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| | **CLASS NOTES** |
| **Class: XI** | **Topic: Sources of Business Finance ( Trade credit, Public Deposits, Commercial Banks, Financial institutions, ADR , GDR, IDR)** |
| **Subject: BUSINESS STUDIES** | |

**Trade Credit**

The facility provided to the business enterprise to purchase inventories or services without making immediate payment is called Trade Credit.

**Features:**

1. It is extended by the suppliers of business enterprise and for the business enterprise they are called as Creditors or Accounts Payable.
2. It does not involve any payment of interest to the supplier.
3. It is a short term source of finance and is a current liability for the firm.
4. It reduces the need of working capital for the firm availing credit facility.
5. The extending of Trade Credit depends on the firm's credit worthiness, purchase volume, market competition and financial status of buyer and seller.

**Advantages:**

1. Trade credit can be obtained without creating any charge on the assets of the firm.
2. It does not involve any payment of interest on the credit availed.
3. It is the most convenient source of finance as it does not involve any formalities and is based on the relationship between buyer and seller.
4. It enables the firm to meet the expected increase in demand due to festivals, seasonal business etc by maintaining high stock of raw materials and finished goods.

**Limitations:**

1. It may lead to overtrading as the firms may purchase more goods than required thus leading to huge stock levels remaining unsold.
2. Limited amount of funds can be generated through trade credit.

**Public Deposits**

The funds which are raised by the business enterprise directly from the public are known as Public Deposits.

**Features:**

1. Public deposits are regulated by the Reserve Bank of India.
2. They are a source of long term, medium term and short term source of finance.
3. Public deposits are paid interest at a higher rate than offered by the banks.

**Merits:**

1. Issue of public deposits does not create any charge on the assets of the firm. Hence the assets of the firm are free to be used for raising loans from other sources.
2. The procedure for obtaining public deposits is simple and fewer restrictions are involved in obtaining the same.

3. The interest paid on public deposits is lower than the interest paid on loans obtained from banks and financial institutions.
4. The public depositors invest money but do not have any voting rights hence the control of the business firm over the management of the company is not diluted.

**Limitations**

1. It is difficult for new companies to raise funds through public deposits.
2. It is an unreliable source of finance as the company may not get funds from the public when it needs it.
3. When large amount of funds are to be raised then its collection becomes difficult as the funds are to be collected from numerous and scattered depositors.

**Commercial Banks**

Commercial banks provide funds for different purposes, different time period and of different types to all types of firms.

**Merits**

1. Banks provide funds to different business as and when they need it.
2. Raising loan from bank is simple and fast as fewer formalities are required.
3. It is a flexible source of finance as it allows business to raise loans as per their needs and to repay it as per their convenience and availability of funds.

**Demerits**

1. Procedure for procedure for obtaining funds from the bank is complicated as banks make detailed investigation of the company's affairs , financial f structure etc.
2. For obtaining loan from the bank business firms may have to keep business assets as mortgage.
3. In some cases banks may impose terms and conditions on the use of funds. This reduces financial flexibility of the business firms.

**Financial Institutions**

The institutions which has been established by the government all over the country to provide finance to the business firms are known as Financial Institutions. The main aim of financial institutions is to provide sufficient funds to business organisations so that they can contribute towards the industrial development of the country. These institutions are also called Development Banks.

**Merits**

1. Financial Institutions provide long term finance.
2. In addition to providing financial assistance these institutions conduct market surveys and provide technical assistance and managerial services to business firms.
3. Repayment of loan can be made in easy instalments; this reduces the burden on business enterprise.
4. Financial Institutions funds even during periods of depression when other sources of finance are not available.
5. The goodwill and the credit worthiness of firms who obtain funds from Financial Institutions are enhanced.

**Limitations**

1.Obtaining loan from Financial Institutions is time consuming and expensive as they follow rigid rules and regulations.
2. They Impose restrictions powers on the powers of the borrowing company like they may impose restrictions on the payment of dividends.
3. They may reduce the operational flexibility of the company by appointing their nominees on the board of directors.

**International Sources of financing**

**GDR (Global depository receipts)**

1. GDR is a negotiable instrument issued in US dollars.
2. It is an instrument issued abroad by a company to raise funds in some foreign currency.
3. It is listed and traded on a foreign Stock Exchange.
4. The holder of GDR can at any time convert it into the number of shares it represents.
5. The holder of GDR does not carry any voting rights.
6. The Global depository receipts are the depository receipts issued by the depository bank against the receipt of local currency shares of a company.
7. The holder of GDR enjoys dividend and capital appreciation.

**ADR (American depository receipts)**

1. It is a receipt issued by non US Company to an American citizen.
2. It is listed and traded on USA stock exchange only.
3. The features of ADR are similar to GDR.

**IDR (Indian depository receipts)**

1. It is a financial instrument denominated in Indian rupees in the form of a depository receipt.
2. It enables the foreign companies to raise funds from the Indian securities market.
3. It is registered with the securities and exchange Board of India.
4. The foreign companies buy the shares of Indian companies and the Indian depository issues receipts to such investors.