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The Development of Accounts Receivable Financing

When the federal reserve system was organized it was thought by many that two-name commercial paper would provide the chief medium through which the resources of the Reserve Banks would be made available to the banking community. As a result, considerable interest was focused on the trade acceptance; Federal Reserve authorities and other agencies encouraged its wider use in commercial transactions. It is well known that these efforts were for the most part unavailing; for a variety of reasons the trade acceptance did not come into as wide a usage as had been hoped for. Broadly speaking, the method of financing that was involved did not conform to the practices of American business.

While this attempt to promote the use of the trade acceptance was meeting with disappointing results, a related technique of business financing based on the open account sale of merchandise was developing in the American short-term credit market. This occurred not only without organized support or official sponsorship but even in spite of considerable resistance. The technique of open accounts receivable financing is important from a number of points of view, not the least of which is that it was apparently so well adapted to the financing needs of certain types of business concerns that it gained wide application while the trade acceptance of conventional form failed to develop even with the most patient cultivation.

Accounts receivable financing is not a new development. The open account has long been recognized as one of the preferred assets of business concerns; a good deal of the attention of the banker has always been centered on the amount and quality of these accounts and on their relation

to other quantities in the corporate balance sheet. Beyond this, the account receivable has been, for centuries, the specific basis of short-term financing in the textile trades by individuals and concerns known as "factors."

Of late there has developed a wider and keener interest in accounts receivable financing and in its position in the short-term credit market. This new interest can be explained by several related points. First, there is a present tendency for the technique to be applied to an ever-widening range of industries. This has given rise to new problems of credit appraisal and, to some extent, to new competitive situations in short-term financing. Second, non-bank institutions, other than the factoring companies that have long been active in receivables financing, have developed during relatively recent years and have come to occupy a prominent position in the short-term business credit field. Third, the business has recently been taken up by commercial banks, a development that can be traced primarily to the pressure that banks have felt for new avenues of credit extension and to the example of rapidly growing commercial finance companies. Fourth, although the movement has been retarded somewhat by the war program, an increasing number of business concerns are now depending on the sale or assignment of their receivables for the acquisition of working capital. Some of these do so because their financial position precludes borrowing on any other basis, others because they prefer receivables financing over other types of financing. Because many of the concerns financed through the sale or assignment of their receivables are relatively small and of limited financial strength the technique has received added attention in recent years in connection with questions relating to the availability of credit for small business enterprises.

While this study deals almost exclusively with accounts receivable financing, an attempt has been made to show how it is related to other financing methods. The study deals with the development and present quantitative importance of open accounts receivable financing; the nature of institutions extend-

ing credit on this basis; the main features of the services offered by them; the chief characteristics of the businesses obtaining financial support from these agencies; the methods followed in conducting such financing; and the charges levied, income earned, costs of operation, and profitability of the business.

Definition of Accounts Receivable Financing

Accounts receivable financing is a continuing arrangement whereby funds are made available to a business concern by a financing agency that purchases the concern's invoices or accounts receivable over a period of time or makes that concern advances or loans, taking one or a series of assignments of the accounts as primary collateral security.[1] There are two principal types of receivables financing. One type is known as factoring. This consists of purchasing invoices or receivables, where trade debtors are notified that payments are to be made to the financing agency and where this agency generally assumes the credit risks on the receivables. The other major type will be referred to as non-notification financing. This involves the purchase or assignment of invoices or receivables without notice to the trade debtor that the account has been sold or assigned and without the assumption by the financing agency of credit risks on purchased or assigned accounts.

Two limitations on the scope of the study should be noted. First, primary emphasis is laid on the financing of open accounts receivable as distinguished from the financing of instalment notes receivable. The discounting of instalment receivables has been discussed in detail in previous studies of the National Bureau of Economic Research.[2] Second, this

[1] In factoring and in non-notification financing as conducted by commercial finance companies the financing agency buys invoices rather than accounts receivable, which may be cumulations of several unpaid invoices. Although "invoice financing" is a more strictly accurate term for this type of arrangement the expression "accounts receivable financing" is widely used in the trade and will be used here.

[2] See National Bureau of Economic Research (Financial Research Program), *Sales Finance Companies and Their Credit Practices,* by Wilbur C. Plummer and Ralph A. Young (1940); and *Commercial Banks and Consumer Instalment Credit,* by John M. Chapman and Associates (1940).

study does not treat, except incidentally, of the use of the accounts receivable financing technique by commercial banks as a method of "working out" unsatisfactory credit relationships arising from previous loans made on another basis. It is concerned with open accounts receivable financing entered into on its own merits, where the primary dependence of the financing agency is, from the outset, on the purchased or assigned account receivable.

