SAMPLE CONTENT

SMART NOTES

Based on New Paper Pattern and Latest Textbook

Std. XII

Secretarial Practice

It is mandatory for every listed company to appoint a full time Company Secretary.

Target Publications® Pvt. Ltd.

SMART NOTES

SECRETARIAL PRACTICE

Std. XII

MAHARASHTRA STATE BOARD

(Written as per the Latest Textbook published by the Maharashtra State Bureau of Textbook Production and Curriculum Research, Pune.)

Salient Features:

- Based on the Latest Textbook
- Exhaustive content coverage in Question and Answer format
- Answers presented exactly the way they are to be written in exams
- Smart Codes and Smart Recaps to memorise answers
- 'For your understanding' section for conceptual clarity
- Includes GG - our very own mascot that offers a practical touch to theory
- Includes QR codes for reference content
- Replete with practical and real life examples
- Highlighted key words and sentences that aid recall as well as revision
- Tagging of relevant board questions upto March 2022 exam
- Assessment and answer key at the end of every chapter for self-evaluation
- Includes Board Question Paper of February 2023 (Solution in pdf format through QR code)

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PREFACE

Smart Notes: Secretarial Practice (SP) is a book curated to facilitate learning and instil conceptual understanding within students. This treasure trove of knowledge fosters robust conceptual clarity and inspires confidence within the nimble mind of young learners.

This book not only provides answers to all textual questions but also addresses extra questions in each lesson with the aim of covering the entire topic and making students ready to face the competition. Throughout this book, questions are answered in a detailed, point-wise format which is exactly how the students are expected to write their answers in the exam.

We have incorporated 'Smart Codes' to facilitate easy answer recall. In case of long and complex answers, we have provided 'Smart Recap' for quick revision. 'For your understanding' section provides the required conceptual clarity to understand a particular point. 'Gyan Guru', our very own mascot, offers a practical touch to theory by sharing interesting and real facts. 'QR codes' present throughout the book offer students practical knowledge through reference content. We're sure that students, parents and teachers alike would love our value proposition and the unique presentation of content.

\- Publisher

Edition: Fifth

The journey to create a complete book is strewn with triumphs, failures and near misses. If you think we've nearly missed something or want to applaud us for our triumphs, we'd love to hear from you.

Please write to us at: mail@targetpublications.org

Why to study Secretarial Practice ?

Apart from the basic objective of doing well in your exams, there are various reasons for studying Secretarial Practice (SP):

1. This subject gives us detailed knowledge about the role and functions of a company secretary. A student who aspires to be a CS will gain good theoretical knowledge through this subject.
2. A company secretary has to correspond with various stakeholders such as shareholders, depositors, debenture holders, bankers etc. This subject helps us to understand the manner in which such correspondence is required to be done.
3. The chapters like 'Depository system', 'Financial markets' and 'Stock exchange' give us in-depth and practical knowledge from company's point of view and the role that company secretary plays in it.

For students pursuing professional courses, this subject has added importance.

How to study from this book ?

This book is divided into the following parts:

1. Theory questions
2. Interpretative based questions

<u>Theory questions</u>

Questions covered in theory section are in the flow of textbook. Thus, once you read all the questions, it's as good as reading an entire chapter from the textbook. We advise you to study from this section first.

<u>Interpretative based questions</u>

This section is at the end of the theory section. Questions covered in this section are either objectives or application-based questions. Once you have read and understood the theory, you are better equipped to solve and answer these questions. We have also provided answers for you to enable self-evaluation.

KEY FEATURES

Smart Code

At times, answers are too lengthy and it's difficult to remember all the points. Hence, we have created 'Smart Codes' for a few questions to aid you in remembering and recollecting these points. Please do not memorise each and every Smart Code. Instead of helping, it might end up confusing you. Memorise only those Smart Codes wherein you find the answer difficult to comprehend.

Smart Recap

In theory subjects, at times, answers are quite long and complex. It's difficult to remember the entire answer. Hence, we have provided 'Smart Recap' i.e. summary of the entire answer for students to revise it immediately.

For Your Understanding

Certain concepts are tricky and difficult to understand with a limited amount of explanation. To explain these concepts efficiently, we have provided a section named 'For your understanding' that provides better conceptual clarity. Please note that the content provided in this section need not be written in the examination.

