

The year ahead for SMALL BUSINESS

The experts weigh in on what small business owners can expect in 2012...

"The short-term global economic outlook is negative. Things are going to become darker before they become lighter." While these words from American economist Nouriel Roubini are not ones we'd hope to start 2012 off on, they are well backed by evidence of insufficient recovery from the last recession, growing debt and worldwide confidence crises.

And as a global player, South Africa, and indeed local SMEs, cannot expect to avoid the effects of this world condition. "While the last recession affected South African small businesses far less severely than it did their global counterparts, many ventures were forced to close down or move to survival mode," says Gerrie van Biljon, Executive Director for Business Investments at Business Partners. He goes on to say that today's economy is so integrated that no industry is safe, although certain sectors will feel the brunt more than others. "Businesses offering products and services in the category of discretionary spend will always be more vulnerable, as consumers are forced to cut their level of luxury spend. Tourism is an example of such an industry."

On a positive note are the comments from Cees Bruggemans, Chief Economist at FNB, in light of the 15 November release of the FNB/BER consumer confidence index for the fourth quarter of 2011, who says that consumers are somewhat less exuberant than a year ago, but still show high levels of confidence. "This latest survey suggests that for some consumers, perhaps fearing the worst around mid-2011, the worst did not in fact happen, restoring some strength to the positive convictions still driving consumer spending onward."

Factors affecting SMEs

Purely economic factors, aside, Dr Mike Herrington, Director of the UCT Centre for Innovation and Entrepreneurship at the UCT Graduate School of Business points to some overarching factors that he believes will affect South African entrepreneurs in 2012. The first is political instability. "Strikes and talk of nationalisation are just two areas that are creating a lot of uncertainty amongst overseas investors," says Herrington. "I don't think there is going to be a lot of capital coming in and businesses are not re-investing in the way that they would normally invest."

A second area for concern that he sees are the onerous labour laws. "There is a direct correlation between the level of entrepreneurial activity in a country and the labour law practices. The statistics show that if it's easier to hire and fire people, it's easier to start businesses," Herrington acknowledges that these laws have been brought into effect to protect employees' rights and as such there is no current solution; but it is something to bear in mind.

The third factor that entrepreneurs need to take into consideration is the lack of availability of finance. "Let me quantify that, there is a lot of funding that is supposed to be available from government," says Herrington: "But if you speak to people who have actually had any joy, the figures are infinitesimal."



Gerrie van Biljon

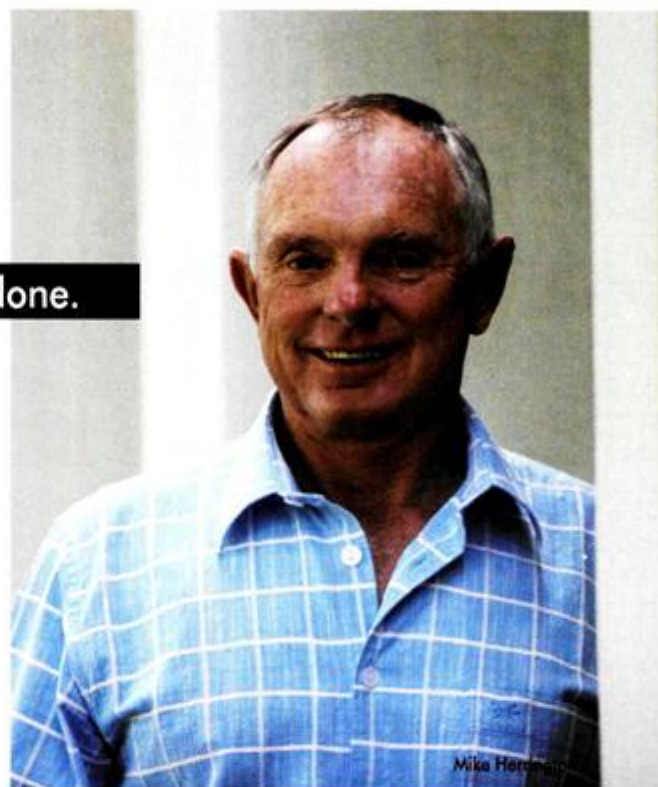
**With the right frame of mind,
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Mika Herrington

