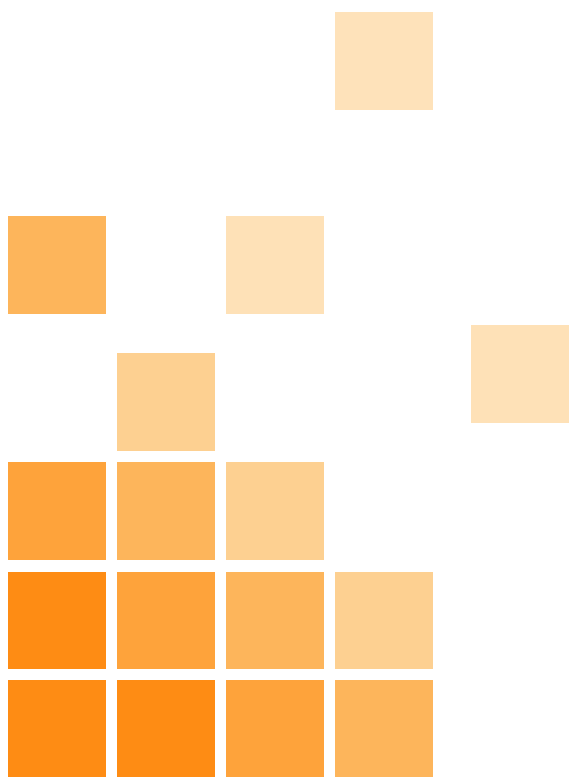


Modelling Explained

Our views on financial modelling



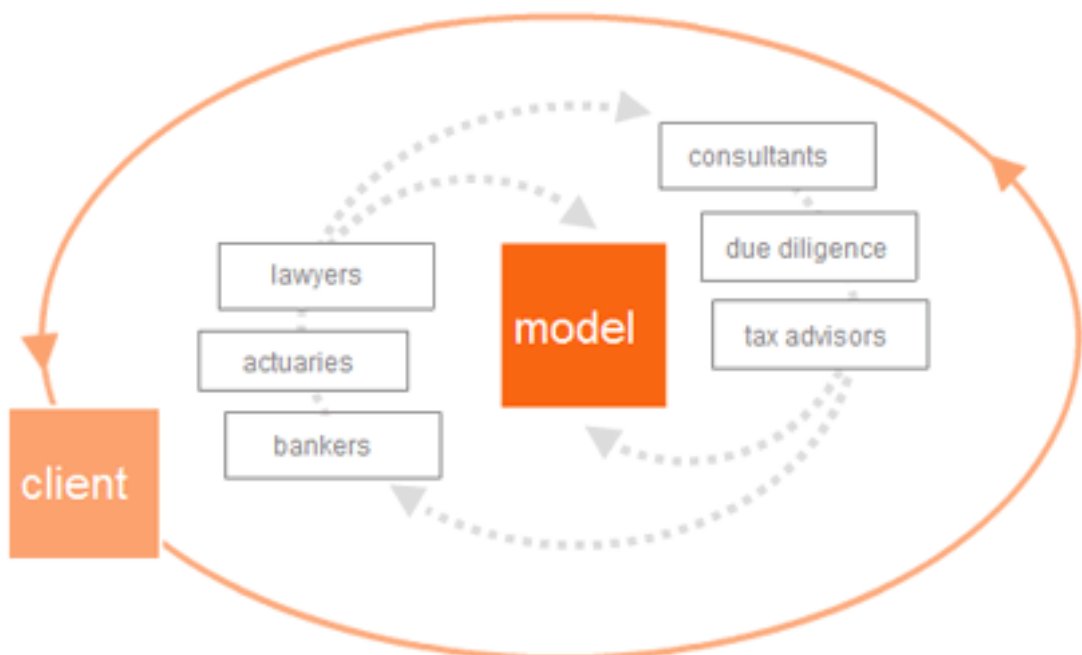
Modelling Explained....

