2. SOURCES OF CORPORATE FINANCE

Q.1 A) Select the correct answer from the options given below and rewrite the statement.

1. .... is a smallest unit in the total share capital of the company.
a) Debenture
b) Bonds
c) Share

2. The benefit of Depository Receipt is ability to raise capital in ...... market.
a) National
b) Local
c) International

3. .... are residual claimants against the income or assets of the company.
a) Bondholders
b) Equity Shareholders
c) Debenture Holders

4. ..... participate in the management of their company.
a) Preference shareholders.
b) Depositors
c) Equity shareholders

5. .... shares are issued free of cost to existing equity shareholders.
a) Bonus
b) Right
c) Equity

6. The holder of preference shares has right to receive ...... rate of dividend.
a) fixed
b) fluctuating
c) lower

7. Accumulated dividend is paid to .... preference shares.
a) redeemable
b) cumulative
c) convertible

8. The holder of .... preference shares have right to convert their shares into equity shares.

a) cumulative
b) convertible
c) redeemable

9. Debenture holders are .... of the company.
a) creditors
b) owners
c) suppliers

10. .... is paid on borrowed capital.
a) Interest
b) Discount
c) Dividend

11. Debenture Holders get fixed rate of .... as return on their investment.
a) interest
b) dividend
c) discount

12. Convertible debentures are converted into.........after a specific period.
a) equity shares
b) deposits
c) bonds

13. Retained earnings are .... source of financing.
a) internal
b) external
c) additional

14. The holder of bond is .... of the company.
a) secretary
b) owner
c) creditor

15. Company can accept deposits from public, minimum for .... months.
a) six
b) nine
c) twelve

16. Company can accept deposits from public, maximum for .... months.
a) 12
b) 24
c) 36

17. A depository receipt traded in .... is called American Depository receipt.

a) London
b) Japan
C) U.S.A.

B) Match the pairs.

Group 'A'	Group 'B'
a) Equity Share Capital	1) Agreement
b) Debenture Trustees	2) Capitalisation of Profit
c) Preference Shareholders	3) Bold Investor
d) Debenture Certificate	4) Venture Capital
e) Bonus Shares	5) Document of Ownership
	6) Capitalisation of Loan
	7) Safe Capital
	8) Instrument of Debt
	9) Trust Deed
	10) Cautious Investor

Answers

Group 'A'	Answers
a) Equity Share Capital	1) venture Capital
b) Debenture Trustees	2) Trust Deed
c) Preference Shareholders	3) Cautious Investor
d) Debenture Certificate	4) instruments of debt
e) Bonus Shares	5) Capitalisation of profit

C) Write a word or a term or a phrase which can substitute each of the following statement.

1. The 'real masters of the company.
Ans: Equity shareholders

2. A document of title of ownership of shares.
Ans: Share Certificate

3. The holders of these shares are entitled to participate in the surplus profit.
Ans: Participating Preference Shares

4. A party through whom the company deals with debenture holders.
Ans: Debenture trustees

5. Name the shareholders who participate in the management.
Ans: Equity Shareholders

6. The value of share which is written on the share certificate.
Ans: Face value

7. The value of share which is determined by demand and supply forces in the share market.
Ans: Market Value

8. The policy of using undistributed profit for the business.
Ans: Retained earnings

9. It is an acknowledgement of loan issued by company to depositor.
Ans: Deposit Receipt

10. A Dollar denominated instruments traded in USA.
Ans: American Depository Receipt (A.D.R.)

11. The Depository Receipt traded in country other than USA.
Ans: Global Depository Recipient (G.D.R.)

12. Money raised by company from public for minimum 6 months to maximum 36 months.
Ans: Public Deposits

13. Credit extended by the suppliers with an intention to increase their sales.
Ans: Trade Credit

14. The credit facility provided to a company having current account with bank.
Ans: Overdraft

D) State whether the following statements are true or false.

1. Equity share capital is known as venture capital.
Ans: True

2. Equity shareholders enjoy fixed rate of dividend.
Ans: False

3. Equity shareholders are described as 'shock absorber when company has financial crisis.
Ans: True

4. Debenture holders have right to vote at general meeting of the company.
Ans: False

5. Bond holders are owners of the company.
Ans: False

6. Depository bank stores the shares on behalf of GDR holder..
Ans: True

7. Financial institutions underwrite the issue of securities.
Ans: True

8. Cash credit is given against hypothecation of goods or any security.
Ans: True

9. Trade credit is major source of long term finance.
Ans: False

E) Find the odd one.

1. Debenture, Public deposit, Retained earnings.
Ans: Retained earnings

2. Face value, Market value, Redemption value.
Ans: Redemption value

3. Share Certificate, Debenture Certificate, ADR.
Ans: ADR

4. Trade Credit, Overdraft, Cash Credit.
Ans: Trade Credit

F) Complete the sentences.

1. The finance needed by business organisation is termed as **Capital**

2. The convertible preference share holders have a right to convert their shares into **Equity shares**

3. Equity shareholders elect their representatives called **Board of Directors**

4. Bonus shares are issued as gift to **Equity shareholders**

5. The bond holders are **creditors** of the company

6. Depository receipt traded in a country other than USA is called **Global Depository Receipt**

7. First Industrial policy was declared in the year **1948**

8. When goods are delivered by supplier to customer on basis of deferred payment it is called as **Trade Credit**

G) Select the correct option from the bracket.
(Fluctuating rate of dividend, Preference shares, Interest at fixed rate, Retained earnings, Short term loan.)

