CHAPTER 2

Financing: Capital and Financial Planning

> "Hence the King shall be ever active in the management of the economy. The root of wealth is economic activity and lack of it brings material distress. In the absence of fruitful economic activity, both current prosperity and future growth will be destroyed".
>
> —*Chanakya from the Arthashastra*

LEARNING OBJECTIVES

- Concept and Characteristics of Business Finance
- Importance of Business Finance
- Sources of Business Finance for Different Business Enterprises
- Financial Planning
- Factors Affecting Capital Structure
- Fixed Capital
- Working Capital

CONCEPT AND CHARACTERISTICS OF BUSINESS FINANCE

Business is an economic activity, which is related to continuous and regular production and distribution of goods and services for satisfying human wants. Finance is the management of money and other valuables. Finance is the lifeblood of any business. Money required for carrying out business activities is called business finance. Thus, finance is required for acquiring not only fixed assets like plant and machinery, building, etc., but also carrying out day to day operations like buying raw material, salaries and wages, etc. Accordingly, characteristics of business finance are depicted below in a diagram:

Characteristics of Business Finance

- Business finance is needed in all types of organisations, *i.e.*, large, medium or small (basis size); trading, manufacturing or service (basis nature); profit-oriented or non-profit-oriented (basis: objective)
- Business finance involves estimation of funds and identification of the sources of funds based on the estimations.
- Business finance includes all types of funds, *i.e.*, long-term, short-term, or for tangible, intangible assets
- Raising funds from different sources in an economical manner as well as investment of funds for different purposes in a judicious manner so as to bring down the overall cost of funds

Business finance refers to the money required for carrying out business activities. Every business organisation, either big or small, needs finance to carry out their operations. Finance is required while starting a venture, to run its daily operations and for growing and diversifying needs of the business. The financial need helps to decide about the future requirements of finance.

Definition of Finance

According to BO Wheeler, 'Business finance is concerned with the acquisition and utilisation of capital funds in meeting financial needs and overall objectives of a business enterprise'.

Financial Needs of a Firm

There can be two types of financial needs, as given below:

(*i*) **Fixed capital requirement** A business needs various fixed assets like land, building, plant and machinery, etc to carry out its activities. Money invested in fixed assets is fixed capital. Generally, long-term sources of finance are used to meet these financial needs.

(*ii*) **Working capital requirement** Capital is also required to meet the day-to-day needs of business. Money spent on current assets like stock, bills receivables, etc is called working capital. Working capital needs can be met through both short-term and long-term sources of finance.

Financial Planning

It is the preparation of financial blue print, which foresees the entire fund requirement, in respect of quantum as well as the timing. It is the process of estimating the fund requirements of business and specifying the sources of funds. It involves the preparation of a financial blue print of an organisation's future operations. The objective of financial planning is to ensure that enough funds are available at the right time and that the enterprise does not raise capital unnecessarily.

While making financial plans, three important questions need to be answered:

(*i*) How much capital is required, i.e. estimation of quantum of finance.

(*ii*) What methods and sources should be used for meeting financial needs, i.e. determining the pattern or structure of capital into debt and equity.

(*iii*) How to use the available funds in an adequate manner, i.e. proper utilisation of funds.

Objectives of Financial Planning

Financial planning strives to achieve the following objectives:

(*i*) **To ensure availability of funds whenever these are required** This includes a proper estimation of the funds required for different purposes such as for the purchase of long-term assets or to meet day-to-day expenses of business, etc. Apart from this, there is a need to estimate the time at which these funds are to be made available. Financial planning also tries to specify possible sources of these funds.

(*ii*) **To ensure unnecessary finance is not raised** Excess funding is almost as bad as inadequate funding. Even if there is some surplus money, good financial planning would put it to the best possible use, so that the financial resources are not left idle and don't unnecessarily add to the cost.

