

# SMEs and GOVERNANCE

11 December 2019

BUSINESS/PARTNERS  
Investing in entrepreneurs

# INTRODUCTION



We're a specialist risk finance company that provides customized financial solutions and mentorship to SMEs in South Africa

We expanded our service offering in 2004 to other African countries including Kenya, Malawi, Namibia, Rwanda, Uganda and Zambia

With initial capital of \$20 million provided by our Shareholders in 1981 - the lending portfolio increased to \$300 million without further contributions from the Shareholders

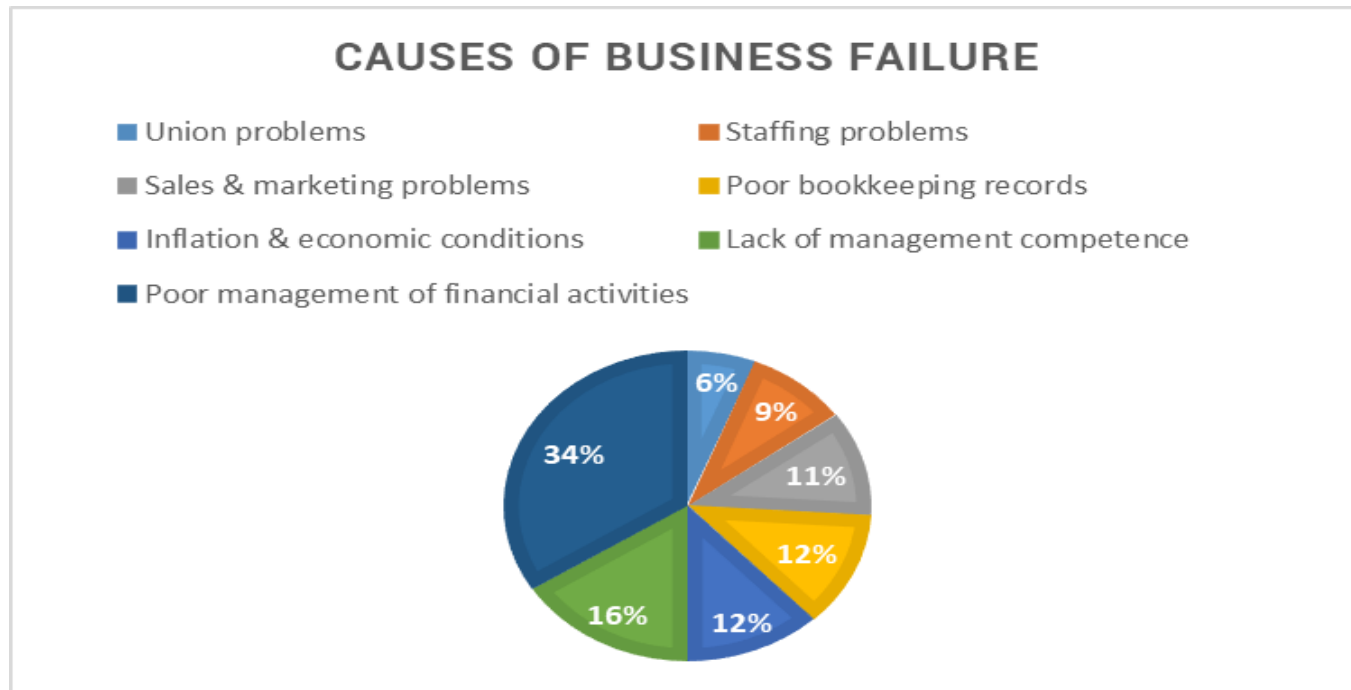
Between 2005 and 2013, we returned to our Shareholders in excess of 2.5 x their original investment in the form of dividends

***This presentation provides instances where poor governance could have a detrimental effect on the SME and the remedial action implemented***

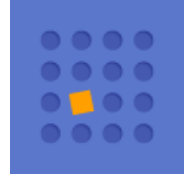
# CAUSES OF SME BUSINESS FAILURE



A review over 5 years of Business Partners South African SME lending portfolio found that *62% of business failures could be attributed to financial, management and reporting factors*



# COMMON ISSUES EXPERIENCED BY SMEs



*Entrepreneurs' key challenges are commonly cited as:*

- Access to finance
- Access to support services

Lack of credible management information severely restricts the level of funding as well as the cost thereof

*Entrepreneurs often have industry-specific skills but need access to:*

- Business expertise and resources
- Good management practices
- Information, know-how and learning opportunities
- Networking opportunities
- Non-financial support

