

LM12 · FINANCIAL STATEMENT ANALYSIS · CFA LEVEL I

Introduction to Financial Statement Modeling

Building pro-forma statements to forecast, value, and stress-test a firm

What This Reading Covers

Financial statement modeling takes historical financials plus assumptions about the economy, industry, and firm, and projects a full set of pro-forma statements. Those projections are the raw material for a DCF valuation, scenario analysis, and credit assessment. The craft is choosing sensible **revenue drivers**, linking **costs** to those drivers, rolling forward the **balance sheet**, deriving the **cash flow statement**, and letting a **plug** (usually a revolver or cash line) make the three statements balance.

What You Will Learn

Purpose	Why analysts build models: forecast future FS to value a firm, test scenarios, and stress-test credit
Revenue	Top-down (GDP · industry · market share) vs bottom-up (units × price, segments) vs hybrid
Costs	Fixed vs variable decomposition, operating leverage, margins, SG&A behaviour
Non-operating	Interest expense (debt × rate) and taxes (effective vs cash rate)
Balance Sheet	PP&E via capex – depreciation, working capital via DSO/DOH/DPO, debt via leverage targets, equity via NI – dividends
Cash Flow	Derived from forecast income statement and changes in the balance sheet
Integration	The balancing plug — why every integrated model needs one
Biases	Overconfidence, confirmation, illusion-of-control, representativeness, conservatism
Competition	Porter's five forces & strategy (cost leadership, differentiation, focus) influence prices/costs
Inflation	Revenue indexing, cost pass-through, hedging, and lag effects on margins
Quality	Scenario and sensitivity analysis — forecasts should be ranges, not points

Exam Tip: LM12 is conceptual — there are no formulas to memorize for the exam. The testable material is **vocabulary** (top-down vs bottom-up), **classifications** (which items are revenue-driven vs inflation-driven), and **analyst biases** that distort forecasts.

PURPOSE · THE SALES-BASED PRO FORMA PROCESS

Why Build a Financial Statement Model?

A financial statement model is a **forward-looking translation** of business expectations into projected income statements, balance sheets, and cash flow statements. The three primary uses are:

VALUATION

Forecast cash flows or earnings so they can be discounted (DCF) or multiplied (P/E, EV/EBITDA) to estimate intrinsic value.

SCENARIO ANALYSIS

Change one or more assumptions (revenue growth, margins, capex) to see how the income, balance sheet, and leverage react under upside, base, and downside cases.

CREDIT & RISK

Project coverage and leverage ratios to assess a company's ability to service debt and remain within covenants across the forecast horizon.

The Sales-Based Pro Forma Model — Eight Steps

- 1 Estimate **revenue growth** and forecast revenue (top-down, bottom-up, or hybrid)
- 2 Estimate **COGS** as a percentage of sales (or by volume/price if more appropriate)
- 3 Estimate **SG&A** — splitting variable components (% of sales) from fixed (growth-rate based)
- 4 Estimate **financing costs** — interest expense based on debt levels and rates
- 5 Estimate **income taxes** — book (effective) tax expense for net income; cash tax for cash flow
- 6 Model the **balance sheet** — working capital items via activity ratios, debt via target leverage, equity via NI – dividends
- 7 Use **depreciation and capex** to project net PP&E
- 8 Construct the pro forma **cash flow statement** from the forecast IS and the change in BS items

Exam Tip: A complete model is *integrated*: every forecast line in one statement must be consistent with the other two. The integration is what produces the "plug" — the line item that absorbs any imbalance so that $\text{Assets} = \text{Liabilities} + \text{Equity}$.

REVENUE MODELING · TOP-DOWN VS BOTTOM-UP VS HYBRID

Forecasting Revenue

THREE APPROACHES TO REVENUE FORECASTING



Top-Down — Two Flavours

(1) Growth relative to GDP — forecast nominal GDP growth, then express revenue growth as a premium or discount to GDP (e.g., "Pfizer grows 100 bps above nominal GDP") or in relative terms ("Oracle grows 25% faster than GDP"). Nominal GDP can be decomposed into real GDP × inflation so that volume and price can be modeled separately.

(2) Market growth & market share — forecast the size of the relevant market, then forecast the company's market share.

Example: Tesla holds 1% of a 30bn automarket → revenue = 130bn = \$300m.

