

Financial Acumen Inventory Self Report



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Financial Acumen Inventory Self Report

Contents

- **Introduction**
- **jon warner's Self Interpretation Report**
- **Interpreting the Financial Acumen Inventory**
- **The Financial Acumen Inventory Model**
- **Development Action Planning**
- **Maximizing Revenue**
- **A simple sales mix**
- **Reducing the Cost of Sales**
- **Measuring the cost and performance of all suppliers**
- **Controlling Expenses**
- **General operating budget checklist**
- **Managing Cash Flows**
- **Cash Flow Projection for 6 Months**
- **Summary**
- **Personal Action Planning Sheet**

Introduction

Purpose

This instrument will help you evaluate your overall comprehension of the finances of your team, department or organization in four key areas.

1. maximizing revenues
2. reducing the overall cost of sales
3. controlling costs or expenses
4. managing cash flows.

The more that we can understand these areas well, the more commercially aware we become, leading to greater success for ourselves and for the team and organisation of which we are a part.

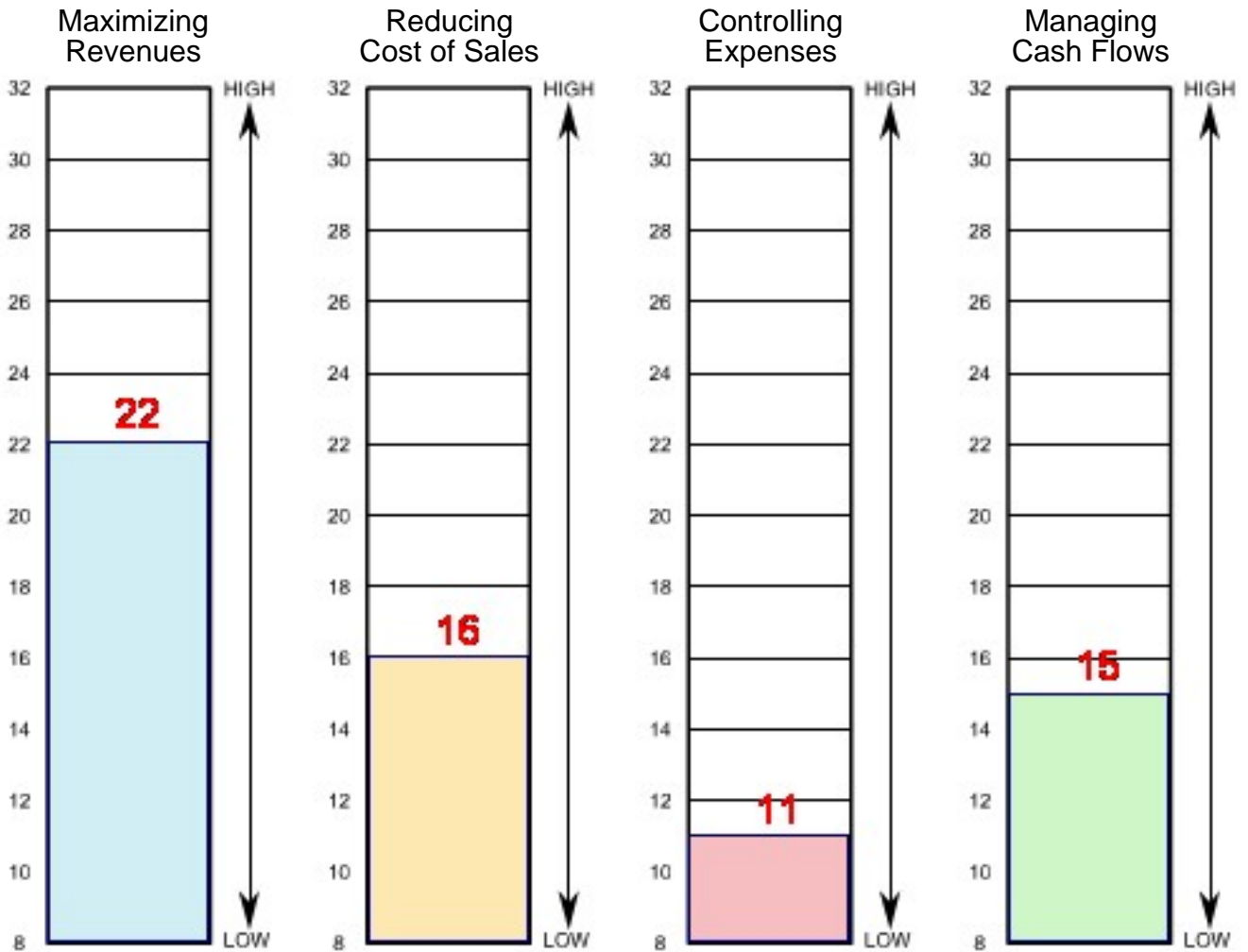
The graph on the next page shows your results in each of the financial acumen areas, and also offers an overall financial acumen score. The rest of this report offers interpretive information for you to use as you wish.



