

SMEs need to create a cash cushion to survive

The National Debt Mediation Association announced last week that there has been a substantial increase in small businesses going under due to financial stress, and that many people are taking out personal micro loans to support their businesses. Unlike large corporations, small and medium enterprises (SMEs) do not have the large cash reserves required to navigate the turbulent economic conditions currently being experienced in South Africa.

According to Gerrie van Biljon, executive director at Business Partners Limited, saving can be a challenging task for SMEs, but may prove to be crucial in determining a company's survival in the long run. "In light of the recent global financial crisis and European debt crisis, this year's national savings month needs to play an important role in reminding business owners of the importance and long-term financial benefits of building a sufficient cash cushion."

Build a cash cushion

He advises that from inception, SMEs should create a culture of setting aside savings for financially stressful periods. "When spare capital becomes available business owners naturally tend to invest in productive assets rather than cash reserves. Although in normal conditions this would be a sound strategy, it is critical that SME decision-makers consider first building a cash cushion to provide for short-term liquidity needs that may arrive unexpectedly."

Van Biljon says that one of the primary reasons companies fail is due to the lack of a sound financing structure, especially amongst highly leveraged businesses. "These businesses typically have fixed financial commitments, which places undue pressure on operations and make the business more vulnerable to volatile changes in market conditions. Financial pressures, such as this, may result in the focus of the company shifting to satisfying short-term financial obligations rather than focussing on long-term prosperity and growth."

"At the very least a cash cushion should consist of two to three month's net income. Thereafter, business owners need to start saving on a monthly basis in order to reach the short to long-term goals of their company. Only when this sort of culture is established among local SMEs we can start to safeguard and grow this vital economy-driving sector," concludes Van Biljon.