Covid Bounce-Back Programme - **Building Financial Resilience**

Will Carruthers & Agata Miskowiec

March 2022

Agenda

- Importance of good financial planning and management (case study)
- Introduction to financial statements (and how to use them)
- Financial forecasting
- Ideas how to improve financial resilience
- Questions

Temperature Check

- What is your involvement in financial matters in your organisation?

- Does financial management frighten you or are you comfortable talking finance?

The importance of good financial planning and management

Why is finance important?

- Whatever the size of your organisation, sound financial management is essential for sustainability.
- Rather than being seen as a separate function (just 'doing the books'), the finance function should be integrated within, and add value to, your organisation's fundraising and overall planning activities.
- Being able to read your financial statements and financial reports is critical!

Let's do the test!

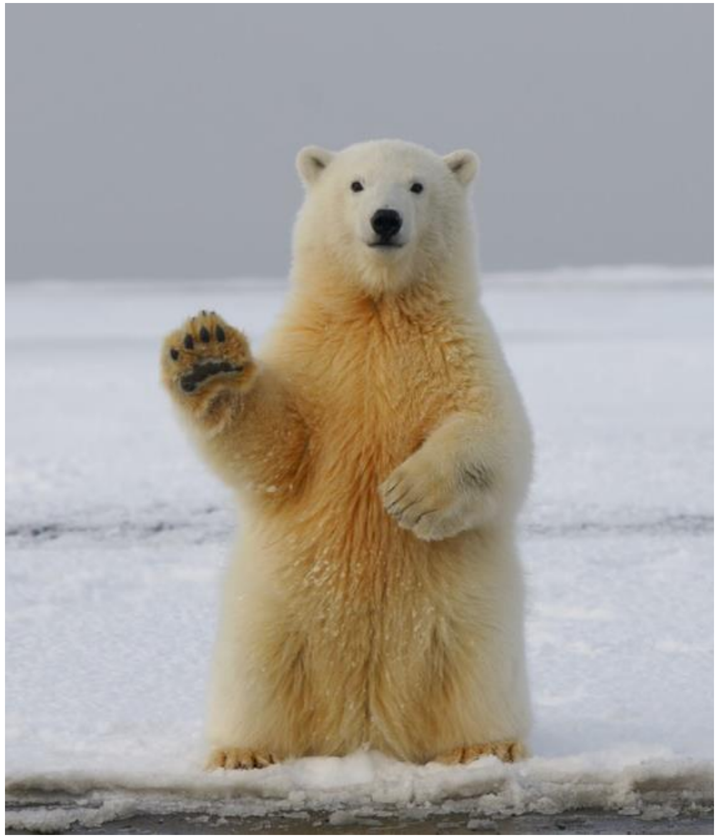
Watch this video and follow the instructions on screen:
https://www.youtube.com/watch?v=1_UuZQhlZ5k

What does this video tell us?

The bears are the risks that hide in plain sight!

- When you know it's there, it's obvious.
- But when people are engrossed in the highs and lows of the basketball game, many fail to notice the bear.

- Most risks to your organisation's financial stability are obvious when looking at your financial statements and reports.
- But you may miss them if you don't know where to look and focus on day to day operations.



Case study – Kids Company

Company profile

Establishment

Founded in 1996 (registered as a charity in February 1998)
Won the Ernst and Young 'Social Entrepreneur of the Year 2005' award

Purpose

Charitable purpose was to provide support to deprived inner city children

Services

Operated 11 children's centres and delivered services through about 40 schools

Funding

In 2013, turnover was £23.1million, with most funding provided through central and local government grants

Collapse

In 2015 it was first reported that the company was in significant financial difficulty and it ceased operations. In February 2022, the Charity Commission published its long-awaited report into the closure of Kids Company, six years after the charity closed its doors.

The headlines

Case study – Kids Company

Finances and employees (financial years 2008 – 2013)

Year	Income (£ million)	Spending (£ million)	Employees (full-time equiv.)
2008	11.2	11.0	176
2009	13.0	13.3	231
2010	14.2	14.2	244
2011	15.6	15.5	330
2012	20.3	19.0	356
2013	23.1	23.0	496

Questions:

1. How would you assess the financial situation of the company based on the above information?
2. Can you see any red flags?

Case study – Kids Company

Finances and employees (financial years 2008 – 2013)

Year	Income (£ million)	Y/Y income growth	Spending (£ million)	Y/Y spending growth	Employees (full-time equiv.)	Income per FTE (£)
2008	11.2	*16%*	11.0	*21%*	176	*63,636*
2009	13.0	*9%*	13.3	*7%*	231	*56,277*
2010	14.2	*10%*	14.2	*9%*	244	*58,197*
2011	15.6	*30%*	15.5	*23%*	330	*47,273*
2012	20.3	*14%*	19.0	*21%*	356	*57,022*
2013	23.1	*16%*	23.0	*21%*	496	*46,573*
		Total: 52%		Total: 52%		

Positives

1. Income growing year on year
2. Profit or break even point in all years (except for 2009)

Potential red flags

1. Between 2008 and 2013, both income and spending increased by 52%, in 2012 and 2013 spending growing faster than income - limited reserves, overinvestment?
2. Decreasing income per FTE ratio – decreased efficiency / overstaffed?

