# Class 11 Business Studies Chapter 8: Sources of Business Finance - Notes, Important Questions and MCQs (2026-27)

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Class 11 Business Studies Chapter 8, Sources of Business Finance, opens Part B (Corporate Organisation, Finance and Trade). It explains where businesses get money from and how they choose the right source.

These notes cover the meaning and significance of business finance, classification of sources, each source with merits and limitations, international financing and factors affecting the choice of a source. (Chapter 7, Formation of a Company, is not part of the current NCERT book.)

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## Chapter Overview

Business finance refers to the funds required for carrying out business activities – buying fixed assets, meeting day-to-day expenses, modernisation and expansion.

Funds can be raised for different periods, from owners or lenders, and from inside or outside the firm. The right mix depends on cost, risk, control and the purpose of the funds.

## Important Topics and Concepts

## Meaning and Significance of Business Finance

- Finance is needed to establish a business, run day-to-day operations and expand.
- Fixed capital requirements: funds for land, building, machinery – long-term in nature.
- Working capital requirements: funds for raw materials, wages, rent and other routine expenses.
- The amount needed varies with the nature and size of business.

## Classification of Sources of Funds

- On the basis of period: long-term (more than 5 years – shares, debentures, term loans), medium-term (1–5 years – public deposits, lease finance, bank loans), short-term (less than 1 year – trade credit, factoring, commercial paper, bank credit).
- On the basis of ownership: owner's funds (equity shares, retained earnings) and borrowed funds (debentures, loans, public deposits, trade credit).
- On the basis of source of generation: internal sources (retained earnings, collection of receivables, disposal of surplus assets) and external sources (shares, debentures, loans, public deposits, trade credit, factoring).

## Retained Earnings

- The portion of net profit not distributed as dividend but reinvested – also called ploughing back of profit.
- Merits: permanent source; no explicit cost; no dilution of control; enhances capacity to absorb losses; may increase share price.
- Limitations: excessive ploughing back may cause shareholder dissatisfaction; uncertain amount; opportunity cost often ignored.

## Trade Credit and Factoring

- Trade credit: credit extended by one trader to another for purchase of goods – shown as sundry creditors or accounts payable. Merits: convenient, continuous, no charge on assets; limitations: may encourage overtrading, limited amount, costly if discount lost.
- Factoring: a financial service in which a factor provides services like discounting of bills, providing information about creditworthiness and collecting receivables. Merits: cheaper than borrowing, no charge on assets, independence from receivables; limitations: costly if invoices are small, may not be suitable for weak clients.

## Lease Financing and Public Deposits

- Lease: an agreement where the owner (lessor) conveys the right to use an asset to the lessee for a periodic payment called lease rent. Merits: no ownership needed, lower initial outlay, protects from obsolescence; limitations: restrictions on use, may be costly, no ownership at end.
- Public deposits: deposits raised by companies directly from the public, usually for 1–3 years, regulated by the RBI and the Companies Act. Merits: simple procedure, cheaper than bank loans, no dilution of control; limitations: difficult for new companies, limited funds.

## Commercial Paper

- An unsecured promissory note with a fixed maturity of 7 days to one year, issued by large, creditworthy companies to raise short-term funds.

- Merits: no charge on assets, flexible maturity, cheaper than bank loans, freely transferable.
- Limitations: only financially sound firms can issue it, amount limited by liquidity in the market, cannot be redeemed early.

### Issue of Shares

- Equity shares: represent ownership; shareholders get dividends after preference shareholders and have voting rights; they bear the maximum risk. Merits: permanent capital, no fixed dividend burden, no charge on assets; limitations: costly to issue, dilution of control, risk for investors.
- Preference shares: carry preferential rights to fixed dividend and return of capital; usually no voting rights. Types: cumulative/non-cumulative, participating/non-participating, convertible/non-convertible, redeemable/irredeemable.

### Debentures

- A debenture is an acknowledgement of a debt by a company; holders are creditors who get fixed interest whether or not there is profit.
- Types: secured/unsecured, registered/bearer, convertible/non-convertible, redeemable/irredeemable.
- Merits: fixed interest, no dilution of control, tax-deductible interest, suitable when sales are stable.
- Limitations: fixed obligation is a burden in bad years, charge on assets, reduced borrowing capacity.

