CBSE Class 12 Business Studies Question Paper 2014 with Solution PDF-Set 66/2/3

Question Paper with Solutions

Conducted by the Central Board of Secondary Education (CBSE)

Time Allowed: 3 hours **Maximum Marks: 90**

General Instructions

(i) Answers to questions carrying **1 mark** may be from **one word to one sentence**.
(ii) Answers to questions carrying **3 marks** may be from **50 – 75** words.
(iii) Answers to questions carrying **4 – 5 marks** may be about **150** words.
(iv) Answers to questions carrying **6 marks** may be about **200** words.
(v) Attempt all parts of a question together.

1. How does 'Cost of Debt' affect the capital structure of a company ? State. [1 mark]

Solution:

Concept:

- Capital structure is the proportion of debt and equity used to finance a company.
- Cost of debt is the rate of interest payable on borrowed funds; it affects the attractiveness of debt financing.

Step 1: Relate borrowing cost to financing A lower cost of debt makes borrowed funds a cheaper source of finance. Subject to its capacity to meet interest and repayment obligations, the company can use a larger proportion of debt.

Step 2: State the effect of a higher cost When the interest rate rises, debt becomes more expensive and the fixed financial burden increases. The company therefore tends to use less debt in its capital structure.

Step 3: Conclusion Other things remaining the same, a lower cost of debt encourages a higher debt proportion, while a higher cost of debt discourages it.

Quick Tip to Solve: Link the interest rate to the choice of finance: cheaper debt encourages borrowing, subject to financial risk.

2. Define 'Financial Management'. [1 mark]

Solution:

Concept:

- Financial management deals with the procurement and effective utilisation of finance in a business.
- It seeks to ensure that funds are available at the right time and are used efficiently.

Step 1: Identify the finance function A business needs funds to acquire assets and carry out its operations. Financial management concerns decisions about obtaining these funds from suitable sources.

Step 2: Include the utilisation of funds Its scope also includes allocating the funds to suitable uses and managing them efficiently. Thus it covers both raising money and using it effectively, rather than merely keeping financial records.

Step 3: Conclusion Financial management means the efficient acquisition and utilisation of finance for the business.

Quick Tip to Solve: A complete definition includes both obtaining funds and using them effectively.

3. 'Maintaining labour relations and union-management relations' is one of the specialised activities performed by Human Resource Management. Mention any two other specialised activities of Human Resource Management. [1 mark]

Solution:

Concept:

- Human Resource Management performs specialised activities concerned with acquiring, developing and maintaining employees.
- Recruitment and training are distinct activities within the wider human resource function.

Step 1: Mention recruitment **Recruiting human resources:** Human Resource Management searches for prospective employees and stimulates them to apply for jobs, creating a pool of suitable candidates.

Step 2: Mention employee development **Training and development:** It arranges learning opportunities to improve employees' present job skills and prepare them for future responsibilities. This is different from maintaining labour and union-management relations.

Step 3: Conclusion Two other specialised HRM activities are recruiting human resources and training and development of employees.

Quick Tip to Solve: Choose two separate HRM activities, such as recruitment and training, rather than repeating labour relations.

4. Give two characteristics of 'Organizational Climate' that influence the behaviour of individuals and act as a non-financial incentive. [1 mark]

Solution:

Concept:

- Organisational climate refers to the characteristics that describe an organisation and distinguish it from others.
- These characteristics shape the work environment and influence individual behaviour as non-financial incentives.

Step 1: State individual autonomy **Individual autonomy:** Employees are allowed appropriate freedom and independence in carrying out their work, which can encourage initiative and a sense of involvement.

Step 2: State the reward orientation **Reward orientation:** The organisation recognises and rewards desired performance. Employees' perception that good work receives recognition influences their behaviour and willingness to perform.

Step 3: Conclusion Individual autonomy and reward orientation are two characteristics of organisational climate that influence behaviour.

Quick Tip to Solve: Name characteristics of the work environment, such as autonomy and reward orientation, rather than cash incentives.

