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FINANCIAL INTELLIGENCE UNLOCKS CAREER GROWTH

By Karen Berman and Joe Knight

Financial intelligence isn't some innate ability that you either have or don't have. So, even if you never liked math or are intimidated by numbers, you can build your financial intelligence. In fact, this is a set of skills that can—and must—be learned by workplace learning and performance (WLP) professionals.

Those of us in training and development have a special ability to help others learn. So, why can't we just leave the numbers side of the business to the finance and accounting folks?

The reason is simple: Competition is fierce, so if you haven't picked up financial intelligence through your work or in the classroom, you will easily be relegated to the sidelines. Do you understand what it means when your CEO talks about EBIT (earnings before interest and tax), EBITDA (earnings before interest, taxes, depreciation, and amortization), earnings per share, and free cash flow? Can you explain a return-on-investment analysis? Do you know how your work in the company affects both cash and profit?

If the answer to any of these questions is no, then you might be unable to participate fully in strategic planning sessions. How can you make the best decisions for your company if you don't speak the financial language and understand how your actions influence the company's bottom line?

Financial intelligence will help you assess if your company—or your client—is a growing concern. It will ensure that you can fully participate in the financial success of your company. And it will give you useful skills that can carry over to whatever you do and wherever you go in business.

Art and science

So let's start building your financial savvy right now. And let's start with a big, perhaps shocking, revelation: Finance is as much art as it is science. In truth, financial figures are just a reflection of reality, and that reflection is dependent upon the ability of accountants and finance professionals to make reasonable assumptions and to calculate reasonable estimates.

Revenue refers to the value of what a company sold during a given period. Sounds simple, but the key question is when should revenue be recorded? Is it when a contract is paid, when the product or service is delivered, when the invoice is sent out, or when the bill is paid?

Revenue is recognized when the product or service is delivered. As an example, think about the last airline ticket you bought. The airline didn't record that revenue when you purchased the fare, but rather when you boarded the plane—that is, when they delivered the service.

Imagine that a company sells a copying machine with a maintenance contract. The machine is delivered in October but the maintenance contract is good for the next 12 months. So, how much of the purchase price should be recorded on the books for October? Remember that the company hasn't delivered all the services it is responsible for—just the machine and one month of service. The accountants for this company must make assumptions about the value of those services and then record the amounts accordingly. A finance professional is often called upon to use his judgment. Part of being financially intelligent means knowing where estimates and assumptions enter in, so you can assess their impact and then make well-informed decisions.

A primary element of financial intelligence is understanding the importance of profit. All businesses need to make money—even not-for-profits—otherwise they won't be around very long. Profits are reflected on the income statement. But there are many forms of profit, and each tells us something different.

Definition of profit

To understand the difference in the term "profit," we have to untangle the language. Accountants sometimes use different words to mean the same thing, such as profit. An income statement might include the terms "gross margin," "operating income," "net profit," and "earnings per share," which are all simply different types of profit. Those types of profit can easily be called "gross profit," "operating profit," "net profit," and "profit per share." When different words are used in one statement, it may seem like those are different concepts, but they aren't. They all imply the same basic concept of revenue minus expenses.

Interestingly enough, though, there are various ways to analyze profitability. The first method is to look at gross profit, which is revenue minus the direct costs of creating the product or delivering the service. It tells us the basic profitability of a product or service, so clearly this is a number to watch.

The next profit number to understand is operating profit. Operating profit is gross profit minus all operating expenses (sometimes called SG&A, which stands for sales, general and administrative). It is also called EBIT, which stands for earnings before interest and taxes. Operating profit is a good gauge of how well a company is generally being managed. Operating profit is watched by bankers, investors, vendors, customers, and even by savvy employees.

The third profitability measure often cited is net profit. This is the proverbial bottom line. Everything, including interest and taxes, has been subtracted from revenue to determine net profit. Net profit is used to calculate earnings per share and price-earnings ratio.

How do you know if the numbers are good or bad? An accurate assessment of financial health depends on the product or service, the company, and the industry being considered. But no matter what, it always helps to compare the results to previous years, so you can understand trends and patterns. Looking at industry results also provides a context. And understanding targets and how they are developed is meaningful, too.

Cash

Another concept that's important to understand is cash.

It would seem reasonable that net profit would be the same as cash in the bank, right? For most businesses, it does not work that way because cash and profit are different.

Remember, revenue shows up on the income statement when the product or service is delivered. But cash may not, and usually doesn't, change hands at the same time the revenue is booked. When a product or service is delivered, customers typically promise to pay for those products or services, but they may take 30 days or more to actually pay out cash.

The second reason cash and profit are not always equal is because of the matching principle. This requires that expenses are matched to the revenue they help generate. To keep revenues and expenses in sync, the expenses on an income statement are not necessarily those that were paid cash for in a given month. Rather, they are the expenses that were incurred to sell what was sold.

The third and final reason cash and profit can be different is that a certain type of cost does not count against profit. Capital expenditures are large purchases that can be used for a substantial length of time—such as production equipment and computer systems. The value of these capital expenditures is tracked on a balance sheet (that is, all the value except that portion which was "used up" by creating revenue during the current period).

What is the result of all this? A company can be profitable, and have no cash. Or, a company can have cash but no profit. In the long run, both are needed for a healthy company. Of course, managers can focus on varying aspects of the business to increase profits, cash, or both. And of course, every employee contributes in some form or fashion to both profit and cash through their daily activities and the resources they consume to create products and services.

Everyone can be, and should be, financially intelligent. Every employee inside of an organization should learn to speak the language of finance, and learn to ask questions both about what the numbers mean and how they were derived. WLP professionals can be instrumental in building their organization's financial intelligence by teaching financial intelligence.

When every employee is financially intelligent, they can use the information to make good business decisions. So don't wait to learn more about your company's financial statements—be prepared for wherever your career takes you.

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