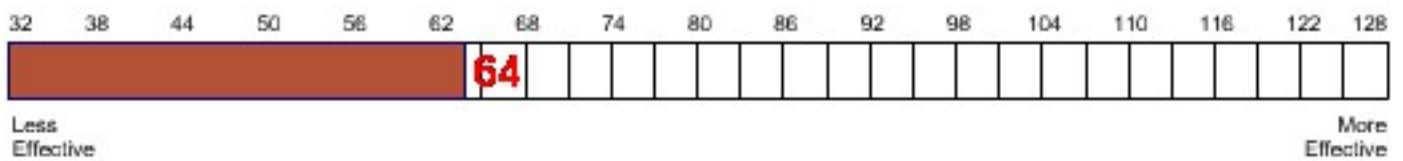
Financial Acumen Inventory

jon warner's FAI Results

Your scores from completing the on-line questionnaire are shown in the four columns below. The higher your score is in a particular column, the more knowledgeable you are regarding that area of financial management.



To determine your overall financial acumen, the scores from the four columns have been added together and have shaded the bar graph below. This shaded area represents your "Total Financial Acumen Score".



Interpreting the Financial Acumen Inventory

The Financial Acumen Inventory (FAI) is a simple instrument designed to help individuals determine whether they are doing as much as they can to understand and manage financial issues or affairs in the team, department or organization of which they are a part.

This inventory assumes that it is important for all individuals to have a reasonable level of financial acumen in order to help the organization as a whole to be financially well-run and as successful as possible in the medium to long term.

The FAI assumes that there are four major aspects in looking to reach a better understanding of business finance. These are an appreciation of how to:

1. Maximize Revenue
2. Reduce the Cost of Sales
3. Control Expenses
4. Manage Cash flows

These four areas can be organized into a four-quadrant grid as follows (with your personal scores shown in the white boxes in the center):

<p>Controlling Expenses</p> <p>Building appropriate budget and other controls and keeping costs within plan</p>	<p>Reducing Cost of Sales</p> <p>Understanding which items make up cost of sales and controlling the major drivers</p>				
<table border="1"> <tbody> <tr> <td style="background-color: white;">11</td> <td style="background-color: white;">16</td> </tr> <tr> <td style="background-color: white;">15</td> <td style="background-color: white;">22</td> </tr> </tbody> </table>	11	16	15	22	
11	16				
15	22				
<p>Managing Cash Flow</p> <p>Optimizing the major flows of money in and out of the enterprise</p>	<p>Maximizing Revenue</p> <p>Recognizing how sales revenue can be protected and new revenues created</p>				

The Financial Acumen Inventory Model

The Financial Acumen Inventory model is designed to be very straightforward. It assumes that in managing organizational finances there are two fundamental control steps:

- **To drive costs down** (cost of sales and expenses)
- **To drive revenues up** (sales and positive cash flows)

In addition, the model assumes that there are four main interventions that people can pursue when it comes to finance or money. These are to seek to:

- **Maximize** revenue or sales to existing and new customers
- **Reduce** cost of sales, mainly through working with suppliers
- **Control** expenses or costs, through widespread employee effort and focus
- **Optimize** cash-flows by working with organizational stakeholders

