Analysis of the Corporate Profit Model behind Financial Statements

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Abstract: In modern enterprise management, financial statements, as a direct reflection of an enterprise's economic activities, are not only an important basis for external stakeholders such as investors and creditors to assess the enterprise's value, but also a key tool for internal managers to understand the business situation and make strategic decisions. An in-depth analysis of the enterprise's profit model behind financial statements is of great significance for understanding how enterprises create value, identifying profit drivers, and predicting future development trends. This article will start from the basic composition of financial statements and explore how to reveal the profit model of an enterprise by analyzing the balance sheet, income statement and cash flow statement.

Keywords: Financial Statements; Profit Model; Balance Sheet; Income Statement; Cash Flow Statement

1. Introduction

In the current context where the process of global economic integration is accelerating and market competition is becoming increasingly fierce, the business environment that enterprises are facing is becoming increasingly complex and changeable. The enterprise profit model, as the core mechanism for enterprises to obtain profits and achieve sustainable development, is becoming increasingly important. An effective profit model can not only help enterprises stand out in the fierce market competition, but also create long-term and stable profits for them [1].

Financial statements, as a comprehensive reflection of an enterprise's financial position, operating results and cash flows, contain rich operational information of the enterprise [2]. It is not only an important bridge for communication between enterprises and external stakeholders, but also a key basis for decision-making analysis by internal managers of enterprises. By conducting in-depth analysis of financial statements, managers can gain insights into the profit model of an enterprise, including key elements such as revenue sources, cost structure, profit margins, and cash flow status [3]. This kind of analysis helps managers understand how enterprises create value, identify the drivers of profits, and then formulate more scientific and reasonable strategic plans to cope with market changes and challenges [4].

In recent years, with the development of information technology and the wide application of big data, the methods and means of financial statement analysis have been constantly innovated and enriched. However, no matter how the analytical methods change, an in-depth analysis of the enterprise's profit model behind the financial statements has always been the core content of financial statement analysis [5]. Therefore, this article aims to start from the basic composition of financial statements, explore how to reveal the profit model of an enterprise by analyzing the balance sheet, income statement and cash flow statement, and illustrate it in combination with practical cases, with the expectation of providing useful references and lessons for enterprise managers.

2. The Basic Composition of Financial Statements

Financial statements mainly consist of three major parts: the balance sheet, the income statement and the cash flow statement. Each of them reflects the financial position and operating results of an enterprise in different aspects.

2.1 Balance Sheet

The balance sheet, a fundamental financial document, serves to illustrate the precise condition of a company's assets, liabilities, and owner's equity at a specific moment in time [6]. Its construction adheres rigorously to the accounting equation "Assets = Liabilities +

Owner's Equity," thereby providing a transparent depiction of the company's financial architecture, debt-servicing capacity, and the efficiency of its asset utilization.

Assets encompass all resources owned or controlled by a company, anticipated to yield economic advantages. Within the balance sheet, asset categories are organized according to their liquidity, primarily comprising two segments: current assets and non-current assets. Current assets, such as cash, accounts receivable, and inventory, exhibit high liquidity, enabling conversion into cash within a brief timeframe to address the company's daily operational financial requirements. Non-current assets, including fixed assets, intangible assets, and long-term investments, predominantly mirror the company's strategic placement and accumulation of long-term investment and production capabilities [7].

Liabilities denote the present obligations of a company, arising from historical transactions or events, with the anticipation of economic benefits exiting the company. Liability categories are also arranged by liquidity, distinguishing between current and non-current liabilities. Current liabilities, such as accounts payable and short-term borrowings, necessitate repayment in the near term, imposing stricter demands on the company's short-term liquidity. Non-current liabilities, such as long-term borrowings and bonds payable, boast extended repayment timelines, granting companies greater flexibility in capital allocation [8].

Owner's equity embodies the residual interest accruing to the company's owners after subtracting liabilities from assets. It incorporates various components, including paid-in capital, capital reserve, surplus reserve, and undistributed profits, each offering a distinct perspective on the company's capital structure and profitability. Paid-in capital signifies the owners' tangible investment in the company. Capital reserve mirrors the appreciation of the company's capital. Surplus reserve and undistributed profits are intricately linked to the company's profit accumulation and distribution.