Case study – Kids Company

MUTUAL VENTURES

What went wrong?

KIDSCOMPANY

Serious cash-flow problem	The charity operated on a financial knife-edge. Without improving the cash position, it was not possible to build reserves and safely invest in new activities and locations.
Financial management	Poor budgeting process and review of spend against budget, and failure to build sufficient financial reserves.
Record keeping	Poor record keeping of how finances were spent, whether taxes were paid, and appropriate accounting.
Internal controls	Poor controls over who spent money, how much money was spent, sticking to budgets, and ensuring funds were used for the correct purposes.
Strategic planning	Lack of clear strategic planning on the priorities for the organisation and the resources needed to achieve its priorities.
Outcomes measurement	Lack of clear measurement of the impact the organisation was making and the number of users it served.
Governance	Not enough (if any) scrutiny by the board of trustees on the services provided, the use of funds, and the effectiveness of the services.

What can we learn from this case study?

1. Importance of cash flow and reserves

- **Cash flow is king** – even a profitable organisation can go bankrupt.
- **Reserves are vital**. If you relied on reserves to stay afloat during the pandemic, you should be looking to rebuild them to help resist future shocks.
- Different organisations will need to take different approaches to reserves, but you should generally aim to hold **three-to-six months of operating costs in reserves**.

USEFUL RESOURCES

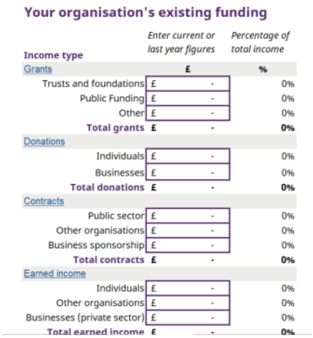
Do you have a reserves policy in place? If not, this practical guide by Sayer and Vincent can help you develop one.

2. Diversifying funding

- Many organisations will recognise Kids Company's **reliance on a small number of sources of funding** and difficulty to secure funding that isn't tied to service delivery.
- You need to **closely manage the relationships with funders** and plan for sustainable income.
- Consider **diversifying your revenue** (new clients, new markets, new sources of funding – corporate donations, fundraising, etc.)

USEFUL RESOURCES

Do you analyse how sustainable your income is? Use a free NCVO funding and income planner to do it.



Your organisation's existing funding

Income type	Enter current or last year figures	Percentage of total income
Grants	£	%
Trusts and foundations	£ -	0%
Public Funding	£ -	0%
Other	£ -	0%
Total grants	**£ -**	**0%**
Donations		
Individuals	£ -	0%
Businesses	£ -	0%
Total donations	**£ -**	**0%**
Contracts		
Public sector	£ -	0%
Other organisations	£ -	0%
Business sponsorship	£ -	0%
Total contracts	**£ -**	**0%**
Earned income		
Individuals	£ -	0%
Other organisations	£ -	0%
Businesses (private sector)	£ -	0%
Total earned income	**£ -**	**0%**

3. Reviewing your governance arrangements

- Even if you are not directly responsible for record keeping, accounting and development of financial statements, you need to **stay on top of your financial information**.
- If you have a **board of trustees** / supervisory board, review their **skills and experience** to ensure that they have strong levels of financial governance.

USEFUL RESOURCES

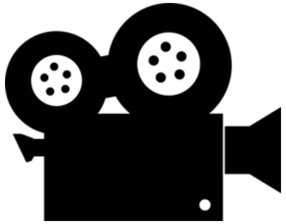
This Essential Charity Finance for trustees provides useful materials for the board skills audit.

Introduction to financial statements (and how to use them)

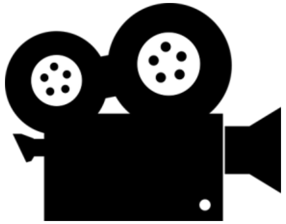
Key Financial Statements

These are formal records of the financial activities of a business:

- Balance Sheet (or "Statement of Financial Position")
  - Snapshot of an organisation's financial position at a single point in time
  - Shows what a company owns and owes, and the amount invested by shareholders