Importance of Financial Planning

The importance of financial planning can be viewed from the following points:

(*i*) **Helps to face the eventualities** It forecasts the future business situations which helps in preparing alternative financial plans to face the eventual situations and problem of shortage of funds.

(*ii*) **Helps in avoiding business shocks and surprises** Proper provision regarding shortage or surplus of funds is made by anticipating future receipts and payments. Hence, it helps in avoiding business shocks and surprises.

(*iii*) **Helps in coordination** It helps in coordinating various business activities, such as sales, purchase, production, finance, etc.

(*iv*) **Helps in avoiding wastage of finance** In the absence of financial planning, wastage of financial resources may take place. This arises due to the complex nature of business operation such as, excessive over or under estimation of finance for a particular business operation. Such type of wastages can be avoided through financial planning.

(*v*) **Maximise shareholders' returns** Through financial planning, a finance manager develops a plan constituting proper amount of debt and equity. Thus, it leads to maximising return to equity shareholders.

(*vi*) **Helps in creating link between investment and financing decisions** It helps in deciding that where to invest and from where the required funds will be made available. Under financial planning, the mix of share capital and debt capital is made in such a manner that cost of capital is reduced to the minimum.

Capital Structure

It refers to the mix between owner's funds (equity) and borrowed funds (debt). After deciding the financial requirement, capital composition decision is taken. It is to decide, how much finance is to be raised from which source and what will be the proportion of various securities.

Source of finance can be classified into the following types:

(*i*) **Owner's funds** It consists of equity shares, preference share capital and retained earnings.

(*ii*) **Borrowed funds** Funds can be borrowed in form of loans, debentures, public deposits, etc.

The ratio of debt and equity in the capital structure is called capital gearing. If the proportion of debt is higher than equity, it is called high gearing or trading on thin equity, where as larger proportion of equity in capital structure is called low gearing or trading on thick equity.

Factors Affecting Choice of Capital Structure

Various factors influencing capital structure are as follows:

(*i*) **Position of cash flow** Size of projected cash flow must be considered before raising debt. Cash flow must not only cover fixed cash payment obligations, but there must be sufficient cash for smooth working of the business.

(*ii*) **Cost of financing** It may be defined as the payment made by the company to obtain capital. Thus, interest is the cost of debentures or loan and dividend paid by the company is the cost of equity and preference share capital. The rate of dividend on preference shares is fixed which is generally lower than that of equity shares. The cost of debentures is generally lower and tax deductible.

(*iii*) **Risk consideration** While deciding the capital structure, risk must be analysed and considered. Total risk consists of two types of risks, which are

(a) **Financial risk** It refers to a position when a company is unable to meet its fixed financial charges namely, interest payment, preference dividend and principal payment obligations. It arises when a company borrows. Use of debt increases the financial risk of a business.

(b) **Business risk** It depends upon fixed operating costs. Higher fixed operating cost means higher business risk and vice-versa. If a firm's operating risk is lower, its capacity to use debt is higher and vice-versa.

(*iv*) **Period and purpose** While equity shares are preferable to obtain long-term funds for fixed capital, preference shares and debentures are suitable for obtaining medium-term finance to fulfil the needs of modernisation and growth.

(*v*) **Flexibility** Since, debentures and preference shares are redeemable, issue of such securities helps to make the capital structure flexible, but within the minimum restrictions specified in loan agreements of the company.

(*vi*) **Trading on equity** Trading on equity refers to the use of fixed cost sources of finance such as debentures and preference share capital in the capital structure so as to increase the return on equity shares.

There are two conditions to use trading on equity favourably, which are as follows:

(a) The rate of interest on loan/debentures should be less than the rate of Return on Investment (RoI).

(b) The interest should be deducted from profit before tax.

Note Return on Investment (RoI) refers to the earning expected from the investment. If RoI of a company is high, it can opt for trading on equity to increase the earning per share. Thus, it is an important determinant of the extent of trading on equity.

