CHOOSING AND USING FINANCE FOR THE GOLF COURSE

"If you would like to know the value of money, go and try to borrow some." Benjamin Franklin

Continue to learn

Every day we are bombarded with financial information and offers. It may be an invitation to sign up for a new credit card or our latest statement from the bank or building society. Either way, the more we know about the different sources and costs of money the easier it becomes to make a better decision, particularly in business, and that includes the golf course.

'Choosing and Using Finance' is not a simple subject. Like course maintenance, it demands considerable professional knowledge and experience. However, understanding the basics is important to the Course Manager and Greenkeeper since it plays an important part in planning and budgeting to ensure that the club has the materials and equipment it needs to deliver the quality of course preparation and presentation that members and others demand.

CASH AND CASHFLOW:

It is impossible to run a business without cash. Income and expenditure are 'cash' and it's essential for a healthy business that cashflow is positive, ie, more income than expenditure. Of course, there are often short-term blips in the cycle. In the golf industry, seasonality has a significant impact on cashflow as green fee income falls during the winter months. Similarly, income probably peaks after members pay their subscriptions when the cycle returns to balance.

To manage the cycle, most people and businesses use a bank account which gives them the use of cash. To provide for short-term deficits in cashflow, the bank may also agree to provide an overdraft so cash payments can still be made even when cashflow is negative.

Cash is essential for day-to-day transactions like paying wages and utility bills, or the costs of raw materials for manufacturing or services, eg, sand in the bunkers and beer in the bar!

CAPITAL INVESTMENT:

However, some items of expenditure - notably items like purchase of machinery, buildings and building refurbishment, carry a larger price tag with a cost that is normally paid back over a longer term than items like wages and utility bills. These are classed as capital expenditure while the wages and other short-term expenses are classified as revenue expenditure.

Attempting to finance the cost of capital expenditure out of cashflow can cause problems. If cash were the only option open to an individual or a business, all but a few of us would live in rented accommodation and drive cheap used cars.

Naturally we could save the money for a car but this would take time and we would still forego the use of that money while we were saving. What's more, given the price of new cars, we might have to make do with something less expensive to match savings and investment over a reasonable time period.

Clearly the more expensive the asset, say, a new house, the less likely it is to be funded from cashflow or savings.

Unfortunately, a business does not have the time to save the money for major capital purchases - largely because it relies on new machinery and other assets to generate income. One could argue that this is not true for a golf club since it doesn't manufacture anything. Nevertheless, it has to provide playing and other facilities of a quality that maintains membership levels and attracts income from visiting parties. This requires considerable investment not just in the course but in the house too.

The acid test for any new capital investment is, first, is it realistic for the business or organisation and, second, can it be cost-justified? If the answer is 'Yes' to both, then the third question is what is the best way to finance it?

SHORT OR LONG TERM:

Cash (unless we have masses of spare cash all the time!) is best kept for short-term expenditure and meeting day-to-day operating expenses. The same is true for 'cash substitutes' like the overdraft and credit cards which provide a short term bridge between income and expenditure. It's also important to retain the flexibility of the overdraft and not to block it up with long-term borrowing.

Capital investment demands financing facilities that can be matched to a realistic working period for a machine or other assets. For example, if the club needs a new greens triple mower and its replacement policy is to change high-use machines like this every three to five years, then it makes sense to match the funding to the period of use, say, between three and five years.

This offers the club a number of benefits. First, cashflow should not be stretched because the cost of the machine is spread over time, meaning it earns its keep as it works for the club. Second, if the repayments are fixed in advance, as is normally the case with loans, HP and leasing, it makes it easier for the club to budget for new machinery. What's more, spreading the cost can increase the budget and the options open to the Head Greenkeeper or Course Manager to specify more machinery - perhaps a combination of machines instead of just one, or to buy a better specification.

FIXED OR VARIABLE:

The cost of finance varies according to the type of facility. The cost of borrowing money is the interest rate at which the lender/market is prepared to lend. Normally, the interest rate reflects the level of risk in the transaction. For example, a long-established business or organisation with

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a strong balance sheet (plenty of assets owned by the business) and a good trading track record offers more security than a start-up business. Hence the rates at which each can borrow from the bank, and the amounts, will be different.

