



Estimating Financial Requirement

Question 1. Answer in not more than 15 words:

- (i) Define 'Capitalisation'.
- (ii) Define the term "Business Finance".
- (iii) What is meant by 'Capital Structure'?
- (iv) Name the plan that shows the inflows and utilization of funds.

Answer:

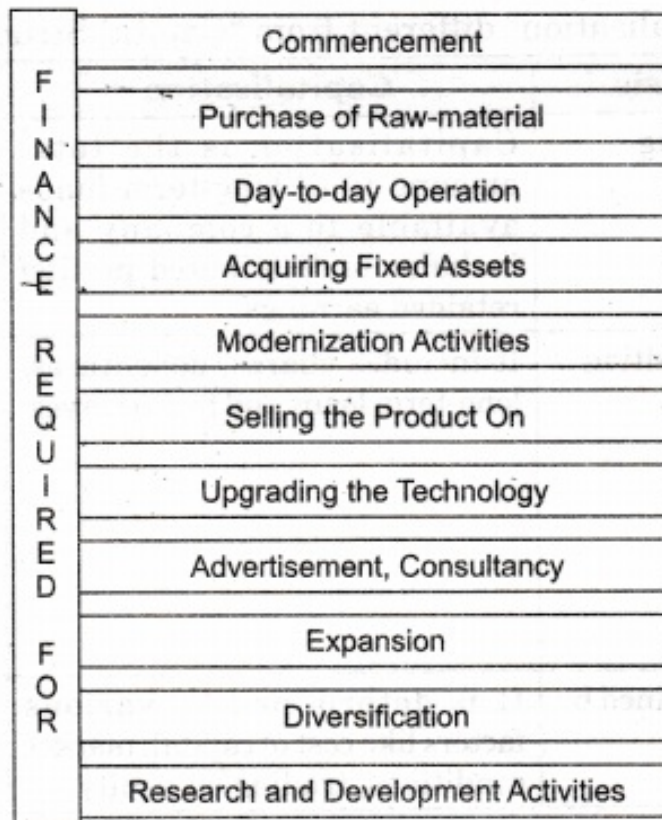
- (i) "Capitalisation of a corporation comprises the ownership capital and the borrowed capital as represented by long-term indebtedness. It may also mean the total accounting value of capital stock surplus in whatever form it may appear and funded long-term debt."—Lillian Doris.
- (ii) Business finance may be defined as the acquisition and utilization of capital funds in meeting the financial needs and overall objectives of a business enterprise.
- (iii) It is the composition or mix of different types of long-term capital whether owned or borrowed. It includes all the long term funds consisting of share capital, debentures, bonds, loans and reserves.
- (iv) Financial Planning.

Question 2. Answer in not more than 50 words:

- (i) Why is finance required for business?
- (ii) Enlist the major areas of financial decision-making by the entrepreneur.
- (iii) The nature of business affects the requirement of fixed capital. Give two examples to support this observations.

Answer:

- (i) Finance is the life blood of the business. It is one of the basic foundations of all kinds of economic activities. It is the master key which provides access to all the other sources for being employed in manufacturing and merchandising activities. It is required for many purpose:



(ii) The two major areas of financial decision-making, requires on part of entrepreneur to take the:

- (a) Funds requirement decision
- (b) Financing decisions

(iii)

- Fixed capital refers to that which is required in a business for meeting the permanent or long term needs.
- The total capital is divided into two parts - (a) Fixed Capital and Working capital. For the business the entrepreneur invest major part of the total capital in the business.
- Need of fixed capital depends upon the nature of business.
- Nature of business is of two kinds: (a) Manufacturing Business, (b) Trading Business and Services.
- In case of manufacturing business, large investment is made in land, building, machinery, etc.



The type or nature of business determines the fixed capital requirement of a concern. Manufacturing concerns require more of fixed capital as they have to invest heavily on purchase of land, plant and machinery building, furniture, other fixed assets according to type of business, etc. Various public utility undertakings like Railways, Electricity, Water supply, other facilities have to invest heavily on fixed assets. Trading organizations does not required heavy investment or it requires very less amount to invest on fixed capital..

Question 3. Answer in not more than 75 words:

- (i) How is "Capitalisation" different from "Capital Structure"?

Answer: (i)

S.No.	Basis	Capitalisation	Capital Structure
1.	Meaning	Capitalisation is the total amount of all long-term funds available to a company and includes undistributed profits/retained earnings.	Capital structure is the composition or mix of different types of long-term capital whether owner's funds or borrowed funds.
2.	Composition	It includes shares, debentures, long-term loans and free reserves.	It includes in the following pattern: (1) Equity shares only (2) Both equity and preference shares (3) Equity and debentures (4) Equity, preference and debentures.
3.	Determined by	It is determined by various factors like cost of capital, market conditions, trading on equity.	It is determined by earning capacity of the company.

