



## Strategic Financial Management in Small and Medium-Sized Enterprises

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### Abstract

Along with the development of social economy and the progress of science and technology, Chinese enterprises are being in a stage filled with opportunities and dangers. This paper introduces the connotation and significance of strategic financial management, elaborates the problems in the financial strategies conducted by small and medium-sized enterprises together with the causes and proposes some countermeasures finally.

**Keywords:** Small and medium-sized enterprises, Strategic financial management, Problems, Countermeasures

The uncertainty of an enterprise's financial environment fills its financial activities with risks. In addition to opportunities, quite a lot of dangers arise from time to time in its financial management. Therefore, it has become the key to the success of an enterprise's financial management whether it can keep track of the trends of changes and absorb what is useful while rejecting what is harmful. Strategic management ideas are significant in enterprises' financial management since we must make efforts to analyze and grasp the general environment and development tendency of an enterprise and therefore to improve the adaptability, changeability and applicability of financial management to uncertain environment. Currently, over 10,000,000 small and medium-sized enterprises have passed the industrial and commercial registration, taking up 90% of the total enterprises in China. Accordingly, their strategic financial management is of particular importance, which is also the topic of this paper.

### 1. Connotation and Main Contents of Strategic Financial Management

Strategic financial management refers to financial management theories according to which financing should be conducted in the most proper way, the collected capital should be utilized and managed in the most effective way in enterprises and decisions on the reinvestment and distribution of profits should be made most reasonably. According to its connotation, we can sum up the three main contents of strategic financial management, including financing strategy, investment strategy and profit-distribution strategy. Details are as follows:

#### Financing strategy

Highly developed modern enterprises are characterized by sharp growth in sales. When faced up with such a situation, enterprises tend to have great demands for capital since stocks and receivables are increased as well. The greater the tension of sales growth is, the greater capital demands will be. Therefore, financing strategy is of significance in strategic financial management. The functions of financing strategy lie in clarifying the guidelines for financing, laying down financing objectives, establishing the overall scale, channels and methods of financing, arranging strategic schemes of capital structure optimization, laying down relevant countermeasures in order to achieve the financing objectives, and finally predicting and collecting the amount of capital the enterprise needs.

#### Investment strategy

As the core of strategic financial management, this strategy determines whether an enterprise can allocate its capital and resources in a reasonable and effective way or not. Investment strategy involves the confirmation of the investment direction of fixed assets, corporate scale and capital scale, the investment choices related to external expansion or internal expansion, the reform of old products or the development of new ones, independent or joint operation, investment with self-capital or with loans and decisions on the percentage between fixed assets and current assets, investment strategies with risks and those during inflation.

#### Profit-distribution strategy

This strategy, including the management of capital gains and the establishment of stock bonus distribution, mainly deals with the proportion an enterprise puts aside in a long run for reproduction on an expanded scale, improvement of employees' welfare and their living standards. Profit-distribution strategy is intended to satisfy the demands for equity capital in the development and improvement of enterprises' core competitiveness based on relevant investment strategy and financing strategy. Meanwhile, when carrying out this strategy, enterprises are expected to establish talent-oriented distribution policies by exploring effective methods to apply those important elements such as knowledge, technique,

patent and management to the profit-distribution course.

## 2. Problems in Strategic Financial Management of Small and Medium-Sized Enterprises in China

Currently, some common problems include:

### 2.1 Lacking in Scientific and Standardized Financial Strategies

Quite a few enterprises are pursuing only a large scale, or purchasing a large amount of land while neglecting asset structure allocation, or having no reasonable arrangement for its capital. They have no financial strategies at all, not to mention their implementation. As for some others, the effect of their strategic financial management is greatly affected due to their unscientific and irregular strategies, which are characterized by the following features: first, their strategic financial aims depart from their enterprises' overall ones; second, financial strategies are regarded equal to financial plans, hence neglecting the comprehensiveness of financial strategies; third, financial strategies are not made based on their enterprises' long-term goals and therefore have great randomness.

