

- Sources of Business Finance
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- Owners' Fund: Meaning, Merits and Limitations
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## Sources of Business Finance

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**Concept Explanation:** Business finance refers to the money required by a business to start, operate, and expand its activities. It is essential for smooth functioning, growth, and risk management of any business enterprise.

### Key Definitions / Features:

- **Business Finance:** Funds needed for business operations and expansion.
- **Owners' Funds:** Capital invested by the owners, including equity shares, preference shares, and retained earnings.
- **Borrowed Funds:** Funds borrowed from external sources like loans, debentures, public deposits, trade credit, and inter-corporate deposits.

**Illustrative Example:** A company may raise funds by issuing equity shares to owners and also by taking loans from banks.

### Practice Set:

- Level 1: Define business finance and list its two main sources.
- Level 2: Explain the difference between owners' funds and borrowed funds with examples.
- Level 3: Discuss why a business needs both fixed capital and working capital.

### Answer Key:

- Business finance is the money required to start and run a business.
- Two main sources: Owners' funds (equity shares, retained earnings) and borrowed funds (loans, debentures).

- Owners' funds are invested by owners and do not require repayment; borrowed funds must be repaid with interest.
- Fixed capital is for long-term assets; working capital is for day-to-day expenses.

**Quick Reference:** Business finance = Owners' funds + Borrowed funds; Fixed capital + Working capital.

### Glossary:

- **Equity Shares:** Shares representing ownership with voting rights.
- **Preference Shares:** Shares with fixed dividends and priority over equity shares.
- **Retained Earnings:** Profits kept in the business for future use.
- **Debentures:** Long-term debt instruments with fixed interest.

## Importance and Need for Business Finance

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**Concept Explanation:** Finance is vital for starting, running, and expanding a business. It supports operations, strategic planning, managing cash flow, and promotion activities.

### Key Definitions / Features:

- **Financial Statements:** Help identify capital shortages and plan finance accordingly.
- **Strategic Planning:** Finance provides the groundwork for business expansion and goal achievement.
- **Cash Flow Management:** Finance helps manage cash shortages and repayment schedules.
- **Promotion:** Finance allocated for marketing to increase product awareness.
- **Need for Finance:** To start business, run daily operations, and expand or modernize.

**Illustrative Example:** A business needs finance to pay salaries, buy raw materials, and invest in new machinery.

### Practice Set:

- Level 1: List four reasons why business finance is important.
- Level 2: Explain how finance aids in strategic planning and cash flow management.
- Level 3: Discuss the consequences of inadequate finance on business operations.

### Answer Key:

- Finance is important for operations, expansion, cash flow, and promotion.
- Strategic planning uses finance to budget and forecast; cash flow management ensures timely payments.
- Inadequate finance can halt production, delay payments, and reduce market competitiveness.

**Quick Reference:** Finance is the lifeblood of business operations and growth.

### Glossary:

- **Cash Flow:** Movement of money in and out of business.
  - **Strategic Planning:** Long-term business goal setting and resource allocation.
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## Owners' Fund: Meaning, Merits and Limitations

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**Concept Explanation:** Owners' funds are the capital invested by the owners of a business. It includes equity shares, preference shares, and retained earnings.

### Key Definitions / Features:

- **Share Capital:** Capital raised by issuing shares.
- **Equity Shares:** Represent ownership; shareholders have voting rights and variable dividends.
- **Preference Shares:** Fixed dividend, priority over equity shareholders in dividend and liquidation.
- **Retained Earnings:** Profits retained in the business for future use, also called ploughing back of profits.

**Illustrative Example:** A company issues equity shares to raise capital and retains some profits to finance expansion.

### Practice Set:

- Level 1: Define equity shares and preference shares.
- Level 2: Explain the advantages of retained earnings as a source of finance.
- Level 3: Discuss the limitations of owners' funds.

### Answer Key:

- Equity shares represent ownership with voting rights; preference shares have fixed dividends.
- Retained earnings provide internal finance without interest or dilution of control.
- Owners' funds may be limited and may dilute control if new shares are issued.

**Quick Reference:** Owners' funds = Equity shares + Preference shares + Retained earnings.

**Glossary:**

- **Shareholder:** Owner of shares in a company.
- **Dividend:** Return paid to shareholders from profits.
- **Ploughing Back of Profits:** Retaining profits for reinvestment.

## Borrowed Funds

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**Concept Explanation:** Borrowed funds are monies raised through loans or borrowings that must be repaid with interest. Sources include debentures, bonds, bank loans, public deposits, trade credit, and inter-corporate deposits.

**Key Definitions / Features:**

- **Debentures:** Long-term debt instruments with fixed interest, representing company borrowings.
- **Bonds:** Secured, non-convertible debt instruments issued by government or financial institutions.
- **Financial Institutions:** Provide owned and loan capital to promote industrial development.
- **Commercial Banks:** Offer various loan facilities like cash credits, overdrafts, and term loans.
- **Public Deposits:** Funds raised directly from the public at higher interest rates than banks.
- **Trade Credit:** Credit allowed by suppliers to customers for purchases without immediate payment.
- **Inter-Corporate Deposits (ICD):** Short-term unsecured deposits between companies for cash management.

**Illustrative Example:** A company issues debentures to raise long-term funds and takes a loan from a bank for working capital.

**Practice Set:**

- Level 1: Define debentures and bonds.
- Level 2: Explain the role of financial institutions in business finance.
- Level 3: Discuss the advantages and risks of borrowed funds.

**Answer Key:**

- Debentures are long-term debt instruments with fixed interest; bonds are secured government-issued debts.

- Financial institutions provide capital to promote industrial growth and supplement banks.
- Borrowed funds increase capital but involve repayment risk and interest obligations.

**Quick Reference:** Borrowed funds = Loans + Debentures + Public deposits + Trade credit + ICD.

### Glossary:

- **Debenture Holder:** Creditor who lends money to the company.
- **Trade Credit:** Short-term credit from suppliers.
- **Inter-Corporate Deposit:** Short-term loan between companies.

## Key Terms

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- **Finance:** Funds or capital required to meet the needs of an organisation.
- **Business Finance:** Acquisition and utilisation of funds to meet financial needs and objectives.
- **Fixed Capital:** Capital invested in long-term assets.
- **Working Capital:** Capital for day-to-day business operations.
- **Owner's Fund:** Capital provided by owners, invested for long duration.
- **Borrowed Fund:** Funds raised through loans repayable with interest.
- **Financial Risk:** Risk of inability to pay interest or repay borrowed funds.
- **Share:** Smallest unit of company capital.
- **Equity Share Capital:** Capital raised by issuing equity shares.
- **Shareholders:** Investors holding shares in a company.
- **Preference Share Capital:** Capital raised by issuing preference shares.
- **Primary Market:** Market for newly issued securities.
- **Residual Owners:** Equity shareholders receiving income after creditors.
- **Dividend:** Return paid to shareholders.
- **Capital Structure:** Composition of long-term capital showing debt and equity proportions.
- **Retained Earnings:** Profits retained for future use.