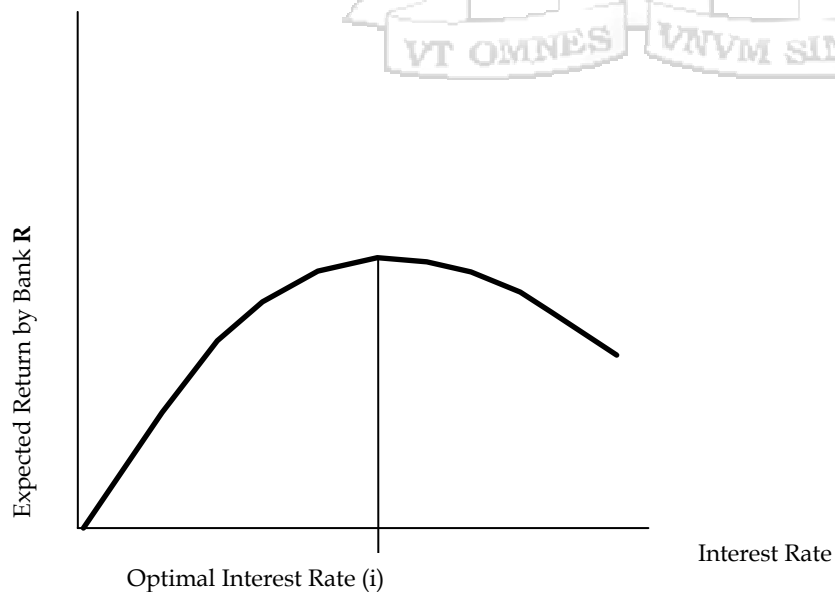
Adverse selection arises where a bank, in trying to identify a good borrower, actually ends up with a bad borrower. According to Stiglitz and Weiss (1981), the interest rate a borrower is willing to pay can be used as a screening device. The other screening device is collateral. It is Stiglitz and Weiss' proposition that an individual or firm willing to pay a higher interest rate poses a higher risk because such a firm/individual is unlikely to repay the loan. Raising the interest rate affects the profitability of low risk borrowers causing them to drop out of the applicant pool. Stiglitz and Weiss (1981) assert that at high interest rates, the only applicants interested are borrowers who perceive the probability of

repaying the loan as low i.e. high risk borrowers. This is what one study described as an adverse compositional effect (Ghosh, Mookherjee and Rav, 1999).

Moral hazard arises where the behaviour of the borrower is likely to change after borrowing. Stiglitz and Weiss (1981) suggest that high interest rates decrease the profitability of projects that succeed, and induce firms to take on higher risk projects. These may have higher payoffs if successful but with lower probabilities of success.

In a world where information is costless and perfect, the bank could specify actions a borrower can or cannot undertake under a loan agreement with a view to ensuring a return on their loan (Stiglitz and Weiss, 1981). However, in the real world, the bank is not able to do so, and is therefore left to formulate the terms of the loan in a manner intended to induce the borrower to take actions which are in the interest of the bank, and to attract low risk borrowers (Stiglitz and Weiss, 1981).

Credit rationing by its very nature seems to suggest an excess demand for loans. The law of supply and demand proposes that if demand is high, then price (interest rate in our case) will increase to equate supply to demand, hence achieve equilibrium. Stiglitz and Weiss (1981) propose that for a bank, equilibrium is attained with demand for loans still being high and interest rate (price) stagnates at an optimal point thus postulating that equilibrium for banks exists with credit rationing. Diagram 2.2 below will graphically demonstrate this.



Source: Stiglitz and Weiss (1981), Credit Rationing in Markets with Imperfect Information

Figure: 2.2 Stiglitz and Weiss' Optimal Interest Rate

According to Stiglitz and Weiss (1981), as a result of the risks associated with increasing the interest rate, banks expect the return (R) to increase less rapidly than the interest rate and beyond a certain point will begin to decrease. Stiglitz and Weiss (1981) proposed a model that works out an optimal interest rate (i) beyond which the bank is unwilling to lend. Their argument is that at this point (i); demand for funds exceeds the supply of funds. This is contrary to the economic model of supply and demand where in the presence of excess demand, unsatisfied borrowers would offer to pay a higher interest rate to the bank driving up the interest rate until demand equals supply. In the Stiglitz and Weiss model this is not the case, since equilibrium is found at the point when the banks begin to experience diminishing returns due to the risk associated with a higher interest rate. There are therefore no competitive forces to meet demand, and credit is therefore rationed. Stiglitz and Weiss (1981) suggest that the law of supply and demand is in fact not a law and is rather a result informed by underlying assumptions that prices have neither sorting nor incentive effects. Banks will not lend to anyone that offers to pay more than the optimal interest rate (i) because, to the bank, the expected return on a loan at an interest rate above (i) is lower than the expected return the bank expects on all its loans.

Other variables that Stiglitz and Weiss's (1981) theory of credit rationing mention besides the rate of interest include: the amount of the loan and the collateral amount. Stiglitz and Weiss (1981) proceed to demonstrate that increasing the collateral requirement of borrowers beyond some point will ultimately end up increasing the riskiness of the bank's loan portfolio. The collateral in this case is in the context of limited liability. They assert that it decreases the risk aversion of the borrower pool and induces individual investors to undertake riskier projects.

Various authors have pointed out that SMEs continue to face systematic credit rationing (Binks and Enew, 1998; Klapper, 2005a). The Stiglitz and Weiss (1981) theory attempts to explain the credit rationing SMEs suffer. Evidently SMEs seem to fall into that group which Stiglitz and Weiss (1981) describe: "with a given supply of credit, they are unable to obtain loans at any interest rate even though with a larger supply of credit, they would".

From this credit rationing theory, a larger supply of funding does exist, but cannot be supplied because it results in a less than the expected rate of return for banks. This could be because of information asymmetry challenges that financial institutions face (Klapper, 2005a).

Factoring is a form of lending that makes use of receivables as collateral. Stiglitz and Weiss (1981) suggest that collateral in the context of limited liability increases the riskiness of the loans. Collateral is defined as property e.g. stocks or bonds pledged as security (Oxford University Press, 1987). The collateral on offer to a lender when factoring differs from property owned. It is in fact money owed. Therefore it can be argued that a loan advanced against accounts receivable is a loan that bears minimal risk, in fact, that risk is removed from the borrower altogether and lies with the debtor (Alford, 2007; Klapper, 2005a).

2.3. Defining Small and Medium Sized Enterprises (SMEs)

Across the world, SMEs are defined on the basis of three indicators: the number of employees, annual sales and total assets (Dababneh and Tukan, 2007). According to the OECD (2004), the characteristics of SMEs not only reflect the economic patterns of a country but also the social and cultural dimensions. For purposes of policy development, UNIDO advises that the definition for a particular country must take into account the qualitative and quantitative indicators (Dababneh and Tukan, 2007). Therefore SME definitions vary among countries as well as within a country over a period of time. For example the standard European Commission definition of 'small' is any organisation with fewer than 50 employees and sales not exceeding \$13m (Kshs 1.105b), while 'medium' describes an organisation with fewer than 250 employees but more than 50 employees with sales of \$67m (Kshs 5.7b) or total assets not exceeding \$56m (Kshs 4.7b). In Kenya the European Commission definition for small would be for a very large enterprise. It is therefore necessary to define an SME within the context of a country. In Kenya the IFC defined SMEs as “formally registered businesses, with 5 - 100 employees and with an annual turnover of between Kshs 6 million and Kshs 100 million”. They are often

considered too big to be called micro enterprises and too small to be big industry players (IFC, 2004). This is the definition the study shall adopt.

2.4. An Analysis of Different Lending Methods

Berger and Frame (2005), when looking to develop a framework that describes credit availability to SMEs, and Bakker, Klapper and Udell (2004), identify six lending methods namely, financial statement lending, credit scoring, relationship lending, asset based lending, factoring and trade credit. Table 2.1 on page 13, examines these lending methods. These methods are assessed for the risk of unreliable information; the risk of adverse selection and the risk of moral hazard. The table outlines the basis on which lending is carried out for each method and the tools used to arrive at the decision to lend or not to lend. The table also provides an outline of the major requirements for each method. Based on each assessment a recommendation is made as to the suitability of the lending method to SMEs. The comparison shows that factoring is a suitable means by which SMEs can access financing.

