

Financial Training for Non Finance Managers

Finance may not be the fundamental part of everyone's role but it is increasing difficult to survive, never mind thrive, without an understanding of the core concepts.

There is a growing trend to work in multi disciplinary teams where knowledge of the core finance concepts is necessary to achieve a common level of understanding and communication in relation to shared objectives and corporate drivers.

Those who need to make presentations to boards or committees will benefit from knowing some of the key financial concepts in order that they can present their ideas with a high level of financial authority. After all there are not many boards that do not have a finance director.

What are the financial statements?

The majority of business will publish at least an annual set of financial statements. The processes and rules and to produce the financial statements can be complex and people can easily spend a whole career developing and maintaining the skills to keep pace with on going change.

At a fundamental level there are 3 core financial statements. The balance sheet, the profit & loss account, and the cash flow statement.

The balance sheet shows a breakdown of assets and liabilities at a specific point in time. The profit & loss account shows income and expenditure for a specific time period (usually one year). The cash flow statement shows a breakdown of cash inflows and outflows over a specific period (usually one year).

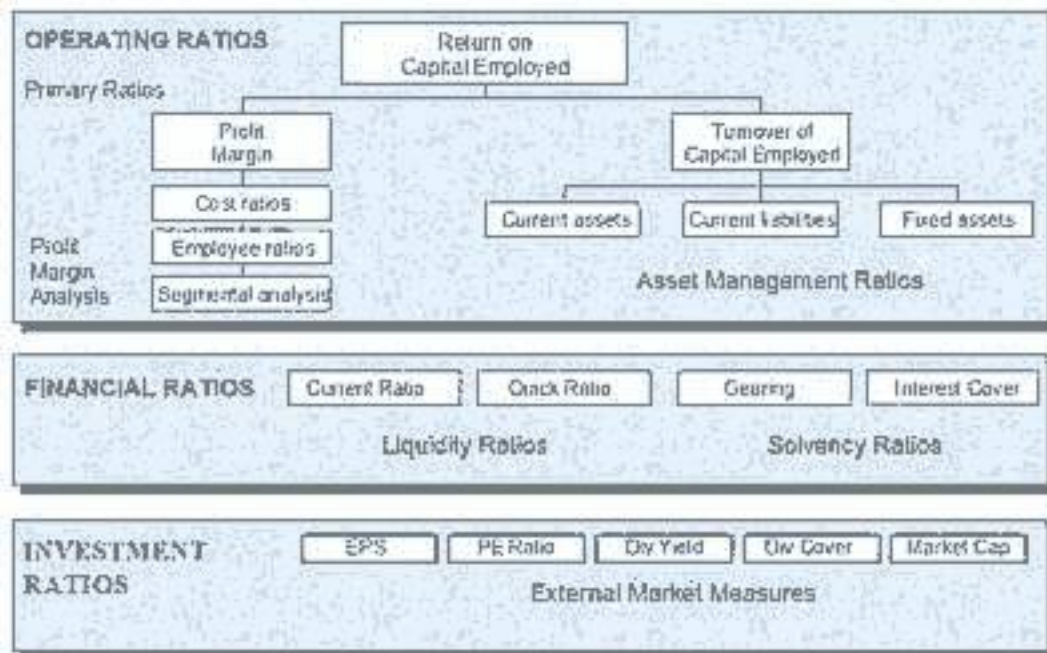
Financial statements can be an excellent way to understand more about your competitors, key customers, business partners, or even your own company.

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Interpreting the financial statements

Interpreting financial statements can be difficult, particularly if you are comparing organisations of different sizes, different industries or different time periods. One mechanism to help understand trends is financial ratio analysis.

Ratios can be wide and varied. Some of the core ratios are included below.



These ratios, based on simple mathematical formulae, can give a quick health check on organisations finances.

But remember, ratios generally tell us which questions to ask, rather than giving us the answers.

'Cash is king'

There are some fundamentally profitable businesses that fail due to cash flow problems.

All successful businesses know where cash is generated and where cash is consumed. It is important to understand a company's cash flow over the short, medium and long-term time horizons.

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There are a number of techniques that can be used to predict future cash flows ranging from simple forecasts to more complex statistical analysis. The most successful techniques include the input from all the functional areas of a business. A company's cash flow should not be the sole preserve of the finance or accounting department.

Ironically the amount of working capital (the amount of cash needed to support the daily business commitments) can grow significantly as the level of business grows. Periods of corporate growth can therefore put a business under a significant cash strain.

Budgeting

Budgets can be used for planning, responsibilities, integration, communication, motivation or evaluation & control.

All budgets are estimated, so as a starting point there needs to be a core framework of assumptions.

A number of different methods are used in practice. These include the identification of key or limiting factors, zero based budgets, activity based budgets or priority based budgeting.

In practice budgets can take considerable effort to develop and are often linked to a corporate planning process to ensure financial budgets are in line with corporate objectives.

Budget monitoring is usually delegated to line management through out the business. To ensure maximum effectiveness line management need to understand how the budget is constructed, monitored and reviewed. Where the budget is phased or activity based, adverse budget variances can easily be established.

Which project - Investment appraisal

All companies are faced with financial choices, which project to invest in? Which product to develop? Which product to pull?

There are a wide number of techniques to use to help manage these decisions. These include payback period, return on capital employed, net present value, internal rate of return, and profitability index.

The most appropriate technique to use will depend on the context and circumstances for an individual business. The decision is also heavily influenced by the quality of the assumptions. The new 'dream' product will score well with whatever appraisal system is used. In these circumstances it may be down to the different parts of the business to assess the realism of any base assumptions.

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Are sales levels realistic given the quality of competitor's products? Have selling costs been underestimated? Will we need more customer support staff?

There are two fundamental principals that influence all financial appraisal techniques. These principals and can influence a decision over what at first sight may seem similar projects or investments. These relate to the 'time value of money' and 'risk and return'.

Time value of money - Money is worth more today than it is tomorrow. When money is received today it can be reinvested and is able to earn interest. This can have a significant impact on large projects.

Risk and return - At a basic level money can be invested in government securities, which are the recognised as the closest thing to a risk free investment. As a minimum a project should earn the equivalent as a government security investment and probably a lot more to compensate for the additional risk. Appraisal techniques can be flexed to get risk-adjusted returns to aid comparison.

Company financial assessment

Most companies are at least partially funded by external bank or third party loan funding. In fact, if this method of financing is optimised it is possible through corporate finance theory to demonstrate how a company's overall value can be maximised.

Are most people aware of how their organisation is assessed by banks or third party investors? Banks lending decisions may be influenced by a number of subjective measures such as quality of management or opinion on the wider industry sector.

There are also a number of key financial benchmarks that can help build a companies credit worthiness. These can only help build bank relationships but are important in building and demonstrating financial credibility with suppliers and customers alike.

~ Brian Harpur ~