Group 'A'	Group B'
a) Equity shares	**1) Fluctuating rate of Dividend**
b) Preference shares	2) Dividend at fixed rate
c) Debentures	**3) Interest at fixed rate**
d) Retained earnings	4) Accumulated corporate profit
e) Public Deposit	**5) Short term loan**

H) Answer in one sentence:

(1) What is a share?

Ans. Share is the smallest unit of the capital of the company.

(2) What are Equity shares?

Ans. Equity shares are ordinary shares which are not preference shares. Equity share is a risky capital.

(3) What are preference shares?

Ans. Preference shares are those shares which carry preferential rights to receive dividend and return of capital.

(4) What are retained earnings?

Ans. Retained earnings are the earnings of the company which are retained (reinvested) in the business.

(5) What is a debenture?

Ans. Debenture means acknowledgment of debt. Debenture is a borrowed capital.

(6) What is a bond?

Ans. Bond is an interest bearing certificate issued by the government.

(7) In which country can ADR be issued?

Ans. American Depository Receipt (ADR) can be issued in USA

(8) In which country can GDR be issued?

Ans. Global Depository Receipt (GDR) can be issued in any country other than USA.

(9) What are convertible debentures?

Ans. The debentures which are converted into equity shares are known as convertible debentures.

(10) What are cumulative preference shares?

Ans. Cumulative preference shares are those shares on which dividend goes on accumulating (adding).

I] Correct the underlined word and rewrite the sentence.

(1) Owned capital is <u>temporary</u> capital.

Ans. Owned capital is permanent capital.

(2) Equity shares get dividend at <u>fixed</u> rate.

Ans. Equity shares get dividend at fluctuating rate.

(3) Preference shares get dividend at <u>fluctuating</u> rate.

Ans. Preference shares get dividend at fixed rate.

(4) Retained earnings is an <u>external</u> sources of finance.

Ans. Retained earnings is an internal sources of finance.

(5) Debenture Holder is <u>owner</u> of the company.

Ans. Debenture Holder is creditor of the company.

(6) Bond is a source of <u>short</u> term finance.

Ans. Bond is a source of long term finance.

(7) Depository Receipt traded in USA is called as <u>Global</u> Depository Receipt.

Ans. Depository Receipt traded in USA is called as American Depository Receipt.

Q.2. Explain the following terms/concept.

(1) Borrowed capital.

Ans. (a) Borrowed capital is that capital which is borrowed from creditors. It is also known as debt capital. Interest has to be paid on borrowed capital whether company makes profit or not.

(b) Company borrows capital when the owned capital is not sufficient. Company can raise borrowed capital in the form of:
Debentures, Public Deposits, Bonds, etc.

(2) Owned capital.

(a) The capital raised by the company with the help of owners (shareholders) is called owned capital or ownership capital. Owned capital is regarded as permanent capital, as it is returned only at the time of winding up of the company.

(b) Owned capital can be raised in the form of Shares, i.e, Equity and Preference Shares, Retain Earning.

(3) Ploughing back of profit.

Ans. (a) Retained earnings are the earnings of the company which are retained (reinvested) in the business. The sum of those profits accumulated over years are re-invested in the business, rather than distributing it as a dividend to shareholders.
(b) It is simple and cheapest method of raising funds. It is an important source of internal financing. Thus, it is also known as 'Self Financing' or 'Ploughing Back of Profits'.

(4) Overdraft.

Ans. (a) An overdraft implies only to existing current account holder. Therefore, it is a credit facility granted by bank to current account holders. Under overdraft facility the bank allows its customer to overdraw an amount, up to a particular limit, i.e. to withdraw more than the amount of credit balance in his current Account.
(b) Generally, low rate of interest is charged by bank and collateral securities usually accepted for overdraft facility.

(5) Trade credit.

Ans. (a) Trade Credit refers to the facilities or credit extended by manufacturer, wholesalers and suppliers of goods to the purchaser but receive payment after the credit period from the date of purchase. Manufacturer, wholesalers and suppliers of goods or materials are called Trade Creditors'.

(b) This practice is done by business concern with an intention to increase its sales or turnover, to generate additional business and maintain good relationship with the purchasers.

Q.3 Study the following case / situation and express your opinion.

(a) Is the company financially sound?

Ans. As per the Balance Sheet of a Donald Company, it has sufficient equity share capital and retained earnings. Thus, the company is financially sound. There is no financial problem of the company.

(b) Can the retained earnings be converted into capital?

Ans. Yes. Company has sufficient amount of retained earnings. Therefore, the retained earnings of the company can be converted into capital.

(c) What type of source retained earnings is?

Ans. Retained earnings is owned or internal source of financing. Every year company keep aside some part reserve out of profit which is used by the company. Thus, retained earnings is also known as 'ploughing back of profit.

(2) Mr. Satish is a speculator. He de to take advantage of growing market for company's product and earn handsomely.