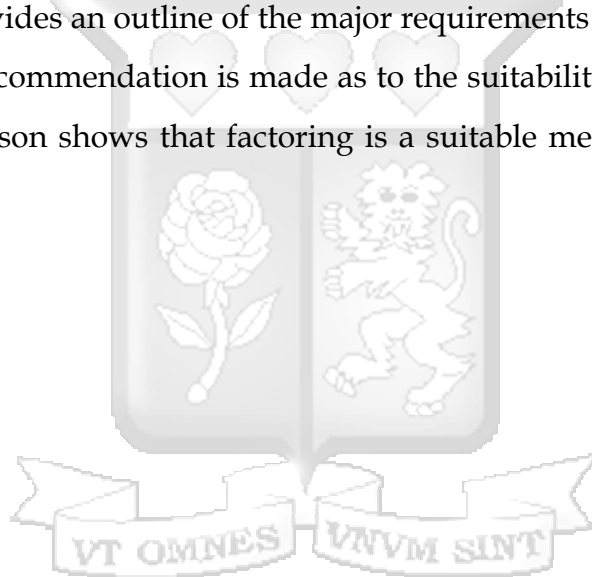


Table 2.1: Analysis of Different Lending Methods

	Method	Risk of inadequate/unreliable information for assessment	Adverse selection risk	Moral hazard risk	Basis of lending	Tools used to assess and arrive at a decision	SME suitability	Major requirements for this lending method
1	Financial Statement Lending	Low – because financial statements are available	High –because financial statements can be falsified.	High –because borrower can divert the funds to risky ventures.	On-going Concern – expected future cash flows	Financial Ratio Analysis	Low	- Well defined accounting rules or standards in the country. - Audited financial statements. - Strong financial conditions as depicted by the financial ratios.
2	Relationship Lending	Low – because the borrower is known/recommended	Low –because borrower is known to the lender.	High - because borrower can divert the funds to a high risk venture.	Relationship	Discretion	Medium	Soft proprietor information collected by the lender on the owner of the business and the business itself.
3	Credit Score Lending	Low - because the borrower has a credit rating	Low – because borrower has a credit rating	High –because borrower can divert funds to a high risk venture.	Credit score	Loan performance prediction model.	Low	Strong informational infrastructures – credit bureaux.
4	Asset Based Lending	N/A – because assets are the basis for lending.	N/A –because assets act as security in event of default.	N/A- because assets guarantee the borrowings.	Value of borrower's assets.	Formula linking credit extended to the estimated liquidation value of assets offered as collateral.	High	- Assets viewed as the primary source of security/ repayment. - Well defined commercial law. - Efficient lien registration system. - Efficient bankruptcy system.
5	Factoring	N/A –because lending is based on accounts receivable.	N/A- because lending is based on accounts receivable and not the health of the business.	N/A – because a security has been provided.	Quality of accounts receivable	Formula linking credit extended to the: - Creditworthiness of underlying receivable. - Minimal dilution issues e.g. returns, merchandise disputes. - Low cost of collection	High	- Is a form of asset based lending but involves financing only of accounts receivable. - Suitable in environments where there exists ambiguous commercial laws or inefficient bankruptcy systems (title passes from borrower to lender)
6	Trade Credit	Low –because the borrower is known to the lender based on past transactions with them.	Low –because the borrower is known.	N/A	Trade relationship(s)	Aspects of other lending methods e.g. relationship, financial statements, credit scoring but ultimately relationship carries a lot of weight.	High	- Soft proprietary information collected by the vendor. - Mutual trust.

Compiled from: Berger and Udell, 2005 and Frame, 2005; Bakker et al., 2004

In Table 2.1, there are six lending methods analysed i.e. financial statement lending, relationship lending, credit score lending, asset based lending, factoring and trade credit. With the exception of asset based lending and factoring, all other methods have a low risk in relation to the risk of inadequate or unreliable information for assessment. The suitability of asset based lending and factoring methods are both high because they both provide some form of collateral. The trade credit method ranks highly for SMEs but strictly speaking is more of an exchange of goods for later payment than a lending method.

With the asset based lending method, the risk of inadequate or unreliable information (information asymmetry) does not arise. Asset based lending is based on a formula linking the credit extended to the estimated liquidation values of the assets offered as collateral (Berger and Udell, 2004). With asset based lending, an efficient lien registration system and effective bankruptcy system preserves lender priority, and lessens the time spent in bankruptcy proceedings (Berger and Udell, 2004). However SMEs have cited availability of collateral as a major drawback to this kind of lending method (Klapper, 2005b, 2006; Berger and Udell, 2004).

The analysis on Table 2.1 shows that factoring is a more suitable lending method for SMEs when compared to other lending methods because it has no adverse selection risk and eliminates the information asymmetry requirement (Berger and Udell, 2004). There is a form of security provided when factoring, therefore no moral hazard risk (Wilson and Summers, 1998). What follows is a closer look at what factoring constitutes.

2.5. Factoring : A Closer View

Factoring is a type of supplier financing in which firms sell their credit-worthy accounts receivable at a discount (usually constituting interest and service fees) and receive immediate cash (Klapper, 2006). Bakker et al., (2004) describe factoring as asset based lending, where the credit extended is based on the value of the borrower's accounts receivable.

Berger and Udell (2004) view factoring as a cousin to asset based lending with three major distinctions. The first is that factoring only involves the financing of accounts receivable unlike asset based financing which involves financing physical assets such as equipment and inventory. Secondly when factoring, the underlying asset is sold to the lender and therefore title passes from borrower to lender. Thirdly factoring is essentially a bundle of three financial services: a financing component, a credit component and a collections component.

The financing component involves a factoring firm advancing a percentage usually between 70-80% of the invoice value, the discount being 30-20%. "A small portion of this discount is compensation for services rendered, but the bulk of it is a reserve that can be used to offset merchandise disputes, returned items or other customer claims" (Berger and Udell 2004). In offering the credit and collection services, factoring firms enjoy economies of scale as they have a larger debtors' list than any one SME client. They can therefore make use of sophisticated technology and employ personnel to specifically handle this list of debtors, in contrast to an SME for whom it would be uneconomical. As a result, factoring firms are able to distinguish a good debtor from a bad one fairly easily and use technology to record and track the age of a debt making it easier to collect.

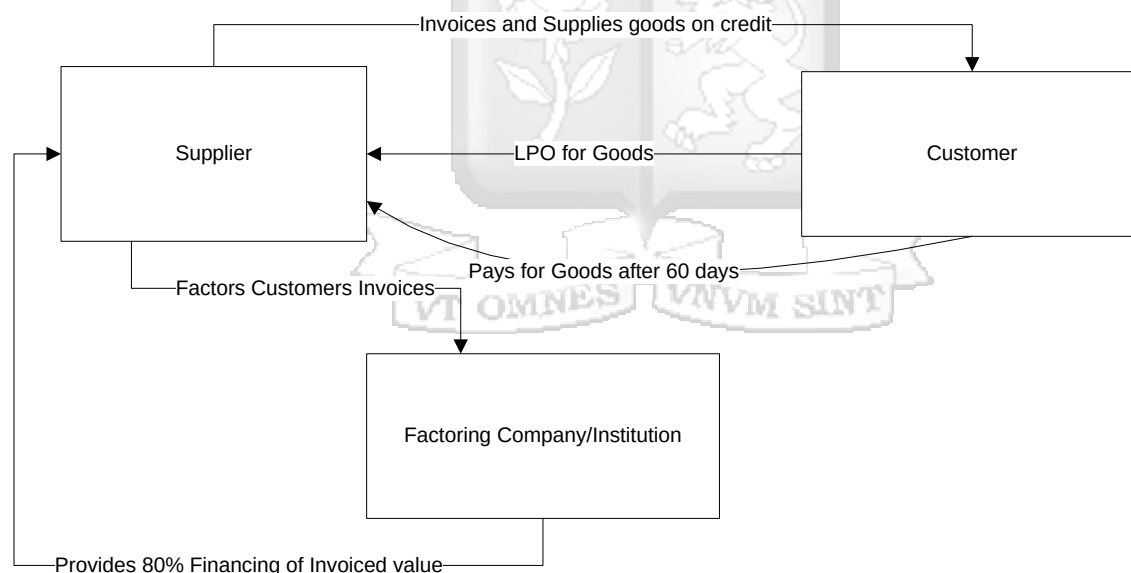
Factoring takes various forms, e.g. recourse factoring, non-recourse factoring, reverse factoring and ordinary factoring.

In recourse factoring, the factoring firm is entitled to claim payments directly from the client in the event that the buyer defaults. In non-recourse factoring, the factoring firm bears the risk of default if any arises (Soufani, 2002).

Ordinary factoring involves purchasing a choice number of listed receivables from a client, effectively diversifying the risk from any one receivable (Klapper 2005b). In ordinary factoring, the factoring firm will require that the client has a minimum number of buyers so that the risk is well spread among buyers. Developed countries like the US and UK rely on "electronic ledgers" which allow firms to input all receivable information online with their customers who have Dun and Bradstreet (D&B) identification numbers.

D&B is the world's largest private business credit registry with a database of 64 million records (Bakker et al., 2004). Klapper (2005b) elaborates further: "the electronic ledger automatically receives the D&B rating for each customer which is a credit score computed by D&B based on the firm's current and expected future performance, and the receivables are instantaneously accepted or rejected as collateral". Most emerging markets do not have this sort of technology to allow them access to commercial credit information that would make ordinary factoring possible (Bakker et al., 2004; Klapper, 2005b).

An alternative to ordinary factoring is reverse factoring. With reverse factoring, informational problems are minimal as the factoring firm only needs to assess the credit worthiness of a specific large firm(s) (Augusto, Gozzi and Schmukler, 2007). In reverse factoring, the lender purchases from the client only accounts receivable of high quality buyers. The factor therefore needs to collect information on only a few selected buyers (Klapper 2005b), as opposed to a whole collection of buyers.



Source: Klapper, L. (2005), The Role of Factoring for Financing Small and Medium Enterprises.

Figure 2.3: Factoring Mechanism

It is important to distinguish factoring from a loan. Whereas a loan is based on the credit worthiness of the applicant, factoring will focus on the creditworthiness of the applicant's customers. In fact, some authors are of the view that when factoring, accounts receivable

are sold like commodities to the factoring firm as opposed to offering them as collateral (Alford 2007). In one author's words, "accounts receivable are effectively sold to the lender such that if the client is bankrupted the factored receivables do not form part of the bankrupt's estate" (Klapper 2005a).

