



# How COVID19 poses a bigger threat to businesses than the Financial Crisis of 2007/08



# Preface



Credit: Internet photo

It has been called the global pandemic for a reason. The coronavirus outbreak continues to claim lives across the world, as it ravages businesses and careers alike. Already, more than 1.3 million people are infected with the virus, which has caused a total lockdown of major cities across the world. With a global average case mortality rate at 5.5%, the impact of the covid19 is pervasive.

Covid19 poses a bigger threat to the global economy than the financial crisis of 2007/2008. To illustrate the point, we have used a case of a fictitious manufacturing company, Company A, which for the past three years to the y/e 2019 has been turning outstanding results, increasing over the years. In line with the growth trend, the

company's management had made projections in 2019 with a positive outlook, without consideration of the potential impact of covid19 pandemic in the worst-case scenario analysis. The shocks caused by this pandemic to the business, and economies as a whole shall have far adverse effects than could have been anticipated. We shall demonstrate with analysis, how any business that had the potential to yield more than Ugx. 600 million in profit after tax in the next five years has been threatened with the risk of being extinguished from the market completely if the situation remains the same, longer and government fails to provide the required stimulus in form of policy incentives to support such a business to recover naturally.

# A Case of a thriving SME, Company A

## Background

In 2008, a top investment bank the Lehman's Brothers along with several financial managers and institutions collapsed following the depreciation of the sub-prime mortgage market in the United States consequently leading to an international banking crisis. Several top firms sought bailout to survive the crisis.

While this crisis threatened the world financial system as analysts speculated a consequent collapse, there was still a safety net being provided by other sectors. The liquidity bubble was mainly a problem of financial service providers.

Not with coronavirus pandemic impact. The surging virus that is now in more than 150 countries worldwide has threatened the existence of even the smallest firms in the world. We should be ready to face the biggest crisis, which could surpass that caused by the Great Depression of the 1930s and the financial crisis of 2017-2018 and here's why.

Consider a thriving manufacturing company, Company A, that has grown faster than Uganda's economy due to high demand and increased expansion. Table 1 shows Company A's performance in the past three years with profit after tax increase by more than 2,020 times from just about Ugx. 14.3 million to Ugx. 303.18 million. Some of the products have outperformed others, but that is not our issue of focus for this analysis. This paper assesses the impact of a pandemic like COVID-19 on Company A's future performance.

Management of organizations must deliver against set financial targets. A positive jaws ration must be maintained for growth to happen. This means the rate at which sales increase must be higher than the rate at which costs increase overtime to control the cost to income ration. At the end of the reporting period, Company A's rate of return was 44.75% above target. The price per share assuming Ugx. One (1) billion was listed would be Ugx.4.87 per share at going conditions and could take up a debt of as much as Ugx. One (1) billion at the time.

Ugx in Millions	2017	2018	2019
Revenue - Coffee	384.00	426.00	390.00
Revenue - Flavoured Milk	490.00	522.00	512.00
Revenue - Water	731.00	715.00	720.00
Revenue - Soda	793.00	771.00	790.00
<b>Total Revenue</b>	<b>2,398.00</b>	<b>2,434.00</b>	<b>2,412.00</b>
Cost of Sales - Coffee	(196.00)	(196.00)	(183.00)
Cost of Sales - Flavoured Milk	(179.00)	(177.00)	(170.00)
Cost of Sales - Water	(392.00)	(389.00)	(391.00)
Cost of Sales - Soda	(634.00)	(621.00)	(623.00)
<b>Total Cost of Goods Sold</b>	<b>(1,401.00)</b>	<b>(1,383.00)</b>	<b>(1,367.00)</b>
<b>Gross Profit</b>	<b>997.00</b>	<b>1,051.00</b>	<b>1,045.00</b>
Other revenue	524.00	550.00	628.00
<b>Income from business streams</b>	<b>1,521.00</b>	<b>1,601.00</b>	<b>1,673.00</b>
Operating expenses	(1,212.18)	(1,245.34)	(1,068.24)
<b>EBITDA</b>	<b>308.82</b>	<b>355.66</b>	<b>604.76</b>
D&A	(31.00)	(44.00)	(41.00)
<b>EBIT</b>	<b>277.82</b>	<b>311.66</b>	<b>563.76</b>
Interest expenses	(56.00)	(65.00)	(52.00)
<b>EBT</b>	<b>221.82</b>	<b>246.66</b>	<b>511.76</b>
Taxes	(207.52)	(209.98)	(208.58)
<b>Net Income</b>	<b>14.30</b>	<b>36.68</b>	<b>303.18</b>

**Figure 1: Company A statement of comprehensive income over 3 years to y/e 2019**

The statement of financial position also showed positive numbers. The company managed to increase assets to more than a billion shillings while being able to meet its debt obligations for the three years. However, in early 2020, #covid19 happened. Can the company continue this good performance?

