PRACTICES ADOPTED BY SMALL BUSINESS FOR FINANCE AND MANAGEMENT CONTROL

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ABSTRACT

In the past, a large numbers of Indian entrepreneurs could survive or even grow despite of inadequate managerial capabilities. Simply because they could not hide their inefficiency and high cost behind large profit margins or high prices resulting from lack of competition.

Despite visible projects and adequate finance, a large number of small and medium enterprises have been failing. There is a need to evaluate and diagnose industrial firms to promote them and to assist them.

The problem of Indian entrepreneurs has been the rather narrow and limited horizons within which they have confined their vision. It is now time for a progressive and broader outlook without which success in industry or business will not be ensured.

Financial analysis lays emphasis entirely on past happenings rather than on problems likely to arise in future. No doubts, the financial snapshot of a company may give some hints about its future, yet it is much better to adopt probes that are inclined more towards the future of the enterprise than its past.

INTRODUCTION

A number of large companies have

been in trouble in the recent past. Share prices of one of them plunged from a peak of Rs 450 to Rs 95, while, another showed a massive, unheard of loss in its annual balance sheet. Even big companies at times face crushing defeats. Yet another incidence of such failures is much more frequent in the case of small and medium scale enterprises.

The paper focuses on finance and management control in the small business enterprises, how and why of this phenomenon and to purpose remedies which could help enterprises to remain on profit oriented. If you wish to diagnose the health of your business you should

Normally we assess a company's present performance and its future well-being through an analysis of its financial results. We do its regardless of whether the company belongs to a big business house or is a tiny industrial unit. The analysis has an advantage in that we can rapidly survey the figures of sales turnover and return on investment and also check whether the company is making a profit or loss. Besides, it is quite natural for a busy entrepreneur to gauge the financial and operating results of his business performance and recon the future of his business through such an analysis. In any case he does not have enough time to bother about other 'trivial' details of his company. The financial analysis is the main instrument that may be used by the small scale entrepreneur while interacting with the banker. He can also compare his financial position and operating performance with that of his competitors and identify areas where he needs to improve both.

The overall health of the business is reflected in its financial and profit statements. All basic strengths and weaknesses will be reflected here. Yet it is often difficult for the adviser to measure quickly and easily the health of a firm in this way for a number of reasons: -

- the confidentiality with which financial statements are often regarded and therefore the day to day difficulty in gaining access
- the frequent inadequacy or absence of records and systems that can be used for purposes of quick analysis
- the adequacy of reported annual accounts in reflecting the true position of the company for variety of tax and other reasons

Given these difficulties the adviser will frequently need to make judgments from inadequate data, to assist in constructing from this data basic financial and profit statements, and advise the business on the design of systems to improve financial and profit information.

This may mean spending time getting to know the business through the owner-manager and reaching an understanding of what is possible and appropriate for the business in terms of financial and management control systems and procedures. It also means helping the owner-manager to understand clearly the relevance of key pieces of financial information to the running of the business.

Businesses do not fail because they do not make profits. They fail because they run out of cash. The management of cash and liquid assets in the small business is usually critical and the relationship of these to profits is not always clearly understood by the entrepreneur.

There are two key questions to be answered:

• How well is the business doing in cash and profit terms? (where are the problems if any?)

• How well do the basic systems in the business assist the management to monitor its health?

Analyzing cash and profit problems

Basically cash problems in the business are likely to stem form the causes set out in Exhibit 1 including:

• basic under-capitalization of the business with a need for the injection of new equity finance
• excess withdrawals by owners
• excess stocks and work in progress
• inadequate control of debtors
• over generous terms of creditors
• too much cash tied up in fixed assets
• trouble with the bank (e.g. at limit of overdraft)

Each of these in turn can be traced to their own distinctive causes, which can be further explored with the owner-managers.

It is important to note that the absence of, or the inadequacy of profits, will soon feed into the liquidity problems.

