TENDER HEART HIGH SCHOOL

Lokesh Arare
Comm Stud
10th

Ch-10
Sources of Finance

Date 7/10/2024
Page (1)

Financial Market :-

A financial market is a market for creating and exchanging financial assets such as shares, debentures, treasury bills, commercial papers etc. It serves as a link between savings and investment by bringing together providers and users of funds.

Financial market is of two main types :-

1. **Capital Market :-**

Market for trading long term financial instruments such as shares and debentures is known as capital market. It consists of all organisations, institutions and instruments that provide long-term funds. A vide variety of instruments are used to raise funds in the capital market. These instruments are ownership securities (equity shares and preference shares) and creditorship securities (debentures and bonds).

Capital market is of two types.

(a) Primary market (b) Secondary market.

2. **Money Market :-**

Money market is that market in which short term securities such as treasury bills and commercial paper are traded.

Characteristics of Capital Market :-

1. Flow of Capital
2. Demand and Supply
3. Financial Intermediaries

Lokesh Arora
Comm Stud
10th

Ch-10
Sources of Finance

classmate
Date 7/10/2024
Page (2)

4. Financial Instruments
5. Liquidity
6. Trading in Securities
For explanation refer to page 134.

Functions of Capital Market:-

1. Promotion of Thrift (Forced savings)
2. Investment Avenue
3. Liquidity
4. Availability of Capital
5. Ready Market
6. Transfer of funds
7. Stability
8. Capital formation
For explanation refer to page 134.

Primary Market:-
Primary market is that market in which new securities (shares) are issued by the companies for the first time. In this securities are sold by the issuing companies.

Secondary Market:-
Secondary market is that market in which already existing securities are purchased and sold. In this, the securities which are already sold in primary market are being traded.
(We can say its a second hand goods market).

Difference between Primary Market and Secondary Market
Refer to page No. 135 of your Book.

Sources of Business Finance:-
Business firm can raise funds from two main sources-
(a) Owners funds:- Funds provided by the owners in the business are owners fund.
(b) Borrowed funds:- Loans taken by the business from persons other than owners. like. banks, financial institutions etc.

A business enterprise requires capital for long term as well as short term. Long term funds are needed to invest in fixed assets such as land and buildings, plant and machinery furniture etc. Such capital is called Fixed Capital.
Short term funds are invested in current assets such as stock, debtors, bills receivables, cash etc. Such capital is known as Working Capital.

Capital

Long Term	Short Term
1. Equity Shares	1. Commercial Banks
2. Preference Shares	2. Public Deposits
3. Retained Earnings	3. Trade Credit
4. Debentures	4. Inter-Corporate Deposits
5. Financial Institutions	

Lokesh Arora
Comm stud
10th

Ch - 10
Sources of Finance

Shares :-

The amount of capital to be raised from members of the public is divided into units of equal value. These units are known as shares and the aggregate values of shares is known as share capital of the company. Those who subscribe to the share capital are called shareholders.
A share is, thus, one of the equal parts into which the capital of a company is divided. The following are the features of a share :-

1. It is an indivisible part of the capital of a company.
2. It confers certain rights on its holder, e.g. dividend, voting power, return of capital, etc.
3. Each share has a distinct number.
4. Each share has a nominal or face value.
5. The holder of a share is issued a share certificate under the seal of the company
6. It is a moveable property and can be transferred in the manner laid down in the Articles of the company.

Shares are of two types :-

1. Equity Shares :-

Equity shares are those shares which do not carry any special or preferential rights in the payment of annual dividend or repayment of capital. The

rate of dividend on such shares is not fixed. Dividend on equity shares is paid after paying interest on debentures and dividend on preference shares. Similarly, equity shares are paid at the time of winding up (closing) of the company after all the debts (loans) and preference shareholders have been paid in full. Therefore, equity shareholders are the real risk-bearers. But they share in the increasing profits of the company. They enjoy voting rights in the management of the company

Characteristics of Equity shares are as follows:-

(1) The holders of equity shares are the main risk bearers. They provide risk capital because when the company fails and closed, equity shareholders may lose their entire investment.