2.2 Profit Statement

The income statement, being a fundamental financial statement, serves to document the revenue, expenses, and profit status of a company within a designated accounting period [9]. Its preparation adheres strictly to the accounting equation "Revenue-Expense = Profit," and it serves as a vital reference point for assessing the operational performance and profitability of businesses.

Revenue denotes the aggregate inflow of economic benefits that an enterprise generates through its routine operational endeavors, fostering an augmentation in the owner's equity and unconnected to the owner's capital investment. Within the income statement, the revenue category typically encompasses various facets, such as primary business income and additional business income. Primary business income is the revenue derived from an enterprise's core business activities and plays a pivotal supporting role in the enterprise's sustainable development. Additional business income may stem from non-core business operations of the enterprise, such as asset leasing, technology transfer, and so forth.

Expenses signify the aggregate outflow of economic benefits that an enterprise incurs through its routine operational activities, resulting in a diminution of the owner's equity and unrelated to the distribution of profits to the owners. The expense categories encompass operating costs, taxes and surcharges, sales expenses, administrative expenses, financial expenses, and more [10]. Operating costs are the direct expenditures incurred by an enterprise for the production of goods or the provision of services. Taxes and surcharges represent the pertinent taxes and fees that enterprises are obligated to bear in their business operations. Selling expenses refer to the myriad costs incurred by an enterprise during the process of selling merchandise and materials and providing services. Administrative expenses denote the diverse costs incurred by the administrative department of an enterprise for organizing and managing production and business activities. Financial expenses represent the financing costs incurred by an enterprise to procure funds necessary for production and operation, and so on.

Profit serves as a reflection of an enterprise's operational outcomes during a specific accounting period, specifically encompassing metrics such as operating profit, total profit, and net profit. Operating profit mirrors the profit scenario resulting from an enterprise's daily business activities. Total profit is predicated on operating profit and considers factors such as non-operating income and expenses. Net profit is

the sum remaining after subtracting income tax expenses from total profit. These metrics illuminate the profitability and operational efficiency of enterprises from varying perspectives, offering a crucial decision-making foundation for stakeholders like enterprise managers, investors, and creditors.

2.3 Cash Flow Statement

The cash flow statement, as a key financial statement, its core function lies in presenting the inflow and outflow dynamics of cash and cash equivalents of an enterprise during a specific accounting period. This report is systematically compiled based on three major categories: operating activities, investment activities and financing activities, thereby accurately reflecting the efficiency level of the enterprise in cash acquisition and capital utilization.

From the perspective of business operations, the cash flows generated mainly reflect the cash receipts and payments situation in the daily operation process of an enterprise. It specifically covers many items, such as the cash received from selling goods and providing services, which directly reflects the cash recovery capacity of the enterprise's main business. The cash paid for purchasing goods and accepting services reflects the cash outflow situation of an enterprise in the daily procurement process.

The cash flows generated from investment activities mainly focus on the acquisition and construction of long-term assets of the enterprise, as well as investment activities not included in the category of cash equivalents and their disposal situations. The cash paid for the purchase and construction of fixed assets, intangible assets and other long-term assets reflects the capital investment of enterprises in expanding production scale and enhancing technological strength, etc. The cash paid for investment reflects the use of funds by the enterprise in terms of external investment.

The cash flows generated from financing activities mainly reveal the changes in the scale and composition of an enterprise's capital and debt. The specific projects include the cash received from absorbing investment, which reflects the funds obtained by the enterprise through equity financing and other means; The cash received from borrowing reflects the funds raised by the enterprise through debt financing channels. The cash paid for debt repayment reflects the cash outflow of an enterprise in terms of debt repayment. Through these projects, a comprehensive understanding of the capital flow and scale changes of the enterprise's financing activities can be achieved.

3. The Relationship between Financial Statements and the Profit Model of Enterprises

There is a close intrinsic connection between the profit model of an enterprise and its financial statements. The two influence and reflect each other, jointly constituting the core framework of an enterprise's economic activities. The profit model, as the way and path for enterprises to obtain profits, directly determines the generation logic and structural characteristics of various data in financial statements. Financial statements, as a quantitative manifestation of an enterprise's operating results, objectively reflect the operational effect and potential problems of the profit model from the data level.