Bottom-Up — Common Techniques

Time-series	Extend historical growth rates using trend or autoregressive models
Return on capital	Forecast balance-sheet accounts and apply the expected return (e.g., ROA × assets)
Capacity-based	For retail: same-store sales × existing stores + sales from new stores
Volume × Price	Build up units and ASP separately, then multiply — also common in commodities/SaaS
Segment build	Forecast each product line, geography, or reporting segment, then sum

The Hybrid Advantage

Running both approaches side-by-side surfaces *internal inconsistencies*. If the bottom-up segment forecasts imply 15% growth but the top-down industry $\times$ share approach implies 5%, the analyst must reconcile — usually by challenging the market-share assumption or by questioning unrealistic unit-growth expectations embedded in the bottom-up build.

COST MODELING · FIXED VS VARIABLE · OPERATING LEVERAGE

Forecasting Operating Costs

Costs can be split along two axes: by **behaviour** (fixed vs variable) or by **function** (COGS vs SG&A vs R&D). The behaviour split drives operating leverage; the function split matches how costs appear on the income statement.

Fixed vs Variable Cost Decomposition

COST TYPE	BEHAVIOUR	FORECASTING METHOD
COGS	Primarily variable	Percentage of forecast revenue: <i>Forecast COGS = (1 - gross margin) × revenue</i> . Can be refined by segment, product, or volume × unit cost.
Selling & distribution	Mostly variable (wages, commissions)	Percentage of sales — responds to volume
General & admin	Mostly fixed	Inflation-adjusted growth rate; steps up in discrete jumps as the firm scales
R&D	Fixed / strategic	Often held at a target % of sales or grown at management's stated rate
Depreciation	Fixed (sunk)	Based on existing PP&E book value and useful life

Contribution Margin & Operating Leverage

Contribution margin per unit equals **price minus variable cost** ($P - VC$). A firm earns profit when the contribution margin per unit is positive and total contribution (units sold × per-unit contribution) exceeds fixed costs.

$$\text{Operating Profit} = Q \times (P - VC) - \text{Fixed Costs}$$

The **degree of operating leverage (DOL)** is the percentage change in operating profit for a 1% change in sales. The larger the fixed-cost base, the higher the operating leverage — operating profit moves more rapidly in both directions when revenue changes.

Economies of Scale & Scope

Economies of scale occur when unit costs decrease as output rises (spread fixed costs over more units). A positive correlation between operating margins and sales is evidence of scale economies. **Economies of scope** arise when adding product lines or divisions lowers unit costs via shared infrastructure.

Forecasting Margins — Competitive Signals

Changes in market share are a leading indicator of gross margin. A company **losing share** to cheaper substitutes will see *gross margin compression* as it cuts price to defend position. A company **gaining share** with a differentiated new product can usually *expand gross margin*. Cross-check estimated margins against peers — large differences should be explainable by business model, not wishful thinking.

Exam Tip: Know these splits cold: **COGS and selling/distribution = variable** (forecast as % of sales). **G&A, R&D, depreciation = mostly fixed** (forecast with growth rate or from the asset base).

NON-OPERATING ITEMS · INTEREST & TAXES

Forecasting Below-the-Line Items

Financing / Interest Expense

Interest expense is forecast as a function of the projected **debt level** and the applicable **interest rate**:

$$InterestExpense = ForecastDebt \times EffectiveInterestRate$$

The inputs:

- **Debt level** — taken from the forecast balance sheet; driven by the company's target capital structure (debt/equity, debt/EBITDA, debt/capital) and by expected borrowing needs tied to capex and working capital
- **Interest rate** — weighted average of existing debt coupons plus the projected market rate on new issuance
- **Average balance** — interest is often applied to the *average* of opening and closing debt to reflect intra-year borrowing

Three Tax Rates You Need to Distinguish

RATE	DEFINITION	USE FOR
Statutory	Jurisdiction's legislated corporate tax rate	Starting reference point; not used directly
Effective	Book tax expense ÷ pre-tax income — reflects permanent differences and credits	Forecasting net income on the income statement
Cash	Actual cash taxes paid ÷ pre-tax income — reflects timing differences (deferred tax)	Forecasting operating cash flows

Normalized Tax Rate

Rather than carrying this year's effective rate forward blindly, analysts often compute a tax rate based on **normalized operating income** — stripping out unusual items and one-offs — and apply that to future pre-tax income. This avoids baking transitory tax events into a multi-year forecast.

