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Enhancing the role of factoring and leasing companies in providing working capital to Small and Medium Enterprises (SMEs) in Namibia[1]

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Table of Contents

List of Acronyms

AGRIBANK	Agricultural Bank of Namibia
APBEF	Association Professionelle des Banques et Etablissements Financiers du Burkina
ATM	Automatic Teller Machine
BIB	Banque Internationale de Burkina
DBN	Development Bank of Namibia
DFI	Development Finance Institution
EU	European Union
FMCSA	Federal Motor Carrier Safety Administration
FMO	Finance for Development
FNB	First National Bank
FSAP	Financial Sector Assessment Programme
GDP	Gross Domestic Product
GTZ	Gesellschaft für Technische Zusammenarbeit
IFC	International Finance Corporation
IT	Information Technology
NAFIN	Nacional Financiera
NAMFISA	Namibia Financial Institutions Supervisory Authority
NBFI	Non-Bank Financial Institution
NHE	National Housing Enterprise
OECD	Organization for Economic Co-operation and Development

ROE	Return on Equity
SBCGT	Small Business Credit Guarantee Trust
SME	Small and medium enterprises
USA	United States of America
VAT	Value Added Tax

Abstract

The primary objective of this paper was to examine how factoring and leasing could be used in making working capital accessible to SMEs in Namibia. In addition, the paper was intended to study how those approaches could be improved. Factoring refers to a method used to provide working capital to SMEs, without collateral. In a factoring relationship the account receivable of the SME is sold to a financial institution (factor) at a discount. The factor then provides working capital to the SME and later collects the credit amount owed from the buyer. Leasing refer to a lending method where SMEs can make use of equipment without having to own these. To undertake the objectives above, the paper adopted a desk review and field surveys to assess the demand and supply of leasing and factoring in Namibia. The results of the field survey suggested that there existed a niche market for both leasing and factoring in Namibia from the supplier's perspective. There are 15 leasing companies and 1 factoring company in the country. On the demand side, factoring seemed to be more favoured than leasing. The survey and desk review were supported by case studies of South Africa, Mexico and Burkina Faso as factoring and leasing seemed to be successful in these case study countries The paper therefore suggested that a reverse factoring approach would be more appropriate in Namibia which could function through the DBN, creating a chain between "big buyers and small suppliers". The study encourages lenders to adopt the recourse factoring approach to mitigate against potential default.

1 Introduction

It has been argued in recent years that small and medium enterprises (SMEs)[3] are the backbone of most economies, and are a key source of economic growth, dynamism and flexibility. SMEs in Namibia have contributed approximately 12 percent to the Gross Domestic Product (GDP) and have employed about 20 percent of the work force during 2004, (Arnold et al. 2005).

Having realised the important role that the SME sector could play in generating economic growth and creating employment, the Government of Namibia, created a number of institutions in an effort to increase the access of SMEs to financial services, as well as responding to the plight of the poor. Due to the operational inefficiencies which characterize most of the Development Finance Institutions (DFIs), some of these entities collapsed or merged to form new companies. Those which are still operational include, Development Bank of Namibia (DBN)[4], Agricultural Bank of Namibia (AGRIBANK), National Housing Enterprise (NHE) and the Small Business Credit Guarantee Trust (SBCGT). This paper focuses on the DBN and the SBCGT, since they are promoting to a larger extent financial access to SMEs. The private sector is also involved in the promotion of SMEs through the establishment of SME branches in banking institutions, as well as the setting up of private venture capital schemes.

Most Namibians do not have the collateral which is required by banking institutions to secure a loan. Moreover, Adongo and Stork (2005) identified high transactions costs in supplying loans to micro-enterprises as challenges for microfinance institutions[5], since it is more costly to process many small loans than a smaller number of larger loans. Lack of information and ability to assess credit applications as well as institutional factors[6], particularly for micro-lenders, are the other challenges in providing financial services to SMEs.

In this connection, the IMF and World Bank's Financial Sector Assessment Programme (2006) also identified limited access to financial services for SMEs as one of the constraints to SME development (FSAP, 2006). This was despite the efforts by both the government and private sector to increase SME access to working capital. The IMF and the World Bank further noted that SME access to working capital was crucial in fostering entrepreneurship, innovation and growth in developing economies such as Namibia. In this connection, the FSAP report has suggested factoring and leasing as alternative approaches which could be used in increasing SME access to working capital.

From the onset it becomes imperative to explain the operations of these approaches, before embarking on the measures to enhance them. Factoring normally occurs when a supplier sells products to a distributor and extends trade credit[7] to the latter usually for

[3] The paper uses the Ministry of Trade and Industry definition of small enterprise as a business employing between 6-30 employees. Medium enterprises are defined as those employing within the range of 31-100 employees, while micro-businesses are defined as employing between 1-5 employees. Small and medium enterprises are the ones which would largely benefit from this study.

[4] DBN was formed from the Development Fund of Namibia in April 2004.

[5] Micro-lenders and commercial bank branches involved in the provision of microfinance were included in this study

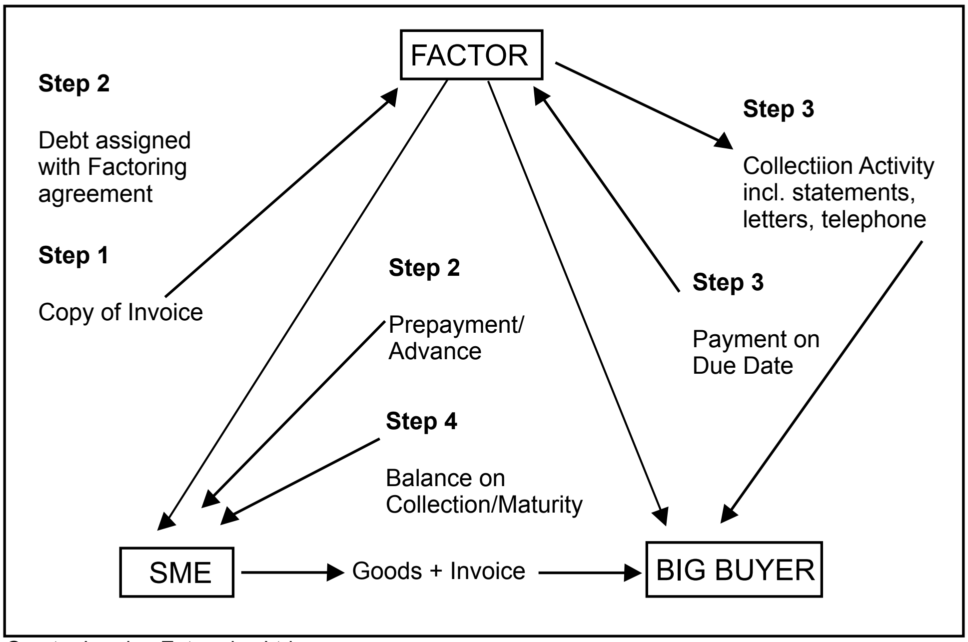
[6] These factors include lack of skills as well as incentives for staff members, unclear ownership structures, fraud, and inadequate capital for loan extensions.

[7] Trade credit exists when one firm provides goods or services to a customer with an agreement to bill them later.

a period of between 30 to 90 days. This phenomenon in effect implies that the supplier is financing the distributor's inventory and is thus directly or indirectly involved in the credit risk assessment process of the distributor, monitoring the distributor's inventory[8] as well as in credit risk-bearing and collection activities. In a factoring relationship, the supplier (manufacturer) has a choice of contracting the aforementioned activities to a third party known as a factor. The factor charges a fee for credit management and credit-risk bearing. During the operation of the factoring process, the factor buys the receivables at an agreed upon schedule and purchase price which is usually based on a discount.

Factoring is not a loan and there are no debt payments and additional liabilities on the firm's balance sheet, although it provides working capital financing. Factoring can be conducted on either a "non-recourse or recourse" basis against the factor's client (the sellers). In non-recourse factoring, the lender not only assumes title to the accounts, but also the default risk because the factor does not have recourse against the supplier if the accounts default. On the other hand, under recourse factoring the factor has a claim (i.e., recourse) against its clients (the "borrower") for any accounts payment deficiency. In this case, losses occur only if the underlying accounts default and the borrower cannot make up the deficiency. Figure 1 underneath is an illustration of a typical factoring relationship.

Figure 1: Factoring Process



Source: Greater London Enterprise Ltd

To explain the factoring process:

Step 1:

SME sends the goods with the original invoice to the Big Buyer and a copy of the invoice to the Factor. The invoice instructs the Big Buyer to pay the Factor, usually with the full payment details.

8 The raw materials, work-in-process goods and completely finished goods that are considered to be the portion of a business's assets that is ready or will be ready for selling.

Step 2:

Upon receipt of the invoice copy by the Factor, the associated debt is assigned to the Factor according to the Factoring Agreement. At the same time the Factor avails up to 80% of the invoice value to the SME.

Step 3:

The Big Buyer pays the full invoice balance directly to the Factor on the payment due date. Step 3 also illustrates that in the case of an overdue payment against an unchallenged invoice, the Factor would initiate the process of credit collection from the Big Buyer.

Step 4:

Upon receipt of the full payment by the Big Buyer, the Factor credits the balance (less the prepayment fees) to the SME account.

