FINANCIAL LITERACY

FOR SMEs

Financial Management

Healthy Credit

Debt Management

Fraud Prevention

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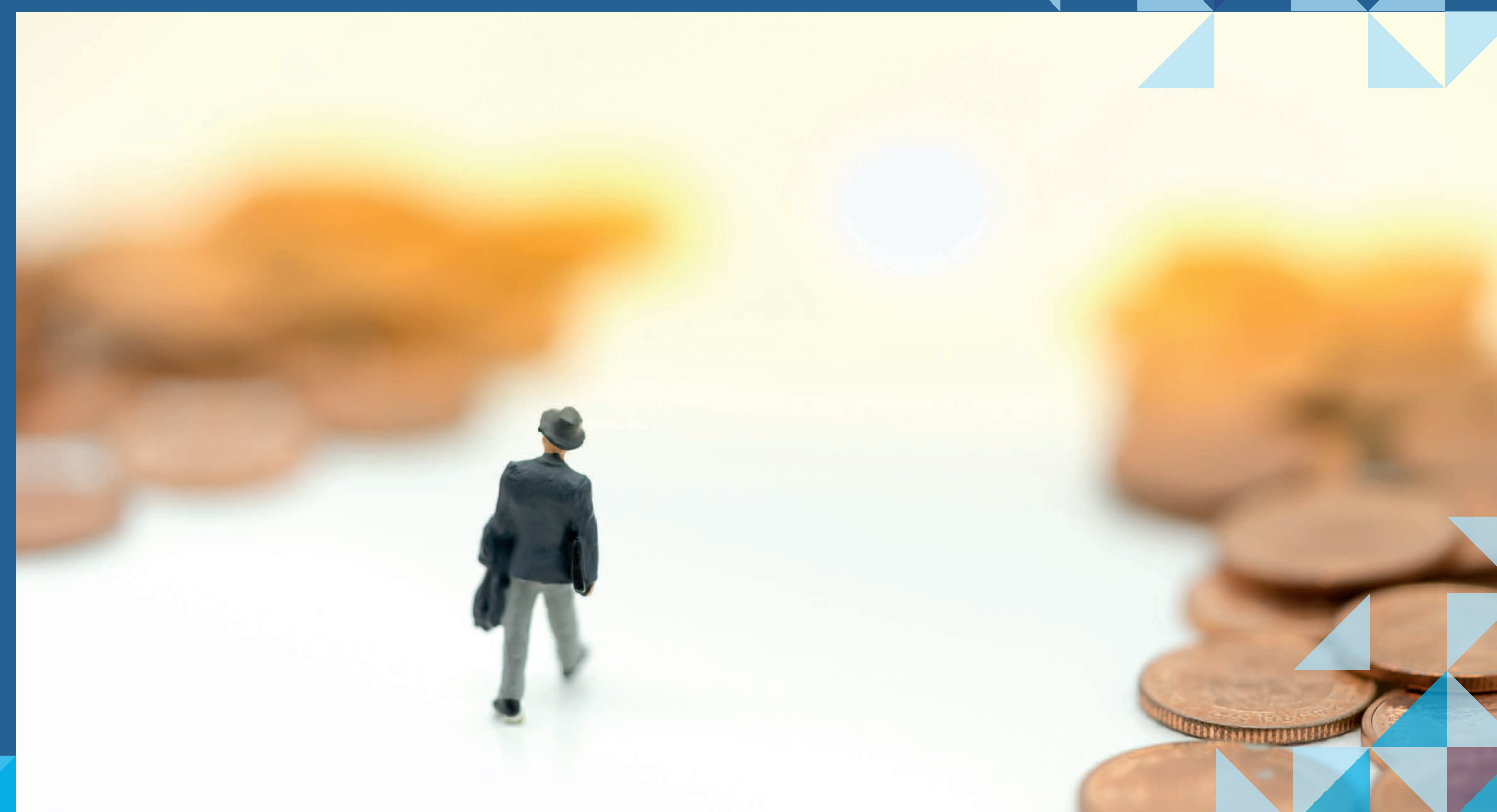
This report is prepared for general financial literacy information, and should not be considered as an investment advice booklet

1. INTRODUCTION



1.1 Defining financial literacy for SMEs

Financial literacy refers to the skills and knowledge required to make informed financial decisions. That means being able to source and comprehend appropriate financial management options, complying with credit terms and keeping abreast of one's credit status.

What does it mean to be a financially literate SME owner?

To be financially literate, an SME owner must understand basic financial concepts, be aware of financial services and products available, familiarize themselves with differing financing and financial management options as their business develops, identify the most suitable products for business growth, interact confidently with suppliers of financial services, and possess sufficient knowledge of legal and regulatory frameworks, rights and resources.

To assess the financial literacy of SME owners, one should gauge their:

1 Knowledge and skills to deal effectively with financial matters, including:

a. Understanding of basic financial mathematics and concepts
b. Effective use of suitable financial resources

2 Awareness and understanding of relevant regulatory frameworks and legal requirements, including:

a. Knowledge of key accounting standards and principles that go beyond basic bookkeeping practices
b. Segregation of personal and business assets and liabilities.

1.2 Understanding the need for financial literacy for businesses

The first step towards becoming financially literate as a business owner is to have knowledge of the different types of companies. Financial literacy goes beyond possessing knowledge of financial news — it is about understanding business finance and how companies and business owners can use appropriate information to make effective decisions.

Why must business owners be financially literate?

Proper financial planning will prepare potential business owners to build a viable company that will scale and withstand business and economic downturns.

Being financially literate in business empowers company owners to develop skills that will enable them to successfully run their businesses. A financially illiterate business owner may cause a business to fail.

Fortunately, such knowledge and skills can be easily acquired with research, guidance and practice.

2. CHOOSING THE RIGHT BUSINESS STRUCTURE

2.1 Governance

Why corporate governance matters to SMEs?