2.6. A Brief History of Factoring

Factoring dates back to ancient Rome when wealthy Romans hired factors to manage and dispose of their estates. The term 'factor' comes from the Latin verb "facere" which meant "to make or do", "one who makes things happen" (Silverman 1948). Later, in the 17th century, the early English textile agents in the United States received merchandise from English textile mills to act on their behalf in foreign sales. These agents were held responsible for the foreign trade credits. Eventually the millers began turning to these agents for advances pending the sale of the merchandise in the agent's possession and the maturity of existing receivables (Owen, 1936). These agents therefore became factors. A factor differed from a broker in that he was entrusted with the property to be sold as opposed to simply making a bargain on it.

The term "del credere agent" was used to express the obligation assumed by factors when selling on credit to hold themselves liable if the buyer defaulted - hence a "del credere commission" (Silverman 1948). Gradually there was a separation of the merchandising and financial functions of these agents. The term 'factor' referred to those firms offering the service of discounting sales, advancing funds, assuming credit risks and collecting accounts (Owen, 1936). Silverman (1948) in his article on "Factoring as a Finance Device" identifies factoring institutions like banks, insurance companies and commercial credit firms. He draws a distinction between banks and commercial credit companies. These commercial credit companies were earlier referred to as the old-line factors. These factoring companies offered a range of services, including sales administration, which involves invoicing and accounting, collection of amounts due and chasing of slow payers.

2.7 The Growth of Factoring

In 2006, international factoring was estimated at € 1,133,193 million (Factors Chain International, 2013). In 2012 that figure stood at € 2,132,230 million equivalent to Kshs. 234m (see appendix III). This represents an 88% growth worldwide in six years.

Factoring has spread out over the last century to 74 countries by the end of 2012 (Factors Chain International, 2013). Africa is ranked fourth out of five continents that participate in factoring with only five countries featuring. These are South Africa, Egypt, Morocco, Tunisia and Mauritius. Their total factoring in 2012 was € 23,927 million (Kshs 2.6b) representing only 1.1% of the total factoring in 2012 (Factors Chain International, 2013). The growth in Africa has been 181% from € 8,513 million in 2006 to € 23,927 million in 2012 but is still markedly lower than other continents (see appendix III).

The growth of factoring suggests an advantage over other forms of lending (Klapper, 2005a). Factoring has facilitated the expansion of sales for exporters in emerging markets (Klapper, 2005a). Soufani (2000), Watson and Head (2004) and Klapper (2005a), have identified advantages that factoring may offer an SME including:

- a) Factoring aids the growth of the business. Money released through factoring can be used to fund other working capital needs and facilitate higher sales. A good example of this advantage would be with businesses that carry stock/ raw material items. If such a business sells their finished product on credit, debtors' invoices can promptly be converted into cash through factoring. Factoring would, in such a case, enable a business turn its inventory over several times, this would in turn result in higher sales;
- b) Prompt payment of suppliers, leading to the obtaining of cash discounts. This occurs if a business that makes use of factoring uses the cash it receives from factoring its receivables to pay its suppliers. The business is able to take advantage of cash discounts offered by such suppliers for prompt payment, hence reducing business costs. Prompt payment also improves the relationship with suppliers;
- c) Savings on sales administration costs. The cost of employing people to manage debtors in an organisation can be prohibitive for a small business. Factoring eliminates the need to employ these people. However, this is an advantage only if factoring occurs for all debts and not some;

d) Credit rating information is made available to the business by factoring agents. By virtue of their activities, factoring agents have information on creditworthy buyers. Small organisations seeking factoring services may not easily obtain this credit rating information by themselves.

Historically, factoring was the reserve of weaker and under-capitalised businesses. In developed countries, like the UK, the United States and Europe, most banks did not want to lend to businesses because of the risks involved. However, over the years, and especially after the Second World War, banks realised that they were missing out on lending opportunities. Prior to this discovery, banks felt that clients who factored did not fit into the asset based lending model that banks used. Shay and Greer (1968) aptly put it: "Most banks have been content to limit short term commercial financing to high grade borrowers under self-liquidating lines of credit. Companies qualified for loans when their financial ratios and past earnings were satisfactory, but when the credit applicant was sub-optimal because of their small size, lack of credit history and poor earnings performance and/or weak financial ratios, banks refused to extend credit. These banks were however, willing to lend to commercial finance companies. These commercial finance companies seized the opportunity to develop factoring services despite the risks and make loans against accounts receivable." Banks therefore eventually sought to buy or consolidate with existing factoring firms. With the banks on board, the factoring industry gained much needed respectability, with the industry being divided between the factoring divisions in banks and independent firms (Alford 2007).

A good example is found in the UK, where in 1999 all banks accounted for over 93% of the invoice discounting and factoring market. The factoring market was in the range of pounds sterling 60 billion (Soufani, 2000). The UK banks were able to control this market through their ownership of factoring divisions, while independently owned firms accounted for the remaining 7% of the market (Soufani, 2000).

2.8 SMEs and Trade Credit

Without trade credit, factoring would not arise. Trade credit arises when a firm sells its goods or services for a promise to receive payment for them at a later agreed upon date.

Various authors have researched on trade credit. Van Horen (2005), having studied firms in thirty nine countries, found that trade credit is used as a competitive tool, particularly for small firms. Fisman and Raturi (2004) found that competition encouraged trade credit provision in five African countries. Demirguc-Kunt and Maksimovic (2001), in their study of ten countries, found that trade credit use is higher relative to bank credit in countries with weak legal environments. Fisman and Love (2002) studied the impact of inter firm financing by showing that industries with a higher dependence on trade credit exhibited higher rates of growth in countries with relatively weak financial institutions. Other authors have cited trade credit as a price discriminatory tool (Meltzer, 1960; Schwartz and Whitcomb, 1979; Brennan, Maksimovic and Zechner, 1988; Mian and Smith, 1992; Petersen and Rajan, 1997) where offering trade credit is viewed as a form of a price discount. Due to their smaller size, SMEs find themselves extending trade credit to large buyers as a guarantee to their product's quality (Long, Malitz, and Ravid 1994). From the above mentioned authors, (Van Horen 2005; Fisman and Raturi 2004; Fisman and Love 2002 and Demirguc-Kunt and Maksimovic 2001), it emerges that SMEs offer trade credit to fuel their growth and also receive trade credit to overcome credit rationing especially in countries with weak legal environments.

Offering trade credit has its limitations and can be detrimental to a business. Summers and Wilson (2000), in their paper on trade credit management, refer to six functional responsibilities associated with extending credit to customers and these involve:

- (1) Assessment of the customer's credit risk;
- (2) Making the credit granting decision;
- (3) Collecting the receivables as they fall due and taking action against defaulters;
- (4) Monitoring customer behaviour and compiling management information;
- (5) Bearing the risk of default or bad debts; and
- (6) Financing the investment in receivables.

Summers and Wilson (2000) further state that a firm can choose to manage the credit administration process in-house or outsource to specialised institutions such as factors, invoice discounters, credit reference agencies and debt collection agencies. Therefore, the motivation to factor can stem from an organisational structure and the cost implications of handling trade receivables in-house. For all intents and purposes it is relatively more costly to handle trade receivables in-house for a smaller organisation than a bigger one.

Smith and Schnucker (1994) have explored the decision to externalise credit management based on the organizational structure of the business (organisational structure theory) while Mian and Smith (1992) have explored the motive to externalise credit management (transaction cost theory). However, Summers and Wilson (2000) in their research on 655 manufacturing firms in the UK argue that the motivation to use factoring stems from financing needs resulting from credit rationing as opposed to transaction costs theory or organisational structure theory.

2.9 Importance of Factoring to SMEs

It is clear that SMEs continue to encounter credit rationing from financial institutions because of hindrances that potential lenders face in producing consistently reliable risk assessment processes (Binks and Enew, 1998). Bickers (1994) asserts that the growth of factoring has been influenced by some of the problems which small firms have. These include: raising institutional finance; late payments by customers and the problem of bad debt among small businesses. Klapper (2005a) highlights that, in emerging markets, SMEs are unable to access sufficient financing from the banking system while large domestic, foreign and multinational firms have cheap access to funds from their domestic and foreign banks not to mention public debt financing.

2.10 Determinants outside the scope of creditworthiness of the receivable

Berger and Udell (2004) and Soufani (2000, 2002) suggest that there are other determinants that are taken into consideration when the decision to factor is made besides the

underlying receivable. Berger and Udell (2004) suggest that the decision to factor is influenced by two other determinants i.e. 'the cost of collection' and 'dilution issues'. The 'cost of collection' refers to the cost of collecting small amounts factored by several borrowers as opposed to large amounts by a few borrowers. It is more costly to collect small amounts from various entities as opposed to collecting from one or two large entities. 'Dilution issues' relate to instances where the product that has been sold may be faulty or does not meet quality expectations and therefore may be returned to the seller. To minimise his risk, a factor will avoid instances where there is likelihood that dilution will occur (Soufani, 2000). It is important to highlight that the two determinants, 'the cost of collection' and 'dilution issues', are determinants that relate to the SME itself and have little to do with the receivable or the debtor, which should ideally be the basis for factoring. Usually 'the cost of collection' will be driven by the sales turnover of the SME, while 'dilution issues' will be driven by the product the SME manufactures. As earlier noted, factoring is most effective and useful to SMEs if the decision to factor is only based on the collectability of the receivable. Examples of determinants outside the scope of collectability would include the product, the turnover, the age of the business, and the management of the business among others. These are aimed at informing the lender about the borrower and not the debtor. A brief look at each determinant and its ranking as based on Soufani's study is outlined below.

