



#### IV. Higher Order Thinking Skills (HOTS)

Question 1. Mr. John has Rs. 1,00,000 for investment purposes. Should he invest in equity shares, preference shares, public deposits or debentures? Justify your answer.

Answer: John's investment depends on many factors:

- If he wants control in the company or participation in management of the company, he should invest in equity shares.
- If he wants some certainty in returns and also wants something extra in case of huge profits, he should invest in preference shares.
- If he wants perfect certainty, he should invest in public deposits or debentures as rate of return is pre fixed.
- He also needs to see if he wants to invest for short term or long term. If he is interested in short term investment, then he should choose public deposits.
- If he is interested in middle term investment, he should invest in preference shares or debentures.
- If he is interested in long term investment, he should invest in equity shares.

Question 2. As a source of finance retained profit is better than other sources. Do you agree with this view? Give reasons for your answer.

Answer: Yes, we agree. Retained earnings are better than other sources of finance because:

- Retained earnings is a permanent source of funds which an organization can avail of.
- It enhances capacity of the business to absorb unexpected losses.
- It does not involve any explicit cost in the form of interest, dividend or flotation cost.
- It may increase the process of equity shares of a company.
- There is a greater degree of operational freedom and flexibility as the funds are generated internally.

#### V. Value Based Questions

Question 1. Retained earnings are not a good source from the values point of view as it is the right of equity shareholders. Do you agree? Justify your answer.

Answer: Equity shareholders get a return only when profits are left after giving interest to debenture holders and preferential dividend to preference shareholders. In case, no profits are left after it, they do not get a return. Therefore, it is unreasonable to transfer funds to general reserves which are called retained profits if there are exceptionally good profits. They took the risk of uncertain returns. Then it is their right to get exceptional returns in good times. But in good times, it is being retained to plough back into the business. Therefore, it is right to say that retained earnings are not a good source from the values point of view as it is the right of equity shareholders.

Question 2. Debentures are good from debenture holders point of view but not for business. Do you agree? Explain.

Answer: Debentures are similar to shares, however, debenture holders do not have voting rights on how the business is run. Debentures have certain merits and demerits from business as well as debenture holders point of view.

These are explained below:

Advantages to Debenture Holders

- They receive annual interest/ benefits (VIP status or free passes) regardless of whether or not the business is making money.

Disadvantages to Debenture Holders

- No say in how the business will run.
- Greatly depends on the business' success to reuse it's value.

Advantages to Business

- Provides good long-term finance without losing control of the business.

Disadvantages to Business

- Firm increases the amount of long-term liabilities raising the amount of interest payments to the lenders.

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