Corporate governance is vitally important for all businesses, irrespective of their size or legal structure. It provides a framework to monitor corporate actions, management performance and business objectives. It is also a tool to protect the rights and interests of both the business itself and its shareholders. Corporate governance is an indispensable building block in creating stable businesses and economies.

A common misconception is that corporate governance is the preserve of large and/or listed companies, and an unnecessary burden to unincorporated or family-owned businesses. However, small-and medium-sized entities (SMEs) can enjoy significant gains from implementing a good corporate governance framework. The key benefits of strong corporate governance for such entities include:

1 Less likelihood of conflicts arising between a business's objectives and its owners' interests, as well as between family members and co-owners.

2 Setting a corporate governance framework bolsters a business's reputation and improves access to credit, also potentially reducing borrowing costs.

3 Stronger internal controls provide greater protection from fraud, theft and other financial crimes

Characteristics of a robust and effective corporate governance framework

The corporate governance framework used by any SME business must take into consideration its business size, structure and maturity. In all cases, a robust and effective corporate governance framework embraces several characteristics, including:

1 A clear corporate structure with defined reporting lines that identify how business-related decisions are made and how other matters are raised with higher authorities for approval.

2 A clear understanding of roles and responsibilities within the company, limits of authority, and an appropriate risk and reward scheme.

3 Transparent communication of all business-related matters from goals to behaviors, and between board, management and staff.

4 Enhanced internal controls and good visibility of management decisions and actions.

2.2 Types of companies

How many types of companies are there?

Broadly speaking, there are five different types of businesses. Note that this does not consider what a company does. It only defines the various structures a business can have.

1

Sole owner
For this type of business, there is only one owner or proprietor, who has full control of every aspect of the company. As such, the single owner is also personally responsible for all financial obligations of the business.

2

Partnership
A business is owned by two or more people, who are partners in the company. They agree to share the profits as well as the losses of the company on a ratio agreed upon at the outset.

3

Limited partnership
In this case, the company is also started by two or more people who come together as partners. However, only one person manages the company. The other partners are not involved in its operations — these are so-called silent partners.

4

Limited liability company (LLC)
Here, a group of people invest in a company. It usually involves 2-50 investors who take an equity stake in the business.

5

Public joint stock company (PJSC)
Here, equity shares of a company are offered to the public and are listed on a stock exchange. According to the commercial company law of the UAE, at least 51% of the company's shares must be owned by UAE nationals, while ownership of the remaining capital is also open to the rest of the public.

3. FINANCIAL MANAGEMENT

3.1 The need for finance

The term "finance" is most commonly understood as the provision of funds as and when needed. It is an essential business requirement since all activities, be it to create a new company or to promote and expand an existing one depends on the adequate and timely availability of financing.

Main reasons for seeking finance

REASON 1

Launch a company

A business in its start-up stage will require funding to launch operations and grow. This can include funds for marketing, to buy stock or raw materials, and to hire staff. Most entrepreneurs commit some of their own funds to start a business, but few manage to entirely self-fund a company to profitability and so must seek external sources of funding. Attaining finance usually requires a detailed business plan and start-ups' inherently risky nature can make it difficult to secure funding.

REASON 2

Working capital

For an SME, securing sufficient working capital is crucial to run its day-to-day activities. Production and advertising costs, salaries, utility payments, employee training and research and development expenditures are among the many costs that must be met. Budgets should be calculated in accordance with the availability of finance. Furthermore, once running costs are covered, businesses can more easily fund any unexpected costs that may arise.

REASON 3

Business expansion

Businesses may seek to tap into new market opportunities, for example through selling their products and services to alternative types of customers or in different markets. The key for SMEs is to align their financial strategy with their corporate objectives.

REASON 4

Asset purchase

Most SMEs must periodically purchase assets such as new machinery, equipment and vehicles to conduct their operations. Investment decisions will directly relate to the total amount of assets that need to be purchased. SMEs must consider the cost of attaining such assets and the different risks associated in making long-term investments to purchase long-term assets versus short-term investments to purchase short-term assets.

3.2 Role of managerial finance

Managerial finance is an interdisciplinary approach that takes from both managerial accounting and corporate finance. To manage the financial affairs of a business is to perform varied financial tasks such as planning, evaluating future expenditure and raising money to fund a firm's operations.

Constant changes to the economic environment and varying regulatory circumstances have increased the importance and complexity of performing such duties, which are vital for a company to survive and grow. As such, efficient management of a business is closely linked with efficient management of its finances.

Importance of managerial finance to SMEs

1

Smooth operations

Managerial finance plays a continuous role in the daily operations of a business. The size of the managerial finance function will largely depend on the scale of the organization. A firm's accounting department normally performs most of these duties, but people in all areas of responsibility, from marketing directors to managers, need a basic understanding of the managerial finance function. This is because interactions take place with financial personnel for negotiating operating budgets, drawing up proposals, dealing with financial performance, and justifying human resource requirements. Additionally, when all areas of a firm understand the financial decision-making process, financial concerns are better addressed as a cohesive unit.

2

Better decision making

Financial managers make long-term decisions that have a lasting impact on the future of a company. The basis of managerial finance is to consistently compose and review financial plans and budgets. Using both current and historic data when performing such tasks allows managers to track a firm's progress and make more informed decisions.

3

Problem solving

A proactive approach to managerial finance from the outset is particularly beneficial to SMEs because it allows managers to assess and plan for problems. Through comparing current and historic data to track the firm's progress, information trends can be spotted. Such information can be used to identify any issues that may arise in budgets, or production changes to which solutions can be formulated quickly in response.

3.3 Accounting for business

Everything you need to know about book-keeping and accounting for businesses

Book-keeping and accounting are distinct but connected financial activities. Book-keeping is the act of recording business transactions in a journal, which is then transferred into a ledger. Accounting uses the ledgers created in book-keeping to formulate financial statements for a business.

What are the different methods of accounting?