(a) According to you which type of share Mr. Satish will choose to invest?

Ans. According to me, Mr. Satish should invest in Equity shares. So that he can take overall benefit of the profits and also enjoy all the rights and can participate in the management of the company.

(b) What does he receive as return on investment?

Ans. He may receive dividend as return on investment. But, the dividend received by equity shareholder is fluctuating. It is depend on the profit of the company.

(c) State any one right which he will enjoy as a shareholder.

Ans. The right which he will enjoy as a shareholder are as follows:

Right to vote: It is the basic right of equity shareholders through which they elect directors, alter Memorandum and Articles of Association, etc.

Right to share in profit: It is an important right of equity shareholders. They have right to share in profit, when distributed as dividend.

Right to inspect books: Equity shareholders have right to inspect statutory books of their company.

Right to transfer shares: Equity shareholders enjoy the right to transfer the shares as per the procedure laid down in the Articles of Association.

[Note: Students can write any one right from the above]

(3) Mr. Rohit, an individual investor, invests his own funds in the securities. He depends on investment income and does not want to take any risk. He is interested in definite rate of income and safety of principal.

(a) Name the type of security that Mr.Rohit will opt for.

Ans. Mr. Rohit, an individual investor, invests his own funds in the securities. He depends on investment income and does not want to take any risk. So according to me, he should opt for preference shares.

(b) What does he receive as return on his investment ?

Ans. He will receive dividend as return on investment. The dividend received by preference shareholder is fixed. They get dividend prior to equity shareholder.

(c) The return on investment which he receives is fixed or fluctuating ?

Ans. Return on investment on preference shares is always fixed, regular and steady. But they don't have the rights to participate in the management of the company. Only equity shareholder has the rights as they are the real owner of the company.

Q.4 Distinguish between the following.

1. Equity shares and Preference shares.
Ans:

1. Equity shares and Preference shares	
Equity Shares	**Preference Shares**
1.Meaning: Equity shares have no priority right while receiving dividend and repayment of capital at the time of winding up of company.	Preference shares carry preferential right in respect of dividend payment and repayment of capital in winding up of company.
2.Rate of dividend: Equity share holders are given dividen at fuctuating rate depending upon the products of the company.	Preference share holders get dividend at fixed rate.
3.Voting right: Equity shareholders enjoy normal	Preference shareholders do not enjoy normal voting right They can vote onl on matters affecting their interest.

voting right. They participate in the management of their company.	
4.Nature of capital: Equity share capital is permanent capital. It is known as 'Risk capital'.	Preference share capital is 'safe capital' with stable retum. .
5.Nature of investor: The investors who are ready to take risk invest in equity shares.	To get immediate return,investor invests in working capital. Investor gets comparatively less return.
6.Face value: The face value of equity shares is generally Rs. 1/- or Rs. l0/- It is relatively low	The face value of preference shares is relatively higher i.e. Rs.100/- and so on
7.Types: ***Equity shares are classified into*** *a*) equity shares with normal voting right b) equity shares with differential voting right	***Preference shares are classified as*** a) Cumulative preference shares b) Non-cumulative preference shares c) Convertible preference shares. d) Non-convertible preference shares e)Redeemable preference shares. f)Irredeemable preference shares. g)Participating preference shares h) Non-participating preference shares
8.Benefit of right shares and bonus shares:equity shareholder is entitled to get right shares and bonus shares.	Preference shareholders are not eligible for right shares and bonus shares.
9.Capital appreciation: Market value of equity shares increases with the prosperity of company. It leads to increase in the Value of shares.	Market Value of preference shares does not fluctuate. So there is no possibility of capital appreciation.
10.Risk: Equity shares are subject to higher risk. That is because of fluctuating rate of dividend and no guarantee of refund of capital	Preference shares are subject to less risk. It is because of fixed rate of dividend and preferential right as regards dividend and repayment of capital.

2. Share and Debenture.
Ans:

2. Shares and Debentures

Shares	Debentures
1.Meaning: It is a smallest unit in the total share capital of the company.	Debenture is an instument under seal evidencing debt.
2.Nature It is a permanent capital. It is not repaid during the life time of the company.	It is temporary capital. Generally it is repaid after a specific period.
3.Status: Share capital is ownership capital. A shareholder is the owner of the company.	Debenture capital is borrowed / loan capital. A debenture holder is creditor of the company.
4.Voting rights: Shareholder being owner enjoys voting rights. Shareholders participate in the management of the company.	Debenture holder being company's creditor does not have any Voting right. He can not participate in the management of company.
5.Return on investment: Shareholders are paid dividend. Equity shareholders receive dividen at fluctuating rate where as preference shareholders receive dividend at fixed rate.	Debenture holders are paid interest at fixed rate. Interest is paid even when company has no product.
6.Security: Share capital is unsecured capital . No Security is offered to the shareholder.	Debenture capital being loan capital is secured by creating a charge on its property.
7.Time of issue: Shares are issued in the initial stage of the company.	Debentures can be issued at the later stage, when the company has securities to offer.
8.Types: Shares are classified into two: a) Equity shares b) Preference shares	Debentures are classified as a) Registered debentures b) Bearer debentures. c) Secured debentures d) Unsecured debentures e) Redeemable debentures t) Irredeemable debentures g) Convertible debentures h) Non convertible debentures .
9.Position on liquidation: On liquidation of a company shareholders rank last in the list of claimants.	Debenture holders being creditors rank prior to shareholders for repayment on liquidation of company.

