Marks : 40	SYJC MARCH' 19 Subject : Secretarial Practice Chapter – 1 & 2	Duration : 1.5 Hours SOLUTION

Q.1 Fill in the blanks **(10)**

1) A business firm is basically **Profit oriented** organisation.

2) Large manufacturing companies have **Huge** investment in fixed assets.

3) **Financial market** refers to management of business funds.

4) The ideal structure far new company is to raise capital through **Equity shares**.

5) If funds are required on regular basis, the company should raise funds through issue of **Equity shares**.

6) A company cannot exist without **Equity** shares.

7) A **share** is an indivisible unit of share capital.

8) Debenture holders are **Creditor** of the companies.

9) Equity shares are paid dividend at **Fluctuating** rate.

10) Convertible debentures are converted into **Equity shares**.

Q.2 Match the pairs. **(5)**

Group A	GROUP B
a) Financial management	1) Minimise market value of equity shares
b) Wealth maximization	2) Investment in fixed assets
c) Financial plan	3) Ratio of buying and selling
d) Capital structure	4) Management of business fund
e) Fixed capital	5) Investment in current asset
	6) Management of business activities
	7) Maximise market value of equity shares
	8) Ratio of different securities in capital
	9) Advance programming of financial management

Ans:- a – 4, b – 7, c – 9, d – 8, e – 2

Q.3 Answer the following (Any Two) **(10)**

1) Define Fixed Capital and explain its factors.

Ans:- Meaning

The concept of 'fixed capital' was first theoretically analysed by economist David Recardo

It refers to any kind of real or physical capital i.e. fixed assets. It is not used for the production of goods. Fixed capital is that portion of total capital which is invested in fixed assets such as land, building, equipment, etc.

According to Karl Marks

'Fixed capital also circulates, except that the circulation time is much longer".

Factors affecting requirement of Fixed Capital

Factors affecting requirement of Fixed Capital
- Nature of business
- Size of business
- Growth and expansion of business
- Stages of development of business
- Business cycle

1. **Nature of business :** The nature of business certainly plays a vital role in determining fixed capital requirement. For e.g. Rail, Road and other public utility services have large fixed investment. They need to invest in huge sum in fixed assets. Their working capital requirements are nominal, because they supply services and not product. They deal in cash sales only.
2. **Size of business :** The size of business also affects fixed capital needs. A general rule applies that the bigger the business, the higher the need of fixed capital. Size of firm, either in terms of its assets or sales, affects the need of fixed capital.
3. **Growth and expansion :** A growing firm may need to invest money in fixed assets in order to sustain its growing production and turnover.
4. **Stage of development of business** : The requirement of fixed capital for a new undertaking is greater than that of an established business.
5. **Business cycle :** When there is boom period in the economy, additional investment in permanent assets may be made by firm to increase their production capacity. Hence the need of fixed capital increases .

2) Define Capital Structure and its Components.

Ans:- Meaning :

Capital structure constitutes two words i.e. capital and structure. Capital refers to investment of funds in the business while structure means arrangement of different components in proper proportion. Thus capital structure means ‘mix-up of various sources of funds in desired proportion’.

Once the capital requirement of firm is decided, attention is given to the kind of capital sources which can be raised to meet this need.

A company can raise its capital from different sources i.e. owned capital or borrowed capital or both. The owned capital consists of equity share capital, preference share capital, reserves and surplus. On the other hand, borrowed sources arc debentures, loans, etc. Proportions of different sources are used in capital structure.

To decide capital structure means, to decide upon the ratio of different securities in total capital. It is nothing but ‘composition of capital’.

Definition :

Weston and Bringham

“Capital structure is the permanent financing of firm represented by long term debt, preferred stock and net worth."

Components of Capital Structure :

The components of Capital Structure are as follows:

i. Equity Share Capital:
- Equity share capital is provided by equity shareholders and it is the basic source of financing activities of business.
- The holders of such shares bear ultimate risk associated with the ownership.
- Equity shares carry dividend at a fluctuating rate, depending upon the profits earned by the company.

ii. Preference Share Capital:
- Preference shares carry dividend at a fixed rate and enjoy preferential right over quality shares for return of capital in case of winding up of the company.
- Unlike equity shareholders, preference shareholders have limited voting rights.

iii. Retained Earnings:

- The part of the profit retained by the company for meeting future financile needs and for expansion of the firm isknown as retained earnings.
- In simple words, it is ploughing back of profits.

iv. Borrowed Capital:

It consists of the following :

- **Debentures:**
  A debentures is a certificate of loan evidencing the fact that the company is liable to pay a specified amount with interest at an agreed rate.
- **Term Loans:**
- Term loans are provided by banks and other financial institutions at a fixed rate of interest.