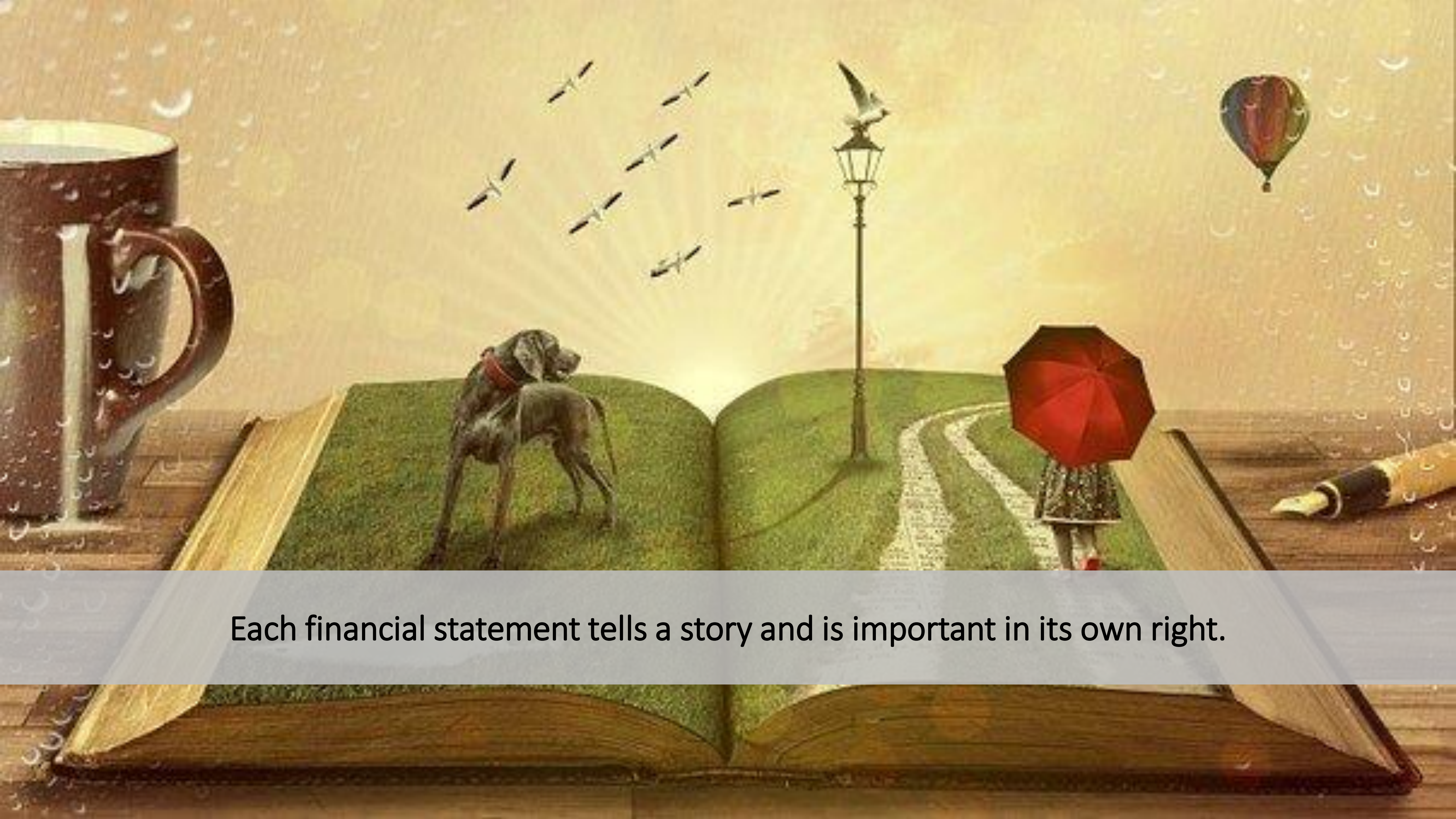


- Profit and Loss (or "Income Statement")
  - Shows an organisation's financial performance (income, expenses and profit) over a given period (usually 1 year)



- Statement of Cash Flows
  - Records as cash leaves and enters the organisation
  - Shows the ability of an organisation to pay debts as they fall due
  - Note that a business can be profitable in a period but cashflow (actually) insolvent

Which financial statement is the most important one?



Each financial statement tells a story and is important in its own right.

Balance sheet

Balance Sheet / SOFP

MUTUAL VENTURES

		£
Assets		
Fixed assets	X	
Current assets		X
Total Assets	X	
Liabilities		
Current liabilities		X
Long-term liabilities	X	
Total Liabilities		X
Equity		
Shareholders' funds	X	
Retained earnings (reserves)		X
Total Equity	X	
Total Liabilities and Equity	X	

Accounting Equation

Assets = Liabilities + Shareholders' funds

Uses of funds

Sources of funds

Sources of funds

Always balance

Why do you need a balance sheet?

1. Balance sheet can show some risks to your organisation
2. Balance sheet can be used to secure business loans and other types of working capital

1

Balance sheet can show some risks to your organisation

By using your balance sheet to identify these serious financial issues, you can avoid long term financial problems:

Comparing your current assets to current liabilities determines whether your organisation can cover its short-term obligations.

