

Executive Summary

The parachute test is conducted on a sample of 200 medium to large SMEs in Singapore. It is based on the detailed financial situation of the firms during the financial period of 2004 vs 2005. The sample SMEs are in existence for at least 3 years and with at least 2 years of audited financial statements. The total equity and reserve base of the portfolio amounted to S\$34.7 billion and total revenues stood at S\$47.7 billion. The large base serves as a good proxy of SME dynamics. The study is carried out across the following 5 key sectors: retail/services, manufacturing, construction, transportation and logistics and industrial.

The parachute test as the name suggests, looks at the extent to which SMEs can handle varying proportion drop in sales by 5%, 10% and 30%, taking into account their existing asset and financing levels.

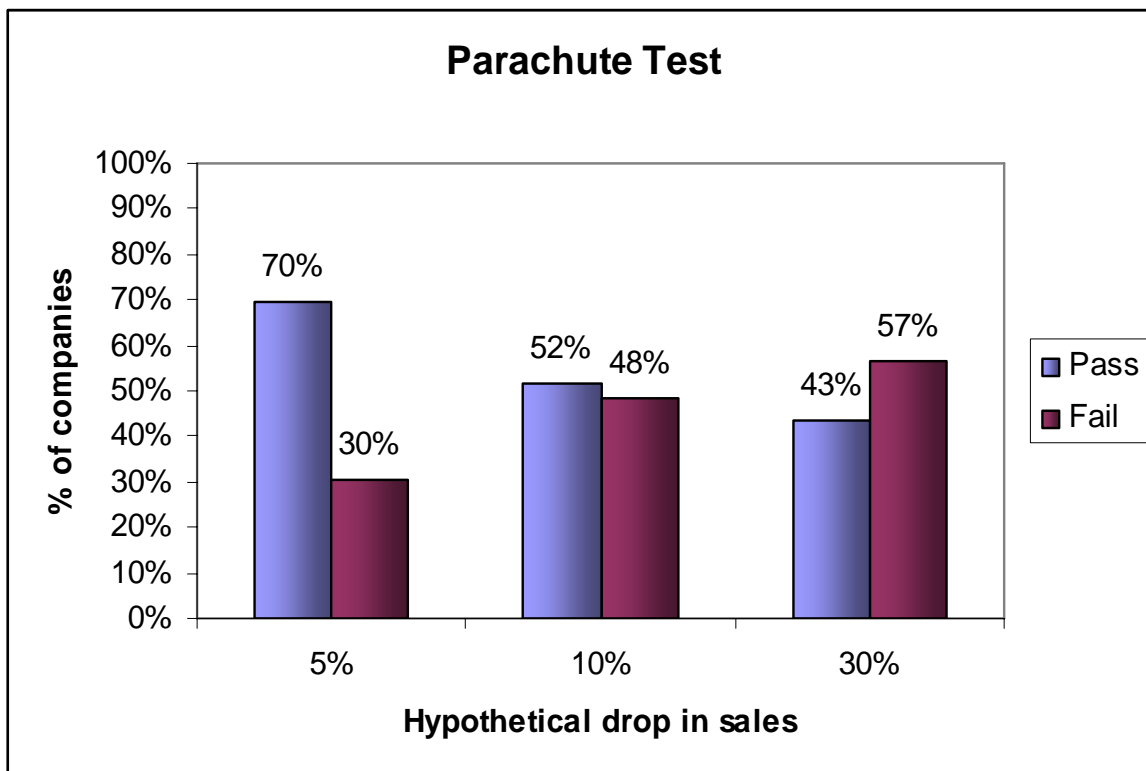


Figure 1

Figure 1 illustrates that the proportion of SMEs that can withstand the drop in sales fall dramatically, as the magnitude of the drop increases. 30% of the sample SMEs are likely to face with cashflow management problems if they experience a 5% drop in sales. Consecutively, 48% and 57% of the sample SMEs are highly likely to experience liquidity issues under a hypothetical 10% and 30% drop in sales respectively. These underscore the fragility of SMEs' P&L, the firms' inadequacy and inability to withstand volatility in earnings. The

test also highlights the importance of SMEs to build more robust clientele and search for higher quality segments, rather than reliance on a single or few groups of customers.