10.Suitability: Shares are suitable for long term finance.	Debentures are suitable for medium term finance.

3. Owned capital and borrowed capital.
Ans:

Owned Capital	Borrowed Capital
1 Meaning: It is that capital which is contributed by shareholders.	It is that capital which is borrowed from creditors. It is also known as debt capital.
2. Sources: This capital is collected by issue of equity shares and preference shares.	It is collected by way of issue of debentures, fixed deposits, loan from bank/financial institutions, etc.
3. Return on Investment: The shareholders get dividend as income on their investment. Rate of dividend is fluctuating in case of equity shares but fixed in case of preference shares.	The debt capital holders get interest as income on their investment. Interest is paid at fixed rate.
4. Status: The shareholders are owners of the company.	The debt holders are creditors of the company
5. Voting right: The equity shareholders enjoy normal voting right at the general meeting.	The creditors do not enjoy voting rights at the general meeting.
6. Repayment of Capital: The shareholders do not enjoy priority over creditors. They are eligible for repayment of Capital only after making payment to creditors at the time of winding up of the company.	The creditors get priority over the shareholders in case of return of principal amount at the time of winding up of the company.
7. Charge on assets: The shareholders do not have any charge on the assets of the company.	The secured debenture holders have a charge on assets of the company.

Q.5. Answer in brief:
(1) What is public deposit?

Ans. Meaning:
(a) Public deposits are an important source of financing short term requirement of company. When companies generally receive deposits from the public for the period ranging from 6 months to 36 months, it is known as Public Deposits'.

(b) Under this method, general public is invited to deposit their savings with the company for varied period. Interest is paid by companies on such deposits. The rate of interest are higher than those allowed by commercial banks.

(c) The company issues 'Deposit Receipt to the depositor. The term of deposit is mentioned in the Deposit Receipt'. Deposit Receipt is an acknowledgement of debt by the company. Deposits are unsecured loans offered to company.

(d) It is considered as risky investment but investors can earn high return on public deposits. Deposits are either secured or unsecured loans offered by the company.

(2) What is Global Depository Receipt?

Ans. Meaning:
(a) Global Depository Receipt (GDR) is an instrument in which a company located in domestic country issues one or more of its shares or convertible bonds outside the domestic country.

(b) Issue of Global Depository Receipt is one of the most popular ways to tap the global equity markets. A company can raise foreign currency funds by issuing equity shares in a foreign country.

(c) Indian company issues shares to an intermediary called Depository'. This depository bank issues GDR to investors against these shares.

(d) The GDR represent fixed number of shares. This GDR are then sold to people in foreign country. The GDR are traded like regular shares. The prices fluctuate depending upon demand and supply and it is listed on stock exchange.

(e) The exchange on which GDR is traded are as follows:

• London Stock Exchange

• Luxembourg Stock Exchange

• NASDAQ

• Singapore Stock Exchange

• Hong Kong Stock Exchange

Following are the advantages of GDRs:
(a) GDR provides access to foreign capital markets.

(b) A company can get itself registered on an overseas stock exchange or over the counter and its shares can be traded in more than one currency.

(c) GDR increases the shareholders base of the company,

(d) With GDR, the non-residents can invest in shares of the foreign company. It can be freely transferred.

Following are the disadvantages of GDRs:
(a) Violating any regulation can lead to serious consequences against the company.

(b) Dividends are paid in domestic countries currency which is subject to volatility in the forex market.

(c) It is mostly beneficial to High Net Worth Individual (HNI) investors due to their capacity to invest high amount in GDR.

(d) GDR is one of the expensive sources of finance.

(3) What is Trade Credit?

Ans. Meaning:
(1) Trade Credit refers to the facilities or credit extended by manufacturer, wholesalers and suppliers of goods to the purchaser but receive payment after the credit period from the date of purchase.

(2) Trade credit is not a cash loan. It results from a credit sale of goods / services, which has to be paid at a future date after the sales take place.

(3) This practice is done by business concern with an intention to increase its sales or turnover, to generate additional business and maintain good relationship with the purchasers.

(4) Suppliers sell the goods and allow 30 days or more for bill to be paid. They even offer discount, if bills are cleared with 30 days.

Following are the advantages of Trade Credit:
(1) It is the cheapest and easiest method of raising short term finance. The terms and conditions are not rigid, i.e, they are flexible.
(2) The supplier (creditor) is able to generate higher volume of sales. The flexibility in purchasing encourages customers to make larger purchases when prices are

right.

(3) Trade credit allows the purchasers to place purchase order without need to pay up front. This allows purchasers to use funds to pay long term debts and other critical payments.

(4) Trade credit has no cost involved, no interest is payable for using the credit.

(5) Due to business relationship involved, the terms and conditions attached to trade credit are simple and not rigid. Also, there is no need of agreement for trade credit.

(4) What are the schemes for disbursement of credit by bank?