An introduction to modelling

“business and financial modelling is integral to decision-making.”

* Source – Stephen Aldridge, MD Numeritas

- With ever-greater scrutiny of corporate and public sector organisations, Directors and key decision makers can no longer afford to take a 'seat of the pants' approach. It is expected, and often required, that adequate analysis is performed to demonstrate that the action taken has been thoroughly evaluated and tested before committing stakeholders' funds.
- Business modelling uses robust assumptions-driven forecasting to understand the strategic and operational choices faced by executives and decision-makers.
- A well structured model illustrates the financial impact of what-if analysis and likely outcomes of more complex scenarios.
- The Model will invariably become the focus of any significant project as the decision deadline approaches.



Modelling Explained....

Benefits of Modelling

Evaluate possible future outcomes, reducing risk!

- With ever-greater scrutiny on corporate and public sector organisations, decision makers can no longer afford to take a 'seat of the pants' approach. It is expected, and often required, that adequate analysis is performed to demonstrate that actions taken have been thoroughly evaluated and tested before committing stakeholders' funds. Specific benefits include:
 - The ability to consider multiple options, assessing the impact of changes on key drivers, thereby identifying the key risk factors.
 - The process of designing a model develops a clearer understanding of which variables are critical and their impact on likely outcomes.
 - Limiting the costs of evaluating ideas prior to approval, reducing or avoiding trial-and-error costs.
 - The scrutiny of logic and assumptions that accompany model design increases precision and enhances insight.
- It is for these and many more reasons that almost every transaction or investment decision now rely heavily on some form of financial model or analysis.

Modelling Explained....

The risks...

The risks are real, but they are not impossible to manage!.

- Given the benefits, why is it that financial modelling is such a potential minefield? The risks are considerable, hence the importance of applying the appropriate care and skill in the performance of modelling assignments.
- The risks associated with financial models in the corporate decision-making realm are analogous to software application development. Would you purchase a significant software application without being confident that it had been properly designed and thoroughly tested?
- In business and financial modelling, users often create applications with no planning, structuring, testing or quality control. Without these basic fundamentals the risk of inappropriate, inaccurate and unreliable analysis increases exponentially.
- These risks are a reality as evidenced by a number of high profile disasters in the last few years. Studies undertaken prior to 1997 indicate error rates of approximately 21%; however, studies from 1997 onwards indicate error rates have increased to an average of 91% of the 54 models reviewed.
- Our experience is that the these increasing error rates are primarily linked to:
 - rapid growth in the usage of spreadsheets within the corporate and public sectors, without suitable modelling best practice training and risk management procedures;
 - the fact that training is provided for spreadsheet applications, but not in the techniques of spreadsheet development for decision-making;
 - increasing complexity of the decisions being evaluated with spreadsheets;
 - advances in spreadsheet functionality and the inherent flexibility of spreadsheet applications;
 - a lack of discipline in design, development and testing of spreadsheet models.

Modelling Explained....

How best to navigate the modelling resource minefield...

Selecting the right modelling support is crucial to success on an important modelling assignment.

- All organisations will handle their day to day modelling requirements in-house, and need to understand the risks inherent in this and manage those risks.
- There are however circumstances where in-house resource is either not available or in some instances lacks the depth of experience and technical expertise. It is in these situations where a professional modeller will be most valuable.
- The landscape of external resources available to organisations requiring modelling support are varied including:
 - Finance Contractors : the “spreadsheet jockey”
 - Independent Modelling Consultant : the one man band
 - Boutique modelling consultancy
 - Specialist Modelling Team within a larger advisory firm
 - Investment Banks
- Each of these options carry risks and trade-offs which you need to match to your requirements.
- Our advice is to be realistic about your objectives, how critical the model is to your organisation, the degree of support and backup you might require and what your budget constraints are.
- In general, these factors will enable you define the resourcing solution best suited to your current need.
- Numeritas are more than happy to discuss your requirements, and provide our expert view on the type of resource which would suit your requirements.

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