

## An outlook of factoring industry in the world and in Kosovo

**Dr. Burhan Rexhepi**

*University of Business and Technology - Kosovo*

### Abstract

Factoring is the most appropriate one for both bank and SMEs as it is considering a method of raising short- term working capital for enterprise by exchanging its A/R, not collateral focused and not adding any liability into their balance sheet. Moreover, factoring is a comprehensive financial service that includes not only financing but also credit protection, accounts receivable bookkeeping and collection services. Factoring not only brings benefit to CBs as a new service for diversification and increasing turnover but also supports SMEs to access financing for roll-up their business and gaining profit from achieving advantages of competitiveness.

Although it has clearly evidence that factoring is well- developed over the world for a long time with the application of about 60 countries and the growth of about more than 20 percent per year, the concept of factoring in Kosovo is not only the new one with enterprises but also the banks.

It said that some registered banks have not implemented this service in real practice or factoring service carry out at extremely low level at Kosovo's commercial banks, including Pro Credit Bank. Pro Credit Bank is one of the largest and fastest growing full service joint-stock banks in Kosovo. At the start time and along with their way on development, Pro Credit Bank has always defined SMEs as their targeted customers and concentrated on developing bank services for this customer sector. Despite the fact that Pro Credit Bank is one of the first four banks applied the services in 2005, up to now this service seems to be not contributed any profit of the Bank. Therefore, requirement of developing factoring service at Pro Credit Bank is crucial on the process of deeply integration world economy and keeping the competitive advantages in the domestic with other foreign banks.

Kosovo is deeply integrating into global economy, especially since it became an independent in 1999. Kosovo's position emphasize increasingly as a light growth economy in Europe. The integration creates breakthroughs for higher development but also brings many threats to overall economy as well as each economic industry. Banking industry is not out of this trend.

**Keywords:** Factoring, industry, world, Kosovo.

### 1. Introduction

UNIDROIT- Convention on international factoring in Ottawa dated 28 May 1988 and General Rule for international factoring (GRIF) under FCI are considered as the main applicable law for the worldwide factoring practice. The GRIF have become the world's most widely recognized legal framework for international factoring. The

GRIF is the standard for correspondent factoring relationships and probably more than 90% of the world's cross border factoring volume has been governed by those rules, since the GRIF's introduction in July 2002.

Factoring is increasingly playing important roles in international commercial through the significant growth in turnover and number of factors year by year.

**Figure 1: World Factored volume**

Unit: Millions of EUR

Year	World domestic factoring	World international factoring	Total
2005	930,061	84,486	1,014,547
2006	1,030,590	103,690	1,134,280
2007	1,153,131	145,996	1,299,127
2008	1,148,943	176,168	1,325,111
2009	1,118,100	165,459	1,283,559
2010	1,402,331	245,898	1,648,229

Source: [www.factors-chain.com](http://www.factors-chain.com)

It is clearly to see that due to the finance crisis during year 2008 causing the consequent in 2009, the factoring volume is decreased 3.14% in 2009 than 2008 while from 2005 to 2008, it was always increasing with time. However, year 2010 was remarked the returns of factoring volume development as before with a 20% growth in domestic factoring and 34% growth in international factoring. The total world-factoring turnover reached EUR 1,648,229.00 in 2010, against 28.41% in 2009.

Looking the figure, the proportion of international factoring is quite smaller than the domestic one. However, the gap between international and domestic ones is reduced annually. While the domestic market seems in downtrend in 2008 (recorded in -0.36% in comparison with 2007), the international market still have the high rate growth of 20.67% and lead the increase in the whole factoring market of 2%. Moreover, in 2010, this volume soared up to 48.62% in comparison with one in 2009. It's believed that the rate will be highly increased due to acknowledge of the parties in international trade. It is clearly stated that international factoring is the future of factoring.

