

EFFECTS OF CAPPING LAW ON TRADE CREDIT SECTOR

Presentation by:

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Discussion



- ✓ Have you personally felt any effect of interest?
- ✓ Have you felt the effect on your organization?
- ✓ Is it an opportunity or threat for trade credit providers?

Introduction of capping Law



- ✓ Signed into law on 25th August 2016
- ✓ Took effect in Sept 2016.
- ✓ Banks lending interest rates capped at 4% above the CBR rate.
- ✓ CRB rate currently at 10.5 per cent.
- ✓ Banks are also compelled to pay 7.35% interest on deposits.

Impact of the Capping Law



- ✓ Decline in **Private Sector Credit Growth** from 5.4% in Sept to 2.1% in march 2017.
- ✓ Decline in total amounts of commercial banks loan growth from 15.7% in Q1 2016 to 7.1% in Q1 2017.
- ✓ Increased average cost of loans by banks arising from other charges.

Bank financing for Working Capital



Bank loans accounts for over 95.0% of funding.

Composition of Bank Loans product

Overdraft	43.4%
Term loans (above 24 months)	24.7%
Asset finance	19.3%
Term loans (Less than 24 months)	10.2%
Trade Finance	2.3%
Other	0.1%

Alternative Sources of short-term funds for Working Capital



- ✓ Capital Markets
- ✓ Trade credit
- ✓ Factoring
- ✓ Invoice discounting
- ✓ Advances from customers

Trade Credit as a Source of Capital



What is Trade Credit?

- ✓ It refers to providing goods and services on credit to customers for payment at a future date.

Types of Trade Credit

- ✓ Commercial credit e.g. goods to retailers
- ✓ Consumer credit e.g. Okoa Jahazi,

Trade Credit as an Alternative Source of Capital



TRADE CREDIT



IN ESSENCE, THE SELLER IS MAKING A SHORT-TERM LOAN TO THE PURCHASER

Trade Credit Opportunities from Capping Law



- ✓ Financing gap arising from restricted credit to businesses. Total gross loans: **Kes.2.293 trillion** in 2016 from **Kes.2.165 trillion** (5.9% increase)
- ✓ No regulation on the margin for risk. Shorter repayment time for trade credit eliminates any delinquency
- ✓ It is a strategic way of increasing revenues

Trade Credit Risks



Trade Credit Risk

- ✓ **The time given to pay** ---the longer the time of payment allowed, the higher the risk of non-payment.
- ✓ **The amount owed** ---the higher the amount owed, the higher the risk is of losing profit and the investment in the product.

Determinants of Trade Credit



- ✓ Size of firm (buyers)
- ✓ Level of competition
- ✓ Nature of product and services
- ✓ Financial position of the seller
- ✓ Financial position of the buyer
- ✓ Cash discount

Challenges with Trade Credit



- ✓ Diversion of cash generated to fund working capital.
- ✓ Dispute in invoices or quality of goods
- ✓ Overtrading may result in business collapse.
- ✓ Risk of customers switching suppliers to avoid payment.
- ✓ Increased liquidity required.

Cost of Trade Credit



- ✓ Cost of financing credit sales
- ✓ Cost of financing credit department and collection procedures.
- ✓ Cost of financing late /extended payments.
- ✓ Cost of financing bad debts (non payments).

Impact of Delayed payments on Trade Credit



Debts owed to KAM members by Retailers (Dec 16)

Days	Amount of Outstanding Debts
Less 60 days	Kes.350 million
Over 60 days	Kes.1.6 billion
Unclear period	Kes.14 million
Total	Kes.1.95 billion

Impact of Delayed payments on Trade Credit



Debts owed to 22 Suppliers by Retailers (Dec 16)

Days	Amount of Debts	% of Debt
Less 30 days	Kes.246 million	31%
30 days	Kes.210 million	27%
60 days	Kes.72 million	9%
90 days	Kes.63 million	8%
Above 90 days	Kes.201 million	25%
Total debts	Kes.792 million -	

Impact of Delayed payments on Trade Credit



Debts Owed by Retailers to 22 local suppliers

Retailer	Amount of Debt	% of total debt
A	Kes.278 million	35%
B	Kes.174 million	21%
C	Kes.123 million	16%
D	Kes.86 million	11%
E	Kes.35 million	4%

Default Experiences of Trade Creditors



Company A Ltd

- ✓ Incorporated in 2009
- ✓ Line of business: manufacture of honey products
- ✓ Took a loan of Kes.5 million to sustain production.
- ✓ The company closed down in March 2017 due to late payments from retailers.

Default Experiences of Trade Creditors



Company B Limited

- ✓ Incorporated in 2001
- ✓ Line of business: specialized engineering services
- ✓ The outstanding debt (Ksh.68 million) accounted for 90% of the company's total receivables
- ✓ Due to delayed payments, the company resorted to borrowing to bridge the cashflow gap.