Business Demand for Factoring Services

Accounts receivable financing, as a technique for supplying funds to business enterprises, evolved many years ago out of business demands that went far beyond the need for advances of funds. As early as the fourteenth century, manufacturers and merchants in both foreign and domestic trade felt the need for some specialized agency to perform a selling and merchandising service for them (not unlike that offered by the commission merchant in more recent times). Since sales were generally made on credit terms of 30 days or longer, it proved to be convenient for the agency responsible for making sales also to advise on the wisdom of extending trade credit to any given buyer. Finally, this agent (the "factor") undertook in some instances to absorb losses arising out of credit sales by buying the open accounts so originated without recourse on the seller (the factor's "client"). In effect, the seller or manufacturer was placed in the position of making all sales for cash.

The demand for this combination of services prompted the emergence of factoring as an economic function. The nature of the services performed by the factor clearly indicates that such services would be particularly useful to concerns selling in foreign markets in which the creditworthiness of buyers was unlikely to be known to the sellers. For this reason the factor came to occupy an important place in American colonial trade, operating as buyer, sales agent, carrier of credit risks, collector of accounts, and general commercial representative on this continent for English companies. The selling and styl-

ing functions of the factor proved to be particularly important in the textile trade where market demand was much affected by fashion changes. Thus, in the nineteenth century the factor was prominently associated with sales in the United States by foreign textile mills and later assumed a major role in financing domestic mills and in marketing their product. Because of the importance of the import market in textiles, and particularly because of their role as selling agents, factors early established themselves in Boston and New York. With the greater growth of New York in importing and merchandising, factoring companies gradually centered in that city. The tendency for these companies to locate on Fourth Avenue, in close proximity to one another, has led to their being referred to as "Fourth Avenue houses." More recently they have been designated as the "old-line" or "straight" factors, in distinction from the newer open accounts financing companies.

In recent years there has been a tendency for the selling and merchandising functions of the factor to be detached from the financing function. It is customary now for the factor's clients either to organize their own sales departments or to use the services of a specialized selling agency or "commission house." In some cases the commission house also performs a financial function, but this service is available only to the manufacturers whose goods it sells.[3]

A number of reasons explain this tendency for the factor's activities to be limited to the performance of a financing function. One is the advantage of specialization gained by the factor, another the independence achieved by the mill that sets up its own sales department. Still another is the fact that while the factor was under no formal obligation to do so, he often had to make loans on goods which he had styled and which proved to be less readily salable than had been antici-

[3] It should be emphasized that this change in the functional and institutional pattern of the market has not resulted in an absolutely clear-cut difference between the factor and the commission or selling house. There are some firms, for example, J. P. Stevens and Co., Inc., New York City, that undertake both functions. The concentration of commission merchants on Worth Street, New York City, accounts for their being designated "Worth Street houses."

pated; frequently these loans were the source of substantial losses. All of these causes were amplified by the growing complexity of the market, its greater susceptibility to fashion influences and the desire of both factor and manufacturer to obtain as stable an economic position as possible.

Through this specialization, the main functions of the factor have come to be the purchasing of receivables with assumption of the credit risk [4] and the necessary corollary of collecting accounts. The performance of this risk-taking function made it necessary for the factor to develop an expert credit appraisal technique and an effective collection procedure and to assemble a specialized personnel to carry on this work. Further, the assumption of credit risks made it necessary to notify the trade debtor of the factor's purchase of the receivable and to instruct that payments be made directly to the factor. In contrast, the mill utilizing the factoring service did not need to maintain an extensive credit department, often none at all, nor to concern itself with the collection of accounts. Furthermore, it was relieved of a large part of its bookkeeping.

It is important to recognize that receivables financing, as offered by the factor, is provided jointly with these other services. The growth and continuance of the demand for factoring must be understood in terms of a demand for this combination of services. Also, the level of client costs, which is higher than that characteristic of some other types of financing, must be interpreted in the light of the variety of functions performed by the factor.