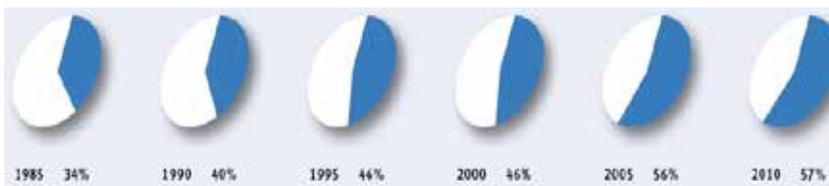
In respect of client of factors, it was shown that SMEs sector is the largest volume with proportion of 83.2%.

FCI – the world largest factoring network counts 247 factors from 66 countries plays more important role in worldwide factoring, counts for nearly 60% of world factoring volume in 2010 whereas the figure was only 34% in 1985. The below figures show FCI's factored volume as well as market share in comparison worldwide factoring market.



**Figure 2: FCI Factored volume in the period of 1985- 2010 in Millions of Euro**

Source: [www.factors-chain.com](http://www.factors-chain.com)



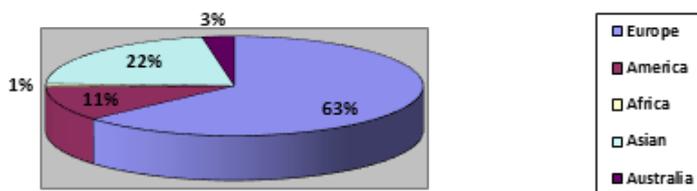
**Figure 3: FCI market share in comparison to worldwide factored volume**

Source: [www.factors-chain.com](http://www.factors-chain.com)

In the respect of continents, Europe is the biggest market with the market share of 63%. The followers are Asian (count for 22%), America with 11% and finally is Australia and Africa.

**Figure 4: Factor volume- market share by continent**

Source: FCI website



Factoring service in Kosovo only penetrated into this market in 2005. The turnover of factoring service in Kosovo is the smallest one in among Europe. The author will take overview Kosovo’s factoring industry in the next section.

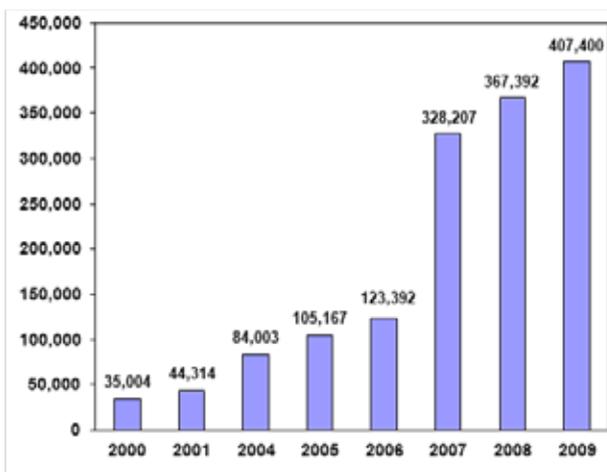
## 2. Overview factoring industry in Kosovo

### 2.1. Assessment for potential developing factoring for SMEs in Kosovo

#### 2.1.1. SMEs growth and its characteristic

As mentioned in section I.2, huge demands from SMEs is one of attraction for develop

factoring. The author will take a look for current situation of SMEs as well as its characteristic for evaluate potential for developing factoring for a whole country. Many laws such as company law, private enterprises law, co-operative law, home investment promotion law, civil law, and commercial law had been passed to create a favorable environment for the development of SMEs. As a result, SME in Kosovo have developed, not only in term of quantity but also in terms of structure and quality of performance. The increase quantity of SMEs in Kosovo business type will be shown in the following chart



**Figure 5: Volume of SMEs in the period 2000 - 2009**

Source: Agency of Statistics

The SMEs had developed remarkably over the past decade, especially in 2007, the total SMEs reached 328,207 enterprises, double with the ones in 2006 and count for 94% of total registered enterprises in Kosovo. Although, year 2008 and begin 2009, Kosovo was still affected by finance crisis, the number of new SME kept increasing. The number of SME increased 12.2% in 2008 and 10.8% in 2009 respectively.

