Think Ahead

ACCA

# Financial management and business success – a guide for entrepreneurs

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Financial management is at the heart of running a successful business. It affects every aspect, from managing cash flow and tracking business performance to developing plans that ensure that business owners can make the most of opportunities.

This guide highlights how financial management can help your business, and how to make sure you have the financial capabilities you need.

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# 1. Introduction

**The right financial capabilities remain vital throughout the life of your business, whether you are just starting out, have an established business or are looking towards a final exit from the business. Your financial management needs will continually evolve as the business grows and circumstances change.**

Running a business can be intensely satisfying but also hugely challenging. Business owners face a multitude of demands on their time, balancing the need to prioritise and deal with a range of urgent tasks while also finding time to look at the bigger picture.

As an entrepreneur, you may well be driven by a passion for what you offer, and focused on what customers want and how you can gain an edge on your competitors. You will also recognise how important it is to be able to raise the financing you need. In fact, financial management can contribute much more to achieving your business goals.

Business planning helps you identify, assess and capitalise on new opportunities. It lets you think through your options and create an action plan that minimises costly mistakes. It is also a crucial tool if you need to convince financiers and others to support your business.

Skilled financial management is critical for putting your plan into practice. Effective administration, compliance and cash flow management are just the starting point. Financial skills let you track and measure performances, identify problem areas and new opportunities, and minimise risks.

The right financial capabilities remain vital throughout the life of your business, whether you are just starting out, have an established business or are looking towards a final exit from the business. Your financial management needs will continually evolve as the business grows and circumstances change.

Successful, growing businesses take a proactive approach to financial management and to making sure that they have the right capabilities. Financial management plays a continuous role in both day-to-day management of the business and broader strategic planning. Senior management must recognise how the needs of the business change as the business grows, and make sure that the organisation has the financial skills that will help the business look to the future.

As a business owner or manager, you need to recognise the importance of financial management. You may be able to delegate some of the tasks involved – to employees or outside experts, but you yourself need to be always looking ahead, ensuring that your business continues to develop the financial capabilities it will need to achieve its full potential.

## EPOS NOW – CASE STUDY

Jacyn Heavens was inspired to start Epos Now by his own experience of how difficult it can be to run a business without the right financial information and controls. Epos Now helps retail and hospitality businesses overcome this by providing point-of-sale systems that let them keep track of transactions and understand their performance.

Before starting Epos Now, Jacyn had been running a café bar. He quickly realised that there was a problem.

> 'I knew how much I was paying suppliers, and I'm a natural haggler, so I was sure I was getting a good deal. But I'd only know what our total outgoings were by looking at the bank statement. The bar could be buzzing, full of people, yet I'd have less at the end of the night than I would on what felt like a quiet day.'

Jacyn was desperate to know what was going on: what his income really was, what products were selling well, what margin he was making and most importantly whether the business was actually profitable.

Those difficulties have now proved to be a blessing in disguise. Over the five years since Jacyn set up Epos Now, the company's annual turnover has grown to reach £10m, with over 150 employees and 10,000 customers. Right from the start, financial management has been critical to the company's success.

> 'Initially, we focused on growth in revenue and our profit margin. As a self-funded business absolutely everything we did needed to make money. We were living month-to-month, and cash flow was crucial. That focus meant we could cope when the launch of our first software was delayed by four months. Otherwise, we'd have folded.'

As the business has grown, the emphasis has shifted to building predictable, recurring revenue. Quarterly results and future trends are more important than the immediate here and now, and financial management has become more detailed.

> 'We've been profitable overall since the early days, but now we look separately at each marketing campaign, each source of new sales leads, each sales channel. Looking back, even in our most profitable months we've made big losses on some individual channels but we never spotted it at the time.'

At the same time, the company has invested heavily in automation. Improved systems give Jacyn and his team real-time access to accurate key performance indicators.

Despite all the success, Jacyn admits that his initial planning was not as good as it should have been.

> 'I saw the opportunity in the market, and thought "let's give it a go", but I'd never recommend this now – I got lucky. I remember the day, later on, when I met a new employee. I realised we had to have a more structured approach. With people dependent on the business for their livelihoods, you can't just rely on gut instinct.'

## CREATING THE CULTURE

Developing the right financial capabilities, and making the best use of them, requires the right culture in your business.

At the top of the organisation, owners and managers must understand how financial management can contribute to the success of the business. Approaching financial management as a chore to be delegated leaves you at considerable risk if things go wrong. Employees need to see how financial management can help them perform better, rather than merely imposing controls on them. Training is likely to be required for all employees, not just financial specialists.

Information should be shared across the business wherever it will help individuals do their jobs and understand how they are contributing to business success. A reasonable degree of financial transparency can both reassure and motivate staff.

Developing advanced financial capabilities will take time and money, and needs to be balanced against other demands on the business. Your business will maximise its success if you plan ahead to see how financial management can help achieve your goals.

