

## **MERCHANT FINANCE BASICS**

Merchant finance is a product that has been around for a number of years. Yet, many agents still do not know much about it nor do they offer the product. Below, I will discuss the basics about merchant finance and how it can be a valuable and profitable product for sales agents to offer.

### **What is Merchant Finance?:**

Merchant finance, also known as merchant cash advance, is a transaction whereby a buyer purchases some of the future credit card processing receipts of a merchant. Merchant finance companies are very careful to point out that the transaction is not a loan. Instead it is the purchase of an asset, which is the right to the future credit card payments. The easiest way to understand how the process works is by way of an example.

Merchant finance companies purchase the future credit card payments (an account receivable) at a discounted rate. Rates vary, but the merchant finance companies usually charge in the range of a 25% to 35% discount on the transaction. Therefore at a 35% discount rate, when the company purchases the asset, for every \$10,000.00 of receivables that it purchases, the merchant finance company pays the merchant \$6,500.00. The merchant finance company pays the merchant cash immediately upon the close of the transaction. In turn, the merchant finance company collects the full \$10,000.00 from the merchant's future credit card receipts, netting the company a profit of \$3,500.00.

Merchant finance companies usually collect from the merchant's credit card receipts by diverting a percentage of the merchant's credit card income. The merchant finance company enters into a relationship with a credit card processor or large ISO to accomplish this diversion of funds. The card processing company automatically pays the merchant finance company a percentage of the merchant's credit card processing income and then deposits the balance to the merchant. In that way, the merchant finance company is assured it will get part of these payments. Some companies allow the merchant to be paid all of the credit card payments and instead debit the merchant's bank account for the merchant finance company's share of the proceeds.

The merchant finance company needs to make sure that the payments it collects from the merchant's card payments do not cause the merchant to go out of business. Some merchants make very small profit margins on their sales volume. For the merchants that make very little profit, the merchant finance company has to reduce the percentage of the credit card receipts it collects in order to ensure that the repayment of the merchant finance obligation does not keep the merchant from funding its ongoing operations. If the merchant finance company tries to collect too high a percentage of the merchant's card processing receipts, it could be disastrous and lead to the merchant

finance company not getting paid and the sales agent losing the residuals it derives from the merchant.

### **What are the Risks?:**

The main risk in this transaction to the merchant finance company is that the merchant in question goes out of business. If that happens, then in essence the asset that was bought by the merchant finance company is worthless since there are no further credit card payments received by the merchant. Since it is not a loan, merchant finance companies do not get a personal guarantee from the merchant's owners to ensure repayment of the obligation if the merchant just goes out of business. However, the merchant finance company will generally get a personal guarantee from the merchant's owners to allow the merchant finance company to collect from them if there is fraudulent conduct by the owners.

Merchant finance companies do get personal guarantees from owners whereby the owners will have to personally repay the obligation under certain circumstances, such as if they sell the business, move their credit card processing to keep the merchant finance company from collecting or in general take actions to keep the merchant finance company from collecting on the asset it has purchased. These types of guarantees by the owners are necessary to allow the merchant finance company to collect on the asset it has purchased. Otherwise, the merchant could move it processing or just quit taking credit cards as a method of payment to avoid its repayment obligations.

### **How Do Sales Agents Benefit?:**

Most merchant finance companies use sales agents as their sales and marketing arm. Merchant finance companies will allow sales agents to sell their products and the sales agents in turn get a percentage of the amount of the receivables that are purchased by the merchant finance company. As a sales agent, it is important to make sure that you receive a commission not just on the initial funding to the merchant, but on each renewal funding to the merchant. Most merchant finance companies tout that more than 50% of the merchants renew after the initial fundings are repaid. As a sales agent, if for example, the merchant renews the obligation 4 times you want to make sure that your reseller agreement with the merchant finance company states you get paid your commissions each of the 4 times that merchant renews.

Merchant finance is a product that many of my clients are beginning to offer. I see it as a sort of replacement for leasing equipment to merchants. Equipment leasing, and the large up front revenue it provided to sales agents, has for the most part disappeared. The merchant finance product allows sales agents to again generate those large initial revenues from merchants that sales agents once obtained from leasing transactions. Not all merchants will need merchant finance, but enough usually do to

make it worth while for sales agents to ask every merchant “do you need some extra cash?” during the sale presentation.

Some sales agents have even thought of actually offering merchant finance marketing as their primary form of sales activity. However, most of the sales agents I have talked to have not had much success abandoning selling their core product of payment processing services. Merchant finance is best used to add another product to your arsenal of products to allow you to make a little extra income. It’s a great add on product for your overall sales mix that any sales agent should be happy to offer to its merchants.

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