

Why Is Financial Management So Important in Business?

- **Small Business | Managing Employees | Business Management**

By **Jim Woodruff** Updated January 28, 2019

Financial management is one of the most important responsibilities of owners and business managers. They must consider the potential consequences of their management decisions on profits, cash flow and on the financial condition of the company. The activities of every aspect of a business have an impact on the company's financial performance and must be evaluated and controlled by the business owner.

1. Life Cycles of a Business

Most companies experience losses and negative cash flows during their start up period. Financial management is extremely important during this time. Managers must make sure that they have enough cash on hand to pay employees and suppliers even though they have more money going out than coming in during the early months of the business. This means the owner must make financial projections of these negative cash flows so he has some idea how much capital will be needed to fund the business until it becomes profitable.

As a business grows and matures, it will need more cash to finance its growth. Planning and budgeting for these financial needs is crucial. Deciding whether to fund expansion internally or borrow from outside lenders is a decision made by financial managers. Financial management is finding the proper source of funds at the lowest cost, controlling the company's cost of capital, and not letting the balance sheet become too highly leveraged with debt with an adverse effect of its credit rating.

2. Financial Management in Normal Operations

In its normal operations, a company provides a product or service, makes a sale to its customer, collects the money, and starts the process over again. Financial management is moving cash efficiently through this cycle. This means that managing the turnover ratios of raw materials and finished goods inventories, selling to customers, and collecting the receivables on a timely basis and starting over by purchasing more raw materials.

In the meantime, the business must pay its bills, its suppliers, and employees. All of this must be done with cash, and it takes astute financial management to make sure that these funds flow efficiently.

Even though economies have a long-term history of going up, occasionally they will also experience sharp declines. Businesses must plan to have enough liquidity to

weather these economic downturns, otherwise they may need to close their doors for lack of cash.

3. Reporting on Business Operations

Every business is responsible for providing reports of its operations. Shareholders want regular information about the return and security of their investments. State and local governments need reports so that they can collect sales tax. Business managers need other types of reports, with key performance indicators, which measure the activities of different parts of their businesses.

As well, a comprehensive financial management system can produce the various types of reports needed by all these different entities.

4. Filing and Paying Taxes

The government is always around to collect taxes. Financial management must plan to pay its taxes on a timely basis.

Financial management is an important skill of every small business owner or manager. Every decision that an owner makes has a financial impact on the company, and he must make these decisions within the total context of the company's operations.

Source: Woodruff, J., 2019, Huston Chronicle, USA, URL:-
<https://smallbusiness.chron.com/financial-management-important-business-57073.html> (accessed 25 April 2021)