Chapter – 19

Sources of Business Finance

I. Choose the Correct Answer

Question 1.
What is defined as the provision of money at the time when it is required?
(a) Finance
(b) Bank
(c) Cash management
(d) None of these

Answer:
(a) Finance

Question 2.
Internal sources of capital are those that are ……………..
(a) a generated through outsiders such as suppliers
(b) generated through loans from commercial banks
(c) generated through issue of shares
(d) generated within the business

Answer:
(d) generated within the business

Question 3.
Debenture holders are entitled to a fixed rate of ……………..
(a) Dividend
(b) Profits
(c) Interest
(d) Ratios

Answer:
(c) Interest

Question 4.
Public deposits are the deposits which are raised directly from ……………..

(a) the public
(b) the directors
(c) the auditors
(d) the owners

Answer:
(a) the public

Question 5.
Equity shareholders are the …………….. of a company.
(a) Creditors
(b) Owners
(c) Debtors
(d) Employees

Answer:
(b) Owners

Question 6.
Funds required for purchasing current assets is an example for ……………..
(a) Fixed Capital Requirement
(b) Ploughing Back of Profits
(c) Working Capital Requirement
(d) Lease Financing

Answer:
(c) Working Capital Requirement

Question 7.
Which of the following holder is given voting right?
(a) Debentures
(b) Preference Shares
(c) Equity shares
(d) Bonds

Answer:
(c) Equity shares

Question 8.
It may be wise to finance fixed assets through ………………
(a) Creditors
(b) Long term debts
(c) Bank Overdraft
(d) Bills Discounting

Answer:
(b) Long term debts

II. Very Short Answer Questions

Question 1.
Write short notes on debentures.

Answer:
Debentures are an important instrument for raising long term debt capital. It is a medium to long-term debt instrument used by large companies to borrow money, at a fixed rate of interest.

Question 2.
What do you mean by public deposits?

Answer:
Debentures are an important instrument for raising long term debt capital. A company can raise funds through the issue of debentures which bear a fixed rate of interest.

Question 3.
Name any two sources of funds classified under borrowed funds.

Answer:
Debentures and Loans from banks and financial institutions.

Question 4.
Name any two internal sources of business finance.

Answer:

1. Retained earnings
2. Collections form receivables

Question 5.
State any two factors that affect the choice of source of finance.

Answer:

1. The creditworthiness of the firms.
2. The time period for which the business finance is required determines the suitable source.

III. Short Answer Questions

Question 1.
Define Business finance.

Answer:
"Finance is that business activity which is concerned with the acquisition and conservation of capital fund in meeting the financial needs and overall objectives of business enterprises." – B.O. Wheeler

Question 2.
What is pledge?

Answer:
A customer transfers the possession of an article with the creditor (banker) and receives loan. Till the repayment of loan, the article is under the custody of the borrower. If the debtor fails to refund the loan, creditor (banker) will auction the article pawned and adjust the outstanding loan from the sale proceeds. This is known as pledge.

Question 3.
List sources of raising long – term and short – term finance.

Answer:
Sources of Short-Term Finance:

- Loans and Advances
- Bank Overdraft
- Discounting Bills of Exchange
- Trade Credit
- Pledge
- Hypothecation
- Mortgage
- Loans Against the Securities
- Clean Loan
- Commercial Paper (CP)
- Hire Purchase Finance
- Factoring

Sources of Long-Term Finance:

- Shares (i) Equity Shares (ii) Preference Shares
- Debentures
- Retained Earnings
- Public Deposits
- Long Term Loan from Commercial Banks
- The Loans from Financial Institutions

Question 4.
For which purpose fixed capital is needed in business?

Answer:
Fixed capital is needed for the purchase of plant, machinery, furniture, fixtures, vehicles, and all other assets. It helps to lay down the basic infrastructure on which business is supposed to stand and flourish in a long run. It is also used to purchase intangible assets like patents, copyrights, goodwill, etc.

Question 5.
What do you mean by the working capital requirement of a business?

Answer:
Working capital requirements include the purchase of raw materials, payment

of salary and. wages, incurring operating expenses like telephone bills, carriage inward and outward, electricity charges, premium, stationery, etc.

IV. Long Answer Questions

Question 1.
List out the various sources of financing.

Answer:
The various sources of business finance can be classified into three categories on the basis of

- period basis
- ownership basis
- source of generation basis.

On the basis of the period:

- Short term finance
- Medium-term finance
- Long term finance

Sources of Short-Term Finance:

- Loans and Advances
- Bank Overdraft
- Discounting Bills of Exchange
- Trade Credit
- Pledge
- Hypothecation
- Mortgage
- Loans Against the Securities
- Clean Loan
- Commercial Paper (CP)
- Hire Purchase Finance
- Factoring

Sources of Medium-Term Finance:

1. Loans from Banks
2. Loan from Financial Institutions
3. Lease Financing

Sources of Long-Term Finance:

1. Shares
    - Equity Shares
    - Preference Shares
2. Debentures
3. Retained Earnings
4. Public Deposits
5. Long Term Loan from Commercial Banks
6. The Loans from Financial Institutions

On the Basis of Ownership:

1. Owner's Funds
2. Borrowed Funds

On the Basis of Generation of Funds:

1. Internal Sources
2. External Sources

Question 2.
What are the different types of short term finances given by commercial banks?

