

Legal Environment for Financial Factoring in Albania and its Comparison with Other Countries of the World



Economics

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Shpresa Çela

Prof. External Finance Department, FEUT, Head of Finance at CELA Sh.p.k
Faculty of Economics, University of Tirana, Albania.

Abstract

The judicial and legal environment of each country plays a critical role in determining the various financing products of the country. It influences the importance and magnitude of the factoring industry. A key issue for factoring can be considered whether a financial system of commercial law sees it more as a sale and purchase transaction, or as a loan. In this paper, we will see how factoring is treated by the legal system in Albania. Also, credit bureaus basically address a key obstacle to credit: the asymmetry of information. If the sharing of information between lenders and borrowers is too wide, then it may result to the rationalization of credit. Participation by lenders in public credit bureau known as credit registry, often in different countries, is amended by law over a certain limit. This study considers the various limitations of a public credit registry in relation to a credit bureau. In addition, it shows the comparison of the legal environment between countries in which financial factoring is regarded as a literal industry. JEL Classification: G24.

Legal and Judicial Environment

Consequently, the legal and judicial environment of Albania is seeking to play a critical role in determining the various financial products, and the importance of factoring. Factoring activity is an industry that is supervised by the Bank of Albania. However, factoring activity may be done by the bank, or might be created under the law of commercial companies. This is according to the government's decision, which envisions amendments to the current law, no. 9630, dated 30.10.2006 "on factoring". Subsequently, one of the main changes made to the law of factoring is that all entities that will have the activity of factoring as their object will be monitored. Furthermore, their activity will be regulated by the Bank of Albania in accordance with the provisions of the law "on banks in the Republic of Albania" and bylaws issued by it for this purpose. A key issue for factoring is considered whether a financial system of commercial law sees it more as a sale and purchase transaction, or as a loan. If the legal system in Albania would treat it as such, where factoring is only a sale-purchase transaction, then the rights of the creditors of the credit contract in implementation are less important for factoring. Thus, this is because factoring commissioners are not creditors. In the case of a firm that goes bankrupt, its accounts receivable will not be part of its bankruptcy assets because they will be the property of the commissioner of factoring.

In fact, the legal system treats factoring as the purchase of accounts receivable to the supplier. Therefore, this means that the factoring company at the moment of binding the contract will have its ownership, the supplier's accounts receivable.

According to the above law, in considering a contract as a factoring contract, it should not be a loan contract or contract for the transfer of credits of clients account. This helps to facilitate the collection of accounts. Also, the factor and the supplier are not of the same entity. Factoring contract is related to both national accounts receivable and international accounts receivable.

1.1 The Tax System

The tax system of a country can also affect the magnitude of the factoring industry. The obligatory stamps on sales invoices and other taxes in factoring can inhibit the growth of the industry.

Value added tax (VAT), can have an effect depending on the tax system structure. For example, although the payment of services related to factoring should usually be subjected to VAT, the financing must be excluded in order to ensure a level playing field between factors and other lenders. Similarly, factoring commissioners should enjoy the same tax treatment for the provision of bad accounts receivable as other lenders (eg banks). Oftentimes, they are not treated as such, because they are not recognized as formal financial institutions. This occurs especially if they are completely outside the scope of formal regulation. Based on the treatment that the law of VAT makes for financial services, factoring companies should clearly define the income made on the basis of interest for the use of funds that resemble the loan and the income made on the basis of collection of accounts receivable. Consequently, this is because the difference in these two elements will make a more accurate invoicing about the service as exempted from VAT or VAT service.

Factoring as a source of financing for working capital for SMEs in Albania is in its infancy stage. Thus, this is as a result of the fact that factoring companies have just started to realize their sales after a period of acquiring licenses. Their service is divided into two types of income as permitted by the law. It ensures higher income from collection service, rather than the interests insured by the use of funds. The income generated by the use of funds is exempted from VAT, whereas the income generated by accounts receivable collection service is not.

Factoring activity is assessed by the annual volumes delivered. This activity, undertaken by non- bank financial institutions in Albania, remains at low levels. Although during 2014, there has been an increasing trend. As noted in the table below, the annual turnover realized by this service is ALL 578.22 million, while the surplus of the portfolio is ALL 241.38 million.

