

**Regional Workshop: Factoring/Receivable Discounting: a financing tool for  
agriculture sector  
Barbados, Savannah Hotel - 4 -5 Nov 09**

**Workshop report and recommendations**

The workshop brought together about 50 participants from 11 CARICOM member countries representing farmers associations, national and agricultural development banks, regional bodies, government ministries and commercial financial institutions and the tourism sector.

The workshop was officially opened by the Minister of Agriculture and Rural Development of Barbados, H.E. Mr. Haynesley Benn. The other key speakers at the opening ceremony included Ms. Yvonne Moses Grant, Division Chief of the Caribbean Development Bank, and Mr. Hubert Perr, Head of Operations of the Delegation of the European Commission in Barbados and the Eastern Caribbean.

***Workshop purpose and goal***

The workshop's primary objective was to raise awareness and build capacity in the area of factoring and invoice discounting as a financing technique that can be used to help farmers access financing and reinforce the linkage between agriculture sector and the tourism industry. This is achieved as the technique focuses not on the borrower's risk of repaying a loan but on the borrower's customers' creditworthiness, which is often a better risk. By using receivables as a source of repayment, a small-scale enterprise does not have to post its own collateral to secure a loan but can use its receivables as a finance-able 'asset class'. Hence, as farmers often lack sufficient eligible collateral, including uncertain ownership rights and land tenure on the land they farm, factoring and invoice discounting must be appealing financial techniques.

***General comments and observations***

The workshop atmosphere was certainly dynamic and there was quite active participation from a number of delegates.

The proceedings helped to highlight that in fact there is considerable activity in a number of countries (Barbados, St. Lucia, Trinidad & Tobago, Jamaica in particular) in the area of increasing farmer access to financing in order to promote sales to the tourism sector. The workshop helped raise awareness of these various efforts among the participants and learn from each others experience.

***Impact of extended payment terms as a constraint for farmers to sell produce***

When supplying agricultural commodities such as fruit and vegetable to the main players of the tourism industry, mainly hotels, one of the constraints faced by farmers is the delays in payments by buyers which can go to 90 and 180 days after the delivery of their produce. The delay in payment not only deteriorates farmers' cash-

flow situation but also discourages the sale of agricultural production to the tourism industry.

If properly structured, Factoring can contribute to addressing this constraint, thereby providing farmers with immediate cash flows. For the tourism industry, there could be the prospect of enhanced terms of trade and finance under the right set of conditions of factoring schemes.

The facilitator posed the question: “Can you estimate to what extent sales to the tourism sector would be affected if there was immediate payment?” A farmer organisation representative from Jamaica estimated that sales would increase at least 25-30% and almost certainly more. The other delegates appeared to concur with this statement. Hence we can set as a hypothesis that resolving the payment problem can have an immediate and beneficial effect on farmers’ livelihoods.

### ***Workshop structure***

Day 1 was the ‘technical day’ in which the nature of factoring was presented along with key legal and tax topics (though the tax presentation was rescheduled as the first presentation on Day 2). Day 1 also featured a case study in Barbados. Day 2, after an opening presentation on tax issues was mostly devoted to country presentations and discussion including the case study of the St. Lucia Buffer Fund.

*Presentation 1 & 2: The role of trade credit in the customer & Receivables Discounting.* The key learning points of these two topics were:

- Trade credit is the most effective (in terms of cost, ease of use and documentation) source of financing for any company and many companies seek to maximise this source
- Even the largest companies such as Nestle find that they must offer trade credit to their customers
- Trade credit is in fact an integral part of the seller-customer relationship and while presenting the seller with credit risk and financing demands, sellers should embrace trade credit and learn to use it effectively
- Factoring is one variation of a larger universe of receivables discounting and generally focuses on the financing needs of SMEs.

*Presentation 3: The nature of factoring:* This presentation gave an overview of factoring offering statistics from Factors Chain International illustrating how substantial the factoring industry is throughout the world.

### ***Key learning points***

One essential point of the workshop was to bring home the fact that factoring is a considerable financing technique in many parts of the world. Its appeals stems from

the fact that the 'asset' being used to secure the pre-payment is the buyer's creditworthiness. Therefore the factor looks to the buyer and does not require the seller to post any additional collateral or security. For farmers who may lack assets or even clear title to their land, this is an attractive proposition.