If your current liabilities exceed your cash balance, your organisation may require additional working capital from outside sources.

Working capital (solvency ratio)

Current assets - current liabilities

If below 0, raises a warning sign as to whether the organisation is able to pay its short-term obligations when due

Figures in $1,000s

Grande Corporation
Balance Sheet at 31 December 20YY

Assets		
Current Assets	9,609	
Long Term Investments & Funds	1,460	
Property, Plant & Equipment	9,716	
Intangible Assets	1,222	
Other Assets	68	
Total Assets		22,075
Liabilities		
Current Liabilities	3,464	
Long Term Liabilities	5,474	
Total Liabilities		8,938
Owners Equity		
Contributed Capital	9,439	
Retained Earnings	3,698	
Total Stockholder's Equity		13,137
Total Liabilities and Equities		22,075

1

Balance sheet can show some risks to your organisation

By using your balance sheet to identify these serious financial issues, you can avoid long term financial problems:

A balance sheet can also show you when your debt levels aren't sustainable.

Debt is not necessarily bad. But if you have too much debt on your balance sheet, you may default on debt payments (principal and interest payments).

Debt to equity ratio:
Long term debt / Equity

A high ratio means the organisation has been growing due to debt (leverage).

Figures in $1,000s

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2

Balance sheet can be used to secure business loans and other types of working capital

- Your balance sheet allows people outside your company to quickly understand its financial position.
- Most business lenders require a balance sheet to determine how secure the organisation’s financial health has been over time.
- They will look at the balance sheet changes over time and investigate how the ratios have trended.

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Debt to equity ratio:

Long term debt / Equity

If a company operates on high leverage and has maintained a high debt ratio, it is not alarming as a company with a low debt ratio suddenly showing a spike.

Profit and loss statement

Profit & Loss / Income Statement

Top line	Turnover	X
	Cost of sales	(X)
	Gross profit	**X**
	Operating costs	(X)
	Operating profit	**X**
	Interest payable	(X)
	Profit before tax	**X**
	Tax	(X)
Bottom line	**Net Profit**	**X**
	Dividends	(X)
	Retained profit	**X**

Take to the profit and loss reserve

Cost of products / services sold within the same period e.g. materials, direct labour

Usually directly increase as a result of the number of units sold.

Overheads, admin, rent, marketing, R&D

May increase year-over-year, but this is largely driven by management decisions to allocate resources to strategic priorities

Accruals concept: income for a period must be matched against the costs for the same period

Why do you need a profit and loss statement?

1. Profit and loss statement provide information about an organisation’s ability to generate profit and helps make better business decisions

2. Profit and loss statement is analysed by investors, creditors (and sometimes also commissioners) to evaluate the risk

3. Required to file taxes

1&2

These are some ratios to help understand how the organisation is performing:

$$\text{Gross margin} = \frac{\text{Gross Profit}}{\text{Turnover}}$$

how much profit you retain after incurring the cost associated with the goods/services sold

It shows your organisation's efficiency at using its staff and supplies in producing goods or services

Figures in $1,000s

Grande Corporation
Income Statement for the year ending 31 December 20YY

Revenues			
Gross sales revenues		33,329	
Less returns & allowances		346	
Net sales revenues			32,983
Cost of goods sold			
Direct materials		6,320	
Direct labor		6,100	
Manufacturing overhead			
Indirect labor	5,263		
Depreciation, manufacturing equip	360		
Other mfr overhead	4,000		
Net mfr overhead		9,623	
Net cost of goods sold			22,043
Gross profit			10,940
Operating expenses			
Selling expenses			
Sales salaries	4,200		
Warranty expenses	730		
Depreciation, store equipment	120		
Other selling expenses	972		
Total selling expenses		6,022	
General & administrative expenses			
Administration salaries	1,229		
Rent expenses	180		
Depreciation, computers	179		
Other general & admin expenses	200		
Total general & admin expenses		1,788	
Total operating expenses			7,810
Operating income before taxes			3,130
Financial revenue & expenses			
Revenue from investments		118	
Less interest expense		511	
Net financial gain (expense)			(393)
Income before tax & extraordinary item:			2,737
Less income tax on operations			958
Income before extraordinary items			1,779
Extraordinary items			
Sale of land	610		
Less initial cost	145		
Net gain on sale of land		465	
Less income tax on gain		118	
Extraordinary items after tax			347
Net Income (Profit)			2,126

These are some ratios to help understand how the organisation is performing:

1&2

Mark-up = $\dfrac{\text{Gross Profit}}{\text{Cost of sales}}$

how much premium you are adding to the cost of your goods/services

It shows how much money is being made on good or services related to their direct costs. It can be helpful to determine if price setting is done appropriately.

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1&2

These are some ratios to help understand how the organisation is performing:

$$\text{Net profit} = \frac{\text{Net Profit}}{\text{Turnover}}$$

how much of each £ earned is translated into profits

It is an all-inclusive metric for profitability and provides insight into how well the management team runs all aspects of the organisation.