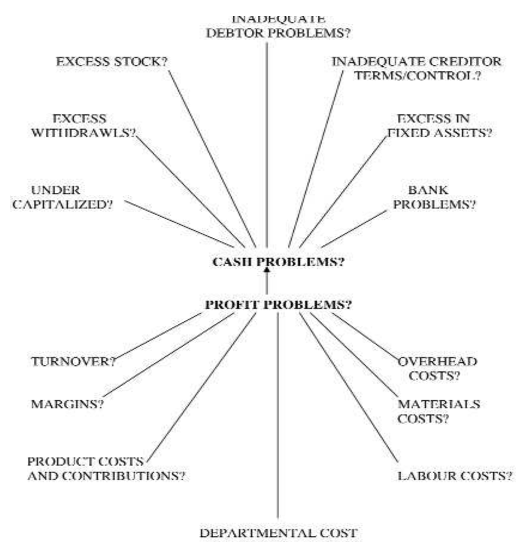
If the problem is profitability then the major points to explore are (Exhibit 1):

• the overall adequacy of turnover
• the overall adequacy of process margins and the gross contribution
• the detailed contribution of particular activities, departments or products to turnover and profit
• the control of labor, materials and overhead costs

Each of these can then in turn be analyzed further to highlight distinctive causes of identified performance problems.

EXHIBIT 1

CASH OR PROFIT PROBLEMS?



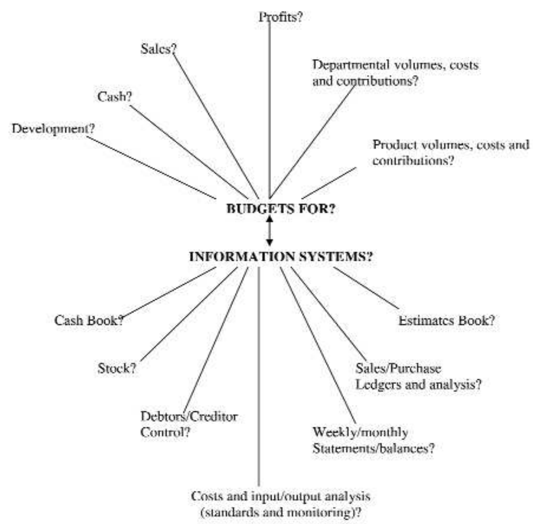
The Adequacy of records and systems

Difficulties in advising small businesses stemming from the inadequacy, or unavailability of information have been mentioned above. A wide variation in systems may be found dependent upon the type of business. Many of these will have been invented by the owner/manager; others will have been installed on the advice of accountants or consultants Exhibit 2 indicates the basic ledgers and systems that might be available for inspection, enabling in turn:

- monitoring of cash
- monitoring and/or analysis of sales and purchases
- monitoring of the debtor and creditor situation
- monitoring of product or job costs and contribution
- monitoring of departmental costs and contribution
- monitoring of materials and stocks and work in progress
- overall monitoring of profits, sales, outputs and contributions in the form of regular weekly, monthly or quarterly trading or operating accounts

These records can provide the basis for the setting of standards and budgets for cash, profits, turnover, and departmental and product costs and contributions along with perhaps a separate development budget.

EXHIBIT 2
MONITORING AND CONTROL



CONCLUSION

It is observed that the small business entrepreneur fail because of lack of necessary financial accounting data. It is because the small entrepreneur feels that they cannot afford to employ an accountant. Many small entrepreneur think that they have such a thorough knowledge of their business that ignore the importance of financial data for future decision making.

Many entrepreneurs who are such green horns in business that they can hardly spell out exact difference between total cost and gross profit margins or when does the business bread even. They find it unnecessary to get accurate up-to-date information about such vital data of their business activity from time to time. Nor they show adequate appreciation of the importance of financial data in the forms required for proper cash and working capital management. They run the business like a car driver who drives at night without head lights. Small business should set up sound financial and cost information systems that will help you to know the product costs, income from sales, profit/loss and cash flow in an authentic and reliable manner. They money that you spend for establishing such systems is not to be regarded as an expense but as an investment. Without such systems, you will be groping in the dark about the outcome of your business decisions that you want to take or have already taken.

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