



# Navigating the Global Financial Markets

**Global financial markets are in trouble. As they affect your life as an entrepreneur, how do you survive?**

**Aly-Khan Satchu**

**W**hether you live in London, Nairobi, New York, or Timbuktu, it has been hard to avoid the financial markets. International markets have been like a thriller, with daily twists and turns, precipitous and gut-wrenching falls, and short-lived rallies. No Hollywood writer could have written the script better.

Nearly every equity market you care to look at right now is at multiyear lows. In some cases, such as Iceland and Pakistan, they have gone technically bankrupt. In Iceland supermarket shelves were emptied as imports were cancelled because there was no more hard currency. What started in the United States of America (the centre) has infected the periphery. Even here in Kenya, we have felt the hot breath of the angry bear. The shilling has been hammered lower; the Nairobi Stock Exchange has slumped. What happened?

I'll start at the beginning. In the UK and the US, banks made loans against real estate to every Tom, Dick, and Harriet. As they lowered their lending standards, loans

became easier to get and real estate values spiked higher. They bundled up these loans into packages, which contained hundreds of different borrowers. These loans became bonds. Many of them were made with artificially low teaser rates, which then ratcheted higher after 12 or 24 months. For as long as folks met the interest payments, all was hunky-dory. Sometime in 2008, however, as teaser rates expired, people started to default on their loans. They could no longer afford to pay.

Very soon the value of properties started to slump. What banks said was worth 98 cents to the US dollar was now worth the difference between what the house was currently worth minus what was initially paid for it. Banks woke up to the fact that their collateral was eroding at spectacular speed; they were very deep in an avalanche. Merrill Lynch sold some of these bonds for 20 cents to the US dollar and the game was up. A further problem was that banks had bought these bonds with borrowed money. In some instances they had bought USD100 worth of these bonds with only USD4 of their own and the rest, borrowed.



Subhadip Mukherjee

## The first thing an SME needs is a coherent view of the world and an awareness of the challenges other SMEs face.

Suddenly, those who had made the loans to banks said, “Hang on! This doesn’t make sense. We’re in big trouble.”

The problem was felt most sharply in the United Kingdom and the United States. Their banks had gone overboard in a big way, but the risk had been distributed all over, so banks from China to the Gulf suffered more than they did. In this regard we have to be grateful that our African banks have stuck to the basics of banking and played on their home turf. For the first time in my life, I can say that your money is apparently safer in a well-capitalised African bank than in many banks in the Western world. This is something quite noteworthy and investors the world over need to recognise this. For example, the default rate in microfinance is a measly two percent. In terms of credit-adjusted lending, lending to the poor is probably the best risk any bank can take.

The international reverberations of this crisis in subprime, however, have been severe. The ripple effects are there for all to see. Western banks and hedge funds have indulged in a good old-fashioned liquidity grab, selling anything they could. Whether shares in Russia, Safaricom, or whatever else you care to mention, they have sold what they could lay their hands on. They have done this to shore up their losses back home. They have taken their profits (and

losses) back into the US dollar. Borrowers have been punished and cash has become king.

What lessons can a Kenyan SME draw from this situation and how can it navigate the new landscape?

### **Lesson 1. No SME is an island.**

I met a venture capitalist who lent money to small businesses and I asked him, “What is the first thing you look for?” He told me, “I need to see that the owners and management have their eyes wide open. I find that out by asking them what is happening in the world.”

I agree with that. We may be a long way away, but if we snooze, we lose. The first thing an SME needs is a coherent view of the world and an awareness of the challenges other SMEs face. There are many websites where SMEs and entrepreneurs might find colleagues ready to share their challenges. Businessweek.com is just one example.

### **Lesson 2. Always consider how international conditions might affect your SME.**

You need to consider and forecast how your SME might be affected by unprecedented international events.

**Example 1.** I met some very bright entrepreneurial Kenyans who had set up a website called Mamamikes.com. If you were a Kenyan in the diaspora, you could go online and send a gift back home. The choices were wide and the site, really user-friendly. In the last quarter of 2008, however, the average spend on the site had dropped from USD100 to USD60. Now they have to take action because they are directly affected. They have a solid business, but they need to trim their cloth and quickly. The lower spend is correlated to remittances, which have also slumped by 33 percent already. This business sinks or swims by the speed with which it cuts costs now. It's all about staying in the game.

**Example 2.** The recent strength in the US dollar has translated into some extraordinary moves in African currencies. The South African rand fell by 17 percent in a single session and near enough 50 percent from several months ago. The Kenyan shilling traded at 58 versus the US dollar and now hovers in the higher 70s. This kind of currency volatility translates into a major boon for importers from South Africa (everything is a whole lot cheaper) but an absolute nightmare for exporters. Can you imagine going back to a customer in Johannesburg and explaining that what was ordered two months ago is now 50 percent more expensive? You will probably be on the next flight back home in no time.

**Example 3.** International headwinds are such that one might expect a tightening of credit. If you have been running your SME on bank overdrafts, you need to constantly focus on ensuring that your lender is there and not flying off into the sunset the moment an opportunity arises. It might make sense to reduce your dependency on this type of short-term borrowing. Cash flow is key. Household names are finding that they cannot make payroll because short-term funds are not being rolled over. SMEs need to be alert. If your SME has a long time before it breaks even, you need to accelerate that breakeven point. Stay on the core plan; don't get distracted by sideshows or experiments that are off message.

**Look outside. Do you see potholes or opportunities?**

Now these sorts of circumstances (incredible turbulence in international markets) also tend to open up a vista of opportunities. Big multinationals tend to scale back and look to off-load non-core businesses. They might even withdraw from competition in some markets, opening up space for SMEs and entrepreneurs to step in. Smart folks, whom you never thought might consider jumping ship, suddenly do so.

It was John Ngumi, Director of Investment Banking for CFC Stanbic Bank, who gave me the title of this section. He is currently receiving CVs from all over the world. You might find this moment as one where you can upgrade your human capital. Human capital might well be the key for the 21st-century knowledge economy.

**Conclusion**

We live in challenging and testing times. SMEs do not operate in a vacuum. You need to be alert. You need to be on top of your cash flow and ready to capture opportunities. Things are very fluid.

It was the great Muhammad Ali who said, "Impossible is nothing."

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