Teach Yourself: Economic Evaluation:

3 d. So what is financial modelling?

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Financial Modelling – using 100% equity

Many people on the periphery of the profession talk of "financial modelling" or "financial analysis". Even worse some engineers call it "cost modelling".

- They are wrong!
  - It is like calling an electrician a plumber.

Financial modelling is the study of how to fund the project or business.

  - How should the money be raised by the company? What mix of equity and debt?
  - The first step is to decide use the economic evaluation to decide if the project/business is a healthy investment regardless of ownership and financing? The second step is to feed the data from this model into the financial model to work through alternatives for funding. **They are complementary activities but economic evaluation is done first.**

Some people then talk about financial modelling using 100% equity. Again they are wrong and confused!

  - The discount rate being used to the evaluate that company's investment in that industry has an implicit level of debt funding.
  - Any one who talks about using debt in an evaluation to improve NPV and IRR is really on the wrong track.
  - They may get a marginal mathematical improvement but they are missing the big picture, not understanding their role and getting lost in trivial mathematics.

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