The Importance of Financial Management for the Success of the Organization in a Challenging Business Environment

Tanja Janačković

Marko Janačković

Abstract: The current economic environment poses challenges for the function of financial management and the financial function in general, on several levels. Organizations are required to change existing priorities, with an emphasis on cash management and forecasting activities, as well as risk management. Challenges in the business environment require organizations to raise additional capital. They need efficient financial management that will create an adequate capital structure, in order to react positively to changes in the business environment and use the available financial resources optimally and better meet the requirements in terms of obligations. The COVID-19 pandemic poses a challenge to organizations around the world, forcing them to rethink their existing business models as they struggle to survive. The paper first examines the impact of the COVID-19 pandemic on organizations and their business, and especially on finances and the process of financial management, and then points out the importance and techniques of financial management that are necessary for the success of organizations. This paper aims to point out the importance of efficient financial management and the application of its essential concepts in order to achieve the success and development of business organizations, especially in a challenging environment.

1. INTRODUCTION

Finance is focused on decisions about money or cash flows, while financial decisions are about how companies, individuals, and governments collect and use money. Three basic principles are key to making adequate financial decisions, and they include the following: 1) more value is desirable in relation to less value, 2) money is worth more the sooner it is reached, and 3) less risky assets are desirable than risky assets. By considering these principles when making decisions, companies become able to provide consumers with better products at lower prices, higher salaries for employees, as well as higher returns to investors who have provided their funds to start a business (Besley & Brigham, 2015, p. 3).

Good financial management contributes to well-being of both individuals and the general population. It covers the decisions made by all companies regarding their cash flows, including inflows and outflows. With this in mind, financial management is important for all types of companies, with responsibilities involving moving from the process of deciding on the expansion of factory capacity to selecting the type of financial instrument that should be issued to finance such expansion. The responsibility of financial management is also on deciding on credit conditions, the amount of stock that the company should have, the amount of cash held, analysis of mergers, as well as deciding on how much to reinvest and how much of the annual profit to

---

Creative Commons Non Commercial CC BY-NC: This article is distributed under the terms of the Creative Commons Attribution-NonCommercial 4.0 License (https://creativecommons.org/licenses/by-nc/4.0/) which permits non-commercial use, reproduction and distribution of the work without further permission.
pay to dividend owners. Given that each company operates with limited resources, financial management involves process of planning and monitoring the use of financial resources by a company. In order to efficiently use resources to achieve the goals of the organization, it is necessary to implement adequate financial practice. Financial management activities may include cash flow management, profitability analysis, as well as risk management.

Financial management includes planning, organizing, directing and controlling company’s financial resources. It includes the activities of procurement and distribution of funds, as well as the application of general principles and methods of managing the financial resources of a project and estimating the value of project returns. Thanks to financial management techniques, company can monitor future cash flow and achieve business goals. The basic goals of financial management are reflected in creating the company’s wealth, generating revenue, and ensuring a sufficient return on investment (Jayashree & Carmel Mercy Priya, 2016).

Good financial management is key to success of any organization, where an organization can be viewed as a whole composed of the following interrelated elements, namely: 1) people (employees, contractors, owners), 2) architecture (reporting lines, responsibilities, structures) governance and informal relationships), 3) routines (processes, policies, reward structures, and decision-making approaches) and 4) culture (values, beliefs, and norms of behavior). These elements of the organization are shown in Figure 1.

![Figure 1. Business environment Source: ICAEW, 2009, p. 3.]