Finding finance

And it doesn't look like 2012 will ring in any changes on the funding landscape either. "Unless organisations like the National Youth Development Agency stop allocating 45% of their budget on salaries, entrepreneurs can't look to government for help," says Herrington. And the banks? "The banks are trying, but they're restricted. And they do asset-based lending so are never the best option for start-ups."

Herrington says that business owners will more than likely look to private organisations that support entrepreneurs in all areas of their start-up, including finance. "Or microfinanciers, though they are not cheap. Or angel investors, though they expect good returns too and are few and far between."

Against this somewhat gloomy backdrop, Van Biljon is confident that business opportunities still abound. "With the right frame of mind, a positive attitude and an eye for business, there are gaps to be spotted."

Herrington still sees tourism as a major opportunity. "And anything to do with sustainability. We know that we need to build a lot of houses, and these houses need to use less electricity and reflect green principles; so there is a lot of money to be made by people supplying good, solid materials for this industry." He recalls a recent comment made by a visiting British businessman: "There are amazing opportunities in South Africa – from agro-processing to hydroponics to IT; there are just so many gaps."

And of course, Africa represents great prospects too. Maria Ramos, Group CEO of Absa Group Ltd, shared her view at the

2011 Discovery Invest Leadership Summit that Africa (together with Asia) has the potential to become the epicentre of the global economy. "The challenges now faced by developed economies also present a unique opportunity to close the gap between them and developing economies," she said.

Quoting Harvard economist Dani Rodrik, she said that rapid growth in the developing world is the only thing that could propel the world economy forward and generate increasing demand for rich-country goods and services; it's the only silver lining in an otherwise dreary future. "The questions we must now ask ourselves are the following: What are the drivers of unprecedented growth in Africa and Asia? And perhaps, more importantly, what must Africa and Asia do, immediately, to capitalise on this historic opportunity to converge on developed economies?"

These are questions that South African business owners need to be asking too, bearing in mind the advantage of proximity to the rest of the continent that they have playing in their favour.

Herrington's advice for entrepreneurs looking to start up in 2012 is therefore to look for these huge opportunities and to go after them. "But look for something that has not been done, and that is different to what has been done. Because if you start another me-too business, you won't succeed."

If the advice of the experts is anything to go by, 2012 won't be easy. But being a business owner is never about having it easy, and perhaps it is in difficult circumstances that entrepreneurs thrive most. We wish you all the best for a challenging, flourishing year ahead. **YB**

Put your limited capital to best use

Tips for capital budgeting and managing your cash flow...

In the final instalment of this series, we're going to look at the big "C" of business – capital. First off, we'll be dealing with the practice of allocating it effectively for big expenditures – known as capital budgeting – and we'll follow that with an overview of its day-to-day flow – which is working capital, and the management thereof.

Capital budgeting

Most business owners have to make a variety of decisions when they come to a fork in the road. These could be operational; deciding which model of machine to replace the current one with, for example, or which new product to start manufacturing out of an assortment of options. Or they could be more strategic; such as picking between huge marketing campaigns, or deciding where to open the next branch. Whatever the decision, there will be a number of routes that could be followed. But they all have one thing in common: they cost money.

Faced with having to put your limited capital to best use, it helps to have a set of tools to identify and evaluate potential investments, and this is where capital budgeting comes in.

A few fundamental principles should be applied. Firstly, capital budgeting focuses on cash flows from investments, and not necessarily on profit or loss. Reduced to its most basic level, if a project isn't generating (or saving) cash, then it's not worth looking at. The second principle is that projects should only be considered if they're going to add value to your firm. To add value, a project must generate a return higher than your required rate of return (also referred to as the cost of capital). If the project doesn't generate a return of at least the minimum required, then the scarce capital could be put to better use elsewhere, and the project should be discarded.