Exam Tip: Exam trap: if the question is about *net income*, use the **effective tax rate**. If the question is about *cash flow*, use the **cash tax rate**. The statutory rate is rarely the right answer unless the firm has no permanent differences and no deferred taxes.

QUIZ 1 · CHECKPOINT

Test Your Understanding: Revenue, Costs & Non-Operating

Q1. An analyst forecasts revenue by first projecting nominal GDP growth, then layering on an industry premium, and finally applying a target market share. This approach is *best* described as:

Q2. A retailer forecasts next year's sales by projecting same-store sales growth of 3% and adding the expected revenue from 40 new stores. This is an example of:

Q3. Which of the following costs is *most likely* to be forecast as a percentage of sales?

Q4. Two firms have identical revenues and identical operating profits. Firm A has a much higher proportion of fixed costs than Firm B. Compared with Firm B, Firm A's operating profit will be *most likely* to:

Q5. An analyst wants to forecast a company's operating cash flow. The *most appropriate* tax rate to apply is the:

BALANCE SHEET MODELING · WORKING CAPITAL VIA ACTIVITY RATIOS

Forecasting Working Capital

Three balance-sheet items together form the working capital forecast: **accounts receivable, inventories, and accounts payable**. Each is tied mechanically to an income-statement driver through an activity ratio.

The Three Activity Ratios

BS ITEM	DRIVER	FORECASTING FORMULA
Accounts Receivable	Revenue	$\text{DSO} \times (\text{Forecast Revenue} / 365)$ or Revenue / Receivables Turnover
Inventory	COGS	$\text{DOH} \times (\text{Forecast COGS} / 365)$ or COGS / Inventory Turnover
Accounts Payable	COGS (or Purchases)	$\text{DPO} \times (\text{Forecast COGS} / 365)$ or Purchases / Payables Turnover

WORKED EXAMPLE

Worked Example — AR Forecast

Forecast revenue next year = \$365m. The firm's historical DSO = 45 days.

$$\text{AR} = 45 \times (\$365\text{m} / 365) = 45 \times \$1\text{m} = \$45\text{m}$$

An analyst who expects the economy to slow (and collection periods to lengthen) would raise DSO — perhaps to 55 days — producing AR = \$55m and a larger use of cash in the CFS.

SOLUTION

The **top-down** flavour flexes DSO/DOH/DPO with the macro outlook. The **bottom-up** flavour uses the company's historical ratios as a base, adjusted for known operational changes.

PP&E — Roll-Forward via Capex and Depreciation

Net PP&E is projected with a rollforward schedule:

$$\text{Ending Net PP\&E} = \text{Opening Net PP\&E} + \text{Capex} - \text{Depreciation} - \text{Disposals}$$

Capex splits into two:

- 1 **Maintenance capex** — starting point is historical depreciation expense, adjusted for inflation. Keeps the existing asset base productive.
- 2 **Growth capex** — derived from management's growth strategy (new capacity, new stores, geographic expansion). Requires judgment and often must be modelled alongside borrowing assumptions.

Depreciation is typically forecast using net book value of PP&E divided by estimated useful life, or as a historical % of gross PP&E.

Exam Tip: Memorize the three activity-ratio formulas and their drivers: **AR** ← **Revenue (DSO)**, **Inventory** ← **COGS (DOH)**, **AP** ← **COGS/Purchases (DPO)**. Getting the driver wrong is a classic exam error.

BALANCE SHEET · DEBT, EQUITY & THE PLUG

Completing the Balance Sheet — and the Plug

Debt (Capital Structure)

Debt is forecast by reference to the firm's target **leverage ratios**:

Debt / Equity Common capital-structure target

Debt / Capital Debt as share of total capitalisation

Debt / EBITDA Leverage gauge favoured by credit analysts

Management may publicly commit to a target range. Analysts should also overlay *borrowing requirements* driven by capex plans, scheduled maturities, and working-capital needs — financing needs often dictate debt in the short run even when the long-run target is different.

