

INTEREST RATE ARE RISING, HOW IS YOUR STORE POSITIONED?

Well today it was announced where interest rates are heading and that is up. For the first time in nearly a decade the squeeze will be put on Rural Merchants to improve their cash flow and reduce their debt obligations. It is now time for your store and branch to do a liquidity health check. With greater competitive pressure in this industry and slimmer margins, combined with an increased need for capital investment in fit-outs, technology and point of sale computers, attention to liquidity and return on capital become increasingly important as the cost of capital will rise in the future.

A cash shortage is usually the first obvious sign to a business that something is not right. This is instigated by the Bank who suddenly becomes nervous as the cheques race through but the deposits dry up. However, it is often the last thing business operator's project, so we only recognise a problem when we have a **negative** cash position. Do you know what your desired cash levels or minimum **positive** working cash needs are?

Here are 4 key areas you can check:-

1. Debt to Equity

Your level of total debt will obviously be the first area we should look at. Called the 'gearing' of your business, the greater the ratio of debt to equity the more highly geared you are, the more exposed you are to the interest rate rise we are about to get. Also the higher the ratio the less you have of a negotiating success of borrowing more money to finance growth or that great marketing idea of diversifying into product lines and departments your competition are not into.

The ratio is simply
$$\frac{\text{Total External Debt}}{\text{Total Equity}}$$

These figures are off your Balance Sheet as provided by your accountant or your own accounting system. We need to exclude any intercompany director loans and focus on external debt (i.e. creditors, the bank and provisions).

At a ratio of one to one, for every dollar owners have tied up in the business (that is equity) they owe \$1 to outside creditors (either long or short term

loans, trade creditors and other liabilities). If the ratio is higher the higher degree of 'gearing' the business has and the greater risk to shareholders if interest rates rise. If your ratio is too high get your accountant to scrutinise your Balance Sheet with you, review your assets, type of debt and prepare a cash flow plan for the next twelve months to give you security of mind for the future should rates rise as well as other costs.

2. Working Capital Ratio

Sometimes called the Current Ratio this is a more readily available figure to pick up each month. It is found in the following way:

$$\frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Current Assets are basically stock, debtors, cash and cash investments. Current liabilities are basically trade creditors, overdraft, provisions for tax, leases, etc to be incurred in the next 12 months. A comfortable ratio is 1.3 to 2.0. Which means for every dollar you are up to pay out in the short term is covered by \$1.30 to \$2.00 in short term assets. These two items should move together so that if Current Liabilities are rising the capital is reflected in Current Assets. If not it could mean current debt is rising to cover a cash flow need to service long term debt or excessive owners drawings. If your ratio is less than 1.0, don't panic; get your accountant to evaluate the type of loans classed as current and the quality of the assets. Again ask for a cash flow projection. If your ratio is 2.0 or higher it could indicate excessive cash tied up in stock, debtors or cash reserves and that you are not using those assets well enough. So you need to review your stock and debtor turns.

3. No. of weeks Overheads Covered

Found by dividing your cash and quick cash reserves by your average monthly overheads. A minimum comfortable figure is 2 to 4 weeks. Excessive cash at the bank does nothing but keep the bank manager happy. If you know you don't need it for a while, (by looking at your cash flow projection!), then invest it in a cash trust account at a higher rate of interest or take advantage of settlement discounts from your regular suppliers if available. If your ratio is very low you need to look first to release excessive

cash in stock or debtors and whether you are taking correct advantage of credit terms from suppliers, but not to their abuse.

Obviously how close you run in these balances depends somewhat on your personal comfort factor. However, we saw the demise of many good long standing rural merchants during the excessive eighties who threw out the old traditional ratios and fell victim to the high interest rate climate. I am not saying that those bad days will return but I think the days of the constant low interest rate regime are over.

If you have large debts then project your cash needs and ensure your store can not only cover the interest but the principal reduction on those loans as well

In my next article I will look at the 4th key liquidity ratio for a rural store, which can be looked at on a monthly basis, the Cash Cycle, which measures, how quickly you pay your creditors, how quickly you turn over your stock and how quickly you collect your accounts.

The formulas and the targets for 2005 in Rural Merchandise are in the next issue, get your calculators ready!