In realistic terms, there are two approaches when making capital budgeting decisions. The first is an accept-reject approach, where a project or investment has to meet specific minimum requirements to even be considered. The second is a ranking approach, where projects are ranked according to their projected returns, with those with the highest potential first in line to have capital allocated to them.

In practice, a combination of the two approaches is usually used; the former

WHAT'S A DECENT RATE OF RETURN?

This depends on a number of factors, and will differ from business to business. It basically boils down to what percentage you want to make on your money – versus what you could be earning if you put it elsewhere.

One factor to take into account would be prevailing interest rates. If interest rates are high, your money could earn a solid return sitting in a risk-free savings or money market account. Another factor would be the riskiness of the venture. If a business or project is deemed high risk (say, a start-up, or moving into an untested marketplace) then investors and shareholders would want to be compensated for that extra risk, and would want a good margin over and above what they could earn risk free.

With prime currently sitting in the high single digits, it's safe to say that most would want a percentage return in at least the teens. A broad rule of thumb is that you shouldn't go into a small business unless you're looking at a return of 20% a year. Venture capitalists would generally want an even higher return than that – again, it all boils down to the people involved, their options, their alternatives, and their risk appetite.

is used as an initial screening tool, with the latter then used to make final spending decisions.

While a detailed discussion of the actual tools used in capital budgeting is beyond the scope of this article, a broad-brush sweep over them would look like this:

- **Payback period.** This method looks at the number of years worth of cash flow it would take to recover the initial outlay.
- **Net present value.** Using the time value of money, future cash flows are discounted to a present value (today), to allow for comparison to the initial outlay.
- **Profitability index.** Using the time value of money again, this method measures the present value return of each rand invested.
- **Internal rate of return.** The most complex of the methods, this calculates the exact return that an investment would entail, to cover the cost of the initial expenditure to the rand.

Managing working capital

Even if much of what has been said above doesn't apply to your business – if for instance, you run a service business without huge fixed assets or capital investment - you're almost certainly going to have to face up to what follows...

The working capital of a business refers to the difference between its current assets and its current liabilities. The former would generally be a mix of cash, debtors (accounts receivable – what you're owed by your customers) and inventory. The latter would be things like short-term debt (an overdraft for most businesses) and creditors (accounts payable – what you owe your suppliers).

You ultimately want to have positive working capital; this implies that you

have enough short-term assets to cover your short-term liabilities. This all ties in with the liquidity of your business – the more liquid a business, the easier it is to pay your bills when they fall due, the easier it is to take advantage of market opportunities, and the less stress you have to endure...

Managing working capital can be broken up into three main areas: managing inventory, managing accounts receivable and payable, and managing cash itself.

1. Managing inventory

The reason it's so important to manage inventory (or stock, as it's also commonly known) is that it can use up your cash resources. Inventory sitting in your office or warehouse represents cash that's tied up and can't be used somewhere else to earn a return. And it also costs money to keep it there. Whether it's paying for storage, insurance or salaries - the costs attached to keeping inventory on hand are real.

So, is the answer to keep little or no inventory? Unfortunately it's not quite that simple. You have to keep stock on hand to fulfil orders as they come in. If you can't fulfil, you'll lose customers. It becomes a juggling act; keep enough stock around to fulfil workflow and orders, but not too much, or you're wasting money and tying up valuable cash.

2. Managing accounts receivable and accounts payable

You want to hold onto your cash for as long as you can. This may mean that you stash it in an account to earn a few bob in interest, or at the very least, pay less on your overdraft every month. The idea then is to collect on any money owed to you as quickly as possible, and take as long as possible to pay it out - without damaging your reputation or relationship with your suppliers.

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The process of managing your accounts receivable starts before you even make a sale. By applying solid credit selection principles, you can proactively weed out those customers who are likely to give you trouble when it comes time to pay up. Run credit checks, ask for references, look at their financials – these are just a few of the ways to weigh up if you should grant credit to a potential client.