Leasing on the other hand, is a means of helping SMEs make use of equipment without having to own them (Wakelin et al, 2003). It eliminates the need for SMEs to commit capital to purchase equipment; by either borrowing or using their own resources. A leasing agreement is a usage agreement between the owner of equipment (the lessor) and a user of the equipment (the lessee). The lessee pays a monthly instalment to the lessor for the use of the equipment. The leasing contract usually contains certain conditions, which are amongst others; the length of the term, amount and timing of payments, and any end-of-lease conditions or restrictions. These conditions in most of the cases give one options between; returning the equipment and signing a new lease for more updated equipment; exercising a purchase option and buying the equipment; or renewing or extending the lease.

Against this background, the objectives of this paper are to examine how factoring and leasing would increase access to working capital for SMEs in Namibia. The paper also seeks to ascertain how these methods of lending to SMEs could be enhanced. To undertake the objectives above, the paper utilises field surveys to suppliers and potential suppliers, as well as clients and potential clients of leasing and factoring services based in Windhoek, Oshakati and Ondangwa. The surveys were augmented with case studies of South Africa, Mexico and Burkina Faso due to the fact that these countries had successfully introduced such instruments for the improvement of access to finance for SMEs. The surveys are intended to assess the existing operations of leasing and factoring companies in Namibia; determine the demand for their services; and suggest strategies to enhance their operations. The case study review was conducted to learn from the experiences of other countries and drawing lessons for Namibia.

The remainder of the paper is organized as follows: Section 2 provides an institutional framework for SME financing in Namibia, while Section 3 reviews the literature. Section 4 looks at the survey design, as well as results, while Section 5 derives lessons for Namibia from the experiences of South Africa, Mexico and Burkina Faso. Section 6 concludes and provides policy recommendations.

2 The access of SMEs to working capital in Namibia

2.1 Institutional Framework for SME financing in Namibia

Access to finance has been acknowledged by many as one of the major barriers to the development and growth of small businesses in the country. Grossmann, Mwatotele, Stork and Tobias, 2005, asserted that SMEs were one of the backbones of the Namibian economy. They further estimated that SMEs contributed approximately 12 percent to GDP and employed about 20 percent of the work force during 2004, growing at an average annual rate of 2 percent.

In spite of the significance of SMEs to the economy, formal financial institutions in general have been reluctant to provide credit and finance facilities to SMEs until the early 2000s. This was due to, amongst other things, a lack of collateral and the high transaction costs involved in small transactions. In response to the predicaments of the SMEs, the Government of Namibia set up a number of institutions. Due to operational inefficiencies which characterize most of the development finance institutions (DFIs), some of these entities collapsed or merged to form new companies. In addition, banking institutions started to realise the importance of SMEs in the domestic economy. As a result, Bank Windhoek and First National Bank established branches tailor-made to take charge of the needs of the SMEs. Similarly, venture capital or private equity firms were established which could enhance access to working capital for SMEs in Namibia, namely Stimulus and Oshipe Development Fund.

In the same vein, some microlenders have also emerged recently to provide working capital to SMEs, despite the fact that their loans were extended at a very high cost, while the loan sizes are fairly small. There are also a number of leasing companies and one factoring company in the market. The factoring operations are, however, limited due to capital constraints. The leasing services are largely linked to cars or hire purchase agreements for durable goods. These companies are operating under the Usury Act (No. 73 of 1968), thus there is no separate legislation on factoring and leasing in Namibia (FSAP, 2006). Each of these institutions will be discussed shortly.

2.1.1 Development finance institutions

The Development Bank of Namibia (DBN) and the Small Business Credit Guarantee Trust (SBCGT) are the main development finance institutions providing access to financial services for SMEs. The objective of the DBN is to fill the existing gap in financing the major medium and long-term development projects of both the private and public sectors. The DBN caters for the larger firms and larger projects, yet through their Special Development Fund (SDF) also focuses on SMEs, thereby supporting key sustainable projects and programmes of development importance.

Such support can take the form of credit lines managed by banking institutions in low-interest accounts which are extended at lower (subsidized) rates, direct lending and provision of working capital. The direct lending provides bridging finance in the form of working capital for SMEs which are awarded tenders or contracts by well established institutions to supply goods and services. It has a minimum of N$250 000 and a maximum of N$3 million and is repayable over a maximum period of 18 months. Clients are required to provide acceptable collateral. DBN lending also includes training, mentoring, monitoring and the evaluation of SMEs, and clients have to contribute two percent of the total training cost.

The DBN furthermore provides medium-term finance through banking institutions with the same minimum and maximum amounts as well as collateral which needs to be provided. The repayment however differs as the medium-term finance has a repayment period of a maximum of 5 years. Through its SME operations, the DBN has created 319 new jobs in 2006 and 290 in 2007. The SME loan portfolio in 2006 and 2007 was N$34.1 million and N$34 million respectively, and is reportedly healthy, paving the way for further expansion.

The SBCGT was established with the purpose of assisting small business entrepreneurs with the security required to access commercial bank loans. SBCGT provides guarantees to participating lending banks of up to 80 per cent of the loan, of which the maximum limit is N$250,000. In terms of the qualifying criteria the business must have fewer than 5 employees, less than N$1 million in annual turnover, and less than N$500, 000 in capital. The only exception to this is in the case of manufacturing business, where all the criteria are doubled. The Trust has until 2007, provided guarantees to about 762 businesses to the tune of N$69 million. The average loan guarantees range between N$1,500 to N$200,000 with a repayment period of 3 years. Interest rates are capped at prime plus 5[9], and the banks are expected to charge less if the risk profile of the borrower allows this (FSAP, 2006). Through its guarantees, the Trust has also positively impacted on 4 630 jobs. The problems, nevertheless, which the SBCGT has encountered, were the poor credit appraisals and monitoring of its supported loans on the part of banking institutions.

2.1.2 Banking institutions

There are four banking institutions in Namibia, namely: First National Bank of Namibia (FNB), Standard Bank of Namibia, Nedbank and Bank Windhoek. Of the four banks, only Bank Windhoek and FNB have separate branches for SMEs in Namibia. During 2007, the FNB SME Business Unit has provided financial support to more than 140 SMEs with loan funding ranging from N$50,000 to N$2 million. The estimated number of jobs created by SMEs which benefited from the FNB financial support is over 500. Bank Windhoek has supported over 400 SMEs and disbursed more than N$80 million. This figure includes the amount which the Development Bank of Namibia (DBN) has made available through the partnership. The estimated number of jobs created by the SMEs which have benefited from the financial support of Bank Windhoek and DBN is approximately over 1, 000.

The specialised SME division at Bank Windhoek provides lending and institutional support to SMEs including a mentorship programme of 12 months. The lending period ranges from 3 to 5 years. The typical interest rate that Bank Windhoek charges is the prime interest rate plus 2 or 3 percent; FNB offers its lending for 3 years at prime plus 3 percent. Moreover, FNB is considering offering a mentorship programme on a cost-sharing basis. Both these banks require clients to have a proper business plan. It should be noted, however, that both the FNB and Bank Windhoek SME finance centres are concentrated in Windhoek and the northern regions. The SME portfolio of these banks did not have default rates at the time of the survey. The other two banks, Standard Bank and Nedbank, have only allocated consultants who are providing financial services to SME.

[9] This includes 2.5 percent of the guaranteed amount that is paid to SBCGT.

2.1.3 Private equity firms[10]

Two private equity firms are operating in the country, namely Stimulus and the Oshipe Development Fund[11]. Stimulus' investments are focused in well established and successful Namibian companies and typically in the form of expansion capital and funding of management buy-outs or empowerment buy-ins. The size of investments which Stimulus undertakes, ranges between N$5 million and N$30 million, although at times they are guided by the nature of the transactions as they have also made investments within the N$1 – 2 million range. Stimulus is represented on all of the Boards of their investee companies as well as the Board Sub-Committees, if any. The types of projects Stimulus has invested in have ranged between a stevedoring business[12], aviation, office automation, hospitality, broadcasting and retail.

The Oshipe Development Fund promotes entrepreneurship and SME development through investment in commercially viable business ventures in Namibia. Since its inception in 2006, Oshipe has invested in about 7 SMEs with a combined value of about N$5 million, creating jobs for more than 70 Namibians. Most of the businesses which Oshipe has invested in so far are in the manufacturing industry; however its scope is not limited to the manufacturing sector only. It is expected that Oshipe will make a further investment of about N$ 3 million in 5 SMEs for the remainder of 2007, creating 30 additional jobs. The target investment range is between N$ 500,000 to N$1 million. The shareholding of Oshipe in a company ranges between 26 percent to 49 percent, with a representative on the Board. Loans are repayable over 3-5 years. Owners should, however, contribute 25 percent to the business capital requirement. Upon self-sustainability and adequate skills transfer of the business, Oshipe ends its involvement in the company, offering its shares to the business owners at fair value.

2.1.4 Microlenders[13]

The microlending sector in Namibia is one of the fastest growing sectors, increasing from only 34 operators in 2002 to 180[14] in 2006. There are two types of specialized microlending institutions in Namibia: term lenders and cash lenders. The term lenders offer term loans of up to a maximum of 36 months, while cash lenders extend credit for a period of only 30 days, with some giving 60 days to creditworthy clients.

Microlenders require no collateral from borrowers. They, however, use payroll deduction in the case of term lenders and the retention of Automatic Teller Machine (ATM) cards and pins in the case of cash lenders as security for the loans. The maximum loans which the term lenders are allowed to offer are N$20, 000, whereas the cash lenders are allowed to provide clients with up to 50 percent of their take-home salary after deductions[15]. Term-lenders are allowed to apply financial charges up to a usury ceiling of twice the prevailing prime rate, reflecting risks involved in their lending. To remain financially sustainable, however, cash lenders charge between 25-30 percent per month.