# 2. Business planning



Whether you are starting a new venture, looking at new opportunities for an existing business or updating your strategy, planning is essential.

## PLAN FIRST

Business planning is not just an exercise that you have to go through to raise financing for your business. Business planning has a critical role to play, at every stage in the life of your business.

For a busy entrepreneur, it can be difficult to find the time for planning. Working on a business plan rarely seems as urgent as more immediate tasks. Yet whether you are starting a new venture, looking at new opportunities for an existing business or updating your strategy, planning is essential.

Even if you have no need for external funding, regularly reviewing and updating your business plan offers significant benefits. Preparing a business plan pushes you to identify and assess the opportunities and threats facing your business. It helps ensure that you have an in-depth understanding of your market, the competition and the broader business environment.

Creating the plan forces you to make choices. Which opportunities will you pursue? How will you trade off conflicting options, such as continuing to invest in new product development while also controlling costs?

The planning process lets you think through possible courses of action and what might happen. You plan how you will deal with any challenges, overcoming any weaknesses your business may have and making the most of your strengths. You can identify potential pitfalls, such as overstretching yourself financially, and work out how to avoid them – without suffering the consequences.

Developing the plan also helps you focus on the assumptions you are making and areas of uncertainty. You can take steps to reduce uncertainty and control risks, or choose to avoid excessively risky opportunities altogether. Anticipating what might happen – good or bad – allows you to think in advance about how you would respond. You minimise the risk of being forced to react to unexpected events with hurried decisions.

The whole planning process acts as a checklist, helping to ensure that you think about all the important issues and that nothing is overlooked. You choose what the best options are. You decide where to focus your efforts and what you need to do to give yourself the best chance of success. Without a plan, you are running your business by trial and error.

Being part of the planning process helps to engage the team and encourage everyone to work together towards a common goal.

Your approach to planning should recognise and include the whole team involved in the business. That allows you to get their input and make the most of their knowledge and skills. Being part of the planning process helps to engage the team and encourage everyone to work together towards a common goal.

The completed business plan acts as a powerful communications tool. Within the business, it enables everyone to understand

what the strategy is and how what they do needs to fit with it. Externally, you can use the plan to help explain your business to lenders, investors and other key business partners and convince them to support you.

Perhaps most importantly, your business plan provides a blueprint, helping to guide your day-to-day management of the business. Regular review lets you see how well the plan is working and how it needs to evolve as circumstances change.

'I'm a businesswoman and I get it. Sometimes having a plan is like driving with a satnav that takes you the wrong way up a no entry street. But the alternative, no plan, that's much worse, you'd end up driving in the wrong direction for miles and the trip ends up costing you substantially more unnecessarily.'
Rhonda A. Best FCCA, Director at Alexander Bain, Member of ACCA Global Forum for SMEs

## ACHIEVING YOUR GOAL

Effective planning starts with deciding what you are trying to achieve and takes this all the way through to creating a realistic plan. It should encompass all the following aspects.

- **Your long-term goal.** What really matters to you? What is the purpose of your business? As your business reacts to changing circumstances, how will you keep on track?
- **Your objectives.** What would you like to achieve in the next 12 months, 24 months and 36 months? Why have you chosen these targets, now? Is there an opportunity you want to exploit, and why do you think it exists? What are others in your market doing?
- **The strategy.** How can you take best advantage of the opportunities you have identified? What are the key risks and how can you control them? What assumptions have you made and what would it help to know?
- **Tactics.** How will you put your strategy into action? Who will do what, when?
- **Financial review.** Can you afford your plans? Which tactics are likely to be the most cost-effective? How will you monitor progress?

A 'SWOT analysis' can be a useful starting point. The analysis focuses on identifying the strengths and weaknesses of your business, and looking at the opportunities and threats you face. This helps you to plan the best way to make the most of your strengths and take advantage of opportunities while reducing and controlling risks.

'Are you working hard to achieve continuous business success? Always keep financial management at the heart of decision making.'
Uresha Walpitagama FCCA, Director – Staylanka Bookings (Private) Limited, Member of ACCA Global Forum for SMEs

The better your understanding of the environment in which your business operates, the stronger your plan will be.

80%

**of businesses employ fewer than 10 people**

(OECD, *The Dynamics of Employment Growth*[1])

8-14%

**of companies go out of business each year**

(ACCA, *Financial Education for Entrepreneurs: What Next? 2013*[2])

## PLANNING CAPABILITIES

Pulling together a business plan involves a wide range of knowledge and skills.

The better your understanding of the environment in which your business operates, the stronger your plan will be. That includes understanding customer requirements, what your competitors offer and key market trends. Your understanding of the wider business environment should cover regulatory, economic, social and technical factors affecting your business. What are the key tax, labour and environmental laws? Are there any special incentives for your type of business?

