QB365 Question Bank Software Study Materials

Sources of Business Finance Important 2,3 & 5 Marks Questions With Answers (Book Back and Creative)

11th Standard

Commerce

Total Marks : 75

2 Marks

10 x 2 = 20

1) Write a short notes on debentures.

Answer : 1. Debentures are an important instrument for raising long term debt capital.
2. A company can raise funds through issue of debentures which bear a fixed rate of interest.

2) Name any two sources of funds classified under borrowed funds.

Answer : **The sources of funds can be grouped into two categories based on generation:**
1. Internal sources
2. External sources

3) Write any two examples of Post Office Savings Schemes.

Answer : There are different types of postal small savings schemes namely Post Office Savings Account, Post Office Recurring Deposit Account (RD), Post Office Fixed Deposit Account (FD/TD).

4) What is Mortgage?

Answer : (i) This type of loan taken from the bank by lodging with the banker title deeds of immovable Assets like Land and Buildings.
(ii) Business people raise loans by depositing the title deeds of the properties with the bank.

5) What is Commercial Paper (CP)?

Answer : Commercial paper (CP) is an unsecured money market instrument in the form of a promissory note. It was introduced in India in 1990 under Section 45W of the Reserve Bank of India Act.

6) What are the different sources of Business finance?

Answer : **The different sources of Business finance are:**
(i) Short term finance
(ii) Medium term finance
(iii) Long term finance

7) Explain mortgage.

Answer : Mortgage is a type of loan taken from the bank by lodging with the banker title deeds of immovable assets like land and building; Business people raise loans by depositing the title deeds of the properties with the bank.

8) Write notes on trade credit.

Answer : (i)Trade credit is the credit extended by one trader to another for the purpose of purchasing goods and services.
(ii) Purchaser need not pay money immediately after the purchase.
(iii) Such credit appears in balance sheet as Trade Creditors, or Accounts Payable.

9) What are public deposits?

Answer : 1. Under this method, companies invite public deposits by giving advertisements in the media.
2. It offers deposit schemes for a longer tenure.
3. Person interested in making public deposit has to undergo a simple formality.
4. The interest rates offered by companies on public deposits are relatively higher than the bank.

10) Write notes on mortgage.

Answer : **Mortgage:**

1. This is a type of loan taken from-the bank by lodging with the banker title deeds of immovable assets like land and building.
2. Business people raise loans by depositing the title deeds of the properties with the bank.

<u>3 Marks</u> 10 x 3 = 30

11) Define Business Finance?

Answer : **Definition:**

"The Finance function is the process of acquiring and utilizing funds by a business" - R.C.Osborn

"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

12) What is pledge?

Answer : (i) A customer transfers the possession of an article with the creditor (banker) and receives loan.

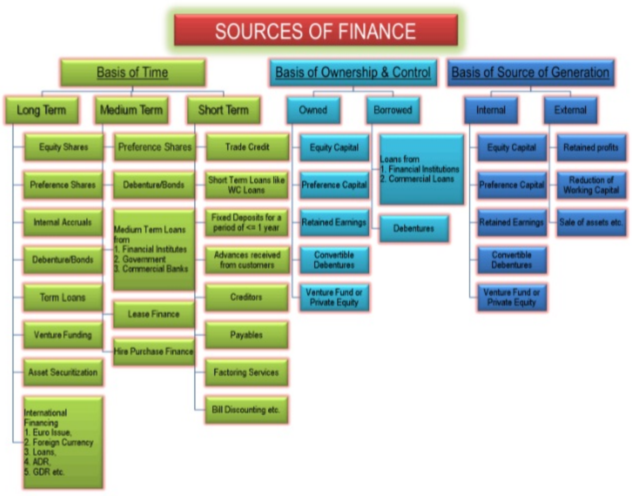
(ii) Till the repayment of loan, the article is under the custody of the borrower.

(iii) If the debtor fails to refund the loan, creditor (banker) will auction the article pledged and adjust the outstanding loan from the sale proceeds.