3.1 The Driving Role of the Profit Model on Financial Statements

Different profit models correspond to differentiated revenue recognition methods, cost composition ratios and cash flow characteristics. For instance, in traditional manufacturing industries that focus on product sales, their profit model relies on large-scale production and channel distribution. This is reflected in financial statements as the scale matching of "operating income" and "operating costs", as well as the coordinated fluctuations of "inventory turnover rate" and "accounts receivable turnover rate". For software enterprises mainly providing technical services, they obtain income through project-based or subscription-based systems. In their financial statements, the proportion of "intangible assets" and "research and development expenses" is relatively high, and the "deferred income" item may become an important profit adjustment item. This difference further extends to the balance sheet and cash flow statement: Enterprises with a heavy asset model need to invest a large amount of fixed assets, resulting in the synchronous growth of "fixed assets" and "depreciation expenses", and at the same time, capital expenditures may occupy cash flow. In contrast, enterprises with a light-asset model rely more on human capital and brand value. Their "intangible assets" and "sales expenses" have become key accounts, and the cash flow from operating activities is often

relatively abundant.

3.2 Feedback and Optimization of the Profit Model by Financial Statements

Through profitability analysis (such as gross profit margin and net profit margin), debt-paying ability assessment (such as asset-liability ratio and current ratio), and cash flow health judgment (such as net operating cash flow), enterprises can accurately identify the potential risks and improvement space of their profit models. For instance, if the "gross profit margin" of a certain enterprise continues to decline, it may indicate that there is a deviation in its product pricing strategy or cost control ability, and it needs to respond by adjusting the profit model (such as launching high value-added products) or optimizing supply chain management (such as reducing raw material costs). If the "asset-liability ratio" is too high, one should be vigilant against the debt repayment pressure brought about by excessive borrowing and expansion, and optimize the capital structure in a timely manner through equity financing or asset divestiture. In addition, items such as "Research and Development Expenses" and "Intangible Assets" in financial statements can also reflect the intensity of an enterprise's investment in technological innovation and model upgrading, providing data support for the continuous evolution of its profit model.

3.3 The Impact of Policies and Market Environment on the Profit Model

Adjustments in tax policies (such as additional deductions for research and development expenses), industrial policy orientation (such as green transformation under the "dual carbon" goals), and changes in international trade rules (such as the implementation of the RCEP agreement) may all reshape the cost structure, revenue sources, and competitive landscape of enterprises. This is then reflected in the financial statements as fluctuations in items such as "Taxes and surcharges", "Other Income", and "Non-operating Income and Expenses". Enterprises need to achieve a dual improvement in policy dividends and financial performance by dynamically adjusting their profit models (such as laying out new energy businesses and expanding overseas markets) and optimizing tax planning (such as taking advantage of regional tax preferences).

3.4 Typical Case: Apple's Profit Model and Financial Characteristics

Apple, through its ecological profit model of "hardware + software + services", presents distinct features of "high gross profit margin", "low debt ratio" and "strong cash flow" in its financial statements. Its "inventory turnover rate" and "accounts receivable turnover rate" have long maintained a leading level in the industry, reflecting the efficiency of supply chain management and customer credit control. The huge reserves of patents and technologies in "intangible assets" provide a solid guarantee for long-term competitiveness. In contrast, some enterprises in trouble, such as LetV, which led to a sharp increase in "short-term borrowing" and a depletion of "monetary funds" due to blind expansion, eventually went bankrupt and underwent reorganization due to a liquidity crisis. The extreme data of a "debt-to-asset ratio" exceeding 100% in its financial statements is a direct manifestation of the loss of control over its profit model.

Looking ahead, digital transformation and green development will become the key variables in reshaping the relationship between profit models and financial statements. Enterprises need to achieve continuous upgrading of their profit models and stable growth in financial performance through "service-oriented transformation" (such as shifting from product manufacturers to solution providers), "digital empowerment" (such as financial process automation and supply chain finance platforms), and "policy-driven innovation" (such as increasing investment in green technologies in response to the "dual carbon" goals). For instance, photovoltaic enterprises can adopt a dual-track profit model of "government subsidies + market-oriented operation" to balance the relationship between "non-operating income" and "main business income" in their financial statements. At the same time, they can enhance their long-term competitiveness through the reasonable allocation of "construction in progress" and "intangible assets".

