

FACTORING IN ALBANIA, AN UNDERESTIMATED FINANCIAL PRODUCT

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Abstract: Factoring is a financial product that essentially converts business accounts receivable into liquidity, through the sale of invoices to the provider of this financial service. This allows the business immediate liquidity, without having to wait until the buyer pays the bill. Although it is not a new, or particularly sophisticated product, albanian businesses still use it very little today. It has been more than a decade since the licensing of the first factoring companies, however this market remains very small. At the end of 2020, the balance of the factoring portfolio had a total value of ALL 520 million. The volume of activity fell for the third year in a row in 2020, for a total value of less than 8 million euros. Factoring can be provided by discounting the invoice value by the financier, in the form of a commission, or by paying an interest rate for the period from the sale of the invoice to its collection. This second type of factoring is most used in the Albanian market. The pandemic did not have very major consequences in this market, also due to its limited size and prudent financing policies pursued. The main reason why the factoring market in Albania is not growing is the lack of sufficient knowledge of the product and the difficulty to understand and assimilate it, by the business. With a solid legal framework that anticipates all situations, from disbursement to execution, it will be easier for factoring companies to measure the risks they take. Another problem is the high informality in business. The fiscal reform is intended to help reduce informality, creating more potential for the factoring business as well.

Key words: factoring, financing, fiscal reform, liquidity, risk, solid legal framework.

JEL Classification Codes: G14, G32.

1. INTRODUCTION

Factoring is a financial product that essentially converts business accounts receivable into liquidity, through the sale of invoices to the provider of this financial service. This allows the business immediate liquidity, without having to wait until the buyer pays the bill. Factoring is considered an alternative to a bank loan although it offers higher interest rates.

A factoring company must offer some or all of the following services: To finance receivables, payables or both; assume the risk of non-payment on time by the debtor / creditor; to collect invoices on behalf of customers; manage customer receivables.

Among the main advantages of factoring are: improves the working capital of the buyer; improves access of the supplier to capital; factoring does not increase bank exposure to other debits; provides the opportunity to expand and personalize trade terms; offers the opportunity to handle more affordable prices; provides the opportunity to have new suppliers; offers the opportunity of a financial analysis of the client etc.

2. LITERATURE REVIEW

The factoring market in Albania has remained stagnant in the last five years. Financial institutions that have been pioneers in this market, have gradually either been acquired and assimilated by other institutions, or have changed the profile of business. Today it remains an



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interesting market to explore, but there are many difficulties in this business. Although it is not a new, or particularly sophisticated product, albanian businesses still use factoring very little today. It has been more than a decade since the licensing of the first factoring companies, however this market remains very small. At the end of 2020, the balance of the factoring portfolio had a total value of ALL 520 million. The volume of activity fell for the third year in a row in 2020, for a total value of less than 8 million euros. In total, the number of invoices financed through factoring decreased in 2076, from 2609 that had been in 2019. The factoring activity is realized in the majority, in the domestic market and mainly for guaranteed financing, which constitutes 88% of the volume of activity for the previous year.

Factoring can be provided by discounting the invoice value by the financier, in the form of a commission, or by paying an interest rate for the period from the sale of the invoice to its collection. This second type of factoring is most used in the albanian market. Factoring activity in Albania is regulated by a special law since 2006. The first factoring companies were established almost a decade ago, but their activity was quite limited. The first two licensed factoring companies have already left the market and their licenses have been revoked. According to the register of non-bank financial institutions of the Bank of Albania, there are currently seven companies licensed to provide factoring services. Based on the data of the financial statements, for most of the entities, factoring is a secondary activity, even some of them do not have an active factoring portfolio. Most commercial banks in the country also have a license to provide factoring service, but the provision of this service by them is at negligible levels.