GG – Gyan Guru

Gyan Guru, our very own mascot, keeps popping up throughout the book. He offers you a practical and real-life example or an interesting fact, associated with the topic. Look out for him!

QR Codes

S.P. has numerous real-life applications. We have given an additional piece of relevant information via QR codes for better understanding.

Chapter Assessment

Chapter assessment is provided at the end of every chapter for self-evaluation. The answer key of assessment is provided in the form of QR Code.

Board Question Papers

i. Selective questions from Board Question Papers till March 2022 along with their solutions have been included.

ii. Includes Board Question Paper of February 2023.

PAPER PATTERN

Marks: 80 Time: 3.00 Hrs.

Q. No.	Questions	Marks per Que.	No. of Questions to Attempt	Marks without option	Marks with option
1.	From the following types of sub questions, any 4 will be asked.				
	A. Select the correct option and rewrite the sentence.	1	5	5	5
	B. Match the pairs.	1	5	5	5
	C. Given one word/pharse/term.	1	5	5	5
	D. State true or false.	1	5	5	5
	E. Find the odd one.	1	5	5	5
	F. Complete the sentences.	1	5	5	5
	G. Select the correct option from the bracket.	1	5	5	5
	H. Answer in one sentence.	1	5	5	5
	I. Correct the underlined word and rewrite the following sentences.	1	5	5	5
	J. Arrange in proper order.	1	5	5	5
2.	Explain the following terms/concepts.	2	Any (4) Out of (6)	8	12
3.	Study the following case/situation and express your opinion.	3	Any (2) Out of (3)	6	9
4.	Distinguish between.	4	Any (3) Out of (4)	12	16
5.	Answer in brief.	4	Any (2) Out of (3)	8	12
6.	Justify the following statements.	4	Any (2) Out of (4)	8	16
7.	Attempt the following. (Letter writing)	5	Any (2) Out of (3)	10	15
8.	Answer the following. (Long Answer)	8	Any (1) Out of (2)	8	16
	Total Marks			80	116

Question Wise Distribution of Marks

Sr.No.	Questions	Marks	Marks With Option	Percentage
1	Objective Type	20	20	25%
2	Short Answer	52	80	65%
3	Long Answer	08	16	10%
	Total	80	116	100%

Variety of questions covered

In this book, you will be studying below types of questions:

Sr. No.	Nature of Question	Ch. 1	Ch. 2	Ch. 3	Ch. 4	Ch. 5	Ch. 6	Ch. 7	Ch. 8	Ch. 9	Ch. 10	Ch. 11	Ch. 12
	Theory section												
1.	Answer the following.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
2.	Draft specimen letter for the following.	×	×	×	×	×	✓	✓	✓	×	×	×	×
3.	Distinguish between.	✓	✓	✓	×	×	×	✓	×	✓	✓	✓	✓
	Objective section												
A.	Select the correct answer from the options given below and rewrite the statements.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
B.	Match the pairs.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
C.	Write a word or a term or a phrase which can substitute each of the following statements.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
D.	State whether the following statements are true or false.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
E.	Find the odd one.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
F.	Complete the sentences.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
G.	Select the correct option from the bracket.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
H.	Answer in one sentence.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
I.	Correct the underlined word and rewrite the following sentences.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
J.	Arrange in proper order	✓	×	✓	✓	✓	✓	✓	✓	✓	✓	×	×
	Explain the following terms / concepts.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Justify the following statements.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Study the following case / situation and express your opinion.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓

“ **Note:** All the above variety of questions are a part of textbook. ”

INDEX

Sr. No.	Titles	Marks	Marks with option	Page No. (Theory)	Page No. (Objectives)
1.	Introduction to Corporate Finance	17	25	1	193
2.	Sources of Corporate Finance			17	204
3.	Issue of Shares			44	216
4.	Issue of Debentures	24	35	73	234
5.	Deposits			85	245
6.	Correspondence with Members			99	258
7.	Correspondence with Debenture holders	13	18	112	264
8.	Correspondence with Depositors			126	271
9.	Depository System	07	11	139	277
10.	Dividend and Interest	09	13	154	287
11.	Financial Market	10	14	167	301
12.	Stock Exchange			180	309
	Total	80	116		
	Includes Board Question Paper of February 2023 (Solution in pdf format through QR code)			319	

Note: 1. All textual questions are represented by (T) mark.

