Should Your Company Purchase Accounts Receivable Insurance?

Arthur F. Rothberg, Managing Director, CFO Edge, LLC

You face many risks as the owner of a closely held business. These include market risks, like changing customer preferences and tastes that could affect demand for your products or services; competitive risks, such as the entry of new competitors into your market area or industry; and regulatory risks, including the passage of new laws and regulations that could affect the way you manufacture and/or deliver your products or services.

Of course, there are also financial risks involved in owning a business. One of the biggest of these is the risk of non-payment by one (or more) of your large customers. Even if you conduct credit checks and are diligent in collecting your accounts receivable, you may face situations in which customers simply refuse to (or cannot) pay your invoice. If the invoice is large enough, non-payment could threaten your company's very existence.

A Solution: Accounts Receivable Insurance

One of the best ways to guard against non-payment risk is to purchase accounts receivable insurance. Also known as trade credit insurance, this type of policy would pay out if one of your customers fails to pay an invoice. "On average, one in every ten invoices becomes delinquent, with many ultimately becoming an unpaid bad debt. When a major customer — or even multiple customers — defaults on a debt, there are devastating consequences to a company's cash flow, earnings, and capital," says Johnny Beenes, senior agent with Euler Hermes, the world's leading provider of accounts receivable insurance.

Johnny points out that each time you grant credit to a customer, your company is exposed to the risk of non-payment. "The key is having the right information to make informed credit decisions and therefore avoid or minimize losses. Using this information, companies also have the confidence to make more strategic decisions to profitably grow their business," he says.

"While protection is often perceived as the primary reason to purchase credit insurance, the most common benefit companies receive by investing in a policy is that it helps them increase their sales and profits without additional risk. It is in this way that a credit insurance policy can typically offset its own cost many times over, even if the policyholder never makes a claim," Johnny continues.

"As important as it is to know what trade credit insurance is, it is equally important to know what it is not. Credit insurance is not a substitute for prudent, thoughtful credit management. Sound credit management practices should be the foundation of any credit insurance policy and partnership. Credit insurance goes beyond indemnification and does not replace a company's credit practices, but rather supplements and enhances the job of a credit professional," he concludes.

How Receivables Insurance Works

When purchasing receivables insurance, you can choose which customers' invoices you want to insure. For example, if you have a particularly large customer whose invoices account for a large percentage of your revenue, it could make sense to insure these receivables. The same goes for a customer who might have a questionable credit history.

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Receivables insurance typically covers non-payments due to:

- A customer going out of business.
- A customer going bankrupt or becoming insolvent.
- A change in a customer's ownership.

Policies can also be customized to cover non-payment due to such factors as natural disasters, geopolitical events, economic downturns and seasonal business cycles. Receivables insurance can be purchased to cover domestic as well as international clients.

The cost of receivables insurance varies depending on such factors as your customer's credit rating and industry and how much coverage you're purchasing. A ballpark cost range is 0.25 percent of the invoice amounts for domestic clients and between 0.25 percent and 0.5 percent of the invoice amounts for international clients.

Benefits of Purchasing Receivables Insurance

An added benefit of purchasing receivables insurance is the fact that the insurer monitors the companies whose receivables it's insuring. Not only can this help you with your credit checks on new customers, but the insurer may give you an early heads-up about any signs of financial problems at your customer. This may enable you to take preventative action early, before your customer's financial problems become your problems.

Beenes lists several more benefits of purchasing receivables insurance:

- More security and peace of mind in granting trade credit to new customers.
- The ability to approve credit limits faster and thus capture more revenue.
- Stronger cash flow and more consistent profitability.
- Better management of your accounts receivable concentration risk.
- The ability to offer better credit terms to your customers.

It may also be easier to obtain bank working capital at favorable rates, since insured receivables are viewed by banks as secure collateral.

Concluding Thoughts

One of the biggest financial risks business owners face is the risk of non-payment by a large customer. Even if you are diligent and proactive in collecting your accounts receivable, you may face situations in which customers simply refuse to (or cannot) pay your invoice. One of the best ways to guard against this risk is to purchase accounts receivable insurance. This type of policy would pay out if one of your customers fails to pay an invoice. An outsourced CFO services provider can look at your company's financial structure and accounts receivable to help you determine if purchasing receivables insurance is a wise move for you.

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