



SHORT TERM FINANCE

L Young
National Bank of
New Zealand Limited
ROTORUA

Short term finance needs long term planning - if you have not arranged it when you need it, it is probably too late.

Like the temperature of a body (or an engine) the liquidity of a business is usually a good indicator of its health.

What then is the role of short term finance. Does its use indicate that there are fundamental problems in the business? Do you arrange short term finance in order to hide the difficulties you are experiencing. Usually neither is the case however use of short term finance must be made with care and considerable prudence.

TYPES OF SHORT TERM FINANCE

All borrowings must be repaid from your income but short term finance must be repaid from funds due shortly. It is therefore quite inappropriate to raid your working capital sources to purchase long term assets.

Short term finance must be related to short term assets. Get your accountant to show you an appropriate Current Assets Ratio and how long will it take you to cash up the value of your short term assets in order to meet repayment of short term liabilities.

1. OVERDRAFT FACILITIES

An arrangement for an overdraft limit is a commitment by the bank to lend whether you do actually borrow or not, once the commitment is in place and once made the funds may be used at your discretion. Don't imagine that even though you believe you will not need the overdraft a

lesser degree of care is required when applying for an OD limit than for a straight loan.

In my view the budget and monthly cash forecast of a logging contractor should not show a requirement for overdraft.

What circumstances might occur that necessitate the requirement for overdraft? (Bear in mind that all outgoings have to be met from your income - borrowings of any description only cover the position until your income comes to hand).

An overdraft limit is the maximum the bank, after full consideration, has agreed to.

2. BRIDGING LOAN

Usually a specified fully drawn loan against an assured and clear source of repayment. Must not be open ended.

3. SHORT TERM LOAN - SAY 3-6 MONTHS

Servicing costs and repayment must be clearly indicated from a strong cash flow surplus or alternative and reliable source. Term may be indicated by anticipated life of asset being purchased.

PROCEDURE FOR OBTAINING SHORT TERM FINANCE

The bank is not in the business of taking risks. Any application should demonstrate that the risks for the bank are minimal and that come what may you will be able to survive and repay the

bank without difficulty. What then are the basic criteria?

CHARACTER - If you are not known to be reliable how can the bank believe and rely on what you tell them. Get to know your banker - give him something to judge you on and make sure your record is good. Figures speak louder than words.

CAPABILITY

ARE YOU ABLE TO YOU HAVE THE EXPERIENCE AND SKILL OF MANAGEMENT

DO YOU HAVE THE CREW, EQUIPMENT, CONTRACT

WHAT HAPPENS IF

WHAT ABOUT THE CONTINGENCIES

CAPITAL - How much cash are you putting in to your business you should own most of it and have more to lose than your creditors it is fails). Inadequate capital is in the main cause of business failure and businesses with inadequate capital usually fail.

PURPOSE - Have you identified why you might need short term finance.

REPAYMENT - No one lends money unless they can see where it is to be repaid from. Be sure you can demonstrate this when you apply for the advance.

SECURITY

This ensures the borrowers continued interest in the obligations and underpins the liability should the borrower prove 'incompetent' in subsequent situation and/or have a nervous breakdown and walk away from the whole venture. We are not pawnbrokers.

CASHFLOW FORECAST

This planning tool tells you and your banker what your cash position might be like at certain times over the next few months. It does not measure profit or loss but only cash received and paid out. Whilst losses will in time erode

your cash and leave you broke, profits are likely to have little effect on your cash position.

Bear in mind that the cardinal sin is to run out of money. Consider the events that will cause this to occur:

- Substantial unplanned expenditure
- Slow debtor collection
- Poor control of expenses
- Fingers in the till
- Inadequate financial planning resulting in poor financial structure

The cash forecast is seldom 'correct' but it is a benchmark from which you can assess your position.

Distinguish between you budget (assesses what sort of profit you might make) and your Cash Forecast (which tells you if you can pay your bills - and if you cannot pay your bills no one wants to know you).

COSTS

APPLICATION FEE

SERVICE COMMITMENT FEE - Quarterly - charged on OD limit or peak overdraft balance.

INTEREST - Calculated on the daily balance. You pay only for what you use. Base Rate (Moveable) plus a margin (Fixed).

Interest rate margin reflects the historic or anticipated attractiveness of your account to the bank. The presence of full fluctuations to significant credit balances will generally result in finer margins. Hardcore overdraft attracts higher margins. Penalty rate for excesses of overdraft limit can be very severe indeed.

COSTS CAN BE REDUCED BY:

Borrowing less by having more of your own capital. Structuring your finances so that overdraft is used sparingly. (This may mean taking a little more but not too much - in long term finance). Never use overdraft in excess of limit. Always have sufficient cash so you can qualify for discounts. Do not incur penalties PAYE, GST RATES. If you take a short term (or a long term) loan negotiate arrangement for lender to accept early repayment without penalty.

REPAYMENT ARRANGEMENTS

"We are not interested in repayment arrangement which requires the kids to go to school in shoes that are too small". How much fat is there in the system - what happens if A contractor who does not provide for repairs is no better than a farmer who complains about the weather.

DANGER SIGNALS

- Pressure on the limit
- Hardcore OD
- Withholding payment to creditors
- Difficulty meeting wages (or wanting excess OD to meet wages cheque)
- Late payment of PAYE or GST
- Bounced cheques and threats from creditors
- Credit cut off by suppliers
- Cash required up front for repairs
- Idle machinery
- No income
- Redundancy pay required for dismissed workers
- Repossession of machinery

Bankruptcy

At what stage would it be prudent for the bank to be put on enquiry? At what stage do you think the bank should 'pull the plug'.

PLANNING

Takes the surprise out of the problems. It is no good requesting today an increase in OD needed as a result of something that happened 6 weeks ago.

You have had six months notice that tax has to be paid. If you spend that money (or use it in the business) it comes as a big shock when you have to pay out. It could cause you to place too much reliance on your banker. Better to be master of your own destiny and plan ahead. Put the money aside monthly on an interest bearing account then you do not have to keep thinking about it.

CURRENT DEVELOPMENTS

- Liquidity in the finance sector
- Illiquidity in the commercial sector
- High (but reducing) costs of credit
- Reducing inflation
- Business outlook