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Ratio Analysis – case study

Company LTD
Year Ending 31 December 2014

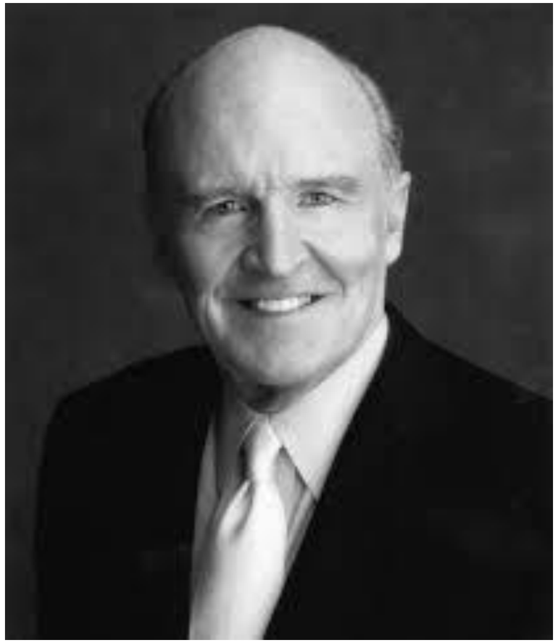
Turnover	£120,000
Cost of Goods Sold	£(80,000)
Gross Profit	£40,000
Operating costs	£(30,000)
Operating profit	£10,000
Interest & Tax	£(4,000)
Net Profit	£6,000
Current Assets	£40,000
Current Liabilities	£42,000

- Gross margin = $\frac{\text{Gross Profit}}{\text{Turnover}}$
- Mark-up = $\frac{\text{Gross Profit}}{\text{Cost of sales}}$
- Net margin = $\frac{\text{Net Profit}}{\text{Turnover}}$
- Working Capital = Current Assets – Current Liabilities

- What is the Gross margin? 33%
- What is the Mark-up the company applies to the cost of its goods/services? 50%
- What is the Net margin? 5%
- What can you tell from the working capital of the company? Company is in financial difficulty

Cash flow statement

If I had to run a company on three measures, those measures would be customer satisfaction, employee satisfaction, and cash flow.



General Electric

Statement of Cash Flows

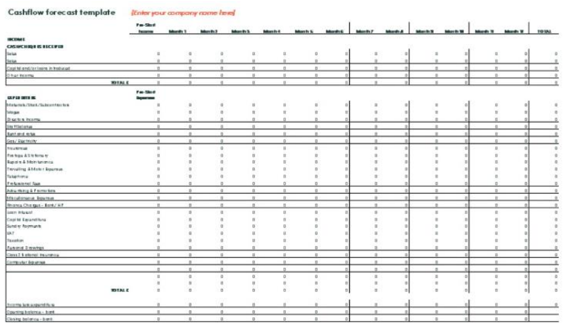
- This shows the cash amounts entering and leaving a company in a period (income statement and balance sheet include items which do not involve actual cash).

- Cash is KING! Poor cashflow management is the main reason small businesses fail.

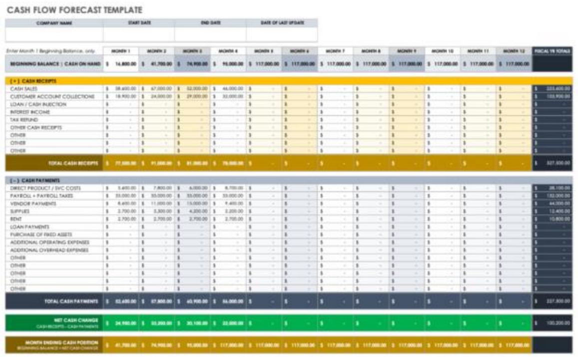
- Good financial planning involves estimating not only how much income you will receive or expenditure you will incur but vitally ***when*** you will receive payment and ***when*** you will need to pay your bills.

USEFUL RESOURCES

Online you can find a number of cash flow templates in excel to download and use for your organisation free of charge. Here are a couple, but find what works for you!



Wenta – a very simple template, good at the beginning for a small organisation



Smartsheet - templates available for a variety of forecasting needs, depending on the organisation size. Also templates that provide short or long-term insights (daily, monthly, quarterly, yearly, 3-year).

Differences between Cash Flow and Profit & Loss statement

While the two are very closely linked, they show different things, and you should be producing both in order to understand the financial position of your business.