2.10.1 Age of the Business

From Soufani's study (2000), the majority of firms by age in the UK were between one and five years, accounting for over 70% of an estimated 24,000 firms receiving factoring services. It was noted that firms outside this age bracket, had preference for other types of financial services more suited to their needs and their stage of the business life cycle. Soufani (2002) carried out a ranking of the various factors that factoring agents considered most important ranking them between 1 and 5 with 5 being most important. Age of the business was ranked by the market at 4.2 on a scale of 5, (refer to table 2.2 on page 26). Whereas the ranking depicts the age of the business as being important, it still ranked fifth after other factors. The reasons given for ranking it as important are that, it was possible to get more information on an older client company for purposes of assessing risk than it

was for a younger company e.g. less than three years old. Besides, the mortality rate for younger companies was higher relative to that of older existing entities.

The age of the business is also closely associated with the minimal dilution determinant that affects collect-ability of the invoice. Minimal dilution arises when a firm that is young has to grapple with their product quality being accepted by buyers (Summers and Wilson, 2000). A factor may want to be cautious before lending to such an entity because of this reason.

2.10.2 Size of the Business

Whereas size by number of employees is considered irrelevant in Soufani's study scoring 1.125 out of a possible 5, size by turnover seems to be important to factors scoring 4.3 out of a possible 5, (refer to table 2.2 on page 25). Soufani (2002) established that bank owned factors were particularly interested in larger turnovers. The banks' appetite towards large turnovers is related to 'the cost of collection'. As earlier indicated the 'cost of collection' factor refers to the cost incurred in collecting accounts receivable. These costs can be higher when the amounts involved are small in nature and numerous, as opposed to a few large amounts.

While factor agents would prefer large sized businesses, factoring is usually not the preserve of large businesses. Summers and Wilson (2000) in their empirical study of trade credit management, and the decision to use factoring, found that while factors may not turn away smaller firms for factoring services, they certainly do not find them attractive.

Soufani (2002) clearly established a negative correlation between the size of the client business, as measured by turnover, and the decision to factor. This relationship, in Soufani's opinion, was due to the unwillingness of large client businesses to opt for credit management by an external party. Large businesses opt for the integration of this task internally. This unwillingness to outsource the credit function is further supported by Smith and Schnucker (1994) who argue that the larger the number of customer accounts, the lower the fixed costs associated with the credit function, therefore giving economic legitimacy to an internal credit department.

Mian and Smith (1992) support outsourcing the credit function by asserting that a factoring agent's credit management operation is likely to be more efficient than those of several smaller firms. Efficiency will result from the ability of the factor to invest in specialized personnel and sophisticated information technology systems.

All in all, factoring agents are left to decide on what threshold to use when determining size of the business as they make their decision whether to factor or not.

2.10.3 Sector / Industry

When establishing the determinants that factor agents in the UK considered when making the decision to factor, Soufani (2002) rated 'sector' at neutral to important at 3.34 on a scale of 5 (refer to table 2.2 on page 26). It constitutes a determinant when factoring because of the numeracy of the borrowers, what the study refers to as the 'cost of collection'.

In the United Kingdom, factoring services seem to be concentrated into three main sectors i.e. manufacturing, distribution and services. Manufacturing accounted for about 50%, distribution 30% and services 15% (Soufani, 2000). According to Andrews, Friedland and Shapiro (1959), in the United States, factoring services were offered to firms that were either in manufacturing or the wholesale trade. In addition, the products they dealt with had stable markets and average sales invoices were of substantial amounts. These businesses sold primarily to other businesses, as opposed to retail consumers. The profile emerging here is that of business to business transaction based companies with large amounts to transact.

Klapper (2005a) asserts that in the US, factoring was concentrated in certain industries and was a primary source of working capital finance. This is supported by Shay and Greer (1968) who noted that, as far back as 1965, when nationally chartered banks in the US began offering factoring services, the banks involved were located in areas with substantial textile or allied interest, where old line factoring was accepted as a practice. The textile industry referred to here was largely export based therefore dealing with large quantities and large transaction amounts.

Receivables of service organizations, in Soufani's (2000) study, were unlikely to get factored because the product was intangible and the collateral value of the receivable less certain as a result. Firms in the retail business were virtually excluded since the risk of non-payment was considered extremely high with consumers in addition to the number of transactions being high and therefore costly to collect.

2.10.4 Product

Soufani (2002) rated the product factor at 4.5 out of a possible 5 (refer to Table 2.2 on page 26). Summers and Wilson (2000) found that there was a significant positive relationship between factoring and the extent to which the product is physically similar to others in the market. The argument here is that similar products have an increased collateral value to a third party. Mian and Smith (1992) argued that the extent to which products are specific to an individual buyer, affects the willingness of a third party to finance the transaction. Highly specialised goods or services would be difficult to sell to another party, should the need by a factoring agent to mitigate a loss arise (Summers and Wilson, 2000).

'Dilution issues' as used by Berger and Udell (2004) refers to instances where the product sold may not meet quality expectations and therefore needs to be returned to the seller. They imply that 'dilution issues' revolve around the nature of the product. If so, their view presents an opportunity to view a highly specialised product that has the effect of reducing the collateral value for the lender in the event of a dispute as a 'dilution issue'.

2.10.5 Financial Statements

Soufani (2002) found financial statements relatively unimportant to factor agents. They are ranked 2.85 as per the ratings in Table 2.2 on page 26. He argues, "... although financial statements are considered to be an essential requirement for evaluation by the factoring company, their overall strengths or weaknesses are not considered an important criterion in the decision to supply credit." This statement reiterates the argument that SMEs that face barriers to financing due to insufficient collateral can opt for factoring. He states that, "factoring firms appear to appreciate the fact that businesses often seek invoice financing to bolster weaknesses with their cash flow, precisely when their financial

statements indicate problems”, implying that, it is precisely because of their weak financial statements, that they sought factoring in the first instance.

2.10.6 Management of the Business

In Soufani’s study (2002), the score on the management of the business ranked 4.25 out of a possible 5 (refer to Table 2.2 on page 26). He enumerates a number of reasons for this high score. The first is the recognition that factoring companies conduct their business with people – first and foremost. The argument here is that, if the management of an enterprise is undependable, they will produce low quality products and that will result in high ‘dilution issues’. Management’s integrity on a personal and business level, dynamism, efficiency and motivation to adapt to market changes and new methods of operation, were important to the factoring companies (Soufani 2002). Given the strength of the score, it would seem, therefore, that lenders have ‘management of the business’ concerns, a factor which is beyond the collectability of the receivable in arriving at the decision to factor or not to factor.

Table 2.2: Factoring Determinants in Soufani's 2002 Study and their Likert Scale Scores

	Determinant	Soufani (2002) Likert Scale Score for Bank Owned Factors on a scale of 1-5
1	Invoice Collectability	4.875
2	The creditworthiness of the debtor(buyer)	4.5
3	The Product on the invoice	4.5
4	Turnover of the business (size)	4.3
5	Management of Business	4.25
6	Age of the Business	4.2
7	Sector/ Industry	3.34
8	Financial Statements	2.85
9	Client’s Profitability	1.625
10	Number of Employees (size)	1.125

Source: Soufani, K. (2002), ‘The Decision to Finance Accounts Receivable: The Factoring Option.’

In the table 2.2 on page 26, the ranking in the last column is the Likert scale scores obtained in Soufani's 2002 study. If it is adopted that the 'creditworthiness of the underlying receivable' is the most important consideration when factoring, the determinants that are relevant to the factoring method of lending are invoice collectability and the creditworthiness of debtor or buyer. Indeed, they do rank among the highest at 4.875 and 4.5 respectively out of a possible 5. In the strictest sense of the term factoring, these two can be referred to as the determinants that comprise the "creditworthiness of the underlying receivable". From the literature reviewed thus far all other determinants arising from Soufani's research should not have a bearing in the decision to factor.

That being the case, Soufani's findings show that the bank owned factors still considered these other determinants as important. From the Likert scale scores, any determinant that scored above 3 was considered important enough to influence the decision on whether to factor or not.

Soufani (2002) may have determined these other factoring determinants of: the nature of product; the size of the client; the age of business; the sector and/or the industry; financial statements and profitability in his studies, but, he has not expressly stated their unsuitability as determinants when making a decision to factor. However borrowing from the writings of Bakker et al. (2004); Berger and Udell (2004) and Klapper (2005b), factor agents/ lenders, should as much as possible, remain within the scope of the determinants that constitute what has been referred to as, the "creditworthiness of the underlying receivable". By not restricting themselves to these determinants, factor agents/ lenders risk extending the credit rationing motives encountered in other lending methods to factoring.

2.11 Conceptual Framework

Various authors, among them Berger and Udell, (2004), Bakker, Klapper and Udell, (2004) and Klapper, (2005b, 2006) have suggested that factoring decisions focus on the creditworthiness of the underlying receivable as opposed to the borrower's own credit

worthiness. Soufani (2000, 2002) and Berger and Udell (2004) also state that beyond the creditworthiness of the underlying receivable other influences to the decision to factor receivables which can broadly be categorised as: cost of collection and dilution issues. Yet Berger and Udell, (2004), Bakker, Klapper and Udell, (2004) and Klapper, (2005b, 2006) state that the focus on the underlying receivable makes factoring a more appropriate lending technology for SMEs because SMEs will normally exhibit information asymmetry problems, and/or are unable to raise collateral.

