Steve Woods

It's the Cash Flow, Stupid! How SMEs Can Capitalise on Buying Shares to Benefit Themselves

IPOs and hot shares seem to be the "big thing" in Kenya these days. They draw millions of individual shareholders every time they appear in the scene. Should SMEs be quick to join the madding crowd? Aly-Khan dishes out the answer. Straight.

Aly-Khan Satchu

How can small and medium enterprises (SMEs) capitalise on buying shares to benefit themselves? The answer is they should manage their cash flow properly. This is essential and a no-brainer for any business. In what is oftentimes a Darwinian world, this is even the first imperative. The Right Honourable Margaret Thatcher, who won three consecutive terms as the British prime minister, always referred to herself as a grocer's daughter who learned principles that applied at the family, business, and state levels. She once famously banged her handbag on a table at a European Heads of State summit to make that very point. So one of the first things I analyse is the balance sheet.

The term SME applies to many different businesses at various points in the development curve. If you are a start-up in a particular niche, it would not be prudent to venture into the stock market. At an early stage, it makes more tactical sense to expend your energies on your core business and offering. If you have invited investors into your start-up, they will also prefer a focused team rather than one that's off message. The rule in early stages then is to concentrate on your cash flow and get it to work. It would be unconscionable for you to ask for more cash for your business when you lost funds on the bourse. Your investors will consider you irresponsible, especially if they felt you had a compelling business. So an SME in its infant phase should not dabble in the stock exchange. Conserve your cash to reduce your dependency on overdrafts and bank borrowings. Interest rates in Kenya remain severe. Those with longer memories will remember their sharp spike in the 1990s, which crippled many worthy and ordinarily profitable businesses.

Now that you have fixed the cash flow

Once you have stabilised your cash flow, you reduce your reliance on banks and can now throw off excess cash. Of course the business has to come first, so the cash flow I talk about is the free cash flow. In this case you now have a treasury-type function. You must deliberate on the best ways to maximise the returns from your free cash flow. You have to recognise the cash flow's longevity. You might have millions in the bank now, but you might need it for capital expenditure in four weeks' time. It would certainly make more sense then to put those funds on deposit, so the maturity coincides with the capex.

Today the bourse trades automatically. You can buy or sell shares for cash within five days, so investors take comfort in their investments as "near cash" instruments. When the SME is in a surplus cash position, the treasurer might then contemplate investing the surplus in the stock exchange. It is always advisable to have a time horizon because the market can be highly speculative. Not so long ago, Sameer Africa was allegedly the subject of a takeover bid, which caused its shares to rise from KES12 to a high of KES38 in a few short days. It did not happen though and its share price currently trades at about KES8.10 (late September 2008 figure).

An SME that wants to invest needs either a very skilled equity investor in its team or some value-added advice. It should not treat its foray into the stock market as it would a visit to the casino but as an intelligent investment designed to maximise and add value to its bottom line. Compare Sameer Africa to Equity Bank, which has risen about 800 percent in the last 24 months. Clearly, if you had invested some surplus funds in Equity Bank (versus putting it in a fixed deposit, which would have ended up at a maximum of 20 percent all in), you would have done very well. I certainly feel the market is worthy of attention. Once the SME is in a positive cash flow, it will be worth its while to think of investing in it. I know I put a lot of caveats in, but they are for a reason.

I regard this period ahead of us as a golden age for the sub-Saharan equity markets. Just look at ourselves. Safaricom was just shy of USD1 billion and was many times oversubscribed. We have nearly 1.5 million shareholders, which

Steps for transacting at the bourse

1. The first step is to open a Central Depository and Settlement Corporation (CDSC) account, which is like a bank account. You can use the same account to trade through multiple brokerages.

2. The next step is to identify a broker with whom you can do business. Some basic considerations for your choice are the following:

- Capitalisation. Your broker should be well capitalised. It would be outrageous to find yourself in a queue of creditors. I accept you can make a loss on an investment because of a wrong decision. If you make the right decision though and can't get your funds, then that is just not on. It's a partnership; you first need to consider your partner's strength.