2. IMPACT OF COVID-19 PANDEMIC ON ORGANIZATION AND FINANCIAL FUNCTION

Organizations around the world are facing the challenges posed by the COVID-19 pandemic, and they are forced to reshape their business models while struggling to survive. There are many issues and challenges facing companies in changing business conditions, from supply chain disruptions to changes in consumer behavior, employee safety and issues related to the new work environment. To examine the impact of the pandemic on financial function in organizations, the Institute of Management Accountants (IMA) conducted a global study on the impact of the pandemic on financial function, focusing on changes in staff, compensation and skills required (Lawson, 2020). The research covered the impact of the pandemic on organizations as a whole, following changes in income and staffing levels, with an emphasis on the impact on staff in finance and the priorities
of the finance function. In addition, areas related to the improvement of skills by financial experts and their retraining were pointed out. The research is based on a survey of 1,481 experts in the field of accounting and finance and includes companies from five countries: India, Saudi Arabia, the United Arab Emirates, China and the United States. More than a third of the respondents were women, and the percentage varied by country (from 51% in China to 18% in Saudi Arabia).

The fact is that organizations of all sizes are facing extreme financial difficulties and the risk of shutting down due to the COVID-19 pandemic. Large companies like airlines turn to the state asking for help, while small companies, like restaurants, do not have the financial resources of larger companies and are also struggling to survive. The results of the survey indicate a larger drop in revenue, with very large companies (with more than $10 billion in revenue) most likely to experience a significant drop in revenue. Despite the decline in revenue among organizations of all sizes, a third of respondents think they are doing better than the competition, while less than 10% think they are lagging behind the competition. The belief of companies regarding business in relation to competitors varies depending on their size. Thus, larger organizations with more than 1,000 employees more often believe that they are better than the competition (39% of them), compared to smaller ones (less than 100 employees) which believe that only 29% of them are better than the competition.

When it comes to the impact of the pandemic on employment, the results are unsatisfactory, i.e. about half of the companies have laid off part of their staff. Companies’ reactions to the pandemic on these issues have varied by region. For example, in the United States, companies were least likely to reduce their staff (36.6% of respondents said the organization laid off part or most of its staff), followed by China (42.4%) and India (59.8%), while companies in the Middle East and Saudi Arabia (60.3%) and the UAE (61.1%) were likely to have fewer staff.

The impact of the pandemic is also significant on the compensation of those who are still employed, with the majority of respondents having reduced benefits (salary, bonus or both). In this case, too, the impact of the pandemic varied from country to country. Thus, in the USA, companies are the least likely to change the amount of compensation to employees, Chinese companies will not change salaries, but will reduce the amount of bonuses, while companies in India, Saudi Arabia and the UAE are most likely to reduce employees’ salaries. In addition, the impact of the COVID 19 pandemic varied depending on the industry, with some experiencing a gradual closure initially, with the gradual reopening, while other industries remained open and little affected.

When it comes to the impact of the pandemic by industry, the most affected are experts in tourism and hospitality (13% were fired and 58% work with reduced wages), followed by experts in government, education and non-profit activities (5% were absent and 52% of them experienced a reduction in salaries), while the smallest impact was in the field of accounting and finance. The change in the number of employees was also reflected in changes in the compensation of individuals, i.e. the companies that reduced their staff have also reduced the compensation of employees. Respondents who stated that the company fired part of its staff, stated that they also experienced a reduction in salaries, bonuses or that they were fired (80.3%). This result was 55.9% for respondents in companies where there was no decrease in number of employees, and 35% for those who worked in companies where the staff was increased.

When it comes to the impact of the pandemic on financial function, the focus is on risk management, i.e. 43.7% of companies spend a lot of time in this area, followed by forecasting and cash
management. With this in mind, less time was spent on business partnership and decision support, i.e. 33.5% of companies spend less time in this area compared to 22.2% who spend more time.

Based on research by IMA and the Association of Chartered Certified Accountants (ACCA), The CFO of the Future, the financial director is seen as a strategic business partner who has a leading role in formulating business strategy, its validation and execution, and has a broad view of performance of various stakeholder groups, while providing insight into the organization’s future business activities. When it comes to industries, especially in the fields of tourism, travel and hospitality, the pandemic is having a significant impact, with companies reducing staff to survive, and focusing on core functions to survive.

