

Good Financial Management for SMEs

George Korah
Chartered Accountant

There is a saying that “Money makes the World go around”. This is also very true in the case of every Business. Good Money or Financial Management is the key factor, which determines whether a business will be successful over the long term.

I have found that many persons, who start & run a business, do not involve or want to involve themselves in the financial management of the organisation. This may be because:

- a. They are extremely tied up with the other aspects of the business like purchase, production, sales & managing people.
- b. They do not have enough knowledge (or interest) about how financial transactions are recorded, financial statements prepared or how these statements are analysed.

These entrepreneurs rely a great deal on their Accountants and sometimes if the technical capacity of the Accountant is below par, then the area of Finance & Accounting becomes a big mess.

Today many businessmen use financial statements like the Balance Sheet & Profit & Loss Statement of their business, only for filing statutory obligations like Income Tax Returns, VAT Returns, and submission to Bankers etc. Very few entrepreneurs use these statements for internal purposes like control or

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as a basis for decision making -- which really is the prime reason for maintaining books of accounts & preparing financial statements.

Financial Management for a business covers the following areas.

1. Book-keeping

The financial transactions to be correctly recorded, vouchers & other relevant documents to be maintained & filed properly & the financial statements to be prepared on a regular basis.

2. Working Capital Management

A successful business man tries to have optimum working capital - not minimum or maximum but optimum. If you have too much working capital, then you incur costs like interest which can & should be avoided. Very little working capital can also have a disastrous effect on your business – for example very little or no stock of raw material could result in a break in production – which in turn could result in huge losses.

The major components of working capital are:

- a. Raw material
- b. Work - in – progress
- c. Finished Goods
- d. Sundry Debtors , and
- e. Cash

Each of these components need to be looked into – are you holding too much stock, is your sundry debtors' level very high. For each component, different people in your organisation may be responsible & you must give them separate targets so that they work towards an optimum holding of their component of working capital.

3. Cost Control

Two major tools for effective cost control are :

- Budgets
- Internal Controls

In some organizations the Budgeting process is a very rigorous one & much effort goes into its preparation & periodic review with actuals. However in the vast majority of businesses, the Budgeting exercise is non – existent.

4. Analysis of Financial Statements

A regular analysis of the financial statements will help the entrepreneur,

- a) get early warning signals
- b) see trends developing
- c) take corrective action
- e) expand business into unrepresented areas .

5. Sourcing of funds

Today, the entrepreneur has several options for financing his business. The traditional routes of loans & own funds have now several variants. Certain financial institutions are now offering 'Factoring' services –they finance your

credit sales – your sales force now needs to concentrate only on sales & not on collections.

One mistake that several entrepreneurs commit is that they use short term loans (like cash credit, overdraft) for purchasing fixed assets. This leads to a severe strain on the funds position.

6. Fixed Asset Acquisition

Many times decisions regarding investment into fixed assets, like Factory Building, Plant & Machinery are taken without doing any scientific analysis. Very rough criteria like “Pay Back” are applied without considering the time value of money.

These decisions have long term effects on the business & should be taken only after a detailed analysis of the market scope, competition & by applying discounted cash flow techniques like IRR.

Here are some tips for managing your business more effectively.

1. Get more knowledge about basic financial concepts – either through books/ magazines or by attending a workshop on finance.
2. Have a good in- house Accounts department who are well versed in Accounting principles & are computer savvy.
3. Get basic working knowledge about the financial software that your business is using.
4. Insist on a monthly reporting system – so that the Profitability Statements & Balance Sheet are on your table by the 5th of every successive month.

5. Sit with your managers to prepare an Annual Budget which should be broken down to monthly budgets. Do a monthly joint review of actual achievements with the budgeted/target figures. Take corrective action immediately.
6. Keep a constant check on items which affect the liquidity of the business -level of debtors, stock of raw materials & finished goods.
7. Interact with your Banker or Financial Institution on a regular basis – not just when you require your cheque to be passed or when you want your credit limit to be raised!! – check out their new financial products.
8. Ask your Accounts department to prepare a check list of the various statutory payments & filings. Keep a close check on whether compliance takes place.
9. Have an interim audit of your accounts done – say for 9 months ended 31st December. This will give you enough time to take corrective action, based on the inputs of the auditors.
10. Never make hasty decisions about purchasing huge fixed assets or getting into new ventures or diversification. Make a detailed study & apply evaluation techniques like IRR.
11. Keep looking for ways to reduce cost – mere cost control procedures may not be long lasting – new innovative methods which will bring down the cost of delivery of your product & services need to be constantly encouraged among all employee of the organisation.