Equally, you need a clear understanding of your own business strengths and weaknesses. Your plan needs to cover the full range of business functions: sales and marketing, purchasing, production, human resources, administration and finance. What people, skills, premises, equipment and financing do you have and what do you need? What are the particular problems that are holding you back? A good plan will be based on hard data and research, not just a 'feeling' that something is a good idea. Wherever possible you should be talking to customers and testing out ideas before committing yourself.

Your completed plan should pull together all this information, creating a vision for the business, setting clear objectives and providing an action plan. You also need to be able to turn those plans into numbers, with forecasts of the implications for cash flow and profitability.

Most entrepreneurs find that they are strong in some areas of planning, but weaker in others. You can strengthen your planning ability by making the most of everyone in your business. Individual employees often have a keen understanding of where their particular area of the business is succeeding – or going wrong – and how it could be improved.

Membership of business associations is often a helpful step in gaining access to data and information about your particular type of business.

Equally, astute analysis of the data that your business holds, such as sales trends for particular products or customer groups, can be very revealing. Understanding what has happened in the past helps you refine your plans for the future.

## FINANCIAL EXPERTISE

Financial calculations and forecasts are at the heart of business planning.

Specific, numerical forecasts make it easier to check that your expectations are realistic. How will you achieve any sales growth you are forecasting? Have you taken into account all the costs you are likely to incur?

As a believer in your own products or services, you may be overconfident about your sales prospects. Looking at these in more detail provides a useful reality check. How many sales calls will you need to make? What percentage of enquiries will convert into sales?

Pulling your expected revenues and costs together in a cash flow forecast lets you identify any expected cash shortfalls in advance. It gives you time to arrange any financing you need, and helps convince lenders and investors that you have your finances under control.

You can also vary your assumptions, looking at different potential outcomes to help you understand how risky your business is. What if your sales turn out to be 10% lower than expected or a key supplier puts up their prices? How can you protect yourself against possibilities like these?

Unless you have all the financial and planning skills you need, you will want to turn to a suitably qualified external adviser such as your accountant. You may also want to develop your own skills or those of your employees. ACCA-X online training offers free and low-cost courses covering business planning and related financial skills.

1 http://www.oecd-ilibrary.org/science-and-technology/the-dynamics-of-employment-growth_5jz417hj6hg6-en

2 http://www.accaglobal.com/content/dam/acca/global/PDF-technical/small-business/pol-tp-fefe.pdf

The approach you take to managing your business finances – and even your personal finances – can make a big difference to how creditworthy you are seen to be and how keen investors would be to support you.

**5%**

**of small start-ups grow to employ more than 10 people within three years**

**(OECD, *The Dynamics of Employment Growth*)**

## STARTING UP

If you are starting a new business, it is likely that your resources – both people and money – are very limited. At the same time, the decisions you make at this early stage can have a huge impact on your future prospects.

Initially, you may have a choice of different business structures, such as whether to form a company or a partnership. Your choice can affect the legal requirements for your business, whether your personal assets are at risk, how profits are taxed and so on. You may also want – or be legally required – to organise your business in a way that clearly distinguishes between your personal activities, assets and liabilities and those of your business.

The right financing is critical. As well as making sure that your business is adequately financed, you should aim to use the right kinds of financing. For example, borrowing too heavily might make your business unnecessarily risky and limit your options if you need further financing later on.

The way you invest your own money, or any investments from friends and family, can also have important consequences. You may want to reduce your risks – for example, by providing your financing in the form of loans secured against any business assets. Doing too much to reduce your own risk might, however, deter other sources of finance from supporting your business.

The approach you take to managing your business finances – and even your personal finances – can make a big difference to how creditworthy you are seen to be and how keen investors would be to support you. Even if you do not require extra financing at the outset, you may want this flexibility as your business grows.

A thorough, realistic business plan is particularly vital at the start-up stage, whether you are seeking external funding or not. The plan helps you set the right course and avoid many of the mistakes you might otherwise make.

## START-UP ADVICE

In a start-up, recruiting an expert to deal with issues such as those discussed above is unlikely to be an option. Most start-ups find that their first finance recruit is a bookkeeper rather than a more highly qualified financial manager. Even this tends to be delayed until the volume of business justifies it.

Instead, financial management is typically the responsibility of the owner-manager. That may not be a bad thing, as it means that key decisions are getting the top-level attention they deserve. In practice, however, unless you are an experienced entrepreneur or come from a financial management background, you are unlikely to have the personal expertise needed.

The solution is to take the right advice.