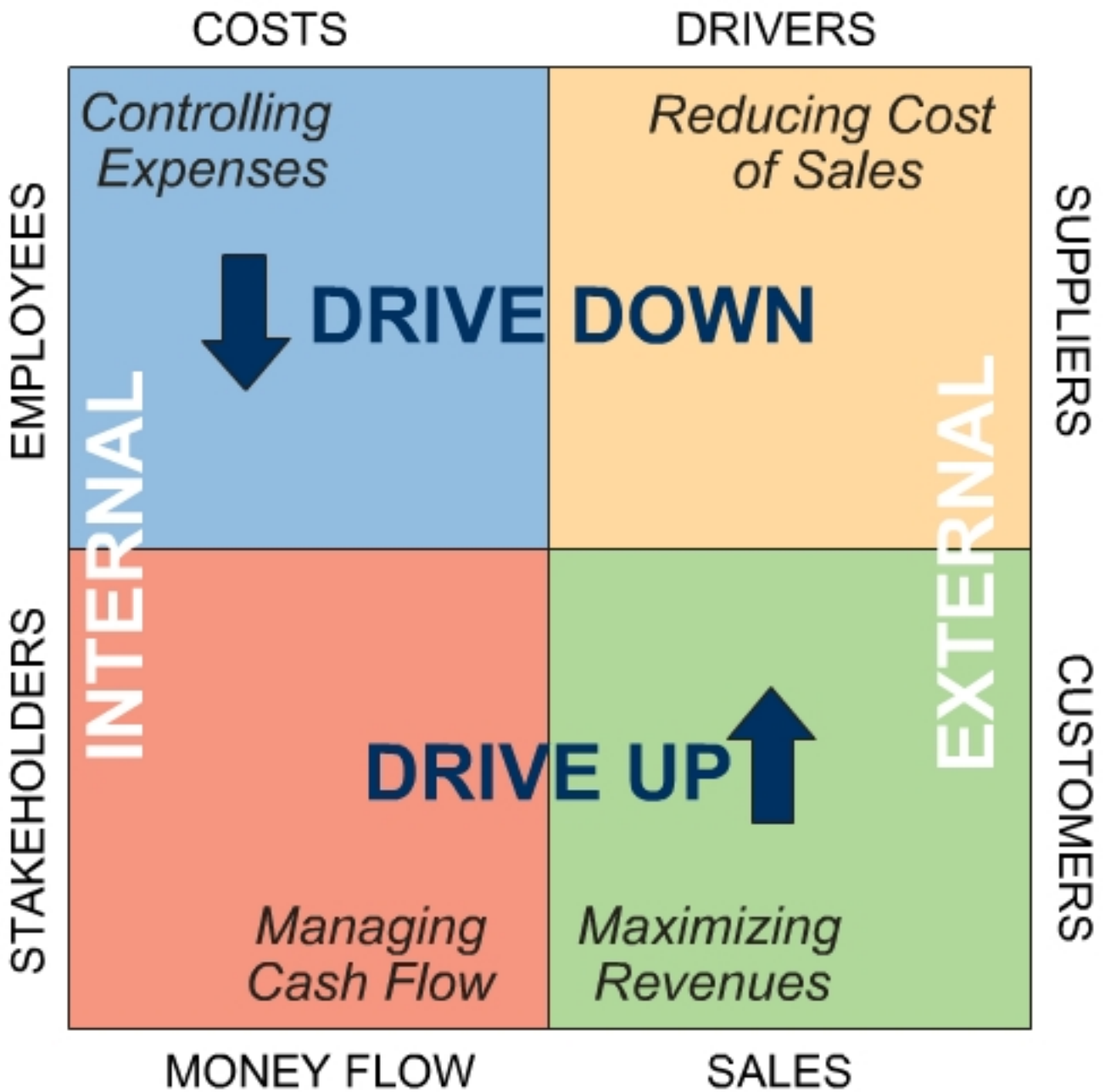
The finance function within a given enterprise (however small or large it is) may use a wide variety of techniques, methods and strategies to influence and control all of the above factors, some of which will be simple (such as establishing good procedures and controls, managing receivables tightly and running bank accounts efficiently) and some of which will be quite sophisticated (such as insuring or hedging against significant risk, investing free cash cleverly or finding creative project financing options).

However, this will inevitably have only a limited impact on the organization as a whole, as many people in many areas are usually responsible for money spent and money made. It is therefore up to each and every individual within the enterprise to both develop a sound awareness about financial matters and to take steps to help to make the management of finance as healthy as possible.

As a way of helping all individuals (and especially those outside the finance or accounting function) to focus on the areas of most financial importance, each of the above factors have been represented in a grid to offer a visual representation of four discrete areas upon which we can concentrate our time and energy (either at one time or concurrently) in order to understand and control our organizational finances.