Business Demand for Non-Notification Financing

The conditions that led to the development of non-notification receivables financing differ in a number of important respects from those that account for the growth of factoring. In contrast to the conditions affecting factoring, the demand for non-notification financing is not necessarily associated with a demand for credit approval, collection or risk-assumption

[4] This function is sometimes referred to incorrectly as "insuring" credits.

services. The business enterprise seeking capital on this basis usually desires to convert its open accounts into cash without disclosing the fact that it obtains funds in this way. Since its customers are not notified that their accounts have been sold or assigned it is therefore necessary that the concern being financed make collections on its own receivables and turn these collections over to the financing agency. The fact that collections are made in this way raises considerably the risks undertaken by the financing agency and explains in large part why the receivables are purchased with recourse on the borrower. Under this arrangement the concern selling or assigning its receivables (the "client") must agree either to repurchase those of its receivables that become excessively delinquent or to substitute acceptable receivables for them. Consequently, the client must operate his own credit department in order to assure himself that his sales do not produce an unreasonable proportion of credit losses. The financing agency is concerned mainly with determining the validity of the accounts taken, avoiding loss through fraud and assuring itself as to the continued solvency of its clients; to this end it also operates a specialized credit department.

A number of forceful reasons account for the use of the non-notification procedure.[5] It developed much later than old-line factoring, not being practiced on any considerable scale until after 1908. Although notification had been well established in the textile trade for many years before that time, when concerns in other industries sought funds on the basis of their open accounts they had no precedent to support this policy. Their customers were unaccustomed to making payments to third parties; the only occasion for this would arise out of the placing of accounts in the hands of a collection agency and this action was generally regarded as a sign of financial embarrassment either on the part of the concern or of its customer.

[5] On this point see *The Receivables Business,* a reprint of an extemporaneous address given in Boston by A. E. Duncan, Chairman of the Board, Commercial Credit Company, before the Robert Morris Associates, November 16, 1923.

Another reason for the use of the non-notification procedure, although less important than other motives and less relevant at present than formerly, seems to have been the desire on the part of the concern being financed to keep the fact of its use of this source of funds from becoming known to its creditors. Presumably these creditors would be less likely to grant the concern further credit on the ground that resort to accounts receivable financing reflected an unsatisfactory financial position and impaired their own security. It seems likely that this attitude toward non-notification financing may be traced to a mixture of simple prejudice and genuine experience with cases where creditors' meetings disclosed for the first time that the bankrupt had secretly assigned his most liquid assets and made unproductive use of the funds so acquired. Genuine experience must have been the more important basis of the two for it is unlikely that an attitude and prejudice so deeply imbedded could be founded entirely on misinformation and irrational judgment. On the other hand, the fact that commercial banks, the agencies most frequently antagonistic to the procedure, are at present becoming more active in this type of financing would seem to indicate that "tragic experience" was not the sole ground of opposition and that lack of understanding, more attractive alternative uses for funds, or a combination of these reasons had a large part in it.

While the above conditions account for the use of the non-notification feature in receivables financing, other considerations, any one or more of which may be relevant to a particular borrower, account for the use of the receivables financing technique itself. First, some concerns able to obtain funds through this arrangement would not have credit facilities available to them on any other basis. A concern ineligible for open-line credit may be made creditworthy by the sale or assignment of its receivables. In taking receivables the financing agency may shift its emphasis from the financial condition of its client to the quality of its client's customers and thus

qualify certain concerns that would not otherwise be able to obtain funds.

Second, this type of financing may be used by concerns that, while they can get some credit on other bases, can borrow more heavily by pledging their receivables. This is especially likely where a concern has a seasonal business requiring short-term financing in amounts considerably beyond what would be appropriate on an unsecured open-line basis or where the concern's sales are expanding faster than working capital.

Third, other concerns are attracted to receivables financing because it enables them to get funds needed for the conduct of their business on more favorable terms than are available on other bases. For example, the company may be small and undercapitalized and find that the additional financing which it needs can be had through sale or pledge of receivables without diluting the ownership with additional equity funds or borrowing for long periods. This is an especially strong consideration if funds are needed to finance short-period increases in volume. Also, there may be cases in which the receivables loan is more attractive if it can be obtained on terms that do not require endorsements of officers.

Fourth, some borrowers prefer receivables financing because of its convenience. As a kind of revolving credit it has the advantages of the semi-automatic features of this type of financing as contrasted with the straight loan payable in one sum at maturity or in instalment payments. The arrangement is such that the loan balance varies automatically with the volume of receivables assigned and the rate at which collections are made; thus the loan balance is not a subject of periodic negotiation.