- Your accountant is likely to be your key financial adviser. Involve your accountant at the planning stage to take full advantage of their expertise in areas such as business planning, raising business finance, tax planning and setting up financial management systems.
- You may be able to involve individuals with business experience and financial expertise in other roles: for example, as a mentor or a non-executive director.
- Whomever you get support from, check that they have the right expertise and are helping you in the right areas. If you are going to rely on a bookkeeper, make sure they know how to prepare a cash flow forecast and will warn you of potential cash flow problems.
- Once your business is up and running, you are likely to find yourself under constant pressure to deal with urgent tasks rather than broader business strategy. Meetings with your accountant and other advisers can help you refocus on the bigger picture.

From the outset, your aim should be to look ahead. Your business plan should tell you what you are trying to achieve and the kinds of financial management capabilities you will need to reach your goals.

# 3. Financing the business



Your business plan – and the cash flow forecasts in it – gives you a clear indication of the financing the business needs.

## YOUR FINANCING GOALS

Your business plan – and the cash flow forecasts in it – gives you a clear indication of the financing the business needs. As well as identifying your initial requirements, the forecasts look forward, identifying what additional financing you may need in future.

In fact, the right financing can do more than just providing the cash your business needs to function: it can also minimise costs and reduce risks. Careful consideration of your financing goals will help you decide what your financial priorities are. Although you may not be able to achieve everything you would like, you will have a better understanding of which trade-offs you are prepared to accept.

- **Financial strength.** You will want to ensure that you will be able to cope if your business is less financially successful than you hope or if you face a sudden, one-off cost.

- **Financing cost.** You will want to minimise the costs of financing, whether that means the interest you pay or the share of the business you give up in return for funding.

- **Financial flexibility.** Your business should retain flexibility, for example so that you can obtain additional money to help you pursue new opportunities in the future.

- **Business control.** You will want to retain control of the business, with lenders and investors placing as few restrictions as possible on what you can do; and you will want to restrict their entitlement to a role in decision-making.

- **Financial risk.** You will want to limit your personal financial risk, and the risks to any family and friends who have invested in the business, minimising the risk of losing more than you can afford if things go wrong.

- **Personal finances.** Your financing plans should take into account how much income you require from the business, and to what extent you are prepared to limit your income in order to reinvest in the business.

- **Business strategy.** Your ability to raise financing will determine whether you can afford to invest for growth or need to focus on controlling costs and generating cash.

Whatever financing you raise, it is essential to ensure that it is used for the intended purpose as planned. Losing financial discipline by diverting money to alternative projects, or for personal use, can be disastrous.

**>50%**

**of start-ups fail within five years**

**(OECD, *Entrepreneurship at a Glance*, 2015[3])**

As well as clarifying your goals, building a deeper understanding of your business finances helps you demonstrate your expertise to potential sources of finance, making it more likely that they will be willing to support you.

## UNDERSTANDING YOUR FINANCING OPTIONS

Significant financial expertise may be needed to understand and evaluate the different financial options you may have.

Your assessment of how much financing you need will be based on your business plan and the cash flow forecasts you produce. You also need to be able to assess how much impact uncertain events, such as disappointing sales, could have on your financial position.

You need to be aware of the different types of financing, and the roles they play. For example, it makes sense to fund long-term investments with long-term loans (or equity) rather than relying on short-term financing. Other options, such as leasing vehicles or equipment rather than purchasing them outright, may increase your total borrowing capacity and offer more financial flexibility than relying on bank borrowings.

Whatever financing options are available, you need to be able to compare their costs. This might include assessing how interest payable on borrowings compares with the less direct costs of equity investment. You also need to understand the tax implications – for example, whether interest payments are tax-deductible and whether you can recover any sales tax paid on equipment that you lease.

In many cases, businesses find they have relatively limited financing options: for example, relying on the owner's resources or funding from family and friends. In situations like these, it is essential to avoid unsuitable forms of finance, such as long-term reliance on informal lending at high interest rates that the business cannot afford.

Financial tools such as measuring return on capital employed can help you compare the expected profitability of a project with your cost of financing. A broader analysis can look at the most appropriate balance between different types of financing. For example, a business that needs to invest in uncertain, long-term projects should avoid too much borrowing. Excessive reliance on short-term finance can leave you vulnerable if the business climate changes or lenders become unwilling to support you.

Whatever financing you raise, it is essential to ensure that it is used for the intended purpose as planned. Losing financial discipline by diverting money to alternative projects, or for personal use, can be disastrous.

## WORKING CAPITAL

Understanding the impact of different ways of managing your working capital can be particularly important.

You may be able to reduce your financing needs significantly by limiting the credit you offer to customers and negotiating extended credit from suppliers. Actively managing the way you collect payments from customers, for example by chasing up overdue debts, is likely to be essential.

At the same time, you need to consider the broader business impact of your terms of trade. You might need to be willing to offer credit terms that match those of your competitors, or find that you are forced to accept a major customer's terms if you want to do business with them. Your financing plans need to take into account customers' real behaviour – for example, in some countries late payment is almost routine.