Equity — Retained Earnings

The equity line rolls forward mechanically:

$$EndingRetainedEarnings = OpeningRE + NetIncome - Dividends$$

Dividends come from management's stated payout policy or historical payout ratio. Share repurchases, if significant, reduce shareholders' equity separately and are usually modelled as a % of net income or a fixed dollar amount.

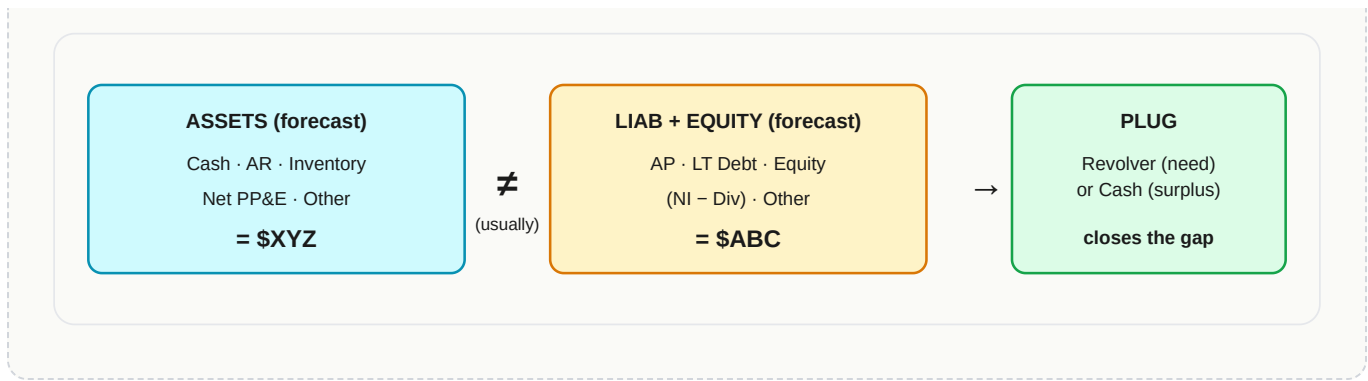
The Plug — Making Everything Balance

An integrated three-statement model almost never balances on the first pass. Assets and Liabilities+Equity will differ by some amount each period. The analyst designates one account as a **plug** (also called the balancing or revolver item) to absorb the mismatch:

- **Revolver / short-term debt** — plug of choice when the firm has a funding need ($A > L+E$)
- **Cash** / excess cash — plug when the firm has surplus funds ($L+E > A$)

Many models use both: a revolver that can go up or down as needed, with a cash minimum balance.

WHY THE PLUG IS NEEDED



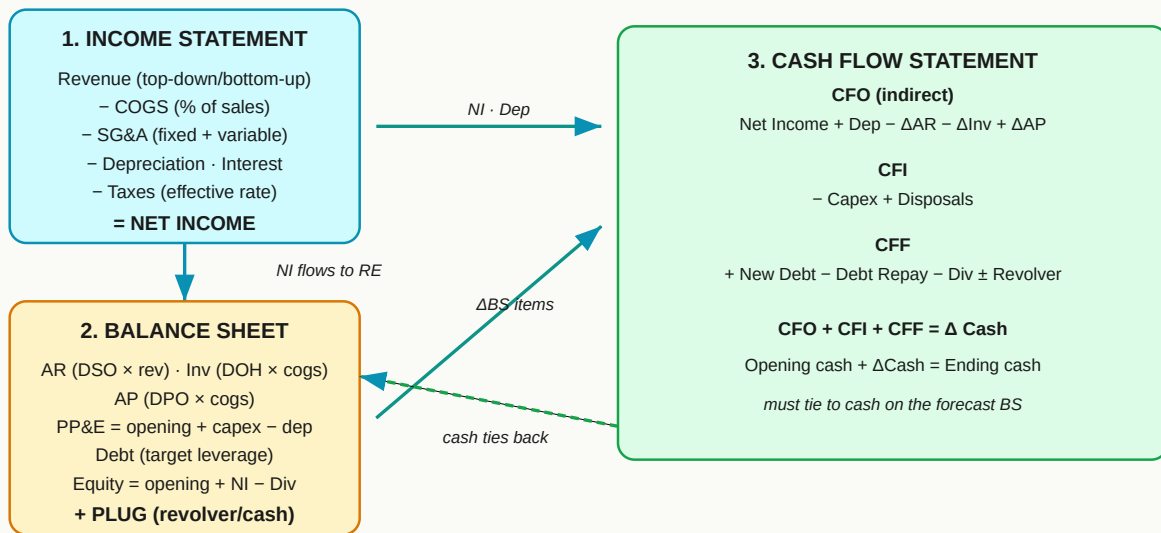
Exam Tip: The plug is not an accounting fudge — it represents the real-world financing decision that must be made to keep the business funded. An increase in the revolver in the forecast is a signal that the business is *consuming cash*; a growing cash balance signals *surplus generation*.