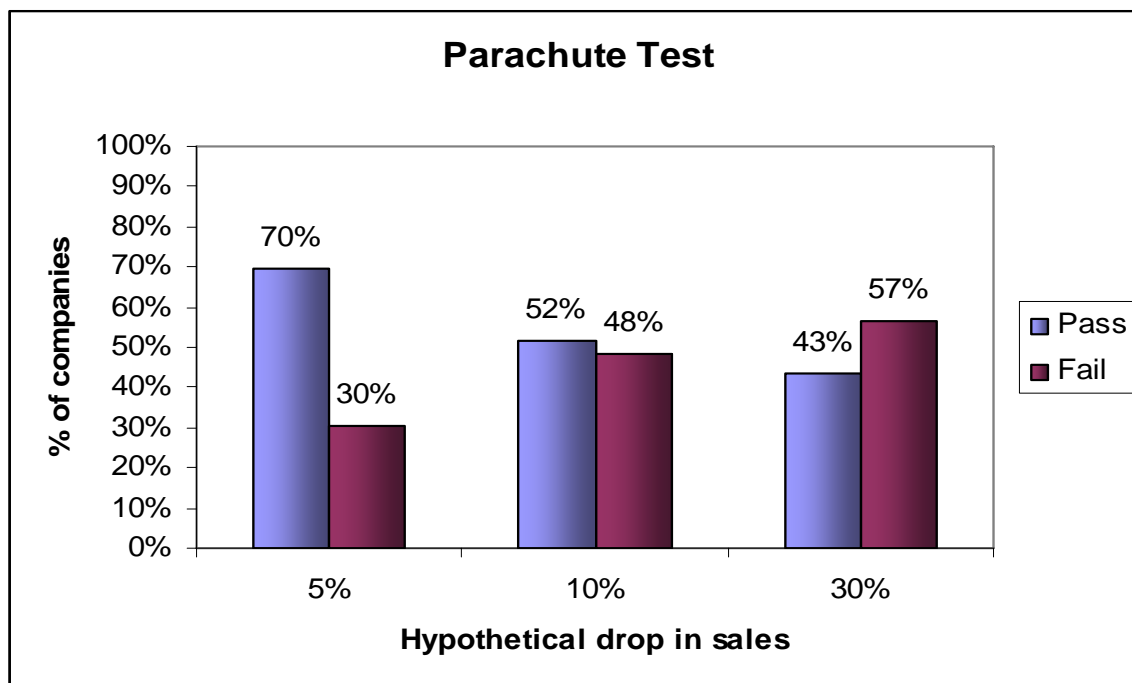


Figure 2

From Figure 2, it can be inferred that a hypothetical drop in sales by 5%, 10% and 30% will result to a shortage of \$153 million, \$256 million and \$2.2 billion respectively. This finding demonstrates and quantifies the extent to which SMEs are likely to experience shortages of fund even after liquidating their current assets and utilising the existing financing options.

Implication

The parachute test highlights the need for SMEs to verify the quality of their earnings, in terms of its sustainability and scalability, to withstand unpredictable economic and industry shocks.

This also necessitates SME to question and evaluate themselves if their respective growth or concentration strategies that they adopt, equip them with the readiness and ability to overcome shocks to their P&L and balance sheet.

It is apparent that banks and investors to play greater role in SMEs funding strategies, with the implication that SMEs may want to look for other growth alternative such as 3rd Board listing and explore the various organic and non-organic strategies such as joint ventures and strategic partnerships, if the traditional funding is not easily available.

Outlook for SMEs

The outlook for SMEs is demanding. This is mainly because of the effect of margin compression, which leads to the pursuit of growth strategies – little to come from cost reduction. SMEs have to focus on alternative means of funding, other than traditional bank funding.

Moving forward, SMEs are expected to gear up beyond the tolerable level of their net worth to overcome the liquidity issues as well as adequacy of net worth. In addition, as most SMEs will pursue the growth/expansion route, the duration of mismatch/gap is likely to widen. There will also be a wave of new product innovations, where brick-and-mortar model is to be topped with a twist of technology and innovative packaging/delivery for end customers.

Conclusion

To summarize, financial and risk management is an inherent part of overall strategic management. Making sense of numbers is important for business owners because this will encourage them to adopt growth strategies that address liquidity and solvency issues while simultaneously focusing on their core competencies and business franchise.