CASH BASIS:
Accounting records including revenues and expenses are recognized according to real-time cash flow, i.e. only once the funds have been received or paid by the company. This method does not deal with any projected or expected revenues or expenses — it only records 'actual' revenues and expenses.

ACCRUAL BASIS:
In this technique, revenue and expenses are recorded in the accounts as soon as they occur, even before cash is received.

3.4 Concepts of accounting

What are the main concepts in accounting?

CONSISTENCY CONCEPT:
A fundamental concept — companies must maintain just one method of accounting and never change.

BUSINESS ENTITY CONCEPT:
A business and its owner should be treated as two separate identifiable parties. This requires separate accounting records for the business that exclude transactions related to owners' personal assets and liabilities

GOING CONCERN CONCEPT:
A company identified as such will continue operations for the foreseeable future with stable capital and budgeting strategies.

3.5 Financial statements

Different types of financial statements

There are four types of financial statements.

1

Income statement: Also known as a profit and loss statement, this records a company's financial performance over a particular accounting period. Analysing all income and expenses to calculate a net profit or loss, and shows how the firm performed at the end of a quarter or year.

2

Balance sheet: This records a company's assets, liabilities and equity at a specific point in time. Assets comprise inventory, plants and machinery, and accounts receivables. Liabilities include expenses, accounts payable and debts to banks or creditors. Equity is the value of the owners' capital at year-end. Assets must be equal to liabilities plus equity.

3

Cash flow statement: This tracks the movement of cash and bank balances during the accounting period. Flows are classified as investing activities; cash used to purchase or sell assets and inventory; operating activities; operational expenses; financing activities and the cash used for debt repayment; lines of credit; and dividends.

4

Statement of changes in equity: This records any changes to owners' equity during the accounting period. These include dividend payments, gains or losses in equity value, and share capital repaid or issued.

Samples of financial statements

ABC Co.
Income Statement
For the Five Months Ended May 31, 2016

Revenues & Gains	
Sales revenues	$100,000
Interest revenues	5,000
Gain on sales of assets	3,000
Total revenue & gains	**108,000**
Expenses & Losses	
Cost of goods sold	75,000
Commissions expense	5,000
Office supplies expense	3,500
Office equipment expense	2,500
Advertising expense	2,000
Interest expense	500
Loss from lawsuit	1,500
Total revenue & gains	**90,000**
Cost of goods sold	**$18,000**

A. Income statement

XYZ Corporation
Balance Sheet
December 31, 2016

ASSETS	
Current assets	
Cash	$ 2,100
Petty cash	100
Temporary investments	10,000
Accounts receivable - net	40,500
Inventory	31,000
Supplies	3,800
Prepaid insurance	1,500
Total current assets	**89,000**
Investments	**36,000**
Property, plant & equipment	
Land	5,500
Land improvements	6,500
Buildings	180,000
Equipment	201,000
Less accum depreciation	(56,000)
Prop, plant & equip - net	**337,000**
Intangible assets	
Goodwill	105,000
Trade names	200,000
Total intangible assets	**305,000**
Other assets	**3,000**
Total assets	**$770,000**

LIABILITIES	
Current liabilities	
Notes payable	$ 5,000
Accounts payable	35,900
Wages payable	8,500
Interest payable	2,900
Taxes payable	6,100
Warranty liability	1,100
Unearned revenues	1,500
Total current liabilities	**61,000**
Long-term liabilities	
Notes payable	20,000
Bonds payable	400,000
Total long-term liabilities	**420,000**
Total liabilities	**481,000**
STOCKHOLDERS' EQUITY	
Common stock	110,000
Retained earnings	220,000
Accum other comprehensive income	9,000
Less: Treasury stock	(50,000)
Total stockholders' equity	**289,000**
Total liabilities & stockholders' equity	**$770,000**

The notes to the sample balance sheet have been omitted.

B. Balance sheet

XYZ, Inc.
Statement of Cash Flows
For the year ended December 31, 2015

Operations		
Next income	$ 25	
Depreciation	10	
Increase in accounts receivable	(4)	
Decrease in inventory	8	
Increase in accounts payable	12	
Increase in other short term liabilities	(6)	
Cash from operations		**45**
Investing		
Sales of property	22	
Purchase of equipment	(33)	
Cash from investing		**(11)**
Financing		
Issue debt	100	
Dividends paid	(10)	
Cash from financing		**90**
Change in cash		**124**
Beginning cash at Dec. 31, 2014		**20**
Ending cash at Dec. 31, 2015		**$144**