CASH FLOW · THREE-STATEMENT INTEGRATION

Deriving the Cash Flow Statement

The pro forma cash flow statement is **not forecast independently**. It is constructed mechanically from the forecast income statement and the changes in the forecast balance sheet — which is why the integration works.

THE THREE-STATEMENT FLOW



CFO — Indirect Method

$$CFO = NetIncome + Depreciation - \Delta AR - \Delta Inventory + \Delta AP + other\ non - cash$$

Every working-capital line on the balance sheet generates a cash flow: an *increase* in AR or inventory is a use of cash; an *increase* in AP is a source.

CFI & CFF

CFI captures capital investment (– capex, + disposals). **CFF** captures financing activity (+ new debt, – debt repaid, – dividends, ± revolver/cash plug activity, + equity raises).

The Tie-Out Test

Opening cash + (CFO + CFI + CFF) must equal the ending cash line on the forecast balance sheet. If it doesn't, there is a linkage error somewhere in the model. This cash reconciliation is the single most powerful check that a three-statement forecast is internally consistent.

BEHAVIOURAL • BIASES THAT DISTORT ANALYST FORECASTS

Five Biases That Corrupt Forecasts

Good mechanics are not enough — forecasts are only as good as the assumptions behind them, and assumptions are made by humans. Five biases consistently distort analyst forecasts.

BIAS	WHAT HAPPENS	HOW IT HURTS FORECASTS
Overconfidence	Unwarranted faith in one's own abilities	Forecast ranges too narrow; underestimated downside; overprecision on point estimates
Illusion of control	Belief you can control what you cannot	Fruitless actions in pursuit of control; over-reliance on complex models vs simple checks
Conservatism	Sticking to prior views even as new information arrives	Forecasts lag reality; slow to incorporate fundamental changes (anchoring on prior targets)
Representativeness	Classifying new information by past categories	"This-time-is-the-same" reasoning; ignoring what's new about current data
Confirmation	Looking only for evidence that supports your hypothesis	Undervalues disconfirming data; leads to one-sided scenario analysis

What This Looks Like in Practice

Anchoring on prior targets

Analyst sets revenue growth at last year's published number even though market share has deteriorated. A form of *conservatism*.

One-sided scenarios

Three scenarios all vary upside assumptions only. *Confirmation bias* in action — the downside case is not stress-tested.

Too-tight forecast bands

Point estimates presented without sensitivity analysis. A classic *overconfidence* symptom.

Ignoring management guidance cuts

Analyst maintains bullish forecast despite guidance reduction — searching only for confirming news. *Confirmation + illusion of control*.

Exam Tip: The fix is discipline: require scenario/sensitivity analysis, separate the forecast from the recommendation, track prior forecast accuracy, and deliberately seek disconfirming evidence before finalising a model.

EXTERNAL INFLUENCES · COMPETITION · INFLATION · TECHNOLOGY

External Drivers of the Forecast

Porter's Five Forces — Impact on Prices & Costs

Porter's framework identifies the five competitive pressures that determine an industry's base rate of profitability. Each one shapes the pricing power the firm can assume in its forecast.

FORCE	EFFECT ON FORECAST
Threat of substitutes	Fewer substitutes or higher switching costs → higher industry profitability; firm can assume stronger pricing power
Internal rivalry	Lower rivalry → higher margins; price-taker markets force margins toward cost of capital (zero economic profit)
Supplier power	Many suppliers → limited upstream pricing power → lower input-cost pressure on the firm
Customer power	Many buyers → limited downstream negotiating power → firm can hold selling prices
Threat of new entrants	High barriers to entry (capital, scale, brand, regulation) → sustained premium pricing

Competitive Strategy — Cost vs Differentiation vs Focus

Cost Leadership

Lowest costs in industry; offer lowest prices; generate volume for superior returns. Forecast: low-margin, high-turnover profile.

