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From the People of Japan

Co-Creation Hub V: Financial Goals & Resilience Building

Let's Talk about Financial Goals & Resilience Building

What is financial management: Financial management deals with finding a healthy balance between profit and risk so that even with a setback, the business is profitable in the long term. This type of business management involves planning, directing and coordinating with the accounting, investing, banking, insurance, collaterals, assets and other financial activities of a business. Financial management is one of the main features of running small businesses efficiently. But MSME entrepreneurs frequently ignore their financial procedure and cross the burden on accounting activities, which are often outsourced. However, while accounting activities more commonly cover filing taxes, preparing salaries; financial management has a broader coverage and a bigger system including issues such as budgeting, forecasting.

Dimensions of financial and business management and planning

- Registration, taxes and other legal requirements
- Keeping records and accounting
- Short-term financial management
- Planning beyond the short term

The **three key elements** of financial management are **financial planning, financial control and financial decision making. Financial planning** is the process of calculating the amount of funds and capital that is required by a business and then determining its allocation as well as building frameworks of the business' financial policies. Short-term financial management is often referred to as "working capital management" and relates to cash management, inventory management and debtor management. Both the assessment and technique of financial decisions fall under this type of business management. Financial control is to assess whether an organisation is meeting its objectives or not. **Financial control** answers the questions of whether the enterprise's assets being used competently and are secure; whether the management is acting in the best financial interests of the enterprise and financial decision-making outcomes are in favour of the resilience and sustainable growth of the business. Finally, financial decision-making involves investment and financing decisions and is about how the organisation should raise finance, or how the profit should be used.

Why do you need to consider financial management? In developing your business plan and financial forecasts it is advisable that you speak to a qualified professional business advisor like an accountant, lawyer or a bank manager to support you developing your business. You would also need to use financial services to support you in the financial management of your business. Banks and other financial institutions support businesses in basic payment and deposit services, financing and through their non-financial products that can add value to your business management, productivity, innovation, and sustainability.

At the pre start-up stage, you would need funds for researching the market and assessing potential demand for your product or service (proof of concept) and produce a business plan incorporating financial forecasts. At the start-up stage, you as business owners can consider securing finance to grow your businesses and strong financial management is vital for a good credit rating and funding with favorable conditions. In addition, you would need to take into account financial forecasts and start implementing your business plan which also includes careful cash management which is key to your business' survivability since many small businesses fail when they run out of cash. When you are pass the start-up stage, you may seriously seek qualified independent financial advice before accessing finance to grow their business while considering the following questions:

1. What is the next stage for your business? Does your business plan and financial forecasts reflect the next phase of company growth? **2.** Are you monitoring cash flow and do you have a person responsible for chasing customer payments? Have you established a procedure for dealing with late payments from customers? **3.** Do you have a system of budgeting sales and expenses? **4.** Does the business have enough finance to meet its needs? Is accessing finance a problem? If so, what are you doing to address this? **5.** Do you produce regular management accounts which are made available to financial institutions and other credit institutions?

Financial management is thus important for various reasons:

- Helps enterprises in financial planning;
- Assists enterprises in the planning and acquisition of funds;
- Helps enterprises in effectively utilising and allocating the funds received or acquired;
- Assists enterprises in making critical financial decisions;
- Helps in improving the profitability of enterprises;
- Increases the overall value of the firms or enterprises;
- Provides economic and financial stability and resilience.

What is resilience building: Business resilience is an enterprise's capacity to absorb stress, recover critical functionality in times of crisis, and thrive in changing circumstances. Building resilience is especially important today because the business environment is becoming more dynamic and unpredictable as we have all experienced through the economic fall out of the

Covid-19 pandemic. Resilience building requires a fundamentally new mental model of business, one that embraces complexity, uncertainty, interdependence, systems thinking, and a multi-timescale perspective. It is somewhat different than risk management, which concerns mostly to understand and minimize exposure to specific, known risks. Resilience, on the other hand, must deal also with unidentified risks, and it must consider the adaptations and transformations an enterprise must make to absorb environmental stress and even turn it to advantage.