What happens?	Impact on P&L	Impact on Cash Flow
Sales of goods / services	When you make a sale, it shows up on your profit & loss report straight away – no matter when the payment is due.	Sales will be recorded in cash flow when it arrives in your account (may be later, depending on the payment terms).
Purchase of equipment	The cost of equipment is spread over its useful life (several years) – this is called depreciation.	The cost of purchase is reflected in a cash flow in a single chunk the moment you make the payment.
Taking a loan	On the P&L you haven't gained anything – there is no profit from taking out a loan because it must be repaid. Only the interest paid on the loan is a cost to the business. As the balance goes down, the interest charge often decreases, so the impact on the P&L starts high and goes down with it.	By taking out a loan you immediately have more cash. This is reflected as cash in. However, repayments will affect the cash flow negatively.
VAT	VAT doesn't affect your profits. VAT isn't actually your money (you just act as a kind of tax collector for the government)!	VAT passes through your business – so it does affect your cash flow. If you're VAT registered, you will be collecting an extra 20% in payments from your customers, which will go into your bank account. But at some point that money will need to go back out. Forgetting to set aside the VAT trips up a lot of startups and small businesses!

Because of these differences, a profitable organisation can go bankrupt!

Impact of Cash Flows

- What are the key reasons for poor cashflow?
- How would you improve cashflow in your organisation?

Causes of poor cash flow

- Collection of payment is too slow
- Too high or low pricing
- Not following up on sales leads
- Paying suppliers too quickly
- Overinvestment
- Unexpected expenses
- Poor stock management

Ways of improving cash flow

- Speed up receipt of payment (send invoices promptly)
- Give early bird discounts
- Consider longer-term financing
- Make your unique selling point known
- Negotiate favourable payment terms
- Spending guidelines
- Scheduled stock purchases

Financial Forecasting

Financial Forecasting

MUTUAL VENTURES

The lack of planning and control of finances is the reason most businesses fail:

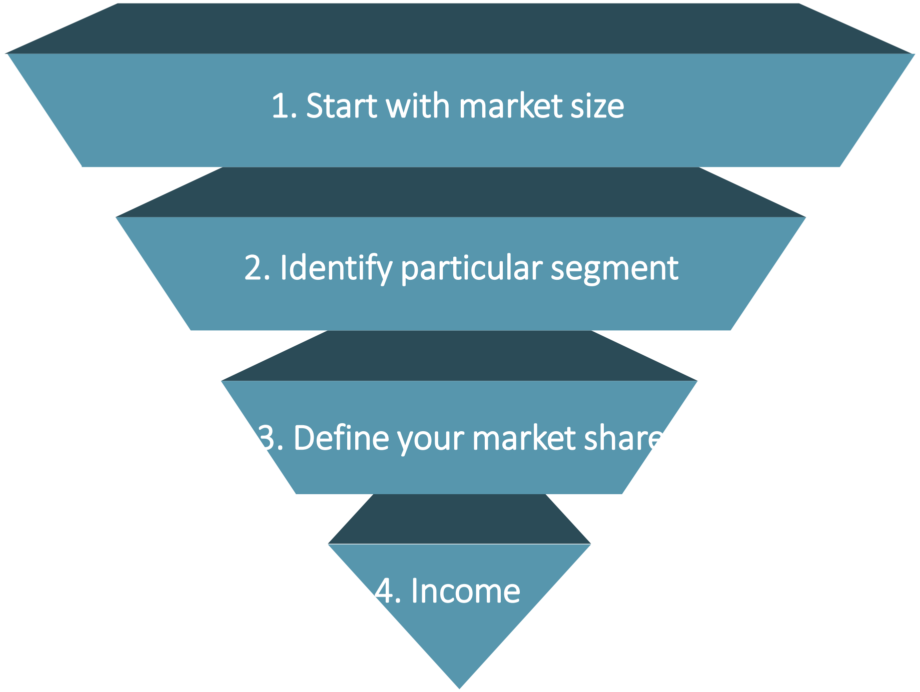
- Gives you confidence your business plan is achievable
- Allows you to measure the actual financial position against what you forecast
- Identifies potential risks and cash shortfalls
- Gives any investors/stakeholders confidence in your business plan
- A forecast is only as good as the data you have and the time you spend on it

- Key financial forecasts:
  - Expenditure forecast
  - Income forecast
  - Cashflow forecast

Income forecast: two approaches

Top down projections

New products / services



Bottom up projections

Existing products / services

In either case, ensure the forecast matches the level of resource that will be available to deliver the service.

Most common errors in forecasting include underestimating costs and overestimating income.