(*vii*) **Control consideration** If a company wants to retain control, especially in case of closely held companies, they opt for debt financing. Larger equity share financing dilutes their control because shareholders have voting rights and can interfere in the management.

(*viii*) **Capital market conditions** During boom in the share market, it is easy to finance through shares, but in the other case, companies have to resort to issue debentures and preference shares.

(*ix*) **Investors choice** Attitudes of investors, whether they are risk takers or conservative in their approach, also help in deciding the capital structure.

(*x*) **Statutory requirements** The Companies Act and SEBI have laid down certain norms of debt equity ratios, which are to be adhered by all the companies.

(*xi*) **Nature of business** Business firms that have a stable and high income, can afford to make use of greater amount of debt, in comparison to such firms whose earnings are low and irregular.

Fixed Capital (Permanent Capital)

The amount of capital investment in fixed assets is called fixed capital, e.g. plant and machinery, land and building, etc. These assets are permanently used in the business. Fixed capital is required for setting up the business, for growth, mordernisation and for diversification requirements.

Fixed capital is raised through long-term sources of finance like issue of shares, debentures, long-term loans and retained earnings.

Factors Affecting Fixed Capital

The various factors that affect the amount of fixed capital are:

(*i*) **Nature of business** Manufacturing enterprises require more fixed capital, while trading enterprises require less fixed capital.

(*ii*) **Size of the business** Large scale enterprises require more fixed capital, whereas small scale enterprises require less fixed capital.

(*iii*) **Nature of products** Enterprises producing capital items require more fixed capital, whereas enterprises producing consumer goods require less fixed capital.

(*iv*) **Method of production** Enterprises using capital intensive technique require more fixed capital than the enterprises using labour intensive technique.

(*v*) **Diversity of products** Enterprises engaged in manufacturing/dealing in single product require less fixed capital. Enterprises engaged or dealing in multiple products require more fixed capital.

(*vi*) **Mode of acquiring fixed assets** Enterprises acquiring fixed assets on cash payment basis require more fixed capital, whereas enterprises acquiring fixed assets on lease/hire-purchase system require less fixed capital.

(*vii*) **Intangible assets** Enterprises desirous of acquiring high goodwill, patents, copyrights, etc require more fixed capital. Enterprises not desirous of acquiring high goodwill, patents, copyrights, etc require less fixed capital.

Working Capital (Circulating Capital)

It is that part of total capital, which is required for holding current assets. It represents the liquid funds, which are required for day-to-day operations of the firm. It is also known as the 'circulating capital or revolving capital'. This is because the current assets are changed from one form to another in the regular operations of the business, in the following manner

Cash → Raw material → Work-in-progress → Finished goods → Debtors

Cash again → Bills receivables

Working capital is also defined as an excess of current assets over current liabilities. The term is used in two senses, which are given below:

(*i*) **Gross working capital** It is the total amount of funds invested in current assets.

Gross Working Capital = Current Assets

(*ii*) **Net working capital** It is the excess of current assets over current liabilities.

Net Working Capital = Current Assets − Current Liabilities

Types of Working Capital

Working capital can be classified into two types, which are as follows:

(*i*) **Permanent working capital** It is minimum amount of capital required permanently in business to maintain the regular operations of business. It is of two kinds, which are:

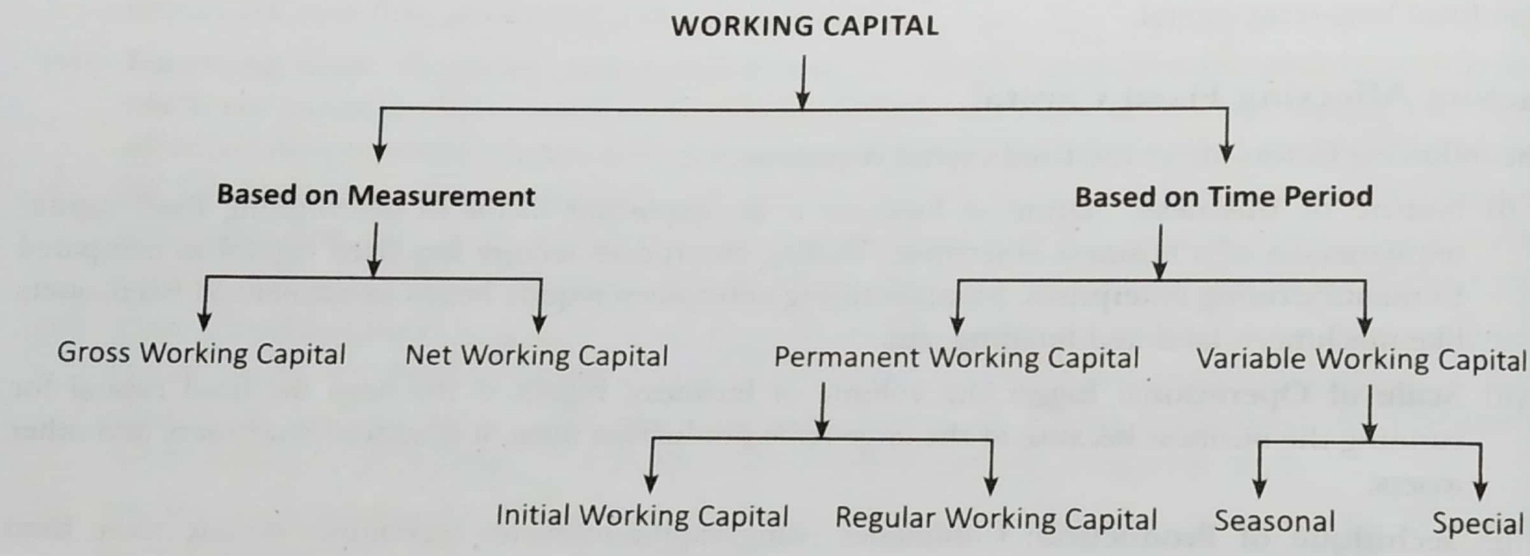
(a) **Initial working capital** It required at the time of commencement of business.

(b) **Regular working capital** It is a part of permanent working capital, which is regularly required for continuous operations.

(*ii*) **Temporary working capital** It is the capital which is required in addition to permanent working capital for meeting seasonal and special needs of the business.

Types of Working Capital

Primarily, different types of working capital are shown in the following chart:



(i) **Initial working capital:** It is that part of permanent working capital which is required at the time of commencement of business. The capital required at the time of commencement of business is usually contributed by the owners.

(ii) **Regular working capital:** It is that part of permanent capital which is required for the day-to-day operations of the business. It ensures sufficient amount of cash to maintain reasonable quantities of raw materials for processing into finished goods at all times.

Variable Working Capital: The temporary or variable working capital varies with the volume of operations. This is the additional working capital required from time to time over and above the permanent working capital. It is of two types:

(i) **Seasonal working capital:** It refers to liquid capital needed during a particular season. During the peak season, business enterprises have to increase the purchase of raw materials (*e.g.*, wool by woollen mills, etc.) and employ more people to convert them into finished goods. This requires large amount of working capital during the peak season.

(ii) **Special working capital:** It is that part of the variable capital which is needed for financing special operations. It is the extra capital required to meet specific business expenses or unforeseen contingencies such as advertisement campaigns for increasing sales or coping up with increased prices, strikes, natural calamities, etc.

Importance of Working Capital

Working capital plays a vital role in business. It is the lifeblood of a business. The importance of working capital can be understood with the help of following points:

(i) Adequate working capital is required to meet the commitments towards short-term liabilities like salaries, wages, power and fuel expenses, taxes, etc.

(ii) It ensures to maintain the operations on a smooth basis by maintaining the required level of inventory.