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10 Information used in this sub-section has been obtained from Stimulus and the Oshipe Development Fund.

11 Oshipe is a subsidiary of NAMDEB nevertheless; its core functions are far removed from NAMDEB's core functions. Oshipe does equity investment with funds provided by NAMDEB and since NAMDEB is a private company, Oshipe can be seen to fall under the category of private equity.

12 Stevedoring is the service of loading and offloading ship cargo between the quay and the ship.

13 The information in this sub-section has been obtained from Namibia Financial Institutions Supervisory Authority (NAMFISA).

14 Only 5 of the microlenders are term lenders whereas the other 175 are cash lenders.

15 The loan book of the microlending industry is approximately N$500 million per annum.

2.1.5 Factoring and leasing operations in Namibia

In Namibia there is one factoring company and about 15 leasing companies. The factoring company provides working capital of up to 75 percent of the accounts receivable of SMEs. The factoring company buys the accounts receivable of the SMEs and the "high quality buyers" pay the invoice amount directly to the factoring company upon the delivery of the service/goods. The factoring company then deducts the amount which they have advanced to the SMEs and from the remaining 25 percent, they deduct the factoring fee and the discount fee (prime linked) based on the criteria below. The cost of financing for factoring depends on three factors: (i) The capital needed, (ii) the time period for which capital is needed and (iii) collateral. Thus clients with collateral and those who need lesser amounts with a shorter repayment period, are charged lower rates compared to clients who need larger amounts, with longer repayment periods and without collateral. This operation is however limited due to lack of funds. Typical clients of the factoring company are not limited to SMEs. During 2008 about 60 percent of clients were in the construction industry, 20 percent in retail (general dealers), 10 percent in motor repairs and 20 percent in the medical practice.

The leasing companies offer three major types of conventional leasing, namely operational, financial and full maintenance leases. In the operational lease agreement, clients acquire an asset for operational purposes and the generation of income without the intention of assuming ownership at the end of the financing term. Typical examples are those of photocopiers, etc.

On the other hand, financial leases are used where companies purchase assets such as machinery, equipment or vehicles for the purpose of operations and generating income and then assume ownership at the end of the initial lease term. Such an agreement can then be done with or without additional financial obligations, but usually no additional payments/residuals are payable at the end of the term. The third product which is the full maintenance lease entails renting or leasing of vehicles and equipment over a period of up to 60 months. At the end of such an agreement there is a substantial payment of a residual amount in the case where a client wants to acquire ownership. Clients usually do not opt for this option and enter into a new agreement with a new asset and return the previously used asset. Full maintenance leasing covers the monthly operational costs of a vehicle excluding fuel and insurances and the owning costs, in other words the financing costs and interest payable. Costs of leasing also differ from client to client and such costs are prime linked.

2.2 Summary

Both the private sector and the Government have introduced measures on how to improve access to finance for SMEs. The DBN and SBCGT in particular on the Government side, have provided assistance in the form of direct and indirect funding through the banking institutions and loan guarantees, respectively. Nevertheless such lending by the DBN still requires collateral, which some of the SMEs might not necessarily have. Banking institutions could also be applauded for the efforts that they are putting in place, to provide access to finance for SMEs, although much still needs to be done. Private equity firms and venture capital in the country are still in a nascent stage and needs to be expanded. The micro-lending industry does not have specific funding for SMEs, and therefore only provides finance for owners of SMEs. From the outset it is clear that despite all the efforts by both the Government and the private sector, access to finance for Namibian

SMEs remains limited. In this connection it is imperative, that additional instruments should be encouraged to improve SME access to finance, particularly in catering for the SMEs which do not have collateral. Such instruments are already provided by the one factoring company and a number of leasing companies. The constraint at present is that the lack of finance to extend these services to a wider range of SMEs. In addition, both the factoring and leasing operations are in an infant stage in providing working capital to SMEs.

3 Literature on leasing and factoring as instruments to promote the access of SMEs to working capital

3.1 Theoretical literature on Factoring and Leasing[16]

Factoring is a pecuniary feature which offers working capital to SMEs. According to Klapper (2005) factoring appears to be a powerful tool in providing financing to high-risk informationally opaque firms, especially SMEs. A key feature of factoring is that the underwriting is based on the risk of the accounts receivable rather than on the risk of the borrower. The mechanics of factoring enable high-risk suppliers to transfer their credit risk to their high-quality buyers. Similar to the traditional forms of commercial lending, factoring provides SMEs with working capital financing. Unlike the traditional forms of working capital financing, factoring involves the outright purchase of the accounts receivable by the factor, rather than the collateralization of a loan (Klapper, 2005). Factoring serves an important role in a fragile business environment because the account receivables are removed from the bankrupt estate of the borrower and become the property of the factor.

Factoring normally occurs when a supplier sells products to a distributor and extends trade credit to the latter, usually for a period of between 30 to 90 days[17]. This phenomenon in effect implies that the supplier is financing the distributor's inventory[18] and is thus directly or indirectly involved in the credit risk-assessment process of the distributor, monitoring the inventory of the distributor as well as in the credit risk-bearing and collection activities. In a factoring relationship, the supplier (manufacturer) has a choice of contracting these activities to a third party known as a factor. The factor charges a fee for credit management and credit-risk bearing. During the operation of the factoring process, the factor buys the receivables at an agreed upon schedule and a purchase price, which is usually based on a discount.

Factoring is not a loan and there are no debt payments or additional liabilities on the balance sheet of the firm, although it provides working capital financing. The concept is better explained by way of an example. Suppose a small Namibian supplier (S), sells tomatoes for N$1 million to its customer, big buyer (B), who is a large multinational exporter. As a competitive gesture, S offers B 30 days' trade credit. S records the sale as N$1 million in accounts receivable (cash inflows) and B records the purchase as N$1 million in accounts payable (cash outflows).

In the second step of the example, S needs working capital to produce more stock. A factor, F, purchases S's accounts receivable (S "assigns" its accounts receivable from B to F). S today receives 70 percent of the face value of the accounts receivable (i.e. N$700,000) from F. B is notified that S's receivables have been factored. Finally, in 30 days, F receives the full payment directly from B, and S receives the remaining 30 percent less interest on the N$700,000 and service fees. Around the world factoring is the dominant form of asset-based finance and an important source of external financing for corporations and small and medium-size enterprises (SMEs).

16 This sub-section is largely borrowed from http://www.bized.co.uk/virtual/bank/business/finance/sources/theories1.htm

17 Trade credit exists when firms provide goods or services to customers with an agreement to bill them later.

18 The raw materials, work-in-process goods and finished goods that are considered to be the portion of the assets of a business which are ready or will be ready for sale.

Factoring companies can offer services through the "reverse factoring" approach. In this approach, the factor purchases accounts receivables only from high-quality buyers[19], and the factor merely needs to collect credit information and calculate credit risk for a few selected buyers. The credit risk is therefore equal to the default risk of the high-quality consumer and not the risky SME (Klapper, 2005). Reverse factoring is particularly beneficial in developing countries which have weak credit information systems. This type of factoring provides benefits to all three parties involved[20].

Factoring can be conducted on either a "non-recourse" or "recourse" basis against the factor's clients (the sellers). In non-recourse factoring, the lender not only assumes title to the accounts, but also the default risk, because the factor does not have recourse against the supplier if the accounts default. Under recourse factoring the factor has a claim (i.e. recourse) against its clients (the "borrowers") for any account payment deficiency. In this case losses occur only if the underlying accounts default and the borrower cannot make up the deficiency. In this connection, through reverse factoring, creditors are permitted to factor "without recourse" (Klapper, 2005).

Leasing, on the other hand, is a means of helping SMEs make use of equipment without having to own it (Wakelin et al., 2003). It eliminates the need for SMEs to commit capital to purchase equipment either by borrowing or using their own resources. When the contract is in force, the lessee pays a monthly instalment to the lessor for the use of the equipment. Other conditions usually contained in the lease contract include, the length of the term, amount and timing of payments, and any end-of-lease conditions or restrictions. It may also include options such as returning the equipment and signing a new lease for more updated equipment, purchasing of the equipment, and renewing or extending the lease. Leasing agreements could be either on a full maintenance[21], operational[22] or financial[23] lease basis.

3.2 Empirical literature on factoring

Empirical evidence indicates that factoring is used in both developed and developing countries. It has been known amongst business and finance professionals for a while in the US, Europe and Japan and does not require a very specific legal framework to be promoted (ADBI, 2006). Factoring has been rapidly growing due to private initiatives in some of the developing and transitional countries, to support and complement banking services. In 2005, the total worldwide factoring value stood at more than US$1,016 billion.

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19 High quality buyers mean government institutions and private companies with strong balance sheet positions.

20 SMEs can borrow greater amounts than they would otherwise be able to do, because the credit risk is transferred to the high-quality, creditworthy borrowers. Lenders can develop good relationships with SMEs without taking on additional risks. This would enable the lenders to build credit history on the SMEs which would enable them to qualify for additional lending. The large quality buyers would benefit in the sense of being in a position of negotiating better terms with the SMEs to for example, extend the payment period from 30 to 60 days. The buyers then also benefit from outsourcing their accounts payable administration as payments are sent to the factor who would distribute the funds to the different SMEs with whom they are in agreement (Klapper, 2005).

21 With a full maintenance lease, lessors are responsible for maintenance and the repair of the equipment. This type of leasing agreement generally has a bulk payment of residual which is payable at the end of the term.

22 During an operational lease agreement clients are able to acquire assets for operational purposes and for income generation. They would however not acquire ownership at the end of the leasing term.