### 2.2 Neglecting Strategic Environment Analysis and Having Unreasonable Strategic Financial Goals

Strategic environment analysis is both the foundation of financial strategies and the guarantee for its implementation. It includes internal and external environment analysis with the former being the internal foundation and implementation basis for the establishment of financial strategies. At present, quite a lot of small and medium enterprises haven't realized the importance of strategic environment for the establishment and implementation of financial strategies and accordingly failed to have proper analysis on their strategic financial environment especially its internal environment. As a result, their unpractical and unreasonable strategies have restricted the effective implementation of their financial strategies.

### 2.3 Lessening the Role of Budgeting in Strategic Financial Implementation

Budgeting mainly exerts its role in strategic financial implementation in two aspects. First, it further clarifies and specifies strategic financial ideas so as to be understood and conducted by all the staff. Budgeting can help to divide strategic goals into every section of an enterprise and even every employee. In addition, when implementing a task jointly, all sections and all employees will have better cooperation and communication with each other. Second, budgeting also provides a standard for an enterprise's daily operation and performance. With a quantitative financial goal set in budget, the actual implementation can be compared with the budget to reveal the disparity between the goal and the reality and take effective countermeasures. Now, most small and medium enterprises in China have no systematic and complete budget system made up of sales budget, production cost budget, general indirect cost budget, loss and expense budget and cash budget and so on. Even if some have such a system, its shortage of careful budgeting and strict implementation also lessens the role of budgeting as well as the implementation of financial strategies.

### 2.4 Problems in Enterprises' Financial Management

Now, some problems in small and medium enterprises' financial management have also restricted the establishment and implementation of their financial strategies. Some main problems are as follows.

- ① Obsolete ideas, unclear duty division and disordered management. Enterprises have no idea of "corporate management should be based on financial management and financial management should center on capital management; entrepreneurs and financial staff's lack of scientific and advanced financial ideas including time value, risk value, marginal cost, opportunity cost and insufficient knowledge about financial management theories and methods have resulted in unclear duty division, disordered management, ineffective monitor, false accounting information and so on.
- ② Extensive financial calculation, including simplifying accounting procedures at will, keeping additional accounts in addition to the authorized one, adopting irregular check of properties and cash, having no regular check of their bank deposits, claims and debts which cause their accounts inconsistent with items or funds, blindly promising bonuses and evading taxes by distributing bonuses before paying taxes.
- ③ Difficult financing, mainly manifested in insufficient channels and scales of financing channels as well as disordered financing orders. Currently, most small and medium enterprises are faced with great difficulty in gaining short-term loans, not to mention long-term ones. 81% of all enterprises have no enough current funds for their operation. The longer the periods of loans are, the less money they can really utilize from their loans. As is shown in a survey, 60.5% enterprises have no access to long-term loans, among those who can really get such loans, 16% enterprises' demands are fully fulfilled, 52.7% are partially fulfilled, 31.2% are not fulfilled. (Huang, 2008)
- ④ (Note 1) Poor financial control. First, loose cash management tends to cause inactive or insufficient capital. For some enterprises, the more cash, the better. Therefore, a large sum of cash is not allocated to operation, failing to exert its role; for some others, their cash is overspent on real properties, hence failing to tackle some emergent uses. Second, slow turnover of accounts receivable causes great difficulty in recovering capital or even bad debts. Third, the control over stock is poor. Many enterprises have a stock over twice its turnover, leading to failures in capital turnover. Fourth,

too much emphasis is put on money instead of properties, causing serious waste of assets. Actually, quite a few small and medium enterprises are lacking in effective management of their raw materials, semi-manufactured goods, fixed assets and so on, as a result of which asset wastes are quite serious.