4. Analysis Method of Enterprise Profit Model Based on Financial Statements

4.1 Penetrate the Essence of the Profit Model Through the Structure of Financial Statements

The structure of financial statements is a direct reflection of an enterprise's profit model. By analyzing the core components of the balance sheet, income statement and cash flow statement, the essential characteristics of an enterprise's profit model can be revealed. In the balance sheet, the difference in the proportion of fixed assets and intangible assets often reflects whether an enterprise operates with heavy assets or light assets. The turnover speed of inventory and accounts receivable reflects the sales strategy and the efficiency of capital recovery of an enterprise. In the income statement, the source structure of operating income (such as the proportion of main business income to other business income) directly reflects whether the company's profit sources are diversified, while the ratio of cost and expense to income (such as gross profit margin and net profit margin) reveals the company's cost control ability and pricing strategy. In the cash flow statement, the net amounts and proportional relationships of cash flows from operating activities, investing activities and financing activities can be used to determine the cash flow support capacity of an enterprise's profit model. For instance, the proportion of "research and development expenses" in the income statement of a certain technology enterprise has consistently been higher than the industry average, while the scale of "intangible assets" in the balance sheet has expanded rapidly. This indicates that its profit model is highly dependent on technological innovation and the accumulation of intellectual property rights. This structural feature provides a financial guarantee for its long-term competitiveness.

4.2 Analyze the Sustainability of the Profit Model Using Financial Ratios

Financial ratio analysis is an important tool for evaluating the sustainability of an enterprise's profit model. Through a comprehensive analysis of profitability ratios (such as ROE and ROA), debt-paying ability ratios (such as asset-liability ratio and current ratio), and operational efficiency ratios (such as inventory turnover rate and accounts receivable turnover rate), it can be determined whether a company's profit model has a solid financial foundation. The high levels of ROE and ROA indicate that an enterprise can effectively utilize assets to generate profits. However, it is necessary to combine the asset-liability ratio to determine whether it overly relies on debt financing. The optimization of inventory turnover rate and accounts receivable turnover rate reflects the effectiveness of the enterprise's profit model in supply chain management and customer credit management. For instance, a certain retail enterprise has significantly increased its inventory turnover rate by optimizing the supply chain system and reduced the risk of bad debts by strengthening the management of accounts receivable. As a result, the sustainability of its profit model has been significantly enhanced. In addition, industry comparative analysis is also indispensable. Enterprises need to identify the relative advantages and disadvantages of their own profit models by comparing their financial ratios with those of their competitors in the same industry, providing data support for strategic adjustments.

4.3 Analyze the Quality of the Profit Model in Combination with the Characteristics of Cash Flow

Cash flow is the "blood" of an enterprise's profit model, and its characteristics directly determine the quality of the profit model. The stability and growth of the net cash flow from operating activities are the core indicators for judging whether an enterprise's profit model has the self-sustaining ability. The positive or negative direction of the net cash flow from investment activities reflects whether the enterprise's profit model relies on external expansion or internal optimization. The fluctuation of the net cash flow from financing activities reveals the degree to which an enterprise's profit model relies on external financing. For instance, a certain manufacturing enterprise has achieved capacity expansion through continuous investment in fixed assets, resulting in a long-term negative net cash flow from investment activities. However, its net cash flow from operating activities has maintained a steady growth, indicating that although its profit model requires high initial investment, it is sustainable in the long term. Conversely, if the net cash flow from operating activities of an enterprise remains negative for a long time, it is necessary to be vigilant about whether its profit model has fallen into a vicious cycle of "burning money for expansion". Furthermore, the sufficiency of free cash flow (net cash flow from operating activities-capital expenditures) is a key indicator for measuring whether a company's profit model can support

future growth and shareholder returns.

