II. Short Answer Type Questions

Question 1. State the meaning of finance. What factors determine working capital and fixed capital requirements of a business?
Answer: No business can be started, run or expanded without finance. There are many sources of finance. Each source has its own merits and demerits. Business needs to choose right source of finance to make the best use of it.
Business finance refers to the money required for carrying out business activities. Factors determining working capital requirements of a business:

- Whether firm is selling goods on credit or cash: If the firm is selling goods on credit or cash, then its working capital requirements will be more. On the other hand, if it is selling in cash, its working capital requirements will be less.
- Speed of sales turnover: A firm whose sales process gets converted into cash soon will have lesser working capital requirements and a firm whose sales process gets converted into cash in delay will have more working capital requirements.
- Size and scale of business: If business is operating at a larger scale then working capital requirements will be more. On the other hand, if size and scale of operations is small, its working capital requirements will be less.

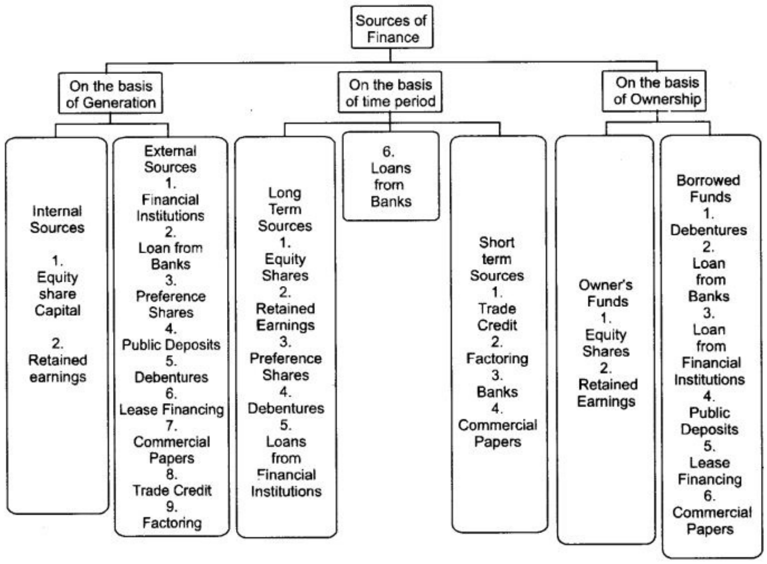
Factors determining Fixed Capital Requirements

- Size and scale of business: If business is operating at a larger scale then fixed capital requirements will be more. On the other hand, if size and scale of operations is small, its fixed capital requirements will be less.
- Technology: A firm using labour intensive method needs lesser fixed capital and a firm using capital intensive methods needs more fixed capital.

Question 2. Why does business enterprise need finance?
Answer: A business needs finance because:

1. Business is concerned with production and distribution of goods and services for the satisfaction of needs of society. There are four factors required for any production: land, labour, capital and entrepreneur. All these factors need to be paid for their services.
2. No business can be carried without availability of adequate funds.
3. As soon as a decision is taken to start a business, requirement of funds initiates.
4. Finance is called 'life blood of a business'.
5. It is very important to assess financial needs of the organization and the identification of various sources of finance.

Question 3. List different types of finance.
Answer:



Question 4. Differentiate between:
(a) Fixed Capital and Working Capital
(b) Short Term Finance and Long Term finance
(c) Owner's Funds and Borrowed Funds
(d) Internal Sources and External Sources
Answer: (a) Fixed Capital and Working Capital

Basis	Fixed Capital	Working Capital
Meaning	In order to start business, funds are required to purchase fixed assets like land and building, plant and machinery, furniture and fixtures etc. It is called fixed capital.	A business needs funds for its day to day operations. This is known as working capital of an enterprise.
Use	It is used to create basic and fundamental structure of business.	It is used for holding current assets such as stock of material, cash in hand, bills receivable and for meeting current expenses like salaries, electricity bill, rent etc.

(b) Short Term Finance and Long Term Finance

Basis	Long Term Finance	Short Term Finance
Meaning	Long term finance fulfils the financial requirements of an enterprise for a period exceeding 5 years.	Short term finance fulfils requirements of an enterprise for a period not exceeding one year.
Use	It is used of requiring fixed assets like equipment, plant and machinery etc.	It is used to meet working capital needs.
Example	Shares, debentures, Long term borrowing and Loans from Financial Institutions.	Trade credit, loans from commercial banks, commercial papers etc.

(c) Owner's Funds and Borrowed Funds

Basis	Owner's Funds	Borrowed Funds
Meaning	Owner's funds means funds that are provided by the owners of an enterprise.	Borrowed funds refer to the funds raised through loans and borrowings.
Duration	Owner's funds remain in business for a longer duration.	It is in business for shorter duration.
Refund	It is not required to be refunded.	It is required to be refunded.
Example	Equity shares, retained earnings.	Debentures, trade credit, loans, public deposits etc.