2. At the start of each chapter, we have provided a chapter index to enable the students to get an overview of the chapter. We have also marked the years in which the questions have been previously asked. Please note that this marking is only indicative and not exhaustive.

1 Introduction to Corporate Finance

SR. NO.	PARTICULARS	BOARD EXAM
1.	What is corporate finance and state two decisions which are basis of corporate finance. (T)	
2.	What are the different aspects covered by corporate finance? What decisions does a finance manager of a corporation have to deal with?	
3.	Discuss the importance of corporate finance. (T)	
4.	What are the different steps an entrepreneur has to take before starting a business?	
5.	Explain the concept of fixed capital.	
6.	State any four factors affecting fixed capital requirement. (T)	Oct'21, Feb' 18
7.	Explain the concept of working capital.	
8.	Discuss the factors determining working capital requirement. (T)	
9.	Define capital structure and state its components. (T)	Feb' 20, Mar' 16, Oct' 15
10.	Distinguish between:	
11.	Chapter Assessment	

INTRODUCTION

Finance is the life blood of any business organisation. The term 'finance' is related to money and management of money. Success of any business organisation depends upon the efficiency with which it is able to generate and use funds. Corporate finance deals with the aspect of arrangement of finance and its proper utilisation. It has two main aspects, viz. financing decisions and investing decisions. Financing decisions relate to capital structure while investment decisions relate to capital budgeting.

A company has to estimate its capital requirements in order to draft an appropriate financial plan. It has to take into consideration its fixed capital as well as working capital requirements. This chapter explains basic concepts associated with corporate finance.

Q.I. Answer the following

1. What is corporate finance and state two decisions which are basis of corporate finance. T

Ans: Corporate finance is **that part of finance which deals with raising and using of funds by a corporation.** It involves financing the activities of corporation, capital structuring and making various investment decisions.

According to **Henry Hoagland,** "Corporate finance deals primarily with the acquisition and use of capital by business corporation."

The decisions that are basis of corporate finance are as follows:

1) FINANCING DECISION

   i. Financing decision **relates to deciding the source of finance.** A firm has multiple choices of sources of finance.
   ii. A firm has access to capital market to fulfil its financing requirements.
   iii. The firm can choose whether it wants to raise equity capital or debt capital.
   iv. It can even raise funds through bank loans, public deposits, debentures etc.
   v. The finance manager ensures that the firm is well capitalised i.e. the firm has required amount of capital as well as the right combination of equity and debt.

2) INVESTMENT DECISION

   i. After the firm has received the necessary finance, **the finance manager has to take decisions regarding the usage of funds in a systematic manner** so that it results in the maximum returns to the firm.
   ii. In order to achieve this, the firm has to know the cost of capital.
   iii. Once the cost of capital is known, a firm has to use the funds in such a manner that the returns from investment are more than the cost of capital.
   iv. Finding investments which ensure successful usage of funds is known as investing decision. It is also known as 'Capital budgeting'.

FOR YOUR UNDERSTANDING

Capital budgeting is a very important aspect of any business. The business has to identify the projects which are worth investing money. If a business gets its capital investments wrong, it can end up with a non-functioning business. Over-investment as well as under-investment may have adverse impact on a business.

SMART RECAP

Financing decisions	Investment decisions
1. Relates to capital structure	1. Relates to capital budgeting
2. Decisions related to sources of finance	2. Decisions related to successful usage of funds
3. Option of owned capital and borrowed capital.	3. Important to calculate cost of capital
4. Sources of finance: <u>Owned capital</u>: Share capital, free reserves and surplus <u>Borrowed capital</u>: Debentures, bank loans and loans from financial institutions	4. Returns from investment should be more than cost of capital

2. What are the different aspects covered by corporate finance? What decisions does a finance manager of a corporation have to deal with?

Ans: Corporate finance refers to the generation and usage of funds by a corporation. The success of any business depends upon the efficient generation and usage of funds. The financial organisations and banks play a vital role in corporate financing.