Ans.(a) Commercial banks play an important role in providing short term finance to business concern. They have become primary source of financing working capital of the business.

(b) In India, primary source of financing working capital are bank credit and trade credit.

(c) Commercial bank assist corporate enterprises:

• By granting term loans to companies

• By underwriting the issue of securities of the company.

• By subscribing to shares and debentures of the company.

Disbursement of credit by bank: Overdraft, Cash credit, Cash loans, Discounting of Bills of Exchange

The above disbursement of credit by commercial banks are as follows:

(a) Overdraft: An overdraft implies only to existing current account holder. Therefore, it is a credit facility granted by bank to current account holders. Under overdraft facility the bank allows its customers to overdraw an amount, up to a particular limit, i.e. to withdraw more than the amount of credit balance in his current Account. Generally, low rate of interest is charged by bank and collateral securities usually accepted for overdraft facility.

(b) Cash credit:
It is an important form of providing finance to business organisations. Cash Credit is

given against pledge of goods or by providing alternative securities.
Cash Credit account is operated on the similar lines as the overdraft facility.
On the security margin, the amount of cash credit is sanctioned by the bank and the borrower can withdraw the amount from his current account up to this limit as and when company needs. Interest is charged on the actual amount outstanding and not the amount of credit limit sanctioned by the bank.

(c) Cash loans: Commercial Banks credit the account of the borrower with the amount of loan. The borrower has to pay interest on the entire amount sanctioned by the bank as loan. If the amount of loan is paid in instalments, the interest to be paid will be on the actual balance outstanding.

(d) Discounting of Bills of Exchange: Bills of Exchange is an acknowledgment received by seller (drawer) from the buyer (drawee) promising to pay him certain amount on a specific date. The drawer of the bill can receive money from drawee on due date. Drawer can receive money before due date by discounting of bills. This is nothing but selling the bills to bank. Drawer gets money immediately from bank against the bill. The bank gives money to the drawer less than the face value of the bill. The amount received less is called discount. They are accepted by banks and cash is advanced against them. Thus, Bill of Exchange are Trade Bills.

(5) State the features of Bonds.

Ans. Meaning and Definition of Bonds:
(a) Bond is a debt security. It is a loan. Bond is a formal contract to repay the borrowed money with interest.

(b) It is an interest bearing certificate issued by government, semi- government or business firms to raise capital. The person holding such an instrument is known as bond holder.
He becomes the creditor of the company.

According to Webster Dictionary,
"A bond is an interest bearing certificate issued by the government or business firms, promising to pay the holder a specific sum at a specified date".

Features of Bonds are as follows:

(a) Nature of finances: Bond is a debt or loan finance. It represents long term finance of the company.
Generally, the bonds are issued for a long period. For instance, 5 years, 10 years and so on.

(b) Status of investor: The bond holders are the creditors of the company. Being creditor and non owners, they do not enjoy any voting rights.
They are not entitled to participate in general meeting and in the management of the company.

(c) Return on bonds:
Bonds are issued bearing a fixed rate of interest. So, the bondholders get a fixed rate of interest.
It is payable at regular interval, but it may be paid on the maturity also.

(d) Repayment: Bonds have specific maturity date because, a bond is a formal contract to pay the borrowed money.
Thus, the repayment of principal amount is due on maturity date.

Q.6 Justify the following statements.

1. Equity shareholders are real owners and controllers of company.

Ans: Justification:
(a) Equity shares are the ordinary shares.
These are the shares which constitute the major part of total share of the company.
The person holding equity share is known as 'Equity Shareholder'.

(b) Equity Shareholders are the real owners of the company and bear the ultimate risk associated with ownership.

(c) They are often described as "Real Master of the company. They enjoy control over the company. They have voting rights and can participate in the management of the company.

(d) Thus, it is rightly justified that, equity shareholders are real owner and controller of the company.

(2) Preference shares do not carry any voting right.

Ans. Justification:
(a) Preference Shares are those shares which enjoy certain privileges and preferential rights over equity shares. The person holding preference share is known as 'Preference Shareholder'.
(b) Preference Shareholders do not have normal voting rights like equity shares.

(c) However, they can vote on any such matter which directly affects their interest as investors.

(d) Thus, it is rightly justified that, preference shares do not carry any voting right.

(3) The debentures are secured by charge on assets of the company,

Ans. Justification:
(a) Secured debentures are the debentures which are secured by some charge on the assets or property of the company.

(b) The charge may be either fixed charge or floating charge.

(c) In case of fixed charge, specific assets are mortgaged as a security for the debentures.

(d) Under floating charges, the debenture holders have a claim over all assets of the company. Thus, it is rightly justified that, debentures are secured by charge on assets of the company.

(4) Retained earnings is simple and cheapest method of raising finance.

Ans. Justification:
(a) Retained earnings are the earnings of the company which are retained (reinvested) in the business, (b) The sum of those profits accumulated over years are re-invested in the business, rather than distributing it as a dividend to shareholders.

(c) The company can utilize such reserves for financing various projects such as expansion, diversification, etc.

(d) It is an important source of internal financing. Thus, it is also known as 'Self Financing' or 'Ploughing Back of Profits'. Thus, it is rightly justified that, retained earnings is simple and cheapest method of raising finance.