Example: Jewel loan.

13) Classify the sources of business finance on the basis of period.

Answer : On the basis of a time period, sources are classified as long-term, medium term, and short term. Ownership and control classify sources of finance into owned and borrowed capital. Internal sources and external sources are the two sources of generation of capital. All the sources have different characteristics to suit different types of requirements. Let’s understand them in a little depth.



14) What do you mean by working capital requirement of business?

Answer : 1. Every company needs working capital.

2. Working capital requirements include purchase of raw materials, payment of salary and wages, incurring operating expenses like telephone bills, carriage inward and outward, electricity charges, premium, stationery, etc.

15) Narrate the nature of Business Finance?

Answer : **The following are the characteristics of Business Finance:**

(i) Business Finance companies of all types of Funds namely short, medium and term used in the business.

(ii) All types of organisations namely small, medium and large enterprises require Business Finance.

(iii) The volume of Business Finance required varies from one business enterprises to another depending upon its nature and size. In other words, small and medium enterprises require relatively lower level of Business Finance than the large scale enterprises.

(iv) The amount of Business Finance required differs from one period to another. In other words, the requirement of Business Finance is heavy during the peak season while it is at low level during the dull season.

(v) The amount of Business Finance determines the scale of operations of Business Enterprises.

16) Mention any three significance of business finance.

Answer : 1. A firm with adequate business finance can easily start any business venture.

2. Business finance helps the business organisation to purchase raw materials from the supplier easily to produce goods.

3. The business firm can meet financial liabilities like prompt payment of salary and wages, expenses, etc., in time with the help of sound financial support.

17) What are the Personal Investment Avenues?

Answer : **The Personal Investment Avenues are:**

(i) Public Provident Fund

(ii) Mutual Funds

(iii) Direct Equity

(iv) Real Estate Investments.

(v) Investing in Metals

(vi) Post office Saving Schemes

18) Write notes on clean loan.

Answer : **Clean loan:**

(i) Banks provide clean loan to certain customers of outstanding credit worthiness on the basis of their character, capacity and capability.

(ii) It simply grants loan without any physical security.

(iii) In other words clean loan is loan given without any security or with personal security.

19) Write notes on lease financing.

Answer : **Lease Financing:**

(i) Lease financing denotes procurement of assets through lease.

(ii) For many small and medium enterprises, acquisition of plant and equipment and other permanent assets will be difficult in the initial stage.

(iii) In such a situation Leasing is helping them to an extent.

(iv) The firm which owns the asset is caned 'Lessor'.

(v) The business enterprise which hires the asset is called 'Lessee'.

20) Write notes on internal sources of finance.

Answer : **Internal Sources:**

(i) This includes all those sources generated from within the business enterprises.

(ii) For instance retained earnings, collection from receivables (trade debtors bills and receivable), surplus from disposal of old assets and so on.

(iii) These sources can meet only limited needs of business enterprises.

5 Marks 5 x 5 = 25

21) Explain any five personal Investment Avenues ?

Answer : People invest the savings to gain financial security. They are investing their savings in a various investment avenues for various purposes. They may invest in various securities and wait for a stipulated period to get back their investments with higher value addition. Following are some of the personal investment avenues.

a) Public Provident Fund (PPF) :

(1) It is the safest long term investment option for the investors in India. It is totally tax-free.

(2) PPF Account can be opened in a bank or post office.

(3) The money deposited cannot be withdrawn before 15 years and an investor can earn compound interest from this Account.

(4) 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 maturity date. PPF investor can take loan against PPF Account when he/she experiences Financial difficulties.

b) Mutual Funds:

1. An individual investor who wants to invest in equities and bond with a balance of risk and return generally can invest in mutual funds

2. Nowadays people invest in stock markets through a mutual fund. Systematic investment plan is one of the best investment options in India.

c) Direct Equity or Share Purchase:

1. An individual can opt for investment in shares.

2. But he has to analyse the market price of various shares traded in stock exchange, reputation of the company, consistency in the payment of dividend, the nature of the project undertaken by the company, growth prospects of industry in which a company is operating, before investing in shares.