Question 4. Answer in not more than 150 words:

(i) What are the objectives of financial planning?

(ii) Differentiate between the Fixed Capital Requirement and Working Capital Requirement on the following basis:

(a) Meaning and Scope

(b) Nature

(c) Duration

(d) Sources of Procurement

(iii) State whether the following require small or large working capital. Answer should be supported by a valid reason:

Answer:

(i) Financial planning being an intellectual process of formulating a financial plan, is devised to achieve the following objectives:

(a) To assess the amount of finance needed by enterprise.

(b) To assess the different types of financial requirements, viz. long, medium and short-term.

(c) Funds, i.e. capitalization.

(d) To develop suitable capital structure for the enterprise funds from the suitable sources, keeping in view the principles of economy, convenience, financial commitments, ownership, etc.

(e) According to pre-determined objectives, to allocate the funds to various departments according to requirement to achieve the predetermined objectives.

(f) To make the policies related with the finance for the enterprise.

(g) To safeguard the enterprise from financial risk.

(h) To establish effective control on financial matters.

(i) To provide optimum amount of working capital requirement of the enterprise.

(l) To build up reserves for future contingencies.

(ii)

S.No.	Basis	Fixed Capital Requirement	Working Capital Requirement
(a)	Meaning	The capital which is required for meeting the permanent or long term needs of the business is referred as fixed capital.	Working capital refers to that part of the capital which is needed for the financing of the working or current requirements of the enterprises and for meeting out day-to-day operational expenses.
(b)	Scope		
(c)	Nature	Permanent in nature. It does not change with the change in the volume of output. Nature of business decides the amount of fixed capital in a business.	Fluctuating in nature. It varies with the change in the volume of output. Trading and financial firm's needs less fixed capital. They require more working to invest in current assets.
(d)	Manufacturing	Need sizeable amount of fixed capital. Trading and financial firm's needs less fixed capital services. Public enterprises require huge fixed investment in such as railways, electricity, sewerage system, etc.	Manufacturing unit Services unit Trading business;

(e)	Duration	It is required for meeting long term need of the business enterprise means more than one year.	It is required to meet short term/day to day needs of the business enterprise means within one year.
(f)	Sources of procurement used	It is procured by long-term sources like owner's fund, long term loans and public deposits retained profits.	It is procured by long-term, medium term and short term sources like shares, bank credit, trade credit, financial institutions, public deposits etc.

(iii)

S.No.	Items	Small/Large Working Capital	Reasons
(a)	Selling ice-creams	Small Working Capital	It is a retail shop and the product is sold in cash therefore it requires less working capital.
(b)	Following a liberal credit policy	Large Working Capital	When the market is competitive, then the enterprises /entrepreneur believe in selling goods on credit, needs more working capital.
(c)	Dealing in stainless steel wares	Large Working Capital	He need to stock up inventories. The larger the stocks of finished goods (steel wares) required to be kept, the more will be the need for working capital.
(d)	Using capital intensive technology	Large Working Capital	Using capital intensive technique means it is a manufacturing unit. It gives an indication that large amount of working capital is required.

Question 5. Answer in not more than 250 words:

- Discuss the factors that determine the amount of working capital required by an enterprise.
- Explain the term 'Fixed Capital Requirement'. Discuss the factors to be kept in mind while planning for fixed capital.
- 'An ideal capital structure is the result of great planning and team work'. What factors are required to be planned and paid attention at this time?
- Explain the meaning of "Working Capital". Briefly state any four factors that help determining the working capital requirement of a company.

Answer:

(i) Working capital refers to that part of the capital which is needed for the financing of the working or current requirements of the enterprises and for meeting out day-to-day operational expenses. Factors determining the amount of working capital:

The requirement of working capital is not uniform in all enterprises. It varies from one enterprise to another because of following factors playing the lead role:

- Nature and size of business:** The business that is engaged in production process requires more working capital in comparison to the one lending trade services. Similarly enterprises working on large demands for higher working capital than small scale units.
- Business Cycle:** Boom period is marked by more demand, more production and thus more working capital as compared to depression phase having declined demands.
- Gestation Period:** Longer the time gap between commencement and end of manufacturing process, more is requirement working capital as compared to industries having shorter gestation period.
- Volume and procurement of raw material:** If amount to be spent on raw material is more in total investment, automatically, the requirement for working capital will be higher as compared to those enterprises where the raw material cost involved is smaller.
- Manual vis Automation:** In labour intensive industries, large working capital will be required than in the highly mechanized ones.
- Need to stock up inventories:** The larger the stocks of whether raw material or finished goods required to be kept, more will be the need for working capital and vice-versa.
- Turnover of working capital:** Turnover means the rate at which the working capital is recovered by the sale of finished goods

enterprises where the rate is higher-less working capital is required as compared to enterprises having lesser slow rate.