## Facing the unexpected...

A thorough financial projection would bring down profit by 8% considering the economic conditions remained the same. A favorable upturn would push yield of 5.9% increment in profit after tax while considering the 2021 Ugandan elections were around the corner, the most realistic bottom-line number would yield a 22% fall in profit after tax, albeit the numbers remaining positive. So, either way, this shows the business would still grow in either scenario with rates of return ranging from lows of 38.37% to highs of as much as 49%.

However, what these business executives had not speculated was the covid19 that would become a global pandemic in the first quarter of 2020. While they could have managed to make significant numbers in the first quarter of this year (2020), they are now left with a hurdle to cross in the next 9-10 months of business activity.

Following, a full country lockdown prohibiting the sale of merchandise that is deemed "non-essential", the executives of this company set aside expectations for the remainder of the year. This lockdown did not only shutter their demand from their biggest customers (hotels, inns, lounges, bars, malls, and arcades), it has also weakened the liquidity of most of its secondary markets (individuals) as people look for a product for survival rather than entertainment which this brand had leveraged on.

A business that would yield more than Ugx. 600 million in profit after tax in the next five years has been threatened with the risk of being extinguished from the market completely if the situation remains the same. Study Figure 2 carefully.

Ugx in Millions	2020	2022	2024	2026	2028
Revenue - Coffee	394.85	380.62	376.13	367.13	360.57
Revenue - Flavoured Milk	523.81	524.84	531.41	535.26	540.54
Revenue - Water	714.64	714.48	711.73	710.29	708.20
Revenue - Soda	788.78	797.88	801.87	808.51	813.87
<b>Total Revenue</b>	<b>2,422.08</b>	<b>2,417.82</b>	<b>2,421.14</b>	<b>2,421.18</b>	<b>2,423.19</b>
Cost of Sales - Coffee	(189.49)	(178.79)	(177.90)	(174.10)	(170.30)
Cost of Sales - Flavoured Milk	(180.96)	(177.85)	(180.04)	(182.54)	(183.55)
Cost of Sales - Water	(386.71)	(387.78)	(385.98)	(385.02)	(384.11)
Cost of Sales - Soda	(629.32)	(636.15)	(637.16)	(644.04)	(647.97)
<b>Total Cost of Goods Sold</b>	<b>(1,386.49)</b>	<b>(1,380.57)</b>	<b>(1,381.07)</b>	<b>(1,385.70)</b>	<b>(1,385.93)</b>
<b>Gross Profit</b>	<b>1,035.59</b>	<b>1,037.25</b>	<b>1,040.08</b>	<b>1,035.48</b>	<b>1,037.26</b>
Other revenue	688.11	769.84	852.40	948.72	1,053.20
<b>Income from business streams</b>	<b>1,723.70</b>	<b>1,807.08</b>	<b>1,892.47</b>	<b>1,984.21</b>	<b>2,090.46</b>
Operating expenses	(1,178.76)	(1,161.52)	(1,137.91)	(1,159.80)	(1,154.58)
<b>EBITDA</b>	<b>544.94</b>	<b>645.56</b>	<b>754.57</b>	<b>824.41</b>	<b>935.89</b>
D&A	(39.10)	(43.26)	(42.64)	(44.37)	(44.81)
<b>EBIT</b>	<b>505.84</b>	<b>602.30</b>	<b>711.93</b>	<b>780.04</b>	<b>891.07</b>
Interest expenses	(108.90)	(78.42)	(42.45)	-	-
<b>EBT</b>	<b>396.94</b>	<b>523.88</b>	<b>669.48</b>	<b>780.04</b>	<b>891.07</b>
Taxes	(119.08)	(157.16)	(200.85)	(234.01)	(267.32)
<b>Net Income</b>	<b>277.85</b>	<b>366.72</b>	<b>468.64</b>	<b>546.03</b>	<b>623.75</b>

**Figure 2:** Company A projections at the end of 2019 for the next five years without COVID 19



### Facing the unexpected...

An analysis of the Company's balance sheet in 2019, showed assets had grown from just about Ugx. 932m in 2017 to more than Ugx.1.2 billion. The return on investment for stakeholders was up to 62% in 2019 with asset efficiency of more than 22.4%. Risk management perspective, the leverage ratio was just about 1.53 falling from 4.56 as the company was shifting away from debt and depending more on its operations for sustainability.