Many organizations also face the challenge of maintaining employee productivity while doing jobs from home, with the pandemic setting new challenges in terms of human resources for the finance function. The key challenges are enabling staff to work from home (37.5% of respondents) and creating a safe environment for those who go to work (36.7%). In addition, there is a need to train staff for tools that allow them to work from home (26.3%).

When it comes to retraining, there was interest even before the pandemic (78% of respondents) – of which the highest percentage was in Saudi Arabia (89%), China (88%), and the lowest in the United States (58%). When it comes to belief in the relevance of existing professional skills, the results vary from country to country, with respondents in the US being most confident in the relevance of skills after a pandemic, and those in India being the least certain (69%). In companies with less than 100 employees, there was greater concern about skills (14%), compared to organizations with 100-999 employees (9%) and large organizations with more than 1000 employees (8%).

In addition, due to the high level of unemployment at the global level, there was a greater interest of financial experts in acquiring new skills (68%), with the highest percentage of them in China (78%) and the lowest in the US (49%). A challenging business environment imposes on financial professionals the need to maintain and improve business skills. In this regard, there is a wide range in the field of knowledge in which respondents worked on improving or planning to improve their skills – Figure 2. In addition to the desire for training, financial resources and support of companies in this field are needed. When it comes to real support, 49% of employers supported training and retraining of employees, mostly (57%) in China, 55% in the US, 45% in Saudi Arabia, and least in the UAE (39%).

![Figure 2. Improved skills during the COVID19 pandemic](source: Lawson, 2020)
3. THE IMPORTANCE OF FINANCIAL MANAGEMENT IN A CHALLENGING BUSINESS ENVIRONMENT

Based on the CBIZ Main Street Index survey, it can be observed that 43% of SMEs in the US reported a significant or serious impact of the COVID-19 pandemic on business. Many companies were operating at a loss or reporting lower cash balances. The research was conducted by CBIZ, Inc. (NYSE: CBZ), a leading provider of financial, advisory and insurance services from August to September 2020. The analysis included over 1,600 companies across the United States and within more than 30 industries. The data were estimated as a whole, as well as depending on the size of the company, regional and industrial level. The following are key research findings (Boyd, 2021): 1) drastic impact on overall enterprise health, 2) impact on current value estimates, where future growth potential is uncertain, 3) smaller enterprises were disproportionately affected, 4) impacts were felt within all industries, 5) smaller companies took advantage of lifelines, and 6) although the path is uncertain, there are signs of optimism.

First, over 51% of respondents stated that there was a significant reduction in sales during the pandemic, more than 17% requested an extension based on periodic payments (e.g. rents), and less than 60% received these extensions. According to the results, geographical differences can also be noticed, i.e. companies in the West were more strongly influenced, compared to companies in the Midwest. Second, 22% of respondents said there was a change in the valuation of businesses due to the pandemic, while 68% of respondents expressed concern about declining revenue and 32% about the extended sales cycle. Third, close to 48% of companies with 1-4 employees felt significant or serious impact, while for companies with 20-49 employees, 37% of them experienced significant or serious impact. Fourth, the analysis by industry level showed that the most affected sectors were accommodation and food, arts and entertainment, education services and transport, while professional services, insurance, financial services, government and construction sectors were the least affected by the pandemic. Fifth, close to 85% of respondents took advantage of payroll protection programs, enabling them to improve their business during the crisis and retain team members for the recovery period. Finally, about 27% of SMEs indicated that they will reduce staff in the next six months, and 17% believe that they need applications for additional loans and external financing. Some companies have invested in their business, with 40% planning to increase investment in marketing, and close to 20% to invest in increasing the workforce.