8. Terms of Credit: Those enterprises who believe in selling goods on credit, needs more working capital than the ones selling goods against cash.

(ii) The capital which is required for meeting the permanent or long term needs of the business is referred as fixed capital. It is that part of the total capital of an enterprise which is invested for the purchase of fixed assets like land and building, plant and machinery, etc.

Features:

Fixed capital exhibits the following characteristics:

(a) It is not easy to withdraw the capital from business, as it's more like a permanent capital.

(b) Generally the fixed capital is procured through long term financial resources.

(c) It is invested in procuring fixed assets.

(d) It forms the basis for income generation capacity of the enterprise.

The assessment of fixed capital requirement for a business can be made by preparing a list of fixed assets required. At the same time, an entrepreneur should keep in mind the following factors too:

(a) Nature of his/her business: viz. trading, manufacturing, services.

(b) Size of the business: small business needs less fixed capital in comparison to

large scale enterprises. .

(c) Technology to be used in production, i.e. whether capital intensive or labour intensive.

(d) Range of production: If more diversified products are manufactured, more is

fixed capital requirement in comparison to those who deal in single type of product range. .

(e) Type of product to be manufactured: It may range from being simple (e.g. soap) to a highly complicated machinery, thus demanding more investment in fixed assets.

(f) Method of acquisition of fixed assets: The option of buying a fixed asset demands more capital in comparison to acquiring an asset on lease or hire purchase system.

(iii) Following factors affect the determination of capital structure:

(a) Nature of sales: Higher is the sale of the product, greater is the turnover and consequently the fixed obligations are difficult to fulfill. Here the enterprise has to rely on obtaining more debt. In case the sales are low, debt is not preferred.

(b) Control: If the enterprise is willing to share the power then equity is preferred, If it does not want to dilute its control then it prefers debt, debentures etc.

(c) Flexibility: Capital structure should be flexible enough to raise additional funds without undue delay and cost.

(d) Legal factor: A enterprise has to work within the framework of the law. It has to modify and make changes with the changing laws of the country. The rules for this purpose are made by SEBI, Govt, of India, etc.

(e) Situation of market: During the period of boom, the trust is more on equity shares thus it is preferable. During the situation of depression, the trust is on debentures and also debt is not preferable.

(iv) Working capital refers to that part of the capital which is needed for the financing of the working or current requirements of the enterprises and for meeting out day-to-day operational expenses.

Factors determining the amount of working capital:

The requirement of working capital is not uniform in all enterprises. It varies from one enterprise to another because of following factors playing the lead role:

(a) Size of business: The business that is engaged in production

process requires more working capital in comparison to the one lending trade services.

Larger is the size of enterprise, larger is the requirement of working capital. On the contrary, smaller is the size of enterprise, smaller is the requirement of working capital.

(b) Business Cycle: Boom period is marked by more demand, more production and thus more working capital as compared to depression phase having declined demands.

(c) Gestation Period: It refers to the time gap between commencement and end of manufacturing process. Longer is the length of operating cycle/gestation period larger is the requirement of working capital because it is due to the fact that more money is needed for making stocks, purchasing raw materials, etc. and if shorter the period less working capital is required.

(d) Volume and procurement of raw material: If amount to be spent on raw material is more in total investment, automatically, the requirement for working capital will be higher as compared to those enterprises where the raw material cost involved is smaller.

(e) Manual vis automation: In labour-intensive industries, large working capital will be required than in the highly mechanized ones.

(f) Need to stock up inventories: The larger the stocks of whether raw material or finished goods required to be kept, more will be the need for working capital and vice-versa.

(g) Turnover of working capital: Turnover means the rate at which the working capital is recovered by the sale of finished goods enterprises. Higher is the sales turnover, lower is the requirement of working capital. The revenue obtained from the current assets. On the other hand, lower is the sales turnover; higher is the requirement of working capital.

(h) Terms of Credit: Those enterprises who believe in selling goods on credit, needs more working capital than the ones selling goods against cash.

(i) Nature of the enterprise: Requirement of working capital is different types of enterprises. Restaurants, hotels, etc. have less working capital requirement due to cash sales. Enterprise producing heavy machines needs more working capital, as their operating cycle is longer.

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