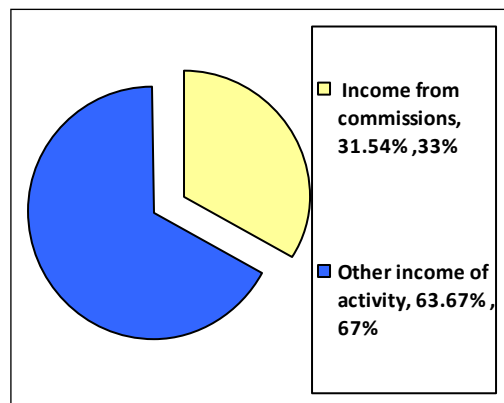
Table 1. Annual volumes of factoring and the surplus until December 2014

Factoring		Annual turnover	The Surplus of the Portfolio
	No. Invoices	Value (ALL /million)	Value (ALL /million)
Total	506	578,22	241,38

Source: Bank of Albania

For the ratio of income from the factoring companies, the income from commissions is 33%, while the other income from the activity or the income of the accounts receivable collection service is 67%. Thus, this was clearly demonstrated in the following figure:

Figure 1.1. Income Ratio from factoring companies
Source: Bank of Albania



Therefore, another fact that should be mentioned on the quality of factoring industry in Albania is also the place of performance of this service.

Until now, it has been reported that the service is performed 100% in Albania without expansion in other countries. So, the service is not exported yet, but it is believed that with the financial problems that our neighbors, Italy and Greece, are facing, the service will soon be exported definitely.

2. Public Registers vs Private Credit Bureaus

2.1. Public Registers

Bank of Albania publishes its credit registry on its website to help factoring companies in obtaining information about loans. Credit Registry represents the financial and identifying data of persons (credit exposures in the banking system and/or financial system), who apply for a loan at a bank, branch of a foreign bank licensed by the Bank of Albania, or from other lending institutions. This register will be used by any party who is involved in a factoring contract. This registry began its functionality from January 3, 2008. Actually, participants in the Registry include 16 banks, 12 financial non-bank entities that operate with lending and leasing, 1 credit-savings association that operates independently from the unions, and 2 credit-savings unions in the role of representatives of their member associations. Initially, there were only banks and branches of foreign banks reporting data to the Credit Registry. From 19 November 2010, the database is enriched with information reported by non-bank financial entities which include factoring companies and credit-savings companies. Data reporters upload new credits every day and update the credit repayment status at the end of the month. Thus, the register contains both positive and negative information about the borrower, and the data are stored in the registry for 5 years.

2.2. Private Credit Bureaus

Credit bureaus are private companies that collect information from lenders and other public sources for the repayment of past loans by borrowers (individuals and enterprises). The objective of credit bureaus is to collect as much data as possible, in order to provide lenders information. It is not only for the repayments of loans in the past, but also for other characteristics of borrowers.

Usually, this information includes credits repayment records, court judgments, bankruptcies, payment for public utilities, and most importantly, information from non-bank financial institutions.

Usually, private credit registry provides lower coverage than the credit bureaus. Therefore, this act on the information they receive regarding borrowers, retailers. Considering their objective for surveillance, most PCR's (private credit registers) are created with the primary aim to supervise banks. Usually, they only include higher credits than a certain minimum amount. In a recent review of World Bank, about 60% of PCR's had credit cuts that were at least twice the national overall average income per capita. As a result, this excludes the majority of credits to businesses retail and small businesses. Thus, the average coverage ratio of PCR's in developing countries was estimated at 3.6% of the active population, while coverage by private credit bureaus was estimated at 16%. Thus, we see that a public credit registry may not be a very good replacement of a private credit bureau, especially when we talk about financing sources like factoring used for SMEs.

Restrictions between them are huge. However, they reflect sources of information, the availability of value-added services, and in some cases, reliability and the permanent value of the data collected. According to a World Bank study, countries that implement large volumes of factoring also have a considerable number of private credit bureau. In Albania, according to research we have done, and according to a World Bank survey in 2014, private credit bureau coverage (% of adults) is 0 %. The number of economies with a credit bureau covering at least 5% of the adult population as recorded by Doing Business, grew from 49 of 145 economies in 2004 to 94 of 189 in 2014. On the other hand, the number with a credit registry covering at least 5% increased

from 22 of 145 economies to 58 of 189 economies. Globally, 28 economies both have a credit registry and a credit bureau covering at least 5% of the adult population.