In this session, we will aim to cover the following:
1. Explore the many sectors of business management
2. Explore traditional methods of financing vs new innovative methods
3. Explore the different financing routes (e.g. Crowdfunding)
4. Access tools needed to manage financing products and services
5. Add enterprise risk (anti-crisis and crisis) resilience measures into business planning

Practical tips to consider in embarking on the financial management of your enterprise.

• **Avoid mixing Business finance vs personal finance:** Entrepreneurs handling a smaller enterprise with no budget and funds to invest in a CFO generally mix their business finance and personal finance with the aid of one single bank account for all transactions. However, this dependency is unhealthy for business and personal finance of the entrepreneur. So it is extremely essential to generate separate business and personal banking accounts. This will not just help you monitor your financial goals and cashflow but additionally support you in getting business loans from banks and other lenders.

• **Maintain financial planning:** Entrepreneurs and SME owners are advised to work out a quarterly financial plan and evaluation each month to have an understanding of calculating the amount of funds and capital that is available to the enterprise, the amount that is required for any investment plan, or any one-off or regular outflows and cost items and then determining the allocation of available and newly acquired funds based on internal frameworks, rules, and deadlines.

• **Always follow deadlines:** Never miss your tax dues, invoices, payables or loan repayment deadlines. Arrears come with administrative and financial fines and fees, which additionally adds to your expense and raise the cost of doing your business. Additionally, regularly missing a payment will combine a red mark on your credit score and credit history, which will produce problems while you require to obtain new external funds for your business development plans.

• **Control your costs: T**hink twice on every cost item of your business and evaluate whether you really need to incur these costs making a cost vs benefit analysis. Once you are convinced that the benefits outweigh costs, check alternative sources, products, service providers to fulfil your needs and compare their process. Usually, there is no one to question the entrepreneur's choices and decisions in a small business. So, entrepreneurs must question their decision and cut the cost to spare cash which could be otherwise saved and invested in more urgent and impactful activities.

• **Search for and be informed about alternative methods of funding:** In times of dire situations requiring additional capital and external funding, SMEs may struggle to receive a bank credit and end up raising funds from informal channels, which in turn charge higher rates of interests. To avoid such situations, SMEs must educate themselves with a mixture of working capital, business loans such as leasing, factoring, and crowdfunding that are accessible in the market.

What steps to follow once you decide to obtain external funding after a careful financial decision-making process?

• **Start with honing your business plan and cash flow model:** Do you struggle with managing your working capital, paying your companies bills, salaries of your employees? Maybe working capital is less of an issue for your company but you want to grow your business. If so, do you have an investment idea through which your business can make that jump you have always wanted? What is your plan to turn that investment idea into a reality? What resources does your business need to make that investment idea an actual investment? Do you need more human resources, new hires? Do you need finance to buy an equipment? When do you want this investment to take place? What volume of finance do you need to make it happen? When will that investment start to benefit your business in terms of higher earnings, revenue, profits? Reflect the answers to these questions in your business and investment plan and a simple cash flow model.

• **Identify your financial needs:** Consider the following questions: What does your cash flow model say to you regarding your financial needs? How much money do you need to make your investment real? Do you need a bank loan to make the investment real? How will the investment effect your revenues? When can you start paying back the bank loan? How much money can you pay back on a monthly basis considering the boost the investment is going to give to the earnings of your business?