Finally, there may be cases in which funds obtained through the sale or assignment of accounts receivable are more economical than funds acquired on any other basis. Again, this results from the revolving character of receivables credits and the fact that the loan balance, on which interest is charged, is geared closely to the amount of funds actually in use. If credit needs vary widely over short periods a receivables

loan may produce a lower interest cost for the borrower than a nominally lower rate that is charged on a straight loan, against which the borrower may accumulate a substantial deposit balance. This possibility of greater economy in receivables borrowing depends, of course, on the immediate application of collections on assigned receivables to the client's loan balance. We may conclude, therefore, that the services of non-notification receivables financing agencies—whether commercial finance company or commercial bank—may be used for any one or more of several reasons; its users may be able to borrow on other bases but prefer receivables financing for the reasons cited, or they may be companies whose financing needs could not be adequately met on any other basis because their financial positions have been partly, perhaps seriously, impaired.

When accounts receivable are sold or assigned without notification the business demand appears to be mainly for the use of funds. This is in sharp contrast to factoring for in this case the client demands, in addition to availability of funds, a credit approval and collection service and release from the carrying of credit risks. In non-notification financing the credit collecting and risk-bearing functions disappear and, to a certain extent, the credit appraisal function also. The fact that the demand is primarily for funds and that these funds are, in most cases, relatively costly as compared to those obtained on other bases, suggests that concerns of relatively weak financial position comprise the bulk of non-notification clients. Thus, while not universally true, it is generally the case that concerns borrowing on a non-notification basis present the financing agency with higher-than-average risks and higher-than-average servicing costs; risk-limiting devices are adopted and rates are set so as to compensate for this fact.

One of the reasons for the development of textile factoring was the need for guidance on questions of style and of merchandising in general, that is, for services going beyond the advancing of funds. In non-notification financing this sort of service was subordinated to the purely financial function but

in recent years there has been a marked tendency for the financing institution to supply the borrower with general management counsel, frequently on some fairly formal basis. Concerns unable to borrow from the usual banking sources at normal banking rates are often in need not only of funds but also of management advice and guidance. Provision of such aid is therefore an important function of the commercial finance companies and has been turned by them into an effective argument for the use of their facilities; some have established special divisions or subsidiaries to supply management counsel to clients. While the demand for this particular service was not the primary force accounting for the emergence of these companies, many of them now find this one of their most important supporting functions.

Commercial Bank Activity in Receivables Financing

The widespread activity of commercial banks in the field of receivables financing is of recent origin, dating from about 1933, and has been stimulated mainly by a desire to increase revenues through additional outlets for funds. The presence in the banking system, over the recent past, of substantial amounts of unused lending capacity and declining returns on bank assets has had the effect of stimulating the interest of commercial banks in different types of financing, particularly if these held out prospects of higher-than-average rates of return. An example of this is the interest of commercial banks in consumer instalment credit.[6] The same conditions that have influenced banks to develop lending in this field have stimulated commercial banks to undertake accounts receivable financing. Interviews with bank officers have invariably indicated that the bank became interested in receivables financing as a means of providing a new use for funds that should be both profitable to the bank and helpful to the borrower.

One of the most important of the conditions affecting the activity of commercial banks in receivables financing has been the legal basis on which the arrangements are made. These legal conditions relate mainly to the validity of the lender's

[6] See John M. Chapman and Associates, *op. cit.*, Chapter 1.

lien on accounts; in most states they merely offer hindrance to bank participation in receivables financing but in some they have been a definitely retarding influence. The position of the financing institution depends on whether the open accounts are purchased or taken on assignment as collateral security for an extension of loan credit; and, ultimately, this distinction depends on whether the accounts are taken with or without recourse on the client. The procedure of buying the open accounts under a purchase and sale agreement, without recourse for credit losses on the vendor of the accounts, is recognized as providing the purchaser with unquestioned title to the accounts; it is this procedure that is followed by factoring companies. Commercial finance companies doing a non-notification business are divided in their procedure; some take receivables on assignment as collateral against a loan balance but the great bulk of this type of financing is done under the purchase and sale type of agreement. However, the fact that trade debtors are not notified and that collections must be made by the client makes it necessary for the financing institution to have recourse on its client for credit losses on purchased receivables; this fact of recourse has generally led to the transaction being construed by the courts as a loan rather than as a purchase.[7]

Bank practice in non-notification financing varies with the laws of the state in which the business is conducted. In some cases the accounts are acquired under a purchase and sale agreement; in other cases the transaction is completed as an

