



Understanding Finance for Non- Financial Leaders

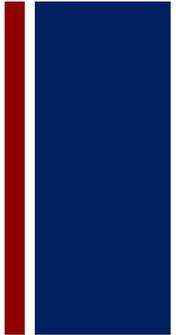


Presentation By KP Persaud

<http://kppersaud.com/>

+ Right People. Right Things. Things Right.

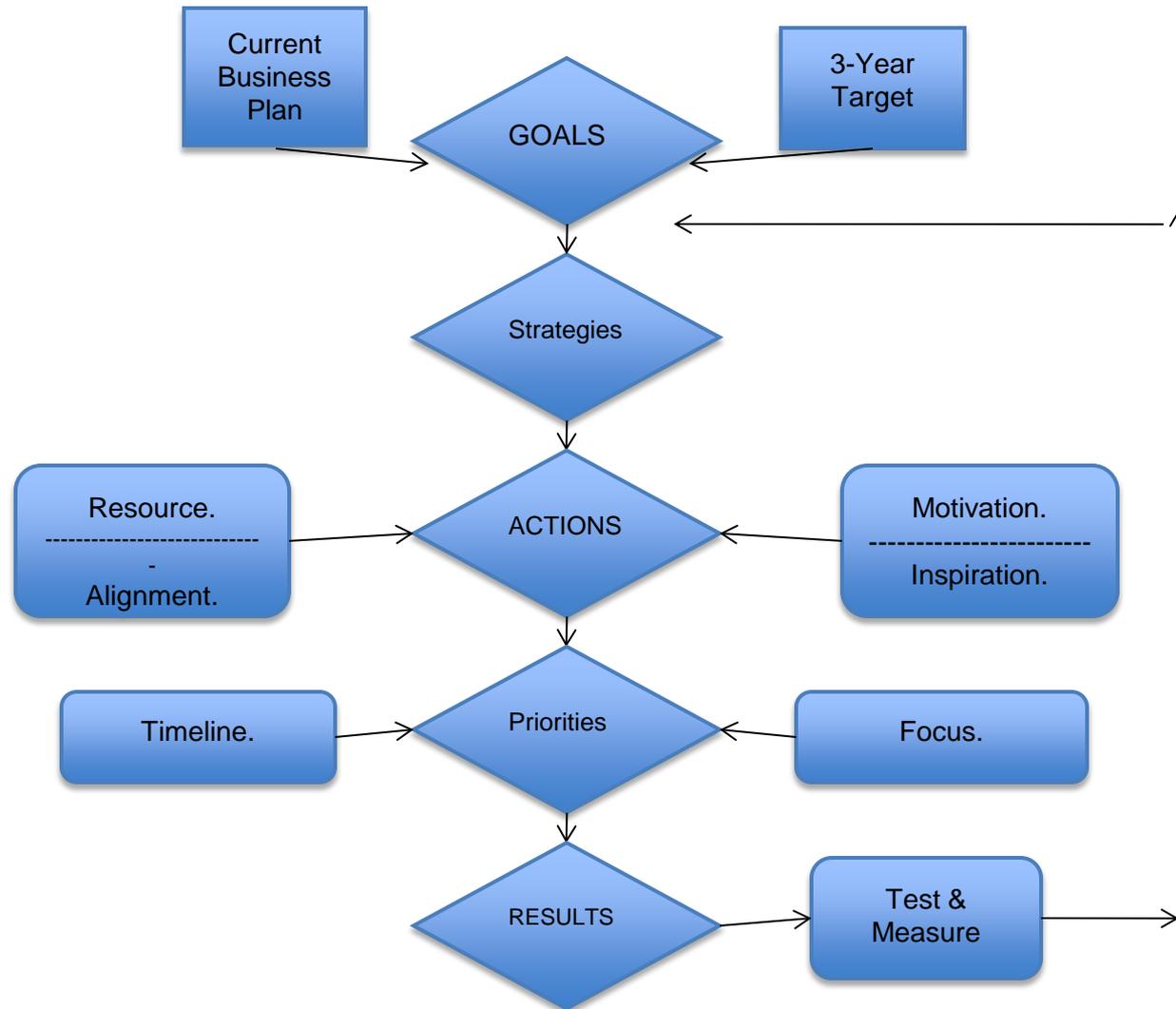
(1) Get the right people; (2) Do the right things; (3) Do things right



