Short questions for NCERT Business Studies Solutions Class 11 Chapter 8

1. What is business finance? Why do businesses need funds? Explain.

Funds required to carry the load of the organisation and its daily operations is called Business finance.
Businesses need funds due to following reasons:

1. An organisation needs machinery, building, furniture etc. to setup operations and for purchasing all these items funds are necessary, it is called fixed capital requirement, the amount of varies with type of business.

2. To run day to day operations like purchasing raw materials require regular funds, also called as working capital requirement.

2. List sources of raising long-term and short-term finance.

Long term finance sources are:

1. Equity Shares

2. Debentures

3. Retained earnings

4. Preference shares

5. Loans from banks and other financial institutions

Short term finance sources are:

1. Commercial papers

2. Trade credit

3. Short term loans from banks

3. What is the difference between the internal and external sources of raising funds? Explain.

Basis of Comparison	Internal Source	External Source
Source	Funds generated from within the business	Funds generated from outside source such as suppliers, investors.
Need Fulfilment	Able to fulfil limited needs	Can gather many links for raising capital
Security	No security required	Security required in form of mortgaging assets

4. What preferential rights are enjoyed by preference shareholders? Explain.

Following rights are enjoyed:

1. At the time of dividend declaration be the first to receive a fixed rate of dividend from profits.

2. In case of liquidation, the preference to receive capital after creditor claims are settled.

3. In case of company dissolution, preference share capital will be refunded before equity share capital.

5. Name any three special financial institutions and state their objectives.

1. Unit Trust of India or UTI: Established in 1964 from the Unit Trust of India Act, 1963. The objective of setting up UTI was to mobilize savings and making the funds that are available towards investment in profitable ventures.

2. Life Insurance Corporation of India or LIC: It was setup in 1956, under the LIC Act, 1956 making all existing insurance companies nationalised. The objective is to encourage savings as premium towards insurance and investing it in form of loans to industrial units.

3. Industrial Finance Corporation of India or IFCI was established in the year 1948, under the Industrial Finance Corporation Act, 1948. Its objective was to provide assistance in balanced regional development and encourage entrepreneurs to explore rising sectors of economy. Also contributing towards management education development.

6. What is the difference between GDR and ADR? Explain.

Global Depository Receipts or GDR: Receipts that are shared by depository banks against company shares. GDR are denoted in US dollars and can be easily converted into shares at any time. They can be listed and traded on all stock exchanges over the world.

American Depository Receipts or ADR: These receipts are issued by companies which are US based, and like other securities get traded in the market. The only factor is that the trading is restricted to US Securities market and these receipts are only sold to US citizens.

Long questions for NCERT Business Studies Solutions Class 11 Chapter 8

1. Explain trade credit and bank credit as sources of short-term finance for business enterprises.

Trade credit: The credit offered by one supplier to a purchaser of goods is called as trade credit. This helps in promoting sale of goods and services, as the purchaser is not required to make payment at that time in the form of cash. Such credit is granted only to creditworthy customers. There are factors that influence the volume and period of the credit and they are:

1. Financial position of seller

2. Past payment record

3. Volume of purchases

Benefits of trade credit:

1. It helps a company in accumulating inventories for increasing sales in future.

2. Trade creditors do not have any rights over company assets. Therefore assets can be mortgaged for raising money from other sources.

Bank credit: Commercial banks provide source of funds and these funds are used for different purposes and time periods in the form of overdrafts, cash credits, discounting bills. These loan needs to be paid in lump sum or by paying in instalments.

Benefits of bank credit

1. There is secrecy in providing information about their customers.

2. Provides flexibility in terms of loan repayment.

2. Discuss the sources from which a large industrial enterprise can raise capital for financing modernisation and expansion.

Following sources of capital are suitable for raising capital for expansion:

1. Equity Shares: These are the shares that are part of owner’s capital. The persons holding such shares are known as equity shareholders and they enjoy decision making capacity in management, they also get high returns when the profits of the business get higher.