3) Explain objectives of financial management.

Ans:- Business firms are profit oriented organizations. Their objectives are expressed in terms of money. The basic objectives of financial management are as follows

a) Profit maximisation
b) Wealth maximisation

A. Profit maximisation

Profit maximisation is a basic principle of any business activity. According to this principle, all functions of business aim at profit. 'The principle of 'profit maximisation' is a traditional concept. It is based on assumption that 'profit is a tool of measuring the success of business firm'. In simple words, the business firm should undertake only such, activities that increase profit. The business activities which decrease profit should be avoided.

Profit maximization is considered to be the most important business objective because of the following reasons

1. It is difficult for business to survive without profit.
2. Profit is a tool of measuring the success of a business firm.
3. High level profitability results in better returns (dividend) to the shareholders.
4. High level profitability can generate funds, which can be used for future expansion of business firm.
5. Profit maximization has to be achieved for socio-economic welfare.

B. Wealth maximisation :

According to Prof. Soloman EZRA the ultimate goal of financial management should be the maximization of owners' wealth.

According to him, maximization of profit is unreal and half motive. The proper aim of financial management is wealth maximization of equity shareholders.

Wealth maximization is also known as 'value maximization.' It means maximising net present value of a firm.

The focus of financial management is on wealth maximization of its owners' i.e. suppliers of equity capital. The wealth shareholder is reflected in market value of the shares. So wealth maximisation means the maximisation of market price of shares. The wealth of equity shareholders is maximised only when market value of equity shares is maximized.

Equity shares are traded in a share market. The share price of a company, quoted in share market index, is a reflection of its earning capacity, dividend and retention policy.

Financial decision making should aim at maximising market value of equity share of company.

Q.4 Match the pairs **(5)**

GROUP A	GROUP B
(1) Equity Share capital (2) Debenture holder (3) Retained profit (4) Public deposit (5) Overdraft facility	(a) Maximum 5 years (b) owner of the company (c) Redeemable capital (d) Permanent Capital (e) Creditor of the company (f) Current Account (g) Maximum 3 years (h) Capitalization of profits (i) Saving Account (j) Distributor of profit

Ans:- 1 – d, 2 – e, 3 – h, 4 – g, 5 – f

Q.5 Long Answers (Any One) **(10)**

1) Define Equity Shares and explain its features.

Ans: Equity shares are those shares, which do not enjoy any preferential right in regard to payment of dividend and repayment of capital. Equity Share Capital is also known as risk capital or real capital because they are last claimants in the case of winding up of a company. It is also called as venture capital. Equity Shares are not paid (redeemed) during the lifetime of the company.

Equity shares are also known as 'ordinary shares'. Every company must issue equity shares.

Features of Equity Shares:

(1) Permanent Capital: As the Equity Share Capital is not paid or redeemed by the company till it is a going concern, it is the permanent capital of the company. It is the basic and non- refundable capital.

(2) Payment of Dividend: The Equity Shareholders get the dividend according to the availability of capital. They are paid after the fixed dividend is paid to the Preference Shareholders. The rate fluctuates as per the available net profit. Sometimes, they have to go without a dividend and sometimes they get very high rate of dividend than Preference Shareholders.

(3) Repayment of Capital: There is no guarantee of repayment of capital in the case of winding up of the company. When the company is wound up, the capital of Equity Shareholders is repaid last, only after all other claims have been paid in full.

(4) Right to Vote: Equity Shareholders enjoy the normal voting rights as per the rule of 'one share one vote'. They are the real owners of the company. They can vote on all matters at general meetings. They get the powers to appoint the Board of Directors.

(5) Actual Owners: Equity Shareholders are the actual owners of the company as they invest their money in the company without there being any guarantee from the company as regards payment of dividend and repayment of capital.