• **Start searching for finance:** Below are the steps you can take in this process.

o *Create a stakeholder mapping:* Make internet searches and explore within your network to learn about all local, national, international, financial and non financial stakeholders active for supporting MSMEs' development in your country. What type of institutions are there in your country that provides finance to MSMEs (especially women-led MSMEs):

- Banking sector - commercial banks, private/public/ thematic banks
- Microfinance institutions
- Leasing, factoring companies
- Any governmental or private investment and development funds
- Relevant ministries providing supports to your sector of activity, women-led businesses, innovation, etc.
- International financial institutions, multilateral and bilateral donors

o *Create a support mechanism mapping:* Create a mapping of various financial and non-financial local, national and international support mechanisms available for MSMEs in your country with focus on any such supports for women-led MSMEs. Try to focus on those support mechanisms that suit your financial and non-financial needs and goals.

o *Decide on which type of financial and non-financial products and services on offer best matches your business' financial needs:*

1. Loans and overdrafts
2. Loans provided under guarantee schemes
3. Micro-credit
4. Grants
5. Trade finance products (letters of guarantees and letters of credit)
6. Leasing and factoring arrangements
7. Finance provided under support schemes proposed by public and international stakeholders
8. Business advisory services and technical support

o *Check requirements, terms and conditions of the selected sources of financial and/or non-financial products:* Learn about the application requirements for credit, grants; their interest rates and fees; maturities and grace periods; repayment schedules; collateral requirements, etc.

o *Start collecting the required information to apply for your selected product:* Try to gather as much information about your business as possible to demonstrate your and your business' repayment capacity. Have an understanding as to what the banks and other financial institutions usually look for in terms of data to evaluate a business' capacity to pay back a loan.

Put yourself in the shoes of a bank loan officer while preparing your application for funding. What would they be looking at to evaluate a business' capacity to pay back a loan? With what information could you make their assessment easier and turn it in favor of your application?

What data type/source?	For which MSME segment or loan sizes can this apply?	What exactly do the banks and other financial institutions check and why?
Information on the MSME	All segments; all volume of loans	History of the company, sector of activity, shareholders/owners/managers, main business partners, company's sources of revenues and main items of cost/expenses, company cashflows or financial statements
MSME loan data (information on any outstanding or past credit line)		Loan, type of loan, maturity of loan, guarantees and collateral value, historical payment performance such as default information and payments in arrears, amounts owed, length of credit history, new credit, and types of credit, collateral
MSME transaction account data		Transactional information from enterprise/owner bank accounts into detailed revenue and expense items, combined with analysis to generate, for example, simplified financial statements and affordability ratios
Public records		Matters of public record such as bankruptcies, judgments, and collection items
Credit bureau checks		Number of loans and total amount owed to the financial system, levels of debt, length of time at address and credit history, number of new credit accounts

What data type/source?	For which MSME segment or loan sizes can this apply?	What exactly do the banks and other financial institutions check and why?
Utilities data	Micro and small enterprises; small volume of loans; working capital loans	Steady records of on-time payments as possible consideration as an indicator of creditworthiness
Mobile applications and Online transactions		Mobile payment systems with possible view on the business owner's behavior and lawful use of granular transactional data with possible insights on spending patterns
Commercial data	Medium/large enterprises; large volume of loans; investment loans	Financial statements, number of working capital loans, and others
Social media (of the enterprise and the owner)		Lawful use of social media data with possible insights on business owner's lifestyle or on company

For those of you who choose crowdfunding as their external funding source, we present below some tips and risks to consider in obtaining funding via crowdfunding platforms.

Crowdfunding: it is relatively a new source of mobilizing funds for MSMEs from the general public by launching a fundraising campaign via a crowdfunding platform through the internet or by making use of social media. The process starts with the offer of an idea that people would love to support with small contributions. If you get lots of people to buy into the idea, you might raise enough funds to reach your set goal/amount. MSMEs can use crowdfunding to generate small amounts of capital from a large number of investors. It is characterized by its easy accessibility using technology. This technology-based platform act as an intermediary between the entrepreneur and the investor providing the latter with information about the opportunities to invest.

In many countries, the concept of crowdfunding is still in its emerging stage with contributions towards social causes usually funded more widely via crowdfunding platforms in the early stages of crowdfunding development. Still, crowdfunding can help in raising funds for small businesses, and also validates the ideas or innovations of the business raising it. Some of the most common ways crowdfunding can be used to grow an MSME are acquiring new equipment/machinery; hiring employees; purchasing real estate; launching a new product; raise donations for non-profits; raising venture capital.

