Will your fear of interest rates hold your business back?

As a business owner, when purchasing a business asset you need to ensure that the asset will help generate an income. We recommend completing a cost versus benefit analysis before deciding to purchase any asset, let alone one that requires a loan.

For instance, if you want to purchase a motor vehicle primarily for personal use, this does nothing to contribute to sales or income for the business. If, on the other hand, a vehicle is purchased for a salesperson that allows them to visit existing and potential new consumers to sell your product, then this should result in returning an income.

Assets are generally purchased:

- as a replacement for aging or broken plant and equipment for production and delivery purposes, or
- to generate new business.

When considering whether to replace an existing asset you should look at what the asset currently costs compared to the possible savings a new one may provide.

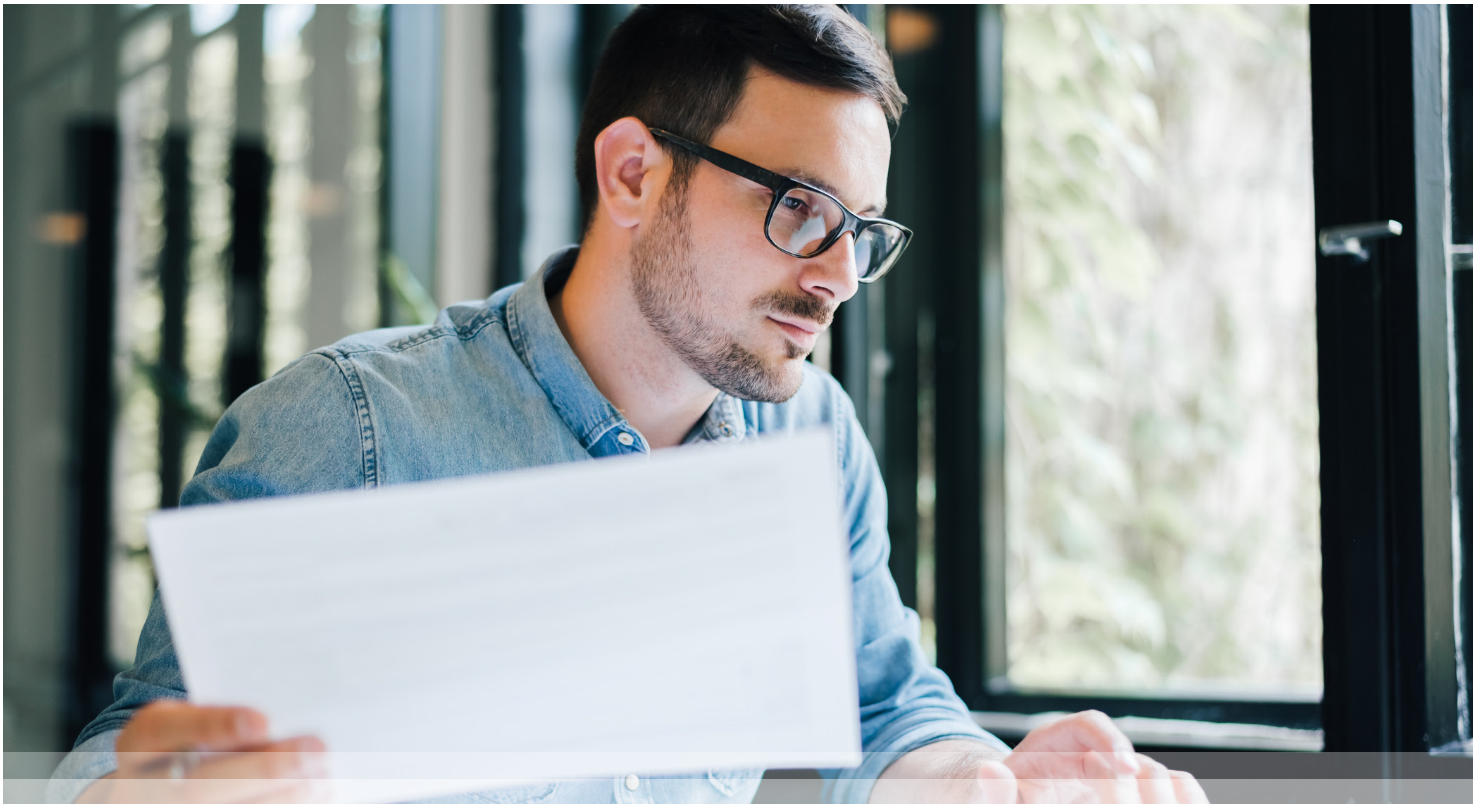
An example could be an aged prime mover that is costing large amounts of money to repair and maintain along with running expenses. Replacement of engines, transmissions and other parts can result in many tens of thousands of dollars in repairs and can impact your business income, cashflow and bottom line.

Every hour your asset is offline, it is not generating an income. The potential loss in income is often not taken into consideration when looking at replacing a new piece of equipment.

One possible solution could be to trade the asset and purchase a new one.

Often the trade and potential repairs cover many months of repayments. **There are also other benefits including:**

- more income due to reduced breakdown
- warranties covering the costs of unexpected breakdowns that require repair
- more efficient and increased productivity, particularly with reduced fuel costs and ongoing maintenance.



The first costs a business owner should research when considering purchasing extra equipment are the costs to operate the plant and equipment. Then you add the loan repayment to the total.

The owner should then estimate the increase in income if the equipment was purchased.

This should help with your decision.

When you can generate more income than the expenses and loan repayment outgoings, it is a good indication that the purchase should be undertaken, even if loan interest rates are considered high.

Key consideration: Your decision should be based on the repayment and ROI – NOT the interest rate.

Purchasing plant and equipment direct from overseas can result in substantial savings on the equipment, however there are a number of issues that need to be considered.