(iii) It enhances liquidity and solvency of a business enterprise.

(iv) It provides necessary funds to meet the contingencies.

(v) It helps in the measurement and analysis of profits of a business enterprise.

(vi) It builds reputation in the market and it becomes easier to raise funds when working capital position is healthy and stable.

Factors Affecting Working Capital

The working capital requirements of an enterprise depend on the following factors:

(i) **Nature of Business:** The requirement of working capital depends on the nature of business. Manufacturing business requires more working capital as compared to trading business. In case of Service providers, working capital is almost nil as there is no stock.

(ii) **Scale of Operations:** The amount of working capital depends directly upon the volume of business. More working capital is required in case of large business enterprises while less working capital is needed in case of small business enterprises.

(iii) **Seasonal Factors:** Some products have seasonal demand. But these are produced the whole year so as to cater to the demand of customers in peak season. Such business enterprises have to maintain large stocks of raw material and hence large amount of working capital is required. *For example*, woollen industry, AC manufacturers, etc. These have their demand in peak season.

It is also of two types, which are:

(a) **Seasonal working capital** It is required in the busy season for business dealing in seasonal products.

(b) **Special working capital** Extra funds required for emergencies and generally kept as reserves for reasons like increase in demand, periods of depression, natural calamities, strikes, lockouts, etc.

Factors Affecting Working Capital Requirements

The factors that affect the working capital requirements of a business are:

(*i*) **Nature of business** Enterprises engaged in manufacturing require more working capital and enterprises engaged in trading/services require less working capital.

(*ii*) **Size of business** Large scale enterprises require more working capital whereas small scale enterprises require less working capital.

(*iii*) **Manufacturing cycle** Firms with longer manufacturing cycle require more working capital as compared to firms with shorter manufacturing cycle.

(*iv*) **Rapidity of turnover** Firms having rapid turnover require less working capital, whereas firms having slow turnover require more working capital.

(*v*) **Terms of sale and purchase** Firms operating on credit sales and cash purchase require more working capital, whereas firms operating on credit purchase and cash sales require less working capital.

(*vi*) **Credit policy** Firms following a liberal credit policy require more working capital than firms following a tight credit policy.

(*vii*) **Operational efficiency** Firms with high operational efficiency require less working capital and the firms with low operational efficiency require more working capital.

(*viii*) **Goodwill** Firms enjoying a good reputation in the market require less working capital and the firms that donot enjoy a good market reputation require more working capital.

(*ix*) **Growth prospects** Firms having higher growth prospects require more working capital as compared to firms having less growth prospects.

(*x*) **Seasonal factor** Firms require more working capital during peak season, while less working capital during lean/off season.

(*xi*) **Cyclical fluctuations** Firms require more working capital during boom and less working capital during depression.

DIFFERENCE BETWEEN FIXED CAPITAL AND WORKING CAPITAL

Basis of Difference	Fixed Capital	Working Capital
Meaning	Fixed capital is that part of total capital which is invested in fixed assets such as land, building, furniture and fixtures, machinery, etc.	Working capital is the money available to a business enterprise for daily operations. Working Capital = Current Assets – Current Liabilities
Time Period	Required for long term	Required for short term
Source	Funds can be raised by means of shares, debentures, long-term loans, etc.	Funds can be raised by means of short-term loans, trade credits, etc.
Nature	Remains invested in business	Revolves in the business
Purpose	To purchase fixed assets	To purchase current assets
Example	Tools and equipment, machinery, furniture, land and building are examples of fixed capital.	Cash in hand and cash at bank (Liquidity), raw material are examples of working capital.

Short Answer Questions

1. What is Business Finance?

Ans. Business is an economic activity, which is related with continuous and regular production and distribution of goods and services for satisfying human wants. Finance is the management of money and other valuables. Finance is the lifeblood of any business. Money required for carrying out business activities is called business finance.