(2) Equity shareholders are likely to enjoy higher return and considerable increase in the value of their shares.

(3) Equity shareholders have a residual claim in the company.

(4) Equity share capital improves the credit worthiness of the creditors. It is the basis on which loan can be raised.

(5) Equity shareholders have the right to elect directors. They can collectively ensure that the company is managed in their best interests.

2. Preference Shares:-
Preference shares are those shares which carry certain preferential or priority rights. Firstly, dividend at fixed rate is payable on these shares before any dividend is paid on equity shares. Secondly, at the time of winding up the company, capital is repaid to preference shareholders prior to the return of equity capital. Preference shares do not carry voting rights.

Characteristics of Preference Shares:-

1. Preference shareholders get preference over equity shares both in payment of dividend and in repayment of capital in case of winding up of the company.
2. Preference shareholders get fixed income as their rate of dividend is fixed.
3. Preference shareholders do not have voting rights.
4. Preference shareholders do not take part in the management of the company.
5. Preference shareholders bear less risk as compared to Equity share-holders.

Difference between Equity shares and Preferences Shares.

Refer to page no. 140 of your Book. (6)

Debentures / Bonds :-

A debenture is a document or certificate issued by a company under its seal as an acknowledgement of its debt. It is also an undertaking (promise) to repay the specified sum with interest to its holder. Holders of debentures are called debentureholders.

Debentures constitute the borrowed funds. Debentureholders are creditors of a company. Debenture capital can also be called as debt capital.

Characteristics of Debentures :-

1. Debentures represent borrowed funds.
2. Interest on debentures is paid at a fixed rate.
3. Interest is payable every year irrespective of whether there are profits or not.
4. Debentures generally carry no voting rights.
5. Debentures may involve a charge on the assets of the company.
6. Debentures are generally repayable after a specified period of time.

Difference between Shares and Debentures
Refer to page No. 146.

Loans From Commercial Banks

Business firms can raise finance from commercial banks in the following ways:-

(a) Term Loans:- Banks offer loans to business

firms for medium term or long term. The whole amount is credited to the account of the borrower. The borrower may withdraw the whole amount in lumpsum or in instalments. Interest is charged on the whole amount of the loan. These loans are secured by the security of tangible assets.

(b) Cash Credit :-
It is a formal and revolving credit agreement under which the borrower is allowed to borrow upto the specified limit. The amount may be withdrawn in instalments. Borrower can also deposit the money in the loan account. Interest is charged on the amount actually withdrawn. Cash credit is normally secured by security of some tangible asset like stock or by personal guarantee of the businessmen.

(c) Overdraft :- An overdraft is a kind of temporary financial accomodation (help) extended by a bank to its regular customers. Under this arrangement, a customer having a current account with bank is allowed to withdraw more money than his account balance. A business enterprise can enter into this agreement to take care of temporary shortage of working capital. Interest is charged on the amount actually overdrawn and not on the amount sanctioned by the bank.

(d) Discounting of Bills of Exchange:
Commercial banks provide short-term finance to business concerns by discounting their bills of exchange, promissory notes and hundies. Banks charge some commission for this service by paying a price lower than the face value of the credit instrument. The holder of the instrument is liable to the bank if the instrument is dishonoured on maturity.
For example, A and Co. sells goods on credit for ₹ 50,000 to B and Co. which signs a bill of exchange due after 60 days. A and Co. can get the payment of the bill from a bank on the same day. The bank will deduct some discount (say ₹ 2000) to cover interest charges for 60 days and will pay ₹ 58,000 to the customer. On the due date (after 60 days) the bank will receive payment of bill from B and Co. (₹60,000)
If B and Co. does not make payment to bank then A and Co. is liable to pay that amount to the bank.

Answer the following questions:-
1. Explain the difference between Shares and Debentures.
2. What are Equity shares?
3. What are Preference shares?
4. Explain various ways through which a business firm can get loan from Commercial banks.

Last Page. 9