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Best Practice Tips to Advance your Financial Modeling Skills!

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Financial modeling involves more than just building a spreadsheet model.

It is a process that helps to understand and analyze a business. To advance your financial modeling skills, consider the following best practices:



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Understand how a business operates: Review past and current financial performance, learn about the industry, and determine the key drivers for the industry.

Suggested Search Terms:

- "Industry research"
- "Financial performance evaluation"
- "Key drivers for an industry"
- "SWOT analysis for businesses"
- "Business operations overview"

** Using a combination of these terms, along with any specific details or industry-specific terms that are relevant to your search, should help you find a wide range of resources on understanding how a business operates.*



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Sketch the business problem on paper: This allows for a high-level view of the problem and helps to identify key inputs and outputs and the relationship between them. Start with the output and work backwards, breaking the problem down into small steps and determining the necessary ingredients or items to calculate each variable.

Suggested Sketching tools:

- Pen and paper: simple and flexible
 - Mind mapping software: you can use customizable templates, link and organize ideas, and the ability to add notes and images.
- Ultimately, the best tool will depend on the specific needs and preferences of the person sketching the business problem



Key things to remember when sketching the model:

- Start with the output and solve backwards.
- Break down the problem into small steps and determine the necessary ingredients to calculate each variable.
- Ask "What do I need to know to calculate it?" for each item.
- Make sure each variable appears only once in your chart or diagram.
- Consider whether indexation or escalation should be incorporated in the model when price is involved in the calculation.



- Use a **consistent layout** on each sheet: This means that each sheet should have the same layout, with each column serving the same function. For example, if column E represents quarter 1 of the first year of the forecast period, this should be the case on every sheet in the workbook.
- Avoid different layouts on different sheets: Operational researchers have found that when sheets have different layouts, **the risk of error increases**. To reduce the risk of error and increase confidence in your workbook, it is best to use a consistent layout on all sheets.



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Inputs, Calculations, and Outputs are the core building blocks of any financial model. Here are some best practices for organizing and separating these elements:

- The input worksheet(s) should contain the hard-coded assumption cells that a user can update.
- It is best to keep this sheet separate from the others, and if needed, make it the only sheet available for editing.
- Document and clearly label all input data: Make sure to document and clearly label all data that is input into the worksheet. This will help users understand the purpose and significance of each input.
- Avoid calculations on input worksheets. This will help keep the worksheet organized and focused on the inputs.



First impressions are important, and they can affect people's perception of the quality of a financial model.

- **Keep it simple:** A simple and transparent model is easier to follow and understand, which can improve the credibility of your work. Avoid using complicated formulae or unnecessarily convoluted structures.
- **Break complex formulae into multiple steps:** Splitting formulae can make them easier to read and understand, which can help improve the clarity of your model.



- **Use color coding:** Consider using color coding to distinguish between different cell types or worksheet categories. This can make it easier to understand the structure and purpose of the model.
- **Use conditional formatting:** Conditional formatting can be used to dynamically highlight cells of interest, such as cells with high or low values or cells that exceed or fall below a certain threshold. This can help draw attention to important information and improve the clarity of the model.
- **Be consistent with formatting:** Consistency is key when formatting a financial model. Use the same formatting styles and techniques throughout the model to improve its overall coherence and clarity.



- **Follow a top-to-bottom, left-to-right flow:** This is the most common and intuitive way to present information, and it can help improve the clarity and coherence of the model.
- **Display assumptions before referring to them in calculations:** Presenting assumptions on calculation pages before referring to them in calculations can help improve the understanding of the model and enhance its overall transparency.
- **Make key outputs the primary focus:** Key outputs should be the primary focus of the forecast business model, and they should be placed on the left side of the model for easy reference.



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Financial Arena is a global leader in financial modeling that combines deep industry knowledge with specialized expertise in strategy, forecasting, risk analysis and data analytics.

For more information, please contact us at [customercare](mailto:customercare@financialarena.co.uk) at financialarena.co.uk

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