### Commercial Banks and Financial Institutions

- Commercial banks provide loans, cash credit, overdraft and discounting of bills for short and medium periods. Merits: timely funds, secrecy, easy procedures; limitations: short-term, collateral and restrictions.
- Financial institutions such as IFCI, ICICI, IDBI, SIDBI and state financial corporations provide long- and medium-term finance, especially for expansion and modernisation. Merits: long-term funds, advisory services; limitations: rigid procedures and restrictions on dividends.

### International Financing

- Commercial banks abroad provide foreign currency loans.
- International agencies and development banks such as the IFC, ADB and EXIM Bank.
- International capital markets: ADR (American Depository Receipt – traded in the US), GDR (Global Depository Receipt – traded in markets outside the US), IDR (Indian Depository Receipt – foreign companies raising funds in India), and FCCB (Foreign Currency Convertible Bonds – bonds convertible into equity).

### Factors Affecting the Choice of Source

- Cost – cost of procurement and of utilisation.
- Financial strength and stability of the business.
- Form of organisation and legal status – e.g. only companies can issue shares.
- Purpose and time period – long-term needs from long-term sources.
- Risk profile, control, effect on credit-worthiness, flexibility, ease, and tax benefits.

## ADR vs GDR vs IDR

Short-answer favourites:

| Instrument | Issued by | Traded in |
|---|---|---|
| ADR | Indian company | US markets, in US dollars |
| GDR | Indian company | Markets outside the US (e.g. Luxembourg, London) |
| IDR | Foreign company | Indian stock exchanges, in rupees |
| FCCB | Indian company | Foreign markets; convertible into equity |

## Equity Shares vs Preference Shares vs Debentures

| Basis | Equity shares | Preference shares | Debentures |
|---|---|---|---|
| Status | Owners | Owners with preference | Creditors |
| Return | Dividend (variable) | Fixed dividend | Fixed interest |
| Voting rights | Yes | Usually no | No |
| Risk | Highest | Moderate | Lowest |
| Repayment | Only on winding up | Redeemable possible | Redeemed after period |
| Charge on assets | No | No | Yes (secured debentures) |
| Tax benefit to company | No | No | Interest is deductible |

## Important Definitions and Terms

| Term | Meaning |
|---|---|
| Business finance | Funds required for business activities. |
| Fixed capital | Funds invested in long-term assets. |
| Working capital | Funds needed for day-to-day operations. |
| Retained earnings | Profits reinvested instead of being distributed. |
| Trade credit | Credit given by suppliers for purchase of goods. |
| Factoring | Service of collecting receivables and providing finance against them. |
| Lease | Contract allowing use of an asset for rent. |
| Commercial paper | Unsecured short-term promissory note of 7 days to 1 year. |
| Debenture | Acknowledgement of debt carrying fixed interest. |
| ADR | Depository receipt traded in the US. |
| GDR | Depository receipt traded in markets outside the US. |

## Short Answer Questions

Q1. Why is business finance needed?

To buy fixed assets, meet day-to-day expenses (working capital), and fund modernisation and

Q2. What are retained earnings?

The part of net profit kept in the business and reinvested instead of being paid as dividends.

Q3. State two merits of trade credit.

It is convenient and continuous, and it does not create a charge on the firm’s assets.

Q4. What is factoring?

A financial service where a factor collects receivables, discounts bills and provides credit information for a fee.

Q5. What is commercial paper?

An unsecured promissory note with maturity of 7 days to one year issued by creditworthy firms.

Q6. Distinguish between equity shares and debentures on return.

Equity shareholders receive variable dividend from profits; debenture holders receive fixed interest even if there is no profit.

Q7. What is a GDR?

A Global Depository Receipt – a negotiable instrument issued by an Indian company and traded in foreign markets outside the US.

Q8. State any three factors affecting choice of source of finance.

Cost, purpose and time period, and the effect on control.

## Long Answer Questions

Q1. Explain the classification of sources of funds.

On the basis of period: long-term (over 5 years), medium-term (1–5 years) and short-term (under 1 year).

On the basis of ownership: owner’s funds such as equity shares and retained earnings, and borrowed funds such as debentures and loans.

On the basis of source of generation: internal sources like retained earnings and external sources like shares, debentures, loans and trade credit.

Q2. Discuss the merits and limitations of equity shares.

Merits: equity capital is permanent and need not be repaid; there is no obligation to pay a fixed dividend; it does not create a charge on assets.

It improves the firm’s creditworthiness and is suitable for investors willing to take risk.

Limitations: cost of issue is high, new issues dilute control, and dividends are not tax-deductible; investors seeking steady income may avoid it.