5. What is meant by 'Feedback' in the concept of communication ? [1 mark]

Solution:

Concept:

- Communication involves transmitting a message and developing a shared understanding between sender and receiver.
- Feedback is the receiver's response that completes the communication process.

Step 1: Identify the response After receiving and interpreting a message, the receiver responds to it. This response is communicated back to the original sender and is called feedback.

Step 2: Explain its purpose Feedback indicates whether the message has been received and understood as intended. It allows the sender to check the effectiveness of communication and, where necessary, clarify the message.

Step 3: Conclusion Feedback is the response of the receiver conveyed back to the sender, indicating how the message has been received and understood.

Quick Tip to Solve: Remember the direction: feedback travels from the receiver back to the original sender.

6. Why do employees become lethargic when the organization uses internal sources of recruitment ? State. [1 mark]

Solution:

Concept:

- Internal recruitment fills vacancies from among existing employees, commonly through promotion or transfer.
- A limitation is the absence of competition from candidates outside the organisation.

Step 1: Identify the missing competition When vacancies are filled only from within, existing employees do not face competition from capable outside applicants. They may feel that advancement is available within the existing group.

Step 2: Explain the effect on effort Without the pressure of fresh talent and outside competition, some employees may lose the incentive to improve their abilities or work harder. This can make them complacent and lethargic.

Step 3: Conclusion Employees may become lethargic because internal recruitment removes competition from outside candidates and can reduce their incentive to improve performance.

Quick Tip to Solve: Connect lethargy specifically with the lack of outside competition under internal recruitment.

7. Give the meaning of 'Accountability' as an element of delegation. [1 mark]

Solution:

Concept:

- Delegation involves authority, responsibility and accountability.
- Accountability is answerability for the final outcome of the responsibility assigned.

Step 1: Identify who must answer A subordinate who has been assigned a task is answerable to the superior for its satisfactory performance. The subordinate must explain the results achieved and the way the assignment was carried out.

Step 2: Distinguish accountability from authority Authority gives the right to act, whereas accountability requires an explanation of the outcome. A manager may delegate authority but cannot escape ultimate accountability to the manager's own superior.

Step 3: Conclusion Accountability means being answerable to a superior for the final outcome of the assigned task.

Quick Tip to Solve: Use the word answerability for accountability; authority is the right to act and responsibility is the duty to perform.

8. What is included in 'Technological Environment' of business ? State. [1 mark]

Solution:

Concept:

- Technological environment is the technological dimension of the external business environment.
- It concerns scientific improvements and innovations that affect how goods and services are produced and delivered.

Step 1: Identify the technological forces Consider the scientific and technological developments available to a business, such as improved machinery, new production processes and advances in communication.

Step 2: State what this environment includes It includes forces relating to scientific improvements and innovations which provide new ways of producing goods and services, and new methods and techniques of operating a business.

Step 3: Conclusion The technological environment includes scientific improvements and innovations that create new methods of production and new techniques of business operation.

Quick Tip to Solve: Link technological environment to innovations in products, production methods and business techniques.

9. What is meant by 'Management of Operations' ? [1 mark]

Solution:

Concept:

- Management of operations is one of the dimensions of management, along with management of work and people.
- Operations transform inputs into the output supplied by an organisation.

Step 1: Identify the production activity Every organisation has a production process through which it turns inputs such as materials, people, equipment and technology into goods or services.

Step 2: Explain how operations are managed Management of operations means managing this transformation process so that the required goods or services are produced effectively and efficiently. It coordinates the inputs and the activities needed to create the output.

Step 3: Conclusion Management of operations is the management of the production process that transforms inputs into the desired goods and services.

Quick Tip to Solve: For operations, remember the sequence: inputs, transformation process, and goods or services as output.

10. Give the meaning of 'Procedure' as a type of plan. [1 mark]

Solution:

Concept:

- A procedure is a standing plan used for activities that recur in an organisation.
- It specifies the chronological sequence in which a task is to be performed.

Step 1: Identify the nature of the plan A procedure lays down the routine steps for carrying out an activity. It guides employees whenever the same kind of situation arises.