4.4 Use Trend Analysis and Scenario Simulation to Predict the Evolution of the Profit Model

Trend analysis and scenario simulation are important methods for predicting the evolution of an enterprise's profit model. By analyzing the historical data trends of key items in financial statements (such as the growth rate of operating income, changes in gross profit margin, and the scale of capital expenditures, etc.), the dynamic adjustment direction of the enterprise's profit model can be revealed. For instance, a certain consumer electronics enterprise has seen a continuous decline in capital expenditure in recent years, while the proportion of research and development expenses has been increasing year by year, indicating that its profit model is shifting from "scale expansion" to "technology-driven innovation". Meanwhile, scenario simulation can predict the risk-resistance and adaptability of an enterprise's profit model by constructing financial models under different market environments (such as growing demand, intensified competition, policy changes, etc.). For instance, in the scenario of a significant increase in raw material prices, a certain chemical enterprise, through the simulation analysis of its cost pass-through capacity and product structure adjustment, found that its profit model could still remain relatively stable, which provided an important basis for its strategic decision-making. In addition, the sensitivity analysis of industry trends and technological changes should also be incorporated into the prediction framework of the evolution of profit models to ensure that enterprises can seize opportunities in a timely manner and avoid risks.

5. Conclusion

This paper, through a systematic study of the relationship between enterprise financial statements and profit models, reveals the core value of financial statements as a "quantitative expression tool" for enterprise profit models. Based on the financial analysis framework and empirical cases, the research reaches the following core conclusions:

First, financial statement data is a direct reflection of the profit model. The structure of a company's balance sheet (such as the proportion of light and heavy assets), the ratios of its income statement (such as gross profit margin and net profit margin), and the characteristics of its cash flow (such as the stability of operating cash flow) all directly reflect the essential features of its profit model. For instance, enterprises operating with light assets typically exhibit financial characteristics such as a high sales expense ratio and a low proportion of fixed assets, while heavy-asset enterprises may rely on high leverage or high turnover to drive profits. This conclusion indicates that enterprises need to use financial statements as a "diagnostic tool" to identify the advantages and potential risks of the profit model.

Second, the sustainability of the profit model can be quantitatively verified through financial ratios. The decomposition of ROE (Return on Equity) (such as DuPont analysis) can reveal the driving factors of a company's profits (high leverage, high turnover or high profit margin), while the stability of cash flow (such as the proportion of net cash flow from operating activities to free cash flow) is directly related to the "blood-making ability" of the profit model. Empirical research shows that enterprises that have long relied on external financing or over-invested (such as an abnormally high proportion of fixed assets) have a weaker sustainability of their profit models, while enterprises with stable cash flows are more resilient to market fluctuations.

Thirdly, the innovation of the profit model needs to be coordinated with the financial strategy. Innovative paths such as digital transformation and service-oriented transformation need to achieve value realization through financial strategy adjustments. For instance, through intelligent manufacturing (reducing unit costs) or new energy layout (opening up a second growth curve), enterprises are reflected in their financial statements as an increase in the proportion of R&D investment, an increase in capital expenditure, and a rise in the proportion of new business revenue. This process indicates that enterprises need to take financial strategy as a "navigator", seek a balance between innovation investment and short-term profits, and avoid financial crises caused by blind expansion.

Fourth, policies and market environments are the "external variables" in the evolution of profit models. External factors such as the "dual carbon" policy and ESG (Environmental, Social and Governance) standards are reshaping the underlying logic of corporate profit models. For

instance, high-energy-consuming enterprises need to reduce the cost of carbon emissions through green technology transformation (increasing capital expenditure), while an improvement in ESG ratings may lead to a decrease in financing costs (such as preferential interest rates on green bonds). This conclusion emphasizes that enterprises need to incorporate policies and market environments into the framework of profit model design and deal with external uncertainties through financial planning.

Fifth, future research needs to focus on dynamic financial analysis and profit model prediction. How to predict the evolution trend of an enterprise's profit model through machine learning algorithms (such as LSTM neural networks)? How to construct a three-dimensional analysis model of "finance-strategy-market" to quantitatively evaluate the financial impact of the transformation of the profit model? These directions will provide more precise quantitative support for enterprise decision-making.

Financial statements are not only a quantitative reflection of an enterprise's past operating results, but also a barometer for future strategic adjustments. Enterprise managers need to review the data in financial statements with a "strategic financial mindset", and by dynamically balancing "short-term profits" and "long-term value", build a core competitiveness that is "clear in profit model and financially healthy and stable". Only in this way can sustainable growth be achieved in the complex and ever-changing market environment.

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