23 Financial leases are entered into by two parties in which case clients purchase assets, usually machinery, equipment or vehicles for operational purposes and income generation. In this case, clients accept ownership at the end of the lease period and this could be done with or without additional financial obligation but generally no additional payments/residuals are payable at the end of the leasing term.

There have been a number of papers which have attempted to examine the reasons why a firm would decide to factor its accounts receivable: Mian and Smith (1992) provided a comprehensive examination of the various cross sectional explanations of receivables policy determinants, with a special emphasis on the formation of captive subsidiaries. Because of the scarcity of factoring observations, their tests have however, provided weak evidence with respect to the variables which motivate the decision of a firm to factor its accounts receivable.

Sopranzetti (1997b) argued that the sale of the accounts receivable could mitigate the underinvestment problem. Smith and Schnucker (1994) took a different approach and derived testable implications about factoring from the industrial organisation literature which is based on vertical integration and transaction costs. They found that firms factored their accounts receivable in order to manage their credit risks better. A question which could not be addressed by their conclusions was that, if factoring was indeed used to manage credit risk, then why was it that firms only manage to factor their highest quality receivables?

Sopranzetti (1999) found that when the seller's level of credit monitoring was unobservable to the factor, a rational factor would expect a moral hazard problem and would reflect this expectation in the equilibrium price they offered to the seller. Accordingly, sellers would factor their highest credit quality receivables without recourse, and their intermediate quality receivables with recourse, and choose not to factor their lowest quality receivables.

Klapper (2005), using a sample of 48 countries, investigated the characteristics which were associated with greater use of factoring. The study tested the hypotheses of a positive relationship between factoring and the macroeconomic and business environment of a given country. The study showed that economic development and growth were crucial for the provision of factoring services. In addition, the study established that factoring was more important in countries with better availability of credit information. Consequently, the study suggested that access to credit information increased not only the provision of bank credit, but greater access to financing from non-bank sources as well. For Namibia factoring could be particularly important for those SMEs with huge debt books. These SMEs are especially visible in the construction sector of the economy.

3.3 Empirical literature on leasing

Evidence shows that leasing is a major business internationally. Total lease volumes reported through leasing companies are in excess of US$500 billion annually. The predominant market is the United States of America (USA), where volume exceeds US$200 billion, followed by Japan in second place with US$68 billion. China and India – two of the fastest growing economies in the world today – have very small leasing markets, amounting to US$ 2.1 billion and US$ 1.4 billion, respectively.

According to the International Finance Corporation (IFC)[24], leasing has proved to be an appropriate financing source for the emerging private sector in transition economies and low-income regions, such as Sub-Saharan Africa (Carter et al. 1996). The IFC also

[24] The IFC's mission is to help reduce poverty and improve people's lives by promoting sustainable private sector investment in developing countries. IFC in partnership with private investors provides loans and equity finance for business ventures in developing countries and helps expand their economies and assist in job creation. Private companies can approach the IFC directly by submitting an Investment Proposal to establish a new venture or expand their existing business. After the first communication, IFC would then request a detailed feasibility study or business plan to determine whether or not to appraise the project. IFC provides up to 25 percent of the project costs and usually makes a minimum commitment of $1 million (www.ifc.org).

provides specific services to SMEs in the form of expanding access to financing, amongst others. Throughout the years, they have developed programmes which could increase the availability of financing to SMEs. These programmes include investments in private equity funds which specialize in SMEs and give support to microfinance institutions, banking institutions which lend to SMEs, and leasing companies. Between 1977 and 1995 the IFC invested a total amount of US$523 million via 120 transactions in 63 leasing companies which operated in 36 countries. The leasing companies in which the IFC has invested have, on average, proved relatively profitable and efficient. Returns on equity have averaged 20 percent. Carter et al. (1996) point out that, given the above rate of return and in combination with relatively low provisioning rates (compared to bank lending), leasing is less vulnerable to default than lending. Tailor made leasing services should be extended to SMEs. This would substantially also enhance the provision of working capital without collateral for SMEs.

3.4 Summary

Factoring and leasing are very useful tools to provide working capital to SMEs without collateral. At the onset, SMEs do not need to provide collateral for both factoring and leasing. In the case of factoring, the accounts receivable of the SMEs are regarded as the collateral and in the case of leasing, equipment that is leased is regarded as the collateral. Factoring and leasing has been used successfully in many countries and although lending institutions would provide working capital financing to SMEs, factoring is not a loan and is thus not treated as a liability. Recourse factoring seems to be the preferred choice rather than non-recourse factoring, as the former provides a cushion to the lender in case of potential default. In the case of leasing, SMEs have three different options between an operational lease; financial lease and full maintenance leasing, depending on the type of business in which SMEs are involved. The IFC has been providing access to finance for SMEs in member countries and could therefore play an active role in providing such services to Namibian SMEs directly or indirectly.

4 Survey Design and Analysis of the Results

A survey was undertaken to determine the views of suppliers, potential suppliers, as well as clients and potential clients of leasing and factoring services in Namibia. Companies which were interviewed included banking institutions, debt collection companies, factoring and leasing companies (on the supply side) and SMEs (on the demand side). Appendix D contains the survey on the demand for factoring and leasing services to Namibian SMEs, whilst Appendix E consists of the questions posed to the potential suppliers of such services.

4.1 Design of the field survey

The survey was conducted during the period May-June 2007 in Windhoek, Ondangwa and Oshakati. The choice of those towns was underpinned by the high concentration of the activities of SMEs in those regions. The survey targeted small and medium enterprises (SMEs) engaged in various economic activities in the selected localities (see Table 1, page 21). SMEs were selected, based on whether they would be the clients of factoring and leasing services. Potential clients of factoring companies were determined by the likelihood of the business to sell on credit terms, while for leasing, the selection was based on whether the business was engaged in a sub-sector which would require them to make use of equipment. The reason for selecting SMEs which were selling on credit, for factoring was, because of the fact that SMEs have to factor out their debt books or accounts receivable.

Based on these criteria, it emerged that the majority of SMEs were mainly micro-enterprises and, therefore, could not qualify for participation in the survey, given that they tended to deal primarily on a cash basis and were mainly in trading activities which did not require machinery and equipment. Only a total number of 33 SMEs were thus interviewed of which 26 were dealing on a credit basis. This represented 11 percent of the 240 SMEs which dealt on a credit basis nationally, and therefore made the sample representative of the population. Due to the size of the sample, the results should nevertheless be treated with caution. Table 1 shows the number and percentage distribution of businesses by activity that was interviewed.

Table 1: Distribution of companies by activity

Sector	Total Number of businesses	Percent
Manufacturing	6	18.2
Coffin Production	2	6.1
Panel Beaters and Spray Painters	3	9.1
Production of glass and aluminium	1	3.0
Repair of canopies	1	3.0
Truck repairs	2	3.0
Butchery	1	3.0
Metals and mechanical manufacturing	1	3.0
Stationery	1	6.1
Mahangu Crushing	1	3.0
Supply of Building materials	1	3.0
Joinery and Carpentry	2	3.0
Agricultural equipments	1	3.0
Web Designing	1	6.1
Quantity Surveyors	1	3.0
Service Station	1	3.0
Hair Salons	2	3.0
Upholstery	1	3.0
Construction	1	6.0
Paint Production	1	3.0
Tailoring	2	6.1
All Sectors	**33**	**100**

Source: Survey, 2007

4.2 Credit sales by SMEs interviewed

The survey results indicated that 78.7 percent of the companies sampled, sold to their clients on a credit basis. Of the 78.7 percent, 33.3 percent sold on a term of 30-60 days, while 30.3 percent sold on a term of 15-30 days. The survey further established that 9.1 percent of the 78.7 percent sold on terms of less than 15 days and 3 percent sold on terms of 30-90 days. The other 3 percent sold on terms of more than 90 days. The remaining 21.3 percent of the enterprises interviewed did not sell on a credit basis.

Table 2: Credit Terms

Terms	<15 days	15-60 days	30 - 60 days	60-90 days	30-90 days	90 days	Not selling on credit
Number of companies	3	10	11	0	1	1	7
Percentage	**9.1**	**30.3**	**33.3**	**0.0**	**3.0**	**3.0**	**21.2**

Source: Survey 2007

4.3 Terms and conditions

Various businesses interviewed imposed a number of conditions on their clients when they sold goods and services on credit terms. The most commonly used conditions were: the payment of a deposit of 50 percent of the total sales amount upon delivery of the goods and services; submission of post-dated cheques, trade references; the requirement that the client should be creditworthy and someone of good standing in the society and; proof of ability to pay requirements such as those for social security, pensions and insurance policies (especially in the case of SMEs which were engaged in undertaking funerals).

4.4 Current and future working capital financing

About 66.7 percent of the SMEs indicated that they financed their working capital requirements through the reinvestment of their profits, while 18.2 percent obtained loans from banking institutions, and the remainder used overdraft facilities of banking institutions. It was evident that the SMEs interviewed had an observable bias towards the reinvestment of profits as a source of working capital finance, and therefore needed to investigate other tools to make such capital available.

Table 3: Could factoring and leasing be used to provide working capital to SMEs?

