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AR Purchase: A Financial Supply Chain Tool for Treasurers

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Corporate treasurers work diligently to arrange the tools needed to manage and fund their firms' activities. Liquidity sits among the core points on which they focus, yet opportunities may exist to accelerate liquidity that lies dormant. Selling your receivables can accelerate cash conversion and address risks of concentration and foreign account debtors.

One company's receivable is another's payable. Every company trades on both sides as buyer (debtor) and supplier (creditor). Determining terms of trade is an art that balances customer or supplier responsiveness against a firm's ability to manage its own liquidity.

But when does this art become a science? Your bank's approach to financial supply chain management should reflect the evolving and growing nature of this discipline in which organisations shape their trade to support liquidity, working capital, and efficiency objectives amongst trading partners.

Accounts receivable (AR) purchase is one of the critical management tools for trading partners that is often misunderstood and underutilised.

Understanding AR Purchase

Selling AR transfers the asset from the corporate balance sheet to that of the purchaser, most likely a bank partner. Doing so offers a number of advantages, but requires organising challenges to create a solution.

AR purchase, as opposed to factoring, requires that corporates also have the ability and the willingness to service the AR on an ongoing basis. True sale treatment is required and the accounting must be symmetrical: what the corporate shows and what the bank shows must correspond on their respective books of account.

Benefits

Your bank's liquidity products satisfy a variety of needs for treasurers, but can leave substantial gaps. Selling receivables can fill those gaps by driving strategic client metrics related to cash flow, balance sheet management, and days sales outstanding (DSO), generating liquidity without creating bank debt.

Selling AR associated with a limited number of obligors and segments can help corporates gain extra liquidity. For example, in a borrowing base or securitisation programme with limits for concentration or foreign domicile of the account debtor, your bank may allow for domestic and foreign account debtors.

For your banks, AR purchase can expand and intensify their relevance to your client. Forces present in today's banking environment work against loan growth. Because of the uncommitted nature of these facilities, selling AR increases a bank's funded credit exposure, and does so in a very capital-efficient manner. This creates a win-win for you and your bank.

Selling receivables can apply broadly across a wide range of companies, including market companies and large multinationals, as well as companies that are highly-levered and depend on a tightly controlled borrowing base for liquidity. Generally, banks have good appetite to buy their clients' receivables owed by account debtors that are investment grade or clients of their institution, as long as the AR seller has sound credit and collection abilities.

Consider the example of a supplier of low-cost products that sells to several large retailers or original equipment manufacturer (OEMs), which borrow using a very traditional asset-based formula. Because the company has three or four names that dominate its receivables, the bank limits how much it can borrow.

The client is selling to very high credit quality account debtors and has had years of successful commercial dealings with them. But like any conventional type of revolving credit facility, limits are imposed on the client if its business with those companies becomes over-concentrated.

However, let's say one of those companies is A or AA-rated and the lender limits it to 20% of a borrowing base or securitisation pool. Their bank partner otherwise likes the A or AA-rated risk. If the client has good trading history with the name, the bank could buy the receivable outside the revolving credit facility. So the client gets liquidity without having to alter their revolving credit facility, and the bank can deliver that liquidity without increasing its direct exposure to the client - another win-win.

Some banks embrace the use of credit enhancement (credit insurance, mostly) to enable purchase of AR for companies with too-high aggregation for the bank, are cross-border, or are sub-investment grade.

The cash conversion cycle on cross-border, cross-jurisdictional activity can be lengthy; it takes longer to get cash converted in an international transaction out of Peru than out of, say, Louisiana. The bank would still be open to buying those receivables to support its client. Credit insurance, of course, is not a substitute for evaluating the underlying exposure. For example, it is pretty unlikely that most banks would purchase receivables from a Ukrainian company right now, even if it was credit insured.

At a high level, corporate treasurers and chief financial officers (CFOs) want to manage their cash in an optimised way. They have a variety of tools available to help them do that as they continue to evolve their financial supply chain management approach. Selling AR offers corporate treasurers another way to accelerate liquidity, strengthen their banking relationships, and achieve the corporation's financial goals.

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