(6) Advantage of Bonus and Right Shares: Accumulated profits (free reserves) of Joint Stock Company are converted into Equity Shares, This is called capitalization of profits. These shares are called as Bonus Shares because they are issued free of cost in proportion to the number of existing Equity Shares. It leads to increase in capital investment of shareholders.

When an existing company goes for fresh issue of Equity Shares, then first priority is given to existing Equity Shareholders. If the existing shareholders do not accept it, then the shares are offered to the public. This benefit of rights issue is available only to the Equity Shareholders.

(7) Controlling Power: The Equity Shareholders enjoy control over the management of the company because they only elect the Board of Directors. They also appoint auditors and indirectly keep a check on the Directors.

(8) Creditworthiness: The Equity Share Capital enhances the credit standing of the company.

(9) Transferability: Equity Shares of public limited companies are freely transferable as per the provisions of Articles of Association.
A Equity Shareholders can transfer or sell his shares as per his will and wish.

(10) Timely Appreciation: The face value of the Equity Share is fixed but the market value fluctuates. The market value is the price of the share purchased or sold in the stock market. The market value of an Equity Share depends on profitability and the rate of dividend paid. Higher the rate of dividend, higher the market value of the Equity Shares.

2) Define Preference shares and explain different types of preference shares.

Ans:- Preference shares are those shares, which enjoy preferential rights over equity shareholders in regard to payment of dividend and repayment of capital. The dividend payable to Preference Shareholders is fixed and they get priority over Equity Shareholders in respect of return of capital in the event of winding up of the company. However, they do not enjoy normal voting rights.
Preference shareholders are co-owners of the company but not controllers. They are cautious investors who are satisfied with low but regular income by way of dividend.

(1) Cumulative Preference Shares: Normally, the company pays the dividend every year. Sometimes, the company is not in a position to pay the dividend due to lack of profits in a particular year. In case of the cumulative Preference Shares, such unpaid dividend gets accumulated along with the fixed rate of dividend and becomes payable in the next financial year. The unpaid dividend is called arrears. It is accumulated year after year, if not paid regularly.
The dividend on cumulative shares is a permanent charge or liability on the company. All Preference Shares are always presumed to be cumulative unless the company has stated it specifically.

(2) Non-Cumulative Preference Shares: Non-Cumulative Preference Shares do not carry the right to receive the arrears of the dividend. These shares are paid dividend at an agreed rate out of sufficient net profits only. If in a certain year, the company is in the loss, it need not pay the dividend for that concerned year.

(3) Participating Preference Shares: Usually, the company pays the dividend on Preference Shares at an agreed rate out of net profit and then declares the dividend on Equity Shares. The balance of Net Profit, if any, will be retained in the business. However, if a company issues participating preference shares, then it has to pay additional dividend from the net profit left after paying the dividend on equity shares. The rate of the second time dividend depends on the surplus profits of the company.

(4) Non-Participating Preference Shares: These Preference Shares are entitled to only a fixed rate of dividend and do not participate further in the surplus profits irrespective of the amount of such profits. All Preference Shares are deemed to be non-participating unless stated otherwise in the terms of issue.

(5) Redeemable Preference Shares: Redeemable Preference Shares are those Preference Shares, which are repaid after a specific period. These shares are paid dividend at an agreed rate and after the expiry of the term, the amount is paid or redeemed to the investors.

(6) Irredeemable Preference Shares: These are those Preference Shares, which are not redeemed or repaid the principal during the life time of the company. They are repaid before the Equity Shares only at the time of winding u£ of the company. All Preference Shares are irredeemable otherwise specifically stated at the time of issue. However, as per the Companies (Amendment) Act, 1988, the government has prohibited the issue of Irredeemable Preference Shares. So, now there exists no such type of Preference Shares.

(7) Convertible Preference Shares: Convertible Preference Shares are those shares, which are converted into Equity Shares at the option of the shareholders after a certain period. At the time of issue, they are issued as Preference Shares but later on a specified date, they are converted into Equity Shares. Then they are eligible to enjoy all the rights of a member or owner of the company.

(8) Non-Convertible Preference Shares: These are those shares, which are not converted into Equity Shares. All Preference Shares are deemed to be non-convertible unless specified at the time of issue.