2. What is capital structure?

Ans. Capital structure means the arrangement of capital from different sources so that the funding needs of the business are satisfied. In other words, Capital structure means the proportion of debt and equity used for financing the operations of a business.

3. Identify whether the following are part of fixed capital or working capital:

(i) Cash in Hand	(ii) Cash at Bank
(iii) Laptops	(iv) Debtors
(v) Plant and Machinery	(vi) Work in progress
(vii) Stock of raw material	(viii) Accounts Receivable
(ix) Building	(x) Furniture

Ans.

(i) Working Capital	(ii) Working Capital
(iii) Fixed Capital	(iv) Working Capital
(v) Fixed Capital	(vi) Working Capital
(vii) Working Capital	(viii) Working Capital
(ix) Fixed Capital	(x) Fixed Capital

4. Why is working capital termed as circulating or rotating capital?

Ans. Working capital refers to the current assets of a company that are changed from one form to another during the operating cycle. *For example*, cash to inventory, inventory to work in progress (WIP), WIP to finished goods, finished goods to receivables and from receivables to cash. In this cycle, current asset, *i.e.*, cash changes its form to another current asset, *i.e.*, inventory and so on. Thus, working capital is termed as circulating capital.

Long Answer Questions

1. What are the different types of finance available for different business forms?

Ans. **Funds for Sole Proprietorship:** A sole proprietor is an individual who runs a business in his own name, provides all the funds and bears all the risks. The ability of a sole trader is limited as compared to a joint stock company because he operates on a small scale. The sole trader may utilise his personal capital, retained profits, etc., for raising funds. He can also raise loans from banks and financial institutions.

Funds for Partnership: Partnership is a relationship between persons who have agreed to share their profits and losses of a business carried on by all or any of them acting for all. The capital base of a partnership is more than that of a sole proprietor. A partnership firm can borrow as much capital as commercial banks and other lenders are willing to lend to the partnership firm and the partners. Partners introduce the capital (owned capital) in agreed ratio as per the partnership deed.

Funds for Joint Stock Company: A Joint Stock Company is a voluntary association of persons to carry on a business. A Joint Stock Company requires large amount of capital. A public company can raise capital by issuing shares. Like Proprietorship and Partnerships, companies can borrow money from banks and other lenders. It can also raise funds by issuing debentures.

2. What is financial planning? Why is it important for a business enterprise?

Ans. Financial Planning is the process of framing financial policies for the purpose of estimating the capital requirements of an enterprise. Given below are some reasons why financial planning is important:

(i) **Usage of Funds:** The benefit of financial planning is judiciously utilising all the funds that are available with the business organisation. Financial plans made well in advance help in the utilisation of scare funds as well as in planning the financial goals of the business organisation.

(ii) **Long-term Planning:** Financial Planning works by preparing specific plans for future. A financial plan is not static, but dynamic in nature. So, a detailed analysis is required before setting financial goals which helps in the growth of business in the long run.

(iii) **Mitigation of Risks:** Financial Planning helps a business organisation prepare for risks. There can be contingencies like major unforeseen expenditures, natural calamities causing major loss, etc., but financial plans will help the business organisation prepare for such contingencies.

(iv) **Evaluation of Performance:** The finance team while planning prepares numerous reports which help the business organisation to analyse and evaluate the profits and losses. This analysis helps in cost control and strategical planning to maximise the profits.

(v) **Developing Capital Structure:** Financial Planning helps in developing a sound capital structure for the organisation. It ensures parity between debt and equity. Different asset classes have different risk return characteristics. Financial Planning ensures proper allocation of funds so as to maximise returns.