**This also provides a debt cushion in case the company requires more debt financing to cope with the growing demand.**

This company also had significant debt by the year-end which was to be cleared by 2022. The financial performance in preceding years guaranteed lenders the ability to borrow a significant amount to finance their assets for expansion of their business which would

position them to sustainable growth in the coming years. This is an example of most of the performing businesses in the country that have gained a dominant market share, with a very high rate of return for shareholders as well as a bigger contribution to the treasury through taxes. This, however, does not shield them from debt and other fixed costs they have to pay when operating. The projections showed growth in profitability over the next five years, 2020 inclusive.

### Enter the Presidential Directives

On 30th March 2020, the President of Uganda issued directives to lock down most of the organizations, operations, and businesses that were deemed non-essential as a proactive measure to reduce the spread of the coronavirus in Uganda. However, none of these guidelines protected these organizations from the looming troubles. Yet, some of these organizations have an outstanding debt of more than Ugx. 605 million from a commercial bank at an interest rate of more than 18%. To respond to the pandemic, management makes revised forecasts assuming the pandemic persists for the rest of 2020.

Ugx in Millions	2020	2021	2022	2023	2024
Revenue - Coffee	-	375.24	370.59	361.29	354.51
Revenue - Flavoured Milk	-	492.63	498.48	501.91	506.62
Revenue - Water	-	692.76	689.97	688.49	686.37
Revenue - Soda	-	760.11	764.10	770.73	776.10
<b>Total Revenue</b>	-	<b>2,320.73</b>	<b>2,323.14</b>	<b>2,322.42</b>	<b>2,323.61</b>
Cost of Sales - Coffee	-	(176.27)	(175.28)	(171.32)	(167.44)
Cost of Sales - Flavoured Milk	-	(166.93)	(168.88)	(171.17)	(172.03)
Cost of Sales - Water	-	(375.99)	(374.17)	(373.20)	(372.27)
Cost of Sales - Soda	-	(606.04)	(607.14)	(613.95)	(617.90)
<b>Total Cost of Goods Sold</b>	-	<b>(1,325.23)</b>	<b>(1,325.47)</b>	<b>(1,329.65)</b>	<b>(1,329.63)</b>
<b>Gross Profit</b>	-	<b>995.51</b>	<b>997.67</b>	<b>992.77</b>	<b>993.97</b>
Other revenue	-	604.24	665.80	737.27	814.41
<b>Income from business streams</b>	-	<b>1,599.75</b>	<b>1,663.47</b>	<b>1,730.05</b>	<b>1,808.38</b>
Operating expenses	(1,121.65)	(1,177.73)	(1,236.62)	(1,298.45)	(1,363.38)
<b>EBITDA</b>	<b>(1,121.65)</b>	<b>422.01</b>	<b>426.84</b>	<b>431.60</b>	<b>445.01</b>
D&A	(39.10)	(39.97)	(39.53)	(41.25)	(41.77)
<b>EBIT</b>	<b>(1,160.75)</b>	<b>382.04</b>	<b>387.31</b>	<b>390.34</b>	<b>403.23</b>
Interest expenses	(108.90)	(78.42)	(42.45)	-	-
<b>EBT</b>	<b>(1,269.65)</b>	<b>303.62</b>	<b>344.87</b>	<b>390.34</b>	<b>403.23</b>
Taxes	-	(91.09)	(103.46)	(117.10)	(120.97)
<b>Net Income</b>	<b>(1,269.65)</b>	<b>212.54</b>	<b>241.41</b>	<b>273.24</b>	<b>282.26</b>

**Figure 3: P&L projection if the pandemic persists for more than a year**

## The projected balance sheet in time of COVID-19.

A negative cash balance begins at the end of 2020 with a cash deficit of Ugx 1.14 billion.

To offset this, the company needs to have its current loan interest and principal payments postponed to the following year. Also, the stakeholders shall be required to source more than Ugx. 819 million to sustain the current business operations given they don't lay off workers, relocate their properties and have remained operating at the same magnitude. With a rent waiver for this business, which rent costs around Ugx. 283m annually for its many warehouses and other statutory payments, they could offset the bill by a significant ratio.