# COMMON ISSUES EXPERIENCED BY SMEs



- **WANTING TO EXPAND TOO QUICKLY**

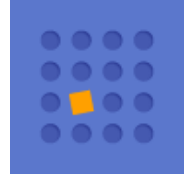
The Entrepreneur has built a successful business and now wants to expand / grow too quickly

Entrepreneurs have a tendency to focus on increasing sales / growth and then find ways to finance the growth

An example:

*An Entrepreneur was operating a successful 10-roomed hotel and wanted to finance an expansion plan to increase the number of rooms to 40*

# COMMON ISSUES EXPERIENCED BY SMEs



- WANTING TO EXPAND TOO QUICKLY

## How to overcome this challenge:

By obtaining advice and having access to a Financial Consultant, Entrepreneurs can obtain an independent view as well as be guided / informed of potential financial and labor issues and necessary changes to the business model due to expansion

Potential risks to the business can be identified such as customer / product / market concentration risk

Working capital management and managing cash collections from customers

# COMMON ISSUES EXPERIENCED BY SMEs



- **MERGING SUCCESSFUL BUSINESSES**

An example:

*Three Entrepreneurs operated successful businesses in the same industry and they decided to significantly grow their businesses and market share by merging the three businesses together*

# COMMON ISSUES EXPERIENCED BY SMEs



- **MERGING SUCCESSFUL BUSINESSES**

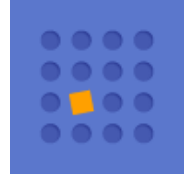
## **How to overcome this challenge:**

Prior to merging businesses together, it is vitally important that the Entrepreneurs clearly and formally document their expectations on how the new business will operate, its strategy and each Entrepreneurs' role and responsibilities in the new business

By formally documenting their understanding, the Entrepreneurs ensure that they are in agreement with the direction which the business will take and their respective roles



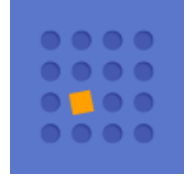
# COMMON ISSUES EXPERIENCED BY SMEs



- **POOR ACCOUNTING RECORDS / CASHFLOW MANAGEMENT**

As the business grows, the lack of real-time management information is a significant operating constraint as it is difficult (if not impossible) to track the performance of the business such as delivery schedules, payment dates for creditors, extent of available cash and cashflow forecasting, ensuring compliance with Revenue Authorities and other Regulatory Bodies, etc.

# COMMON ISSUES EXPERIENCED BY SMEs



- POOR ACCOUNTING / CASHFLOW MANAGEMENT

## How to overcome this challenge:

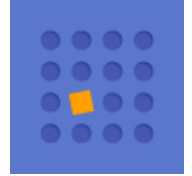
Many Entrepreneurs view the appointment of an Accountant and the purchase of record-keeping software as an expensive “grudge” purchase

On the positive side – the cost of technology is decreasing and the type of software available is becoming more extensive and easier to operate

Entrepreneurs need to have / obtain an understanding of financial information

The capital structure of SMEs in the first few years of operating have high gearing levels in relation to the available capital – by reassessing how funding is provided to SMEs, the levels of debt could be decreased, impacting positively on cashflow management and reducing the interest burden

# COMMON ISSUES EXPERIENCED BY SMEs



- **ENTREPRENEUR UNWILLING / HAVING DIFFICULTY IN DELEGATING RESPONSIBILITY**

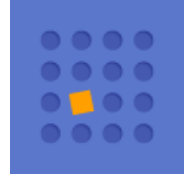
This is a significant constraint in preventing a good business turning into a great business

It requires an upfront cost before benefits are seen / materialized

An example:

*If the Entrepreneur hires additional sales personnel, the salary costs are incurred immediately, but the benefit in terms of increased sales takes time*

# COMMON ISSUES EXPERIENCED BY SMEs



- Entrepreneur unwilling / having difficulty in delegating responsibility

## How to overcome this challenge:

As mentioned previously, the benefit of having a Financial Consultant is that he can be the “voice of reason” with the Entrepreneur

For any growing business, it reaches the point where the Entrepreneur has to divorce their lives from the business and implement clear lines of authority and responsibility between Shareholders, Directors and Management

# FINAL THOUGHTS



**Entrepreneurs can't afford to make mistakes as they do not have excess capital available to recover from bad decisions**

**Success is due to a lot of small correct decisions taken each day**