The main reason why the factoring market in Albania is not growing is the lack of sufficient knowledge and the difficulty to understand and assimilate it, by the business. Factoring has the specificity that, in any case, requires the approval of both parties to apply, the issuer of the invoice (seller) and its recipient (buyer). From the experience of factoring institutions, convincing both parties, even in the face of little product knowledge, is difficult. The main problem with factoring is the need of cooperation of the other party. The factor, finance the seller, but also needs the buyer's approval that this invoice will be paid to the factor. Legally, there is no obligation to force the buyer to pay the invoice to the factor. By not recognizing factoring as a product, often the buyer does not want to be part of such a relationship.

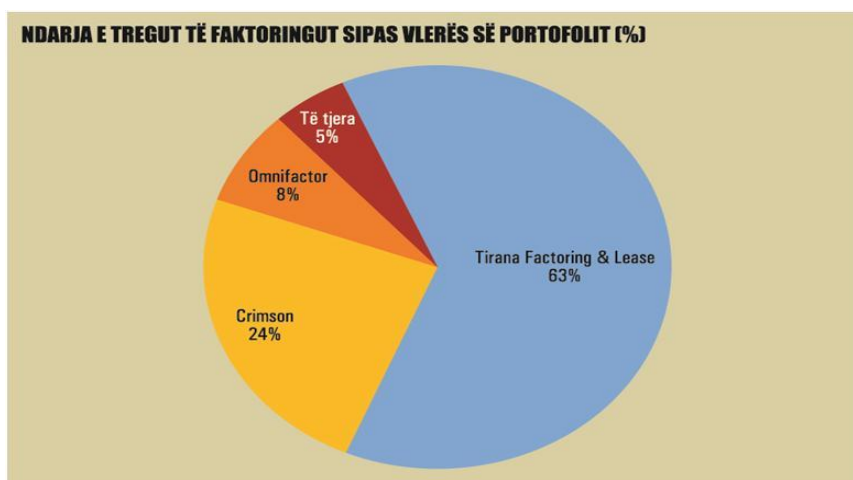
Another problem, may be the buyer's relationship with the tax authorities, because there have been cases when they have had difficulty explaining to tax inspectors the payment mechanism and why invoice rights are registered on behalf of the factor and not of the seller of the goods or service. Another problem too, is the moment of execution of the obligation. Due to the limited court practice with this product, execution can often result in a very long and difficult process. Unlike the bank loan, for a factoring contract it is difficult to require the issuance of an immediate execution order. In most cases, the courts require the opening of a fundamental case, for the obligation arising from these contracts and in this case, the duration of the case, can reach years. However, factoring is one of the faster and with more flexibility financial products. The business can benefit from it when is needed most, while with bank loan such a thing is often not possible.

Factoring is a product that has potential for use in most sectors and economic activities in Albania. There is no typical or specific sector for this product. Any business that has late payment terms is a good potential customer for factoring. Interest rates are flexible, by industry and by risk. Factoring is a product that can have great potential also for use in exporting businesses, mainly in letter of credit financing or bank guarantees.

The pandemic did not have very major consequences in this market, also due to the limited size and prudent financing policies followed. The effects were felt more in the management of portfolios than in the performance of new financing. Sensitivity relates more to the client profile

than to the financial product itself. The frequency of disbursements has a trajectory that is more or less similar every year, there are periods with higher and lower demand. Last year there were not deviations from this usual volatility.