Expenditure Forecasting

- What costs do you incur in your organisation?
- How would you categorise the costs in your organisation in terms of:
  - Working Capital Costs (recurring expenditure)
  - Capital Purchases (One-off or non-recurring high value expenditure)

Start up/ Development Capital *One off or non-recurring expenditure*	Working capital *Recurring expenditure*	Capital purchase *One-off/ non-recurring high value expenditure*
Brand & logo development	Salaries & employee costs (PAYE, training, etc)	Buildings/ property
Website development	Rent & rates	IT equipment
Legal costs associated with start- up	Utilities	Machinery
Advisor costs associated with start-up	Phone & internet charges	Motor vehicles
Furniture	Insurance	
Fixtures & fittings	Marketing	
	Print, postage, stationery	
	Accountancy fees	

Cash Flow Forecasting

- Consider the timing of all income and all payments

	1st Year Cashflow Summary £'000											
	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar
Cash Brought Forward	**0.0**	**626.5**	**323.6**	**20.7**	**647.1**	**344.2**	**41.3**	**667.8**	**364.9**	**62.0**	**688.4**	**385.5**
Receipts:												
Customer receipts	1,228.1	180.5	180.5	1,228.1	180.5	180.5	1,228.1	180.5	180.5	1,228.1	180.5	180.5
Total Cash In	**1,228.1**	**180.5**	**180.5**	**1,228.1**	**180.5**	**180.5**	**1,228.1**	**180.5**	**180.5**	**1,228.1**	**180.5**	**180.5**
Payments:												
Direct costs	(544.8)	(435.9)	(435.9)	(544.8)	(435.9)	(435.9)	(544.8)	(435.9)	(435.9)	(544.8)	(435.9)	(435.9)
Overheads	(46.4)	(37.1)	(37.1)	(46.4)	(37.1)	(37.1)	(46.4)	(37.1)	(37.1)	(46.4)	(37.1)	(37.1)
Irrecoverable VAT	(10.4)	(10.4)	(10.4)	(10.4)	(10.4)	(10.4)	(10.4)	(10.4)	(10.4)	(10.4)	(10.4)	(10.4)
Total Cash Out	**(601.6)**	**(483.4)**	**(483.4)**	**(601.6)**	**(483.4)**	**(483.4)**	**(601.6)**	**(483.4)**	**(483.4)**	**(601.6)**	**(483.4)**	**(483.4)**
Cash Carried Forward	**626.5**	**323.6**	**20.7**	**647.1**	**344.2**	**41.3**	**667.8**	**364.9**	**62.0**	**688.4**	**385.5**	**82.6**

			£'000		
	2014/15	2015/16	2016/17	2017/18	2018/19
Cash Brought Forward	**0**	**83**	**178**	**207**	**283**
Receipts:					
Customer receipts	6,356	6,567	6,767	6,977	7,207
Total Cash In	**6,356**	**6,567**	**6,767**	**6,977**	**7,207**
Payments:					
Direct costs	(5,666)	(5,834)	(6,024)	(6,185)	(6,365)
Overheads	(482)	(421)	(432)	(434)	(434)
Reinvestment / Contingency	0	(50)	(100)	(100)	(100)
Irrecoverable VAT	(125)	(150)	(150)	(150)	(150)
Tax Paid	0	(17)	(32)	(32)	(42)
Total Cash Out	**(6,274)**	**(6,471)**	**(6,738)**	**(6,901)**	**(7,091)**
Cash Carried Forward	**83**	**178**	**207**	**283**	**399**

Sensitivity analysis

What is a sensitivity analysis?

- The process of estimating how target variables change in relation to changes in input variables.
- This allows to accommodate uncertainty in forecasts: assessing the best case (bullish) and worst case (conservative) scenarios, and the impact to the organisation.

Main benefits:

- Increased understanding of the revenue or cost drivers influencing financial returns
- Uncertainty reduction: identifying model inputs that cause significant uncertainty in the output and should therefore be the focus of attention if the robustness is to be increased (perhaps by further research).
- Enhancing communication from modellers to decision makers (e.g. by making recommendations more credible, understandable, compelling or persuasive).

The key to sensitivity analysis is to identify the most significant assumptions that affect the forecast.

Sensitivity analysis example

MUTUAL VENTURES

Income Statement	Base Case
Revenue	£1,000,000
- Variable costs	£600,000
- Fixed costs	£200,000
Operating margin	£200,000

What question would you ask to conduct the sensitivity analysis of this forecast?
Which assumption would you test?

Revenue?

Common mistake:
Performing sensitivity analysis at a too high level variable.
Not every type of change in revenue has the same effect on operating margin!

Sensitivity analysis example

MUTUAL VENTURES

Income Statement	Base Case	Volume -10%	Price -10%
Revenue	£1,000,000	£900,000	£900,000
- Variable costs	£600,000		
- Fixed costs	£200,000		
Operating margin	£200,000		

90,000 units at £10 per unit

100,000 units at £9 per unit

Sales forecast – base case:
100,000 units at £10 each

Sensitivity analysis example

Income Statement	Base Case	Volume -10%	Price -10%
Revenue	£1,000,000	£900,000	£900,000
- Variable costs	£600,000	£540,000	£600,000
- Fixed costs	£200,000		
Operating margin	£200,000		