	Factoring			Leasing			
	Yes	**No**	**Don't know**	**Yes, but should be offered by DBN together with other working capital instruments[25]**	**Yes**	**No**	**Depends on cost[26]**
Percent	34.6	26.9	11.5	26.9	30.8	46.1	23.1
Number	**9**	**7**	**3**	**7**	**8**	**12**	**6**

Source: Survey 2007

Table 3, reports the findings from the survey with regard to the demand for factoring and leasing services by SMEs. A question was posed to SMEs whether factoring and leasing services could be used to provide working capital to SMEs. As is evident from the table, 61.5 percent of the SMEs consider factoring as a viable means of acquiring working capital. Out of this, 26.9 percent felt that factoring should rather be offered by the DBN and 11.5 percent of the SMEs felt that they did not know whether factoring could be used as means for providing working capital. This could be attributed to the lack of general understanding of factoring.

SMEs in favour of factoring believed that it would work well when they conduct work on behalf of the Government through tenders (contracts) where it usually took longer for payment to be received for the work done. They felt that factoring would enable them to have better access to working capital, as it did not require collateral, but rather used the accounts receivable of the SME to advance funds.

On the other hand, 26.9 percent of the SMEs were of the opinion that factoring would not work for them because it was likely to be costly and would enable factors realise

[25] These SMEs expressed their willingness to participate in factoring services provided that such factoring services are offered by DBN together with other instruments also providing working capital such as leasing.

[26] These are SMEs that indicated that the extension of leasing services could work, depending on the costs involved.

excessive profits. Furthermore, the operations of factoring would be undermined by the information asymmetry problem between borrowers and lenders. Opponents of factoring argued that it was better for the Development Bank of Namibia (DBN) to play a more proactive role in advancing finance to the SMEs. In addition, they believed that the Ministry of Trade and Industry and banking institutions should provide working capital to SMEs, while the Small Business Credit Guarantee Trust (SBCGT) should guarantee more loans to the SMEs.

Survey results indicated that 30.8 percent of the SMEs interviewed were in favour of leasing, while 23.1 percent were indifferent saying it would depend on the cost of leasing compared to buying equipment. The majority or 46.1 percent of the SMEs interviewed were not in favour of leasing. SMEs opposed to leasing, argued that it was a very costly arrangement and, at the end of the lease period, the lessee would have paid twice the cost of the equipment. Instead, they proposed that SMEs should rather purchase the machinery and equipment themselves. Pro-leasing SMEs would prefer to lease the machinery and equipment with the option of buying it at the end of the lease period.

4.5 Views of suppliers on factoring and leasing

Apart from the SMEs, the survey attempted to explore the views of suppliers and potential suppliers of factoring and leasing services. The companies which were targeted for this exercise were banking institutions, debt-collection companies, as well as factoring and leasing companies.

4.5.1 Views of banking institutions

Strictly stated, banking institutions in Namibia did not offer factoring services. One bank however, advanced credit on the basis of accounts receivable as collateral. This was, nevertheless, not formal factoring, because the borrower's books were not necessarily factored out to the bank. Some of the banking institutions expressed the view that factoring was in general a risky and expensive method of providing working capital and, they would therefore not consider it as an additional product to offer. Furthermore, factoring was seen as being administratively complicated and highly specialised.

On the other hand, another banking institution argued that, if factoring was considered to be a feasible and viable business, it would consider offering it to potential clients. Banking institutions maintained that for factoring services to take off effectively, there was a need to tackle a number of crucial factors such as: the establishment of a proper and enforceable legal base, to minimise losses due to improper controls, to increase awareness of factoring services, to simplify factoring services so that the technical complexities were reduced, and to create a pool of specialised expertise and skills in the area of factoring.

Some of the banking institutions were already offering financial leases to SMEs. The assessment was done on the basis of the normal risk and credit criteria. They indicated however, that most SMEs did not seem aware of the available financial leasing products. As far as risk was concerned; banking institutions were of the opinion that financial leasing did not pose a higher risk. In addition, they indicated that the cost of leasing services would depend on the administrative burden, as well as the credit risk. Banking institutions who did not provide financial leasing to the SMEs, expressed the view that it was a complex product to administer.

4.5.2 View of factoring and leasing companies and debt-collection companies

The equipment-leasing industry in Namibia appeared to be relatively well developed. There were approximately 15 major equipment-leasing companies in the country which covered various sub-sectors such as forklifts for construction, road construction and maintenance equipment, earthmoving equipment and trucks etc. The factoring industry, however, was relatively less developed. There was only one company in the country which engaged in formal factoring services.

The factoring and leasing companies interviewed argued that there was a market for these products. The clients are SMEs, start-up companies as well as established businesses. They maintained that factoring and leasing would be particularly more appropriate for SMEs that dealt with government contracts and were formally registered for value added tax (VAT) purposes and social security.

The factoring company visited cited the lack of capital as a key constraint to the optimal take-off of the factoring industry in Namibia. It was argued that factoring was not well known to SMEs. The interest charges of the factoring company ranged from prime to prime plus 4, in addition to a minimal factoring charge of between 3 to 5 percent of the factored amount. It further contended that factoring is a very useful working-capital and cash-flow-management facility which would provide market participants with more options in accessing financial services. The company argued that factoring minimised a company’s debtors department and enables businesses to negotiate better rates with creditors.

The leasing companies interviewed believed that it is a good working-capital and cash-flow-management tool. They maintained that the key benefit of leasing is the separation of ownership of the equipment and the ability to generate cash flows. With leasing, the SMEs are released from owning depreciating assets, such as machinery and equipment.

Debt-collection companies maintained that they would undertake factoring if there was a guarantee from the government or the Bank of Namibia. Some of the debt collectors stated that for factoring and leasing to function properly in Namibia, there was a need for a strong sense of integrity and honesty amongst business people.

4.6 Summary

Opinions on factoring and leasing were mixed from both the demand side as well as the supply side. On the demand side, SMEs lacked awareness regarding the available factoring and financial leasing services. Nevertheless, the majority of SMEs interviewed were in favour of factoring rather than leasing, despite the fact that leasing was a well established business in Namibia. This could be attributed to the sample size selected, as the selected SMEs, did not seem to make use of leasing services, which could in turn be due to a lack of awareness. SMEs had a negative perception of banking institutions which offered leasing and factoring services, and preferred to have them offered by the DBN. This could be attributed to the cost aspect as SMEs felt that banking institutions were charging very high rates for these services.

On the supply side, it was found that banking institutions were already offering financial leasing services, while one was offering factoring on a limited scope. One banking institution expressed the view that it could consider offering factoring if this was found to be feasible, while others stated that it was expensive to offer these services. Moreover, there was already a factoring company in the market. This factoring company however cited a shortage of funds and lack of awareness of these products as a major hindrance to the development of the factoring market. Leasing companies seemed to be doing fairly well, and such services could therefore provide a greater variety of equipment, especially in sectors which relied heavily on the usage of machinery. It could be deduced that most clients of leasing were larger enterprises. Debt-collection companies seemed to have a misconception about the role of the Bank of Namibia and the Government in promoting factoring and leasing in Namibia. Nevertheless, information availability could play a role in clarifying those roles.

5 Lessons from South Africa, Mexico and Burkina Faso

This chapter attempts to summarise case studies of three countries[27] . The main idea of undertaking case studies was to draw lessons from these countries on the enhancement of factoring and leasing operations in Namibia. A summary of the lessons drawn from the case studies follows.

5.1 Institutional framework

In South Africa, factoring and leasing services are offered by specialist divisions of banking institutions and other independent financing companies, although the latter usually constitute a smaller portion of debt financing. In Mexico, the Nacional Financiera (Nafin) factoring is a second-tier development bank. In the case of Burkina Faso factoring and leasing services are offered by a non-bank financial institution (NBFI), Burkina Bail.

In Namibia, the existing formal factoring company and leasing companies are non-bank financial institutions registered with NAMFISA. In addition, banking institutions undertake financial leasing as part of their normal banking business. Existing leasing companies, banking institutions and debt collection companies could extend their services to include factoring services as in the case study countries. In addition, the DBN could consider offering factoring products as is the case of Nafin.

5.2 Terms and conditions of contracts

In all three cases factoring services are offered on 30 to 90 day terms. Factoring companies do not finance debt which is older than 90 days. In the case of South Africa, a sale and purchase agreement in terms of receivables is signed as well as a collateral letter which is usually required from SME shareholders. In the case of factoring, the factor “owns” the debt legally, since the SMEs sign over their debt books to the factor. Namibian SMEs would benefit greatly from such services, since they lack collateral. Lease agreements in these countries range between 24 to 36 months. Conditions such as the usage of equipment, maintenance, damage and repair of the equipment are also considered. In most cases leasing services do not require collateral from SMEs as the equipment which is leased out is considered as collateral.

5.3 Costs of factoring and leasing services

The costs of factoring in all case study countries is linked to either the prime rate or the bank rate. In South Africa, for example, it is prime linked, whereas in Mexico it is linked to the bank rate, which is usually lower than the normal commercial bank interest rates on loans. In Burkina Faso interest rates are calculated on a case-by-case basis depending on the risks involved. South Africa and Burkina Faso charge administration fees to the SMEs, whereas Nafin in Mexico charges interest to the banks which are participating in the programme. The Mexican SMEs are therefore not charged with any additional service fees.

[27] See Appendix A, B and C for a detailed discussion.

5.4 Default

Only a very limited number of SMEs default on the payments on factoring and leasing. In most cases it has been less than 10 percent of the SMEs which defaulted on payments. With Nafin, defaults mostly occur when the buyers are not satisfied with the goods and services delivered. Nafin nevertheless, solves this problem with the buyer paying future receivable payments to the factor[28]. Mitigation measures of other countries include an ongoing evaluation of the debtor's books and the monitoring of the financial performance of SMEs, letters of guarantee, debtors insurance, repossession of equipment as well as restructuring of debt repayments.