(5) Public deposit is good source of short term financing.

Ans. Justification:
(a) Public deposits are an important source of financing short term requirement of company. In other words, company accepts public deposits for meeting short term needs.

(b) When companies generally receive deposits from the public for the period ranging from 6 months to 36 months, it is known as 'Public Deposits'.

(c) It is considered as risky investment but investors can earn high return on public deposits. Deposits are either secured or unsecured loans offered by the company.

(d) Thus, public deposit is good source of short term financing.

(6) Bond holder is creditor of the company.

Ans. Justification:
(a) Bond is a debt security. It is a loan. Bond is a formal contract to repay the borrowed money with interest.

(b) It is an interest bearing certificate issued by government, semi- government or business firms to raise capital.

(c) The person holding such an instrument is known as bond holder. He becomes the creditor of the company.

(d) As bond holder is the creditor of the company, he does not enjoy any voting rights and cannot participate in the management of the company.
Thus, it is rightly justified that, bond holder is creditor of the company

(7) Trade credit is not a cash loan.

Ans. Justification:
(a) Trade Credit refers to the facilities or credit extended by manufacturer, wholesalers and suppliers of goods to the purchaser but receive payment after the credit period from the date of purchase.

(b) Manufacturer, wholesalers and suppliers of goods or materials are called "Trade Creditors'

(c) Trade credit is not a cash loan. It results from a credit sale of goods / services, which has to be paid at a future date after the sales take place.

(d) This practice is done by business concern with an intention to increase its sales or turnover, to generate additional business and maintain good relationship with the purchasers. Thus, it is rightly justified that, trade credit is not a cash loan.

(8) Different investors have different preferences.

Ans. Justification:
(a) The investors are the persons who invest the capital in the company. They can invest in equity share capital or preference share capital.

(b) The investors who can take risk, invest in equity shares. They are known as ultimate risk bearer.

(c) The investors who are cautious, conservative, interested in safety of capital, generally invest in preference shares.

(d) Thus, it is rightly justified that, different investors have different preferences.

(9) Equity share capital is risk capital.

Ans. Justification:
(a) The person holding equity share capital is known as 'Equity Shareholder'.

(b) The dividend received by equity shareholders is fluctuating. Also, if a company does not earn profit in a particular year then equity shareholders will not get any dividend.

(c) Hence, Equity shareholders bear maximum risk in the company. They are described as 'Shock absorbers' when company has financial crisis.

(d) Thus, it is rightly justified that, equity share capital is risk capital.

Q.7 Answer the following questions.

1. What is share and state its features ?

Ans. Meaning and Definition of Shares:
(a) Share capital of a company is divided into many units of small denominations. Each such unit is called as a share.

(b) In other words, a share is small part of the total capital of a company. A person holding such shares is known as shareholders.

(c) According to section 2 (84) of the Companies Act, 2013 "Share means a share in the share capital of the company and includes stock".

1. Meaning : Share is a smallest unit in the total share capital of a company

2 Ownership: The owner of share is called as shareholder. It shows the ownership of a shareholder in the company

3 Distinctive Number : Unless dematerialised, each share has distinct number for identification. It is mentioned in the Share Certificate.

4. Evidence of title: A share certificate is issued by a company under it's common seal. It is a document of title of ownership of shares. A share is not any visible thing. It is shown by share certificate or in the form of Demat share.

5. Each share has a value expressed in terms of money. There may be:

(a) Face value : This value is written on the share certificate and mentioned in the Memorandum of Association.

(b) Issue price : It is the price at which company sells its shares.

(c) Market Value: This value of share is determined by demand and supply forces in the share market. Rights A share confers certain rights on its holder such as right to receive dividend, right to inspect statutory books, right to attend shareholders' meeting and right to vote at such meetings,

7. Income: A shareholder is entitled to get a share in the net profit of the company. It is called dividend.

8. Transferability : The shares of public limited company are freely transferable in the manner provided in the Articles of Association

9. Property of Shareholder:
Share is a movable property of a shareholder.

10. Kinds of Shares: A Company can issue two kinds of shares:

(a) Equity shares.

(b) Preference shares.

2. What is equity share?State the features of equity shares.

Ans: Equity shares are also known as 'ordinary shares'.For legal reasone, a company can not exist without equity shares.
Companies Act 1956 defines equity share as "those shares which are not preference shares."

Features of Equity shares are as follows:
1.Permanent capital :
Equity shares are irredeemable shares. The amount received from Equity Shares is not remndable by the company during the life time. Equity shares become redeemable
only in the event of winding up of the company. Equity shareholders provide long term and permanent capital to the company.

2.Fluctuating Dividend:
Equity shares do not have a fixed rate of dividend. The rate of dividend depends upon amount of profit earned by company. If company earns more profit, dividend is paid at higher rate. On the other hand if there is insufficient profit, Board of Directors may postpone the payment of dividend. The shareholders can not compel them to declare and pay the dividend. The income of equity shares is irregular and uncertain. They get dividend which is always fluctuating.