The initial thoughts should be what the supplier will require:

- part payments to cover the cost of construction, and
- full payment before shipping to Australia.

If the purchaser does not have the cash, they will have to set up a facility known as 'escrow finance' prior to the equipment being loaded onboard a vessel in the overseas country.

Contact us to learn more about 'Trade finance and how it can reduce your risk'.

Escrow finance, otherwise also known as trade finance, is a form of bridging facility that has two separate products brought together and marketed as one. It is generally used during the construction of an asset and allows for progress payments to the supplier and final payment of the asset.

While this facility can be used for locally constructed equipment, it is generally used to assist the importing of an asset from overseas. Once the asset is ready for delivery to the client in Australia, the asset finance loan is drawn down and the escrow finance is cleared.

With any escrow finance a lender will not use the asset as security. Therefore the lender will require another form of security. Generally this is property. The lender will discharge the escrow security and replace it with the equipment once it is delivered and installed.

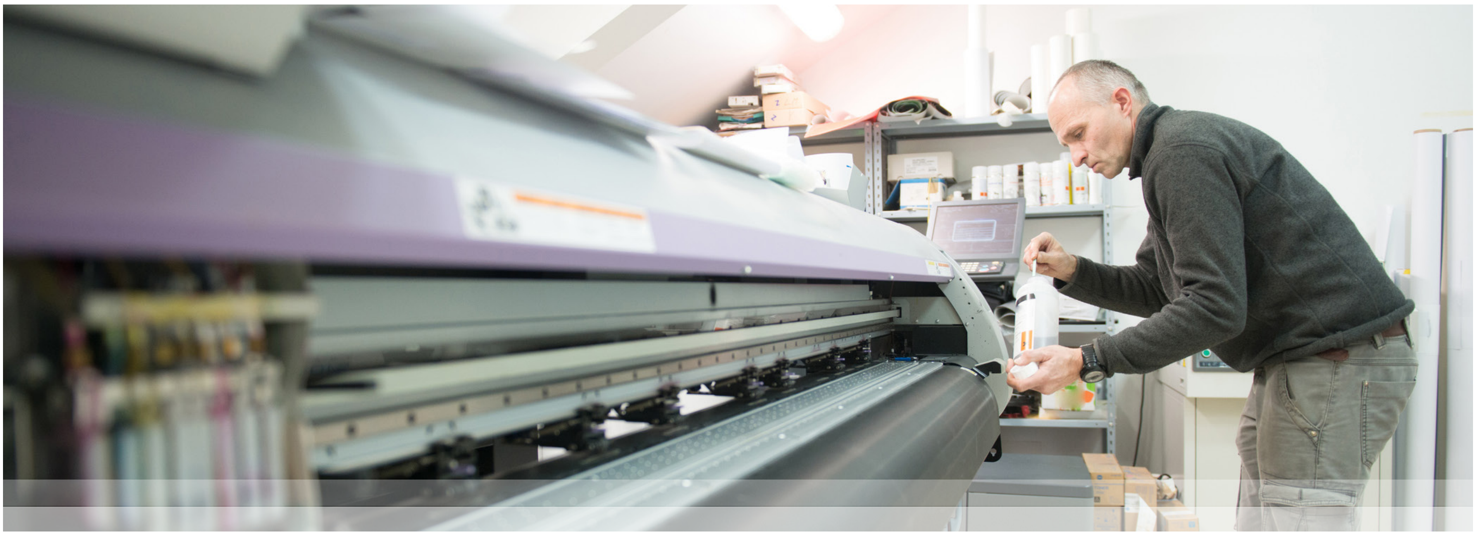
This type of temporary finance can be costly and you should make enquiries with us first before making any decision. Purchasers should also carefully consider the ramifications of importing assets.

1. Payment for the equipment is required prior to shipment and often in a foreign currency, generally US Dollars.
2. Payment in a foreign currency raises a risk to the client if exchange rates fluctuate.

This risk can be minimised by taking out a **Forward Exchange Contract** and locking in a fixed payment amount.

Other issues to consider are:

- possible lack of warranties
- if qualified tradespeople in Australia are required for installation
- the availability of qualified and authorised repair persons in Australia should repairs be needed
- availability of spare parts in the event of breakdown
- value and saleability of the asset if required to sell



An example of what can go wrong is in the case study below:

A printing company client decided to purchase an additional printing machine for the business that would allow them to expand their product range into brochures and magazines.

After researching suppliers they found they could purchase a machine from Germany for $20,000 less than they could in Australia.

The machine had been built, however the supplier required payment in US Dollars before they would load the shipment onto a vessel. The cost to arrange escrow finance was around $2,000.

In addition to this, the machine needed to be installed in Australia and they had to pay a further $4,000 for a technician from Germany to carry out the installation. The Australian team operating the machine also had to be trained incurring further costs of $1,000.

The additional installation and training costs amounted to $7,000 resulting in a reduced saving of $13,000. So it still appeared to be a good investment.

Within a few months, the printing machine broke down. Because it was not under an Australian warranty a technician from Germany had to be flown to Australia to repair the machine. This resulted in a further expense of $6,000 for parts and labour. Another issue was that production was shut down for six weeks until the repairs were carried out.

This additional cost of repairs reduced the original savings down to $7,000. However due to the downtime of operation, the businesses could not fulfil orders and lost approximately $15,000 additional profit.

This example is not common but does show how a lack of local support from an overseas supplier can erase any savings when purchasing a machine from overseas.

When considering asset finance do not make a decision based solely on interest rates.

Consider all factors that can improve the business profitability and ways to minimise your risk. Do your research and reach out for our help and expertise in these areas of finance.

Contact us to read
'How trade finance can reduce your risk'

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