This grid is shown on the page overleaf. On the pages that follow the grid, we have included some greater detail on each of the four quadrants and space for development an action plan.

The Financial Acumen Inventory Model



Development Action Planning

Your results shown earlier in this report, will indicate in which areas you may have the potential to improve your financial acumen in four areas or categories – Maximizing Revenue, Reducing the Cost of Sales, Controlling Expenses and Managing Cash Flows.

As we suggested earlier, there are many specific subject areas and individual functional realms within the overall finance function or topic that we could have included in this inventory. However, we have taken the view that for most employees within an enterprise (of almost any size or type), knowledge of these four key areas is critical. As such, any effort to develop our knowledge or skills in each of these four areas is likely to be beneficial to the organization as a whole.

The table below gives some summary detail on what each of the four key financial areas covers:

Category	Brief Description
MAXIMIZING REVENUE	Maximizing revenue involves an individual's, team's or even whole organization's efforts to increase sales revenues. This is done by working with existing customers to increase the volume of sales or the price of products or services, or to find entirely new customers.
REDUCING THE COST OF SALES	Reducing the cost of sales involves identifying the major drivers of cost within the enterprise and then ensuring that continual analysis takes place to make the necessary adjustments (particularly working with the organization's major suppliers).
CONTROLLING EXPENSES	Controlling expenses involves having robust plans and budgets in the first place and then establishing effective tracking systems and controls to stay within reasonable limits or to make appropriate adjustments where necessary.
MANAGING CASH FLOWS	Managing cash flows involves understanding the major flows of money in and out of the enterprise and then working with external stakeholders (banks and shareholders etc) to ensure that the organization optimally has the funding that it needs.

When reviewing your overall and individual section scores, you may find that you have the greatest improvement potential in one of the four categories. This is the one upon which you may therefore wish to concentrate your future attention most. Equally, there may be improvement potential in two, three or all four categories and you may therefore want to work on all of these at the same time.

Whether the development focus is on one or more categories, the remaining pages in this report provide some useful background information and ideas on all four of the Financial Acumen Inventory categories. Please use the notes boxes at the foot of each page to record any ideas of your own in terms of what you might do to improve your financial knowledge or effectiveness in the future.

Maximizing Revenue

Your Score in this quadrant was 22

In business, “nothing happens until you make a sale.” In other words, if you don’t make a sale you don’t have a business. The ultimate profit made by a business is heavily reliant on the revenue generated. You can cut costs all you like but if you do not make enough revenue in the first place, you still won’t make a profit.

Increasing revenue is an obvious way to increase profit. However, it is often easier to find more revenues (especially from existing customers according to extensive research into the subject). In addition, in many cases, the additional revenue earned will be made at a lower cost because the business infrastructure has already been provided and is largely paid for.

Despite the above, there are always constraints on increasing revenue. The size of the market, the activities of competitors, the additional cost of making sales, can all limit the capacity for increased revenue. Maximization efforts therefore need coordinated efforts on a widespread basis to work with existing customers and to find new ones.

How is it done?

By examining our current situation, looking at the strategies that are available to us and making changes to the way in which we manage our revenue generation, we can effectively work towards maximizing our sales revenue (and thereby profits).

In any situation, whether you are selling goods or services, the total revenue is the result of the simple formula:

$$\text{Revenue} = \text{Volume of Sales} \\ \times \text{Selling Price per Unit}$$

A unit may be a single product, an ounce or a litre of some commodity, or a defined service of some kind. Clearly then, anything which affects the volume sold or the price charged will have an impact on total revenue. Also important is the sales mix. The sales mix is the comparative quantity of each product or product group in the sales total. Where several different products are sold, the sales mix is just as important as the overall quantity sold. This is illustrated on the chart on the next page.