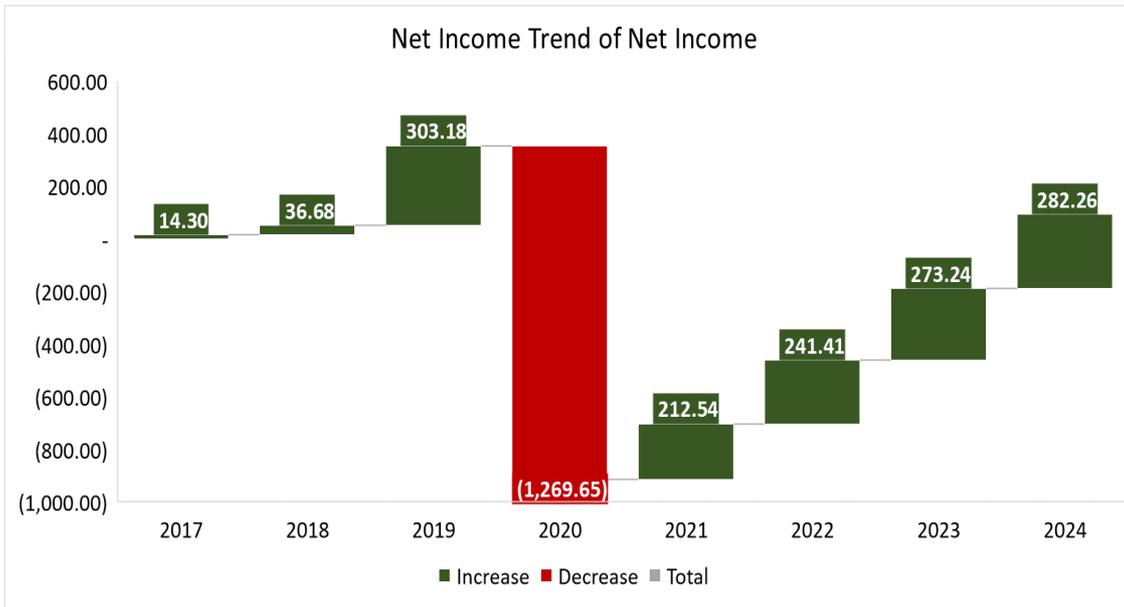
Even if Company A tends to debt securities by issuing high yield bonds, liquidity in the markets is at an all-time low. Financial institutions (whose impact will be explained in a later phase) are the biggest buyers of these fixed income securities. Right now as the entire economy is on the brink of crushing, fixed income markets are not as liquid as they were a few months ago.

