PROJECTING CAPITAL FROM THE START

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By David A. Murray,

One of the main constraints for many medium sized Irish manufacturers is the availability of working capital finance.

Many financial controllers have had sleepless nights while the rest of the company's management team continue unabated with their celebration of the award of a major windfall in the form of a profitable export order gained after long negotiations and marketing effort.

The reason for the financial controllers headache is not that they are "not in the mood" to celebrate success but rather knowing the difficulty in raising the funds necessary to finance the period from purchase of raw material through the manufacture of finished goods to despatch and receipt of payment for goods.

Solving the chicken and egg situation

The traditional method of financing by way of overdraft for such an order may result in pushing the company's total facilities above the permission limit of the banks credit committee. This increased overdraft may mean a decision has to be taken by a higher credit committee or even the banks main board. There is a natural reluctance on the part of the financial controller to opt for this route as it may result in all the company's facilities being subject to review by its main bankers.

The other type of financial facilities, heretofore, utilised extensively by such rapidly expanding manufacturing companies was that of invoice discounting and factoring. However, while providing much needed working capital for rapidly expanding companies, it does not solve the classic chicken and egg financial situation. Factoring or invoice discounting only provides finance for the company after the sale has been completed and goods have been delivered to the customer, whereas the company requires the finance in order to be able to manufacture the goods in the first instance.

From start to finish line

One of the methods of financing such export orders which is gaining increased popularity with Irish manufacturers is that of project finance from UK based financial institutions and banks - Nat Bank of Washington, ANZ Bank, IOIB Bank, Stenhams, Harvey Thompson, NMB Bank and Fennoscendia Bank. There are over 600 banks based in London, some of whose origins date back to the last century and beyond. Such banks have long history and pedigree in the provision of finance to rapidly expanding companies and economies.

While Irish banks are familiar with the instruments of trade finance such as letters of credit, bills of exchange and so on, there is a clear reluctance on their part to this form of project finance for manufacturers. They incorrectly consider it as a form of unsecured credit, whereas it is secured within the nature of the manufacturing contract.

Rags to riches

A typical example of the uniqueness of this form of project finance to manufacturers can be seen in the case of the clothing industry. There are a number of such Irish companies who supply many of the large multiple retail outlets in the UK. These companies obtain their orders from UK multiples a season in advance. Some of the leading UK retail outlets include BHS, Littlewoods, ASDA, Woolworths, Levens Textiles, Sears, Selfridges and C & A Stores.

The company must then place an order for cloth from their foreign supplier, await manufacture of cloth, transport cloth to their factory premises in Ireland, manufacture garments through various stages of production, despatch goods to customer, and finally await payment from customer.

150 day financing period

The company has a requirement for a 150 day financing period, whereas in the case of invoice discounting or factoring their bankers will only make advances to the company at time of accepted invoice to the customer. This only allows for a 45-55 day finance period.

The UK financial institution will under project finance provide the funds for the purchase of the cloth directly to the foreign supplier on foot of the appropriate documentation and authorisation from the company.

The loan advanced for the purchase of the cloth is only repaid when the company receives payment in respect of the manufactured garments from its customers. Such receipts from customers can be spread out over a two month period as the UK multiple may only require delivery of goods (and attendant invoices) on a weekly basis to its various outlets.

Facilities versus requirements

The project finance facility grants the company the finance when it needs it - that is when the company places the purchase order with its foreign supplier. If the company has not the finance at this stage then it will not be able to reach day 95 of the cycle when it can factor or discount its invoices to customers.

The minimum facility that UK project financiers will provide is Stg£250,000, although each transaction financed can be as low as £5,000.