With such high growth rate, Kosovoese SMEs have strongly provided a large number of diversified products, occupied 60 percent of GDP and 45 percent of industrial outputs. Moreover, they have also created jobs for 4.5 million people; mobilized temporarily unused resources such as land, capital, labor and management skills to develop production, and increased export volume and lessening trade deficits. The booming of SMEs in Kosovo creates such huge potential customers for developing factoring in Kosovo as mentioned in Section I.2.

According to SBK's report, SMEs make up 95% of all registered enterprises nationwide, but they have been beset with problems accessing credit. Outstanding loans to SMEs was for 27% of total outstanding loans. This implies that SMEs have found difficulties on the way to development due to difficulties on obtaining financial resources.

Freeman and Le (2007) designed a survey to research about SMEs in Kosovo comprising 197 enterprises at 3 provinces at North of Kosovo (Mitrovica) to analysis SME's obstacles to gain access to bank loan. It is proved that the main constraint that the bank refuse to grant credit to SMEs is lack of enough collateral (marked 3.94 in

benchmark of 5 as greatest obstacle) and too high interest rate.

Also according to the same survey, SMEs' awareness and understanding of external finance resources seems quite limited. Almost all enterprises immediately think of bank loans when they need more capital for business expansion, even though there are many other forms of funding available, such as financial leasing, factoring and venture capital funds. However, up to 45% of enterprises surveyed said that they knew nothing about leasing and 60% did not know about factoring. This knowledge constraint needs to be overcome because, in addition to bank loans, other financial resources can also serve as effective capital mobilization channels. Especially factoring, as it can be eliminated the constraint of lack of collateral for SMEs when applying. Furthermore, factoring is competitive due to its additional service of collection of A/R and maintenance of sales ledger or event payment guarantee in case of credit default. In short, Kosovo business matches the characteristic of huge demands for factoring service. Besides, the most obstacle for SMEs in Kosovo the same in the world is limit to access to finance due to inefficiency collateral. Therefore, it is emphasized that Kosovo has potential environment for developing factoring.

### 2.1.2. Legal framework

All basic issues related to factoring activities were defined with law No.02/L-123 accepted by The state Bank of Kosovo (SBK). Then due to realizing some insufficiencies in this law, SBK issued the revision and make some changes No 04/L- 006 of Regulations on factoring operation of credit organizations. Some main amendment briefly introduced as followed table:

**Table 2: Amendment**

Article 2:	Factoring operation is only applied for receivables that derived directly from sales contract, not mentioned the case of providing services. In fact that service is on the uptrend and has many advantages for development. Therefore, factoring service should be allowed to use with receivables that derived from service contract and <i>in Decision 30, this matter has already adjusted.</i>
Items c, d, đ, e under provision 1 article 13	<p>The decision shown that :</p> <p>(c) factors and the seller agree and sign factoring contract,</p> <p>(d). Both factors and seller agree to sign and then send to buyer and related parties a written document to notify about their factoring contract, in which stating clearly that the seller transfers debt collection to factors and guiding buyer pay directly to factors;</p> <p>(đ). Buyer sends a written document to Seller and factors to confirm by upon receipt and commits paying debt to factors;</p> <p>(e). Then the Seller sends to factors original sales contract, shipping documents and other related documents.</p> <p>These regulations create difficulties to Kosovoese credit institutions on performing factoring operation. When seller and factors agree to send to buyer their factoring contract but buyer does not agree and send confirmed documents in returns. This is a problem for seller and factors as it is illegal for this service without the buyer's confirmation. Reliable this limits, the new one has regulated that in case the buyer do not confirmed in return, the factoring contract between factor and the Seller still has valid if they are willingness continuously carry out and have to be bear for all arisen risks.</p>

However, the Decisions are only contained basic issue of factoring such as definition of factoring, regulation about factoring contact, factor limits. As stated, the most consideration for legal framework for factoring is the transfer of ownership of debt and the rights of creditors in case of default payment. However, these Decisions do not regulate procedures for protecting creditor rights, legal recourse to recover overdue payments as well. Kosovoese factors will feel discreet when implementing this service accordingly.