1) <u>DIFFERENT ASPECTS COVERED BY CORPORATE FINANCE</u>

Corporate finance includes various aspects like:

i. Financial planning
ii. Study of capital market and money market
iii. Capital formation and foreign capital

2) <u>FUNCTIONS OF FINANCE MANAGER</u>

The finance manager of any corporation has to make sure that:

i. The firm has adequate finance.
ii. The firm is using funds from the right source at the minimum cost.
iii. The firm invests those funds in an effective manner.
iv. The firm is generating maximum returns for its owners.

3. Discuss the importance of corporate finance. T

Ans: In any business enterprise, the important functional areas are production, finance, marketing and personnel activities. Out of these, financial activities are given the utmost importance. The importance of corporate finance is as follows:

SMART CODE	4H	3P	B	M	R

1) HELPS IN DECISION MAKING

i. Availability of funds is an important factor that influences major business decisions.
ii. It is difficult to perform any function of business enterprise without finance.
iii. Every decision in the business needs to be taken by considering its impact on profitability.
iv. Out of various alternatives available to the business, the management is required to select the best one that ensures maximum profitability.
v. Business organisation undertakes a project only if it is financially viable.
vi. Thus, corporate finance plays a very important role in the decision-making process.

FOR YOUR UNDERSTANDING

Financially viable: It means the capability of a project/ idea/ business to generate sufficient income so as to meet the expenses.

2) HELPS IN RAISING CAPITAL FOR A PROJECT

A business firm needs finance to start a new venture. There are various sources for a business firm to raise funds like issue of shares, debentures, bonds or even taking loans from the banks.

3) HELPS IN RESEARCH AND DEVELOPMENT

i. Research and Development play a crucial role in growth and expansion of business. Detailed technical work is essential for the execution of projects.
ii. Research and Development is a lengthy process. Therefore, funds have to be made available throughout the research work. It necessitates continuous financial support.
iii. Also, a company may need to improve its old product or develop a new product in order to attract customers.
iv. In order to do this, company has to conduct survey, market analysis etc. which again requires financial support.

4) HELPS IN SMOOTH RUNNING OF BUSINESS

A smooth flow of corporate finance ensures that the:

i. Salaries of employees are paid on time.
ii. Loans are cleared on time.
iii. Raw materials are purchased as per requirement.
iv. Sales promotion of existing products is carried out smoothly.
v. New products are launched effectively.

5) PROMOTES EXPANSION AND DIVERSIFICATION
   i. Modern machines and modern techniques are required for the expansion and diversification of a business.
   ii. Corporate finance ensures that the funds are available to purchase modern machines and techniques.
   iii. Hence, finance becomes mandatory for the expansion and diversification of a company.

6) PAYMENT OF DIVIDEND AND INTEREST
   Finance is required to pay dividend to shareholders and interest to creditors, banks etc.

7) PAYMENT OF TAXES AND FEES
   A company has to pay various taxes and fees to the government like income tax, Goods and Services Tax (GST), fees to Registrar of Companies etc. on various occasions. Finance is needed to pay these taxes and fees.

8) BRINGS CO-ORDINATION BETWEEN VARIOUS ACTIVITIES
   i. Corporate finance plays a very significant role in control and co-ordination of various business activities.
   ii. E.g.: if finance department does not provide adequate funds for the purchase of raw materials and to meet other day-to-day financial requirements that ensure smooth running of production department, it will affect the production activities. As a result, the sales may suffer which in turn will adversely affect the income and profits of the business.
   iii. Thus, efficiency of every department in a business organisation depends upon the effective financial management.

9) MANAGING RISK
   A company has to manage several financial risks such as loss due to sudden fall in sales, loss due to natural calamity, loss due to strikes etc. In order to manage these risks, a company needs financial aid.

10) REPLACE OLD ASSETS
   The assets of a company like plant and machinery become old and outdated over the years. The company needs to replace them with new assets. Finance is required for the purchase of new assets.

4. What are the different steps an entrepreneur has to take before starting a business?

Ans: When an entrepreneur conceives a business idea, he first investigates the commercial viability or feasibility of the project. Once he is satisfied with the feasibility of the project, he takes serious steps to start the project. The steps taken by him are as follows:

1) DECIDING CAPITAL REQUIREMENT

Once the entrepreneur decides to start the project, the first and foremost step that he has to take is to decide the amount of capital required to start and run the business. This has to be done with utmost care.