Default Experiences of Trade Creditors



Company C Limited

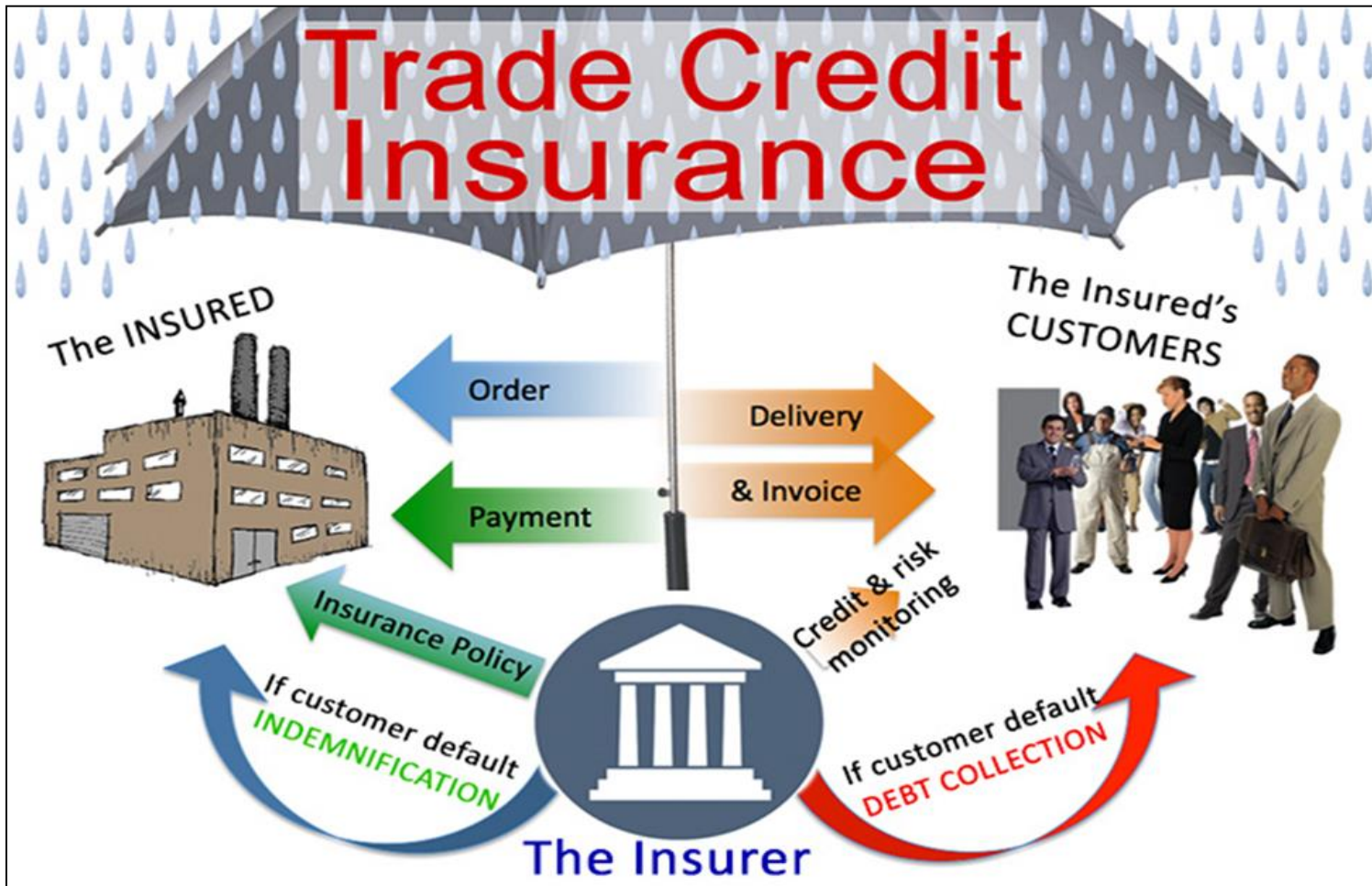
- ✓ Line of business: deals in air and gas compressors, petrol pumps and petroleum equipment.
- ✓ Debts more than 60 days: Kes.6 million.
- ✓ Debts less than 60 days: Kes.12 million by April 2017.
- ✓ The company resorted to borrowing at high cost to mitigate cashflow challenges.

Risk Mitigation Measures



- ✓ Credit Risk insurance e.g. African Trade Insurance Agency (ATIA)
- ✓ Factoring e.g. Premier Capital, Biashara factors Ltd.
- ✓ Credit information sharing
- ✓ Debt collection
- ✓ Bank guarantee and letter of credit.

Trade Credit Insurance



When to avoid Trade Credit



- ✓ No credit policy in place
- ✓ No mechanism to handle late payments
- ✓ No access to affordable working capital to finance trade credit.
- ✓ Procure or rely on trade credit for raw materials
- ✓ When facing liquidity challenges

Risky Customers to avoid for Trade Credit



- ✓ Government agencies, contractors and suppliers
- ✓ Businesses with liquidity challenges
- ✓ Retail sector players
- ✓ Newly formed companies /businesses
- ✓ Businesses in expansion phase

Thank You....



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