Introduction to Financial Statement Analysis

Financial Statement Analysis is the process of evaluating a company's financial information to understand its performance, position, and future prospects. **It involves examining financial statements to assess profitability, liquidity, efficiency, solvency, and overall financial health.** This analysis is essential for various stakeholders, including investors, creditors, management, and regulatory bodies, to make informed decisions

Types of Business Enterprises

1. **Sole Proprietorship**
    - **Owned and managed by one person.**
    - The owner earns all profits but also takes all risks.
    - **Example:** A small shop run by an individual.
2. **Partnership**
    - **Owned by two or more people** who share profits and losses.
    - Partners contribute money and share responsibilities.
    - **Example:** A law firm owned by multiple lawyers.
3. **Corporation / Company**
    - **A legal entity separate from its owners** (shareholders).
    - It can raise large amounts of money by selling shares.
    - **Example:** Big companies like Tata or Samsung
4. **Non-Profit Organization (NPO)**
    - **Works for social or charitable purposes** rather than profit.
    - Profits (if any) are reinvested in the mission.
    - **Example:** NGOs or charities like Red Cross.

Objectives of Business Enterprises

1. **Profit Maximization**
    - The primary goal for most businesses is **to earn profits**.
    - Example: A company sells products to earn as much revenue as possible.
2. **Growth and Expansion**
    - Businesses aim to **grow** by increasing customers, sales, and market presence.
    - Example: A restaurant opening new branches in different cities.
3. **Customer Satisfaction**

- Providing **good products and services** to keep customers happy.
- Example: A clothing store offering quality clothes and good service.

4. **Social Responsibility**
   - Businesses contribute to **society and the environment**, like reducing pollution or helping communities.
   - Example: A company planting trees as part of a green initiative.
5. **Innovation and Development**
   - Businesses constantly **create new products** and improve existing ones to stay competitive.
   - Example: A mobile company launching new features every year.
6. **Employee Welfare**
   - Ensuring employees are happy and productive by providing **good working conditions and fair wages**.
   - Example: A company giving bonuses and paid vacations.

Conventional & Non-Conventional Sources of Financing Business Enterprise.

Conventional Sources of Financing

Definition:
Conventional financing refers to traditional methods of raising funds that are widely accepted in the business world. These sources typically involve formal agreements, structured repayment terms, and are often regulated by government laws.

1. Bank Loans:

- **Description:** Businesses borrow money from banks with a fixed interest rate and repayment schedule.
- **Advantages:**
  - Typically lower interest rates than other sources.
  - Structured repayment plans.
- **Example:** A small business takes a loan of ₹5 lakhs from a bank to purchase equipment.

2. Equity Financing:

- **Description:** Raising funds by selling shares of the company to investors.
- **Advantages:**
  - No repayment obligation like loans.
  - Investors may provide valuable expertise and networking opportunities.
- **Example:** A startup sells 20% equity to venture capitalists in exchange for ₹10 crores to scale its operations.

3. Bonds:

- **Description:** Companies issue bonds to raise money, promising to pay back the principal along with interest over a specified period.
- **Advantages:**
  - Attracts large amounts of capital.
  - Interest payments are often tax-deductible.
- **Example:** A corporation issues ₹50 crores worth of bonds at an interest rate of 6%

Non-Conventional Sources of Financing

Definition: Non-conventional sources of financing are ways to get money for your business that are different from traditional methods like bank loans or issuing shares. These sources often involve less formal processes and can be more flexible.

Crowdfunding

- **What it is**: Raising small amounts of money from a large number of people, typically via the internet.
- **How it works**: You present your business idea on a crowdfunding platform (like Kickstarter or Indiegogo), and people can contribute money to help fund it. If your project is successful, they may receive a product or reward in return.