As comedian Bob Hope quipped: "A bank is a place that will lend you money if you can prove that you don't need it!"

The overdraft carries a variable rate of interest, which moves up and down in relation to changes in bank base rates. The same is true of credit cards, although the rate of interest charged on overdue amounts is considerably higher.

Fixed cost facilities include bank loans, hire purchase and leasing agreements, where the cost and repayments are fixed at the outset and will not change during the life of the agreement, which makes accurate budgeting far easier. While the strength of the business is still important to security, the finance company also considers the security in the asset (good equipment with a ready resale market value is easier to underwrite than a one-off machine with a doubtful provenance!) and the ability of the business to repay.

Mortgages for property and other building work are normally variable rate, linked to bank base rates but with a lower margin than other forms of variable rate lending. The lender normally retains the deeds to property until the debt is repaid.

Generally, loans, HP and other fixed-cost financing are over medium-term periods between two and five years, although they can be longer depending on the asset. This makes them suitable for machinery and other assets with a limited economic life to the business or organisation.

COST OF BORROWING - TIME AND MONEY:

Many factors impact on the cost of borrowing. A key factor is the interest rate and, as a rule, the higher the rate the greater the total amount you repay. However, the period over which payments are spread also affects the total cost of borrowing. A bit like a snowball travelling down a hill, the longer it rolls the more snow it gathers.

Unfortunately, interest rates can be calculated and expressed in different ways, which makes it difficult to compare one type of deal with another simply by looking at the nominal rate of interest. Most common are flat rates, which relate to simple interest calculation and true rates which relate to compound interest calculation. The table here shows the difference.

INTEREST RATES & THE COST OF FINANCE

Imagine you want to buy a new greensmower at a cost of £12,000, financed over 36 months. You receive three finance quotes, each with a different interest rate. Which would you choose?

1. 4.83 per cent flat pa
2. 9.00 per cent true pa
3. 9.30 per cent APR

On the face of it, 4.83 per cent flat pa wins hands down – but in reality the payments are the same for each at £381.60 per month.

Make sure you compare 'apples with apples' about what you pay and when you pay.

Spreading costs over time, makes it easier for clubs to budget for new machinery and can even increase the budget for greenkeepers to specify more equipment

Because of the difficulty in comparing flat and true rates of interest, the Consumer Credit Act requires that all credit agreements (hire purchase and loans) show an APR, which enables one lender's deal to be compared accurately with another's - provided the payment structures are the same.

However, two other factors affect the total cost of borrowing. One is specific fees and other charges that are included under the agreement, for example arrangement fees. The other is the availability of tax allowances, which vary according to whether the business or organisation buys or hires the assets.

BUY OR HIRE:

There are only two ways that a business, an individual or an organisation can acquire anything - either it can buy it or hire/rent it. The difference is who owns it after the transaction. Legal ownership is called 'title' and where title passes the prospective owner can offset part of the cost of capital purchases against taxable profits. This is called a capital allowance. Further, the interest paid each year is also normally allowable as a business expense.

Where the business or organisation simply hires an asset using leasing or contract hire, which is a special type of operating lease, then it never owns the capital asset. Under these circumstances it is able to offset the rentals paid each year as a business expense against profits for the corresponding period.

Both routes have their merits, but to claim allowances the business or organisation must pay tax, which rules out many members clubs. Obviously professional advice is essential to make the most cost effective choice, although many golf clubs now use leasing not because they are tax-paying businesses but because it enables them to spread the VAT and to fix their costs in advance. What's more, they can often benefit from low-cost finance offers made by the manufacturer with a new machine, which cut the cost of borrowing.

Eddie Henderson has more than 25 years experience in providing asset finance solutions for organisations in turfcare and agriculture. This includes retail banking and senior positions in a number of leading finance companies. More recently, his company has acted as a financial consultant to some household names in machinery manufacture and distribution. Eddie can be contacted at: eddie@echenderson.co.uk or on: 07776 197499.