Differentiation

Distinctive product, quality, or delivery. Cost of differentiation must be less than the price premium buyers will pay. Forecast: higher gross margin, sustainable only if premium sustains.

Focus

Target a niche market. May combine elements of cost leadership or differentiation within that niche.

Inflation & Deflation in the Forecast

Revenue side

Higher input costs typically push end prices up. Because demand is usually price-elastic, raising prices *too soon* loses volume; raising them *too late* compresses margins. The **timing of pass-through** is the key

modelling decision.

Cost side

If the firm uses **long-term forward contracts or hedges**, input-cost increases are gradual rather than abrupt. Firms with **alternative input sources** or **vertical integration** have lower sensitivity to input-cost volatility. An analyst should index revenue and certain cost lines to explicit inflation assumptions — especially fixed G&A, wages, and maintenance capex.

Technology & Economic Change

Technological innovation can dramatically reshape an industry. *Sustaining* innovation improves existing products; *disruptive* innovation creates new markets or re-frames existing ones. Long forecast horizons for growth industries must account for adoption curves, obsolescence of incumbent products, and shifting cost curves.

Economic / structural change — demographics, productivity, labour force growth, interest rates, and credit availability — all feed back into revenue (demand) and cost (wages, rates) assumptions.

PESTLE as a Checklist

A helpful external-factor checklist: **P**olitical · **E**conomic · **S**ocial · **T**echnological · **L**egal ·

Environmental. Run through each before finalising the forecast to surface drivers you haven't priced in.

FORECAST HORIZON · QUALITY · SCENARIO ANALYSIS

Forecast Horizon & Quality of Assumptions

Choosing the Forecast Horizon

The appropriate forecast horizon depends on:

- 1 The **investment strategy** or portfolio manager's time horizon
- 2 The **cyclicality of the industry** — cyclical industries require forecasts that span a full business cycle
- 3 **Company-specific factors** — transitions, turnarounds, new product cycles need horizons long enough to capture the payoff
- 4 Employer / firm preferences and conventions

Normalized Earnings & Terminal Value

Longer-term projections often give a better picture of **normalized earnings** — mid-cycle earnings power absent unusual or temporary factors. At the end of the forecast horizon, analysts compute a **terminal value** two ways:

Multiples-based Apply a forward P/E, EV/EBITDA, etc. If future growth differs from history, adjust the multiple with a premium/discount.

DCF / Perpetuity Grow normalized terminal-year cash flow at a sustainable long-term rate, then discount. The terminal CF must be a mid-cycle value — no lingering temporary effects.

Scenario & Sensitivity Analysis

A forecast should **never** be a single point estimate. The quality of a model is judged by how well the analyst has explored *alternative* paths:

- **Sensitivity analysis** — flex one assumption at a time (e.g., revenue growth $\pm$ 200 bps) and observe the effect on valuation
- **Scenario analysis** — change multiple coherent assumptions together (upside, base, downside cases) to produce a valuation range

This converts a model from a single number into a probability-weighted range — and forces the analyst to confront downside cases that confirmation bias would otherwise ignore.

Management Guidance — Use With Care

Analysts lean on management guidance because managers have information not yet public. But guidance is typically a *range*, and managers are known to **shade revenue guidance downward and expense guidance upward** to engineer "beat expectations" headlines. Using the midpoint of the range is therefore often too optimistic on earnings. Guidance is most useful when management has a history of providing reasonable estimates.

Exam Tip: Nonrecurring items should **not** be in the forecast object — analyse them stand-alone. But if a company cites "nonrecurring" items year after year, treat them as a recurring cost of doing business and include them.

QUIZ 2 · CHECKPOINT

Test Your Understanding: Balance Sheet, CFS & Biases

Q6. An analyst forecasts accounts receivable using days' sales outstanding (DSO). The appropriate formula is $DSO \times (\text{forecast revenue} / 365)$. Which balance-sheet item uses *COGS* (rather than revenue) as its driver?