Angel Investors

- **What it is**: Wealthy individuals who invest their personal money into startups or small businesses.
- **How it works**: They provide funding in exchange for ownership equity or convertible debt. Besides money, they often offer advice and connections to help the business grow
- **Example:** An angel investor provides ₹2 crores to a fledgling restaurant in exchange for a 15% equity stake.

Venture Capitalists (VCs)

- **What it is**: Firms or individuals that invest large sums of money into businesses with high growth potential in exchange for equity (ownership).
- **How it works**: VCs usually look for innovative startups and take an active role in managing the business. They expect a high return on their investment within a few years.

Peer-to-Peer Lending (P2P Lending)

- **What it is**: Borrowing money directly from individuals or groups through online platforms, cutting out traditional financial institutions.

- **How it works**: You can apply for a loan on a P2P platform, and individual investors can choose to fund part or all of your loan based on your creditworthiness and business plan.

Identification of Financial Statement Formats Manufacturing A/c, Trading A/c, Profit & Loss A/c

Accounting rules:

In accounting, accounts are classified into three main categories: **Personal Accounts**, **Real Accounts**, and **Nominal Accounts**. Each type serves a specific purpose and follows distinct rules. Here's a detailed explanation of each type along with examples:

1. Personal Accounts

Definition: Personal accounts relate to individuals, companies, or other entities. They represent the financial relationships an entity has with people or organizations.

Types:

- **Natural Persons:** Accounts of individuals (e.g., John Doe's Account).
- **Artificial Persons:** Accounts of companies, partnerships, and organizations (e.g., ABC Corporation).

Rule: The basic rule for personal accounts is: **"Debit the receiver, Credit the giver."**

Example:

- If a company receives cash from a customer (let's say, John Doe), the entry would be:
    - **Debit** Cash Account (Real Account) – cash is received (increased).
    - **Credit** John Doe's Account (Personal Account) – John Doe is giving cash (decreased).

2. Real Accounts

Definition: Real accounts are related to assets and liabilities. They represent tangible and intangible assets owned by the business.

Types:

- **Tangible Assets:** Physical items (e.g., cash, inventory, buildings).
- **Intangible Assets:** Non-physical items (e.g., patents, trademarks).

Rule: The rule for real accounts is: **"Debit what comes in, Credit what goes out."**

Example:

- If a company purchases machinery for $10,000, the entry would be:
  - **Debit** Machinery Account (Real Account) – the asset is received (increased).
  - **Credit** Cash Account (Real Account) – cash is given out (decreased).

3. Nominal Accounts

Definition: Nominal accounts are temporary accounts that represent expenses, losses, income, and gains. These accounts are closed at the end of each accounting period.

Types:

- **Expenses:** Costs incurred by the business (e.g., Rent Expense, Salaries Expense).
- **Income:** Revenue earned by the business (e.g., Sales Revenue, Interest Income).

Rule: The rule for nominal accounts is: **"Debit all expenses and losses, Credit all incomes and gains."**

Example:

- If a company earns $5,000 from sales, the entry would be:
  - **Debit** Sales Revenue (Nominal Account) – income is earned (increased).
  - **Credit** Cash Account (Real Account) – cash is received (increased).

Summary of Rules

Account Type	Rule
Personal	Debit the receiver, Credit the giver.
Real	Debit what comes in, Credit what goes out.
Nominal	Debit all expenses and losses, Credit all incomes and gains.

Comparison of Personal, Real, and Nominal Accounts

Aspect	Personal Accounts	Real Accounts	Nominal Accounts
Definition	Accounts related to individuals or entities.	Accounts related to assets and resources.	Accounts related to income and expenses.
Types	Natural, Artificial, Representative.	Tangible and Intangible.	Revenue and Expense Accounts.
Rule	Debit the receiver, Credit the giver.	Debit what comes in, Credit what goes out.	Debit all expenses and losses, Credit all incomes and gains.
Examples	John Doe's Account, ABC Corporation Account.	Cash, Inventory, Machinery, Patents.	Sales Revenue, Rent Expense, Cost of Goods Sold.