

Entrepreneur

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CFO: Engine of the Finance Function

A good CFO can be a true asset to an SME and ensure efficient financial management.

By Bhairav Kothari

Ever wondered how some companies are able to raise substantial debt and equity funds and rapidly grow both organically and inorganically? Or how they manage crisis far better than the industry average when the going gets tough? The answer: They have good CFOs, which makes a lot of difference. A CFO, besides supervising the accounting function, ensures robust enterprise-wide systems and controls, manages cash flow and costs, negotiates key contracts/agreements, drives fund raising, handles investor relations, addresses key HR issues, strategizes M&A and post-acquisition integration plans, is the official spokesperson of the company for banks and investors, and is also an important member in board meetings.

Let me give you some practical examples across multiple functions to illustrate the importance of a CFO:

ACCOUNTING SYSTEMS

Under accounting, let's start with bank reconciliation. I have interacted with quite a few companies and a few common responses I get when I ask about bank reconciliation are:

- ▶ What is that? Our auditors handle it.
- ▶ We prepare it once in a quarter, but it is never checked by us (the promoters/CEO).
- ▶ We prepare it, but we clear the bank reconciliation once in a few months.

Let me share an experience here regarding a finance company I was involved with. They had a bank reconciliation that was regularly prepared, but cleared once every few months. When inspecting it closely, we noticed that there were a couple of cheque returns from a customer lying in the bank reco. This meant that the system showed that he had paid on time. Now,



after three cheque bounces, that smart customer prepaid his loan and the company even returned all his papers. Later, the company found out about the three cheque bounces, but by then it was too late to recover the same.

COMPLIANCE

When cash flow is under stress, the Government of India becomes the funding agency by default. This happens by virtue of businesses electing to defer Statutory Dues, which is not right and can be dangerous for the following reasons:

- ▶ This is not free money. The company will have to pay it back someday. And this deferral comes with a high interest cost, penalties and sometimes settlement cost.
- ▶ This becomes a negative remark when you go out to seek external investors. PEs/VCs do not like non-compliant companies.

CASH FLOW FORECASTING

It is important to have a long-term cash flow forecast for two to three years, and also a detailed monthly forecast for the next 12 months and a detailed weekly forecast for 13 weeks. As an entrepreneur, you don't want surprises and last minute panic to meet basic payment requirements.

RECEIVABLES MANAGEMENT

It is surprising to see SMEs chase banks for working capital/OD limits, while running huge receivables from clients. Here are a few steps to keep your receivables management efficient:

- ▶ Have a dedicated team and a clear process.
- ▶ Calculate your interest loss, and offer some cash discount to your clients as an incentive to pay earlier.
- ▶ Draft and provide your teams with standard collection follow-up letters and escalation matrices.
- ▶ Include the cumulative outstanding amount in invoices. This is a simple yet powerful tool.

COST MANAGEMENT

Though the domain of cost management is very wide, let me give you a few quick examples:

- ▶ **Rentals:** Check the chargeable area. Sometimes landlords give a sharp per sq. ft. rate but an inflated chargeable area.
- ▶ **Employee Expenses:** Check reimbursements of all key employees. Check fuel and meal bills. Check business lunch reimbursements of the sales team.

- ▶ **Lawyers:** Hiring lawyers can turn into an expensive proposition. Even after negotiating the best hourly rate, check what they are billing you for. They tend to charge you even for the time they spend understanding your case. Sometimes I have seen Associates (juniors) charging for understanding the matter from the client, and then Partners (seniors) charging for understanding it from the Associates. Then there is the actual work done/advice given, which is charged for separately.
- ▶ **Travel:** Check travel reservations of your senior employees. They are the ones who can influence the admin department. Check if the choice of airlines is governed by the cost of travel or Frequent Flier Miles.

FINANCE REPORTING

Reporting financials is an art, one that distinguishes a good finance professional from the rest. Let me give you the following three options of financials being reported by a company.

Option 1: The company closed Q3 with Rs. 22.5 crore in sales and Rs.2.25 crore in losses.

Option 2: The company closed Q3 with Rs.22.5 crore in sales, as compared to a budget of Rs.27 crore and a net loss of Rs.2.25 crore as compared to budgeted loss of Rs.90 lakh.

Option 3: The company closed Q3 with Rs. 22.5 crore in sales as compared to Rs.18 crore in sales in the previous quarter, and Rs.9 crore in the same quarter last year, thereby posting a growth of 150 percent YoY. While the company had set an aggressive sales target this year of Rs. 27 crore, efforts are on to focus more on costs and EBITDA, and to avoid chasing revenues, pursuant to strategic decisions made at the last BOD meeting. While the net loss for the quarter was Rs.2.25 crore, the company incurred a one-time, non-cash cost on account of ESOPs issued to certain key senior employees, that we want to retain, of Rs.4.5 crore. If this is excluded, the company generated a profit of Rs.2.25 crore, being the highest profit per quarter since inception.

CONCLUSION

Engaging a good quality CFO is very important to the success of an SME. While it may seem out of reach from a cost/budget point of view, with virtual and part-time CFO services providers, it is no longer a perk that only large companies can afford. ■

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