Q7. In a fully integrated three-statement forecast, assets exceed liabilities plus equity by \$120m. The most common treatment is to:

Q8. Forecast depreciation for the coming year is *40m*. *Forecast capex is 65m*. Opening net PP&E is \$300m. Assuming no disposals, forecast closing net PP&E is *closest to*:

Q9. An analyst constructs the cash flow statement using the indirect method. Which item would *not* appear in the CFO section?

Q10. An analyst continues to publish a bullish 12% revenue growth forecast after management has guided to 4% growth and three quarters of data have confirmed the slowdown. This behaviour is *best* described as:

QUIZ 3 · CHECKPOINT

Test Your Understanding: Competition, Inflation & Quality

Q11. According to Porter's five forces, industry profitability is *highest* when:

Q12. In an inflationary environment, a company that raises its prices *too late* is *most likely* to experience:

Q13. A cost leadership competitive strategy is *most consistent* with a forecast that features:

Q14. An analyst presenting a valuation to an investment committee presents a single point estimate of intrinsic value with no sensitivity table. This approach is *most vulnerable* to:

Q15. When computing terminal value using the DCF approach, the analyst should *most appropriately*:

MODULE COMPLETE

Your Scorecard

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LM12 Key Takeaways — Exam-Ready Cheat Sheet

Revenue Forecasting

- 1 **Top-down:** $\text{GDP} \rightarrow \text{industry} \rightarrow \text{market share} \times \text{price}$. Best for mature / cyclical firms.
- 2 **Bottom-up:** $\text{units} \times \text{ASP}$, segments, capacity-based (same-store + new). Best for growth / segmented firms.
- 3 **Hybrid:** combine both to surface inconsistencies.

Costs & Non-Operating

- 4 **Variable (% of sales):** COGS, selling & distribution. **Fixed (growth-rate):** G&A, R&D, depreciation.
- 5 **Operating leverage** rises with fixed-cost share; $\text{DOL} = \% \text{ change in operating profit} / \% \text{ change in sales}$.
- 6 **Interest** = **debt** $\times$ **rate**. Use **effective tax rate** for NI, **cash tax rate** for cash flow.

Balance Sheet & CFS

- 7 $\text{AR} = \text{DSO} \times \text{Rev}/365 \cdot \text{Inv} = \text{DOH} \times \text{COGS}/365 \cdot \text{AP} = \text{DPO} \times \text{COGS}/365$
- 8 **PP&E rollforward:** opening + capex – depreciation. **RE rollforward:** opening + NI – dividends.
- 9 **Debt** sized by target leverage (D/E, D/EBITDA) plus funding needs. **Plug** = revolver (shortage) or cash (surplus).

- 10 **CFS** is derived: CFO from NI + dep + Δ working capital; CFI from capex; CFF from debt/dividends/plug. Opening cash + Δ Cash must tie to BS cash.

Biases, Competition & Quality

- 11 **Five biases:** overconfidence, illusion of control, conservatism, representativeness, confirmation. Defense = explicit scenario & sensitivity.
- 12 **Porter's 5 forces:** high barriers + few substitutes + low rivalry + weak buyer/supplier power → high profitability.
- 13 **Strategy:** cost leadership (low margin $\times$ high volume), differentiation (premium price), focus (niche).
- 14 **Inflation:** too-early price hikes → lost volume; too-late hikes → margin compression. Hedges / vertical integration smooth the path.
- 15 **Quality:** forecasts should be ranges, not points. Normalize terminal cash flow; sustainable long-term growth; management guidance is a range — discount optimistic shading.

Last-Minute Exam Checklist

Revenue approaches: Top-down = GDP/industry/share · Bottom-up = units $\times$ price / segments · Hybrid = both

Variable costs = % of sales (COGS, selling) · **Fixed costs** = growth rate (G&A, R&D)

Activity ratios: AR $\leftarrow$ revenue (DSO), Inv $\leftarrow$ COGS (DOH), AP $\leftarrow$ COGS (DPO)

Integration: NI → RE; Δ BS → CFS; plug = revolver (shortage) or cash (surplus)

Taxes: Effective for NI, Cash for CFO

Biases: Overconfidence · Illusion of control · Conservatism · Representativeness · Confirmation

Porter high profit: Weak forces = high barriers, few substitutes, low rivalry

Strategy: Cost leader (volume) · Differentiator (premium) · Focus (niche)