Working capital can be a significant limiting factor as sales volumes grow. You may need to identify ways of financing this, such as by using factoring to borrow against outstanding invoices. Taking out a long-term loan might be a better option than continually relying on an overdraft.

Any financing method you use to increase your working capital must be carefully evaluated, in the same way as your other financing needs. If profits are not high enough to cover any extra costs, you may need to take deliberate measures to limit your speed of growth.

'Many businesses find that tight financial control and strong supplier relationships help them avoid the need for extra financing altogether'.

Rosanna Choi FCCA, Partner CWCC (Certified Public Accountants Hong Kong), Chair of ACCA Global Forum for SMEs

3 http://www.keepeek.com/Digital-Asset-Management/oecd/industry-and-services/entrepreneurship-at-a-glance-2015_entrepreneur_aag-2015-en#page1

Understanding all your options, and making the right decisions, requires specialist expertise.

# 36%

**of business failures are caused by inadequate financial management**

(Turnaround Management Society 2014[4])

## ACCESSING FINANCING EXPERTISE

Understanding all your options, and making the right decisions, requires specialist expertise. For example, few entrepreneurs understand the detailed working of leases, or have the time to devote to finding out more.

You are likely to turn to your accountant for advice in some areas. For example, you might consult your accountant when you need to make major financing decisions, such as starting a new business or funding a major expansion.

You might also want your accountant to review your overall financing structure on a regular basis, alongside preparation of your annual accounts.

Other financing issues, such as keeping cash flow forecasts up to date and managing working capital, will need more frequent attention. You may want to develop in-house capabilities to deal with these as part of your wider approach to bookkeeping and financial control (see page 13: Financial control).

### ATTRACTING FINANCE

Banks and investors need to be convinced that you have a good idea and know what you are doing. In many cases, they will want to see a business plan demonstrating that you have a good use for the financing you want and will make enough money to provide a return.

Credibility is essential. Do you have evidence to back up what you say in the business plan? Can they believe what you say about your current finances and your future financial prospects? Have you shown that you are personally committed to the business (for example, by putting in your own time and money)?

## CREDITWORTHINESS

For banks and other lenders, the security of the money they lend you is crucial. As their return is limited to the interest they charge, they focus on risk, assessing how creditworthy you are.

The assessment is based on several factors and different sources of information. You can take simple steps to improve how creditworthy a lender is likely to think you are.

- Establish your identity. Make sure you are registered (for example, to vote) or have an identity card.
- Build a record of good financial management. It is a good idea to start creating your financial history as soon as possible (for example, by opening a savings account).
- Use your account. Banking cash you receive and paying expenses from your account, rather than dealing with cash all the time, helps build up your financial history.
- Pay on time. Whether you already owe money and have interest payments to make, or need to pay suppliers, show that you can be trusted to make agreed payments.
- Stick to your credit limits, for example if you have an overdraft or credit card. Show that you can control your borrowing needs.
- Obey the rules. If you are already in business, make sure you are complying with any regulatory requirements: for example, filing financial returns and paying taxes on time.
- Avoid borrowing too much. Even making too many applications can worry lenders if they think it is a sign that you are desperate for money.
- Be creditworthy both personally and in business. Your personal creditworthiness can have a big impact on how a bank treats a business loan application, particularly for smaller businesses and start-ups.

4 http://turnaround-society.com/companies-fail-2014-survey-results/

> ‘Cash flow information’ is what banks say is the most important factor when deciding whether to lend.
>
> (ACCA Financial Education for Entrepreneurs)

## IS YOUR BUSINESS INVESTABLE?

Like lenders, potential investors will want to know that they are not taking an excessive risk. They will also want to know how big a return they are likely to make if things go well.