Traditional Funding

Large amounts from one, or a few, sources

CrowdFunding

Many small sums from a large group of individuals

TYPES OF CROWDFUNDING

1. Donation-based: This method is for registered nonprofit organizations and involves asking the investors for donations for a charity-based project. The project is cause-driven benefiting society and may or may not associate rewards with the amount of donation made. This method is used for raising money to aid certain research, for disaster relief or organisations working on a social mission. On rare occasions, for-profit organisations can also receive donations through this channel.

2. Reward-/sponsorship-based: This model works by offering a reward to backers as encouragement for their investment. Set by the fundraiser/MSME, this reward can be in different forms. If the potential investors/backers are backing a prototype product, donors at certain levels could get early access to buy the product at a discount or can own the product itself before others (pre-selling or pre-ordering model). Rewards could be merchandises like t-shirts with the MSME logos and the purpose on them, stickers with a message stamped on it, or a handwritten thank you note from the owner of the MSME.

3. Lending-/debt-based: Debt-based crowdfunding is similar to a bank loan. It can sometimes offer a lower interest rate and more flexibility in the terms. Investors in this form of crowd-funding seek equity in the business they are investing in, which makes it similar to but slightly different from equity-based crowdfunding. Here MSMEs raise funds from individuals expecting a fixed return on the shares they hold and instead of paying them through profits they pay them interest on money borrowed. This method is complicated, just as equity-based funding, so MSMEs should check it carefully with the help of a qualified financial consultant.

4. Equity-based: In this model, the business seeking funds issues shares to the investors, who are in the hope that those shares will grow in value over time, and offer them to become stakeholders in the company using an online platform for crowdfunding. Initially, the company raises funds through private equity, angel investors and loan arrangements with financial institutions. Once the business becomes commercially viable, it can open its equity to the public. This method is highly risky and thus calls for regulations. MSMEs should check the respective regulatory framework in their countries for the legal status and authorization of the platforms generating equity-based crowdfunds and investigate this option very carefully with the help of a qualified financial consultant.

BENEFITS OF CROWDFUNDING

• **Alternative funding source:** Crowdfunding can be a way of funding your business idea or projects with access to a large number of people who could be interested in your business if risks are carefully considered and the goals are realistically set.

• **Proof of concept and validation:** Crowdfunding could be a reality check of your business idea letting you see if others share the belief and value in your project. If your campaign is successful it is a strong validation that investors and the associated market approve.

• **Complementary to other forms of financing:** A successful campaign may demonstrate that there is a demand for your products and services that people believe in, which could be useful when seeking additional finance from other types of FSPs such as banks, VCs, angel investors. It may set a track-record making you seem less risky to the FSPs, thus help you to get better terms and conditions.

• **Access to a new network of potential customers and investors:** through the technology-based platforms, you may be accessing a wide-raging crowd of individuals, some of whom could have valuable expertise and insights for the growth of your business. Crowdfunding allows you to interact with new groups of investors and clients and may help you collect valuable feedback at a very limited cost.

• **Good marketing tool:** Crowdfunding can be an effective way to market and present a new business, idea or line of products by digitally pitching to people who would become your customers.

Steps and tips to best benefit from crowdfunding and avoid risks

• First, analyze your financial needs and see if crowdfunding matches your requirements as an alternative financing instrument. In most cases, it is a complement not a substitute for bank financing. Carefully analyze your **budget and funding plan** when deciding to raise money under a crowdfunding platform. Include the platform's share and any uncertain costs in your budget to meet your goal.

• Read as many guides, blogs and ongoing campaigns as you can for inspiration and learn from the experience of other campaigns. You may contact platforms and successful campaign owners.