Good financial management can create such a capital structure that will enable companies to react positively to changes in a challenging business environment. In addition to a large number of challenges and questions, the research included the impact of the pandemic on the health of companies, sales and revenues, staff and number of employees, as well as participation in the salary protection program. Companies need resources to create and deliver a product to consumers. Capital budgeting is a process that involves creating a plan to procure or replace fixed assets and becomes more complicated in cases where companies are not profitable and raise less money. In these conditions, financial management becomes important. A challenging business environment requires companies to raise additional capital. The two decisions of financial management related to the capital structure include the following: a) debt financing and b) dividend payment or retained earnings.

Significant concepts of financial management that are applied to grow the business of organizations are the following: 1) budgeting and forecasting, i.e. creating a formal budgeting process and completing the budget before the beginning of next year, 2) cash flow management, 3) debt
monitoring and payment, 4) inventory management, 5) efficient use of funds, and 6) assessment of profitability and rewarding shareholders.

In case of a manufacturing company, budgeting would include the following: a) sales – forecasting annual sales units for each product, b) production – determining labor and raw material costs and overheads based on sales forecasts, while procurement costs depend on sales, c) management cash – design of cash inflows and outflows based on cash receipts from customers and cash payments for production and other costs, and e) inclusion of details on marketing, sales and office management costs.

A company must produce enough cash inflows to procure raw materials, make financial payments and pay marketing costs. The receivables turnover ratio is a significant indicator of cash flow management. A common problem in business is that sales are growing, but it is impossible to collect receivables quickly enough, and there may be a shortage of money. In order to adequately manage cash, it is necessary to monitor the receivables turnover ratio (net annual sales on credit / average receivables). If the business is adequately managed, sales on credit can be increased and the balance of receivables can be maintained at a reasonable level, i.e. if the turnover ratio is increased, it is possible to collect receivables faster. By applying the concept of financial management in business, adequate debt management, efficient use of funds, control of inventory costs and achieving profitability are achieved.

Financial management provides risk management assistance including the risk of incurring excessive debt. Some companies cannot generate enough money to pay interest on debt. In order to avoid this problem, it is necessary to use the debt-to-equity ratio (total liabilities / total capital). The indicator monitors the increase and decrease in liabilities as a percentage of equity, and if liabilities increase faster than equity, it is a signal that the company may be taking on too much debt.

If you manage retail or wholesale, inventories can make up the bulk of the assets in the balance sheet and may require a lot of money to invest. In this case, it is necessary to use the inventory turnover ratio to monitor them and collect cash. This coefficient is the ratio of the cost of goods sold and the average stock.

In order to assess the efficiency of the use of funds, it is necessary to apply the formula of return on assets (ROA), which shows the ratio (net income/average total assets). Well-managed companies can increase the profit generated from each monetary unit of funds. If there is a good understanding of the use of funds, it is possible to make better investment decisions.

Profitability can be assessed using earnings per share (EPS), which is calculated as the ratio (net income available to common shareholders) / (average common stock shares outstanding). If it is possible to earn higher earnings per share, ordinary shares are more valuable. By increasing earnings per share, part of the earnings can be paid as a dividend to shareholders, or part of the earnings for business can be retained.

4. CONCLUSION

Every company plans and implements business activities to make a profit. Profit means growth, sustainability and successful business of the organization. The financial manager has a key role to play in maintaining the success of the organization. His main responsibilities relate to fund-
raising, resource allocation, capital market operations, and profit planning. The challenge for every organization is to choose an efficient financial manager, who will make right decisions in managing the company’s financial resources. Concepts and methods of financial management help managers in making adequate decisions to effectively achieve organizational goals.

The COVID-19 pandemic has posed challenges to the business of organizations, with the impact being global and affecting all countries and organizations of all sizes. When it comes to the impact on financial function, many companies have reduced their staff or compensation for them. In addition, a challenging economic environment requires a shift in priorities with a focus on risk management processes, forecasting and cash management. It is necessary to enable employees to work from home, as well as to provide safety measures if they work in offices. In addition, financial professionals are required to constantly work on improving their skills to advance and sustain their careers.

REFERENCES