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Headline: Chinese factoring market set to grow to over USD 3tr in size

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Strategic Considerations: The Chinese factoring market is on track to reach CNY 20tr (USD 3.12tr) by 2021, according to Qianzhan Intelligence, with growth focused on small to mid-sized enterprises which Beijing wants to become a larger part of the economy. Frost & Sullivan predicts that China will have more than 538,400 small and medium-enterprises by 2020, partly due to Chinese policies that encourage entrepreneurship.

Frost & Sullivan predicts turnover of commercial factoring will increase at an annual rate of 53.1% to CNY 1.75tr (USD 273.27bn) in 2020 from CNY 207.7bn (USD 32.4bn) in 2015.

Since 2012, the number of registered commercial factoring companies in China has increased from 45 in 2012 to over 6,641 as of June 2017

Demand for supply chain financing and factoring should continue to grow, this despite double digit yields that can reach up to 20% and average around 12%, according to different data providers and Sheng Ye Capital Chairman Jeff Tung.

The size of China's supply chain financing and factoring market could reach CNY 20tr (USD 3.12tr at today's exchange rate) by 2021, according to a research report from Qianzhan Intelligence. Frost & Sullivan predicts the turnover of commercial factoring will increase at an annual rate of 53.1% to CNY 1.75tr (USD 273.27bn) in 2020 from CNY 207.7bn (USD 32.4bn) in 2015.

In comparison, the nearly 300 members of the Factors Chain International industry association factored a total of USD 1.52tr globally in 2016, according to the group's statistics. According to FCI, China is already the country with the highest volume of factoring and will be larger than all of Europe by 2020.

The accounts receivables of industrial enterprises above a designated size (with annual turnover of over CNY 20m) rose 8.1% YoY to CNY 13.9tr (USD 2.17bn) as of November 2017, according to data provided by the National Bureau of Statistics. Frost & Sullivan predicts China will have more than 538,400 small and medium-enterprises by 2020, partly due to Chinese policies that encourage entrepreneurship.

This helps explain why the number of Sheng Ye Capital's clients increased to 110 as of 30 September 2017 from 65 as of 31 December 2016. However, the company has been more focused on lending to SOEs and their smaller suppliers which have good credit ratings to minimize the risk of nonperforming assets. The strategy has kept non-performing assets low, with only one overdue account as of 30 September, 2017, according to the firm's latest quarterly report.

Net interest margins, however, were 13.6% in 2015 and 9.1% in 2016, and the average service fee was 0.33% in 2015 and 0.82% in 2016, this due to the double digit rates charged on the loans.

"It is not just about charging a higher rate, but to lower the financing cost which is relatively high in China," Tung said. His firm has focused on factoring and supply chain financing, two areas ripe for growth in a nation where smaller companies are becoming a larger part of the economy and are mostly cut-off from traditional credit.

The Ministry of Commerce in 2012 released the commercial factoring pilot project in areas including Binhai New Area in Tianjin and Pudong New Area in Shanghai to optimize the use of foreign funds for supply chain financing and to support mid- to small-sized enterprises.

Since then, the number of registered commercial factoring companies in China has increased from 45 in 2012 to over 6,641 as of June 2017, according to the Commercial Factoring Expertise Committee of China Association of Trade in Services. However, only 1,000 of all registered commercial factoring companies are in operation due to the need for expertise in compliance, risk management and credit review, according to a local report.

In contrast to traditional commercial lenders that ask for fixed asset collateral, Sheng Ye prices its factoring services by assessing the trade background and the quality of the accounts receivable. Establishing a close business relationship with its clients, Sheng Ye develops its own database with reference to key financial data and previous trading record, which can be used to evaluate other business opportunities.

“Taking a supplier of CNOOC as an example, we need to know whether this company has supplied the same cargo to CNOOC before, the pricing terms of cargo that they trade, and the pricing trend over the past few years to evaluate whether the invoice is authentic,” Tung said. “Sometimes they may want to inflate the cargo value just to get more credit. We also need to know where they store the cargo, because we need to verify whether the cargo is really there.”

by Cecilia AuYeung