3. State **any five** factors that affect the capital structure of a business enterprise.

Ans. The five factors that affect the capital structure of a business enterprise are:

(i) **Trading on Equity:** Trading on Equity or Financial leverage refers to proportion of debt in the overall capital. In simple words, Trading on equity refers to the increase in profit earned by the equity shareholders due to the presence of fixed financial charges in the capital structure of an organisation. This can be understood with the help of the following example:

Particulars	Company A	Company B
Equity Share Capital (₹ 100 each share)	10,00,000	6,00,000
Loan (bearing interest @10%)	NIL	4,00,000
Total	**10,00,000**	**10,00,000**
Profit before Interest and Tax (Assuming 20% on ROI)	2,00,000	2,00,000
Less: Interest @ 10% of ₹ 4,00,000	NIL	40,000
Profit before Tax (PBT)	2,00,000	1,60,000
Less: Tax (Assuming tax rate of 30%)	60,000	48,000
Profit after Tax (PAT)	1,40,000	1,12,000
No. of Equity Shares [Equity Share Capital / 100]	10,000	6,000
Earnings per share (EPS) [PAT / No. of Equity Shares]	**14**	**18.67**

From the above example, it is clear that the EPS of Company B is higher than that of Company A. The reason for this is the presence of debt in the capital structure of Company B. More debt will result in increase in earning when rate of return on investment (ROI) is more than rate of interest on debt.

(ii) **Regulatory Framework:** While raising funds from the public, various guidelines (like SEBI guidelines, provisions of The Companies Act, 2013) are to be complied with. If the regulatory requirements are not very stringent then raising of fund from the public is easy. The regulations impact the capital structure.

(iii) **Flexibility:** Capital structure should be flexible. This can be done by creating a perfect blend between debt and equity. Excess of debt may restrict the business organisation's capacity to borrow further. Capital structure should be flexible enough to cope with any contingencies.

(iv) **Control:** The equity shareholders are the owners of the company and they have complete control over the company. If the owners want to have complete control over the company, they must raise more of debt funds in the capital structure because if more of equity shares are issued, then the control of the existing shareholders will be diluted.

(v) **Cash Flows:** Capital structure depends to a great extent on the ability of a business enterprise to generate cash flows. A business enterprise employs more of debt in its capital structure when there is surety of generating enough cash, whereas if there is cash crunch, then the business enterprise should raise funds by means of equity in its capital structure as there is no liability as such to pay to equity shareholders.

4. What is Fixed Capital? What are the factors affecting the fixed capital?

Ans. Fixed capital is that part of the total capital which is invested in fixed assets such as land, building, furniture and fixtures, machinery, etc. The following factors affect the fixed capital requirements:

(i) **Nature of Business:** Nature of business is an important factor in determining fixed capital requirements of a business enterprise. Trading enterprises require less fixed capital as compared to manufacturing enterprises. Manufacturing enterprises require heavy investment in fixed assets like machinery, land and building, etc.

(ii) **Scale of Operations:** Bigger the business, higher is the need of fixed capital for running the business because of the need of heavy machinery and other assets.

(iii) **Technique of Production:** Companies using capital-intensive techniques require more fixed capital because of the use of plant and machinery, whereas companies using labour-intensive techniques require less capital.

(iv) **Diversification:** Business enterprises which have plans to diversify their activities require more fixed capital so as to produce more products. For this purpose, more funds are required for investment in plants and machineries, land and building, etc.

(v) **Availability of Finance:** If finance facilities like loans, hire purchase, lease, etc., are easily available then less fixed capital is required because business enterprises can make use of instalment facilities instead of spending such huge amount in one go.

(vi) **Business Cycle:** When there is a boom in the market, then business enterprises will investment more in fixed assets so that production can be increased which in turn increases the profits. However, at the time of recession, business enterprises avoid taking risk and hence investment in fixed assets is minimal.

(vii) **Purchasing Intangible Assets:** Investment in intangible assets like patents, copyrights, trademarks, goodwill, etc., requires huge capital investment and this is an important factor which determines the fixed capital requirements of a business enterprise.