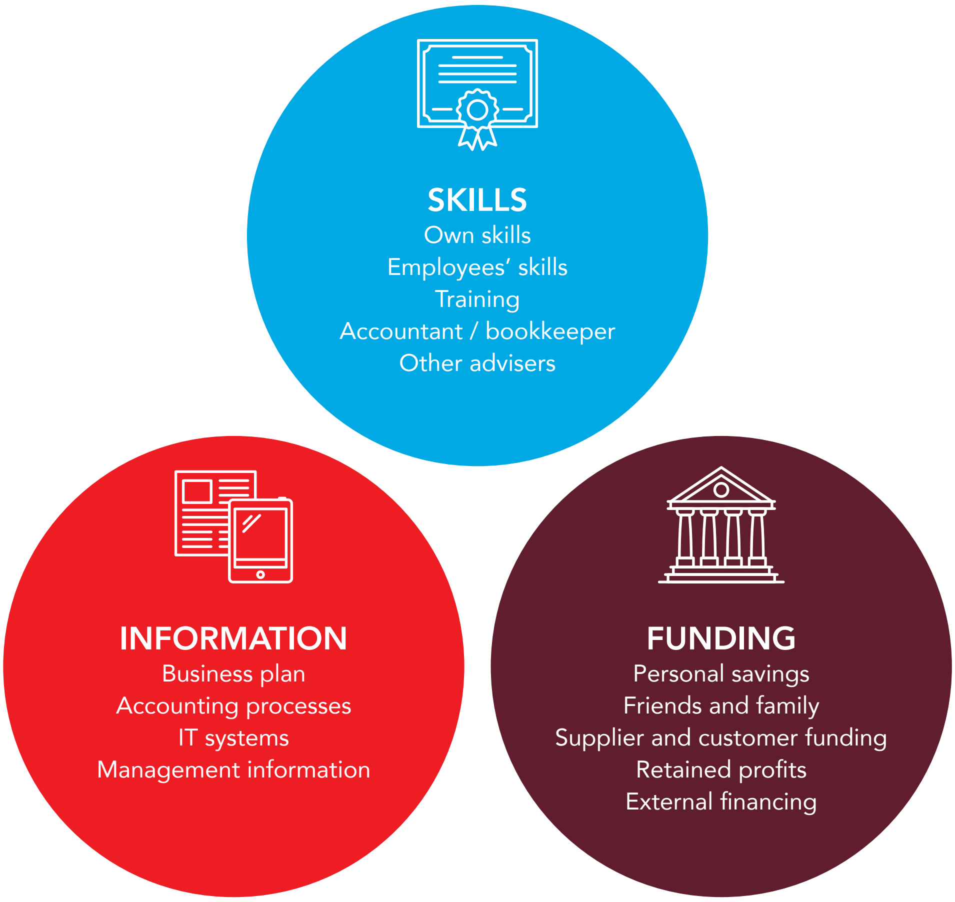
A lender focuses on the downside in your business plan – how likely it is that your business will fail. For an investor, the upside is equally important – how much your business could grow. Your business plan needs to show that your business will not just survive but thrive.

For many investors, the quality of the managers is a key concern. Do you/they have the right experience? And where you lack skills, are you getting the right support and advice?

Investors will want to look ahead, to see how big a return they might get on their investment and when this might be. Again, your business plan is the key to convincing them to support you.

> ‘Banks’ lending decisions are based on customers’ financial behaviour. Customers with a good track record can borrow more, at lower rates.’
>
> Anne Kimari FCCA, Chief Operating Officer, African Academy of Sciences, Member of ACCA Global Forum for SMEs

**Figure 3.1:** Financial capabilities and business success



# 4. Financial control



Good financial control offers far more than just keeping track of purchases and sales.

## KEY CONTROLS

Good financial control offers far more than just keeping track of purchases and sales. Rather than approaching financial control as a chore to be left to the bookkeeper, your aim should be to see how the right capabilities can improve your business.

- Basic record-keeping is an essential requirement. As well as recording transactions, you want to use data to generate useful information. Are costs under control or are there opportunities to save money? Are you achieving your sales targets?
- You must have an up-to-date picture of your cash position. This lets you minimise bank charges (for example, by making sure you stay within borrowing limits) and put any surplus cash to good use.
- You must keep a clear distinction between business and personal finances. Any personal loans to the business, or money drawn from the business, should be clearly recorded. Personal borrowings from the business should be limited.
- Effective cash management is also a key ingredient in demonstrating your financial control to lenders and investors. Over time, good cash management improves your financial reputation and creditworthiness.
- Managing customer and supplier payments professionally – for example, chasing overdue payments politely but firmly – helps improve your working capital position without damaging relationships.
- Your financial controls help you to comply with tax and other regulatory requirements. For example, you need accurate information to complete tax returns and pay any tax required.
- Strong controls help reduce risks: for example, making it more difficult for suppliers to overcharge you or for unauthorised payments to be made.

> ‘Credible financial statements don’t only help businesses access finance – they can reduce its cost as well.’
>
> Hastings Mtine FCCA, Managing Partner MPH Chartered Accountants, Member of ACCA Global Forum for SMEs

Financial control becomes more useful if you can look ahead as well as keeping track of the past.

## LOOKING AHEAD

Financial control becomes more useful if you can look ahead as well as keeping track of the past.

- Cash flow management lets you anticipate your future cash position. You can take steps to arrange any additional financing you will need before it becomes a crisis.
- Your cash flow forecasts feed back into your budgeting and planning process. You know what will be affordable.
- Planning ahead is vital for effective tax planning – when you start a new venture, on a continuing basis thereafter and as part of planning an eventual exit from the business.

You need to decide how best to organise the financial capabilities you want.

- How up-to-date does information need to be? For example, you might want your cash position and cash flow forecast updated daily.
- What areas will you deal with personally, and what will you delegate to employees or external suppliers?
- What skills do employees (and external suppliers) need? For example, you have to ensure that any customer contact is handled in the right way.

'We don't produce management reports just for the sake of it. They tell the board what's going on and where action is needed.'