[7] As regards the legal position of the factor and the commercial finance company, an important question arises from the fact that, in addition to purchasers of open accounts, advances are frequently made to clients on the pledge of merchandise inventory. In the case of the factor, the validity of the lien on merchandise inventory is established, where the merchandise is held in New York State, by the New York State law, dealing with factors' liens. The lien is acquired in this case by recordation with the County Clerk and by posting, on all points of ingress to the customer's premises, signs indicating that the company is factored by the specified factoring company. Some problems surround advances on goods held outside of New York State. However, in such cases the financing agency might establish its lien by placing goods in a public warehouse and taking a receipt thereon, through the acquisition of a field warehouse receipt whenever this is feasible or by the establishment of a trust receipt arrangement.

assignment of collateral to secure a loan balance. However, insofar as the bank has recourse on the vendor of the accounts it would seem that, in either case, the transaction would be viewed, in law, as an assignment. This is of crucial importance to the development of bank interest in receivables financing because of the questions that surround the validity of such assignments in different states and the procedures that must be followed in order to establish a valid lien.

The main question involved is whether the lending institution, in the event that the borrower is involved in bankruptcy, has a lien on the assigned accounts that is prior to that of the general creditors of the borrower. State laws differ widely in their definition of what constitutes a perfected lien. In some instances, as in Ohio, the lender's lien is perfected if an intention to take assignments of accounts from the borrower in question has been recorded with the county recorder. In this state the filing of an affidavit with the county recorder constitutes notice to all persons, except the obligors on the assigned accounts, that the borrower (transferor) intends to assign accounts to the lender (transferee) and gives to the latter a prior or paramount lien on the accounts and on any proceeds arising therefrom. The affidavit is valid for three years and is renewable.[8] Likewise, in Michigan the courts have held that a "continuing assignment" of all the assignor's receivables can be made and that the assignee's lien is perfected thereon even though no notice is given to trade debtors. In fact, however, some Michigan banks notify other creditors of such an assignment mainly in order to protect against abuse of the privileges afforded by the law. These favorable legal conditions do not prevail in all states. Lenders located in states where perfection of lien is easily established may refuse to take assignments of receivables of customers located in a state having an unfavorable law on the ground that the transaction may be viewed as having been effected in that state.

[8] House Bill No. 533, *An act to regulate the assignment of accounts receivable by providing for the filing and indexing of an affidavit setting forth the intention of the transferor to assign the same and by prescribing the form and the effect of the assignment thereof.* Passed May 15, 1941; approved June 5, 1941.

Thus, from the point of view of the commercial bank, the critical point is whether an assignment can be held as valid if the trade debtor is not notified thereof. The Ohio recordation statute reviewed above grants this priority but in some states, for example in Tennessee, it is agreed that notification is essential. In other states the whole question is open to doubt. Since most concerns desiring to borrow on open accounts do not want their customers notified of the assignment of their accounts, this situation has tended to restrain commercial banks from entering the field of open accounts financing. The fact that their position is likely to be vulnerable in receivership proceedings has meant that commercial banks will generally lend money on this basis only to concerns that have a relatively strong financial position, or at the least are in no immediate danger of business failure.[9] Since this type of financing is often sought by concerns that are in a relatively weak financial position and are therefore unable to obtain any or adequate funds on other bases, commercial banks in states having unfavorable laws are seriously limited in the scope of their operations.

The legal hindrances to non-notification open accounts financing, as the banks conduct the business, are traceable in large part to the revision of the Federal bankruptcy laws made in 1939 under the Chandler Act of that year and to the interpretations placed upon Section 60(a) of that Act. On this point the language of the Chandler Act is as follows: " . . . a transfer shall be deemed to have been made when it became so far perfected that no *bona fide* purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein, and, if such transfer is not so perfected prior to the filing of the petition in bankruptcy or of the original petition under Chapter 10, 11, 12 or 13 of this Act, it shall be deemed to have been made immediately before bankruptcy." [10]

[9] The bank will, in most instances, retain an option to notify trade debtors but will do so only if it feels that the borrower is in danger of insolvency.

[10] Federal Code Annotated, Title 11, sec. 96(a). On the effect of the Chandler Act on the assignment of accounts receivable see 26 Virginia Law Review 168 (December 1939) and 34 Illinois Law Review 538 (January 1940).

The Act further provides that if the transfer was made four months or less before bankruptcy it is a voidable preference.