Once you've decided to grant credit, you can either be proactive – send out invoices

early and often, offer early payment discounts – or reactive – charge interest on overdue accounts, withhold stock, threaten legal action. As any seasoned business owner will tell you, it's more often than not a combination of the two.

Managing accounts payable boils down to hustling for extended payment terms from your suppliers. Once you've built up some form of track record or history with them, ask if they'd be prepared to extend you terms. If you've been a good customer

to them, and there are other potential suppliers out there, they're not likely to refuse you. Once you've got terms, though, don't abuse them. Make use of the extra period of time you can hold onto your cash for, by all means, but treat your suppliers with the same respect that you would expect from your own customers.

3. Managing cash

As much as cash is the holy grail of the business world (cash is king, after all), it's also the area of your business that is most susceptible to fraud and theft. There are a number of good reasons for holding cash in your business (paying wages, for example, or negotiating for cash discounts with suppliers), but this needs to be countered with a solid system of checks and controls.

Centralise the receiving and disbursement of cash as much as possible, but try to separate handling cash from bookkeeping

How to buy assets for your business

Are you looking to replace an outdated asset, introduce new technology or expand your operations?

Before making the purchase decision, consider carefully the impact on your business. Assets include: fixed assets such as buildings and land, productive assets such as plant and machinery and operational assets such as vehicles, office furniture, computers and machinery. Before acquiring an asset, consider the following:

- Is it absolutely necessary to acquire it immediately?
- Can the current asset still be used?
- Is finance available to pay for the acquisition?
- What impact will the new asset have on the company? (cash flow, staff training, production, extra sales, more inventory etc.)

When making this decision:

- Take the affordability of the asset into

consideration,

- Conduct a needs analysis, and
- Identify how productive and profitable the asset will be, taking into account its impact on the entire business.

A new asset on your balance sheet will raise your borrowing percentage or gearing, and could negatively impact your ability to borrow for working capital. It also has a non cash flow impact on profits through depreciation. These factors could affect your decision...

Your funding options include:

- Own cash resources,
- Bank funding (hire purchase, mortgages, leases, bank loans and overdrafts),
- Vendor finance (where the seller of the asset is prepared to accept payment over a

period of time),

- Specialist risk finance company Business Partners (specifically for the acquisition of small industrial space), and
- Industrial Development Corporation (for larger industrial and manufacturing plants).

The department of trade and industry provides financial support to qualifying companies in various sectors of the economy. Financial support is offered for economic activities, including manufacturing, business competitiveness, export development and market access, as well as foreign direct investment. Other development agencies such as the Umsobomvu Youth Fund, National Empowerment Fund, National Youth Development Agency (NYDA) and CIDA Empowerment Fund ("CEF"), also

and recording it. Simple systems like ensuring cash receipts are given to customers, and written requisitions or slips being signed before cash is handed out, will go a long way to keeping your cash under control.

So, whether you're trying to decide where to allocate capital for big expenditures, or simply trying to manage it in its cash flow form, using and applying the tools mentioned here is a solid step towards making your business as effective and efficient as possible. **YB**

Gareth Cotten is an experienced financial consultant and is the course convener for the part-time University of Cape Town *Start and Manage a Small Business* course, starting February 13, 2012, and the part-time University of Cape Town Basics of Financial Management course, starting February 10, 2012. Both courses are presented online throughout South Africa in conjunction with online education company GetSmarter. Visit: www.GetSmarter.co.za.

assist in making capital available to selected constituencies.

When considering acquiring assets for your business, approach your accountant, banker or other trusted source to help you make an informed decision regarding issues such as finance and the impact on the business. A spur-of-the-moment decision could negatively impact the business.

Also consider your reasons for acquisition carefully and whether the item is a nice-to-have or a must have. Will it improve productivity, will it improve processes and outputs? Will this purchase have a positive impact on the long-term wellbeing of your business?

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