Although the legal framework on factoring is still insufficiencies and limitation, it also create fundamental for start up a new factoring industry in Kosovo and bring potential for developing factoring in Kosovo. Furthermore, revision the first decision law No.02/L-123 SBK has remarked the concerns of SBK for developing this service in Kosovo.

In conclusion, a reformation of business environment with booming in quantity of SMEs and SMEs' obstacle in access outsource finance as well as fundamental legal framework specific for factoring service create good potential market for developing factoring in Kosovo.

## **2.2. Current situation of factoring industry in Kosovo**

As factoring service has just implemented in Kosovo, the transaction volume and the variety of this service is limited. However, factoring is one of the financial – banking commitments and it will be strongly developed in the near future in Kosovo

The issuance of law No.02/L-123 and 04/L- 006 of promulgating the regulation on factoring operation by credit institutions by the governor of the State Bank of Kosovo created the premises for developing factoring service in Kosovo. According to that, financial institutes started to implement and develop this service in Kosovo market. And up to 2005, factoring service is officially established in Kosovo.

There are ten (10) banks that are operating nowadays in banking system in Kosovo, representing 69.0 percent of the total assets in the financial sector. Their products and services include banking accounts, loans, domestic and international payments, banking cards, banking guarantees, letter of credit, e-banking. The access to these services it is enabled through 263 branches and sub branches, 540 ATM's, 9,493 POS and 196,656 e-banking accounts.

Their activity is dominated by loans and the maturity can be up to 15 years, depending on the type of loan. 65.2 percent of the total loans are loans to enterprises. Most of these loans are absorbed by trading enterprises sector (51.8 percent of loans to enterprises), whereas loans issued to the industrial sector (including mines, production, energy and construction) compose 23.0 percent of total loans to enterprises. The agricultural sector represents 4.0 percent of total loans. The household loans participation is 34.4 percent of total loans.

The structure of banking sector liabilities is dominated by deposits, which represent 80.2 percent of total liabilities. Deposits at the banking sectors have recorded an annual growth of 46.45 percent, amounting at euro 2.7 billion. Deposits in the banking sector consist of household deposits, which participate with a share of 74.4 percent in total

deposits, whereas the deposits of private sector enterprises compose 17.5 percent of total deposits.

Commercial banks in Kosovo have different shareholding structure. Eight of them are foreign-owned banks and two domestically owned.

There are 3,337 commercial banks employees. (<http://bankassoc-kos.com/>)

Currently, there are: State bank of Kosovo, Banka ekonomike, Banka kombëtare tregtare, Banka për biznes, Türkiye iş bankasi, Nlb, Procredit bank, Raiffeisen bank, Teb bank and T.c. ziraat bankasi a.s. – dega ne kosovë.

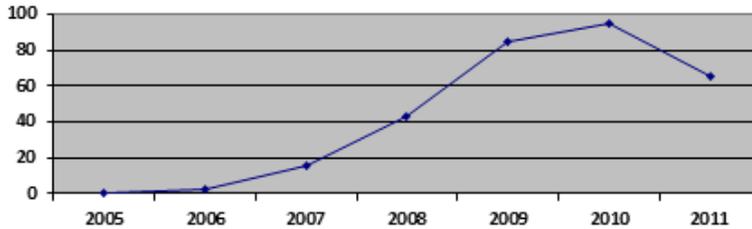


Figure 7: Kosovo's factoring volume from 2005 - 2011

Unit: thousands of EUR

Source: [www.factors-chain.com](http://www.factors-chain.com)

As FCI's report, Kosovo's factoring volume increased 05.77% - the significant high growth among developed countries in Europe. In the fact that it's really a small figure in comparison to other countries in the region. However, it can be considered the significant development for Kosovo's factoring market, especially in the difficult situations during world financial crisis.