2. Preference Shares: This is a type of share that gives shareholders a preferential right with regard to repayment of capital and earning payments after a period of time. The payment to preference shareholders is done as per the Section 80 of the Companies Act, 1956

3. Loans: A business can borrow funds from bank and similar financial institutions for a fixed time at a fixed rate/variable rate, they have to pay interest.

4. Retained earnings: These are parts of profit that are kept for use in future. It is called as retained earnings.

5. Debentures: These are instruments that are helpful in raising long term capital. Debentures are like loans having a fixed rate of return.

3. What advantages does issue of debentures provide over the issue of equity shares?

Debentures provide the following advantages over equity shares:

1. Issuing equity shares makes the shareholders own the company, and they become entitled to voting rights while debenture holders do not have any rights in the organisation. They get a fixed amount in form of payment. Debentures thus do not contribute towards dilution of ownership of company and can be issued without any risk.

2. For issuing shares, the company has to bear huge costs, also dividends payment is not tax deductible. For interest paid to debenture company receives tax deductions, so issuing debenture is beneficial.

3. Debentures are having a fixed rate of return. So if no profit is also earned, then also the company needs to pay the dividend, which is at a fixed rate, on the other hand, a company issuing equity shares and making profit needs to share more with the shareholders, which varies with the profit earned. Thus, it is better to issue debentures.

4. State the merits and demerits of public deposits and retained earnings as methods of business finance.

Public deposits are raised by organisations directly from the public and which helps them to finance short and medium term requirements. These deposits provide higher return than bank deposits. Anyone interested in doing investment needs to submit a prescribed form along with the amount to be deposited. A deposit receipt will be issued as acknowledgement.

Merits:

1. Requires very few regulations.

2. Fund raising from public is less costly than borrowing loans from banks.

3. As depositors do not have any voting rights, ownership is not diluted.

Demerits:

1. Amount of money raised from public is limited as it depends on willingness and availability of funds.

2. New companies find it difficult to raise fund as trust is less among people

3. A firm with high capital requirement, this will not be a good option.

Retained Earnings: Firms keep a part of profit before distributing the dividends to the shareholders, such profits are kept for future use in business and is called as retained earnings.

Merits:

1. Funds are raised from internal source and therefore do not involve any cost.

2. As retained earnings increase, the price in equity shares also increase.

3. As these are profits which are surplus, it reduces chances of unexpected loss.

Demerits:

1. Business profits can fluctuate so retained earnings are uncertain.

2. Investing large amount of profit into business can make shareholders unhappy

3. Funds are misused sometimes as firms do not cash in on the opportunity at the right time.

5. Discuss the financial instruments used in international financing.

These three financial instruments are mainly used in international financing:

1. American Depository Receipts or ADR: These receipts are issued by companies which are US based, and like other securities get traded in the market. The only factor is that the trading is restricted to US Securities market and these receipts are only sold to US citizens.

2. Foreign Currency Convertible Bonds or FCCB: These are debt securities which are qualified to be converted into depository receipts and equity shares after a certain time period. The terms of conversion and price are specified in advance and returns on such securities are fixed prior which is lower than returns on securities that are non-convertible.

3. Global Depository Receipts or GDR: Receipts that are shared by depository banks against company shares. GDR are denoted in US dollars and can be easily converted into shares at any time. They can be listed and traded on all stock exchanges over the world.

6. What is a commercial paper? What are its advantages and limitations?

One type of credit instrument that is used by creditworthy firms to raise short term finance for their business is called as Commercial Paper. It is a type of unsecured promissory note with a maturity ranging from 90 to 364 days. It is issued to insurance companies, banks, business firms and pension funds, it is regulated by RBI (Reserve Bank of India).

Advantages:
1. Lower cost than securing bank loans from commercial banks.
2. A highly liquid asset that can be transferred to anyone.
3. Companies earn good returns by investing the surplus earnings
4. Provides a continuous source of finance for firms

Limitations:
1. Firms that have a strong market hold can only raise money
2. Time period cannot be extended in case funds are not available