Step 2: State its defining feature It prescribes the exact order or sequence of the steps to be followed. For example, a purchasing procedure can specify making a requisition, obtaining approval, placing the order and receiving the goods.

Step 3: Conclusion A procedure is a plan specifying the routine steps, in chronological order, to be followed in carrying out an activity.

Quick Tip to Solve: Use the phrase chronological sequence of steps to distinguish a procedure from a general policy.

11. Define organization as a structure. [1 mark]

Solution:

Concept:

- Organisation structure is the framework created by the organising process.

- It defines the relationships among jobs, people, authority and responsibility.

Step 1: Identify the framework Organising divides work into jobs and departments and assigns duties to people. The resulting arrangement becomes the structure within which the organisation functions.

Step 2: Define the relationships established Organisation as a structure is the framework of authority and responsibility relationships among positions and people. It makes clear who performs which task, who reports to whom and how different activities are coordinated.

Step 3: Conclusion Organisation structure is the framework within which managerial and operating tasks are performed and authority-responsibility relationships are defined.

Quick Tip to Solve: In a structure definition, include the framework and the authority-responsibility or reporting relationships.

12. What is determined by 'Fatigue Study' ? [1 mark]

Solution:

Concept:

- Fatigue study is a technique of scientific management concerned with reducing physical and mental tiredness.
- Suitable rest intervals help workers recover and sustain efficient performance.

Step 1: Identify the problem studied Continuous work makes workers tired, reducing attention and efficiency. The degree of fatigue depends on the nature of work and working conditions.

Step 2: State what the study determines Fatigue study determines the amount and frequency of rest intervals needed while completing a task. Rest pauses are arranged so that workers can regain stamina and continue work efficiently without unnecessary exhaustion.

Step 3: Conclusion Fatigue study determines the amount and frequency of rest intervals required to complete a task efficiently.

Quick Tip to Solve: For fatigue study, state both the duration or amount of rest and how frequently rest is required.

13. Crackers Ltd., a fire-cracker manufacturing company launched some new products on the eve of Diwali in the market, which attracted many buyers. To meet the increased demand the company employed children from nearby villages. Although the products were in great demand, appropriate safety warnings for use were not mentioned on the labels, which led to many accidents.

(i) Identify and explain the important product related decision that was not taken into consideration by the company.

(ii) Also state any two values which were violated by the company. [3 marks]

Solution:

Concept:

- Labelling is the product-related decision of designing and providing the information displayed on a product or its package.
- Labels identify and describe products, and provide instructions and warnings necessary for safe use.

Step 1: Identify and explain the neglected product decision **Labelling:** The case states that "appropriate safety warnings for use were not mentioned on the labels". Thus, the neglected product-related decision was labelling. A label carries information about the product and its use. For fire-crackers, it must communicate the precautions and warnings needed for safe handling and use. Merely attracting buyers does not fulfil this information function; omitting the warnings exposed users to accidents.

Step 2: State the two values violated **Concern for consumer safety:** The omission of "appropriate safety warnings" which "led to many accidents" shows disregard for the safety and welfare of buyers. Honest and adequate product information should help consumers use a potentially dangerous product safely.

Protection of children and social responsibility: The company "employed children from nearby villages" to meet demand. Using children for hazardous fire-cracker manufacturing disregards their safety and welfare. The business should protect children rather than expose them to dangerous work in pursuit of higher sales.

Step 3: Conclusion The company neglected labelling, especially safety information. It violated concern for consumer safety and protection of children through socially responsible business conduct.

Quick Tip to Solve: Quote the missing warnings to identify labelling, then link each value to a separate action in the case.

14. How are consumer grievances redressed by the three-tier machinery under Consumer Protection Act, 1986 ? Explain. [3 marks]

Solution:

Concept:

- The Consumer Protection Act, 1986 provides a three-tier quasi-judicial machinery at district, state and national levels for inexpensive and speedy redressal of consumer grievances.
- For this 2014 paper, pecuniary jurisdiction is determined by the value of goods or services and the

compensation claimed under the 1986 Act as then applicable.

