



10 essentials of good financial management for small businesses

Description

Proper financial management is the backbone of the success of any entity. Many entrepreneurs realize too late that businesses seldom fail because of a lack of profit, but usually from poor cash flow.

Proper financial management can help avoid many of the pitfalls that lead to poor cash flow and high business mortality. Finance sages are quite pricey and you might need to manage your business's finances yourself while you are starting out.

Follow these few tips to help you keep good circulation in your business.

1. Account for Every Single Cent

This one might seem rather obvious, but it's not. By every cent, we mean every cent, no matter how insignificant it may seem. If your business makes millions, you might be tempted to overlook expenditure on a pen or pad or other similarly small things.

But the truth is, you tend to go through a lot of the small consumables in your business, and the bill adds up. If you are not accounting for them, you may miss this effect and overlook acquiring them more economically, affecting your profits negatively, unnecessarily.

And you are in business to make a profit. Sure there's a lot more to it, but profit is very important. That means you want your business to generate revenue in excess of costs.

But you could continue investing in the business thinking it's breaking even, all the while you are in the red, because of the pens you buy, and lose and replace.

True the loss might not be much, but you are missing out on an important goal for your business, generating a positive return.

2. Know the Essentials

Not just the essentials but the bare essentials. This means knowing the resources below which your business cannot be operated. Think of it as business Jenga, how many resources can you remove from the business without it completely collapsing.

This forms the basis of all financial planning and can be built upon in all the other tips discussed here. It is important not to be too strict when determining these essentials otherwise your financials will underperform when called upon.

And this is also a blueprint for a [lean start-up](#), particularly good for those bootstrapping their businesses. It generally eases the task of finding financing as you have less to look for.

By reducing your needs, you make sources like savings, angel investors, friends and family and crowdfunding more viable. Plus, smaller amounts are more easily approved by [funding institutions](#).

The bonus is, of course, a shorter path to positive returns, which is good for your business.

3. Create a Financial Contingency Plan

In business, it's always tough to acknowledge that the path to success will get rocky. Failing to plan ahead for tough times will, however, make them even tougher to survive when they eventually come around.

You need a fallback for when your financials are in a bad state. Despite your best efforts, a few factors could derail you, including;

- Clients paying later than anticipated
- Sales being lower than forecasted
- Costs exceeding forecasts
- Opportunities arising that you need to take advantage of

There's much that could go on that list but the lesson is; a good financial plan leaves you prepared. A contingency should address mainly three things;

1. Should a crisis arise, where can you get bridging finance, for how much and under what terms

2. According to what you established under point two, the bare minimum, what do you need to finance for the [business to recover after a tough time](#)
3. Should you fail to weather the storm, what's going to be your exit strategy

4. Budget, Forecast and Analyse Variances

You need to keep a clear picture of where you are going in terms of both revenue and costs. Management without a roadmap is awfully tough and financial management is no different.

Budgeting for costs goes a long way in managing expenditures. You allocate money to key resources and shop around for the best possible price, or at least you should make sure you do.

Revise deviations from your budget strictly to make sure expenditure is minimised to essentials.

The same goes for revenue, forecast what you believe you can make. Take into account all the macro and micro factors. This will motivate you to take advantage of all the opportunities that may come your way in any period.

It also keeps you ahead of possible challenges, just in case you need to whip out the contingency plans. At the end of the period, drill down into variances in budgets and forecasts.

Take note of the factors contributing to them and use them to update your process for better budgets and forecasts in the future.

5. Visualize, Set Benchmarks and Analyse Performance

Ultimately you are in business to make a good return on your investment. Even if you are a non-profit, you need to ensure you stay financially viable to carry out your mandate.

So at the centre of good financial management is proper performance appraisal. You need to make sure you are meeting goals, and if not, what's standing in your way.

[Analyze all the financial data](#) you are getting from your business and create an overall picture.