Factoring is differentiated from invoice discounting in that in factoring a factor purchases invoices for an immediate cash payment to the seller and hence becomes the legal owner of the receivables from the buyers. Invoice discounting does not involve purchase or transfer of ownership of the invoice but rather the invoice's use as a security element in what is a traditional loan arrangement. The fact that the factor, subject to the stipulations in the law, can legally own the invoice gives the factor enhanced legal rights vis-à-vis other creditors in the event the buyer (or even the seller) becomes insolvent.

Factoring however has different definitions ranging from a more rigid US definition, which includes the following activities:

1. Purchase of invoices for immediate cash payment
2. Administration and book-keeping of sales ledger
3. Accounts receivable collection
4. Bad debt protection

In the US, factoring is deemed to perform all of these functions.

By way of contrast, the UNIDROIT Convention on International Factoring, says that factoring is when a factor performs any 2 of the 4 functions listed above.

The broadest definition of factoring comes from the UK which runs the gamut from the US definition (performing all 4 functions) to what is clearly invoice discounting and not factoring and can include any combination of the 4 functions listed above.

As CARICOM countries generally speaking look to England for legal context, the UK practice is the more appropriate reference point.

As the sale and purchase of a receivable, an intangible, is purely a legal construct, the concept appeared to be not necessarily intuitive to some of the participants (and it is not completely intuitive).

The presentation also laid out the fundamental options that a UK factoring agreement presents to a company. In essence there are five basic decisions to be made:

1. *Recourse v. non-recourse*: In non-recourse factoring, the factor accepts the buyer's insolvency and default risk and forgoes recourse to the seller in the event of default.
2. *Discounting or no discounting*: Or in effect funding or no funding where the seller may want other factoring services (e.g., sales ledger administration) but has a cash flow situation that does not require receiving discounted funds.

3. *Discount-to-collection v. discount-to-maturity*: The discount fee can be applied in one of two ways. First, discount-to-maturity, which is the method practiced in the USA, simply applies the discount rate to the receivable period up to the due date. This results in a fixed discount fee. Discount-to-collection applies the discount fee rather like a loan, and the rate is charged up until the time the invoice is actually paid. Hence, under this method, if the borrower delays payment the factor still has the right to accrue fees (exactly as in a loan or overdraft facility). Discount-to-maturity results in certain and typically lower fees. However, as buyers often stretch payments in practice, the downside is the potential disturbance of customer relations as US factors tend to be more aggressive pursuing late payments as they do not have the benefit of receiving more income on late payments. UK factors tend to be more flexible and this flexibility is a direct function of discount-to-collection method.
4. *Agency v. no agency*: The concept of agency in its factoring context was a tricky one to convey as some delegates interpreted this to mean that a third party agent is introduced to administer the sales ledger, which is in fact not the case. In the factoring context, agency refers to the practice of the factor allowing the seller to retain control of managing the sales ledger and collecting the receivables, in effect acting as an ‘agent’ for the factor who owns the invoices.
5. *Disclosure v. non-disclosure*: While factors generally want their purchase of invoices made known to buyers, some clients prefer to not have the factor’s presence known.

A survey was conducted during workshop by stakeholder group on their preferences vis-à-vis the five options above. Seventeen responses were collected with the following interesting results:

- *Recourse/Non-recourse*: The development bank/financial institution group split (3 in favour of non-recourse; 4 in favour of recourse). All other respondents from other stakeholder groups voted for non-recourse factoring. As it can be assumed that development banks and financial institutions must take the lead in developing factoring, this issue would appear to be a key one to address in designing any factoring programme.
- *Discount-to-maturity v. discount-to-collection*: The delegates split on this with 8 in favour of discount-to-maturity v. 9 opting for discount-to-collection. As the method of calculating the discount fee has an impact on cost to the seller, the implications of these two methods need to be understood by all parties in a factoring scheme; this will certainly be a key issue to address.
- *Agency v. no agency*: The results were probably distorted by the apparent interpretation of agency meaning a third party agent entering into the picture, which is not the case. The development banks and financial institutions all opted for no agency, i.e., the factor should administer the sales ledger and collect the funds, while it is the farmers’ representatives who according to their comments in the discussion expressed the view that farmers should retain their control of the collection process in order to build business experience.