Q3. Explain international sources of finance.

Commercial banks abroad provide foreign currency loans; international agencies like the IFC and ADB fund development projects.

Indian companies raise funds through ADRs (US markets), GDRs (other markets) and FCCBs

Foreign companies can raise funds in India through IDRs, which are listed on Indian exchanges.

## MCQs with Answers

1. Ploughing back of profit refers to:(a) Trade credit (b) Retained earnings (c) Debentures (d) FactoringAnswer: (b) Retained earnings

2. Commercial paper maturity ranges from:(a) 1–3 years (b) 7 days to 1 year (c) 5–10 years (d) Over 10 yearsAnswer: (b) 7 days to 1 year

3. Debenture holders are:(a) Owners (b) Creditors (c) Directors (d) PartnersAnswer: (b) Creditors

4. Which is an owner’s fund?(a) Debentures (b) Public deposits (c) Equity shares (d) Trade creditAnswer: (c) Equity shares

5. ADRs are traded in:(a) India (b) USA (c) UK (d) JapanAnswer: (b) USA

6. Foreign companies raise funds in India through:(a) ADR (b) GDR (c) IDR (d) FCCBAnswer: (c) IDR

7. Factoring involves:(a) Leasing assets (b) Collecting receivables (c) Issuing shares (d) Paying taxesAnswer: (b) Collecting receivables

8. Interest on debentures is:(a) Not deductible (b) Tax-deductible (c) Paid only if profit (d) VariableAnswer: (b) Tax-deductible

9. Preference shares usually have:(a) Voting rights (b) Fixed dividend (c) No preference in capital (d) Highest riskAnswer: (b) Fixed dividend

10. Lease rent is paid by:(a) Lessor (b) Lessee (c) Bank (d) GovernmentAnswer: (b) Lessee

## Quick Revision Points

- Finance needed for fixed and working capital.
- Classification: period, ownership, source of generation.
- Retained earnings – internal, no explicit cost.
- Trade credit and factoring – short-term.
- Lease – lessor and lessee; lease rent.
- Public deposits – 1–3 years; commercial paper – 7 days to 1 year.
- Equity shares – owners, voting, highest risk.
- Preference shares – fixed dividend, preference in capital.
- Debentures – creditors, fixed interest, tax-deductible.
- International: ADR, GDR, IDR, FCCB; factors affecting choice.

## Chapter Summary

Business finance is needed for fixed and working capital. Sources can be classified by period, ownership and source of generation. Internal sources such as retained earnings are cheap and preserve control, while short-term needs are met through trade credit, factoring, commercial paper and bank credit.

Long-term funds come from equity and preference shares, debentures and financial

## Exam Tips and PYQ Pattern

- The equity vs preference vs debentures comparison is a high-scoring 4–6 mark question.
- In case studies, identify the source from clues like “fixed interest” or “ownership”.
- Memorise ADR, GDR, IDR and FCCB with one line each.
- Write merits and limitations separately with headings.
- Use classification charts for long answers.
- Remember: Chapter 7 is not in the current NCERT book, so numbering jumps from 6 to 8.

## Frequently Asked Questions

Is this chapter in the 2026-27 CBSE syllabus?

Yes. It is part of the Class 11 Business Studies Part B (Corporate Organisation, Finance and Trade) of the NCERT Class 11 Business Studies textbook, prescribed in the CBSE 2026-27 syllabus.

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What are the sources of business finance?

Retained earnings, trade credit, factoring, lease, public deposits, commercial paper, shares, debentures, bank loans, financial institutions and international sources.

Why does chapter numbering jump from 6 to 8?

The chapter on Formation of a Company was removed in NCERT rationalisation; numbering of remaining chapters was kept.

What is the difference between ADR and GDR?

ADRs are traded in the US; GDRs are traded in markets outside the US.

## Conclusion

Sources of Business Finance is one of the most scoring chapters of Part B. Revise the classification, comparison tables and international instruments, and download the free PDF for quick revision.

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Author Bio: Written and reviewed by the Nextoper Editorial Team, a group of CBSE business studies educators who build chapter notes directly from the NCERT textbook and past board paper patterns.

Freshness Note: These notes follow the NCERT Class 11 Business Studies textbook, Business Studies (Class XI) (NCERT reprint 2026-27, rationalised syllabus), and the CBSE syllabus for the 2026-27 session. Last checked on 28 November 2026.