The appropriateness of factoring is even greater in environments where there are weak informational systems, weak bankruptcy systems and generally weak commercial laws (Berger and Udell, 2004; Bakker, et al., 2004; Klapper, 2005b). Factoring is therefore meant to focus on the 'creditworthiness of the underlying receivable' with a view to mitigate the informational asymmetry problem, the lack of collateral and unsuitable lending environments. Nevertheless, as observed in preceding paragraphs, 'dilution issues' determinants, namely: the nature of the product; the management of the business and the age of the business have a bearing on the decision to factor accounts receivable. Also 'cost of collection' determinants like the turnover and the sector/industry of the business also played a role in the decision making process by lenders. The study classifies the seven determinants that scored more than 3 out of 5 on the Likert scale from Soufani's 2002 study (see table 2.2 page 26) into the three categories of 'creditworthiness of the underlying receivable', 'cost of collection' and 'dilution issues'. Table 2.3 below shows this classification. The determinants that scored less than three were financial statements, profitability and size (number of employees).

Table 2.3: Categorisation of the Variables That Influence the Decision to Factor

Categories	Variable
Creditworthiness of Underlying Receivable	• Creditworthiness of Debtor • Invoice Collectability
Cost of Collection	• Turnover (size) • Sector of the business
Dilution Issues	• Product on the invoice • Management of the firm • Age of the business

From the literature review carried out the study summarises the findings into a conceptual framework as depicted below in figure 2.4.

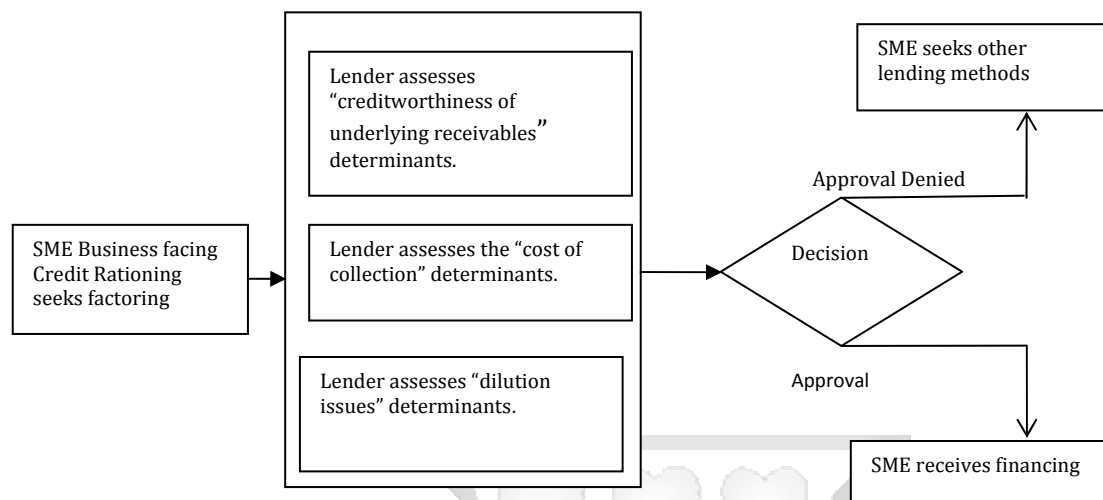


Figure 2.4: Conceptual Framework

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

The chapter discusses how the study was carried out, the research design, target population, sampling procedure. The chapter then outlines the data collection method, data analysis and presentation.

3.2 Research Design

The research was an exploratory study aimed at surveying the supply of factoring services to businesses in Kenya. The survey approach was adopted due to lack of secondary information on factoring by banks in Kenya. To get the profiles of businesses accessing factoring services, the study made use of descriptive statistics. The decision to finance the receivables of an entity was influenced by various variables. Due to the ordinal nature of the data the study makes use of the Spearman's Rank Correlation to determine the relationship between each determinant and the decision to factor.

3.3 Population and Sampling

Data for the study was sought from all forty five commercial banks registered with the Central Bank of Kenya at the time. Since the population is small, the study collected data from all banks that confirmed carrying out factoring/invoice discounting services. The process used to determine the banks providing factoring services was determined with the use of a survey telephone call to credit officers/managers of all the forty five banks with the aim of establishing whether factoring receivables and/or invoice discounting was a service they offered. From a possible forty five commercial banks, only fifteen banks were found to be offering factoring services. These fifteen banks are considered for the study and responses were obtained from all fifteen banks.

3.4 Data Collection Methods

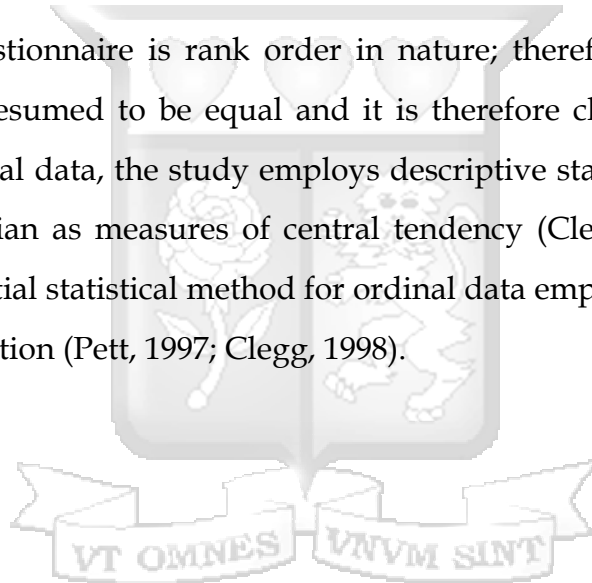
The data collected from the banks is split into the characteristics and profiles of the businesses using factoring services, and the variables that influence the decision to factor when making a decision to factor by banks. This data was collected using a research assistant by way of a semi structured interview using the above mentioned questionnaire

that contained open-ended and close-ended and Likert scale-type questions. The questionnaire was administered to credit officers and branch managers of the fifteen banks. All the fifteen banks responded to the questionnaire. The survey addressed areas relating to the characteristic and profile of the businesses using this financial service.

3.5 Data Analysis and Presentation

The data collected are qualitative and quantitative in nature. The data is coded and summarised with some data undergoing further analysis using percentages, descriptive statistics and correlation to give the profiles of the businesses currently accessing factoring services and the criteria that banks in Kenya use to make their decisions to factor account receivables.

The data from the questionnaire is rank order in nature; therefore the intervals of the responses cannot be presumed to be equal and it is therefore classified as ordinal data (Pett, 1997). Being ordinal data, the study employs descriptive statistical methods such as the mode and the median as measures of central tendency (Clegg, 1998, Blaikie, 2003). The appropriate inferential statistical method for ordinal data employed in the study is the Spearman's rank correlation (Pett, 1997; Clegg, 1998).



CHAPTER FOUR: RESEARCH FINDINGS

4.1 Introduction

This chapter presents the findings of the analysed data from the fifteen banks that offered factoring services. These banks offered this service to approximately 557 clients out of a possible 664 who applied for factoring services. Data analysis made use of Statistical Package for Social Sciences (SPSS) and Ms-Excel to derive the descriptive statistics and correlation. The data has been presented in the form of tables and graphs. The purpose of this chapter is therefore to present and to interpret these findings.

4.2 Profiles of Businesses Seeking Factoring Services

Questions 3 to 6 of the questionnaire seek to address the first objective of establishing what profile of businesses is accessing factoring services offered by Kenyan banks. Question 3 seeks to establish the size of firms by turnover and by number of employees. These two criteria, turnover and number of employees, are important in establishing the sizes of the firms because they indicate whether it was SMEs that obtained the aforementioned services.

Table 4.1: Profiles of Businesses Seeking Factoring Services

<i>Size of Client Firm (Turnover)</i>	<i>Proportion</i>
<6m	17%
6 - 50m	52%
51-100m	31%
>100m	0%
<i>Size of Client Firm (Employees)</i>	<i>Proportion</i>
1-15	2%
16-50	54%
51-100	44%
>100	0%
<i>Age of the Business</i>	<i>Proportion</i>
<1 year	0%
1-5 years	11%
6-10 years	89%
11-15 years	0%
<i>Ownership</i>	<i>Proportion</i>
SP	0%
Partnership	2%
LLC	97%
PLC	1%
<i>Sectors</i>	<i>Proportion</i>
Manufacturing	25%
Distribution	26%
Service	24%
Transport	16%
Construction	9%

Referring to Table 4.1 on page 32, the findings suggest that 83% (6m-50m: 52%; 51m – 100m: 31%) of firms accessing factoring services earn above Kshs 6million and over 98% (16-50: 54% ; 51- 100: 44%) have 16 – 100 employees. As earlier indicated in our scope of the study, the study adopts the IFC definition of an SME, i.e. an SME is a formally registered business with 5-100 employees, with an annual turnover of between Kshs 6 million and Kshs100 million. From this question it is established that firms accessing factoring services are SMEs.

Question 4 from the questionnaire seeks to establish from what sectors the organisations seeking factoring are drawn from. These are classified into manufacturing, distribution, services, transport and construction. Referring to Table 4.1, 26% of the firms were drawn from the distribution sector, 25% from the manufacturing sector and 24% from the services sector. Transport and Construction had 16% and 9% respectively. It is therefore concluded that firms from the distribution sector sought factoring services the most.