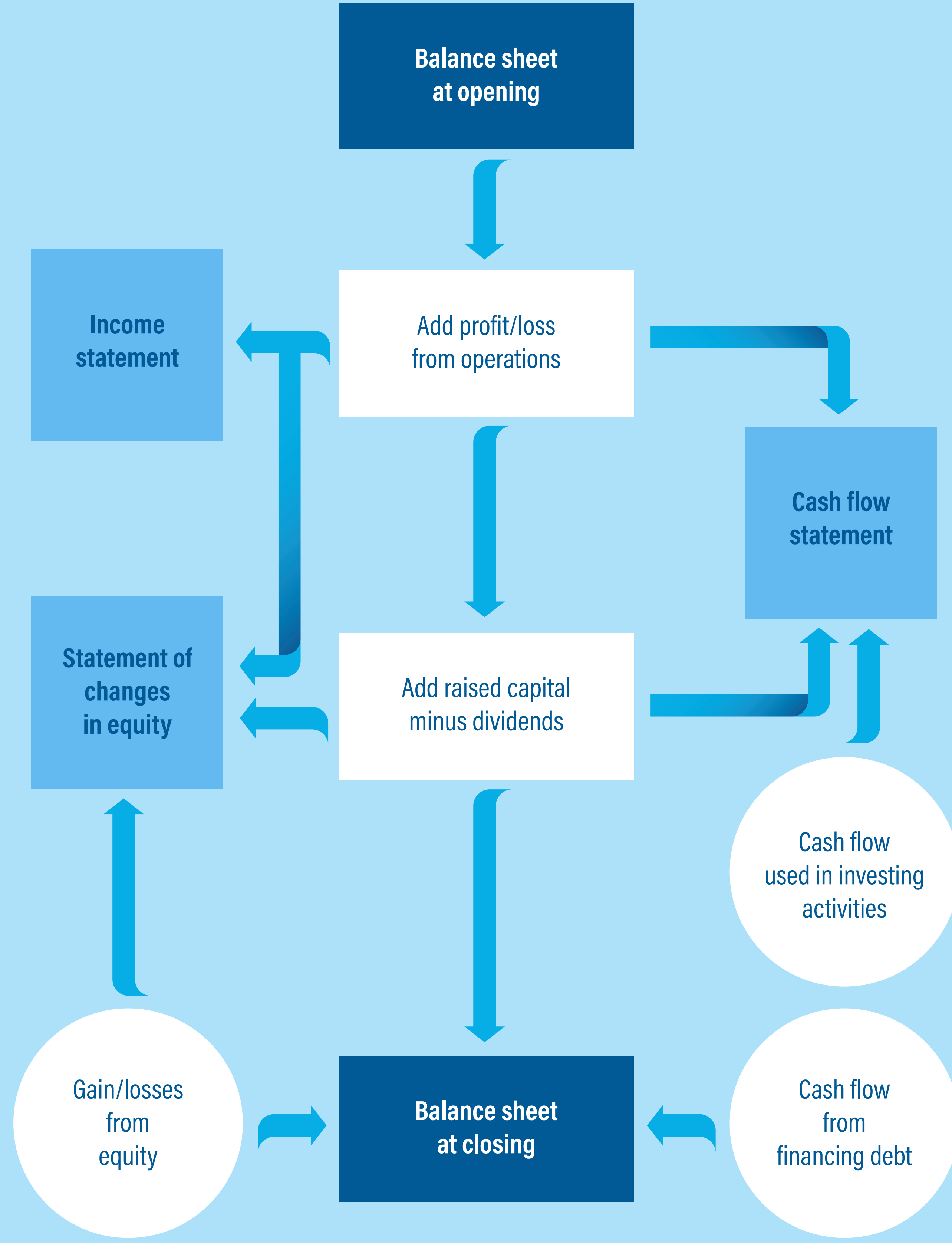
C. Cash Flow Statement

ABC Company
Statement of Owner's Equity
For the year ended December 31, 20X5

Kent Black, capital, Jan 1, 20X5	$ 90,000
Add: Investment by owner	$ 82,000
Net Loss	$ (28,000)
	$ 144,000
Less: Withdrawals by owner	$ (18,000)
Kent Black, capital, Dec. 31, 20X5	$ 126,000

D. Statement of Changes in Equity

All four financial statements are interlinked and are interdependent on one another. The diagram below illustrates the connections between all financial statements as a balance sheet is recalculated for a new financial period.



3.6 Financial planning

Financial planning: four top methods to manage business finances

Financial planning involves the comprehensive evaluation of the ongoing financial health of a business. The various analysis tools explained in this section can be used to gauge the present and future cash flows of a business.

What are the different methods to manage business finances?

CASH MANAGEMENT:
Companies use cash management formulas to determine the amount of cash they generate from operations. This is done by analysing the cash flow statement, which lists all income and expenditures from operating, investing and financing activities. Another common calculation used is the net present value (NPV), which is used to determine cash inflows and future returns.

INVESTMENT ANALYSIS:
Businesses often use formulas to estimate the profitability of potential investments such as Return on Investment (ROI) and Capital Asset Pricing Model (CAPM).

FINANCING ANALYSIS:
Businesses should analyse their financing needs prior to approaching lenders or banks to assess the risk-return trade-off. Ratio analysis such as the Weighted Average Cost of Capital (WACC) is used to determine the proper ratio of debt to equity when seeking financing.

BALANCE SHEET:
The balance sheet provides insight into the financial health of the business, by keeping track of a company's assets and liabilities and calculates the balance of capital at the end of a financial period. A businesses can analyze a balance sheet, for example, to determine how much cash it holds to offset short-term debts. This will help the business develop both short-term and long-term financial strategies, and make better financial decisions.

3.7 Budgeting and forecasting

What is budgeting?

Budgeting is the act of planning and recording income and expenditure to determine profits or loss and minimize excessive expenses.

After a company is established, it is crucial to keep track of cash inflows and outflows to monitor its financial health. This is where budgeting comes in. Budgeting helps business owners understand the financial trends within a company's performance. It can also alert owners if a change of strategy is necessary to increase returns.

What are the different methods of budgeting?

There are numerous ways to prepare a budget to help understand cash flows. Here are the most commonly used techniques.

METHOD 1

Incremental budgeting:
In this method, the current cash inflow and outflow of a company is considered and a certain percentage is added to this existing budget. This is done in order to account for inflation. The main advantage of this method is that it allocates funds to each department in a proportional manner, ensuring even distribution. However, just adding a percentage increment to the year's expenditures and earnings may not necessarily be the best way to build an annual budget.

METHOD 2

Zero-based budgeting:
This method essentially reduces the budget to zero each year , with business owners then re-evaluating every expense to allocate a new budget to each for the forthcoming year. This method is more suited for small businesses or start-ups. The main disadvantage is that it is very time-consuming because every calculation must be redone annually.

METHOD 3

Top-down budgeting:
This technique helps business owners track expenses and projected profits to create a practical budget, starting from top management and working down to the bottom. This is typically used for larger companies. It is comparatively more manageable than other methods because it is relatively easier to collect all the required information. However, because top layers of management get more focus and attention, this method may result in lower management levels receiving less funding.

METHOD 4

Bottom-up budgeting:
This approach is the reverse of the previous method: here, the budget is created starting from the lower levels of management first. The head of each department drafts their budgets and submits them to upper management for approval. The advantage of this method is that it allows more employee input. However, a danger is that department heads may inflate their requirements to secure more funds and resources for their departments. This may result in an allocation imbalance.