In summary, revenue can be increased by:

- selling more (or more widely)
- selling at a higher price
- changing the sales mix

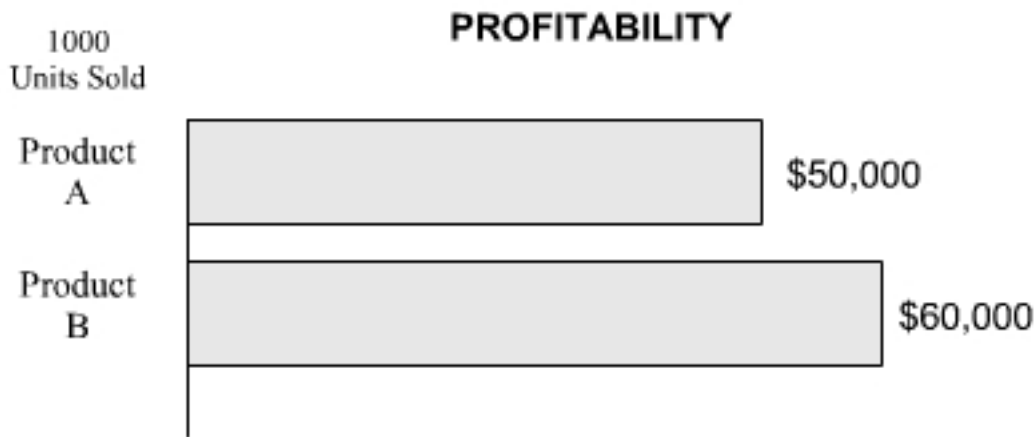
I can develop my ability to Maximize Revenue by:

The Financial Acumen Inventory

A Simple Sales Mix



A salesperson would concentrate on Product A in gross price.



But would be better off concentrating on Product B if they focus on net margin or net profitability.

Reducing the Cost of Sales

Your Score in this quadrant was 16

Consider the following statement:

“The profit that any organization makes originates from the relationship between the revenue it earns and the direct cost of earning that revenue.”

In a supermarket for instance, the difference between the selling prices and the purchase prices of the goods sold provides the margin that pays for everything else and (hopefully) provides a profit. In a bank, the difference between the purchase price of money and, the interest paid to depositors, as well as the selling price of money and the interest charged to borrowers, provides the margin.

For many businesses the first major cost consideration is the cost of sales. This is often the cost of having a product to sell in its saleable state. In many service businesses this has only relatively minor significance because there is no tangible product to sell. In the travel industry, for example, packaged holidays are sold like any other product and the cost of sales is the wholesale cost of the package.

For manufacturing and other operational businesses the margin arises from the surplus of the selling price over the cost of production. So, anything that is done to reduce the cost of earning the revenue; buying trading stock for less, paying lower interest rates, cutting production costs, etc, increases the total margin earned and ultimately the profit. This cost of earning (or what is usually more commonly called cost of sales) is often a significant proportion of the cost and therefore needs special attention.

How do you do it?

All costs in any kind of business have some major factor that makes them get bigger or smaller. This factor which drives the cost up or down is called the cost driver. The cost driver is the factor responsible for increasing and decreasing the particular cost. For example, the fuel cost for delivery vehicles is driven by the distance traveled by the vehicles. Costs of providing annual leave are driven by the number of employees with annual leave entitlements. In a trading business, the cost of sales is driven by the quantity of sales made.

Cost of sales will be lower if we can recognize and manage the major drivers. Many of these involve working closely with our key suppliers. The page overleaf offers a simple process framework for measuring supplier performance as a key way to control cost of sale drivers.

I can develop my ability to Reduce the Cost of Sales by:

Measuring the cost and performance of all suppliers

There are two major methods that can be used to assess suppliers performance in major areas (and other areas that may be important to you):

1. A CATEGORICAL APPRAISAL

Under this approach:

- Purchasing staff maintain separate performance records on each key supplier measuring them against key performance criteria such as price, quality and due date delivery.
- Each vendor is rated against these criteria.
- At a monthly meeting, each supplier is given a combined group rating.
- A positive rating may lead to additional business for that supplier; a negative rating may lead to the use of alternative suppliers or discussion with the vendor about the problem.
- Add the weighted ratings to calculate an overall performance index.

A categorical appraisal is a more qualitative way of rating suppliers and their overall performance. This can be useful if an organization has a lot of suppliers or if the product or service they provide is clear to judge.

Its disadvantages are that this method lacks detailed data (which might be important if you want to reduce cost of sales over the long term).

2. A PERFORMANCE INDEX APPRAISAL

Under this approach:

- A list is made of critical performance factors.
- Weights are assigned to each of these factors reflecting their importance to the company. These weights add up to 100%, which is perfect performance.
- Procedures are decided for measuring the supplier performance on each factor. For example, a percentage based on actual performance. If 70% of deliveries are on time, then a rating of 70% of the possible score for due date delivery is calculated. If due date delivery is critically important, there may be a doubling of the penalty so that if 20% of deliveries are late, 40% is deducted from the score.
- Cross-multiply the performance ratings with the respective weights to arrive at weighted ratings.
- Add the weighted ratings to calculate an overall performance index
- Compare the rating with a performance schedule previously agreed upon with the supplier. This may contain penalties and bonuses relating to performance.