3.No preferential right :
Equity shareholders do not enjoy preferential right in respect of payment of dividend. It means equity shareholders are paid dividend only after dividend on preference shares has been paid.
At the time of winding up of the company also, the equity shareholders are paid in the last. They are the last claimants. If no surplus amount is available after paying debts and preference shares, equity shareholders will not get anything. Thus, equity shareholders stand second in case of getting dividend on their shares as well as getting back their capital at the time of liquidation of company.

4.Rights :

Equity shareholders enjoy certain rights. These include:
a) Right to share in profit, when distributed as dividend, is the most important right of equity shareholder. If company is successful and makes handsome profit, they have advantage of large dividend.

b) Right to vote is the basic right of equity shareholders by which they elect directors, amend Memorandum, Articles etc.

c) Right to inspect books of account of their company of which they are owners.

(d) Right to transfer shares is one of the most important right of shareholder.

5.Control :
The control of company is vested in equity shareholders. They are often described as real masters of the company. It is because they enjoy exclusive voting right. The voting rights of equity shareholder are protected as far as possible. Equity shareholders may exercise their voting rights by proxies, without attending meeting in person. The Act provides the right to cast vote in proportion to number of shareholdings. Equity shareholders participate in the management of the company. They elect their representatives called Directors on the Board for the management of company.

6.Risk :
Equity shareholders bear maximum risk in the company. They are described as 'shock absorbers' when company has iinancial crisis. If the income of company falls, the rate of dividend also comes down. Due to this, market value of equity shares goes down resulting into capital loss. Thus, equity shareholders are main risk takers.

7.Residual claimants :
Equity shareholders are owners and they are residual claimants to all earning after expenses, taxes, etc. have been paid.
Although equity shareholders are last claimants they have advantage of receiving entire earnings that is left over.

8.Face value :
The face value of equity shares is low, in comparison to preference shares. It is generally Rs.l0/- per share or even Rs.1/- per share.

9.Market Value :
There is more fluctuation in the market value of equity shares in comparison to other securities. Therefore, equity shares are more appealing to the speculators.

10.Bonus and Right Issue :
Bonus shares…

3. Define preference share.State the different types of preference shares.
Ans: As the name Indicates, these shares have certain privileges and preferentlal rights distinct from those attaching to equity shares.
The shares which carry following preferential rights are termed as preference shares.

(a) A preferential right as to the payment of dividend during the life time of the company.

(b) A preferential right as to the return of capital in the event of winding up of the company.

1.Cumulative preference shares:
Cumulative preference shares are those shares on which dividend goes on accumulating until it is fully paid. This means, if the dividend is not paid in one or more years due to inadequate profit, then such unpaid dividend gets accumulated. The accumulated dividend is paid when company performs well. The arrears of dividend are paid before making payment to equity share holders The preference shares are always cumulative unless otherwise stated in the Articles of Association. It means that if dividend is not paid in any year or falls short of prescribed rate, the unpaid amount is carried forward to next year and so on until all arrears have been paid.

2.Non-cumulative preference shares:
Dividend on these shares does not accumulate. This means, the dividend on shares can be paid only out of profits of that year. The right to claim dividend will lapse, if company does not make profit in that particular year. If dividend is not paid in any year, it is lost.

3.Participating preference shares:
The holders of these shares are entitled to participate in surplus profit besides preferential dividend. The surplus profit which remains after the dividend has been paid to equity shareholders up to certain limit, is distributed to preferenCe shareholders.

4.Non-participating preference shares:
The preference shares are deemed to be non-participating, if there is no clear provision in Articles of Association. These shareholders are entitled only to fixed rate of dividend prescribed in the issue.

5. Convertible preference shares:
These shareholders have a right to convert their preference shares into equity shares. The conversion takes place within a certain fixed period.

6. Non-convertible preference shares:
These shares cannot be converted into equity shares.

7. Redeemable preference shares:
Shares which can be redeemed after a certain fixed period are called redeemable preference shares. A company limited by shares, if authorized by Articles of Association, issues redeemable preference shares. Such shares must be fully paid. These shares are redeemed out of divisible profit only or out of fresh issue of shares made for this purpose.

8. Irredeemable preference shares:
Shares which are not redeemable i.e. payable only on the winding up of the company are called irredeemable preference shares. As per Companies Act (Amendment made in 1988) the company can not issue irredeemable preference shares.

4. What are preference shares? State its features.

Ans: As the name Indicates, these shares have certain privileges and preferentlal rights distinct from those attaching to equity shares.
The shares which carry following preferential rights are termed as preference shares.

(a) A preferential right as to the payment of dividend during the life time of the company.

(b) A preferential right as to the return of capital in the event of winding up of the company.

Features of Preference Shares are as follows:
1. Preferential dividend :
The dividend is payable to preference shareholders before anything else is paid to equity shares. The company must assure their preferential right as to payment of dividend during the life of the company.

2. Prior repayment of capital :
Perference shareholders have a preference over equity shareholders in respect of return of capital when the company is liquidated. It saves preference shareholder from capital losses.

3. Fixed return :
These shares carry dividend at a fixed rate. The rate of dividend is predetermined. It may be in the form of fixed sum or may be calculated at a fixed rate.
One point must be made clear. The preference shareholders are entitled to dividend which can be paid only out of profit. Although the rate of dividend is fixed, the directors, in financial prudence, decide that no dividend be paid as there are no

profits, the preference shareholders have no claims for dividend.

