Financial Modeling to Guarantee Financial Decision Success

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In the corporate sphere, there is a great deal of uncertainty and risk. It can be difficult to predict the chances of a project's success or of reaping profit. It is therefore for such purposes that many companies are turning to financial modeling. A financial model involves the building of an abstract representation of a particular situation involving financial investment. These are usually mathematical models, involving the use of one or several equations to model the performance of a financial asset, investment, or project.

Financial models may be used in a wide variety of situations to assess how a particular financial decision will fare under different economic situations, as well as to determine how the company will react under such circumstances. While financial modeling can be challenging, and sometimes prone to error, the many benefits make the effort well worthwhile.

Cash Flow Forecasting

In the corporate and accounting sectors, financial modeling usually involves primarily cash flow forecasting. Cash flow forecasting enables corporations to predict potential rises and falls in company funds by identifying sources of cash inflows and avenues by which cash may go out over the course of the given period.

A cash flow forecast typically represents sources and amounts of cash flowing in and out of the business over the course of a set year or quarter. The designated period under analysis is then divided further into monthly or weekly segments. In certain instances, when the model is particularly complex, the forecast may need to be divided still further into daily predictions. Regardless of the divisions your company ultimately chooses, they ought to be based on periods during which the majority of fixed costs, such as employee salaries, are paid.

A cash flow forecast ought to list any money expected to come in or go out during the period, the bank balance at the beginning of the period, and the bank balance at the end. When creating your financial model, it is advisable to be realistic. Be conservative in estimates so as to avoid planning for more funds than will actually be available.

Building a Financial Model

There are a number of tools available for building financial models. The most easily accessible program that may be used for financial modeling is Microsoft Excel. Excel is an exceptionally versatile tool. It is also readily available, making it a particularly desirable program for financial modeling. While Excel works exceptionally well for financial modeling, if used correctly, it can still be prone to error. Therefore, those attempting to create a financial model using Excel ought to exercise caution, and ensure that only those with specialist knowledge are working on the project.

If Microsoft Excel seems like too risky a program to use for these purposes, there are dedicated programs available. Software programs, such as Adaptive Planning or Quantrix, possess built-in models, making them significantly less prone to user error. These programs are more costly than Microsoft Excel, but if you are planning to create regular financial models, or lack staff with expert knowledge of the software, it can be useful to invest in a dedicated program.

The most important thing when building a financial model is to define the deliverables at each stage of the building process. It is also crucial to ensure that expectations for desired results are set for the entire financial modeling team, as well as for any eventual users of the model.

In Summary

Financial modeling is a useful tool for predicting the behaviour of particular financial scenarios. Accurate financial modeling can make it possible to anticipate how your finances will react to environmental factors, as well as ensuring that all employees are working together to guarantee the actual results match your expectations. In summary:

- Financial modeling involves the use of mathematical formulas to create a representation of how capital investments, operational expenditures and revenue might behave over a given period.

- In corporate and accounting sectors, cash flow forecasts are one of the most common types of financial modeling. Cash flow forecasting involves developing a picture of how cash can be expected to move in and out of the company during a specified period.

- There are a number of programs available that can be used to create financial models. While Microsoft Excel is readily available and can be a useful tool, it can be prone to error. There is also dedicated software available that, though more expensive, can simplify the process as they usually include built-in models.

As financial modeling can be challenging, Los Angeles CEOs and CFOs may consider working with an outsourced CFO services firm before attempting to create a model. A specialist can look objectively at your projects and investments, and create an accurate, detailed model on your behalf.

References and Further Reading

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