

TRADE FINANCE:

How to qualify for Trade Finance

In our last white paper on Trade Finance (<http://www.arcashflow.com.au/whitepapers>) we covered what it is and more specifically how it works and what's required of you. In this white paper we are going to focus on how you can qualify for Trade Finance.

So to begin with, what would make a financier consider your application for Trade Finance?

Well there are a few things.

- The first thing you need to have is a decent profit margin. Anything over a 30% gross margin is preferred to the lender.
- The second thing you need to have are solid customers you are supplying to, the Purchase Orders you get need to be from bigger blue chip types of customers.
- The third thing is the Purchase order must be for finished goods.

What is the main thing a financier doesn't want to hear when applying for a facility?

The main thing that we hear a lot which we don't want to hear is that you want us to finance work in progress (WIP). Paying for goods that are not actually complete and/or raw materials that are used to go into production to produce different types of products.

If I'm going to seek funding, what's the first step I can take to prepare?

You need to get all your paperwork in order if you're looking at applying for Trade Finance. The first thing you will be asked for is a copy of the Purchase Order. If you don't have that then you need to demonstrate that it can be produced.

Please note: This is a Purchase order from your customer, not from your supplier. Sometimes this can get confusing please make sure you have correct PO from your customer before submitting.

Do you have experience in this industry? What's your experience in importing products from overseas?

Are you going into business with a product or industry in which you are not only familiar with but have a track record of experience in?

Have you traded overseas before? Have you bought from an overseas supplier and had successful transactions? Do you know how it works? What's required? Basically if this is your first rodeo it's not something the financier really feels comfortable funding. Those that have experience in this type of transaction know that there are many elements that need to be taken into consideration.

How long have you been trading?

If you can show us a history of a successful business in trading then we are going to feel more confident taking on your purchase orders. As this is quite a risky transaction, a proven track record of ongoing sales and transactions is going to give the financier more incentive to invest in your company.

Have you sold to the customer before?

So you have a large order from a customer. Have you sold to this customer before? Are we going to supply funds for the goods only to find out on the other end the customer doesn't want the goods anymore? How reliable is this customer? What's their buying/trading history? Are they reliable with payments? How does their business check out? It's unlikely we will fund to you if your customer has a bad credit history or doesn't pass our credit checks and if you have never supplied to this customer before then that's a bit of a red flag for us.

Do you currently have orders?

You might have a great idea, say to buy t-shirts from an overseas manufacturer and then make a killing by importing them. Do you have any actual orders or is this what we call Speculative Purchasing? Without solid pre orders from strong customers you will not qualify for Trade Finance. We can't finance your project on a maybe return on investment; we need a guarantee you are actually going to sell the goods.

Side note: *Speculative Purchasing in reference to Trade Finance is when you buy stock for your inventory that is not pre-committed or pre-sold to your customers. A lot of businesses require that kind of inventory where they've got an idea of what they are going to sell over the next 3 months but they don't have baton down orders for it, we refer to that as 'Speculative' but that's not something we can fund.*

Have you dealt with your chosen manufacturer before?

Have you worked with your chosen manufacturer? Can you trust that the order you place will be manufactured properly in an environment that passes all regulations? Do you know the ins and outs of your chosen manufacturer? Can you ensure that they will make and deliver to your exact specifications on time and of a high quality? If you haven't used your chosen manufacturer before or even visited their premises that is not going to go down well. They need to qualify and pass audits.

Have you conducted a factory audit?

For a Trade Finance facility to go ahead, there are a few crucial components you must have in place. As it's a specialised and potentially risky transaction, it is important that every element is accounted for.

So why is it necessary to have a factory audit?

Have you been to the factory before? Do you know how they operate? Are they a trust worthy and well run operation? It is unlikely a Trade Financier will agree to a facility if an audit hasn't been done on your chosen manufacturer, or they are a solid manufacturer with a track record.

A factory audit can be critical before locking in any order; in the long run it can save you from potential disaster, money loss, disappointment and ultimately business failure! So when selecting your supplier you need accurate and concrete information to assist you in determining if they are the right supplier for your business. Don't rush this decision or base it solely on price, there are many factors you have to take into consideration. Some factories are renowned for bad quality, cutting corners, rough handling and even worse signing off on product they may have not even checked. Not to mention the social issues such as child labour, environmental degradation and unfair working conditions. So it's up to you to research your manufacturer, visit their premises and make sure they check out before entering into a business agreement.

So what does a typical factory audit include?

There are all kinds of factory audits, but I will give an example of areas covered in a typical one which I sourced from the China Blue Print Website (www.chinablueprint.com.au)

- A review of the factory's formal business documents; business registration, exporting license, testing certifications, accounting documents;
- A report on the factories operational structure; systems in place, employee breakdown, machinery types, recording processes, quality assurance and systems related certificates, inspection track record;
- Photographic representations: factory entrance, factory production line, machinery, administrative offices, business documents, storage facilities, packing rooms, sampling rooms;
- Charts: factory organizational flow chart, production work flow chart;
- Production information; production line/capacity calculations, daily output checks, information of sensitive points/bottle necks, machinery condition, power supply, transportation;
- Raw materials; supplier and sub-supplier details;
- Sampling; details of sampling capacity; and
- Any client special requests.

So before you lock yourself down with a manufacturer, make sure you have done a proper and sufficient audit. If this isn't done, you will not qualify for Trade Finance.

Payments are often made via Letter of Credit; does your factory accept this?

All different types of payment can be negotiated with your supplier, however most trade financiers preferred payment method is a letter of credit.

The reasons why a financier uses letter of credit instead of funding upfront is it protects against things like loss, incorrectly produced product and failure to deliver. Payment is received once goods are produced. It covers you against all the associated risk when paying upfront.

Side note: *What is a letter of credit? A standard, commercial **letter of credit** (LC) is a document issued mostly by a financial institution, used primarily in trade finance, which usually provides an irrevocable payment undertaking *sourced from Wikipedia.*

Do you do product testing?

In most cases we would insist that an inspection or quality check be performed. We can organise an Independent third party inspection service.

Purchase Order finance check list

So now you know more about Purchase Order Finance. If you think you want to go ahead with a facility make sure you have the following action items in order?

- € **Copy of Purchase order**
- € **Strong customer**
- € **Supplier agreement**
- € **Detailed Factory review**
- € **Warranty insurance**
- € **Enough margin to make at least 30% profit**
- € **Experience in dealing with the type of exchange**

To talk to a product specialist and book in an appointment please call the office on 1300 652 158.

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