Ugx in millions	12/31/2017	12/31/2018	12/31/2019	12/31/2020	12/31/2021	12/31/2022	12/31/2023	12/31/2024
Cash	24.80	21.80	220.00	(1,146.73)	(1,161.89)	(1,178.28)	(910.92)	(644.95)
<b>Trade Receivables</b>	<b>143.90</b>	<b>154.80</b>	<b>169.30</b>	<b>169.30</b>	<b>180.06</b>	<b>182.10</b>	<b>178.41</b>	<b>179.44</b>
Receivables - Coffee	44.61	40.25	44.02	44.02	39.42	40.24	38.72	37.91
Receivables - Flavoured Milk	31.66	34.06	40.63	40.63	35.20	36.65	35.92	36.57
Receivables - Other	33.10	29.41	32.17	32.17	29.78	30.39	30.18	30.13
Receivables - Water	20.15	27.86	27.09	27.09	47.34	46.39	45.83	46.25
Receivables - Soda	14.39	23.22	25.40	25.40	28.32	28.43	27.77	28.59
<b>Inventory</b>	<b>85.00</b>	<b>92.00</b>	<b>110.00</b>	<b>110.00</b>	<b>91.58</b>	<b>94.16</b>	<b>91.99</b>	<b>92.23</b>
Inventory - Coffee	29.75	24.84	26.40	26.40	24.20	24.68	23.93	23.32
Inventory - Flavoured Milk	16.15	17.48	20.90	20.90	18.12	18.88	18.51	18.84
Inventory - Other	9.35	17.48	20.90	20.90	14.18	14.29	14.42	14.33
Inventory - Water	11.05	11.96	16.50	16.50	13.37	13.90	13.24	13.42
Inventory - Soda	18.70	20.24	25.30	25.30	21.70	22.39	21.88	22.31
Other assets	45.90	46.90	68.00	-	53.89	57.00	54.16	55.05
PP&E	632.50	632.50	659.50	620.40	639.05	653.36	668.35	681.63
<b>Total Assets</b>	<b>932.10</b>	<b>948.00</b>	<b>1,226.80</b>	<b>(247.03)</b>	<b>(197.32)</b>	<b>(191.65)</b>	<b>81.98</b>	<b>363.40</b>
<b>Trade Payables</b>	<b>68.00</b>	<b>68.90</b>	<b>68.90</b>	<b>68.90</b>	<b>65.59</b>	<b>65.77</b>	<b>65.31</b>	<b>65.11</b>
Trade Payables - Coffee	17.00	19.98	19.98	19.98	18.24	18.23	17.52	17.29
Trade Payables - Flavoured Milk	10.20	10.34	10.34	10.34	9.90	10.07	10.14	10.21
Trade Payables - Other	17.00	14.47	14.47	14.47	14.18	14.29	14.42	14.33
Trade Payables - Water	8.84	15.85	15.85	15.85	14.52	14.19	13.83	14.10
Trade Payables - Soda	14.96	8.27	8.27	8.27	8.75	8.99	9.41	9.18
Provisions	32.50	28.70	28.70	32.77	32.92	33.14	33.21	32.96
Financial Liabilities	615.80	610.40	605.00	435.65	235.81	-	-	-
Other liabilities	48.30	43.30	38.90	-	40.18	39.85	40.63	40.25
<b>Total Liabilities</b>	<b>764.60</b>	<b>751.30</b>	<b>741.50</b>	<b>537.32</b>	<b>374.50</b>	<b>138.75</b>	<b>139.15</b>	<b>138.31</b>
Minority interest	18.43	18.43	18.43	18.43	18.43	18.43	18.43	18.43
Retained Earnings	132.33	161.53	450.13	(819.53)	(606.99)	(365.58)	(92.34)	189.92
Share Capital	16.75	16.75	16.75	16.75	16.75	16.75	16.75	16.75
<b>Total Shareholder's Equity</b>	<b>167.50</b>	<b>196.70</b>	<b>485.30</b>	<b>(784.35)</b>	<b>(571.82)</b>	<b>(330.41)</b>	<b>(57.17)</b>	<b>225.10</b>
<b>Total Liabilities and Shareholder's Equity</b>	<b>932.10</b>	<b>948.00</b>	<b>1,226.80</b>	<b>(247.03)</b>	<b>(197.32)</b>	<b>(191.65)</b>	<b>81.98</b>	<b>363.40</b>

**Figure 4:** Projected Balance sheet during and after the recession caused by COVID-19

Looking at Company A's balance sheet, it's on life support and might have to seek a bailout from the government and other institutions by the end of the year of more than a billion Uganda shillings. This is one of many companies out there that are suffering. Yet, the manufacturing sector has over 9,000 different firms big and small, all facing the same challenge. This example is of a manufacturer. Take note that all Small and Medium-Sized Enterprises Face similar challenges in the country. What happened in the United States in 2008 when big fund managers like AIG and Lehman's brothers could not sustain liquidity is likely to happen in the coming months to several organizations like this.

# How the government can offset these effects of systematic risk on SMEs



**Figure 5:** How can companies overcome the red zone in these trying times

## a. Short Term Fixed Income Securities for Land Lords

One of the biggest problems many SMEs like Company A above are facing during these times is the costs of occupancy. 30% of the fixed costs for the company in our case were attributed to rent for offices, warehouses and other points of occupancy it has acquired. It had however acquired a loan to start developing areas that would offset these costs in the long-term and had a three-year plan to do this.

While most landlords in the country are not well versed with financial management and how to transfer risk for a positive return, there would be a call for them to issue fixed income securities. Now the government of Uganda's job would be purchasing these bonds at interest from the landlords which would be offset by these organizations in the future once the storm has set. Waiving rent would not necessarily cover the opportunity cost that these landlords would incur but promise them interest over and above the discount rate. This would afford these organizations time to recover from these looming costs, reduce the impact of layoffs and last but not least encourage the landlords to waive these fees. The short term ease of the liquidity would provide space for long term planning, which is critical for business continuity.