2) DRAFTING FINANCIAL PLANS

Financial plan refers to assessment of financial requirement and arranging sources of capital. The entrepreneur has to draft the financial plan very carefully. It should be drafted keeping in mind the present and future requirements of the business. While drafting the financial plan, the entrepreneur has to take into consideration the fixed capital as well as working capital requirements of the business.

FOR YOUR UNDERSTANDING

Commercial viability: It is a process of identifying objectives of the project, recognising opportunities and obstacles as well as analysing various alternatives available. It helps to decide whether it is profitable to develop the business idea further.

5. Explain the concept of fixed capital.

Ans: 1) MEANING OF FIXED CAPITAL

Fixed capital is the **capital which is used to purchase fixed assets of the business.** In other words, fixed capital refers to the capital invested for acquiring fixed assets. These fixed assets are used for a longer period of time and are not meant for resale.

2) NATURE OF FIXED CAPITAL

Fixed capital **stays in the business for a long period of time** almost permanently. Examples of fixed capital are capital used for purchasing assets like land and building, furniture, plant and machinery etc.

3) TIME OF REQUIREMENT

Fixed capital is usually required at the time of establishment of a new company. However, existing companies may also require fixed capital for their expansion and development, replacement of equipment etc.

4) STEPS IN ESTIMATION OF FIXED CAPITAL REQUIREMENT

Initial planning of fixed capital requirement is done by the company's promoters. First, they prepare a list of fixed assets required by the company and then estimate the cost of acquiring these assets. They collect information regarding price of land, cost of construction of building, cost of plant and machinery etc. The cost of different fixed assets is thus calculated and the resulting figure would be the total fixed capital requirement of the new firm.

5) <u>IMPORTANCE OF ESTIMATION</u>

The estimation of fixed capital requirement has assumed great importance in the recent years particularly because of the modern industrial processes which require increased use of heavy and automated machineries.

6) <u>SOURCES OF FUNDS FOR FIXED CAPITAL</u>

An entrepreneur obtains funds to meet the fixed capital requirement from capital market. Funds can come through issue of shares, debentures, bonds or long-term loans.

6. State any four factors affecting fixed capital requirement. (Oct'21, Feb' 18) T

Ans: Fixed capital is the capital which is used to purchase fixed assets of the business. These assets are used for a longer period of time and are not meant for resale. The factors affecting fixed capital requirement are as follows:

1) <u>NATURE OF BUSINESS</u>

Nature of the business determines the fixed capital requirement. Manufacturing industries and public utility companies have to invest huge amounts to acquire fixed assets while trading businesses may not require huge investments in fixed assets.

2) <u>SIZE OF BUSINESS</u>

When a firm is set up to carry business operations on a large scale, it has higher fixed capital requirement as most of the production processes are based on automatic machines and equipment.

3) <u>SCOPE OF BUSINESS</u>

The business firms that are formed to carry on production or distribution on a large scale would require more amount of fixed capital.

4) <u>EXTENT OF LEASE OR RENT</u>

If an entrepreneur decides to acquire assets on lease or on rental basis, then the business requires lesser amount of funds for acquiring fixed assets.

5) <u>ARRANGEMENT OF SUB-CONTRACT</u>

If a business chooses to sub-contract some processes of production to outside companies, then limited assets are required to carry out the production. This would minimise the fixed capital requirement of business.

FOR YOUR UNDERSTANDING

Sub-contract: It means a business firm entering into a contract with an outsider to perform a certain type of work. For example: a manufacturing firm may sub-contract the task of maintaining its accounts to an outside firm.

6) ACQUISITION OF OLD ASSETS

If the company can acquire old equipment and plants at low prices, then it would reduce the need for investment in fixed assets.

7) ACQUISITION OF ASSETS ON CONCESSIONAL RATE

In order to encourage industrial growth at regional level, the government may provide land and building at concessional rates. The plant and equipment may also be made available on instalment basis. Such facilities reduce the fixed capital requirement of a business.

8) INTERNATIONAL CONDITIONS

International conditions play a significant role, particularly in large organisations carrying out business on international level. E.g.: if a company is expecting war, it may decide to invest huge amount of funds to expand fixed assets before there is a shortage.