The importance of financial forecasting

Financial forecasting is essential for any individual starting a business. Forecasting a company's revenue and expenses is necessary to adhere to the planned budget.

What should be considered before financial forecasting?

Prior to creating a financial forecast, it is wise to keep certain things in mind and proceed in a methodical manner, being aware of the following concepts:

ALWAYS FORECAST FOR DIFFERENT SCENARIOS:
Before forecasting, it is always better to be both optimistic and cautious, and to consider various scenarios that may affect a business. Doing this makes business owners better prepared to react and address potential uncertainties in the market. Be sure to consider factors such as economic downturns or changes to legislative regulations, which could affect the business either positively or negatively.

MAKE CALCULATED ASSUMPTIONS ABOUT THE ECONOMY:
A comprehensive forecast requires calculated assumptions on whether the market will grow, decline or remain stable. While the reality may sometimes be far off the mark from forecasts, it is important that business owners be conscious of any potential opportunities that could arise. Similarly, it would be beneficial to prepare for a possible downturn or the introduction of some new factor that is disadvantageous. Some examples include advances in technology affecting the market or an increase or decrease in the number of competitors.

IDENTIFY THE SALES PROCESS:
Revenue is typically channeled through a company's sales department. When forecasting, the sales process should be clearly and accurately forecast so business owners can have a reasonable projection of potential revenue. Some crucial projections that must be taken into account include the total value of the market in which the business operates, the market share the business is attempting to capture, and the potential demand for the business product or service.

MAKE COMPARISONS WITH COMPETITORS:
Before forecasting, always compare initial analysis with existing companies in similar markets. Analyze key financial ratios and assess the number of staff that competitors require to produce a product or service. This will help position the business in a proper way and will identify potential threats.

What are the essential steps for financial forecasting?

Detail all expenses:
Especially in the early stages of a business, all anticipated expenses should be properly forecast. It is also important to differentiate between fixed and variable costs.

Estimate all revenues:
A conservative approach is always better when projecting revenues. This allows for delays in payments from clients, because this can spoil an aggressive estimate that predicts high revenue.

Use different ratio calculations:
When forecasting expenses and revenue, it is important to use all ratio calculations to get a more comprehensive outlook on a business's financial health. Calculate ratios such as gross margin and operating margin every quarter to keep track of inflows and outflows.

Assess potential and existing business risks:
Alongside a company's financial forecasts, it is wise to review and assess all risks — existing and potential — a business could face. Care should be taken to prepare for all contingencies and ensure adequate insurance coverage.

Various types of risks that could affect a business are;

- Competitors
- Commercial risks — pricing, delivery, service
- Operational risks — product failure, fraud or cyber attacks
- Staffing risks — unavailability of skilled staff or high cost of hiring staff
- Natural risk — losing business to natural or manmade disasters such as earthquakes, fires or floods

4. ACCESS TO FINANCE AND BORROWING

4.1 Sources of finance

There are several sources to consider when seeking finance for a business. An SME should first plan its growth trajectory to estimate the amount of funds required and how quickly these will be needed. Subsequently, the suitability of different funding sources can then be assessed based on business objectives and financial needs. Below are the main sources of finance available to SMEs.

External sources of finance

Bank financing

SMEs can potentially borrow from banks, usually in the form of overdrafts or loans. Such lending does not provide the creditor with ownership or control over the business, but does incur interest charges. The rate of interest will generally depend on the purpose of funding, the length of time for which funds are required, the borrower's financial history and its credit rating.

1

Overdraft:
Business overdraft borrowing is a form of credit extension, where the business is permitted to make payments after it has exceeded the available account balance up to a certain amount. An overdraft is ideal for businesses with fluctuating finance requirements and can be provided as a rolling facility or within a pre-determined fixed period at a lower interest rate. Other than interest, the main direct costs to be considered may include arrangement and line renewal fees.

2

Short-term loan:
Bank loans are one of the most common forms of finance for SMEs. A short-term business loan is ideal for established firms who require financial support for new small-sized projects, to purchase inventory or to fulfill large, unexpected orders. The term of this this type of loan typically ranges between 6-12 months.

3

Unsecured business loans:
Long-term loans are usually more difficult to obtain, especially for start-ups which may be unable to offer assets against which to secure the loan, nor proof of a strong financial track record. Unsecured loans are designed with such businesses in mind and are ideal for start-ups that operate on low resources or in small teams. Amounts borrowed are typically small. Flexible repayment options are a benefit, though this type of loan incurs higher interest rates than secured loans.

Equity financing

4

Angel investors:

These investors are wealthy, entrepreneurial individuals who invest in a business in exchange for equity. Angel investors will usually insist that a prospective business can show it has an innovative product or service to sell along with a well-constructed business plan. This type of investment is common when an early injection of capital is required and when a business needs more than just financial support. It is vital for the finance seeker to build a close relationship with the business angel as they can share vital market knowledge and provide access to networks and contacts that can help strengthen and propel a business forward.

Alternative financing

5

Crowdfunding:

A fundraising concept used to finance new projects or business ventures based on small contributions from a large number of investors. Through social media, crowdfunding websites and forums, entrepreneurs connect with investors. These platforms give business founders the opportunity to pitch their idea. Kickstarter and Dubai-based Beehive, for example, are some of the top crowdfunding websites, attracting thousands of investors and entrepreneurs to make new business ideas a reality.

4.2 Main factors that affect borrowing

CREDIT RATING:
Most lenders require full information about the borrower's personal and business credit rating. These will be used to assess their ability to pay back debt. In the UAE, the Al-Etihad Credit Bureau holds all individual and business credit histories. To maintain a high credit rating, it is important to avoid defaulting on debt repayments.

YEARS IN OPERATION AND PERFORMANCE RECORD:
Lenders are typically wary about providing financing to a company in its infancy. Often, companies must be operational for a number of years before they can qualify for certain types of business loans.