When assessing a client's eligibility, bank officials will seek information on the customer in what is commonly referred to as (KYC) know-your-customer. From this exercise a bank official will determine an entity's age. Table 4.1 on page 32 has a summary of their response to question 5. 11% of the firms were aged between 1 and 5 years while 89% were aged between 6 and 10 years. This led to the conclusion that the vast majority of firms seeking factoring services ranged between 6 and 10 years. Notably firms above 10 years of age did not seek factoring services.

Question 6 is aimed at establishing the forms of ownership of enterprises that sought factoring services. From Table 4.1 on page 32, in the opinion of the bankers 97% were limited liability companies with a small percentage belonging to other categories. None of the banks indicated that sole proprietors were seekers of factoring services.

4.3 Criteria Banks Used in Making Decision to Factor Receivables

To establish the determinants used by banks in their decision to factor, respondents were asked, in question 7, to indicate the level of importance of the following determinants: age of the business, turnover of the business, number of employees, creditworthiness of the customer, financial statements, the management of the business, profitability of the business, collect-ability of the invoice and the product on the invoice. The rating was on a scale of 1 to 5 with 5 being the most important. Question 8 gave the respondents an opportunity to state any other factors they felt were important in making their decision to factor. Some respondents gave an additional five determinants to obtain factoring services namely provision of security/collateral, an LPO from the buyer, evidence of a quotation to the buyer for the business invoiced, being an account holder with the bank and type of business the SME was engaged in.

Being ordinal data the study employs the mode and the median as measures of central tendency because the arithmetical manipulations required to calculate the mean and standard deviation are inappropriate for ordinal data (Blaikie, 2003; Clegg, 1998). From the descriptive statistics in table 4.2 on page 35, judging by the modes, the study established that when making the decision to factor, banks in Kenya mostly consider an entity's financial Statements (5), turnover (5), creditworthiness of the debtor (5), age (5) and management (5). Profits (4); Invoice collectability (3); Product (2); and employee number (1) were considered less when making the decision.

The determinants of security, type of business, account holder, LPO, and quotation were not requirements in all the fifteen banks. These have been grouped and ranked separately. Of these latter rankings, the requirement to provide some form of security was given by nine banks. These findings show with certainty that nine banks out of fifteen that provide factoring will ask for collateral. The requirements for an LPO and the type of business the SME engaged in were also found to be important, but for only three banks. The requirement to provide proof that a quotation has been issued was only from two banks. The requirement to be an account holder was requested by six banks.

The appropriate inferential statistics for ordinal data are those employing non-parametric tests, such as chi-squared, Spearman's Rho, or the Mann-Whitney U-test 1 because parametric tests require data of interval or ratio level (Pett, 1997; Clegg, 1998). We therefore make use of Spearman's Rho to measure correlation.

Table 4.2: Descriptive Statistics

	Mode	Median	N
Financial statements	5	5	15
Management of business	5	5	15
Turnover	5	5	15
Creditworthiness	5	5	15
Age of business	5	5	15
Profitability	4	4	15
Invoice collectability	3	3	15
Product	2	2	15
Number of employees	1	2	15
Security	5	5	9
Local Purchase Order	5	5	3
Quotation	n/a	5	2
Account Holder	5	5	6
Type of Business	n/a	4	3

Table 4.3: Extract of Spearman's Correlation Output

Determinant	Decision to factor-(r)	Significance Test (1 tailed)-(p)
Age of business	-0.067	0.406
Turnover	0.024	0.466
Number of employees	0.171	0.271
Creditworthiness	0.665	0.003
Financial statements	-0.397	0.072
Management of business	0.198	0.239
Profitability	-0.379	0.082
Invoice collectability	0.201	0.236
Product on the business	0.461	0.042

Table 4.3 above is an output of Spearman's correlation that measures whether the two variables are correlated i.e. the decision to factor (dependent variable) and each

determinant (independent variable). In interpreting the results of the correlation, Going by the correlation coefficients $r > 0.5$ and significance test $p > 0.05$, the study observes that only *creditworthiness of the debtor*, has a large positive correlation with the decision to factor ($r = 0.665$ and $p = 0.003$). The remaining determinants age, turnover, number of employees, financial statements, management of the business, profitability, invoice collectability, and product do not have a strong enough correlation with the decision to factor. The test for correlation therefore identifies only one determinant, creditworthiness of the debtor. Based on the literature review, the conceptual framework classified the variables into three categories: 'creditworthiness of the underlying receivable', 'cost of collection' and 'dilution issues' (refer to table 2.3, page 28). The variable of *creditworthiness of the debtor* falls under the category of creditworthiness of the underlying receivable.

The study therefore reveals that the banks in Kenya place creditworthiness of the debtor as the most important determinant of the decision to factor accounts receivable.



CHAPTER FIVE: DISCUSSIONS AND CONCLUSIONS

5.1 Introduction

This study was conducted with the aim of achieving the following objectives:

- a) To establish the profile of businesses receiving factoring services from Kenyan banks.
- b) To determine criteria that influences the decision by Kenyan banks to factor receivables.

The analysis of the data collected from the semi structured interview conducted was done in chapter 4; a discussion of the findings follows below.

5.2 The Profile of the Firms Accessing Factoring Services

From the findings, the profile that emerges as receiving factoring services from banks in Kenya is that of the small and medium sized firms (SMEs). SMEs constitute the major consumers of these services from banks. As earlier stated, the study adopted the IFC (2004) survey definition of an SME; firms that have an annual turnover of Kshs 6m -100m and or employ between 5 and 100 people. The findings corroborate the fact that this service is most suited for SMEs who are likely to face credit rationing from banks (Berger and Frame, 2005). The study shows that banks in Kenya, have adopted factoring as a way by which they can lend to SMEs. This is an improvement from the earlier survey carried out by RPED in 2004 (GOK, 2005) that found that banks had neither the tools, nor the capacity to evaluate loans to profitable SMEs.

Table 5.1: Turnover under Factoring in Kenya

Turnover Range	No of Firms	Total Turnover in millions	% of total firms	% of Turnover
<6m	95	379	17%	2%
6 - 50m	288	8,064	52%	37%
51-100m	174	13,220	31%	61%
>100m	0	-	0%	0%
TOTAL	557	21,663		

The total turnover under factoring in Kenya, from the findings, was estimated to be over Kshs 21 million in 2008. Kshs 13million (62%) of the Kshs 21 million was from SMEs that had a turnover of between Kshs 51 and 100m. Enterprises with turnover between Kshs 6 and 50million followed, with a total turnover of Kshs 8 million (38%) in factoring business.

In terms of the number, the group comprising enterprises with turnover between Kshs 6m and 50m was highest. These enterprises comprise 52% of all firms seeking factoring services. SMEs falling between Kshs 51 and 100m comprised 31% of all SMEs identified to have sought factoring services, while those below Kshs 6m were 17%. Indeed, larger companies with turnovers over 100m were not interested in factoring according to the findings. These findings confirm that larger firms have economies of scale, and therefore, employ their own staff to manage their debtors' portfolio and further have other options for sources of financing, preferable to factoring. Notably firms with turnovers between 51 and 100 million received the lion's share of the 21 million in total business factored despite being only 31% of the applicants. This trend suggests a preference for larger factoring volumes by banks.

Table 5.2: Age and Ownership Structure of Firms Seeking Factoring

Age Of Business			Ownership Structure		
Age Range	No. of Firms	% of Companies	Ownership Structure	No. Of firms	% of Companies
<1 year	0	0.0%	Sole Proprietor	0	0.0%
1-5 years	64	11.5%	Partnership	9	1.6%
6-10 years	493	88.5%	Limited Liability Co.	542	97.3%
11-15 years	0	0.0%	Public Liability Co.	6	1.1%
Total	557		Total	557	

The age of the SME seemed to be fairly consistent; 6 to 10 years being the predominant age group. 88.5% of all firms carrying on factoring with the 15 banks were in this age group. The forms of ownerships search yielded that most firms were privately owned limited liability companies, 97.3% or 542 firms out of a possible 557 firms.

5.3 The Variables Influencing the Decision to Factor

The study has determined that banks in Kenya place a high premium on the 'creditworthiness of the debtor' as has been demonstrated by the statistically significant strong correlation of this variable with the decision to factor. In chapter two, literature suggested that factoring receivables should focus only on the 'creditworthiness of the underlying receivable' as a factor to mitigate the issues revolving around informational asymmetry, the lack of collateral and unsuitable lending environments, (Bakker et al., 2004; Berger and Udell 2004; Klapper 2005b). By not restricting themselves to these determinants, lenders risk extending the credit rationing motives encountered in other lending methods to factoring.

From the study's findings, Kenyan banks are not too concerned with the 'cost of collection' variables (turnover and sector of the business) and 'dilution issue' variables (product, management, age of the business). The decision to factor by Kenyan banks is driven by creditworthiness of the debtor. Therefore, to receive factoring services, SMEs in Kenya are to ensure that they have creditworthy debtors.

5.4 Conclusions

The two objectives the study sought to achieve have been attained. The objectives were:

- a. To establish the profile of businesses receiving factoring services from Kenyan banks.
- b. To determine criteria that influences the decision by Kenyan banks to factor receivables.

The study reveals that receivables factoring is a service that SMEs receive in Kenya albeit from a limited number of banks. It also reveals that a significant amount of factoring carried out in Kenya requires only creditworthy debtors by the entity seeking factoring services. The banks in Kenya therefore follow the internationally accepted criterion that factoring financing depends only on the creditworthiness of receivables.