Whichever of these methods is used, good suppliers must be given incentives to improve even more and bad suppliers must be placed under pressure to lift their performance or be dropped.

Controlling Expenses

Your Score in this quadrant was 11

Expenses are the direct and indirect costs of earning revenue. We match the revenue earned with the expenses of earning that revenue to calculate the profit. So, any decrease in an expense will immediately add to profit. However, sometimes expenses are not well-controlled. Of course, it is easy to accept that certain expenses are inevitable because they are always present. However, almost invariably, attention to any expense leads to ways of reducing it.

The basic profit calculation formula is **Profit=Revenue less expenses.**

As a result, at its most simple level, reduction in expenses will increase profit. However, there is more to reducing costs than switching off the lights when you leave the room. The major reductions in costs come from strategic approaches, such as investing in new processes or equipment, adopting new technology, or redesigning the way that products or services are provided to customers.

Managing the reduction and control of expenses is a very complex business because there are often unseen implications in cost reduction which only become apparent after the process has started. Many organizations that have 'down-sized' in recent years have now realized this. People therefore now often talk about strategic cost reduction as a prime goal. Whilst this is a laudable ambition, it has the same risks to the enterprise if it is not well understood and the implications carefully considered. To seriously reduce and control expense is, however, a direct way of maximizing profits and should be a major part of management effort.

How is it done?

There are some general principles to be followed when seeking cost reductions:

- Non value-added costs must be eliminated as quickly and as fully as possible.
- Strategic cost reduction is likely to be more effective than traditional methods of cost reduction.
- Review and change must be ongoing.

Costs should be analyzed and questioned in detail before changes are made in the most significant areas. Traditional cost cutting strategies may only get you a little way towards your goal. As such, a more strategic approach is needed in which new processes, technology, re-engineering and other initiatives are carefully evaluated for their potential contribution. In the final analysis cost reduction and control is a difficult and ongoing management task that needs almost endless persistence to reach a satisfactory position.

I can develop my ability to Control Expenses by:

General Operating Budget Checklist

	Task Completed
<p>1. Identify business opportunities</p> <p>Identify Organisational plans, programs, opportunities for budget period.</p> <p>Estimate revenue to be derived from above plans, programs, opportunities.</p> <p>Determine acceptable level of profit.</p> <p>Subtract profit from revenue to give funds available for expenses.</p>	
<p>2. Determine Operational Activities.</p> <p>Establish activities required to derive revenue.</p> <p>Determine operational structure including responsibility centers and delegations of authority.</p> <p>Assess relevant budget and expenditure performance.</p>	
<p>3. Build Activity Resource Costs.</p> <p>Build up projects from zero base.</p> <p>Set Budget levels for coming period.</p> <p>Establish detailed cost summaries of all organisational resources.</p>	
<p>4. Measurement and control.</p> <p>Agree budget measurement and control strategies.</p> <p>Form review team - determine review responsibilities.</p> <p>Compare actual performance with budget levels.</p> <p>Assess and discuss major variances and take appropriate action.</p> <p>Document discussion and action on major variables.</p> <p>Assess effectiveness of budget as a predictor.</p>	
<p>5. Monitoring And Review.</p> <p>Discuss success and failures of past budget.</p> <p>Agree action plan to make improvements.</p>	

Managing Cash flows

Your Score in this quadrant was 15

Although maintaining positive cash flow is a commonsense goal that almost all business people will subscribe to without question, according to the major financial institutions like the banks, "lack of cash flow" remains by far the number one reason for businesses failing or "going to the wall."

Perhaps the best advice you can ever consequently give a business person is:

The table below gives some summary detail on what each of the four key financial areas covers:

"Never run out of money"

It is cash that acts as the lifeblood of business so cash flow is of critical importance.

Cash flow needs careful management. This is most effectively done by cash flow budgets which will anticipate the need for additional cash before the situation becomes critical. Leaving the situation until a crisis occurs can lead to very expensive emergency borrowing and even endanger the existence of the entire enterprise.