ASSETS:
Lenders may require collateral as a security on business loans. If a business owner is not able to repay the loan, the lender will liquidate the asset to recover the value of the loan.

ANNUAL REVENUE AND CASH FLOWS:
Strong, proven revenues and a good cash flow position are crucial to secure a business loan. A potential lender will usually analyse the borrower's ability to make loan repayments based on the company's annual revenue, profit and cash flow. Business owners should always ensure their accounting is accurate and consistent with their company's operations.

AUDITED FINANCIAL STATEMENTS:
SMEs should make sure to have their financial statements annually audited by an external auditing firm. Audited statements are important for banks as being a reliable reference to check on the financial performance of the business.

4.3 Key considerations before borrowing

Below are some of the key tips for SMEs to consider before seeking finance:

Calculate total expenses:
Before borrowing money, one should calculate the monthly operating expenses of the business against the income it receives. If there is little money remaining after paying all expenses, it is inadvisable to borrow.

2

Loan calculator:
Use a loan calculator to work out likely monthly repayments prior to taking out a business loan. Such tools are easily found by doing an Internet search for "loan repayment calculator". Can the business afford these repayments?

3

Borrow wisely:
After determining a business's operating expenses, consider whether borrowing is the only way to meet funding needs. Explore all alternatives such as saving more of the company's revenue or selling off existing business assets before deciding to borrow money.

4

Keep your accounts in order:
By maintaining accurate, detailed accounts, business owners will be able to analyse their company's income and expenses, be it over a month, quarter, or financial year. A strong balance sheet indicates the business is in a good position to seek additional financing, whereas weak accounts will make it advisable to reduce debts and/or expenses before trying to borrow more.

4.4 Relationship with banks

A banking relationship is necessary for any business owner to conduct routine banking transactions, as well as the task of raising new capital to expand operations, increase inventory, purchase property and equipment, or bridge short-term and seasonal cash flow needs. Building and maintaining a strong long-term relationship with the bank can benefit a business in several ways, especially when a business is in its early-stage growth phase.

Choose the right bank for your business

Choosing the right bank is critical for SMEs. It is common for small business owners to select a bank based on cost and convenience, often opting for the one where they do their personal banking. When choosing a bank with which to open a business account, company owners must consider their growth plans and what services and support they will require. The bank will aim to support businesses through providing adequate credit and financial solutions, and will try to help on an ad hoc basis when the situation demands.

Establish rapport with the bank

A loan/ financing request is more likely to be approved if there is a strong relationship between the bank and SME. Moreover, if a business has established a track record of making loan repayments on time, this will further enhance its prospects of securing further borrowing. By building rapport with their banks, SME owners can earn additional benefits such temporary overdraft protection.

Ensure a two-way relationship with the bank

As a business evolves, its financing and banking needs will change. Therefore, it is essential to regularly discuss these needs with the bank's relationship manager. Reassessing a company's banking requirements will help in managing its finances more efficiently by potentially saving money on interest, restructuring debt and reducing debt quicker.

Keep the bank fully informed

It is important to keep the bank informed of developments within a business and the industry in which it operates, especially when challenges and problems arise. Owners should be honest and transparent with their banks. If in doubt about how much information to provide, work on the basis of "more is better".

Seek business guidance from your bank

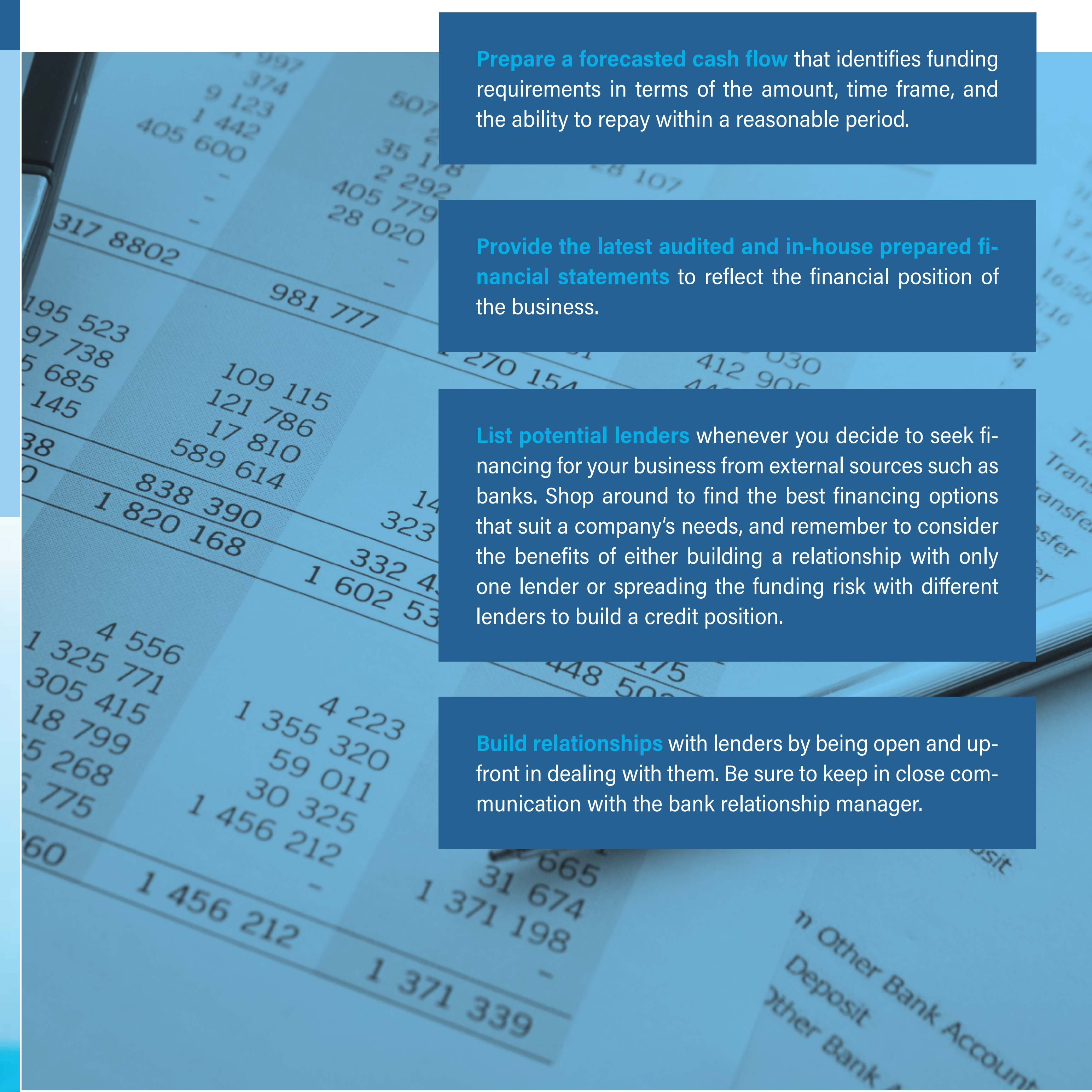
Bank relationship managers are experts in supporting small businesses and can help guide company owners. One can benefit from relationship managers' judgment and advice, especially during the early growth stage of an SME or when there are signs of distress. The bank relationship manager can help find the right solutions to deal with an SME's financial issues.