5.5 Success factors

Critical success factors from the case study countries are the hands-on approach of the factoring and leasing companies. For factoring services in South Africa, for example, companies carry on a continuous follow-up action with clients, in order to make sure that they are using the correct products for the right purposes. In Mexico, Nafin offers technical assistance and training to SMEs, in addition to financial assistance. The reverse factoring practised by Nafin benefits all three parties involved in the process[29]. In Burkina Faso, continuous support to SMEs such as inspections on leased equipment is also offered. Namibian companies considering the offering of these services should develop close relationships with SMEs so that they do not only do their follow-up on the companies once they default on their payments.

The electronic platform used by Nafin also makes it easier for SMEs to obtain working capital instantly, as the whole process only takes a day to implement, unlike conventional credit which takes a longer time horizon. In addition, as it is an internet-based business even rural SMEs can access the factoring services. This could be useful in Namibia, given the concentration of the branches of banking institutions' in urban centres. Other critical factors for the successful operation of factoring and leasing companies include, the economic conditions, financial sector development, fiscal and legislative environment, good corporate governance, good IT systems, the separation of credit and market functions, and experienced and capable staff.

5.6 Legal framework

Both factoring and leasing services do not require any specific legal framework to be implemented. This is because the leasing and factoring business is already being practised under the existing legal framework in Namibia. In the case study countries, it is only in Mexico where Nafin is registered under the second-tier legislation. In South Africa and Burkina Faso, factoring and leasing services are carried out under the existing bank and financial institution legislation.

5.7 Summary

The key lessons that one could draw from the case study countries, is that leasing and factoring in Namibia can be offered by the banking institutions, the non bank financial institutions and the Development Bank of Namibia. The DBN could be involved in factoring and leasing services, either by offering factoring directly, or through a reverse

[28] See Appendix B.

factoring approach. It is also important to note that factoring in Mexico is less costly than traditional credit. The most significant advantage of leasing and factoring is the easier access to working capital, given that in most cases there is no collateral required.

Factoring and leasing services seem to have lower default rates than conventional loans in all three countries. After being granted financial assistance, SMEs are not left on their own but, the lending institutions take constant follow-up action on them. In addition, it can be deduced from the case study countries that no special legislation is needed to operate factoring and leasing services. Factoring and leasing companies could therefore operate under the current Usury Act with a few possible amendments, to make provision for factoring of debt to a third party.

6 Conclusions and recommendations

The primary objective of this paper were to examine how factoring and leasing could be used in making working capital accessible to SMEs in Namibia. In addition, the paper was intended to study how those approaches could be improved.

To undertake the objectives above, the paper adopted a desk review and field surveys methodology to assess the demand and supply of leasing and factoring in the country. The survey and desk review were supported by case studies of South Africa, Mexico and Burkina Faso. The results of the field survey suggested that there existed a niche market for both leasing and factoring in Namibia from the perspective of the suppliers. The clients are SMEs, new companies as well as already existing large businesses. The majority of SMEs could be interested in making use of factoring as a viable means of accessing working capital. They felt it would be ideal particularly for factoring services to be offered by the DBN.

Factoring was not well known and was less developed in Namibia. There was only one factoring company operating in Namibia. In addition, one commercial bank also offered factoring, but not in the strict definition of the term. Some of the banking institutions expressed the view that factoring was in general a risky and expensive method of providing working capital to SMEs, and they would therefore not consider offering this service. Others, however, argued that if found feasible, they would consider offering it to potential clients.

It was cited that for factoring services to take off effectively, there was a need to tackle a number of crucial factors. These factors included a proper and enforceable legal framework, increased awareness of information, simplified factoring services, and skills development. Another issue raised was the need for capital to fund the optimal take-off of the factoring businesses. The IFC could play an important role in providing access to finance for companies which are providing factoring services to SMEs. Factoring is a very useful working capital and cash-flow management facility which would provide market participants with more options to access financial services. Factoring could also minimise the debtors department of a company and enable businesses to negotiate better rates with creditors.

It could be deduced that a reverse factoring approach could be more appropriate in Namibia. This was due to the poor information on SMEs, weak IT infrastructures, a lack of understanding and scepticism from banking institutions about factoring. The “reverse factoring framework” could be modelled on Nafin of Mexico. It could function through the DBN, creating a chain between “big buyers and small suppliers”. The role of the DBN in the transaction is to broker the factoring services. i.e. register participating SMEs and collect information on big buyers. The DBN could also refinance financial institutions involved in the factoring business. After concluding a factoring transaction, funds are transferred directly to the supplier’s bank account, and the factor becomes the creditor.

As far as leasing was concerned, the majority of the SMEs did not seem to be in favour of these services. This was the case, despite the view of suppliers that it is indeed a well established business in Namibia. The contradicting views of suppliers and SMEs could be attributed to the sample selected. The sample of SMEs which were selected did not seem to be using leasing services. A number of financial institutions offered leasing services in Namibia, while some of the banking institutions also offered financial leases to SMEs. To broaden the provision of leasing services to SMEs, the IFC could also invest in private equity funds and banking institutions which would extend leasing services to SMEs. With leasing, SMEs pay in instalments, which make it more affordable than paying a lump sum. Banking institutions which were not providing financial leasing to the SMEs on the other hand, expressed the view that it was a complex product to administer.

Drawing from the case study countries, factoring and leasing services were mostly offered by specialist divisions of banking institutions, non-bank financial institutions and development banks. The most important aspect of both leasing and factoring was the easy access to credit given the fact that there was no collateral required before the SME would obtain working capital. The cost of factoring in Mexico is below the normal lending rates of the banking institutions.

The review of the case study countries revealed that the critical success factors were: the hands-on approach of the factoring and leasing companies, a continuous follow-up with clients, technical assistance and training to SMEs and inspection of leased equipment, in addition to financial assistance. Only a very limited number of SMEs defaulted on the payments on factoring and leasing. In most cases it was less than 10 percent in all case study countries. To mitigate against default, Namibian lending institutions could adopt factoring with recourse options. One could, however, deduce from the study that these products might not cater for all SMEs, especially those without good infrastructure, without proper accounts receivable records and those dealing on cash bases.

Recommendations for factoring

Given the above background, the paper recommends the following actions to enhance the role of factoring in Namibia:

- Factoring services could be extended to SMEs involved in government tenders, the construction industry, as well as those which are oriented towards exports. Factoring companies would have to ensure that the performances of SMEs are continuously monitored and should not only contact them when they default on payments.

- Given the limited information about factoring services and scepticism from many banking institutions, the Development Bank of Namibia should take the lead in the development of factoring services. This could be done by way of a reverse factoring approach, in which the DBN would create a platform for various players to interface with one another. In addition, the DBN should provide refinancing to banks and other financial institutions which participates in the factoring programme and should not factor accounts receivables directly.

- SMEs should be encouraged to invest in IT, to benefit from factoring if the reverse factoring approach was adopted.

- Private companies and banking institutions which would consider improving their current financial instruments through extending factoring services to SMEs could be encouraged to approach the IFC for possible financial assistance.

- Public education or awareness to the SMEs needs to be intensified on the use of factoring services. This could be achieved through a collaborative approach by the Development Bank of Namibia and the Ministry of Trade and Industry.

- In terms of the lending strategy, lending institutions are to be encouraged to adopt the recourse approach to factoring, in order to minimize potential default.

- For factoring to succeed, the Government and big suppliers are to be encouraged to pay their accounts due with SMEs, on time.

- A collaborative approach involving the government, SMEs, banking institutions and other private sector should be engaged in an attempt to increase access to finance for the SMEs in Namibia. In addition, such institutions are encouraged to train and provide skills development on factoring.

Recommendations for leasing

The following actions were recommended to enhance the role of leasing in the country:

- Leasing services could also be extended to SMEs involved in government tenders, the construction industry, as well as those that are oriented towards exports. Leasing companies must ensure that the performances of SMEs are continuously monitored and not only contact them when they default on payments.

- Private companies and banking institutions which would consider improving their current financial instruments through the extension of leasing services to SMEs are encouraged to approach the IFC for possible financial assistance.

- Public education or awareness need to be intensified to the SMEs on how leasing services could be used. This could be achieved through a collaborative approach by the Development Bank of Namibia and the Ministry of Trade and Industry.

- A collaborative approach involving the Government, SMEs, banking institutions and other private sector should be engaged in an attempt to increase access to finance for the SMEs in Namibia. In addition, such institutions are encouraged to train and provide skills development on leasing.

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Appendix A: Case study of factoring and leasing in South Africa[30]

South Africa has been taken as one of the case study countries as it has successfully implemented factoring and leasing services to SMEs. SMEs contributed approximately 60 percent to employment and 50 percent to the GDP in 2005[31]. Thus, SMEs could play an important role in local development and are mostly represented in the four primary areas: agriculture, wholesale, manufacturing and local services. The average factoring amounted to €4467.90 million during 1994-2003, which accounted for 3.4 percent of GDP in South Africa.

Institutional framework

Most debt factoring[32] in South Africa is done by specialist divisions of banking institutions or subsidiary companies. In addition, there are also a small number of independent companies which specialise in different markets. The services offered by these companies include a wide range of debtor financing, such as full factoring/financing[33] , invoice discounting/financing[34], import factoring and export factoring.

Leasing, on the other hand, occurs in both vehicle and goods industries in South Africa. The funding is sourced either from owner's interest or banking institutions in South Africa. Only one questionnaire was returned from South Africa on leasing. This questionnaire was from the vehicle industry and any private or small fleet vehicle user qualifies for their product. SMEs were estimated at less than 2 percent of receivables, although they were not monitored separately. The types of equipment which are leased are light commercial vehicles, tractors and implements sold through the Federal Motor Carrier Safety Administration (FMCSA) dealerships.