Gabriel Low, Head of Accounting and HR Shared Services APAC, GEA Group AG, Member of ACCA Global Forum for SMEs

## BUSINESS GROWTH

Successfully managing a growing business means dealing with continual change.

Manual systems that were adequate in a smaller business may no longer be able to cope with an increasing volume of transactions. You may also require increasingly sophisticated financial management skills. For example, if you start exporting you may need to understand other countries' tax and regulatory systems, and be able to deal with customers in multiple currencies.

At the same time, it becomes impossible to have hands-on involvement in every area of the business. Tasks increasingly need to be delegated. Instead of doing things yourself, you need financial control and management reporting systems that give you a full picture of what is going on.

It is often possible to detect the warning signs of systems that can no longer cope.

- **Delays.** As the workload increases, it becomes increasingly difficult to keep up to date with transaction processing, management reports, company returns and so on.
- **Quality.** The number of errors and inconsistencies increases, while problems recur without the fundamental cause being identified and addressed.
- **Over-reliance.** The operation of systems comes to rely on the one individual who really understands what is going on.
- **Exceptions.** An increasing number of issues arise that have to be dealt with on a one-off basis because the system cannot really cope with them.
- **Morale.** Employee morale suffers as they are asked to perform mundane, repetitive tasks
- **Customer satisfaction.** Complaints increase and sales begin to suffer as customers experience the knock-on effects of poor systems.
- **Finances.** Headline figures and key ratios deteriorate as financial systems prove inadequate.

Wherever possible, you should aim to make sure you are ready to capitalise on new opportunities rather than waiting until a lack of capabilities is already holding you back.

## DEVELOPING YOUR CAPABILITIES

Your strategic plan can help you decide what improvements in your financial capabilities you need and the best way to make these happen. Wherever possible, you should aim to make sure you are ready to capitalise on new opportunities rather than waiting until a lack of capabilities is already holding you back. Make the best use of your networks for support and advice. This might include family and friends with business experience, local business contacts and online networks.

You may want to develop the capabilities of your in-house financial team gradually. For example, you might want to support your bookkeeper through a training programme (such as ACCA-X) to help their skills keep pace with your business growth. Eventually, you may decide that you need a step change in your in-house capabilities, perhaps to deal with a particular opportunity or challenge. Upgrading your accounting and financial control systems can provide substantial benefits. More sophisticated systems can deal with the growing volume and complexity of your financial transactions. The right systems make it easier to collect the information needed for tax and other regulatory returns. Robust systems also help to satisfy regulators (and others) that your business is being properly managed.

At this stage, recruiting a financial expert, with suitable qualifications and experience, may be the best option.

In addition, many growing businesses continue to use outside specialists – such as their accountants – for advice in more complex areas. This typically includes regulatory compliance, other legal issues and tax planning. You should regularly review whether external service providers continue to have the right expertise to meet your changing needs.

In larger businesses, the ability to share information among several employees becomes increasingly valuable. For example, a suitable system would allow a bookkeeper to update transaction records while key information and analysis is shared with management. Up-to-date information needs to be readily accessible. Information can also be shared externally, for example with your accountant. Well-planned systems can link in with those of business customers, distributors and suppliers.

Choosing the right solution for your particular business takes careful planning. Your overall investment in financial capabilities – whether you are paying for additional employees, higher salaries for more skilled employees, training costs, use of external providers or upgraded systems – must be affordable and offer value for money.

See the ACCA guide *Building your Financial Capabilities: A Guide for Growing Businesses.*[5]

'By acting as a "checklist" to ensure that nothing is overlooked – that everything is considered – strict financial management will put the business owner in a position to make smart and informed strategic decisions, thus ensuring the future prosperity of their business.'

Eilis Quinlan FCCA, Principal Quinlan and Co. Accountants, Member of ACCA Global Forum for SMEs

'Running a business is tough, especially in the current economic climate, and business leaders need every advantage they can get. Learning to speak the language of business – accountancy – provides credibility and improved business competence. There's a quote that's often used in business – 'revenue is vanity, profit is sanity, but cash is king'. If you run a business, you need to understand how to measure, forecast and make decisions to control revenue, profit and cash. With online courses like ACCA-X you can gain the foundations you need to build a successful business, at your own pace, using practical examples based on real life scenarios – all for free.'

Valli Rajagopal, Head of Learning, ACCA-X

5 http://www.accaglobal.com/content/dam/acca/global/PDF-technical/small-business/pol-afb-bfc.pdf

# 5. Business improvement



Financial management is at its most powerful when you use it to drive improvements in the business.

Financial management is at its most powerful when you use it to drive improvements in the business.

Accurate and up-to-date information puts you in a position to make intelligent and informed decisions for building your future success. Identifying a small number of key performance indicators that have a major impact on your business helps you to focus on the issues that really matter. A similar focus on a small number of targets helps employees in different areas of the business to understand what their priorities should be. Monthly performance monitoring is essential for long-term success.