4.5 Tips to Increase Financing Opportunities

Focusing on increasing cash flow to reduce the need for external finance is standard practice for business owners. However, just as mainitaining a healthy cash flow and profitabilty position are important, ensuring access to the right amount of finance and the most appropriate mode of financing are also essential to increase a company's opportunities to obtain finance.

What needs to be done before applying for finance?

Before applying for finance, a business owner must take various actions, the most important of which are as follows:



Prepare a forecasted cash flow that identifies funding requirements in terms of the amount, time frame, and the ability to repay within a reasonable period.

Provide the latest audited and in-house prepared financial statements to reflect the financial position of the business.

List potential lenders whenever you decide to seek financing for your business from external sources such as banks. Shop around to find the best financing options that suit a company's needs, and remember to consider the benefits of either building a relationship with only one lender or spreading the funding risk with different lenders to build a credit position.

Build relationships with lenders by being open and upfront in dealing with them. Be sure to keep in close communication with the bank relationship manager.

Tips to improve the chances of increasing credit limits for SMEs

If a business has an existing credit line with a financial institution and needs to increase the credit limit and hasten access to funds, the following three tips can help:

1

Ensure timely repayment: building an excellent relationship with the bank starts with being reliable. Making repayments in a prompt and timely manner will increase the likelihood of securing further credit. A company's credit worthiness tops the checklist of any financial institution's due diligence process.

2

Have a justifiable need for the extra money: carefully evaluate the reasons why a business needs to increase its credit limit or open a new credit facility. The lender will expect owners to provide a realistic rationale to approve further credit.

3

Ensure accounts are up-to-date: whenever there is a need to raise a new credit line with a new lender or increase a credit limit with an existing bank, owners must ensure accounts and other financial records are up-to-date. Providing the latest revenue and turnover figures will increase the chances of enjoying lenders' support.

4.6 Building a Healthy Credit History

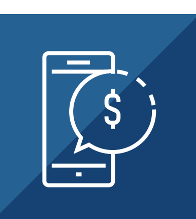
Building a healthy credit history will help create a strong company reputation and boost the chances of obtaining business loans from banks. Commonly, banks provide a due diligence report that includes a borrower's credit rating. This rating ultimately provides a measure for banks to gauge the risk of lending to a particular business. Bad credit ratings will make it more difficult and more costly to borrow.

Here are some tips to keep your business's credit history healthy

1

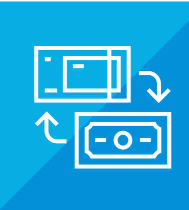
Good habits:
To build a healthy credit history, a business should avoid defaulting in credit payments. Defaulting can incur penalties from the bank and legal action, as well as negatively affecting a business's credit score. Business owners should ensure they pay their monthly instalments in full to maintain a high credit score.

2



Maintain your credit score:
As a business owner, it is important to know the business's credit rating. This information can be obtained from the credit bureau by completing a form with all the necessary information regarding the business's registration and license. Monitoring a company's credit history annually can reveal whether its credit score has changed and will provide an an indication on whether it should re-evaluate its debt structure or maintain the status quo.

3



Trade credit:
If a business has an accounts payable relationship with vendors that allow it to pay suppliers later after receiving goods or services, it will help in building trade credit. Maintaining credit lines with suppliers will broaden a company's credit history, and one should make sure payments are made in a timely manner.

4

Transparent business credit report:
Maintaining a detailed credit report will help banks and credit bureaus monitor a business's consistency in meeting its debt obligations. The credit report contains details of the business's debts and credit facilities. It also includes public records of the business such as bankruptcy filings, unpaid taxes and judgments or liens made against a business.

5. DEBT MANAGEMENT

5.1 Understanding debt

For many SMEs, from start-ups to established businesses, borrowing can be a means to finance expansion, generate working capital or improve cash flow. There are several types of debt for businesses to choose from and it is important to choose the correct type according to the preferred borrowing time frame. For example, long-term debt is more suitable to purchase equipment and furnishings.

Also, debts can be unsecured or secured against collateral. Secured debt could be against property or equipment, while unsecured debt is clean (no collateral secured).

Other debt mechanisms SMEs can obtain are overdrafts and letters of credit. An overdraft allows the customer to withdraw money even if the account has no funds up to an agreed limit. A letter of credit is commonly used in international trade and issued by a bank, guaranteeing the seller will receive payment from the buyer. Should the buyer fail to pay, the bank will cover the purchase amount.

SMEs must ensure debt repayments are made on time. Otherwise, these can turn into bad debts, affecting the credit scoring of the business and the financial standing in the market and may in turn limit future borrowing opportunities.