Terms and conditions of contracts

Debt older than 90 days are not funded and the maximum days for discounting paper are 90 days. Companies also do not accept foreign debt, consignment stock debt, debt which is subjected to sale or return, debt which is subjected to set-off, debt which is in dispute. The conditions attached to factoring contracts are a sale and purchase agreement in respect of receivables, in addition to collateral which is required from shareholders. The duration of the lease agreements is 24 months. The conditions which are attached to these agreements are the usage of the equipment, the maintenance compliance, equipment damage and repair conditions as well as the conditions upon the return of the equipment.

Costs of factoring and leasing services

Costs of factoring services are prime rate linked, ranging from prime rate plus 2 to 4 percent, although it seldom exceeds prime plus 4. The factoring companies also provide

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30 This case study is based on information obtained from the South African Reserve Bank, two questionnaires from factoring companies and one from a leasing company. In addition, information from the Banking Association was also used for this purpose.

31 This information has been adapted from the Framework partnership document France – South Africa (2006-2010).

32 Approximately 70 percent.

33 This product is fully disclosed to the suppliers' debtors with the invoices being marked that they have been ceded or sold to the factor and the factor administers the collection of the outstanding amounts from the debtor.

34 Factors have a choice not to disclose to the suppliers' debtors but the supplier needs to administer the collection of outstanding amounts from the debtor.

full debtor administration services, for which they charge a factoring fee of anything from 0.25 percent to 2 percent on the gross invoice value sold, with a minimum fee being imposed. The costs involved in the factoring agreement are established upfront and both the interest and service fees are negotiated upon signing of the Agreement. Equipment is leased at commercially viable rates and return on equity (ROE), enhancing repayments and taking into account the cost of the equipment, the risk profile of the customer, and the usage and the associated residual risks.

Default

SMEs have default rates of less than 10 percent for both factoring and leasing. SMEs default when there is insufficient fundable debt available to collect the exposure in the case of factoring. In order to mitigate such defaults, factoring companies undertake ongoing evaluations of the debtors' books and confirm with these debtors, where this is allowed. Factoring companies also conduct audits at the client's premises, thus also evaluating the SMEs' financial performance. In addition, letters of guarantee and debtors insurance are also taken as measures to mitigate defaults. The leasing companies ensure compliance with legislation, insurance covers, customer risk assessment, account monitoring and control, collection policies, the restructuring of debt repayments and the repossession of equipment.

Success factors

The critical success factors for these companies are: the state of the economy, as well as eliminating the stigma which is attached to factoring, and which is labelled as last-ditch finance, the effective legislative environment, good corporate governance and the free market process. Enhancing factors for the operation of a successful factoring company include good IT systems, experienced and capable staff, separation of credit and market functions, and good procedures and controls. The Debtor Financing Committee also undertakes a continuous follow-up with clients, to ensure that the SMEs are using the correct products for the right reasons.

Appendix B: Case study of factoring in Mexico[35]

Mexico has successfully implemented the Nacional Financiera (Nafin) factoring programme, in a fragile business environment (Klapper, 2006). Almost 80 percent of small firms in Mexico did not have access to credit in 2004, and thus depended on retained savings and family contributions. Nafin saw this gap and from mid-2004, established Productive Chains with 190 low-risk buyers and more than 70 000 SMEs. SMEs contributed approximately 64 percent to employment and 42 percent to GDP in 2004. The average factoring amounted to €5073.30 million during 1994-2003, which accounted for 1.09 percent of GDP in Mexico.

Institutional framework

Nafin is a second tier development bank which was initially created by the Mexican government. It was then given the responsibility of using technology in assisting micro-enterprises and SMEs with financial assistance, including technical assistance and training. There are approximately 20 banking institutions and independent finance companies participating in this programme and they have extended over US$9 billion in financing since 2001 (Klapper, 2006).

The Nafin factoring programme practises reverse factoring, which only needs complete credit information on the big buyers to whom the SMEs are supplying goods and services. This type of factoring benefits all three parties who are involved in the process. The first beneficiary is the factor, through the low information costs and credit risk, since Nafin already collects credit information on the buyers. The second beneficiary is the high-risk seller, who obtains access to working capital and does not need to administer the process of collecting money from the debtors. The third beneficiary is the low-risk buyer, who can outsource the administration of the funds to be paid to the supplier. In addition, the buyer is able to negotiate favourable terms with its suppliers (Klapper, 2006).

Nafin does reverse factoring through an internet-based market infrastructure which facilitates on-line factoring services to the low-risk buyers and the high-risk SMEs. Nafin also provides refinancing to banks which participate in the factoring programme. Nafin does not factor accounts receivable directly. Nafin's assets grew to $26.75 billion in 2003, from assets of $23.9 billion in 2000. The surplus for the same period was $13.23 billion, after showing a deficit of $429 million in 2000; thus a tremendous turnaround was made in the books of Nafin as a result of factoring facilities it had created. Nafin is able to cover its costs through the interest that it charges the participating banks for refinancing capital. Factoring services are offered on a non-recourse basis.

Nafin offers various products, one of which is the normal factoring agreement and another is called "contract financing". Contract financing is the type of financing where factors can extend credit to SMEs prior to service delivery. SMEs therefore receive up to 50 percent of confirmed contract orders to buy raw materials to be used in the production process, without any collateral or fees and at a fixed interest rate[36] . The paper nevertheless focuses on the normal factoring service, since the Namibian factoring market is still in an infant stage.

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[35] This section is largely adapted from Klapper, 2006.

[36] Usually at seven percent above the bank rate.

Terms and conditions of contracts

Transactions are done electronically between the factor and the supplier, thus SMEs which participate in the programme must have a bank account. After the funds are transferred to the SME upon the sale of the receivables to the factor, the factor becomes the creditor. It therefore collects the amount directly from the buyer within 30-90 days. The SMEs which participate in the Nafin programme must have an account with a bank which is related to the supplier's low-risk buyer. The reputation and relationship between the low risk buyer and the SMEs can therefore improve. In addition, it allows SMEs to negotiate better terms such as extending the payment terms from 30 to 60 or even 90 days (Klapper, 2006).

Costs of factoring services

The factoring services which Nafin facilitates are offered without additional collateral or service fees. The maximum interest rate which could be charged is on average, the bank rate plus seven percent or five percent. This rate is about eight percent below the commercial bank rates. Thus, the Nafin programme is also cheaper than traditional commercial bank lending, as Nafin pays for all the costs involved in operating the electronic factoring platform and the legal work. Such services include preparations and transfers of documents (Klapper, 2006). Since the buyers outsource their accounts payable to the factor, it also means that they can decrease their administrative and processing costs.

Default

Default rates are low, since factors communicate directly with the buyers. The risk factor which occurs sometimes is the dissatisfaction of buyers with the goods or services delivered by SMEs and therefore return them. To solve this, Nafin require participating SMEs to have a certain performance record. The buyer then pays future receivable payments to the factor and adjusts the amount of the negotiable documents on future receivable payments, which are posted on the website, (Klapper, 2006).

Success factors

In the Nafin programme approximately 98 percent of all the services are provided electronically; this eliminates time and labour costs and therefore also improves security (Klapper, 2006). Transactions within this programme are completed within 3 hours and funds are credited to the supplier's account by the close of business. SMEs are therefore able to meet their working capital requirements immediately. Since it is an electronic platform which provides access to all the banking institutions, independent finance companies and SMEs through the internet, it is easily accessible even to the rural SMEs.

Appendix C: Case study of factoring and leasing in Burkina Faso[37]

Burkina Bail offers factoring and leasing services to SMEs in Burkina Faso and despite the fact that the country is regarded as one of the poorest countries in the world[38]. The word "Bail" means "leasing" in French and it therefore emphasises the main product that is being offered by Burkina Bail. The company offers leasing services for a wide variety of equipment, which ranges from basic office equipment to highly specialised medical machines. These include industrial machinery and generators, IT hardware and medical equipment, as well as vehicles such as cars, busses and trucks. Only 2 percent of Burkinabés have bank accounts, whilst it is estimated that 44 percent of the families make use of informal finance systems.

Institutional framework

Burkina Bail was established in 1996 as a joint initiative between the Banque Internationale de Burkina (BIB), which is the largest bank in Burkina Faso, the Finance for Development (FMO), a development Bank based in the Netherlands, and Cauris Investissement, a private equity firm. Burkina Bail was established to support the establishment, growth and survival of SMEs through the provision of financial services. Burkina Bail is a non-bank financial institution (NBFI) which offers medium-term loans, micro-leasing, auto-leasing and factoring.

Terms and conditions of contracts

SMEs which are clients of Burkina Bail lease equipment through the payment of monthly instalments rather than one single lump sum, and the term of repayment is over 24 to 36 months. Clients are not required to provide collateral for leasing agreements, as Burkina Bail regards the equipment itself as collateral.

Costs of factoring and leasing services

The costs are calculated on an individual basis by considering the expected costs of supplying the service to the client, the likely interest rate to be charged as well as the level of risk involved. Before signing the contract, the client is fully informed about the resultant margins. SMEs which have a longer partnership with the company are charged lower rates.

Default

Burkina Bail has had a low default value, as 76 percent of the total loan repayments are made on time, whilst loan repayments outstanding for 60-90 days were 19 percent and those outstanding for more than 90 days amounted to 5 percent in 2005. Factoring constitutes 31 percent of Burkina Bail's total disbursements.