Figure 2. Which economies have a credit bureau or registry?



Source: Doing Business database.

3. Comparison of the Environment where Factoring is Used as Business in the Financial Service Industry

3.1. Commercial Law

Commercial law in a financial system and the level of its implementation will assist in determining the environment in which financial changes occur. Commercial law determines property rights associated with a commercial transaction and the implementation of these rights for the appointment of the confidence of the contracting parties in the financial contracts. Together, these two features constitute the rule of law. At one extreme are countries where commercial law is clear and advantageous for commercial transactions and where enforcement is predictable.

At the other extreme are countries where commercial law is unclear and incomplete. Also, the implementation is problematic and criminal behavior and blackmails block the creation of new businesses, damage the existing ones, and inhibit foreign investment.

There are four proxy measures in the world for the rule of law: the cost of enforcing contracts, rule of law, corruption, and political stability . Most developing countries suffer from weak enforcement of the law. Although a weak rule of law affects all lending products, it can have less effect on factoring because it represents the sale and purchase of the property (as opposed to a secured loan). This exchange of property rights should minimize the threat of the competing interests of other creditors. However, a weak rule of law will make factoring collection activities more costly and less efficient. Also, it will reduce the value of factoring against its

suppliers when it engages in factoring with warranty, and when taking a security interest in the assets of clients as a second source of payment.

As noted, factoring is a dominant form in the financial assets world, and it has no significant amount of credit financial assets, except in Australia, Canada, UK, and USA. Although it is difficult to get strong conclusions from the data, these four countries result in a high position on the rule of law measures. Whereas in many countries where factoring is popular (such as Greece and Italy), the result is a rule of law that is not very high. On the other hand, countries with a strong rule of law have a significant amount of factoring, among which are the United Kingdom, Austria, Denmark, and the Netherlands.

In terms of security of interests - which is the collateral line - the country's commercial law should clearly define how the collateral can be perfected, how the priority of the collateral is determined, and how the notice is made? The rules on security interests, may affect the efficiency of all technologies, but not factoring. This is because the collateral can be used in conjunction with each of them. However, even in a factoring relation, a factoring commissioner can get an interest of the collateral in the supplier uncollectible accounts as a secondary source of repayment of the payment. However, a country's trade law for security interests has the greatest impact on credit funds. This is because the collateral is the main source of repayment on the basis of such credits. Australia, Canada, United Kingdom and United States, have well defined and have strongly enforced the laws on security interests. Therefore, this partly explains why credit financial assets exist in these countries, but not elsewhere. Such laws give to credit financial assets. They have the lender's confidence that they have the right to liquidate their collateral or to obtain comparable value in case of bankruptcy.

3.2. Information Infrastructure

Information infrastructure in a financial system can play a critical role in determining the level of credit, in the creation of various products of available credits, and especially based on the importance of factoring. A key aspect of this infrastructure is the information regarding the performance of payment. This information can be critical, because the records of the firm of paying its last liabilities may be the best indicator of its ability to pay in the future. Information exchanges of third parties are the most important source of such information.

Judging from the perspective of factoring company which will buy the accounts receivable, the information about the solvency of the client of its vendor would appear to the credit bureaus. Credit bureaus address a key obstacle to credit: the asymmetry of information. If the sharing of information between lenders and borrowers is too wide, then it may result to the rationalization of credit.