5.2 Tips for managing debt

It is important for SME owners to manage debts to protect the business. The below can act as guidelines.

- **List and prioritise debts:** It is crucial to decide which business liabilities to pay off first to maintain cash flow. Liabilities other than business loans can be fixed or variable such as payroll, invoiced payables, rent and utilities and these should be prioritized first. Once these are paid, secured loans that have been guaranteed by the business owner's personal assets must be paid first, followed by business loans backed by assets that are crucial to the business. This will avoid jeopardising both the owner's personal assets and valuable business assets.

- **Maintain a budget for debt:** A budget must be maintained based on the business's current financial situation. The owner must ensure the company's sales can more than cover both fixed and variable costs. If not, debts will pile up. An accounting package can help keep track of monthly expenses.

- **Enhance cash flow:** Repayment installments should be paid on time to maintain a sustainable cash flow. For that, owners must increase efforts to collect receivables from customers and try to ensure any unnecessary expenses are discontinued.

- **Shift to cheap debt deals:** Borrowing additional money to repay other debts is inadvisable. However, it is possible to borrow more cheaply to replace existing debts and reduce the total amount due to be repaid. For that, shop around for the best loan replacement deal from various lenders. The process can be complicated because there are several aspects that need to be considered such as interest rates, fees and loan terms to ensure the process is beneficial.

- **Consolidate debt:** Another option is take out a new loan to repay other loans. By consolidating debt, it could lower monthly payments and can also be a means to repay debts over a longer period. An additional possible benefit is to lower the interest rate levied, although it could mean payment of more interest overall if the repayment period is longer than previously.

- **Refer to a credit counselor:** Obtaining advice from a credit counselor on ways to manage business debts and negotiate a better deal for debt payment could provide the business owner with better solutions to reduce costs associated with debt.

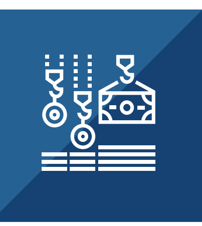
5.3 Debt problem warning signs

Business owners should be aware of warning signs that company debts are becoming problematic. Poor management can make businesses vulnerable, with no margin for safety. Owners may cut short-term investments costs but that could lead to longer-term vulnerabilities.

Warning signs of poor debt management include:

Long debt cycle:
Getting overdrafts and payday loans can lead SME owners to spend more money than they bring in. Getting a new loan to pay off existing loans also increases overall debt levels, which a business may struggle to repay and could lead to default.

2



High financing expenses:
If a notable proportion of a business' expenses are set aside to meet interest expenses or penalty payments for debt, owners should reassess their debt management strategies because these expenses could be better used for other business requirements.

3

Inconsistent cash flows:
Business owners must structure their company's finances to allow for inevitable fluctuations in cash flow. Failure to do so can lead to financial difficulties and put the company in peril.

4

Insufficient funds:
If a business owner wants to invest in new assets such as equipment or facilities, the business may find itself unable to do so because of a lack funds.

5

All assets pledged as security:
Providing collateral such as business equipment will improve a business's chances of securing a loan. However, this could be risky when all available collateral is being used to secure existing debts, including personal guarantees and assets.

6. FRAUD PREVENTION

6.1 Types of fraud

What are the different types of fraud that can affect a business?

TYPE 1

Compensation fraud: Staff may attempt to defraud their employers by fabricating personal injury claims. For example, an employee may exaggerate a minor injury suffered at work in order to claim compensation. To help prevent such a situation, companies should strictly enforce safety procedures and ensure the workplace is free of potential hazards.

TYPE 2

Invoicing fraud: This kind of fraud occurs when a business sends false or fake invoices for products or services that were never purchased or delivered. It is usually perpetrated by an individual within the company who will gain personally from the fraudulent activity. To prevent this occurring, a business should carefully check every invoice received or sent and ensure to match it to products or services received or delivered before making payment.

TYPE 3

Skimming: This fraud occurs when an employee illegally takes cash or monies that were received for a product or service. Here, the employee will pocket a portion of the cash received and record the remainder as revenue received for a product sold or service delivered. To safeguard a company against skimming, there should be adequate checks and balances to ensure that all revenue received is recorded accurately in company accounts.

TYPE 4

Cheque fraud: This type of fraud occurs when an employee writes a check to a non-eligible payee and colludes with that payee, be it another company or an individual, to take the company's money for themselves. Another kind of check fraud occurs when an employee changes the name of the payee on a legitimate cheque to collect the money for themselves. To safeguard a company from cheque fraud, business owners should have final sign off for all company cheques and also ensure there is more than one person managing the company's finances.

6.2 Tips to prevent fraud

What else can business owners do to prevent fraud?

PROTECT BUSINESS ACCOUNTS AND CREDIT CARDS:
It is advisable to keep personal accounts and credit cards separate from business accounts and credit cards. Doing so will help protect the business from criminals who wish to gain access to business and personal accounts. It also makes it easier to track business and personal expenses separately. If corporate cards are given to staff members, strict guidelines must be put in place to prevent company finances from being abused.

MAINTAIN SECURE IT INFRASTRUCTURE:
To protect a company from hackers seeking to infiltrate a company's IT infrastructure and steal sensitive information, it is vital to have a robust firewall, plus robust anti-virus, malware and spyware detection software. It is also important to ensure all company files are backed up on a secure cloud-based program so that any lost files can subsequently be recovered.

TRAIN STAFF REGULARLY:
Company staff should be trained regularly about protection from cyber-attacks and how to control risks in the event of an attack. Strict guidelines need to be established to identify potential threats and safeguard the company. Frequent training helps employees discover potential threats more easily.

HAVE PROPER COMPANY INSURANCE:
A company should purchase insurance that protects the business in case of any cybercrime or fraud. This will help recover any losses incurred from an attack. A company's bank may provide information about insurance policies to protect company's credit cards and accounts.

FINANCIAL LITERACY

FOR SMEs