Success factors

Burkina Bail has a personal relationship with clients and practises an open-door policy. The company not only provides financial services to the clients, but also conducts regular

[37] This section is mainly based on information received from the FinMark Trust.
[38] In the UNDP 2006 Human Development Index, Burkina Faso was ranked 174th out of 177 countries.

follow-ups, such as checking on the leased equipment and offers advice on, and insight into, the local market. Initially when it was established, Burkina Bail only offered leasing services. It has nevertheless expanded and is now also offering medium-term credit and factoring services.

Burkina Bail has offered credit to more than 500 SMEs to date. Clients of Burkina Bail are widespread, with approximately 60 percent based in the capital, about 30 percent in Bobo-Dioulasso and 10 percent elsewhere in the country. Burkina Bail's net profits increased from 85 million CFA (US$170 000) in 2003 to 119.5 million CFA (US$239 000) in 2006. The company's total assets in 2005 amounted to 8137 million CFA, while its total loans to clients amounted to 8377 million CFA. Burkina Bail is the first and only company offering factoring services in Burkina Faso. Burkina Bail is also starting to offer real estate leasing, which is seen as a potentially lucrative business area.

Challenges to Burkina Bail

A lack of funding is a great impediment to the growth of Burkina Bail. This hindrance is mainly influenced by the current economic climate, the financial sector development, and the fiscal and legal frameworks in the country. Burkina Bail is dependent on quasi-commercial funding from investment banks (mostly overseas investment banks) and other financial institutions. Local banking institutions are not involved to a large extent in Burkina Bail's operations. This is a drawback to the company's operations as it is not able to reach a wider clientele.

Appendix D: Survey on assessing the demand for the services of Factoring[39] and Leasing[40] companies amongst Namibian SMEs

PART A: DEMAND FOR FACTORING SERVICES

BACKGROUND INFORMATION

a) Could you indicate the economic sector in which your business is operating?

Food Manufacturing, Selling and Catering	
Textiles and Leather Manufacturing	
Joinery and Carpentry	
Information and Communication Technology	
Transport	
Metal and Mechanical Manufacturing	
Hospitality, Tourism and Crafts	
Body Care, Health, Creches	
Construction, Maintenance, Carpentry	
Other (indicate)	

b) What is the legal form of your company?

(i) Sole Proprietorship

(ii) Pty Limited

(iii) Other (indicate)

c) What is the annual turnover of your business?

Turnover Categories	Indicate turnover Category
Less than N$250,00	
Between N$250,000 and N$500,000	
Between N$500,000 and N$1,000,000	
Between N$1,000,000 and N$2,000,000	
Above N$3,000,000	

39 Factoring normally occurs when a supplier sells products to a distributor and extends trade credit to the latter, usually for a period of between 30 to 90 days. This phenomenon in effect implies that the supplier is financing the distributor's inventory and is thus directly or indirectly involved in the credit risk assessment process of the distributor

40 Leasing is a means of helping SMEs make use of equipment without having to own it.

d) Do you sell to your clients on credit terms (i.e. deliver goods with payment to be cashed in after a certain period of time?

YES ☐ NO ☐

e) If the answer is YES, what are the terms?

Less than 15 days	
Between 15 and 30 days	
Between 30 and 60 days	
Between 60 and 90 days	
Over 90 days	

f) What are the conditions which accompany the credit terms?

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g) How do you finance the working capital requirements of your business?

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……………………………………………………………………………………………

h) Do you think you have enough collateral to cover investment and working capital loans?

YES ☐ NO ☐

i) Do you think that your sales would have been higher if you had more working capital?

YES ☐ NO ☐

j) If the answer to (i) above is YES, do you think that factoring could play an important role in providing more working capital?

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k) If factoring is offered, which do you think would be the relevant institution to offer it?

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PART B: DEMAND LEASING SERVICES

a) Have you heard of leasing companies?

YES ☐ NO ☐

b) If you had an option of buying or leasing equipment used in the production process what would you choose?

BUYING ☐ LEASING ☐

c) If you choose the leasing option in (b) above, would you prefer to be given the option to buy the equipment at the end of the leasing period?

YES ☐ NO ☐

d) Do you think that leasing of equipment without necessarily owning it would increase your operational cost?

YES ☐ NO ☐

e) Do you think that leasing of production equipment will decrease your operational costs?

YES ☐ NO ☐

Appendix E: Survey on the suppliers of Factoring[41] and Leasing[42] services to Namibian SMEs

PART A FACTORING: SUPPLY-SIDE

a) Is your institution offering factoring services?

YES ☐ NO ☐

b) If the answer to (a) above is YES, at what cost (price) do you offer such services?

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…………………………………………………………………………………………

c) Are you aware of factoring services?

YES ☐ NO ☐

d) If the answer in (c) above is NO, are you willing to offer such services and at what cost?

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e) Would you as a financial institution consider offering factoring services to the SMEs?

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f) Do you have any general observations on factoring?

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41 Factoring normally occurs when a supplier sells products to a distributor and extends trade credit to the latter, usually for a period of between 30 to 90 days. This phenomenon in effect implies that the supplier is financing the distributor's inventory and is thus directly or indirectly involved in the credit risk assessment process of the distributor.

42 Leasing is a means of helping SMEs make use of equipment without having to own it.

PART B LEASING: SUPPLY-SIDE

a) Do you offer leasing services to SMEs?

YES ☐ NO ☐

b) If the answer to (a) above is YES, at what cost (price) do you offer such services?

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c) Are you aware of leasing services?

YES ☐ NO ☐

d) If the answer in (c) above is NO, are you willing to offer such services and at what cost?

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……………………………………………………………………………………………

e) Would you as a financial institution consider offering leasing services to the SMEs?

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f) Do you have any general observations on leasing?

……………………………………………………………………………………………

……………………………………………………………………………………………

Thank You

Appendix F: List of people consulted

Name of Person	Position	Institution
1. Mr. G.D. Marais	Deputy MD	Standard BankNamibia
2. Mr. A. Basson	Executive	Bank Windhoek
3. Mr. J.Hill	MD	Bank Windhoek
4. Mr. C.Mathee	Specialist	Bank Windhoek
5. Ms. P. Malherbe	Executive Corporate	Nedbank Namibia
6. Ms. K. Ndilula	National Manager: ESME	Bank Windhoek
7. Mr. J. Mwatotele	MD	Savy Finance and Leasing
8. Mr. T. Lombardt	MD	TML Financial Services
9. Mr. A.G. Piechuzech	CEO	M.Trading cc
10. Mr. P.Kamwanga	Branch Manager	Norman, Basset and Associates
11. Mr. L. Haynes	CEO	First National Bank Namibia
12. Mr. A. Ipinge	Head of SME Department	First National Bank Namibia
13. Mr. E. Masule	Manager SME Department	First National Bank Namibia
14. Mr. P.J. Tromp	CEO	Namibian Factors & Shippers
15. Mr. G. Ellis	Manager	Namibian Factors & Shippers
16. Mr. A. Pretorius	Director	Corporate Equipment Rentals (Pty) Ltd
17. Mr. A. de Jager	Director	Corporate Equipment Rentals (Pty) Ltd
18. Mr. D. Ashikoto	MD	AZ Africa
19. Mrs. W. February	Manager	W.February Upholstery
20. Ms. R. Hidulika	Owner	Wanderzone Tours
21. Ms. C.Pakote	CEO	Desert Rose Beauty Cosmetics
22. Ms. G. Finis	Owner	GFG Slasto Supplies
23. Mr. J. Levi	CEO	Rent-A-Chef
24. Mr. D. Nel	Manager	Dawid Nel Quantity Surveyor
25. Ms. A. Butkus	Owner/Manager	Omautiro Detergents
26. Mr. D.A. September	MD	Capital Press (Pty) Ltd
27. Ms. A. Alberts	MD	Jarman Funeral Services
28. Mr. N. Nembia	Owner	Namibia Furniture Manufacturers
29. Mr. H.Nanyeni	Owner	Spotman Centre
30. Mr. G. Schmidt	Owner	Global Glass
31. Mr. V. Malaquia	Owner	Africa Panel Beating
32. Mr. A. Kadhila	Owner	Master Cupboards
33. Mrs. S. Shivute	MD	C H Alabama
34. Mrs. K.Kandombo	Manager	Omukumo Natango Enterprises
35. Mrs. E.N. Pea	Owner	Pena Manufacturers
36. Mr. O.Valombola	Owner	Valombola Auto Electric
37. Mr. A.Deberti	Managing Member	Ondangwa Service Station cc
38. Mr. S.P. Sheehama	MD	Zionist Funeral Services

Name of Person	Position	Institution
39. Mr. J.N.Simon	Manager	Glass Fibre
40. Mr. S.Ambunda	Owner	Shayela Soaps and Paper Converters
41. Mr. S.Kumar	Owner	Kuku Agri Equipment cc
42. Mrs L. Tuutaleni	Manager	Dr. Shafiishuna.S. Nujoma Multi Project
43. Mr. D.Fortun	MD	Deon Auto Repairs
44. Ms. M.Denovrega	Manager	Countrywide Butchery
45. Ms. E.M. Arangies	Owner	Ondangwa Stationery
46. Mr. T. Mundjele	Owner	Onakathilo
47. Mr. Vermeulen	Manager and Owner	Ondangwa Plastic Converters
48. Messrs Van Zyl and Boshoff	Partners	BZ Truck Repair
49. Mr. E. Shaniika	Owner and Manager	Eskon TT Services
50. Mr. E.P. Shiimi	Owner	Chem Paints