Participation by lenders in public credit bureau, called credit registry, often in different countries is amended by law over a certain limit. Most of the public credit register are managed by the central bank or by a regulatory bank. These government agencies typically require participation by regulated financial institutions over a certain dimension . In some countries such as Belgium and Italy, the threshold is very low for both parties, clients and businesses. Consequently, the participation at the public credit bureau is very high. Different from public credit registries, private bureaus are voluntary. This means that lenders voluntarily provide information to credit bureaus. The inclusion of bank loans data varies from country to country. For example, in the United States, three private credit bureaus (Equifax, Experian, and Trans Union) collects only the information on the client credits, while Equifax in Argentina collects and distributes information on private business as well as information about the supplier, such as the property relationship between firms and credit scores. Moreover, commercial providers of information (sometimes called exchange of trade credit) such as Dun and Bradstreet (D & B), provide reports in relation to the company credit. Subsequently, they also reported that D & B produces typically from information given from payment submitted by retailers. Information produced by private credit bureau can be very useful in making credit decisions. In particular, models of failure prediction

that includes commercial credit information produced by private credit offices, are effective in predicting the strongest failure. This is beyond financial reports and the descriptive information about the firm. Moreover, the existence of exchanges of information with third parties, may affect the availability of credit and macroeconomic performance. Also, a current study of the World Bank shows that the time to process the credit, the cost of borrowing, and the level of the standards, will be higher without the credit bureaus. Another study found that developed countries have more intensity in sharing the main formal information via credit registries or voluntary exchanges of information - bank lending expose greater compared to GNP .

Here also, it is shown that credit risk is negatively correlated with the measures of exchange of official information. There has been no empirical analysis of the impact of the credit bureaus in factoring. Studies have found a strong correlation between high information for credit sharing and bank lending and less credit rationing. It seems that credit information offices will benefit all credit products. Nevertheless, the rate of its importance may change in a developed environment of lending technology. For example, the information of private credit bureaus is required for credit score. Credit information offices of the client are particularly important. This is because in the lending enterprise where credit is the main product, it indicates that the creditors of entrepreneurs compared with the lender business itself, are more likely to dominate .

In terms of lending relations, private credit bureau can be crucial at the early stages of the banking relationship with the borrower, especially when the borrower's reputation is still being developed. However, the importance of exchanges of information on financial tools, lending based on assets and factoring, is less clear. On one hand, such lenders mostly base their credit decisions on collateral value of a firm, rather than on the firm itself. As a result, the information of credit bureaus about their borrowers may be of secondary importance.

On the other hand, the information of private credit bureaus on debtors against their accounts receivable can be quite valuable. However, it may be a compensation effect that factoring and loans based on asset, develops their performance based on the performance of accounts receivable (which is an account of the obligations to the client). This can make less worthy the information from credit private bureaus for institutions that provide financial assets, especially in countries where factoring is a dominant lending technology and factoring commissioners are major. Thus, they can enjoy significant economies of scale due to the size of data on the ownership of the information of accounts payable. In fact, some of these commissioners may have better databases than private credit bureaus operating in their markets. This ascendancy may come from data coverage or high reliability. Therefore, both public credit bureaus and private credit bureaus suffer from inefficiencies of organization (agency problems).

Countries with poor information infrastructure are not likely to have public or private credit bureau. This suggests that factoring in these countries will need to rely mainly on their databases for payment information on debit accounts. Accounting quality is another aspect of the information infrastructure. This dimension is important because the strength of accounting standards determines the extent to which lenders can accurately assess the quality of borrowers and conditions. It is also important because it basically determines the efficiency of the use of the agreements. Consequently, the ability of a country to develop lending to the financial statements may be highly dependent on the quality of accounting information.

Conclusions

- Since the factoring market is in its infancy, it is better if the environment is prepared, as the legal and also fiscal, for a fair treatment of the issues that will face a factoring company, as well as companies that will dare to resolve their liquidity deadlock through factoring financing.
- It must be signed and ratified by the Convention on International Factoring-UNIDROIT.

- Law on financial factoring in Albania exists, but its implementation is rigorous.
- Credit information system is realized through public registries and private credit bureaus. In Albania, there is no credit private bureau. Thus, there is only the public registry which aims to support financial oversight activity of banks and provide data or accounting information for creditors. The best foreign practices highlights that private credit bureaus must exist so that SME-s and companies that are in their infancy stage, may find spacious and accurate data for suppliers and creditors.
- A good information system combined with strong rules and a high applicability of the law would create a more favorable legal environment for economic growth by encouraging firms and new ventures.
- Private credit bureaus should not only exist, they should have an online registry where users can have access when they logged in via the internet. Hence, this would provide a swift, transparent, safe, and qualitative data.

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