(d) Internal and External Sources

Basis	Internal Sources	External Sources
Meaning	Internal sources of funds are those that are generated within the business.	External sources of funds are those sources which lie outside an organization.
Duration	Internal sources remain in business for a longer duration.	It is in business for shorter duration.
Example	Equity shares, retained earnings	Debentures, Trade credit loans, public deposits etc.

Question 5. Preference shares are preferred by company but not by investors. Why?
Answer: Preference shares have a filed percentage dividend before any dividend is paid to the ordinary shareholders. As with ordinary shares a preference dividend can only be paid if sufficient

distributable profits are available, although with 'cumulative' preference shares the right to an unpaid dividend is carried forward to later years. The arrears of dividend on cumulative preference shares must be paid before any dividend is paid to the ordinary shareholders.
From the company's point of view, preference shares are advantageous in the following ways:

1. Dividends do not have to be paid in a year in which profits are poor, while this is not the case with interest payments on long term debt (loans or debentures).
2. Since they do not carry voting rights, preference shares avoid diluting the control of existing shareholders while an issue of equity shares would not.
3. Unless they are redeemable, issuing preference shares will lower the company's gearing. Redeemable preference shares are normally treated as debt when gearing is calculated.
4. The issue of preference shares does not restrict the company's borrowing power, at least in the sense that preference share capital is not secured against assets in the business.
5. The non-payment of dividend does not give the preference shareholders the right to appoint a receiver, a right which is normally given to debenture holders.

However, dividend payments on preference shares are not tax deductible in the way that interest payments on debt are. Furthermore, for preference shares to be attractive to investors, the level of payment needs to be higher than for interest on debt to compensate for the additional risks.
For the investor, preference shares are less attractive than loan stock because:

1. They cannot be secured on the company's assets.
2. The dividend yield traditionally offered on preference dividends has been too low to provide an attractive investment compared with the interest yields on loan stock in view of the additional risk involved.

Question 6. What are the differences between Equity Shares and Preference Shares?
Answer: Differences between Equity shares and Preference shares are as follows:

Basis of Difference	Equity Shares	Preference Shares
1. Payment of dividend	Equity dividend is paid after paying the preference shares dividend.	Preference dividend are paid prior to equity shares dividend.
2. Refund of capital	Equity share is refunded only after refund of preference share capital.	Preference shareholder has prior right to refund the capital over equity capital.
3. Rate of dividend	Rate of dividend may over the year in equity shares.	Rate of dividend is fixed in preference shares.
4. Arrears of dividend	Dividend cannot be accumulated in equity share	Arrears of dividend may be accumulated in preference shares.
5. Convertibility	It is not convertible.	It is convertible.
6. Redeemability	It is not redeemable.	It is redeemable.
7. Voting Right	Every shareholder enjoys voting right on general meeting.	Preference shareholders have no such voting rights.

Question 7. Write a short note on the features of GDRs.
Answer: GDRs have following features:

- A bank certificate issued in more than one country for shares in a foreign company.
  The shares are held by a foreign branch of an international bank. The shares trade as domestic shares, but are offered

for sale globally through the various bank branches.

- A financial instrument used by private markets to raise capital denominated in either U.S. dollars or Euros.
- Holders of GDR are eligible only for capital appreciation and dividend but no voting rights.
- These instruments are called EDRs when private markets are attempting to obtain Euros.
- It is a negotiable instrument and can be traded freely like any other security.
- A holder of GDR can convert it into any other security at any time.

Question 8. Name zones of the Lessors and Lessees in India.
Answer: The Lessors

- Specialised Leasing Companies.
- Banks and Bank Subsidiaries
- Specialised Financial Institutions
- Manufacturer Lessors The Lessees
- Public Sector Undertakings
- Mid Market Companies
- Consumers
- Government Departments and Authorities

Question 9. Classify internal and external sources on the basis of time.
Answer:

	Short-Term	**Medium-Term**	**Long-Term**
Internal Sources	Retained Profits Selling Assets Working Capital	Retained Profits	Investing Extra Cash
External Sources	Overdrafts Trade Credit Government Grants Donations Sponsorships Debt Factoring Leasing Hire Purchase Venture Capitalists Preferred Shares	Government Grants Sponsorship Leasing Hire Purchase Bank Loans and Mortgages Venture Capitalists	Ordinary Shares Government Grants Leasing Hire Purchase Bank Loans and Mortgages Debentures

Question 10. What is factoring? Discuss its pros and cons.
Answer: Debtors are the people who owe money to a business. Debt factoring is a financial service that allows a business to raise funds based on the value owed to them by their debtors. Example: Receiving 80% of debtors outstanding debt on selling fabric abroad.
Advantages:

1. It reduces the probability of bad debt-debtors.
2. Non-recourse factoring allows for insurance against bad debts.
3. Companies don't have to chase up their own debtors.
4. Immediate sources of finance.

Disadvantages:

1. Without non-recourse factoring the company will still have to absorb losses.
2. It is expensive.

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