



Managing your business when interest rates rise

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Careful control of debtors is always good business practice. It is absolutely critical in times of tight monetary control. It is not always immediately recognised that the cheapest form of finance going around is that which is supplied by your suppliers and creditors. Generally you can get 30 to 60 days credit absolutely interest free.

Of course the reverse is true when you are the supplier and therefore giving interest free money to your customers. And just remember that the interest free money that you are providing could be costing you more than 11% if you are

funding it by way of an overdraft.

What is the relevance of this? Quite simply, as interest rates rise borrowers seek new forms of cheaper credit.

Official Reserve Bank interest rates in Australia have increased by 1.75% since May 2006. Lenders always pass on these increases. Over the past year, as the US sub-prime crisis has played out, banks and financial institutions that rely on international markets for part of their funding have found these sources have either dried up or, if available, are at considerably higher costs than in the past.

The cumulative result of these factors has seen most business interest rate costs have grown by more than two percent in the past couple of years. While the

resultant rates are still considerably below those experienced in the late 80s, cost pressures are being experienced by many businesses. Now is certainly the time to be watchful and cautious.

Where should winery owners be directing their attention in these tough times? A substantially increased risk for you is most certainly potential bad debts. Businesses that are poorly managed inevitably strike trouble when monetary policy tightens. Higher interest rates reduce available cash and alternative sources of funds are sought. What better place to start than with one's suppliers? You must therefore be very vigilant in the management and control of your debtors.

It is not always immediately obvious

which debtor, or group of debtors, has become a greater risk to you. An important review tool for you is to monitor the terms of payment of all debtors, and to act immediately if you detect a change in payment patterns. And it is not always those debtors that have always been slow to pay that will be your problem.

A long term significant customer, who has always paid within your normal trading terms, misses a normal payment date and extends by, say, 14 days. Your first reaction is that a good customer should be given some leeway. In tight financial times this is precisely the wrong thing to do. An extension of payment terms may well indicate cashflow problems for this customer, even though his current payment terms are better than some other regular slow payers.

Act quickly. Contact your customer and remind him that he has exceeded payment terms. Try to determine the reason for the extended time for payment. If you are uncertain, do not be afraid to put pressure on and require a return to previous payment patterns. If the slowing of payments continues you should seriously consider whether it is prudent to continue trading with this customer. Remember always that not all creditors are as vigilant as you. If you ensure that you get paid then it could well be that some other creditor is missing out. Better that supplier than you.

Insolvency practitioners list major bad debts as one of the main causes of business failures. Careful control of your debtors is always a must. Today it is even more so.

To put this all in perspective you might like to consider the impact on your business of a bad debt. A customer who owes you, say \$100,000 and becomes insolvent, causes you to suffer a double

loss. If you are working on a gross profit margin of 40% it will take a sale of \$250,000 to recover the \$100,000 loss. That is a lot of catching up to do at a time where sales are already under pressure in tight financial markets.

Of course, the business owner will also be experiencing extra costs as interest rates go up. What can you do to keep borrowings to a minimum, particularly overdraft borrowings, which tend to have the highest interest rates?

Excess stockholdings are never a good idea. When interest rates go up it can be critically dangerous.

Take particular care with the levels of stock you hold. For a winery this will always be difficult with wine stocks as this year's production may take several years to mature to a sale. Wine stocks are determined by your estimate of future sales. Get your projections wrong and your cashflow can be greatly damaged.

In tight times it is better to err on the conservative in estimating sales. You want to be still here in three years' time to make the sale and so better to have a shortage of stock than not be in business and be unable to make any sales. And consumers may well be prepared to experience a shortage of a good vintage as surely, they think, short supply equals high demand.

You do have more control over dry goods stocks than you do over wine stocks. Consider your buying patterns for cartons, bottles and closures etc. These stocks are usually available at relatively short notice. Therefore make your purchases only when you need them. Suppliers sometimes offer discounts for bulk deals. If you are paying substantial interest on your overdraft it may be that the saving in stock price is more than offset by overdraft interest

costs. Do your sums before buying up big.

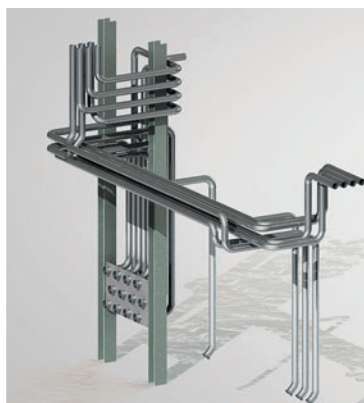
Now is probably not a good time to fix interest rates long term. If you have fixed rate debt which is maturing shortly, do not rush into new fixed rate loans.

Predicting the movement of interest rates is always fraught with danger. However, current consensus is that rates are nearing the peak. It may well be advisable to leave rates on maturing fixed term debt at variable rates for the next six to 12 months while long term rates settle down. Fixed long term rates are not likely to increase in the current climate and may well go down within the next year. Delaying fixing rates will save you longer term costs in these circumstances.

And so, what is new in all this?

Debtors and stock control should always be a priority and so there really is nothing new in the above advice. The practices that you learn and use during the tight times should not be relaxed when money supply is improved. Paul Keating famously described the recession we had to have. While certainly not supporting the view that tough monetary supply is good for business, it can be used to advantage in the good times if you are prepared to remember the lessons learned.

DES CAULFIELD is the senior director of MGI Adelaide, Chartered Accountants which is a member of the worldwide MGI alliance with representation in 75 countries. MGI offices throughout Australasia are business growth advisers to small and medium sized businesses. Des is a past International chairman of MGI and is currently a member of the MGI Managing Committee as well as a member of the MGI Australasia Executive Committee.



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