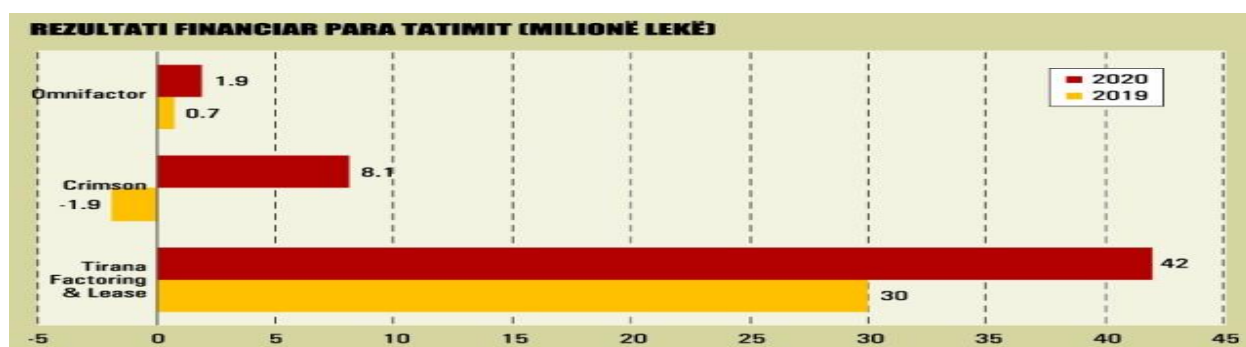
At the end of 2020, the factoring market had a portfolio surplus of ALL 520 million, or about EUR 4.2 million. The entity that owns the dominant part of the portfolio is Tirana Factoring & Lease, with an amount of ALL 328 million, or 63% of the total market. Tirana Factoring & Lease reported a portfolio increase of about 13% compared to 2019. The second largest entity is Crimson Finance Fund Albania, with a factoring portfolio of ALL 125 million, a value that gives about 24% of the market of this product. For 2020, the factoring portfolio of Crimson Finance Fund Albania decreased by 11% compared to a year ago. The third entity is Omnifactor, with a portfolio of ALL 40 million, or about 8% of the market. Omnifactor marked a significant increase last year, increasing its factoring portfolio by approximately 60%.



Source: Bank of Albania, Financial statements of companies.

Figure 1: Factoring market segmentation according to portfolio value

The financial performance of companies with significant factoring activity, last year, has been positive as we can see in the figure no. 2.



Source: Bank of Albania, Financial statements of companies

Figure 2: Profit before tax (ALL million)

Tirana Factoring & Lease reported a profit before tax in the amount of ALL 42 million, an increase of 40% compared to a year ago. Crimson Finance Fund Albania also reported an improving financial result. Profit before tax was worth ALL 8.1 million, while in 2019, it

suffered a loss of about ALL 1.9 million. Omnifactor for 2020 also recorded growing profit. The result before tax reached the value of ALL 1.9 million, from ALL 0.7 million that was the profit of 2019. However, at least for Tirana Factoring & Lease and Crimson Finance Fund Albania, the result is not only generated by the factoring activity, but also by other products, mainly financial leasing.

3. CONCLUSIONS

The ideal relationship to develop factoring in Albania, is when the business partner is at least one company that has good cash management, which applies mainly to large businesses. If such a company is included in the factoring scheme, then it is easier to apply it as a product. At the moment, small or micro entities are served with products that are easier for them and their management standards. Actually in Albania mostly of clients who use factoring, have sales or purchase relationships with large market companies. If these are companies with management experience and pay the bills, then the process is simpler to manage. Trade is a sector with a lot of potential, which fits the product very well.

Manufacturing has a considerable weight as a client, because with this sector is combined factoring with financial leasing, to finance the assets they use. Factoring is mainly about financing supplies or receivables to domestic or foreign customers. There are cases that factoring has been used in foreign trade relations, with foreign companies, but there are still more risks and difficulties. It requires detailed analysis and great customer reliability. In this case is required a cooperation with banks to build a product that connects factoring with the letter of guarantee, then the market in this segment could grow much more.

Bad debt related to factoring is higher than that related to the rest of the portfolio for the companies that offers this product. However, the quality of this portfolio today, is much better compared to the first 2-3 years of activity. The moment factoring is put into a cycle, it is much easier to manage it. With a solid legal framework that anticipates all situations, from disbursement to execution, it will be easier for factoring companies to measure the risks they take. Another problem is the high informality in business. The fiscal reform is intended to help reduce informality, creating more potential for the factoring business as well.

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