The same as world factoring, the total international factoring in Kosovo counted such small rate than domestic ones. In 2010, domestic factoring turnover was bigger than international one. It may be explain due to the first phase of implementation and the limit of agent relationship with international factors

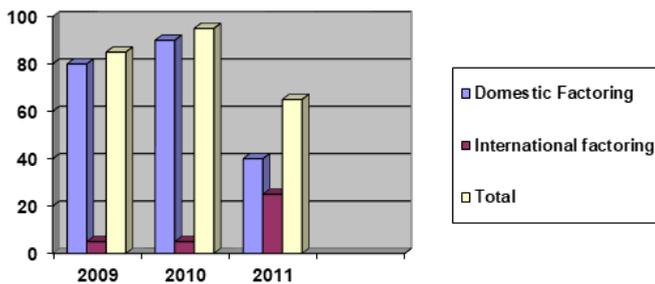


Figure .8: Factoring volume in Kosovo from 2009-2011

Unit: Thousands of EUR

Source: [www.factors-chain.com](http://www.factors-chain.com)

Although the registered factors increased in banking system in Kosovo, not all of the factors implement factoring in practical. Among Kosovoese commercial banks, ACB was the best one in factoring implementing in Kosovo. Up to now, ACB has carry out more than 20 contracts. Their main customers were large business among SME clients with annual international sales.

In spite of having favor conditions for developing factoring service in Kosovo as mentioned in II.2, Kosovo's factoring service is still at the "first phase" of its life cycle. In next section, the author will analyze the difficulties to limit the development of factoring in Kosovo.

### **2.3. Obstacles for developing factoring service in Kosovo**

*Firstly*, Kosovo's SME get familiar with traditional payment such as telegraphic transfer, or L/C. Low SME's acknowledgement as well as unstable business environment leads the difficulties for factors to persuade customers to use the new services, especially for exports. Therefore, the lack of awareness of Kosovo's customers about factoring service caused the limitation for implementing factoring in Kosovo.

*Secondly*, credit information system is inefficient and nontransparent. Kosovo currently has only Credit Information centre (CIC) under SBK which are provided information for credit activities. However, the source is not enough and timely in order to meet the needs from financial institution whereas implementing factoring requires precise and opportune information. It takes time for factors to credit worthiness enterprises and delay countersign- factoring contract accordingly

*Finally*, it derives from internal commercial banks. Kosovo's commercial banks are limited implementing advertisings for factoring services to increase customers' awareness about this service. After launching the service, only ACB, Raiffeisen Bank, Pro Credit Bank and foreign banks has given introduction of factoring service in their website with cursory contents. Whereas NLB, which already announced to launch this products since 2005 still has not given any introduction about this service in their website up til now. With such a new and useful financial service as factoring, commercial banks spending such a little advertising cannot attract customers to use the service. Moreover, lack of skillful staff who well- understand the factoring service and then consult to the customers as well as low banking technology are also considered obstacles for developing this service in Kosovo

As one of the pioneers joining factoring market in early 2005 and gaining the same general advantages as well as external obstacles for developing factoring service as ACB and Raiffeisen bank, Pro Credit Bank has not achieved any result up to now. In the next chapter, we will analysis the limitations of Pro Credit Bank in deploying the factoring service.

## **Conclusions**

Factoring presents a very good manner for both customers and financial institutions. Like traditional commercial lending, factoring provides SMEs with working capital.

However, factoring is quite different from traditional commercial lending, where credit is primarily based on the borrower's creditworthiness rather than the value of the borrower's underlying assets

Factoring offers several advantages over other types of lending. First, factoring may be particularly useful in countries with weak secured lending laws, inefficient bankruptcy systems, and imperfect records of upholding seniority claims, because factored receivables are not part of the estate of a bankrupt SMEs.

Second, in a factoring relationship the credit is primarily based on quality of the underlying accounts-not quality of the borrower. Factoring can mitigate the problem of borrowers' informational opacity in business environments with weak information infrastructures if factors can develop proprietary databases on account payment performance and if the underlying accounts are the obligations of relatively transparent firms. The latter condition holds when a borrowing SME has receivables from larger enterprises or has foreign receivables from firms in countries with a stronger information infrastructure.

Ideally, once enterprises can awareness of advantage and useful of the Factoring for their business, factoring service will be soon improved and become one of financial tools playing crucial role in Kosovo's economy.

At this stage, it is also acknowledged that due to the time constraints and scope of this study, the thesis has only been able to draw conclusions based on a broad review-based analysis.

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