3. If the investment is made for a long time, it may yield good return.

4. However there is equally risky to invest in shares as there is no guaranteed return in their security.

d) Real Estate Investment:

(1) Real Estate is one of the Fastest growing sectors in India.

(2) Buying a flat or plot is the best decision amongst the investment options.

(3) The value of real asset may increase substantially depending upon the area of location and other support facilities available therein.

(4) However an investor in real estate has to be cautious and circumspect in verifying the genuineness of the title deeds before investing in real estate assets.

e) Unit Linked Insurance Plans (ULIP):

ULIP is a life insurance linked product, which provides risk cover for the policy holder along with investment options to invest in any number of qualified investments such as stocks, bonds or mutual funds.

22) Explain the kinds of sources of short term finance.

Answer : **Sources of Short Term Finance:**

Short term funds are those sources which are required by the business firms for a period of within one year. Some of the important sources of short term finance are briefly explained below.

a) Loans and advances :

(1) Loan is a direct advance made in lump sum which is credited to a separate loan account in the name of the borrower.

(2) The borrower can withdraw the entire amount in cash immediately. It can be repaid in one or more installments.

b) Bank overdraft :

(1) 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.

(2) Interest is charged only on the amount actually overdrawn.

c) Discounting of Bills of Exchange:

Discount bills of exchange refers to an act of selling a bill to obtain payment for it before maturity.

d) Trade Credit:

1. Trade credit is the credit extended by one trader to another for the purpose of purchasing goods and services.

2. Purchaser need not pay money immediately afrter the purchase.

3. Such credit appears in balance sheet as Trade Creditors or Accounts Payable.

e) Pledge:

1. A customer transfers the possession of an article with the creditor (banker) and receives loan.

2. Till the repayment of loan, the article is under the custody of the borrower.

3. If the debtor fails to refund the loan, creditor (banker) will auction the article pawned and adjust the outstanding loan from the sale proceeds.

23) What are the factors influencing choice of finance?

Answer : **(i) Cost:**

Business enterprises have to analyse the cost of mobilising and utilising the funds.

For Example: Interest rate is lower for Public deposits, Debentures, Term loans, etc.

(ii) Financial Capacity of the Firm :

(1) Financially sound enterprises have capacity to pay interest promptly and return the Capital at the stipulated time.

(2) Such enterprises can go for borrowed source. On the other hand, if the Firm is not Financially stable, it has to depend on owned source of fund.

(iii) Forms of organisation:

(1) The choice of source of fund depends on the form of organisation. Sole proprietor and partnership firm cannot issue shares and debentures.

(2) They have to depend on short term sources like Bank Finance, Leasing, Hire purchase, factoring, etc. On the other hand companies, Government organisations and co-operative organisations mobilise funds both from long term sources like Shares, Debentures, Public Deposits, etc. and from short term sources.

(iv) Time Period:

(1) The period for which Business Finance is required determines the suitable source.

(2) For instance, where funds required are for shorter period bank finance like overdraft, Cash Credit, Bill discounting, mortgage, pledge, leasing hire purchase, factoring and so on are suitable sources.

(3) Funds required for long term sources like shares, debentures, public deposits, etc. and from short term sources.

(v) Risk Factor:

(1) Owned funds do not invite any risk while using borrowed funds entails a lot of risk.

(2) The probable default in paying interest and capital may lead to the liquidation of business enterprises besides damaging the reputation of the business concern in the business world.

(vi) Control:

(1) Equity shareholders are real owners of corporate enterprises. They exercise complete control over the management of the company.

(2) If the existing shareholders do not like to lose their control, they must not issue more Equity shares to supplement the Financial resources.

(vii) Stage of Development:

(1) New business, enterprises finds it hard to mobilise Business Finance than an established firm.

(2) Therefore, it may have to rely on owned sources in the initial stage.

(3) Once the Business Enterprise has established itself in the Business world, they can tap borrowed source of funds and offer its Assets as security there for.