### **3. Causes of the Problems in Strategic Financial Management of Small and Medium-Sized Chinese Enterprises**

#### *3.1 Rigid Management Pattern, Laggard Management Idea and Managers' Poor Quality*

At present, most small and medium enterprises especially those private ones employ highly unification of ownership and management rights in which the investor is the manager whose power can not be restricted in any case. Having no clear division of duties and strict regulations, these managers don't embody financial management into an effective corporate management system, not to mention regarding financial strategies as a significant part of the enterprise's overall strategies, hence lessening their significance and function. These managers don't believe in strategy but good luck, not system but ties of blood, not procedures but tackling key points, not management but technology and market. Especially for those enterprises venturing out of niches, unfavorable environment is the chief offender.

In addition, managers' poor quality is also an important cause for the failure of financial strategies. It is well known that most managers in small and medium Chinese enterprises have poor comprehensive quality, insufficient management experiences and low efficiency because they haven't gone through any systematic learning of management theories and special professional training. Therefore, they are not able to have reasonable predictions, decisions, budgets, control, analysis and evaluation based on their own characteristics and the market, to have analysis on financial environment and lay down applicable and feasible strategies for financing, investment as well as profit distribution or to fully realize the importance of financial budgeting and therefore to have effective control over its implementation in order to serve the overall goals of their enterprises' development strategies in a better way.

#### *3.2 Lacking Independent Financing System with Diversified Channels*

With changeable market, operation risks are greater, so are financial ones caused by a large amount of debt and high financing cost, hence resulting in enterprises' low credit. Besides, their credit is also affected by their non-transparent operation process, non-standardized financial reports as well as asymmetrical information, hence leading to the difficulty in achieving financing goals.

Seen from the perspective of financing system, these enterprises' lack of independent financing system with diversified channels has greatly restricted their financing strategies. First, there is no national institution or preferential policies to assist small and medium enterprises with their management, causing their unfavorable financing situation. Second, due to these enterprises' private nature, some banks set rigid requirements for loans because of some traditional ideas and administrative interferences. Third, there are not enough financial agencies and loan guarantee institutions specially serving for small and medium enterprises. Fourth, most small and medium enterprises have no direct financing rights and cannot issue stocks or bonds. The main board market is inaccessible and the second board one is too risky.

#### *3.3 Poor Investment Ability and Lacking Feasibility Researches*

Small and medium enterprises suffer from insufficient registered capital, limited operation capital, hence poor investment ability. Focusing on short-term goals to recover investment, they have to rely on simple reproduction instead of expanded one. In addition, without any special institution for market analysis, their investment activities tend to be based on their perception and therefore blindness. These decision makers usually fail to have an overall grasp of the characteristics or principles of market economy or to pursue reasonable economic profits with their proper operation at the capital market. Their poor abilities are also reflected in the shortage of some feasibility researches on their shrink and expansion strategies, how to choose financing channels and structures, how to establish new investment directions and so on. All these greatly affect the establishment and implementation of an enterprise's strategic financial goals.

#### *3.4 Incomplete Internal Control System Leading to Ineffective Control*

Incomplete internal control system commonly exist in small and medium enterprises, which is profoundly manifested in having no or just incomplete internal control system, hence failing to effectively restrain their own economic behavior institutionally. A lot of enterprises have no department for internal audit to guarantee the strict implementation of their financial system. Even if some establish such a department, its lack of independence may lead to ineffective internal control. As a result, financial management as well as financial strategies will be greatly affected.

### **4. Countermeasures for Small and Medium-Sized Enterprises in China**

Seen from the above, the problems in present small and medium Chinese enterprises are mainly attributed to their internal causes and external environment. Therefore, some effective countermeasures should be taken from the following aspects.