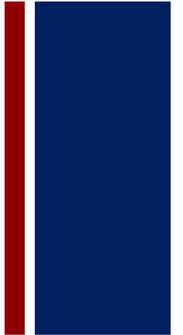
THE BUSINESS MODEL



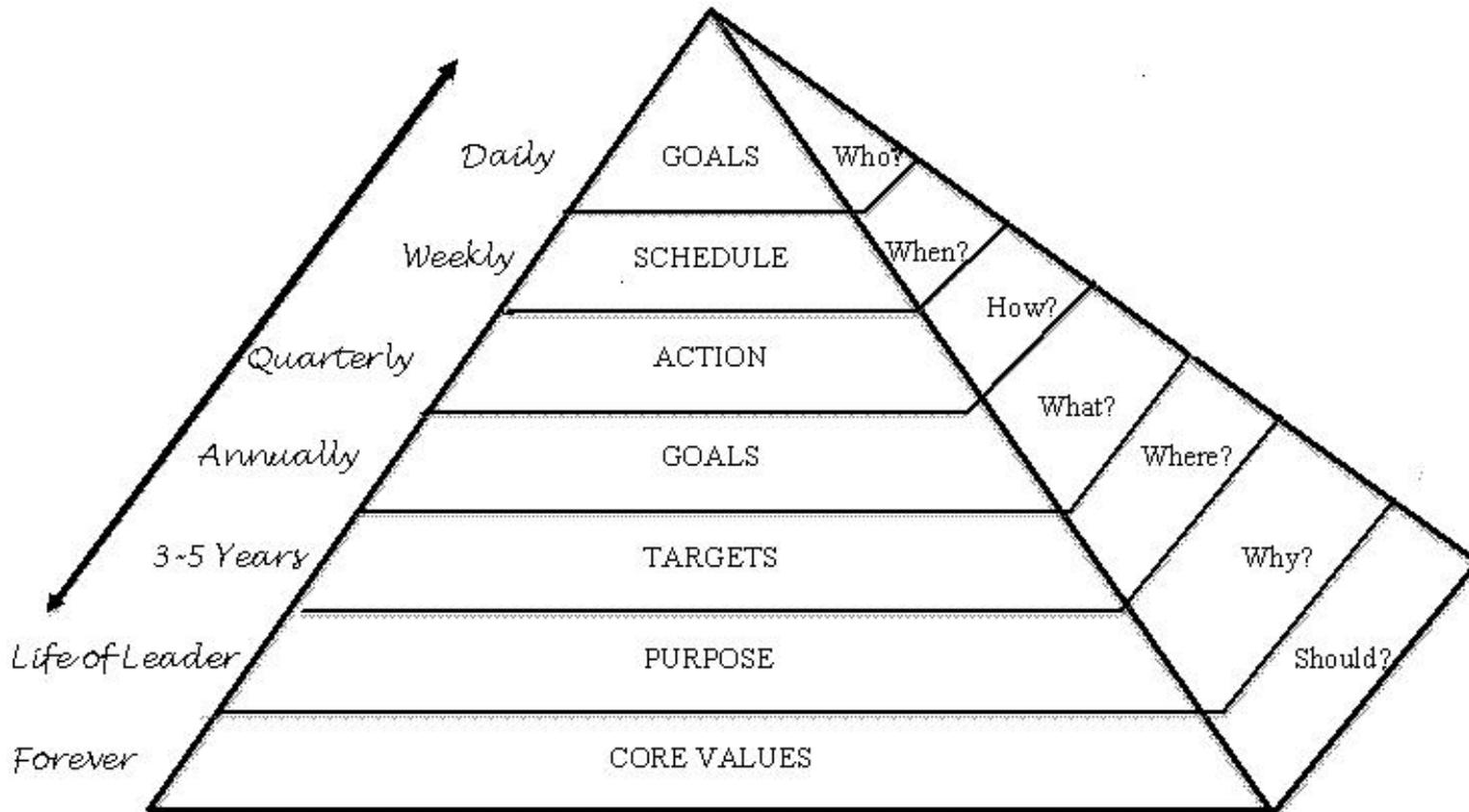
+ Execution: The Getting Results Model



+ Execution for Results

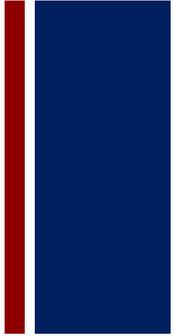


Accountability



Create Alignment

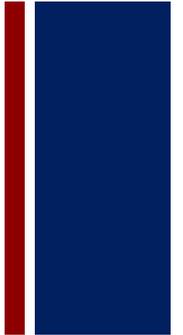
+ The Decision Model



1) Share Holders/Owners

- Solid balance sheet
- Good risk management (ratios)
- Good benchmarking data
- Good historical performance data: Trends