The question arises, then, as to what steps must be taken to perfect a transfer in order to avoid having the transaction viewed, in receivership, as a voidable preference.[11] As indicated above, this question is determined by the law of the state in which the transaction takes place. Opinions as to what is necessary to perfect a lien vary a good deal, but it seems to be the consensus that, whether trade debtors are notified or not at the time of the assignment, ledger books must be stamped so as to indicate which accounts have been assigned and to identify the assignee, and that the transferee must obtain dominion over the proceeds arising out of the assigned accounts, depriving the assignor of "unfettered use" of collections.[12] In order to complete these steps the financing agency necessarily incurs costs not associated with other types of loans but this is apparently not as important a restraint upon bank participation in receivables financing as is the law regarding notification. Interviews with bank credit officers have made it very clear that in those states requiring notification, and in those where doubt as to the legal situation makes notification a necessary precaution, the development of this type of bank lending has been definitely restrained.[13]

Another consideration affecting the entry of commercial banks into the field of receivables financing has been the atti-

[11] Preference means a transfer whereby the rights of one creditor are advanced over those of other creditors. This would generally arise when the transfer was made to satisfy an antecedent debt thus leading to a diminution of the estate of the transferor. See Adams *vs.* City Bank and Trust Co. of Macon, Georgia, *in re* General Box Co., Inc., Circuit Court of Appeals, Fifth Circuit, November 15, 1940.

[12] These conditions are discussed in 25 Marquette Law Review 28 (December 1937) and 44 Yale Law Review 639 (February 1935).

[13] There are, of course, other restraining conditions not the least of which is the relative scarcity of personnel qualified to carry on an open accounts department and the fact that, as in the case of most operations involving a large number of small transactions, it is generally stated that a substantial volume of business is needed before it can be done profitably. Finally, there is still a rather deep-seated antipathy toward the assignment of accounts based on a general, though often exaggerated, feeling that this represents the last resort of an unsuccessful, undercapitalized enterprise.

tude of bank supervisory and examining officials. It is difficult, however, to state definitely either the character or the extent of the influence that supervision has had on commercial bank activity in this field. This is due in part to the fact that we have not one but a number of bank supervisory agencies and also to the fact that there is no standard or uniform policy followed by bank examiners in appraising particular accounts receivable loans. A general agreement as to the procedures and standards that are to be followed in appraising loans of the receivables type does tend to emerge, however, among the bank examining forces. This uncodified yet generally accepted policy, the outlines of which can be stated here, develops in connection with all the various kinds of loans and is formulated over a period of years out of the personal contacts and cooperative work of the examining force.

At the present time the attitude of the bank examiner seems to be affected mainly by past experience with loans secured by assignments of accounts receivable. Since commercial banks have usually placed loans on this basis as a means of working out of an unfavorable situation, the bank examiner often approaches an accounts receivable loan with an initial suspicion that the credit is a weak one. The extent to which this is the case will of course affect the examination process but in any event there are certain points which almost every appraisal of a receivables loan includes. First, the examiner determines whether the bank has assembled an adequate file of relevant credit and financial information on the borrower. Second, the character and quality of the assigned accounts are appraised, with special attention given to the borrower's past collection experience with the trade customers indebted on the assigned accounts. Third, the bank must show that it has established a valid lien on the assigned accounts. This is particularly important if the examiner feels, on examining the financial statement, that there is an inherent weakness in the borrower's position. In practice, such a judgment might lead to a suggestion that the trade customers be notified. Fourth, recognizing that receivables financing is a technical field of lending involv-

ing unique credit hazards, the bank examiner is also influenced by his judgment of the bank's demonstrated ability to conduct this type of lending business. The examiner's opinion on this question ordinarily has considerable influence on the examination process. Finally, account is taken of the collateral margin that the bank has reserved for itself on the loan and whatever other protective measures may have been adopted. The examiner's final judgment emerges as the net result of a consideration of all of these points although the emphasis may be placed on different aspects, in specific cases and in specific banks.

The influence of bank examination on bank participation in receivables financing depends mainly on the relative emphasis that the examiner places on the two main elements in this credit appraisal process—the financial position of the borrower and the quality of the assigned receivables. The examiner may take the position that the loan should be judged as an unsecured credit, or at least that the assigned receivables be viewed as of secondary importance as compared with the credit standing of the borrower. On the other hand, the loan may be appraised with primary emphasis on the collateral security, or at least with equal emphasis on the credit standing of the borrower and on the quality of the assigned accounts. The direction in which the weight of the examination appraisal is thrown necessarily has considerable effect on bank participation in receivables financing because many concerns borrowing on this basis are admittedly of relatively weak financial position, even though their receivables may represent sales to customers of high quality. If the examiner lays principal stress on the creditworthiness of the borrower and regards the assigned accounts as of secondary importance this will tend to restrain bank participation, and vice versa.