#### *4.1 Establishing Right Financial Goals and Firm Strategic Sense*

An enterprise's financial goals are not only the direction of its efforts but an effective standard to measure whether its

financial decisions are right or wrong. Proper goals are beneficial for an enterprise's overall strategic goals. With survival, profit and development as any enterprise's basic goals, maximized corporate value should be regarded as the financial goal. Guided with this goal, enterprises are expected to establish the central status of financial management in the overall corporate management first of all, to put emphasis on the management of financing, investment and profit earning, to take their abilities of debt paying, operation, profit earning and development and guide all the aspects of their production and capital operation by controlling their capital, cost, profit and so on. It is required by strategic management that enterprises must follow the aim of competitive edges and center on strategic management to deal with the relationship between enterprises' benefits and social benefits, between enterprises' overall benefits and sectional ones as well as between long-term benefits and short-term ones and to fully realize the importance of strategic management in enterprises' development and the significant role of financial strategies. Therefore, it is the precondition for the implementation of financial strategies to establish firm strategic sense. In addition, some other modern management ideas should be established, such as those related to risks, time value, cash flow, knowledge benefit and talent value.

#### *4.2 Adopting Budget Control to Guarantee the Effective Implementation of Financial Strategies*

Budget control is the guarantee and key point in converting financial goals into specific action plans and implementing them. First, a variety of financial budgets, including sales, production cost, general indirect expenses, capital expenses, losses and cash, should be compiled in a scientific and reasonable way based on financial strategies and financial predictions. When compiling budget, sales prediction should be based on to pre-calculate the possible sales in the future sales period, then to compile budgets on production cost and general indirect cost and after that to create loss budgets according to the relevant sales budget and cost budget as well as cash budget according to the budget on capital expenses and losses. Next, budget indexes can be disintegrated to be allocated to every section or individual, whose sense of responsibility and enthusiasm can be encouraged by clarified duties and obligations. Third, budgets should be followed strictly in the implementation of financial strategies with no exception. Last, some adjustments should be made according to the changes in strategic environment and new demands of development strategies.

#### *4.3 Creating Favorable Strategic Environment and Emphasizing Environmental Analysis*

For small and medium enterprises, their strategic environment has impact on not only their financing but the establishment and implementation of their financial strategies. Therefore, it is of great importance to create favorable strategic environment and emphasize environmental analysis.

In spite of a series of national policies encouraging, guiding and supporting the development of small and medium enterprises in China, the internal and external environment for their development needs to be improved greatly. Accordingly, China should make more efforts to develop its local banks and financial agents with small or medium scale, to establish a financial system beneficial for these enterprises' development, to establish or perfect effective loans guarantee system to help these enterprises, to offer opportunities for them to issue their stocks or bonds, to expand direct financing channels and encourage the development of risk investment, to promote the development of enterprises specialized in high and new technology by perfecting institutions and organization construction, strengthening the support for these enterprises by financial agents and to establish funds to support their development. For enterprises themselves, they should try to improve their qualities, strengthen their sense of credit and improve their credit as well to create favorable credit environment.

In a word, government, society and enterprises' joint efforts should be relied on to create favorable financial environment for these small and medium enterprises. In addition, these enterprises should be fully aware of the importance of environment for their financial strategies and try to establish scientific, reasonable and feasible strategic goals and guarantee their effective implementation by further strengthening environmental analysis and improve their decision-making abilities.

#### *4.4 Establishing Financial Crisis Early-Warning System to Effectively Control Financial Risks*

Financial crisis early-warning system is a very important means to control financial risks and achieve strategic financial goals for small and medium enterprises. By collecting some information on relevant industrial policies and market competition, setting and observing some sensitivity indexes and employing early-warning models, such a system will provide signals for enterprises to help them take effective preventive measures and to avoid financial crises.

It is critical to fix early-warning indexes and limits when establishing the pre-warning system. These indexes mainly involve early-warnings in cash, the current ratio, debt, operation, credit, turnover, investment, cost, profit and environment and so on. There are two major patterns: the multivariate pattern and the single-variate pattern. Enterprise are supposed to establish their own early-warning systems with different patterns according to their reality.

## **5. Conclusion**

To sum up, a variety of elements related to enterprises' external and internal conditions should be taken into

consideration when they establish their financial strategies. Due to their different characteristics, small and medium-sized enterprises have to establish their own financial management strategies instead of copying those of the large enterprises.

#### Note

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