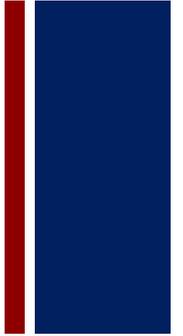
+ The Decision Model, Continued:



2). Customers

- Understand your customer acquisition cost, and ROI for each customer
- Growth trends for customers
- Competitive costing/pricing
- Customer performance metrics

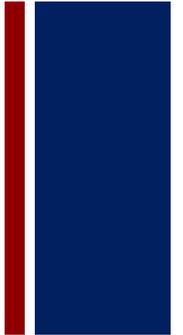
+ The Decision Model, Continued:



3). Employees

- Acquisition cost and competitive data
- Employees' costs and management of those costs
- Employee productivity
- Performance management cost

+ Selling

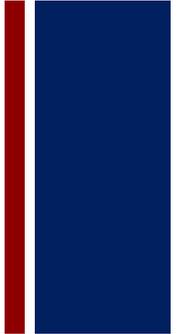


- Distribution and warehousing cost
- Selling cost
- Competitive sales data on the market place
- Sales process metrics:
 - Lead Generation
 - Lead Conversion
 - Sales per Transaction
 - Transactions per Year
 - Profit Margins

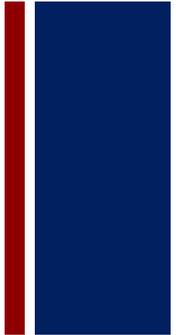


+ Product Costs

- Cost to Make
- Costs to Buy
- Lead Times
- Quality Costs
- Cost of Capital

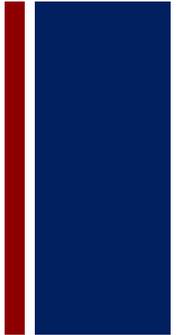


+ Record Keeping



- Organizational strategy and metrics
- Accountability for performance goals
- Regulatory compliance
- Reporting to all stakeholders:
 - How are you doing? (Balance Scorecard)

+ Decision Making



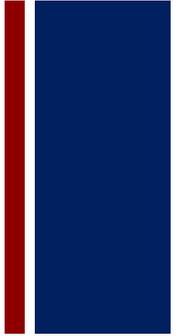
- More Data = Better Decision
- Useful to compare alternative proposals
- Investment decision
- Optimizing shareholder (owner) value
- Create values for customers
- Making changes to improve

+ Planning

- Strategic plans
- Yearly business plans
- Detailed budget plans
- The “PLAN” is the MGMT guide
- Mantra: *“Deliver Results”, “Not in budget, do not spend”*

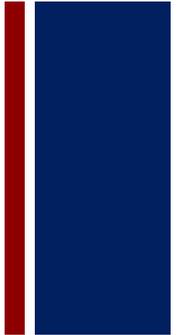


+ Operational Excellence



- Cost Drivers
- Money Cycle (working capital)
- Break-even Analysis
- Efficiencies / Waste
- Profit Margins
- Customer Metrics

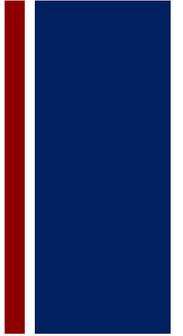
+ Executing



- Budgets and actuals
- Manage results and make changes
- Look at the dashboard
- Keep people focused on priorities
- Set new priorities based on results



+ Three Important Documents



1) Profit and Loss / The P&L Statement

- Income statement – period related
- Annual income statement – yearly

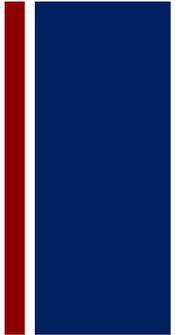
2) The Balance Sheet

- Snapshot of the financial condition of the company at a specific point in time.

