



## FOUNDATIONS OF ENTREPRENEURSHIP

### DEPARTMENT/SCHOOL

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### REFERENCES

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## INTRODUCTION TO FINANCIAL STATEMENTS

The saying goes like this – If one can't manage finances, can't manage a business. Understanding finances is one of the critical part of successful running of a business. Many startups fail because they run out of cash since the founders fail to foresee it coming. Foreseeing is possible only if one has grip on financial statements and have a sharp eye on the future cash flow. If a negative cash flow is looming ahead, the founder should arrange money in advance to avert a negative cash flow situation. The day cash flow is negative, it is almost the end of the company.

## UNDERSTANDING CASH FLOW IS CRITICAL FOR BUSINESS SUCCESS

Data collated by cbinsight.com show that one of the causes of failure of a significant percentage of companies is that they run out of cash. This data emphasizes the logic stated above. All entrepreneurs and non-entrepreneurs who are directly or remotely connected to the past, present and future financials of a company must have a grip on financial statements.

### ACCESS TO FINANCIAL INFORMATION

The primary purpose of financial statements is to report the actual financial state of any company to all stakeholders. Most of the stakeholders do not have access to day-to-day operations of the company and depend on the published financial statements (and some statutory announcements from time to time) to make any assessment of the financial health of the company. Such stakeholders include:

- Founders/ Promoters / Owners
- Shareholders
- Lenders (bankers)
- Government (Income tax and GST department)
- Economists
- Analysts
- Investors
- Employees
- Policymakers or Statisticians

## THE WHY ?

### SIGNIFICANCE OF FINANCIAL STATEMENTS

One particular data would explain the significance of financial statements. The total aggregate transaction value of all the shares traded in stock markets across the world is more than the aggregate global GDP of all the nations of the world. These investment decisions in the stock market are made based on the financial position published in the statements of the companies the shares represent. Anomalies in financial statements would turn the assessment inaccurate and mislead the investment decisions. You can appreciate the need for a system that ensures quality information dissemination in the form of accurate financial statements.

Three key financial statements are prepared by most enterprises:

1. Balance Sheet
2. Profit & Loss or Income statement
3. Cash Flow statement

Balance sheet shows the financial position, i.e., the comprehensive list of assets and liabilities of an enterprise as on a particular day.

The Profit & Loss account/statement shows all the earnings and expenses of an enterprise during a certain period, such as year, half year, or quarter and the surplus left after meeting all the expenses.

The Cash Flow statement exhibits the inflow of cash and outflow of cash. It ends with the final cash balance as on the last day of a particular period for any business.

Financial statements should be viewed from two perspectives: one from the perspective of the entrepreneurs or promoters, and the other, from the other stakeholders'.

Depending on which side you are in, you would like to look at it through different prisms.

Owners of a company frequently under-report or over-report the data in financial statements with different objectives. In particular, over-reporting is done to convey to stakeholders that the company has been performing better than actual with the ultimate goals to either give fake comfort or artificially increase the share price. Under-reporting may be done to bring the share price down and surreptitiously buy them low and later sell them high after over-reporting the results [there is no shortage of crooks/culprits/fraudsters of this kind]. Accounting regulators across the world have been struggling for centuries to invent new techniques or regulations to prevent the makers of the financial statements from falsifying in these statements. But manipulation in financial statements is believed to be all-pervasive till today. However, in-depth knowledge of all the financial statements and thorough analysis may help to identify the fabrication/falsification in financial statements and come up with the real state of the affair by recasting the statements.

### Major Disaster for Accounting Frauds

#### Accounting Fraud: Enron

At its peak, Enron was one of America's largest corporations with 22,000 employees. Enron reported \$111 billion in revenues in 2000, overstated profit, and hid the size of the debt. Investors were gung-ho about the shares and the share price went up to \$90 plus. The size of the manipulation became so large that it was no longer sustainable. It came to light due to some inspection. The share price went down from \$90.75 in August 2000 to just \$0.67 in 2002 to 0.0 soon after that.

#### Accounting Frauds: WorldCom

WorldCom, USA, was the second-biggest phone company. The company was going through tough times and were incurring huge losses consecutively for years. But they fraudulently underreported the cost of a staggering \$3.8 billion. As it happens in all fraudulent acts, they could not sustain the over-reporting and, in 2020, filed for bankruptcy.

#### Accounting Frauds: Satyam Computers of Hyderabad

The chairman of Satyam Computers, Ramalinga Raju, confessed that the company's accounts had been falsified to the extent of Rs 12,318 crore. The company went through indescribable turmoil rendering thousands of employees jobless and millions of investors poorer. Imagine that you bought 1000 shares of Satyam Computers @₹1000 each for ₹10,00,000. Your value went down to ₹10,000 after the scam was busted.

You can now appreciate the importance of having a clear understanding of financial statements for a meaningful assessment of company performance.



*Groww is looking to launch its neo-banking platform. It is planning to emerge as a one-stop solution for the users to help with their banking and investments and thus, be more holistic for the users.*

*They are alumnae of e-commerce companies. They could rightly predict that the disposable incomes of Indians are on the rise and people would explore ease of investment. They made extensive studies of customers' pain and did numerous experiments to identify the best way to provide best possible customer experience. They observed that the existing process of opening various accounts for investment were inefficient, cumbersome and discouraging.*

*The company's mission is to give the investors the greatest experience possible when it comes to managing their money. To make investment as simple as possible.*



## **MICROSOFT CEO SATYA NADELLA JOINS GROWW AS INVESTOR ADVISER**

Groww enables users to invest in stocks, mutual funds, ETFs, IPOs, Gold etc. Starting in 2017, it claims to have more than 15 million registered users.

Groww had raised USD 251 million (around Rs 1,885 crore) in October last year in a funding round led by Iconiq Growth, which valued the mutual fund and