Answer:
Loans and Advances:
The loan is a direct advance made in a lump sum which is credited to a separate loan account in the name of the borrower. The borrower can withdraw the entire amount in cash immediately.

It can be repaid in one or more installments. But the interest on loans and advances is calculated on the whole of the amount borrowed right from the date of sanction. It may be secured or unsecured.

Bank Overdraft:
Bank overdraft refers to an arrangement whereby the bank allows the customers to overdraw the required amount from its current deposit account within a specified limit. Interest is charged only on the amount actually overdrawn.

Discounting Bills of Exchange:
When goods are sold on credit, the suppliers generally draw bills of exchange upon customers who are required to accept it. The duration of such bills of exchange may be ranging from 15 days to 180 days. Discounting bills of exchange refers to an act of selling a bill to obtain payment for it before its maturity.

Trade Credit:
Trade credit is the credit extended by one trader to another for the purpose of purchasing goods and services. Purchaser need not pay money immediately after the purchase. Trade credit is very simple and convenient method of raising short term finance. There is no formality involved in availing this facility. There is no need to give any security for trade credit. It is said to be more economical than bank loans.

Pledge:
A customer transfers the possession of an article with the creditor (banker) and receives a loan. Till the repayment of the loan, the article is under the custody of the borrower. If the debtor fails to refund the loan, the creditor (banker) will auction the article pawned and adjust the outstanding loan from the sale proceeds.

Question 3.
Write short notes on

1. Retained Earnings
2. Lease financing

Answer:

1. Retained Earnings:
Retained earnings refer to the process of retaining a part of net profit year after year and reinvesting them in the business. It is also termed as ploughing back of profit. An individual would like to save a portion of his/her income for meeting the contingencies and growth needs.

Similarly, a profit-making company would retain a portion of the net profit in order to finance its growth and expansion in near future. It is described to be the most convenient and economical method of finance.

2. Lease Financing:
Lease financing denotes procurement of assets through lease. For many small and medium enterprises, the acquisition of plant and equipment and other permanent assets will be difficult in the initial stages. In such a situation Leasing is helping them to a greater extent.

Leasing here refers to the owning of an asset by any individual or a corporate body which will be given for use to another needy business enterprise on a rental basis. The firm which owns the asset is called 'Lessor' and the business enterprise which hires the asset is called 'Lessee'.

The contract is called 'Lease'. The lessee pays a fixed rent on agreed basis to the lessor for the use of the asset. The terms and conditions like lease period, rent fixed, mode of payment and allocation of maintenance, are mentioned in the lease contract.

At the end of the lease period, the asset goes back to the lessor. Alternatively lessee can own the asset taken on lease by paying the balance of price of asset concerned to lessor. Hence lease finance is a popular method of medium term business finance.

Question 4.
Write short notes on

1. Owner's funds
2. Borrowed funds

Answer:
1. Owner's funds:
Owner's funds mean funds which are provided by the owner of the enterprises who may be an individual or partners or shareholders of a company. The profits reinvested in the business (ploughing back of profit or retained earnings) come under the owner's funds. These funds are not required to be refunded during the lifetime of a business enterprise. It provides the owner the right to control the management of the enterprise.

2. Borrowed funds :
The term 'borrowed funds' denotes the funds raised through loans or borrowings. For example debentures, loans from banks and financial institutions, public deposits, trade credit, lease financing, commercial papers, factoring, etc. represent borrowed funds.

- These borrowed sources of funds provide a specific period before which the fund is to be returned.
- The borrower is under a legal obligation to pay interest at the given rate at regular intervals to the lender.
- Generally borrowed funds are obtained on the security of certain assets like bonds, land, building, stock, vehicles, machinery, documents of title to the goods, and the like.

Question 5.
Explain any four personal investment avenues.

Answer:

1. Public Provident Fund (PPF):
It is the safest long-term investment option for investors in India. It is totally tax-free. PPF account can be opened in a bank or post office. The money deposited cannot be withdrawn before 15 years and an investor can earn compound interest from this account.

However, the investor can extend the time frame for the next five years if the investor does not opt to withdraw the amount matured for payment at the maturity date. PPF investor can take a loan against PPF account when he/she experiences financial difficulties.

2. Mutual Funds:
An individual investor who wants to invest in equities and bonds with a balance of risk and return generally can invest in mutual funds. Nowadays people invest in stock markets through a mutual fund. A systematic investment plan is one of the best investment options in India.

3. Direct Equity or Share Purchase:
An individual can opt for investment in shares. But he has to analyze the market price of various shares traded in the stock exchange, the reputation of the company, consistency in the payment of dividends, the nature of the project undertaken by the company, growth prospects of the industry in which a company is operating, before investing in shares. If the investment is made for a long time, it may yield a good return.

4. Real Estate Investment:
Real estate is one of the fastest-growing sectors in India. Buying, a flat or plot is supposed to be the best decision amongst the investment options. The value of the real asset may increase substantially depending upon the area of location and other support facilities available therein.