BIZCOMMUNITY

How SA's 'junk' status impacts your startup

By Tom Jackson

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April began with ratings agencies Standard and Poor's (S&P) and Fitch downgrading South Africa's sovereign credit rating to “junk” status, meaning both existing and new funds borrowed by South Africa will become more expensive. But what impact will this have on the country's startups?

Image via www.disrupt-africa.com

According to Mark Paper, chief operating officer at risk finance firm Business Partners International, the downgrade means lending and seeking loans will become more costly for consumers and businesses, as interest rates and costs rise.

Local businesses will feel the ripple effects from the increased burden placed on domestic banks, including their ability to service foreign currency obligations.

“The South African banks are directly impacted by South Africa’s sovereign credit rating and as a result of the downgrade to junk status, S&P also downgraded South African banks to junk status,” Paper said.

“Thus an increase in borrowing costs by the domestic banks will, over time, put pressure on shareholder return. In order to bolster this return, banks will be forced to increase the cost of funds while reducing operating expenses – both impacting on the South African SME ability to obtain and service loans.”

Ripple effect

These factors can be expected to have a ripple effect for consumers, who will have less disposable income.

“These are all factors that influence the health of a small business’ cash flow at the end of the day,” Paper said.

While investing in South Africa is now deemed to be riskier than it was in March, Paper said this should not deter SMEs from investing in their business and contributing to the country’s economic recovery.

“While faced with these uncertain times, it doesn’t mean that SMEs should suspend activity, or stop moving forward. Borrowing money, in good or bad times, can make a lot of business sense for well-managed companies,” he said.

Factors to consider when seeking new funding

In these uncertain times, there are several factors to consider when managing existing debt or seeking new funding.

“SMEs need to ensure that they understand the funding options that exist, as well as what type of funding is best suited to their needs – be it equity, long-term debt for fixed assets or shorter-term working capital – as this will determine who to approach, the term and price to pay, and what impact this will have on the business’ cash flow,” said Paper.

SMEs should seek expert advice prior to obtaining new funding, he said.

“By speaking to a financier who not only offers the right type of funding, but who also understands the business and the challenges likely to be faced in these uncertain times, will enable the business owner to be realistic about short- and long-term cash flow projection,” Paper said.

He also advised SMEs to take another look at their business plans and review ways in which they could improve performance.

“SMEs should get back to the basics of focusing on the selling the right product or service at the right price and not chasing turnover for turnover’s sake.”

"Bad debt is a problem"

If SMEs are providing credit terms to customers, Paper said business owners should put more emphasis on handling their debtors promptly and professionally to ensure their cash flow is not affected when it is needed.

“Every business has its share of slow-paying and non-paying customers. Bad debt is a problem for businesses of all sizes. This position is made even worse during difficult economic times, especially for a small business where one non-paying customer may be the difference between survival and failure,” he said.

Now more than ever, South Africa should be backing entrepreneurs, Paper believes.

“Creating an enabling conducive environment for SMEs will always go a long way in helping more businesses grow and will add to the overall success of the country’s economy. It is, therefore, crucial, particularly in trying economic times, that South Africa creates an enabling environment which supports business’ ability to transact,” he said.

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ABOUT TOM JACKSON

Co-founder @DisruptAfrica. Tech and business journalist in Africa. Passionate about the vibrant tech startups scene in Africa, Tom can usually be found sniffing out the continent's most exciting new companies and entrepreneurs, funding rounds and any other developments within the growing ecosystem.

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