More detailed analysis can give you deeper insights into where the opportunities for improvement lie. For example, you can look not just at overall levels of profitability, but also at how different products and customers contribute to this. Analysing competitors' prices and your own sales data and margins can help you identify where changing your pricing might boost overall profitability.

Financial information can provide vital early warnings of impending problems. For example, tracking customers' payment patterns (using your own sales records or data from credit rating agencies) can help you identify customers who may be under financial stress and risk becoming bad debts.

Benchmarking your business against competitors and other businesses – for example, comparing key financial ratios and other indicators in published accounts – can help you understand where you are different and where you have opportunities to make improvements.

Developing your financial capabilities can contribute to improved performance across the business. For example, improving sales people's financial awareness can help them understand what flexibility there is on pricing and payment terms. Analysis of sales margins and salary benchmarking against the competition can help you decide appropriate pay levels and bonus schemes for employees.

> An independent, objective view can help you avoid being over-optimistic and overlooking potential pitfalls.

## INVESTMENT DECISIONS

Major investments to drive improvements need careful evaluation to ensure that you understand the potential financial and business impact.

- How high a return does the opportunity offer? What increase in profits do you expect from making the investment, and how does this compare with your cost of financing?
- How risky is the investment and how much risk are you prepared to take? How would you assess an investment that promises a moderate but guaranteed return against a more speculative opportunity that might provide spectacular returns or fail completely?
- How quickly would the investment pay for itself? The longer it takes, the higher the risks are likely to be. For example, an investment in new production equipment might be overtaken by a newer technology or made redundant by changes in customer requirements.
- What would the impact be on your cash flow and overall financing position? What will be the best way of financing the new investment? If you stretch yourself too far, what might the impact be on your ability to finance the rest of your business and take advantage of any other opportunities that might come up?
- More broadly, how does an opportunity fit with your existing business and overall strategy? For example, investing in the ability to offer a wider range of products might be a worthwhile way of increasing customer loyalty even if the new products add relatively little to your profits.

## INVESTMENT ADVICE

Unless you already have the financial expertise you need, you should get help with financial evaluation. This may include preparing a cash flow forecast for the new opportunity, identifying key risk factors and assessing how much impact changes in your key assumptions might have.

An independent, objective view can help you avoid being over-optimistic and overlooking potential pitfalls. An accountant or suitably qualified bookkeeper should also be familiar with the tools that can help you assess different investment opportunities, compare them with each other and consider them against your cost of funding.

Common investment evaluation methods include discounted cash flow analysis, which makes it easy to compare the returns you expect from an investment with its initial cost. A similar tool, the internal rate of return, lets you compare expected returns with your costs of funding. The more straightforward measurement of payback period tells you how long it would take to recover your investment.

An experienced adviser can be particularly useful if you are competing over an investment opportunity. For example, if you are interested in taking over an existing business you will need to work out your negotiation strategy and set a limit on how much you are prepared to pay.

> 'Continually evaluating and improving your organisation's capabilities is essential if you want to maximise its effectiveness'.
>
> Bright Amisi FCCA, Managing Director Avante Advisory Services (Pty) Ltd, Member of ACCA Global Forum for SMEs

> ‘Financial management plays such a vital role for business survival and growth. It’s like a telescope into the future, guiding you to walk around pitfalls and find the shortcuts on the way to your goal.’
> Ken Lee FCCA, Lee & Lee Associates, Member of ACCA Global Forum for SMEs

## BUSINESS EXIT

For many entrepreneurs, a successful business exit – often involving both selling the business and retiring from an active management role – is a fitting end to years of effort. The exit may bring your involvement with the business to a close, but preparation for a successful exit typically begins far in advance of this final date.

For potential investors, understanding how they will realise their investment is often a key issue. Entrepreneurs looking to raise funds from investors may need to have some idea of their exit plans before the business has even started.

Effective exit planning needs to start early and take into account a whole range of issues in order to maximise the value of the business when you sell.

- **Timing.** What will be the right stage in the business lifecycle to get the most interest from potential purchasers?
- **Succession.** Who will take over from you when you retire?
- **Systems.** Are management systems, legal agreements and so on robust?
- **Tax.** What will be the most tax-efficient way to extract money from the business?

You are likely to need advice to help you plan and carry out the business exit. You may want to ask someone with experience of similar transactions to act as an adviser or non-executive director. It can be a good idea to put together an ‘exit team’ charged with managing the exit process. An employee with relevant financial training and experience may be best placed to lead this team.

You will also need to ensure that the team has access to appropriate specialists with experience of similar transactions. This may include your existing accountant (and lawyer) but also more specialised corporate finance advisers. Specialist financial and negotiation skills will be important.

PI-FINANCIAL-MANAGEMENT-ENTREPRENEURS

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