9) TREND IN ECONOMY

If it is expected that the business is going to be successful and has a bright future, then the entrepreneur will carry out all sorts of business expansion. In that case, large amount of funds are invested in fixed assets so as to reap the benefits in future.

10) POPULATION TREND

When the population increases at a high rate, it leads to increase in demand and certain manufacturers find this as an opportunity to expand their business. E.g.: businesses like automobile industry, electronic goods manufacturing industry, ready-made garments, etc. This leads to increase in the amount invested in fixed assets.

11) CONSUMER PREFERENCE

Industries that provide goods and services which are in high demand would require large amount of fixed capital. E.g.: Mobile phone manufactures as well as mobile network providers.

12) COMPETITIVE FACTOR

Competition is a prime element in decision making regarding the fixed capital requirement. If one of the competitors shifts to automation, then all other companies in the same line of activity are forced to follow the competitor.

7. Explain the concept of working capital.

Ans: 1) MEANING OF WORKING CAPITAL

Working capital is the **capital which is required to carry out day-to-day business activities.** After estimating fixed capital requirement, the firm needs to estimate the amount of capital that would be needed to ensure smooth functioning of the business.

2) ASSETS UNDER WORKING CAPITAL

The capital invested in the following assets is referred to as working capital:

i. For building up inventories of raw materials and finished goods

ii. For financing receivables and payables

iii. For covering day-to-day operating expenses

3) NEED OF WORKING CAPITAL

Working capital is needed for the following reasons:

i. A firm requires funds to **store adequate raw material** in stock and to **maintain sufficient stock of finished goods**.

ii. Goods are sold either in cash or on credit. **When goods are sold on credit, it does not fetch cash immediately**. So, a firm has to make arrangement for funds till the amount is collected from the debtors.

iii. Funds are also required to **pay for the overheads**.

iv. Since uncertainty always exists in business, some cash needs to be maintained **to meet unexpected expenses**.

4) NET WORKING CAPITAL

The concept of working capital is viewed differently by different leading authorities. Some authorities consider working capital as being equivalent to excess of current assets over current liabilities. Gerstenbergh defines it as, "the excess of current assets over current liabilities." This approach refers to **'Net Working Capital'**. Gerstenbergh does not call it as working capital. He prefers to call it as **'circulating capital'**.

5) GROSS WORKING CAPITAL

Some other authorities view **working capital as being equivalent to current assets of the company**. According to J. S. Mill, "the sum of current assets is working capital." This approach has broader application. It takes into consideration all current assets of the company. It refers to **'Gross Working Capital'**.

8. Discuss the factors determining working capital requirement. T

Ans: There are no precise standards for a business firm to measure working capital adequacy. The management has to determine the working capital requirement based on the certain aspects of business and economic environment within which the firm operates. The factors determining working capital requirement are as follows:

1) NATURE OF BUSINESS

Working capital requirement depends on the nature of business.

i. Firms engaged in manufacturing essential products of daily consumption would need a relatively lesser amount of working capital as there would be a constant and sufficient cash inflow to take care of liabilities.

ii. Public utility companies also have to maintain lesser amount of working capital due to continuous flow of cash from their customers.

iii. Businesses dealing with luxurious products require huge amount of working capital as the sale of luxurious items is not frequent.

iv. Trading or merchandising firms which are concerned with distribution of goods have to carry big inventories of goods to meet customers' demand. They also have to provide credit facilities to attract customers. Hence, they need a large amount of working capital.

2) SIZE OF BUSINESS

The size of business also affects the working capital requirement. A firm with large scale operations would require a higher amount of working capital.

3) VOLUME OF SALES

The volume of sales is the most important factor affecting the size of working capital. The volume of sales and the size of working capital are directly related to each other. If the volume of sales increases, the amount of working capital required also increases and vice versa.

4) PRODUCTION CYCLE

Production cycle refers to the process of converting raw materials into finished goods. If a firm has longer production cycle, it requires more amount of working capital. If a firm has shorter production cycle, it requires lesser working capital.

5) BUSINESS CYCLE

During a boom in the economy, there is an increase in the sales leading to rise in the investments in stocks. Thus, businesses require additional working capital. During recession, the sales decline and hence, the need for working capital also declines.

FOR YOUR UNDERSTANDING

Boom and recession: These are the phases of economic cycle. During boom, there is an increase in the commercial activities while during recession; there is a decrease in demand, savings, production and prices, i.e. general decline in economic activity.