This is another area that will have to be considered carefully in the design of a factoring programme.

- *Disclosure:* With the expectation of the farmers' representatives and one ministry representative, the other stakeholder groups voted in favour of disclosure. The farmers' representatives split 2:2 on the issue indicating that some farmers or farmers' association might have some reservations disclosing the factoring arrangement.

The next presentation began to introduce the nature of the mechanism by which a factor acquires ownership of an invoice. This mechanism is the legal concept of 'assignment'.

*Presentation on legal issues by Dawn Williams, Partner, Meridian Law*

Dawn Williams considered the regional legal aspects of factoring and made the following points:

- There is no specific legal framework in the Eastern Caribbean region addressing factoring and invoice discounting
- In general the region would follow UK legal principles on the sale and purchase of invoices and the rights of creditors in the event of a buyer's insolvency
- The sale of an invoice and its transfer of ownership is accomplished by the legal device of assignment
- UK law is often not clear in distinguishing the purchase of a invoice v. a loan secured by a receivable

*Tax implications of factoring, Mr. Wayne Lowell, partner and head of tax, KPMG*

Wayne Lowell pointed out that tax issues were not straight forward and would need to be looked at closely in any factoring scheme. He identified the following issues:

- A stamp tax is typically charged on financial transactions; this would obviously increase cost on top of factoring charges
- VAT: The key issue here is whether the purchase of a receivable will attract VAT on the entire amount of the transaction or would it be limited to the discounting fee and charges which represent the income earned by the factor. The key determinant appears to be whether the tax authorities would consider the discounted amount to be a financial transaction which would not be subject to VAT, or a commercial transaction, which would be. Mr. Lowell was of the opinion that a good case could be made for factoring to be characterised as a financial transaction.

### *Technical summary*

The presentations on the nature of factoring and the legal and tax aspects lead to an important observation: there are three different perspectives from which one can look upon factoring.

| <b>Perspective:</b>       | <b>Legal</b>   | <b>Tax</b>  | <b>Accounting</b>   |
|---------------------------|--|---|---|
| Issue considered:         | In the event of the insolvency or default of the buyer or seller, what is the Factor's legal rights and position vis-à-vis other creditors and the defaulting party  | Does the transaction attract VAT and/or stamp duty                      | How should the transaction be shown on the seller's balance sheet or a true sale that takes the receivable off balance  |
| Key question to be asked: | Has there been a true purchase of the invoice according to the law or it is in effect a loan which would imply a different legal position?   | Is the transaction a financial transaction or a commercial transaction? | IFRS accounting standards: Has there been a true sale depending upon how much risk does the seller retain?  |
| Key issues:               | <ul style="list-style-type: none"> <li>▪ Assignment of notice of assignment</li> <li>▪ Perfection of interest against other creditors</li> <li>▪ Sales contract clauses that prohibit or limit assignment</li> </ul> <p>The legal framework appears to be the same throughout the region, i.e., using the UK as the reference point.</p> | Needs to be looked at on a country-by-country basis.                    | Current accounting standards hold that if a seller retains considerable risk, it cannot be a true sale. (1) As discounted amounts are typically 80% or less, sellers still retain the risk of 20% or more; (2) Factoring agreements typically have provisions whereby the factor, under certain circumstances, can require the seller to buy back the invoice(s). Given (1) and (2), it is generally held today that the seller retains enough risk for the transaction not to count as a true sale for accounting purposes |

## ***Factoring in the Caribbean: Day 2***

Day 2 began with the tax presentation by Wayne Lowell of KPMG, Barbados, followed by Dr. Cleve Scott giving a talk on the St. Lucia Buffer Fund that has been created and is operating with seed capital from Oxfam-UK. The rest of the day was devoted to country and stakeholder discussions and presentations, in particular 6 countries reported on developments: Trinidad & Tobago, St. Lucia, Dominica, St. Vincent, Jamaica and Barbados.

### ***Barbados case study: Agricultural Payments Guarantee Fund***

Mr. Andrew Skeete of the Barbados Agricultural Development and Marketing Corporation (BADMC) presented the scheme being developed between BADMC and the Enterprise Growth Fund Ltd (EGFL) to work with registered farmers organisations (RFOs) whereby EGLF will provide funds to BADMC and BADMC will provide these to the RFOs while monitoring the business. The RFOs deal with the farmers, providing immediate payment and selling the produce to buyers.