- Prompt payment and good record keeping and settlement. The market trades for a five-day settlement. You need to have assurance that your broker will be professional and keep to that schedule and maintain proper records and the like.

- Research and advice. I personally like to make my own decisions, which is how I conduct my life. I follow 400 markets—crude oil, coffee, Chinese shares, etc—every day. I like to consume a lot of information, so a strong research department adds lots of value. The basics like a yearly financial calendar (dividends, results, etc) to new eye-popping research are key considerations. It is important to plug yourself into a viable information stream.

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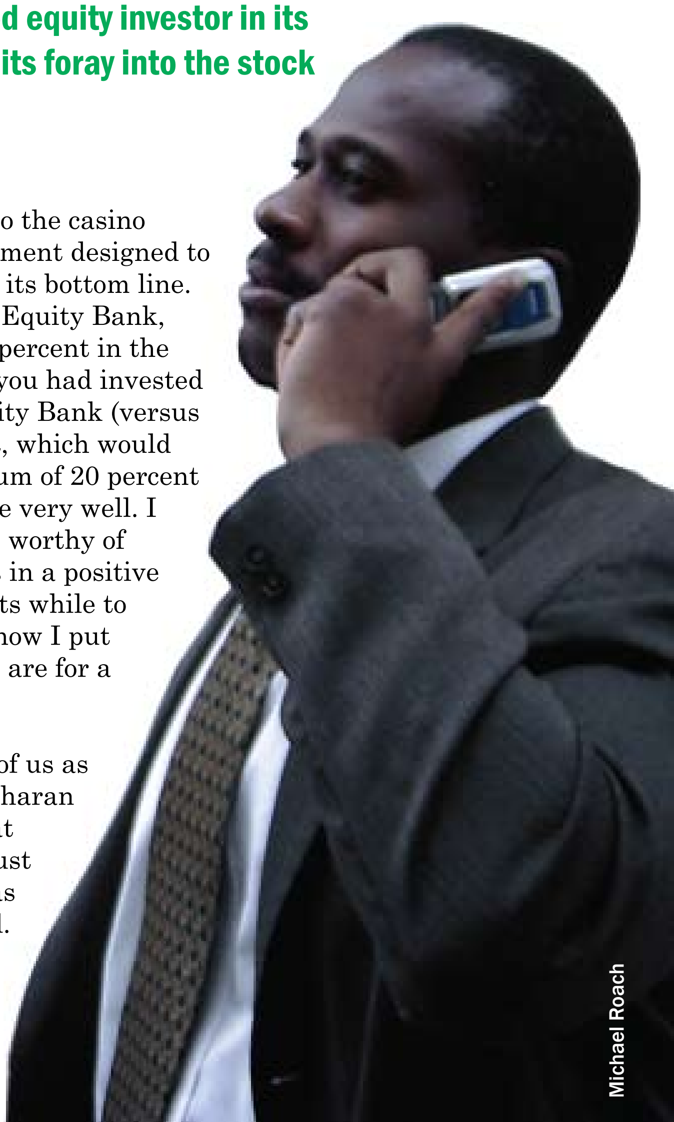

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that issuers will continue to discount IPOs, so we can expect an immediate uplift in the share price. The important thing about investing is setting clear and objective goals. The Daily Nation reported that some investors were disappointed because the Safaricom share did not trade as high as KES50—an insane scenario, if you ask me. Its share had risen to KES7.50, which already gave investors a 50 percent return. In this day such a return is very handsome.

I strongly feel that SMEs should first focus on their core offering. Get the core offering right and get into a position where you have surplus cash and then start looking at the bourse. For example, if you are in farming,

characterises a "shareholder revolution". We see previously fragmented markets develop scale with the mobile phone as the vital driver. I certainly consider the landscape very fertile for savvy equity investors.

Now I would err on participation in the initial public offering (IPO) niche. It presents the best risk-adjusted returns and has a clear and definite timeline. The cycle from application to trading at the bourse is normally less than two months. I believe

you might put your experience to good effect in the agricultural markets. You don't have to limit yourself to the stock exchange. It's no good building an edifice on shaky foundations.

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