5. What is Working Capital? State **any four** factors affecting the working capital.

Ans. Working capital is the money available to a business enterprise for daily operations. Working capital refers to the current assets of a company that are changed from one form to another during the operating cycle. *For example*, cash to inventory, inventory to work in progress (WIP), WIP to finished goods, finished goods to receivables and from receivables to cash. The working capital requirements of an enterprise depend on the following factors:

(i) **Nature of Business:** The requirement of working capital depends on the nature of business. Manufacturing Business requires more working capital as compared to Trading business. In case of Service providers, working capital is almost nil as there is no stock.

(ii) **Scale of Operations:** The amount of working capital depends directly upon the volume of business. More working capital is required in case of large business enterprises while less working capital is needed in case of small business enterprises.

(iii) **Seasonal Factors:** Some products have seasonal demand. But these are produced the whole year so as to cater to the demand of customers in peak season. Such business enterprises have to maintain large stocks of raw material and hence large amount of working capital is required. *For example*, woollen industry, AC manufacturers, etc. These have their demand in peak season.

(iv) **Business Cycle:** The need for the working capital is affected by various phases of business cycle. During a boom period, the demand of a product increases and more working capital is required, whereas during a depression, the demand declines and less working capital is required.

Basis of Difference	Fixed Capital	Working Capital
Meaning	Fixed capital is that part of total capital which is invested in fixed assets such as land, building, furniture and fixtures, machinery, etc.	Working capital is the money available to a business enterprise for daily operations. Working Capital = Current Assets – Current Liabilities
Time Period	Required for long term	Required for short term
Source	Funds can be raised by means of shares, debentures, long-term loans, etc.	Funds can be raised by means of short term loans, trade credits etc.
Nature	Remains invested in business	Revolves in the business
Purpose	To purchase fixed assets	To purchase current assets
Example	Tools and equipment, machinery, furniture, land and building are examples of fixed capital.	Cash in hand and cash at bank (Liquidity) raw material are examples of working capital.

SCANNER—PREVIOUS YEARS' QUESTIONS

Short Answer Questions

1. Distinguish between gross working capital and net working capital. (2014)
2. What is meant by capital gearing ratio? (2015)
3. Explain the meaning of gross working capital. (2015)
4. Why is working capital also known as circulating capital? (2016)
5. What is the importance of finance to a business concern? (2017)

Long Answer Questions

1. Discuss the factors affecting the working capital requirements of a business enterprise. (2010)
2. What is fixed capital? Discuss **any four** factors affecting fixed capital requirements of Joint Stock Company. (2012)
3. Distinguish between fixed capital and working capital of a business concern. (2014)
4. Briefly explain **any five** factors to be considered while preparing a suitable capital plan. (2014)
5. Discuss in brief **any four** factors that affect the working capital requirements of a company. (2015)
6. Explain **any four** factors that affect the capital structure of a company. (2016)
7. You are the finance manager of a newly-established company. The Directors have asked you to determine the amount of fixed capital requirement for the company. Explain **any four** factors that you will consider while determining the fixed capital requirement for the company. (2017)
8. Briefly explain **any four** types of working capital required by a business concern. (2018)

[redacted]

2/3 Marks Questions

1. What is net working capital?
2. Why is business finance required?
3. Identify the varied financial needs of a firm?
4. What are the objectives of financial planning?

4/5 Marks Questions

5. Obtaining funds from debt and equity depend on several factors. Explain any four such factors.
6. Enumerate the various types of working capital.
7. Why is working capital called circulating capital?

6/8/10 Marks Questions

8. What is fixed capital? Explain any five factors affecting fixed capital.
9. Differentiate between fixed capital and working capital.
10. How is financing need different for different types of business firms? Explain the sources of finance for different firms.
11. Write short note on
    (*i*) Gross working capital (*ii*) Financial planning
    (*iii*) Capital structure
12. Explain the various factors affecting working capital.
13. Why is financial planning required?
14. Discuss the importance of business finance.