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How to make better decisions when purchasing machinery and equipment

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Whether your wish list includes manufacturing, medical, transportation or technology equipment, how you finance major purchases may not only impact the return on your investment but the success of your entire company.

David Beckstead, Pacific Region sales manager, CB&T Equipment Finance

"Financing decisions impact cash flow and a company's ability to capitalize on opportunities or respond to adversity," says David Beckstead, Pacific Region sales manager for the Equipment Financing Division at California Bank & Trust. "Executives need to weigh their options carefully before making a decision."

Smart Business spoke with Beckstead about the need for prudent financing decisions when purchasing machinery and equipment.

What should executives consider as they are reviewing various financing options?

The rule of thumb is to match the financing terms to the life of the asset. In other words, it's best to use short-term financing for short-term business needs, and longer-term financing for long-term business assets such as equipment that will generate revenue or reduce operating costs for the foreseeable future.

You can avoid finance charges and interest by paying cash, but leasing the equipment or borrowing the funds lets companies preserve capital for other purposes. You should also consider the tax implications and the ultimate cost of the equipment along with your ability to make a substantial down payment to secure a traditional bank loan.

When does leasing make sense?

Leasing makes sense when companies want to preserve cash for future growth or expansion, they need flexibility or they don't have a lot of cash to put down. Since leasing companies usually maintain ownership of the asset, companies can upgrade or return the equipment should their needs change. For example, you can align the lease terms with a customer agreement or upgrade to a bigger, faster model as your company grows. Plus, most leasing companies don't require a down payment and it may be possible to negotiate a longer-term payment plan, improving cash flow.

With leasing you can usually deduct the lease payments as a business expense on your tax return, and on short-term leases the rental expense may provide a better tax benefit than depreciating the asset. You may be able to transfer the risk of ownership to the leasing company depending on the type of lease.

How can executives research the market and secure favorable leasing terms?

Prioritize your needs, and then search for the best combination of rates, terms, flexibility and customer service by contacting several firms. Bank leasing companies usually have high underwriting standards but lower rates, while finance companies can be more lenient lenders but generally charge higher rates. Vendor finance companies are a third option and are generally the most flexible about taking back or exchanging equipment. However, they usually charge higher rates.

Beware of upfront payments and fees, hefty residual payments, pay-off fees and other clauses that may boost the overall cost of the equipment. In fact, it's a good idea to ask a knowledgeable third party to review the agreement so you don't forsake the benefits of leasing by accepting disadvantageous terms.

What should executives look for in a leasing firm?

Always consider a firm's reputation, check its references and read its contract before requesting a quote. Contracts differ between companies and impact everything from tax deductions and residuals due at the end of the lease to the responsibility for servicing the equipment. Finally, select someone you trust. Your financing partner should provide funding and be committed to your success.

David Beckstead is Pacific Region sales manager for California Bank & Trust Equipment Finance. Reach him at (949) 457-0458 or david.beckstead@calbt.com.

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