

Accounts Receivable Financing- Don't Worry, Be Happy

Contributed by Gregg Elberg
Wednesday, 30 May 2007

Accounts Receivable Financing- "Don't Worry, Be Happy" explores the issues of notification vs. non-notification accounts receivable financing, why some businesses fear that their customers may learn that they are using factoring services, and why worrying about these concerns is usually not justified.

{mosbotwordcount}

There is a reason why accounts receivable financing is a four thousand year old financing technique: it works. Accounts receivable financing, factoring, and asset based financing all mean the same thing as related to asset based lending- invoices are sold or pledged to a third party, usually a commercial finance company (sometimes a bank) to accelerate cash flow.

{bot_wrgoogle}In simple terms, the process follows these steps. A business sells and delivers a product or service to another business. The customer receives an invoice. The business requests funding from the financing entity and a percentage of the invoice (usually 80% to 90%) is transferred to the business by the financing entity. The customer pays the invoice directly to the financing entity. The agreed upon fees are deducted and the remainder is rebated to the business by the financing entity.

How does the customer know to pay the financing entity instead of the business they are receiving goods or services from? The legal term is called "notification". The financing entity informs the customer in writing of the financing agreement and the customer must agree in writing to this arrangement. In general, if the customer refuses to agree in writing to pay the lender instead of the business providing the goods or services, the financing entity will decline to advance funds.

Why? The main security for the financing entity to be repaid is the creditworthiness of the customer paying the invoice. Before funds are advanced to the business there is a second step called "verification". The finance entity verifies with the customer that the goods have been received or the services were performed satisfactorily. There being no dispute, it is reasonable for the financing entity to assume that the invoice will be paid; therefore funds are advanced. This is a general view of how the accounts receivable financing process works.

Non-notification accounts receivable financing is a type of confidential factoring where the customers are not notified of the business' financing arrangement with the financing entity. One typical situation involves a business that sells inexpensive items to thousands of customers; the cost of notification and verification is excessive compared to the risk of nonpayment by an individual customer. It simply may not make economic sense for the financing entity to have several employees contacting hundreds of customers for one financing customer's transactions on a daily basis.

Non-notification factoring may require additional collateral requirements such as real estate; superior credit of the borrowing business may also be required with personal guarantees from the owners. It is more difficult to obtain non-notification factoring than the normal accounts receivable financing with

notification and verification provisions.

Some businesses worry that if their customers learn that a commercial financing entity is factoring their receivables it may hurt their relationship with their customer; perhaps they may lose the customer's business. What is this worry, why does it exist and is it justified?

The MSN Encarta Dictionary defines the word worry as:

“Worry

verb (past and past participle wor•ried, present participle wor•ry•ing, 3rd person present singular wor•ries) Definition: 1. transitive and intransitive verb be or make anxious: to feel anxious about something unpleasant that may have happened or may happen, or make somebody do this

2. transitive verb annoy somebody: to annoy somebody by making insistent demands or complaints

3. transitive verb try to bite animal: to try to wound or kill an animal by biting it

a dog suspected of worrying sheep

4. transitive verb

Same as worry at

5. intransitive verb proceed despite problems: to proceed persistently despite problems or obstacles

6. transitive verb touch something repeatedly: to touch, move, or interfere with something repeatedly

Stop worrying that button or it'll come off.

noun (plural wor•ries) Definition: 1. anxiousness: a troubled unsettled feeling

2. cause of anxiety: something that causes anxiety or concern

3. period of anxiety: a period spent feeling anxious or concerned...”

The opposite is:

”not to worry used to tell somebody that something is not important and need not be a cause of concern (informal)

Not to worry. We'll do better next time.

no worries U.K. Australia New Zealand used to say that something is no trouble or is not worth mentioning (informal)”.

Query: if a business is financing their invoices with accounts receivable

financing, is this an indication of financial strength or weakness? Query: from the point of view of the customer, if you are buying goods or services from a business that is factoring their receivables, should you be concerned? Query: is there one answer to these questions that fits all situations?

The answer is it's a paradox. A paradox is a statement, proposition, or situation that seems to be absurd or contradictory, but in fact is or may be true.

Accounts receivable financing is both a sign of weakness with regard to cash flow and a sign of strength with respect to cash flow. It is a weakness because, prior to financing, funds are not available to provide cash flow to pay for materials, salaries, etc. and it is an indication of strength because, subsequent to funding cash is available to facilitate a business' needs for cash to grow. It is a paradox. When properly structured as a financing tool for growth at a reasonable cost, it is a beneficial solution to cash flow shortages.

If your entire business depended on one supplier, and you were notified that your supplier was factoring their receivables, you might have a justifiable concern. If your only supplier went out of business, your business could be severely compromised. But this is also true whether or not the supplier is utilizing accounts receivable financing. It's a paradox. This involves matters of perception, ego and character of the personalities in charge of the business and the supplier.

Every day, every month thousands of customers accept millions of dollars of goods and services in contracts that involve notification, verification and the factoring of receivables. For most customers, "notification" of accounts receivable financing is a non-issue: it is merely a change of the name or addresses of the payee on a check. This is a job for a person in the accounts payable department to make a minor clerical change. It is a mainstream business practice.

Bobby McFerrin wrote and performed a song called "Don't Worry, Be Happy" for the movie "Cocktails" starring Tom Cruise. The song was a number one U.S. pop hit in 1988 and won the Grammy for Best Song of the Year. Here are the lyrics:

"Here is a little song I wrote

You might want to sing it note for note

Don't worry be happy

In every life we have some trouble

When you worry you make it double

Don't worry, be happy.....

Ain't got no place to lay your head

Somebody came and took your bed

Don't worry, be happy

The land lord say your rent is late

He may have to litigate

Don't worry, be happy
Look at me I am happy
Don't worry, be happy
Here I give you my phone number
When you worry call me
I make you happy
Don't worry, be happy
Ain't got no cash, ain't got no style
Ain't got not girl to make you smile
But don't worry be happy
Cause when you worry
Your face will frown
And that will bring everybody down
So don't worry, be happy (now).....

There is this little song I wrote
I hope you learn it note for note
Like good little children
Don't worry, be happy
Listen to what I say
In your life expect some trouble
But when you worry
You make it double
Don't worry, be happy.....
Don't worry don't do it, be happy
Put a smile on your face
Don't bring everybody down like this
Don't worry, it will soon past
Whatever it is
Don't worry, be happy”

The bottom line: “notification” should not be an issue in most situations involving accounts receivable financing; non-notification factoring is another option that is available for businesses concerned with confidentiality that meet

minimum credit standards for asset based lending. Bobby McFerrin was right: "Don't Worry, Be Happy".

Copyright © 2007 Gregg Financial Services

www.greggfinancialservices.com

Mr. Gregg Elberg is a licensed attorney and licensed real estate broker. Gregg Financial Services is a full service brokerage for commercial finance companies and banks that fund B2B businesses. Mr. Elberg arranges funding from \$25,000 to \$50 million per month at competitive pricing, and works to reduce your financing costs as your company grows. For more information about GFS, please visit our website:

www.greggfinancialservices.com