• Analyse the **target backers**' demographic in your country. Millennials tend to be the largest group of backers of crowdfunded projects, therefore your **offer/ask** and the purpose of your campaign should appeal to your target audience.

• Be aware that crowdfunding requires a significant amount of **effort and hard work.** Do not underestimate just how much time and resources crowdfunding takes. Consider whether the effort you are going to put in will entirely match your financing needs. Judge whether the effort you will put in crowdfunding would be better put in building up a bank relationship and accessing finance via traditional ways.

• Make sure that you chose established and respectable platforms that have a good track record n your country. Check the alternative **crowdfunding websites/platforms,** what **terms and conditions** they propose, **fees** they charge and the **limits** they impose as to the amounts that can be raised. Revise your budget comparing the total cost including the fees of each of the crowdfunding platforms and compare the platforms according to those parameters and choose the one that best fits your needs. Different **fee structures and terms for success** could make or break the success of your **crowdfunding campaign.**

• Make your decision for the **timeline** in which you target to reach your **fundraising goal** and avoid setting unrealistic goals and **reputational damage** that would follow. It is inappropriate to set your goal so high and ask for an unnecessary amount of money. Most platforms dictate that you collect funds and reach your funding goal up to a **deadline.** In most cases, if you do not make the deadline, you do not get any funds. In some other cases, you get to keep whatever money you raise, but if you do not reach your target amount, the platform increases its fee, which can impact your cost projections. Therefore, make sure the contractual arrangements are clear on the rights and obligations of the parties involved in case the funding target is not reached.

• Stay in touch with the credit assessment team from your chosen crowdfunding platform about the information you have submitted and make sure all is in order. Be aware that, depending on the type of crowdfunding you will use and the amount you are seeking to collect, you might need to provide **financial accounts** and your **credit history.** Make sure these are ready if needed.

• If your application is approved, the platform might assign you a risk category according to which your business will be listed on the platform for lenders to bid on.

• Consider r**aising funds in stages** to make the goal achievable and maintaining accountability by using the collected money according to the initially set needs of your business.

• Offer appropriate **rewards** for every category of investors. To get a sense of what can work and how far you can be creative in using rewards, search for small businesses in your country that are using crowdfunding and see what they are doing to promote their campaigns. Most crowdfunding sites will show each tier of rewards and which tiers are selling out fastest, giving you a good sense of the most common investment amount and respective reward.

• Make your budgeting carefully to avoid overpromising and under-delivering on your promises and rewards. Learn whether your backers can support you from abroad and take into account your shipping budget in such a case and whether you could cover such costs before you launch your campaign.

• Set your **campaign strategy** at the start as to how you would like to manage your crowdfunding campaign. Use your **network** and involve/inform as many relevant contacts of yours as you can. Make use of **social media platforms** to reach out to your contacts and ask them to engage you with potential investors. Let your supporters/backers know about the progress you make during your campaign and fundraising by sharing your project within their social networks, extending your reach beyond your immediate network and social circle.

• Prepare an authentic, clear and concise **digital pitch** geared toward your target backer group. Provide potential investors with sufficient information and tell them why you need the collected money and how you are going to use it to grow your business. Be transparent about your business plan. However, also ensure that your **business ideas and your intellectual property** are protected. Make sure you do not give away sensitive details in the materials you provide potential investors. Be aware that for a relatively low cost, your competition might have access to your business plan and duplicate your proposition. Get advice on protecting your intellectual property rights from the crowdfunding platform, your local Chamber of Commerce or a related government agency in your country.

• Each investor/lender will bid their chosen amount and interest rate once your fundraising begins. Do not forget that the campaign is not over when your target is reached. Investors/lenders can keep bidding, lowering the interest rates, so the more popular your campaign becomes and collects more amounts, the better your terms may become. Once the bidding is finished hopefully successfully, the crowdfunding platform will get in touch to confirm the final average interest rate and send the funds to your bank account within an agreed timeframe. After a grace period, your loan and interest rate repayments will begin as agreed with the platform until the loan is repaid in full.