Reducing the cost of sales involves identifying the major drivers of cost within the enterprise and then ensuring that continual analysis takes place to make the necessary adjustments (particularly working with the organization's major suppliers).

Another important part of monitoring cash balances is the management of risk. By effective risk management the organization can ensure that some catastrophic event will not destroy it. The organization should also undertake an investment strategy which will provide funds as required in the short term and long term.

How is it done?

Cash is the lifeblood of business. Therefore, the management of all organizations should ideally make the budgeting of cash flow and the management of cash resources a priority.

Typically, businesses control their cash resources by:

- making effective use of bank accounts
- setting up efficient internal controls over cash receipts
- setting up efficient internal controls over cash payments
- using electronic funds transfer (EFT) systems.

In order to ensure that there are no major unplanned losses of cash due to catastrophic events, the organization must also be involved in efficient risk management. The cash budgets and the risk management strategy should be monitored to ensure that no economically avoidable risks are being taken.

By the judicious use of investments and effective use of temporary borrowings, adequate cash flow can be consistently maintained and profits maximized. A simple template for setting out a cash-flow projection is shown overleaf.

Personal notes on greater awareness or effectiveness in the Managing Cash flows category:

Cash Flow Projection for 6 Months

	Month					
	1	2	3	4	5	6
1. Cash inflow:						
Cash sales						
Cash from accounts receivable						
Other inflows						
Total inflow						
2. Cash outflow:						
Accounts payable						
Supplies						
Rent						
Utilities, phone						
Payroll and related taxes						
Administration						
Marketing and sales						
Administration						
Taxes						
Insurance						
Professional services						
Other operating expenses						
Capital outlays						
Loan repayments and interest						
Loans, advances						
Loans, advances						
Bank drawings						
Other						
Total inflow						
3. Cash flow for month (1-2)						
4. Cash balance at start of month						
5. Cash balance at end of month (3-4)						

Summary

The Financial Acumen Inventory model has suggested that there are four main interventions that people can pursue when it comes to finance or money. These are to seek to:

- **Maximizing** (revenue or sales to existing and new customers)
- **Reduce**(cost of sales, mainly through working with suppliers)
- **Optimize**(cash-flows by working with organizational stakeholders)

It has been suggested that it is up to each individual within the enterprise to both develop a sound awareness about financial matters and to take steps to help make the management of finance as healthy as possible.

As a way of helping all individuals (and especially those outside the finance or accounting function) to focus on the areas of most financial importance, each of the about factors have been represented in a grid to offer a visual representation of four discrete areas upon which we can concentrate our time and energy (either at one time or concurrently) in order to understand and control our organizational finances.

On the following page a simple action template in which you can focus on your particular results and plan to take steps to improve your knowledge over time.

Personal Action Planning Sheet

Use the following questions to help guide your future financial acumen improvement effort.

- Maximizing Revenue

- Reducing the Cost of Sales

- Controlling Expenses

- Managing Cash flows.

Which of the above categories needs the most time and focus in helping to improve my meeting coordination effectiveness and what are the things I can put into practice immediately?

What are my poorest meeting habits or shortfalls?

What are the top three changes that are likely to have the greatest impact on future meetings or help to overcome my current shortfalls?

(A)

(B)

(C)

How will I track or measure my progress in terms of bringing about greater personal effectiveness in attending or running future meetings?

Financial Acumen Inventory

by Jon Warner

ABOUT THE AUTHOR

Jon Warner is a professional manager with over 20 years experience working for major multi-national companies in the United Kingdom, Europe, the United States of America and Australia. After launching Team Publications in 1994, Jon became well known in the area of organisational consultancy and the pursuit of best practice leadership.

Now based in Los Angeles, he is currently involved in the development and launch of corporate universities providing internationally recognised qualifications. Jon has authored literally hundreds of training and HR related tools and resources (under the imprint of Team Publications) and is an expert in the development of profiles and assessments.

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ABOUT THE PUBLISHER

Team Publications was established by CEO Jon Warner in 1994 with the goal of bringing practical and interactive learning materials to the international market. Our team of authors have now developed more than 500 Australian Made® training and HR tools and resources, in the key areas of:

- Career Development/Personal Success
- Communication/Interpersonal Skills
- Management, Leadership and Supervisory Skills
- Occupational Health and Safety
- Sales and Marketing

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