(viii) Credit worthiness of the Firm:

(1) Some sources of funds like debentures and creditors require the business firms to mortgage the Assets.

(2) This hurts the credit worthiness of the business concern in the Financial Market.

24) Explain any five factors influencing the choice of Business Finance.

Answer : The factors influencing the choice of business finance are as follows:

Cost:

Business enterprises have to analyse the cost of mobilising and utilizing the funds. For instance where the interest rate is relatively lower, public deposits, debentures, term loan etc. may be desirable options. Financial Capacity of the Firm Financially sound enterprises have capacity to pay interest promptly and return the capital at the stipulated time. Such enterprises can go for borrowed source. On the other hand, if the firm is not financially stable, it has to depend on owned sources of fund.

Time Period:

The period for which business finance is required determines the suitable source. For instance, where funds are required for shorter period, bank finance like overdraft, cash credit, bill discounting, mortgage, pledge, leasing, hire purchase, factoring and so on, are suitable sources. Funds required for longer period can be tapped from issue of shares, debentures, bonds, term loan and the like.

Control:

Equity shareholders are real owners of corporate enterprises. They exercise complete control over the management of the company. If the existing shareholders do not like to lose their control, they must not issue more equity shares to supplement the financial resources. Contrarily borrowed sources of funds will not disturb the control exercised by the company management. Hence borrowed source is suitable for maintaining the administrative control of the company.

Stage of Development:

A new business enterprise finds it hard to mobilise business finance than an established firm. Therefore it may have to rely on owned sources in the initial stage. Once the business enterprise has established itself in the business world, they can tap borrowed source of funds and offer its assets as security therefor.

Credit Worthiness of Firms:

Some sources of funds like debentures and creditors require the business firms to mortgage the assets. This hurts the creditworthiness of the business concern in the financial market. Contrarily business concerns do nt have to mortgage its assets when they mobilise funds through sources like share capital, retained earnings, unsecured loans, etc. and thereby maintaining good image in the financial market.

25) What are the sources of long term finance?

Answer : Sources of Long Term Financ

Long term sources of funds refer to those sources which are required by the business firms for a period exceeding five years.

The various sources of long term business finance are briefly explained below.

(i) Shares :

(1) Corporate enterprises generally obtain capital mainly from share capital which is divided into small units called shares. Each share has a nominal value.

(2) The Indian Companies Act, 2013 describes a share "to be a share in the share capital of the company".

(3) The person holding a share is called shareholder who has the Interest in the Assets and Profit of the Company.

(4) There are two types of Shares namely Equity Shares and preference shares.

(ii) Debentures :

(1) Debentures are important instrument for raising long term debt capital.

(2) A company can raise funds through issue of debentures which bear a fixed rate of Interest.

(3) The individual or person subscribing to debentures is called debenture holder.

(4) An entry raising funds through debenture has to pay interest at the stipulated period.

(iii) Retained Earnings :

(1) Retained earnings refer to the process of retaining a part of net profit year after year and re-investing them in the business.

(2) It is also termed as ploughing back of profits.

(3) An individual would like to save a portion of his/her income for meeting the contingencies and growth needs.

(4) Similarly profit making company would retain a portion of the net profit in order to finance its growth and expansion in near future.

(5) It is described to be the most convenient and Economical method of Finance.

(iv) Public Deposits:

(1) Under this method companies invite public deposits by giving advertisement in the media.It offers deposit scheme for a longer tenure.

(2) Person interested in making public deposit has to undergo a simple formality.

(3) The interest rates offered by companies on public deposits are relatively higher than the bank.

(v) Long term loan from commercial banks:

(1) Commercial banks are important sources of raising Business Finance for various purposes as well as for different time periods.

(2) Banks in modem times offered long tenured loans for a period beyond 5 years.

(3) The long term loan taken from banks can be repaid either in instalment or one lump sum.

(4) Nowadays the formalities for taking long term loans are simplified by the Reserve Bank of India.