Business warned to watch debt levels in contracting economy

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With the South African economy skirting recession and insolvencies on the rise, experts warn that businesses need to pay closer attention to their financial health to avoid getting into trouble.

The news of an interest rate hike should signal to businesses that they need to pay closer attention to their debt levels and invest more time beefing up financial literacy across their organisation.

Associate professor Mark Graham from the University of Cape Town (UCT) College of Accounting says: “There is no doubt that financial skills become crucially important during economic downturns and when companies are not doing well.”

Professor Graham convenes an annual course at the UCT Graduate School of Business (GSB) on Finance for Non-Financial Managers. He says that while debt is critical for leverage and an important tool to help a company expand and grow - excessive debt can prevent them from being agile, because lenders often place restrictions on loans locking companies into a strategic path.

“And of course if interest and principal payments are not made as per the contract, a company can lose assets or even face bankruptcy. Monitoring balance sheet ratios effectively at such times is critical. Furthermore, working capital and margins need to be carefully monitored and costs kept under control,” he says.

Graham says it should not just be the job of the chief financial officer to keep an eye on the numbers.

“It is during times of economic stress that the ability to read financial statements and do some simple financial analysis becomes paramount at all levels of an organisation,” he says.

The SA economy is definitely stressed. In January George Herman, head of South African investments at Citadel Investment Services said that in addition to a recession, the country will probably be downgraded to sub-investment grade. He cited the weakened rand, the drought, electricity shortages and weak global demand as some of the reasons.

According to trade credit insurance provider, Euler Hermes, insolvencies will increase in 2016 due to the instability in emerging markets. The group’s economic outlook 2015-16 report states that insolvencies in South Africa will increase by about 10% due to a slowdown in economic growth. The report also notes concerns in the business environment: excessive red tape, labour tensions, an embattled power utility, lower international commodity prices, the Chinese economic downturn, as well as the national drought that grips the country, which is expected to escalate food prices.

Smaller businesses will be under more pressure as they often have less access to extra credit or financial support. For them, understanding the nitty gritty of their businesses finances will be crucial to ensuring that they don’t flounder when the economy hits rough waters, says business adviser Brad Farris.

And Graham agrees: “Being financially literate will assist managers in this regard, as they will give an indication of which assets can help their business, and which will not. Unless you can read the language of finance, you might find yourself making the wrong choices."

The Finance for Non-Financial Managers programme offers practical, accessible information about accounting and finance, designed to teach non-financial managers about how finance works in business. It is aimed at team leaders, entrepreneurs, managers or even section heads – anyone wanting to know more about how numbers work.

Graham says the financial skills taught on the intensive four-day programme will enable someone who runs a business or department to identify where their business is at risk or where potential areas of risk are.

“During the course we do cover the ‘red flags’ that can help management identify that the business is moving in the wrong direction,” he adds.

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