### ***St. Lucia Buffer Fund***

Dr. Cleve Scott talked about the St. Buffer Fund with Oxfam-UK providing seed capital to a farmers association (WINFA) which deposits the money with a credit union to partially cash collateralise loans taken by WINFA. WINFA pays its farmers by cheque drawn on its account with the credit union. Farmers are paid typically within one week. The farmers association however has to wait for payment from the hotels and other buyers and from time to time has negative cash flow for which it must use its account overdraft.

### ***Country presentations***

Six countries, St. Lucia, Trinidad & Tobago, Dominica, St. Vincent, Jamaica and Barbados gave presentations on the status and possibilities for factoring in their respective countries.

***St. Lucia:*** Following up on Dr. Scott's presentation, the participants heard from the St. Lucia Development Bank on its development of a financing plan involving a financial clearinghouse. The plan was to be submitted for board approval the week after the workshop. Representatives from the tourism sector and farmers association talked of setting up a physical clearinghouse to replace the government's marketing board where farmers could bring their produce to a physical location. The clearinghouse would package, sell and deliver the produce to local buyers. There appeared to be some scope for the Development Bank to coordinate their efforts with the farmers' efforts.

***Trinidad & Tobago:*** The Trinidad & Tobago Agricultural Development Bank is developing a buffer fund based on the St. Lucia model and is also looking to do true

factoring with assignment of invoices. In general there appeared to be considerable activity and development in arranging better access to finance for farmers.

**Dominica:** Dexia, a public sector trade development organisation, gave a presentation much appreciated for its detailed and comprehensive nature that embraced the idea of factoring and presented concrete ideas and steps needed to be taken to bring it about.

**St. Vincent:** The representative reported that there was planned development to increase sales in the CAFAN area that would require working capital and hence factoring and invoice discounting would be explored. Technical assistance would be required to establish financial and organisational needs, identify actors and define their role, establish the legal and tax frameworks. St. Vincent would look to CAFAN to manage the new solution and to respond to market demand. Seed capital is an issue.

**Jamaica:** The farmers representative (JAS) reported on the development in Jamaica from the marketing board of the 1970s to the Jamaica Agricultural [?] which today would provide an excellent framework to develop factoring and working capital financing. There is no lack of funding in Jamaica, but constraints in respect of accessing funds. Current efforts include the Ministry of Agriculture's registration programme for farmers (150,000 of 230,000 are now registered) and the activities of the Jamaica Development Bank and the National Commercial Bank providing micro-credits. The Ministry of Finance has a guarantee scheme offering 50% protection on amounts up to J\$2 million.

**Barbados:** The farmers' association representative spoke of the efforts to enhance farmers' capacity to structure a business and highlighted education. He proposed that there be an 'institutional audit' that would identify the capacities and activities of various actors engaged in this sector.

It should also be noted that during the discussion, **St. Kitts** talked of its situation which appear to be different and perhaps unique among the countries in that payment terms are quite short and farmers are typically paid within seven days. Factoring was seen to be perhaps a tool for the future.

### **Conclusion**

From the above it can be concluded that there is considerable activity and effort throughout the region in moving in the direction of developing factoring and invoice discounting as a solution to extended payment terms that are constraint to sales.

It is also apparent that while there are a number of initiatives in varying stages of development, the overall situation across the region is that it is most likely that any initiating factoring schemes will be small and have its challenged to implement, and therefore will most likely be of little appeal to the commercial finance sector, particularly in the beginning stages. It is therefore the most likely case that it is the development banks that must drive the development of factoring.

It also appears that much of the context and infrastructure to make factoring an effective tool is in place or being put in place. For example, the legal framework would follow the UK legal framework which despite certain ambiguities in the law there is nonetheless a flourishing factoring industry. Entities in the form of farmers associations as well as development banks and agencies are looking closely at how to make financing work for farmers.

Possible follow-up activities would include:

- Designing a workshop specifically for development banks
- Provide training and consultancy to individual entities to increase internal capacity including developing policies and best practices, identifying operational issues, developing a project management approach
- Provide assistance in developing documentation, including a factoring agreement and other supporting documentation.