



Sustainable
Energy
Communities



What is a financial analysis?

In connection with financing banks will require that financial and economic analyses be under taken for projects.

Both types of analysis aim at assessing whether the proposed investment is viable.

The financial analysis of a project examines the adequacy of returns to the project-operating entity and to the project participants, whereas economic analysis measures the effect of the project on the economy, as a whole.

For a project to be economically viable, it must be financially sustainable, as well as economically efficient. If a project is not financially sustainable, economic benefits will not be realized. Financial analysis and economic analysis are therefore complementary.

Quite often conclusions of economic analysis may contradict those of financial analysis. This may happen in a strongly regulated environment, - eg. if government establishes import tariffs, considerable taxes, minimum wages, etc. that distort market. Part of project benefits goes to government in the form of taxes, the other part - to private companies but in the economic analysis these two are not distinguished (country's viewpoint) and are summed up as the gain of the whole economy. Meanwhile, financial analysis only assesses company's gains and losses (investor's viewpoint) while taxes, import tariffs, etc. are considered losses. Moreover, proper economic analysis should include externalities like environmental damages but financial analysis may not (if the company is not charged with environmental taxes or these are insufficient to cover full harm to the society).

The major difference lies in the definition of costs and benefits. In financial analysis, all expenditures incurred under the project and revenues resulting from it are taken into account.

This form of analysis is necessary to

- (i) assess the degree at which a project will generate revenues sufficient to meet its financial obligations,
- (ii) assess the incentives for producers, and
- (iii) ensure that demand or output forecasts on which the economic analysis is based are consistent with financial charges or available budget resources.