AbdulJaami, PLLC
International Commercial Transactions

Account Receivable Loan

An account receivable loan can be used to get cash by borrowing against outstanding accounts receivable. This particular form of accounts receivable financing helps rapidly growing businesses cover inventory and labor costs. Accounts receivable loans are particularly helpful to (i) rapidly growing businesses; (ii) well-capitalized businesses that are experiencing a decrease in profitability; and (iii) businesses looking to raise money off balance sheet.

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Accounts Receivable Financing

An account receivable loan can be thought of as a way to speed up the cash collection process. Your accounts receivable are used to collateralize a revolving loan. The account receivable loan provides your business with a flexible, revolving source of cash.

For example, a bank or commercial finance company might agree to extend a loan based on your accounts receivable. Let's assume the lender agrees to provide you with 80% of the value of your accounts receivable. Let's also assume that in month 1 you generate 60-day accounts receivable valued at US$100, and in month 2 you generate 60-day accounts receivable valued at US$200. Then, based on the agreement, in month 1 you would have access to US$80 of extra cash, and in month 2 up to US$160 of extra cash.

In the above example, the US$80 and US$160 in immediately available cash represents 80% of the cash that, but for the account receivable loan, you would have to wait maybe 60 days for. Once the accounts receivable are collected, the lender will give you the difference between the accounts receivable collections (e.g. US$100) and the extension of funds (e.g. US$80), minus the fee for its services.

Who Benefits from Accounts Receivable Financing?

Three types of businesses can benefit from account receivable loans:

- **Weakening Well-capitalized Businesses**: well-capitalized businesses that were once profitable, but have hit a rough patch, may use an account receivable loan to cover deficiencies in capital that are a result of recent losses.
- **Strong Businesses with Substantial Debt**: financially strong businesses that have substantial unsecured borrowings and, possibly due to debt covenants, need to raise cash off balance sheet. These businesses can look to an account receivable loan structured as a sale of receivables.
- **Rapidly Growing Businesses**: businesses that have rapidly growing sales and strong profits, but need to speed up cash collections to cover immediate cash demands such as labor and inventory costs.

Basic Features of an Account Receivable Loan

What Accounts Receivable will the Lender lend against?

1. Accounts receivable from a customer located in a jurisdiction where the lender is familiar and comfortable with the direct collection of receivables, through legal process if necessary.

2. Accounts receivable generated by a customer that has accepted your goods or services and does not have any disputes or claims regarding the goods or services.
3. Accounts receivable generated by a customer whose credit is acceptable to the lender.
4. Accounts receivable that are not more than a certain number of days old or, in some cases, past due. The age of the receivable is measured from the date of the invoice.
5. Accounts receivable that were the result of a valid sale in the ordinary course of business.
6. Accounts receivable that are legally enforceable and not subject to any offsets, deductions or counterclaims.
7. Accounts receivable that are not the result of sales made to your company's subsidiaries, or parent company, or other entities under common control with your company.

How Much Money can You expect to Receive?

The lender, either a bank or a commercial finance company, will analyze your receivables and come up with a formula that determines how much cash will be advanced to you. Based on the formula, the lender will provide you with the cash value of some percentage of your receivables. Generally, the account receivable loan is equal to 80-95% of qualified accounts receivable. In some cases, the lender will allow you to borrow 100% or more of the value of the underlying accounts receivable. This is known as an over-advance.

What is the Cost of an Account Receivable Loan?

Account receivable lenders generally charge an interest rate of 1-6 percentage points above the bank prime rate. The expense of an account receivable loan is directly related to the cost of sometimes daily accounts receivable monitoring and loan management costs.

Interest is usually computed based on actual days relative to a 360 day year. The lender will typically collect interest payments by charging your loan account on a monthly basis.

How Will an Account Receivable Loan Affect Your Customer Relationship?

Your customers will not know that you are using your accounts receivable to raise financing. Unless you default on the loan, you continue to be in control of collecting payments from your customers. The lender may either request that you forward customer payments to the lender or have customers send their payments directly to a lockbox account.

Account Receivable Loan – Bank Finance or Commercial Finance?

Convert Accounts Receivable into Cash

Both banks and commercial finance companies provide accounts receivable financing in the form of account receivable loans. There are some fundamental differences in the way the two operate. Commercial finance companies tend to monitor account receivable loans with more frequency than banks. For a company that is unable to secure an account receivable loan from a bank, the resulting higher borrowing costs tend to be an acceptable cost of doing business.

See the below table for a comparison of typical bank and commercial finance lender loan transaction characteristics.

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	Bank	Commercial Finance Co.
Direct Loan to Borrower?	Yes	Yes
Revolving Loan?	Yes	Yes
Frequency of Cash Advances and Loan Fluctuation	Weekly or Monthly	Daily
Loan evidenced by Promissory Note?	Yes. Bank records Borrower's obligation on a single promissory note each time cash is advanced (a grid note)	No. Due to the frequency of loans, Borrower's obligation evidenced solely by the financing agreement and the books and records of the Lender
Loan collateralized by a continuing security interest in borrowers present and future accounts receivable?	Yes	Yes
Borrower required to deliver customer checks to Lender or have customers forward payments to a lockbox?	No	Yes
Borrower's customers notified about the account receivable loan?	No	No
Frequency that Lender maintains records and monitors accounts receivable	Weekly or Monthly	Daily
Frequency that borrower must be in compliance	Weekly or Monthly	Daily
Cash advanced as a percentage of accounts receivable based on a lending formula?	Yes	Yes

Need Help With Your Account Receivable Loan?

To learn more about how we can help you with your account receivable loan, visit www.shajlaw.com and click on "Learn More."

If you have found this accounts receivable financing article to be helpful, please forward the link to a friend or colleague.

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