6) TERMS OF PURCHASES AND SALES

If the firm does not get credit facility for purchases but if it provides easy (liberal) credit facility on sales, then it would require more working capital. However, if the firm gets favourable terms of credit for purchases and terms of credit sales are less liberal, then lesser working capital would be required.

7) CREDIT CONTROL

Credit control policies include factors such as volume of credit sales, the terms of credit sales, the collection policy, etc. If a company has a sound credit control policy, then it would have an improved cash flow and hence, may require lesser working capital. If the credit control policy of the firm is liberal, it may create problem of fund collection and increase the possibility of bad debts. Such firm requires more working capital. The firm making cash sales would require less working capital.

8) GROWTH AND EXPANSION

The working capital requirement increases with the growth of the firm. A growing company needs funds continuously in order to support its large scale operations.

9) MANAGEMENT ABILITY

A firm would require lesser working capital if there is proper co-ordination between production and distribution of goods. If a firm stocks large amount of inventory, then it requires a higher amount of working capital.

10) EXTERNAL FACTORS

If financial institutions and banks provide funds to the firm as and when required, the need for working capital is reduced.

SMART RECAP

Factors affecting requirement of fixed capital	Factors affecting requirement of working capital
Based on business	Based on business
1. Nature of business	1. Nature of business
2. Size of business	2. Size of business
3. Scope of business	3. Volume of sales
Based on acquisition of assets	4. Production cycle
4. Extent of lease or rent	Based on credit policy
5. Arrangement of sub-contract	5. Terms of purchases and sales
6. Acquisition of old assets	6. Credit control
7. Acquisition of assets on concessional rate	Based on firm's ability
Based on external factors	7. Growth and expansion
8. International conditions	8. Management ability
9. Trend in economy	Based on external environment
10. Population trend	9. Business cycle
11. Consumer preference	10. External factors
12. Competitive factor	

9. Define capital structure and state its components. (Feb' 20, Mar' 16, Oct' 15)

Ans: 1) Capital structure refers to **'mix up of various sources of funds in desired proportion'**. To decide capital structure means to decide upon the ratio of different types of capital.

2) A **combination of different sources is used in capital structure.** It is nothing but 'security mix.'

3) The capital structure is **composed of owned funds and borrowed funds.**

4) Owned funds include share capital, free reserves and surplus while borrowed funds include debentures, bank loans and long-term loans provided by financial institutions.

5) **R. H. Wessel** defines capital structure as "the long-term sources of funds employed in a business enterprise".

6) **John Hampton** stated that "A firm's capital structure is the relation between the debt and equity securities that makes up the firm's financing of its assets".

COMPONENTS OF CAPITAL STRUCTURE

The four basic components of capital structure are as follows:

1) EQUITY SHARE CAPITAL

Equity shares are the basic source of financing business activities. Equity shares get dividend and repayment of capital after it is paid to preference shares. Equity shareholders are the owners of the company. They bear ultimate risk associated with ownership. The rate of dividend given to equity shareholders fluctuates depending upon the profits earned.

2) PREFERENCE SHARE CAPITAL

Preferences shares are those shares that carry preferential right as to payment of dividend and have priority over equity shares for repayment of capital on liquidation of the company. Preference shares are paid dividend at a fixed rate.

3) RETAINED EARNINGS

It is ploughing back of profits made by the company. It is an internal source of financing.

FOR YOUR UNDERSTANDING

Ploughing back of profits means a part of the profits made by the company is retained and reinvested in the business itself.

4) BORROWED CAPITAL

It consists of the following:

i. **Debenture:** *It is an acknowledgment of loans raised by the company. A company has to pay interest on debentures at an agreed rate.*

ii. **Term loan:** *These loans are provided by banks and financial institutions. Term loans carry a fixed rate of interest.*

The capital structure of a company can be explained with the help of an example of a Balance sheet as follows:

Balance Sheet of XYZ Ltd as on 31st March, 2019

Liabilities	Amount (₹)	Assets	Amount (₹)
Share Capital		Fixed Assets	
20,000 equity shares of		Building	5,00,000
₹ 10 each fully paid	2,00,000	Plant and Machinery	2,00,000
5,000 preference shares of		Current Assets	
₹ 100 each fully paid	5,00,000	Sundry debtors	1,00,000
		Inventories	40,000
		Cash in hand	20,000
		Cash at bank	40,000
Reserves and Surplus	50,000		
Liabilities			
1000, 10% debentures of			
₹ 100 each fully paid	1,00,000		
Sundry creditors	30,000		
Bills payable	20,000		
	9,00,000		9,00,000

Capital structure = Equity share capital + Preference share capital + Reserves + Debentures

= 2,00,000 + 5, 00,000 + 50,000 + 1, 00,000

= 8,50,000

GG - Gyan Guru *There should be a proper balance between debt and equity. If the company relies too much on debt, then it may increase the risk of default while repaying loans. If the company depends too heavily on equity, it would reduce its earnings to the original investors.*

SMART RECAP

Components of capital structure

- Owned capital
  - Equity share capital
  - Preference share capital
  - Retained earnings
- Borrowed capital
  - Debentures
  - Term loans

Q.2. Distinguish between: (T)

1. Fixed capital and Working capital

(Mar' 22, Feb' 20, July 17, Mar' 17, July 16, Mar' 15, Oct' 14)

Ans:

Fixed capital	Working capital
1) Meaning	
Fixed capital refers to any kind of physical asset i.e. fixed assets.	Working capital refers to excess of current assets over current liabilities.
2) Nature	
Fixed capital stays in the business almost permanently.	Working capital is circulating capital. It keeps changing.
3) Purpose	
Fixed capital is used for financing fixed assets such as land, building, equipment, etc.	Working capital is used for financing short-term assets such as cash, account receivable, inventory, etc.
4) Sources	
Fixed capital funding can come from issuing shares, debentures, bonds, taking long-term loans, etc.	Working capital can be funded with short-term loans, deposits, trade credit, etc.
5) Objectives of investors	
Investors invest money in fixed capital hoping to make future profit.	Investors invest money in working capital for getting immediate returns.
6) Risk	
Investment in fixed capital involves more risk.	Investment in working capital is less risky.

CHAPTER ASSESSMENT

Time: 1 hour | Marks: 25 marks

Q.1. A) Select the correct answer from the options and rewrite the statements. [2]

1. Manufacturing industries have to invest _______ amount of funds to acquire fixed assets.
   a. huge b. less c. minimal

2. A firm keeping _______ requires higher levels of working capital.
   a. low inventory b. higher inventory c. no inventory

B) Write a word or a phrase or a term which can substitute each one of the following. [2]

1. Capital needed to acquire fixed assets which are used for longer period of time.
2. The internal source of financing.

C) State whether the following statements are true or false. [2]

1. Corporate finance deals with only acquisition of finance of a company.
2. Capital for financing receivables comes under working capital.

D) Answer in one sentence. [2]

1. Define corporate finance.
2. Define working capital.

Q.2. Explain the following terms/concepts. (Any 1 out of 2) [2]

1. Investment decision
2. Capital Structure

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

1. Mukesh Traders is a trading firm dealing in essential goods. They have to maintain huge stock of inventories and provide credit facilities to its customers.
   i. Will it need less or more working capital?
   ii. Will it need more fixed capital?
   iii. If they were dealing in luxurious products will they require comparatively more or less working capital?

Q.4. Justify the following statements. (Any 1 out of 2) [4]

1. Research and Development requires continuous financial support.
2. There are various factors affecting the requirement of working capital.

Q.5. Answer the following. (Any 1 out of 2) [8]

1. What are the factors affecting requirement of fixed capital?
2. Define capital structure and state its components.

Scan the given Q. R. Code in **Quill - The Padhai App** to view the answers of the Chapter Assessment.

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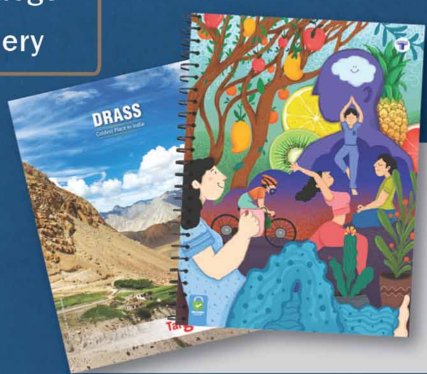

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