3) The Cash Flow Statement

- Movement of cash in and out

+ Profit and Loss Statement



Two Distinct Set of Numbers:

- 1) Income:
 - Booked Revenue: *not necessarily collected*
 - Accrual vs. cash Based Methods

- 2) Expenses
 - Fixed and Variable Costs

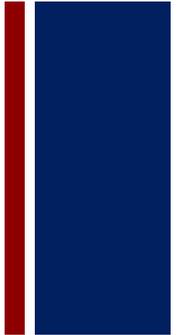
Income – Expenses = Profit or Loss for the Period

+ Example: Income Statement for Year Ending:

	\$'000s	\$'000s	
Sales/Revenue	12,345		
Cost of Sales			
Materials	3,345		
Labour	2,234		
Direct Costs	<u>1,500</u>		
Total Cost of Sales		7,079	
Gross Profit		5,266	(43%)
Overheads			
Staff Costs	1,830		
Indirect Costs	<u>1,500</u>		
Total Overheads		3,330	
Profit before tax		<u>1,936</u>	(16%)

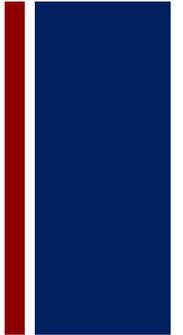
+ Profit vs. Cash

■ Profit Chart –



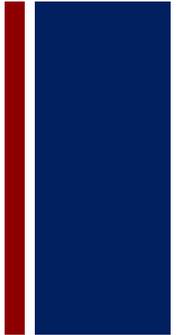
	Jan	Feb	Mar	Apr	May
Sales (\$)	5000	7000	10000	15000	18000
COGS (\$)	(3000)	(4200)	(6000)	(9000)	(10800)
Gross Margin	2000	2800	4000	6000	7200
Overheads	(2000)	(2000)	(2000)	(2000)	(2000)
Profit	-	800	2000	4000	5200

+ Cash Flow Chart



	Jan	Feb	Mar	Apr	May
Opening	10,000	8,000	3,000	(3,200)	(6,200)
Receipts	-	-	-	5,000	7,000
Suppliers	-	(3,000)	(4,200)	(6,000)	(9,000)
Overheads	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)
Closing	8,000	3,000	(3,200)	(6,200)	(10,200)

+ Balance Sheet



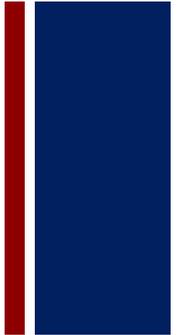
➤ Assets

➤ Liabilities

➤ Equity

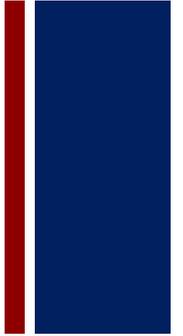
$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

+ Balance Sheet



	(\$000)	(\$000)
Assets		
Cash	12,637	
Stock	2,212	
Accounts Receivable	29,430	
Net Assets	44,279	
Liabilities		
Accounts Payable		(20,665)
Taxes Payable		(2,240)
Net Liabilities		(22,905)
Equity		
Current Profit		(21,274)
Capital		(100)
		(21,374)
Total Liabilities and Equity		(44,279)

+ Strong Balance Sheet



- Positive working capital
- Positive net assets
- ‘Substantial’ profit reserves
- ‘Relatively’ low loans / borrowings

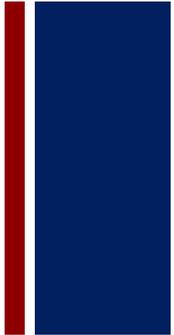
+ Cash Flow Statement:

Cash Flow from 3 Activities

- 1) Cash flow from operating activities
- 2) Cash flow from financing activities
- 3) Cash flow from investing activities

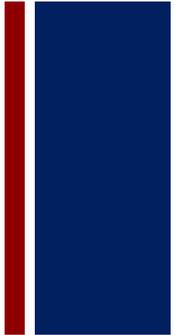
Note: Cash flow from each of the activities listed above can result in positive or negative returns.

+ Statement of Cashflows



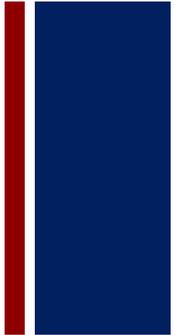
		\$	\$
Net Cash flow from operating activities			2,440
Returns on investments and servicing of debt			
Interest received		44	
Interest paid		(208)	
Dividends paid		(850)	
Net cash inflow from returns on investing servicing of debt		(1,014)	
Investing activities			
Purchase of tangible assts		(102)	
Receipts from sales of assts	<u>27</u>		
Net cash outflow from investing			(75)
Net cash inflow before investing			1,020
Financing			
Increase in cash and cash equivalents			-----
		1,020	

+ Key Questions



- 1) Has the cash increased?
- 2) What is the working capital?
- 3) Has money been spent on fixed assets?
- 4) Taxes and interest
- 5) Movement in loans

+ Financial Ratios



- Provide competitive benchmark
- Provide trend data on the performance of the business
- Lenders need to evaluate risks
- Used by investors to assess risks and returns

+ Liquidity Ratio

Definition: The ratio of all current assets and all current liability.

