

What is Purchase Order Financing?



One of the growing pains of a successful business is struggling to maintain adequate cash flow for the projects and products you're producing for your customers. The problem's compounded by the grim prospect of having to turn away orders because you simply don't have the funds available to cover the costs that come with filling them.

Don't throw in the towel just yet. Purchase order financing (also called *PO financing* and sometimes conflated, but not to be confused with, *invoice factoring*) presents your business with a chance to get the cash you need and meet customer demand without having to turn away business or qualify for a bank loan. Depending on your circumstances and goals, this short-term tool for raising working capital might be the perfect addition to your financial solutions toolkit.

Purchase Order Financing—an Overview

Imagine you're the owner of a small business with a promising future but limited resources currently at your disposal. A large government agency has approved your bid to supply them with Product X, which is great news—except unforeseen circumstances mean your cash flow is a bit thin at the moment. You need to buy

the materials necessary to produce Product X to the quality and quantity specified by the government contract, but how?

The answer lies in a special short-term financing solution known as *factoring*. The “factor” in “factoring” is a *factoring company*, designed to purchase accounts receivable from a business in exchange for cash up front.

In this method of financing, the factoring company issues a letter of credit, or establishes a line of credit, to pay for the materials necessary to fill pending customer orders.

If the factoring company provides an advance or letters of credit to the supplier and collects the invoice from the end customer, they’ll subtract their fees after the customer pays and then return what’s left to the supplier.

If a line of credit is established, then payment terms will vary based on the terms set forth in the factoring agreement.

Small businesses, new businesses, and business owners with a sub-optimal credit history can all take advantage of purchase order financing, provided they meet the criteria established by the factoring company.

These criteria may include, but are not limited to:

- Supplier (the reseller or manufacturer, i.e., your company) must sell tangible goods
- Profit margins and for the factoring company are set at a specific level (e.g., 14%)
- Interest rates may vary, depending on the terms of the advance and the length of the financing.
- End customers are limited to established business or government agencies only. Business-to-Consumer (B2C) companies will likely not qualify for PO financing.

Provided your business meets the criteria set by the factoring company, you’ll be able to get the funding you need with minimal fuss—and much more quickly than you could obtain it using traditional bank loans.

Why? The most important factor affecting whether a purchase order financing company will provide purchase order financing to a given business is **the**

creditworthiness of the company or organization for whom the goods or services are being purchased. If the purchase order finance company regards your customer as a good credit risk with a strong track record, they'll see funding your goods as a reliable investment with a promising return on investment (ROI).

NOTE: While you might hear it used interchangeably with the term "invoice factoring," PO financing is different in two key ways:

- PO financing is used to fund the production and sale of goods to customers; invoice factoring is used to sell invoices for orders already fulfilled.
- Invoice factoring can be used for goods OR services, whereas purchase order financing is limited to companies that sell tangible goods.

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Benefits of Purchase Order Financing for Businesses

While it won't—and shouldn't—replace traditional financing or obviate well-optimized procurement, supply chain management, and financial planning, purchase order financing is still a very useful short-term solution to help your company meet demand and achieve profitable, sustainable growth.

You might find PO financing especially helpful if you're:

- Experiencing seasonal surges or overall sales growth and subsequent demand that outstrips cash flow.
- Holding your working capital in reserve to fund essential projects that cannot be postponed.
- Taking advantage of exceptionally large orders but don't have all the working capital necessary to fund production of goods.

It's a handy tool to have in your back pocket, but it's important to remember that

tools like PO financing work best when you've already incorporated overall improvements like continuous process improvement and workflow optimization supported by a robust purchase order software.

Is Purchase Order Financing Right for You?

Tomorrow's success begins with today's happy customers. Don't let a lack of cash slash your profits and production. If your business can meet the criteria, knows the limitations, and can meet the terms, you can use purchase order financing as a powerful aid in maintaining cash flow, customer satisfaction, and a healthy bottom line for your growing business.

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