5.5 Recommendations

Factoring as a lending method holds great promise for both banks and SMEs in Kenya. The number of banks providing this service in Kenya is a third of the industry. Even with these few players factoring in Kenya is still on a very small scale globally. Banks or other financial institutions in Kenya have a great opportunity to provide this service.

Presently the financial industry in Kenya has seen the advent of credit reference bureaus which are now legally authorised to share information on persons and organisations to banks and financial institutions. It is anticipated that with time, the sharing of such information will form the basis for a more objective way of identifying creditworthy debtors and bring to fore a greater number of creditworthy companies whose invoices can be factored.

The government of Kenya has demonstrated concern for the youth unemployment rate in Kenya by providing for a youth fund, to facilitate the growth of small enterprises among the youth as a way of providing employment for the youth. In the same way, the government could provide a similar fund to be used solely for purposes of factoring. Whereas the youth fund is a direct resource to the youth, a factoring fund would be an indirect resource for the same youth. A factoring fund would target pre-existing businesses aged five years or more with turnovers of six million and above. This proposed fund should lend to SMEs based on the creditworthiness of their debtors, and not the SMEs ability to repay the amount lent or its profitability. Such a fund would greatly facilitate trade among small businesses and create employment.

Thirdly the need for SMEs to be educated on the possibility of factoring cannot be overemphasized. It is evident that the number of SMEs factoring is very low as demonstrated by the findings that only 930 applications to factor had been received by banks out of an estimated 34,000 medium sized enterprises (GOK, 2005). This low rate of application suggests that a relatively small number of SMEs have access to information on

factoring as a form of lending. The initiative to educate SME owners can best be taken up by banks in conjunction with the government as a joint project aimed at boosting the economic welfare of Kenyan SMEs through factoring.

Lastly, the banking industry regulator, the Central Bank of Kenya, needs to put in place specific provisions/guidelines to give factoring a legal framework. One of the reasons banks gave for being restrictive when factoring was that the regulatory guidelines in place do not favour factoring. When factoring, banks borrow the generic regulatory framework that encompasses security based lending. This can be changed with the introduction of a factoring policy in the framework.

5.6 Limitations and Further Research

It was observed that factoring has a low profile in Kenyan banks, in comparison to other services offered by banks. A good understanding of factoring was limited to credit officers at the head offices, and branch managers at branches.

The study has focused on the profiles of firms accessing factoring services and the determinants used when making the factoring decision by Kenyan Banks. A similar study can be carried out to establish if other financial institutions e.g. micro-finance organisations, are providing factoring services in Kenya and to which businesses. The cost of factoring no doubt affects the uptake of the service by SMEs and would be a study worth doing. A similar study to this one after a number of years will likely find growth in the factoring industry in Kenya.

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Appendix I –Questionnaire

Part I

The study sought to establish banks that have carried out factoring in Kenya. The survey was to all commercial banks registered in Kenya. This was done through a telephone survey. The following enquiry was made to credit officers/managers of the respective banks:

- 1) 'Does bank "X" offer factoring services to its customers?

Part II

Once a bank was established to be providing factoring services the following questionnaire was administered to the credit managers.

- 1) Title of respondent: _____
2) Name of the bank (Optional) _____
3) In your experience which organisations do the most factoring or discounting of invoices?

- a) Those with turnover (per annum) of:

☐ Below 6m ☐ 6m-50m ☐ 51m – 100m ☐ >100m

- b) Those with employees numbering:

☐ 1-15 ☐ 16-50 ☐ 51-100 ☐ >100

- 4) From what sectors are these organisations mainly drawn from:

Unlikely		Likely		Most Likely	
a)	Manufacturing	☐		☐	☐
b)	Distribution	☐		☐	☐
c)	Services	☐		☐	☐
d)	Transport	☐		☐	☐
e)	Construction	☐		☐	☐
f)	Other	☐		☐	☐

- 5) What in your experience constitutes the age in years of the businesses that factor or discount invoices with your bank?

☐ < 1 yr ☐ 1-5 yrs ☐ 6-10 yrs ☐ 11- 15 yrs ☐ > 15 yrs

- 6) What form of ownership structure do these organizations usually take:

☐ Sole proprietor ☐ Partnership ☐ Private Ltd. Co. ☐ Public Ltd Co.

7) What is the level of importance of the following determinants in the decision to factor or discount invoices? (With 1 being least important and 5 most important).

- | | | | | | | |
|----|--------------------------------------|----------------------------|----------------------------|----------------------------|----------------------------|----------------------------|
| a) | Age of the business | ☐ 1 | ☐ 2 | ☐ 3 | ☐ 4 | ☐ 5 |
| b) | Turnover of the business | ☐ 1 | ☐ 2 | ☐ 3 | ☐ 4 | ☐ 5 |
| c) | No. of Employees | ☐ 1 | ☐ 2 | ☐ 3 | ☐ 4 | ☐ 5 |
| d) | The Creditworthiness of the debtor | ☐ 1 | ☐ 2 | ☐ 3 | ☐ 4 | ☐ 5 |
| e) | Financial Statements of the business | ☐ 1 | ☐ 2 | ☐ 3 | ☐ 4 | ☐ 5 |
| f) | Management of the business | ☐ 1 | ☐ 2 | ☐ 3 | ☐ 4 | ☐ 5 |
| g) | Profitability of the business | ☐ 1 | ☐ 2 | ☐ 3 | ☐ 4 | ☐ 5 |
| h) | Invoice Collectability | ☐ 1 | ☐ 2 | ☐ 3 | ☐ 4 | ☐ 5 |
| i) | Product on the invoice | ☐ 1 | ☐ 2 | ☐ 3 | ☐ 4 | ☐ 5 |

8) What other criteria does your bank use when making a decision to factor invoices/receivables? Please write them down and proceed to rank them as well (with 1 being least important and 5 being most important).

- | | | | | | | |
|----|---------------------------|----------------------------|----------------------------|----------------------------|---------------------------------------|----------------------------|
| a) | E.g. collateral available | ☐ 1 | ☐ 2 | ☐ 3 | ☒ 4 | ☐ 5 |
| b) | _____ | ☐ 1 | ☐ 2 | ☐ 3 | ☐ 4 | ☐ 5 |
| c) | _____ | ☐ 1 | ☐ 2 | ☐ 3 | ☐ 4 | ☐ 5 |
| d) | _____ | ☐ 1 | ☐ 2 | ☐ 3 | ☐ 4 | ☐ 5 |
| e) | _____ | ☐ 1 | ☐ 2 | ☐ 3 | ☐ 4 | ☐ 5 |

9) This next question is intended to assist in obtaining the proportion of applications the bank has factored using the all criteria listed above:

a) How many applications for factoring or invoice discounting have you received in the last one year?

- ☐ 1-15 ☐ 16-50 ☐ 51-100 ☐ >100

b) Out of these how many applications have been approved for factoring?

Approximately/Exactly _____ (Cross out one and state the number)

Appendix II - Total Factoring Volume by Country in the last 6 years

<i>In Millions of Euros</i>							
	2006	2007	2008	2009	2010	2011	2012
AMERICAS							
Argentina	333	362	355	335	350	475	614
Bolivia				18	18	35	35
Brazil	20,054	21,060	22,055	29,640	49,050	45,623	43,627
Canada	3,386	4,270	3,000	3,250	3,723	5,284	7,100
Chile	11,300	14,620	15,800	14,500	16,422	21,500	24,000
Colombia	100	2,030	2,100	2,392	2,784	4,990	4,562
Costa Rica					160	30	180
El Salvador							300
Guatemala							230
Honduras					160	30	30
Mexico	8,150	9,200	9,550	2,120	14,538	21,074	26,130
Nicaragua							270
Panama	607	483	460	500	600	700	852
Peru	563	648	875	758	2,712	2,461	2,310
United States	96,000	97,000	100,000	88,500	95,000	105,000	77,543
Uruguay							61
Total Americas	140,493	149,673	154,195	142,013	185,517	207,202	187,844
EUROPE							
Austria	4,733	5,219	6,350	6,630	8,307	8,986	10,969
Belgium	16,700	19,200	22,500	23,921	32,203	38,204	42,352
Bosnia & Herzego.				35	45	45	45
Bulgaria	35	300	450	340	550	1,010	1,500
Croatia	340	1,100	2,100	2,450	2,793	2,269	2,269
Cyprus	2,546	2,985	3,255	3,350	3,450	3,758	3,350
Czech Rep.	4,025	4,780	5,000	3,760	4,410	5,115	5,196
Denmark	7,685	8,474	5,500	7,100	8,000	9,160	8,800
Estonia	2,900	1,300	1,427	1,000	1,227	1,164	1,877
Finland	11,100	12,650	12,650	10,752	12,400	13,000	17,000
France	100,009	121,660	135,000	128,182	153,252	174,580	186,494
Germany	72,000	89,000	106,000	96,200	129,536	158,034	157,420
Greece	5,230	7,420	10,200	12,300	14,715	14,731	12,761
Hungary	2,880	3,100	3,200	2,520	3,339	2,817	2,676
Ireland	29,693	22,919	24,000	19,364	20,197	18,330	19,956
Italy	120,435	122,800	128,200	124,250	143,745	175,182	181,878
Latvia	276	1,160	1,520	900	328	371	542
Lithuania	1,896	2,690	3,350	1,755	1,540	2,134	2,488