Formula:
$$\frac{\text{Current Assets}}{\text{Current Liability}}$$

Expectation: Maybe 1 \longrightarrow 2

Limitations: Timing of cash flow could be a problem because inventory is included.

+ Quick Ratio

Definition: The ratio between quickly converted assets into cash and all current liabilities - specifically excludes inventory

Formula:
$$\frac{\text{Cash} + \text{Accounts Receivable}}{\text{Current Liabilities}}$$

Expectation: How quickly can you pay your bills: 1 or more is a good ratio.

Limitations: Although better than the current ratio, the quick ratio ignores timing of cash flow.

+ Debt to Equity Ratio

Definition: The ratio between capital invested by owner/shareholders and lenders.

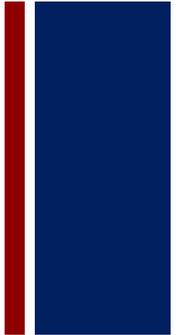
Formula:
$$\frac{\text{Debt}}{\text{Equity}}$$

Expectation: 1:1 \longrightarrow 1:4
Creditors \longrightarrow 2:1

Risks: Too high of a ratio will put the business at risk.

Too low of a ratio means you may not providing shareholders expected values

+ Gross Profit Margin



Definition: How much profit is made without considering selling and administrative costs.

Formula:
$$\frac{\text{Gross Profit}}{\text{Total Sales}}$$

$$\text{Gross Profit} = \text{Sales} - \text{Cost of Goods Sold}$$

Uses:

- Look for trends
- Benchmark comparison with similar companies
- Are you covering your expenses?

+ Net Profit Margin

Definition: How much profit remains after all expenses are taken from sales.

Formula:
$$\frac{\text{Net Profit}}{\text{Total Sales}}$$

Purpose:

- Benchmark peer companies
- Trend up or down?
- Are you controlling your costs?

+ Return on Equity

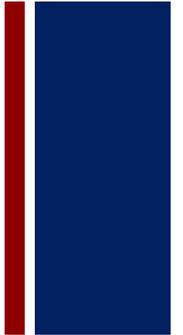
Definition: Rate of return on your investment in the business.

Formula:
$$\frac{\text{Net Profit}}{\text{Equity}}$$

Purpose:

- Benchmark other investment yield
- Benchmark other companies

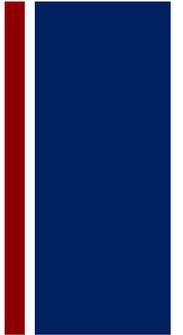
+ Other Key Metrics



- Days in outstanding receivables
- Inventory value in days
- Inventory turns per period
- Days in outstanding payables



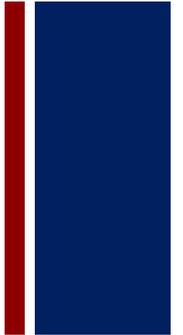
Budgets : Multiple Product Lines



Income	Budget % of Sales	January		
		Budget	Actual	Actual % of Sales
Sales Product Line 1	30.00%	51,300	50,000	28%
Sales Product Line 2	35.00%	59,850	62,000	35%
Sales Product Line 3	35.00%	59,850	65,000	37%
Total Sales	100.00%	171,000	177,000	
COGS Product Line 1	35.00%	17,955	17,500	35.00%
COGS Product Line 2	45.00%	26,933	27,900	45.00%
COGS Product Line 3	52.00%	31,122	33,800	52.00%
Total COGS	44.45%	76,010	79,200	44.75%
Gross Margin	55.55%	94,991	97,800	55.25%

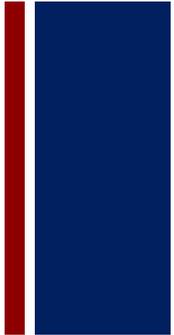
+ Break Even Analysis, Definitions:

- **Breakeven Point:** Where your revenue is equal to your total expenses.
- **Fixed Costs:** All costs associated with the business that does not change because you have to sell more/produce more.
- **Variable Cost:** All expenses that change in proportion to the activity of the business – costs that vary with sales and production levels.
- **Incremental Margins:** Margin increases as you pass the breakeven point.