## b. Repurchase Agreements with interest payment covenants

While Bank of Uganda offered repurchase agreements to commercial banks to offset short term liquidity problems, they should also add clauses that not only monitor the disbursement of these loans but also use them as a cushion for current loans that are outstanding and need immediate repayment within the period of lockdown.

BoU should insist on pushing loan repayments for most organizations and individuals especially those with seasonal loans (loans dependent on seasons like Agriculture and industry that feeds from it) to later dates. This being a systematic risk, the borrowers would fail to meet their obligations. Of course, for the case for bank liquidity, this is our subject to part 2 of this paper.

## c. The company FP&A teams need to upgrade their models

With proper training in financial planning and analysis, the risk management teams of these organizations shall be able to overcome forthcoming risk by providing for adequately in coming seasons of the recession that might or might not be projected.

For instance, elections usually bring a downturn in financial liquidity and based on historical figures can be projected as forthcoming with significant provisioning on part of internal controls, not spending and investing as much towards such periods.

However, for systematic risk that might not be speculated, there is a need to add a fourth scenario in your scenario planning and analysis. While we already have the best case, base case and worst-case scenarios embedded in their models, a pandemic scenario that assumes zero operational performance while incurring fixed costs should always be embedded to help companies prepare for darker periods. Economic recessions like the financial crisis of 2008 and the looming COVID-19 pandemic should be learning points for many businesses.

Otherwise, we might not see great companies in forthcoming years.

Going forward, the government must undertake economic impact analysis and consider alternative policy options for both short term and long term interventions to protect businesses from collapse. Policies that facilities short term liquidity support are needed urgently.

BoU should insist on pushing loan repayments for most organizations and individuals especially those with seasonal loans (loans dependent on seasons like Agriculture and industry that feeds from it) to later dates

## About Summit Consulting

Summit Consulting Ltd is a professional services firm offering proactive and Practical Toolkits and Educative Workshops that help our clients to improve by selling more, cutting costs, raising employee morale and transforming the business. We are the trusted advisor and counsellor to many of the most influential businesses and institutions in the region. We improve the client's condition in our three specialty service offerings:

- 1. summitFORENSICS:** Prevent revenue leakages and grow your Organisation. We offer both proactive and reactive forensics to give you peace of mind. Manage fraud risks. Investigate fraud cases. And never again have staff for disciplinary action give you a headache. Visit [www.summitcl.com/forensics](http://www.summitcl.com/forensics) and download free fraud risk assessment tool or email [training@summitcl.com](mailto:training@summitcl.com)
- 2. summitADVISORY:** Grow your revenue and make stakeholders happy. Get practical tools to grow your profits and transform your business. Craft a winning strategy. automate your risk management processes. Motivate your staff. Our experts will work with you to improve your condition. Contact Godfrey on [sgodfrey@summitcl.com](mailto:sgodfrey@summitcl.com) for IFRS9 Compliance Toolkit and save on costs.
- 3. summitSECURITY:** We offer a 360 degrees cybersecurity solution. From external security reviews to overall IT governance and vulnerability assessments including helping you align your overall cybersecurity resilience framework to your IT strategy and enterprise strategy. This helps you save money, time and worries.

## Team Biographies



### Mustapha B. Mugisa

Mustapha B. Mugisa is one of those rare people who provide value-based consulting to professionals and corporate entities who demand the very best. He is a prolific speaker, a strategy, risk and anti-fraud expert.



### Francis Xavier Mukembo

He is an experienced financial analyst, data analytics and business intelligence expert who has provided consulting for a vast number of organisations re-known for his work in the top 1,000 tax payers developing, training and implementing robust business models in FP&A, Credit Risk, Financial, & Investment Management

## Contacts



4th Floor Ntinda Complex  
Plot 33, Ntinda Road  
Opp St Luke Church  
P.O. Box 40292, Kampala,  
Uganda.  
[support@summitcl.com](mailto:support@summitcl.com)  
+256(414) 231136



For further information,  
please visit us online  
[www.summitcl.com](http://www.summitcl.com)

For data analytics, website [www.summitcl.com/summitbi](http://www.summitcl.com/summitbi)



summitBI™ and all other Summit Consulting Ltd product or service names are registered trademarks or trademarks of Summit Consulting Ltd in Uganda & East Africa. Other brand and product names are trademarks of their respective products. Copyright © 2020, Summit Consulting Ltd. Forensics. Advisory. Security . All Rights Reserved