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Leveraging professional financial management practices to drive small and medium-sized company growth

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Growth of small and medium-sized enterprises (SMEs) is crucial for the Finnish economy, but based on earlier research, there are only few companies who have actually grown to revenues of 200-500M€, and practically no companies have grown to above 1000M€ of revenue during the past 20 years. One of the reasons we have found is that the finance function of a normal SME does not support its growth journey well enough, leaving one important value creation lever under-utilized.

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Increasing competition, regulation and information technology drive requirements up for a company's finance function

In today's fast-changing world, the requirements for a company's finance function have significantly grown. A growing number of companies are facing tough competition already in the early stages of their lifecycle. As competition becomes more diverse, the geographical scope broader, and information technology more sophisticated, navigating in this environment calls for deeper understanding of a company's strongholds, and planning and monitoring operations on more granular level than earlier. A solid fact-based understanding of the company's financial performance is crucial for good decision-making.

In several small and medium-sized enterprises the primary task of a finance function has been to manage basic transactional tasks like financial accounting, invoicing and payments. However, to respond to the changing environment, finance functions are expected to evolve from accounting masters to business partners, providing decision support and control to guide company operations, and, further, to value managers driving the company's value creation initiatives across businesses and functions. This evolution together with increasingly complicated reporting standards is changing the way finance functions and roles are organized. Increasing requirements for each role lead to specialization and fragmentation of the finance function but also put pressure on competence development and recruiting to meet future needs.

Publicly-listed companies have addressed the changing environment and expectations by organizing finance along specialty areas like accounting, controlling and treasury, and rotating people between functions and roles. Nonetheless, even in the big companies, there are few examples of managing company's value creation initiatives systematically across businesses and functions. Few companies are able to follow up the business impact of the portfolio of strategic initiatives centrally to support decision-making and prioritize investments in a fact-based manner, usually running them in multiple functions independent of each other and without proper coordination. Those that are measuring value creation initiatives have introduced new governance models like fixed program management offices coordinating all ongoing strategic initiatives.

SMEs face challenges similar to publicly-listed companies but cannot afford building internal teams of expertise

Whereas publicly-listed companies can afford building teams of expertise and specific governance models, for small and medium-sized enterprises (SMEs) they are usually overly complex and costly. As a result they tend to focus on fulfilling regulated activities such as accounting while overlooking more value-adding activities or performing them through interplay between the CEO and the accounting manager. As these persons have several and usually time-consuming other responsibilities as well, there is a possibility that decision-making is compromised or the company becomes subject to undue risks. In our experience, there are three key benefits of an advanced finance function that tackle areas too often neglected, significantly improving an SME's chances for growth and scalability:

- *Improved understanding of profitability:* Often a major problem even in larger companies, there is a lack of real understanding of the profitability of different products, customers or even entire business areas. This lack of detailed cost accounting leads to non-fact-based decision-making. As the contribution of the different ventures to the company's bottom line is unclear, companies are unable to allocate resources efficiently and manage their business portfolio, eliminating unprofitable ventures and nurturing profitable ones.

- *Better risk management:* It is uncommon in SMEs to monitor cash flow systematically or proactively find ways to optimize the cash cycle by for example managing inbound and outbound payment terms, inventory levels, and pricing and discounts. A cash flow problem is often discovered far too late, when a liquidity issue occurs. Simple measures and proper business control can have an important impact. One SME, for example, hadn't followed up its purchase contracts for a couple of years, despite running a growing and profitable business. Through simple cost monitoring, the company was able to gain significant savings by renegotiating the agreements
- *Opportunities for strategic finance:* Due to lack of resources, many investment and growth-related decisions in SMEs are done without comprehensive analyses of the different strategic alternatives. A developed finance function supports finding the best initiatives, the proper financing for them and can even be helpful in finding opportunities for inorganic growth.

Many of the benefits of putting more emphasis on finance functions are usually hard to measure, decreasing the willingness to invest in them. There are often, however, some low-hanging fruits the company is not aware of before an analysis is performed that provide rapid and tangible business impact as soon as the discovered opportunity is captured. For example, analyzing true product profitability for the first time often significantly challenges existing strategies and their key assumptions.

Some activities in advanced finance functions are needed more infrequently than others and therefore building in-house competencies may not be feasible since hiring a capable person is a big, inflexible and risky investment for many small companies. SMEs need to look at new ways to build required competencies.

Finding more flexible ways to build professional financial management competencies to support an SME's growth journey

To determine competency requirements, an SME needs to understand its development stage and underlying strategy and value-creation drivers. To overcome these challenges a three-step approach may prove useful:

1. Understand the company's long-term ambition, strategy and value drivers.

2. Derive financial management competencies from the strategy in each development stage, and evaluate their importance to strategy execution.

3. Define a roadmap to proactively acquire these competencies in each stage through recruitment, collaboration or outsourcing.

Competency development needs are tightly linked to the company's strategy and it is therefore useful to reflect them through strategy. For smaller companies organizing the basic finance processes may already prove a big task, and therefore utilizing for example incubators, investors or partners can be helpful. After the basic processes have been defined, a company may consider outsourcing general accounting and other transactional activities and focus on more value-adding activities like financing, business control and pricing.

Business and cash flow forecasting, for example, are critical tasks for every company but especially for start-ups with less stable cash flows.

After setting up the foundation, the company's strategy comes more into play. When the company's strategy is based on aggressive growth, the role of the finance function needs to focus on the financing of growth initiatives, international financing and credit management, taxation, setting controls to manage profitability and working capital (avoiding the "growth trap"), and developing value-adding business models and pricing. On the other hand, in case of a turn-around, the finance function needs to forecast business and cash flow intimately, pinpoint main profit drivers and steer decision-making through them. Detailed understanding of the balance sheet and major cost items is needed to manage the company's cash flows. When driving profitability improvements, CFOs need to understand the company's processes to be able to pinpoint inefficiencies, while thorough understanding of product and customer profitability may give new perspectives on profitability losses.

These competencies are far from accounting and therefore usually unavailable in-house. At the same time, they may not be needed regularly and therefore hiring a full-time financial management employee may become too expensive. SMEs need to find more flexible ways to build these competencies. Incubators, investors, business angels or external partners can provide a way to utilize these competencies when needed. Medium-sized companies might also consider sharing an employee with some of their partners, or outsourcing it from a service provider.

At its best, a finance function is far from pure administration and drives the company's performance. This is important not only to the company itself but the whole Finnish economy that is driven by the growth of companies from 10 to 100M€ in revenue. Through prioritizing and driving value creation initiatives, the finance function can become a core strategic asset for a small and medium-sized enterprise as well.