4. Nature of capital:
Preference shares do not provide permanent share capital. They are redeemed after certain period of time. As per Companies (Amendment) Act 1988, a company can not issue irredeemable preference shares.

5. Market value :
The market value of preference share does not change as-the rate of dividend payable to them is fixed. The capital appreciation is considered to be low as compared with . equity shares.

6. Voting right :
The preference shares do not have normal voting rights. They have voting rights in respect of those matters which affect their interests. The preference shares do not enjoy right of control on the affairs of the company.

7. Risk :
The investors who are cautious, generally purchase preference shares. Safety of capital and fixed return on investment are advantages attached to preference shares. They attract moderate type of investors. These shares are boon for shareholders during depression period when interest rate is continuously falling.

8. Face Value :
Face value of preference shares is relatively higher than that of equity shares. They are normally issued at a face value of i 100/-

9. Right or Bonus issue :
Preferential shareholders are not entitled for right or bonus shares.

5. What is Debenture ? Discuss the different types of debentures.

Ans: Debentures have occupied a significant position in the financial structure of the companies. It is one of the main sources of raising debt capital to meet long term financial needs. Debentures represent borrowed capital. The debenture holders are creditors of the company. The debenture holder gets a fixed rate of interest as return on his investment. Board of Directors has the power to issue debentures. The term 'debenture' has come from Latin word 'debare', which means to 'owe". Palmer defines a debenture as - "an instrument under seal evidencing debt, the essence of it being admission of indebtedness".

Types of Debentures:

1.Secured debentures :

The debentures can be secured. The property of company may be charged as security for loan. The security may be for some particular asset (fixed charge) or it may be the asset in general (floating charge). The debentures are secured through 'Trust Deed'.

2.Unsecured debentures :

These are the debentures that have no security. The issue of unsecured debenture is now prohibited by Companies (Amendment) Act, 2000

3.Registered debentures :

Registered debentures are those on which the name of holders are recorded. A company maintains a register of debenture holders in which the names, addresses and particulars of holdings _of debenture holders are entered. The transfer of debentures in this case requires the execution of regular transfer deed.

4.Bearer debenture :

ame of holders are not recorded on the bearer debentures. Their names do not appear on the register of debenture holders. Such debentures are transferable by mere delivery. Payment of interest is made by means of coupons attached to debenture certificate.

5.Redeemable debentures :

Debentures are mostly redeemable i.e. payable at the end of some fixed period, as mentioned on the debenture certificate. Repayment can be made at fixed date at the end of specific period or by instalments during the life time of the company. The provision of repayment is normally made in a trust deed.

6.Irredeemable debentures :

These kind of debentures are not repayable during life time of the company. They are repayable only after the liquidation of the company, or when there is breach of any condition or when some contingency arises.

7.Convertible debentures :

Convertible debentures give the right to the holder to convert them into equity shares after a specific period. Such right is mentioned in the debenture certificate. The issue of convertible debenture must be approved by special resolution in general meeting before they are issued to public. These debentures are advantageous for holder. Because of this conversion right, convertible debenture holder is entitled to equity shares at a rate lower than market value and even he participates in the profit of the company.

8.Non-convertatible debentures : Non convertible debentures are not convertible into equity shares on maturity. These debentures are normally redeemed on maturity date. These debentures suffer from the disadvantage that there is no appreciation in value.

6. Define Debenture and explain the features of debentures.

Ans: The word debenture is derived from the Latin yvord, 'Debare' which means to owe something to someone'. Debenture is an acknowledgement of debt issued by a company under its common seal" It also means that debenture is a proof of loan taken by the company on certain terms and conditions.
Features of Debentures are as follows:

1.Promise :
Debenture is a written promise by company that it owes specified sum of money to ' holder of the debenture.

2.Face value :
The face value of debenture normally carries high denomination. It is Rs.100/— or multiples of Rs.100.

3.Time Of repayment :
Debentures are issued with due date stated in the 'Debenture Certificate'. A debenture provides for the repayment of principal amount on maturity date.

4.Interest :
A iixed rate of interest is agreed upon and is paid periodically in case of debentures. The rate of interest that company offers depends upon the market conditions and nature of the business.

5.Assurance of repayment :
Debentures constitute a long term debt. They carry an assurance of repayment on due date.

6.Parties to debentures:
There are certain parties to debentures such as-

a) Company :
This is the entity which borrows money.

b) Trustee :
This is a party through whom the company deals with debenture holders. The

company makes an agreement with trustees and debenture holders. It is known as 'Trust Deed'. It contains the obligations of company, rights of debenture holders, etc.

c) Debenture holders :
These are the parties who provide loan and receive 'debenture certificate' as evidence of participation.

7.Rights Of Rights of Debenture holder:
Debenture holders have no right to vote at general meeting 0f the company.

8.Terms of issue of debentures :

a) Debentures can be issued at par, at premium and even at discount.

b) According to Companies Act, company can not issue debentures carrying voting rights.

c) According to Companies Act, Sec 292 (1) the Board of Directors has the power to issue debentures.

9.Security : Debentures can be secured with some property of the company.

10.Listing : Debentures must be listed with at least one recognized stock exchange.