If there is a drop in volume, both revenue and variable costs drop by 10%

Revenue drops but variable costs stay the same

Sales forecast – base case:
100,000 units at £10 each

Sensitivity analysis example

Income Statement	Base Case	Volume -10%	Price -10%
Revenue	£1,000,000	£900,000	£900,000
- Variable costs	£600,000	£540,000	£600,00
- Fixed costs	£200,000	£200,000	£200,000
Operating margin	£200,000	£160,000	£100,000

10% drop in volume = 20% drop in operating margin

10% drop in price = 50% drop in operating margin

Sensitivity analysis example

Income Statement	Base Case	Volume -10%	Price -10%	V&P – 10%	
Revenue	£1,000,000	£900,000	£900,000	£810,000	90,000 x £9
- Variable costs	£600,000	£540,000	£600,00	£540,000	90,000 x £6
- Fixed costs	£200,000	£200,000	£200,000	£200,000	
Operating margin	£200,000	£160,000	£100,000	£70,000	

"One assumption at a time"

10% drop in volume AND price =
65% drop in operating margin!

Common mistake:
Assuming that input and output variables are linked in a linear way. The impacts could however be exponential!

Ideas how to improve financial resilience

How to drive operating profit?

MUTUAL VENTURES

PRICE
Are you charging a price that accurately reflects the value you are creating for them?

VOLUME
What opportunities do you have to sell more?

MIX
Can you focus more resources on selling the higher margin products / services in your portfolio?

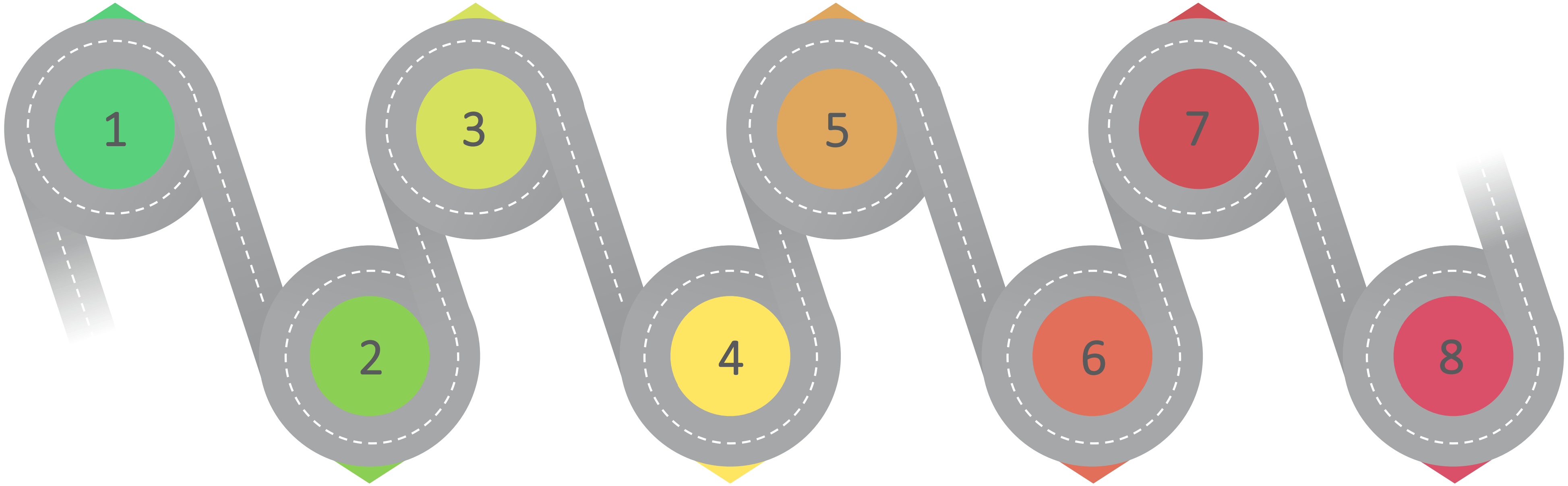
PRODUCTIVITY
Can you do more with resources you have?

SOURCING
Can you renegotiate your contracts with suppliers to get better terms or find new suppliers?

NEW PRODUCTS
Can you develop new offering?

NEW REVENUE SOURCES
Can you diversify income streams (e.g. fundraising, corporate sponsorship, rent)?

SPENDING MORE
Can you invest (in marketing, research, skills)?



It doesn't need to be about cost cutting!

Question to challenge your thinking

MUTUAL VENTURES

Why does a taxi driver have a copy of the opera schedule?

Are you in the right place with the right offering?

Questions?

Feel free to get in touch:

agata.miskowiec@mutualventures.co.uk

Thank you!

This is your last workshop of the Covid Bounce Back Programme!

Thank you for engaging with all the workshops throughout the programme. As with the other workshops, the recordings and slides will be available via the Slack Channel.

Remember, you can still receive support from coaches until the end of March – make use of any deep dives or one-to-one sessions you have!

We looking forward to seeing you at the End of Programme Network and Learning Event on the 8th March – held at Barnsley Civic.