Visualize the data to make it easier to take in. Paint a picture of the performance, literally. Charting your performance immediately brings out critical issues.

Determine a few critical KPIs for your business and keep your reports centred around these. You might be tempted to analyze all the performance areas you can, but this creates a glut and makes your reports less actionable.

It would be tough of course to know if you are hitting the mark if you are only measuring against yourself. So in addition to analyzing your performance against past periods, benchmark yourself against industry peers.

This is essential for ensuring your financial management policies are the best for managing macro factors.

6. Invest in an App/ Software

Depending on your needs it could be as simple as a model in Excel, an accounting suite or full-on Enterprise Resource Planning (ERP) tool. Keep in mind the importance of balancing cost with functionality.

A good choice will allow you to easily navigate the other points mentioned here so use them as a checklist when making your choice.

It's definitely advisable to go for a cloud solution. In addition to acting as an auto backup of your financial data, they come built-in with a lot of handy reports and integrations.

A good choice to evaluate is Zoho Books, a freemium software we discuss in [this article](#).

7. Pay Taxes

Your business might be small now, possibly under the radar, but we are sure [growth](#) is an important objective for you as an entrepreneur.

Failure to be tax compliant at the start of your business plants the seeds for problems that will derail your business at a later date. Tax compliance is also an important viability measure, meaning if you are failing to pay taxes it could mean [your business idea is not viable](#).

Rather than evading your taxes, conduct some research on tax avoidance strategies to ease your business's tax burden.

It's important not just to pay taxes but to pay them on time. One should always avoid delaying tax payments, particularly VAT as a means to bolster cash holdings to survive tough times.

It paints a prettier picture than what's actually on the ground and could mask the extent of a problem. The notion that the business will grow in terms of revenue and then be in a better position to settle old tax obligations is also mistaken as your tax obligations will just grow with it.

8. Invest Surpluses

Financial Management 101 teaches us that there is a time value for money. It is the principle interest is based on, the reward for a willingness to delay consumption.

The long and the short of it is, if you do not need to spend money today, you can earn interest from it by investing what exceeds your immediate needs. Be careful however that you do not invest in overly risky schemes and lose the funds.

Rather [keep your risk appetite low](#) and your expectations of the reward low as well. Secondly, you need to make sure your investment is not difficult to liquidate. A fixed deposit account with your bank is a good example that covers both.

Should you find yourself in a pinch, you do not want to lose money trying to get finance to get out of it; it defies the whole point of investing.

A good strategy is to speak to your bank about moving your surpluses into interest-bearing risk-free savings accounts. Be sure to specify withdrawal terms that line up with your contingency plan.

9. Depreciate, Depreciate, Depreciate

[Depreciation](#) can seem like a very abstract concept, but it has real financial management value. Depreciating your assets allows you to spread their cost through their useful life.

Remember, the cost of assets goes into your balance sheet and not the income statement. Depreciation, therefore, allows you to allocate that cost evenly across the lifespan of the asset in the income statement.

The result is you match income to the value of assets lost to generate it. The wear and tear of the assets is allocated to the income directly attributable to generating it.

The resulting profit calculated is more realistic, reducing overdrawn in your business.

Plus, because profit takes into account the wear and tear of your assets for each period, depreciating creates a cash reserve that can be used to replace your assets as they reach the end of their useful lives.

10. Consult

Financial management is a cornerstone of proper business management, making it essential to ensure you are doing it right.

[From the onset](#), invest in a consultation to ensure you set up the right systems and policies on matters such as reporting, budgeting, variance analysis and so on.

While in the long run you will learn to tackle all matters yourself, just ensure you are off to the right start with a professional.

Also, periodically revise your policies with your consultant as your business grows, particularly in areas where you can't afford to be wrong. A good example is taxation.

Consult with the same firm or individual as much as possible. You will deal with someone who understands the evolution of your business and this greatly boosts the quality of advice you get from them.

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