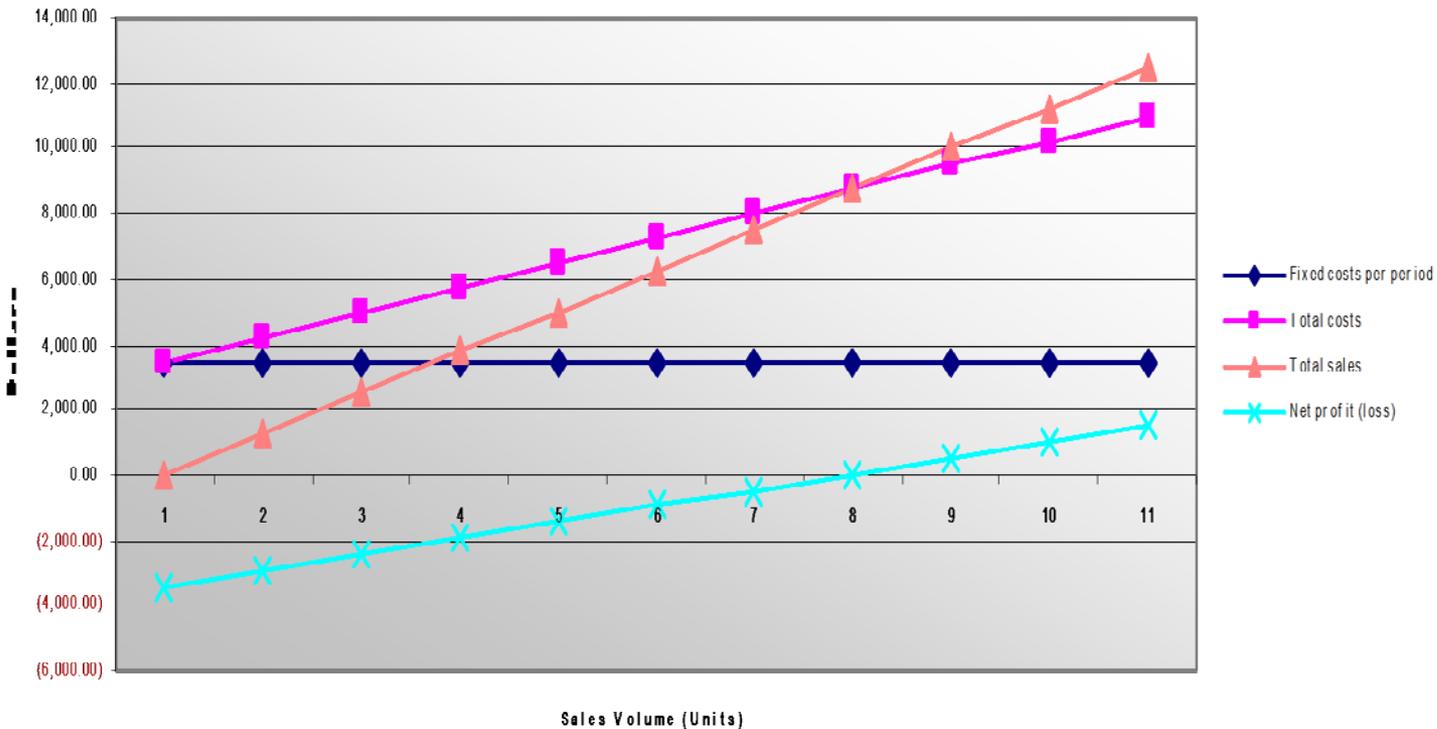




Breakeven Analysis, Chart:



Breakeven Analysis Chart



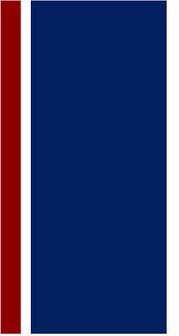
+ Breakeven Analysis

- Fixed costs could be changed by restructuring the business.
- Fixed costs could be changed by restructuring debt.
- Variable costs could be changed by process improvement.
- Useful tools:
 - Value engineering
 - Lean
 - Six Sigma
 - T.O.C
- **Total Strategy**: Better, faster processes to reduce costs.

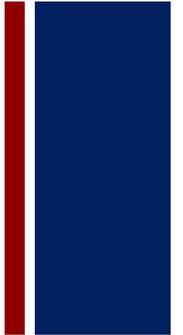


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