Intro to Financial Acumen

Round Table Guide

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THE ALLIANCE OF WOMEN
IN WORKERS' COMPENSATION

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Budget Basics

A budget is a forecast of what you expect to happen. It includes:

- Income statement (how much to you expect to make)
- Balance sheet (what I own, what I owe and what I have invested)
- Cash flow (when is cash coming in and going out)

Key components:

- Revenue projections – how much do I plan to sell next year?
- Expense estimates – what is my best estimate of what it is going to cost to deliver?
  - Direct Costs
  - Overhead Costs
- Staffing plan – who needs to be hired to achieve these plans? What turnover may happen?
- Capital investment plan – what investments are needed to make your plans happen?
  - Fixed Assets
  - Technology

What is a Budget Driver?

- A budget driver is
  - A **variable** that results in a **change** in a component of the budget
  - An **input** that affects the **outcome** of the budget
- Start by thinking
  - What **operational** changes do I **want to make** and what could go wrong?
  - What **operational** changes do I **need to make** in order to hit specific targets?

- Examples
  - If I add more sales people…
    - How much more revenue should I expect to achieve?
    - How long does it take a sales rep to ramp up?
    - How strained will my profit & loss be during the ramp period – how can we make room to afford it?
  - If I launch a new product...
    - How much marketing cost will be required and how does it drive my revenue?
    - Do I get results this year or next?
    - Do I need more staff onboard as a result? In which departments?

What is Gross Profit?

- Gross Profit = Revenue - Cost of Goods or Services Sold (COGS)
- Gross profit is a key metric to understand the efficiency/health of the business model
  - Calculates money earned from directly operating the business before considering administrative expenses
- Gross Profit = Gross Margin (synonymous)

- Revenue is the total amount of sales
  - Examples:
    - Carrier = Premiums Earned
    - TPA = Services Revenue, Claims Management Revenue
- COGS/COSS are the expense directly related to producing products or services
  - the materials that go into a product, and the costs to convert materials into an actual product
  - all direct costs required to close a claim
  - labor that is directly related to making a product OR providing a service
- Gross profit does not include
  - Overhead
  - Operating expenses such sales & marketing, office supplies, executive and administrative salaries

What Levers Can Be Controlled? Fixed vs Variable Expenses

- Two type of expense:
  - Variable costs: ***change with the level output*** (e.g. shipping cost per unit) or based on a ***business decision*** (e.g. running an ad campaign)
  - Fixed costs: ***stay at the same level*** whatever the level of business activity is (at least over the short term)
- You can control:
  - What you have not yet committed to spending (both fixed and variable)
- You can manage:
  - Variable costs - to ensure that such costs are efficient and delivering results
- You can leverage:
  - Fixed costs - to ensure that the optimal output is achieved before investing in new, incremental fixed costs (i.e. headcount, office space)

Cost	Fixed	Variable
Ad Campaign		X
Travel		X
Depreciation of Equipment	X	
Rent	X	
Office Supplies		X
Salaries	X	

What is ROI (Return on Investment)?

- ROI = % Gain
  - (Gain from Investment- Cost of Investment)/ Investment
- ROI is the "what's in it" for the investment your make
  - How much is gained in the future by spending money now
  - Used as tool for trade off decisions by management
  - Measure efficiency of investment
  - Factor in time value of money for longer term investments
- Simple Example:
  - $10,000 investment in marketing drives $100,000 in additional revenue that contributed an additional profit (gain) of $15,000
  - ($15,000 - $10,000) / $10,000 = 50% return
  - Questions to ask
    - If I invested that $10,000 elsewhere in the business, what would the return be?
    - Which investment has the greater return; where is our $$ best invested?

EBITDA: Why is it important?

- EBITDA = Earnings Before Interest, Tax, Depreciation and Amortization
- Measures performance without having to factor in:
  - Financing decisions (interesting expense or income)
  - Accounting decisions (depreciation and amortization)
  - Tax environments (tax rates vary by company)
- EBITDA
  - Allows investors to understand a company's overall operating efficiency
  - Makes it easier to compare companies, industries, etc.