Luxembourg	306	490	600	349	321	180	299
Malta	1	25	52	105	136	200	240
Netherlands	25,500	31,820	30,000	30,000	35,000	46,000	50,000
Norway	11,465	17,000	15,000	15,100	15,075	16,395	18,115
Poland	4,425	7,900	7,800	12,000	16,210	17,900	24,510
Portugal	16,886	16,888	18,000	17,711	20,756	27,879	22,948
Romania	750	1,300	1,650	1,400	1,800	2,582	2,920
Russia	8,555	13,100	16,150	8,580	12,163	21,174	35,176
Serbia	150	226	370	410	500	926	950
Slovakia	1,311	1,380	1,600	1,130	981	1,171	1,024
Slovenia	340	455	650	650	650	550	650
Spain	66,772	83,699	100,000	104,222	112,909	122,125	124,036
Sweden	21,700	21,700	16,000	18,760	18,760	29,259	33,149
Switzerland	2,000	2,513	2,590	5,000	4,000	3,450	3,000
Turkey	14,925	19,625	18,050	20,280	38,988	30,869	31,702
Ukraine	620	890	1,314	530	540	955	1,233
United Kingdom	248,769	286,496	188,000	195,613	226,243	268,080	291,200
Total Europe	806,958	932,264	888,528	876,649	1,045,069	1,218,585	1,298,725
AFRICA							
Egypt	3	20	50	110	200	200	220
Mauritius				121	125	127	128
Morocco	440	660	850	910	1,071	1,406	1,844
South Africa	7,800	9,780	12,110	13,500	15,120	21,378	21,378
Tunisia	270	245	253	276	295	340	357
Total Africa	8,513	10,705	13,263	14,917	16,811	23,451	23,927
ASIA							
Armenia	50	50	7	7	14	14	0
China	14,300	32,976	55,000	67,300	154,550	273,690	343,759
Hong Kong	9,710	7,700	8,500	8,079	14,400	17,388	29,344
India	3,560	5,055	5,200	2,650	2,750	2,800	3,650
Indonesia						3	3
Israel	375	800	1,400	1,400	1,650	1,650	1,422
	2006	2007	2008	2009	2010	2011	2012
Japan	74,530	77,721	106,500	83,700	98,500	111,245	97,210
Jordan				43	43	12	12
Korea	850	955	900	2,937	5,079	8,087	8,000
Lebanon	95	176	306	420	450	327	301
Malaysia	480	468	550	700	1,058	1,050	1,782
Qatar				23	23	75	75

Singapore	2,955	3,270	4,000	4,700	5,800	6,670	8,670
Taiwan	40,000	42,500	48,750	33,800	67,000	79,800	70,000
Thailand	1,925	2,240	2,367	2,107	2,095	3,080	4,339
United Arab Emir.	810	340	1,860	1,910	2,000	1,750	2,900
Vietnam	16	43	85	95	65	67	61
Total Asia	149,656	174,294	235,425	209,871	355,477	507,708	571,528
AUSTRALASIA							
Australia	27,573	33,080	32,546	39,410	44,915	57,491	49,606
New Zealand	0	700	700	700	600	600	600
Total Australasia	27,573	33,780	33,246	40,110	45,515	58,091	50,206
TOTAL WORLD	1,133,193	1,300,716	1,324,657	1,283,560	1,648,389	2,015,037	2,132,230



Appendix III: Research Data Results

Question 3: In your experience which organisations do the most factoring or discounting of invoices?

a) By Turnover

Turnover per annum Range	<6m	6 - 50m	51-100m	>100m
Bank 1		x		
Bank 2	x			
Bank 3	x	x		
Bank 4	x			
Bank 5			x	
Bank 6		x		
Bank 7		x		
Bank 8		x		
Bank 9		x		
Bank 10			x	
Bank 11		x		
Bank 12		x		
Bank 13		x		
Bank 14			x	
Bank 15		x		

b) By number of employees

Employee No. Range	1-15	16-50	51-100	>100
Bank 1			x	
Bank 2	x			
Bank 3		x		
Bank 4		x		
Bank 5			x	
Bank 6		x		
Bank 7		x		
Bank 8			x	
Bank 9		x		
Bank 10			x	
Bank 11		x		
Bank 12		x		
Bank 13		x		
Bank 14			x	
Bank 15		x		

Questions 4: From what sectors are these organisations mainly drawn from?

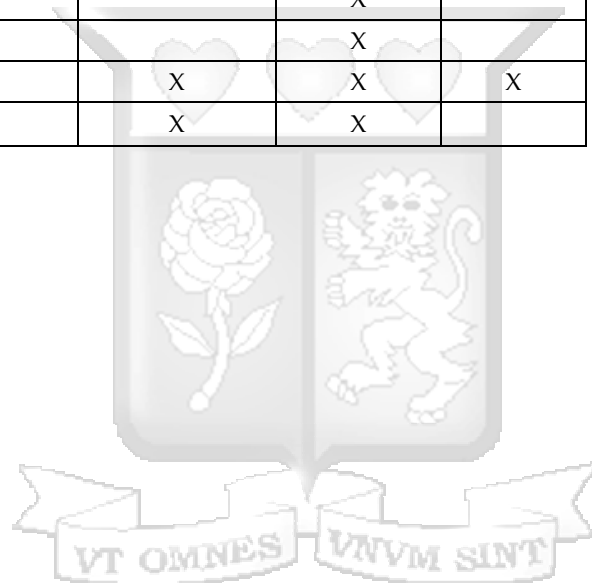
Sector Analysis	Scoring: 1 = unlikely; 3= likely and 5= most likely					
	Manufacturing	Distribution	Service	Transport	Construction	Other
Bank 1	3	3	5	5	1	0
Bank 2	1	5	3	1	3	0
Bank 3	5	5	3	5	0	0
Bank 4	5	5	5	3	3	0
Bank 5	5	5	3	3	3	0
Bank 6	5	5	5	3	1	0
Bank 7	5	5	5	3	1	0
Bank 8	5	5	5	3	1	0
Bank 9	5	5	3	1	1	0
Bank 10	5	5	5	5	3	0
Bank 11	5	5	5	3	1	0
Bank 12	5	5	3	3	1	0
Bank 13	5	5	5	1	1	0
Bank 14	5	5	5	5	3	0
Bank 15	5	5	5	1	1	0

Question 5: What in your experience constitutes the age in years of the businesses that factor or discount invoices with your bank.

Age of the Business				
Range	<1 years	1-5 years	6-10 years	11-15 years
Bank 1			X	
Bank 2		X		
Bank 3			X	
Bank 4			X	
Bank 5			X	
Bank 6			X	
Bank 7		X		
Bank 8			X	
Bank 9			X	
Bank 10			X	
Bank 11			X	
Bank 12		X		
Bank 13		X		
Bank 14			X	
Bank 15		X		

Question 6: What form of ownership structure do these organisations usually take?

Legal Status	Sole Proprietor	Partnership	Limited Liability Co.	Public Ltd Co.
Bank 1			X	
Bank 2		X	X	
Bank 3			X	
Bank 4			X	
Bank 5			X	
Bank 6			X	
Bank 7			X	
Bank 8			X	
Bank 9		X	X	X
Bank 10			X	X
Bank 11		X	X	
Bank 12			X	
Bank 13			X	
Bank 14		X	X	X
Bank 15		X	X	



Question 7 and 8: What is the level of importance of the following determinants in the decision to factor or discount invoices? (With 1 being least important and 5 most important)

	Financial Statements	Management	Turnover	Debtor	Age	Profits	Invoice Collectability	Product	Empl No.	Security	Local Purchase Order	Quotation	Account Holder	Type of Buss
Bank 1	4	5	5	5	4	4	5	5	3					
Bank 2	5	5	5	5	4	5	5	3	1					
Bank 3	5	5	5	5	5	3	3	4	5					
Bank 4	5	5	5	5	4	5	5	5	4					
Bank 5	5	5	4	5	4	5	5	3	2					
Bank 6	5	5	5	4	5	4	3	3	2	5				
Bank 7	5	4	5	5	4	4	3	2	1				5	5
Bank 8	5	5	5	5	5	4	3	3	1	5			1	1
Bank 9	5	5	5	5	5	4	2	2	2	5	5	5		
Bank 10	5	5	5	4	5	4	2	2	2	5			5	
Bank 11	5	5	4	4	5	4	1	1	3	5	4	4	5	
Bank 12	5	5	5	5	5	5	2	2	1	5			5	
Bank 13	5	5	5	4	5	5	3	2	1	4			4	4
Bank 14	5	5	5	5	5	4	2	2	1	5	5			
Bank 15	5	5	5	4	4	4	3	2	2	5				

Question 9a: How many applications for factoring or invoice discounting have you received in the last one year?

Applications Received	1-15	16-50	51-100	>100
Bank 1		X		
Bank 2	X			
Bank 3				X
Bank 4		X		
Bank 5			X	
Bank 6		X		
Bank 7		X		
Bank 8		X		
Bank 9		X		
Bank 10		X		
Bank 11			X	
Bank 12	X			
Bank 13		X		
Bank 14			X	
Bank 15		X		

Question 9b: Out of these applications how many have been approved for factoring?

Applications Approved	Number Approved
Bank 1	40
Bank 2	10
Bank 3	130
Bank 4	20
Bank 5	68
Bank 6	25
Bank 7	21
Bank 8	31
Bank 9	26
Bank 10	22
Bank 11	47
Bank 12	7
Bank 13	10
Bank 14	84
Bank 15	16