Step 1: Explain the district-level forum **District Forum:** A consumer files a complaint here where the value of goods or services, together with compensation claimed, does not exceed Rs 20 lakh. The Forum hears the parties and examines the evidence; where necessary it obtains a laboratory report. If the complaint is established, it orders appropriate relief, such as removal of a defect, replacement, refund or compensation.

Step 2: Explain the state and national levels **State Commission:** It entertains original complaints above Rs 20 lakh and up to Rs 1 crore, as well as appeals against District Forum orders. An aggrieved party may appeal against a District Forum order to the State Commission within 30 days.

National Commission: It entertains original complaints exceeding Rs 1 crore and appeals against State Commission orders. Appeals against State Commission orders may be filed within 30 days. An order of the National Commission made in its original jurisdiction may be appealed to the Supreme Court within 30 days.

Step 3: Conclusion Thus, consumers obtain redress through the District Forum, State Commission and National Commission, according to the claim value and the appellate stage. The machinery can direct corrective action and compensate consumers for established loss or injury.

Quick Tip to Solve: For an old Act question, use its contemporary limits: district up to Rs 20 lakh, state above Rs 20 lakh up to Rs 1 crore, and national above Rs 1 crore.

15. Kavya is working in a company on permanent basis. As per the job agreement she had to work for 8 hours a day and was free to work overtime. Kavya worked overtime. But even after working for long hours and putting in her best efforts, no recognition was given to her by her boss. Due to overtime she fell ill and had to take leave from her work. No one showed concern and enquired about her health. She realised that she was fulfilling only some of her needs while some other needs still remained to be fulfilled.

(i) Identify and explain the needs of Kavya discussed in the above para, by quoting the lines.

(ii) Also explain two other needs of Kavya followed by the above needs, which still remained to be satisfied. [3 marks]

Solution:

Concept:

- Maslow arranges human needs in a hierarchy: basic physiological, safety or security, affiliation or belongingness, esteem, and self-actualisation needs.
- A satisfied lower-level need gives way to a higher-level need as a source of motivation. A secure job alone does not satisfy social acceptance or recognition needs.

Step 1: Identify the lower needs being fulfilled **Basic physiological needs:** These are basic requirements such as food, clothing and shelter; salary enables their satisfaction. The lines 'she had to work for 8 hours a day and was free to work overtime' and 'Kavya worked overtime' describe employment and the opportunity to earn for these basic requirements.

Safety or security needs: These include job security and protection against uncertainty about

continued income. The line 'Kavya is working in a company on permanent basis' shows the security provided by permanent employment.

Step 2: Explain the two higher needs remaining unsatisfied **Affiliation or belongingness needs:** These concern affection, friendship, acceptance and a sense of belonging among colleagues. The line 'No one showed concern and enquired about her health' shows that Kavya lacks the care and social support she expects at work.

Esteem needs: These concern respect, status, recognition, appreciation and self-respect. The line 'even after working for long hours and putting in her best efforts, no recognition was given to her by her boss' shows that this need remains unsatisfied. Appreciation of her contribution would help meet it.

Step 3: Conclusion Kavya's work provides a means of meeting physiological needs, and permanent employment provides safety. The two subsequent needs highlighted as unmet are belongingness and esteem: colleagues show no concern, and her boss gives no recognition.

Quick Tip to Solve: Link each case quotation to the precise need: permanence means security, concern means belongingness, and recognition means esteem.

16. Explain any three semantic barriers to effective communication. [3 marks]

Solution:

Concept:

- Semantic barriers arise when words, symbols or the way a message is expressed prevent the receiver from understanding the meaning intended by the sender.
- The sender encodes ideas into language and the receiver decodes them. Different interpretations at either stage can distort the message even when it reaches the receiver.

Step 1: Explain two language-related barriers **Badly expressed message:** The intended meaning may not be conveyed because of an inadequate vocabulary, incorrect words, omission of necessary words or poor sentence structure. For example, a vague instruction to complete work 'soon' does not state a clear deadline, so employees may interpret it differently.

Symbols with different meanings: A word or symbol can carry several meanings. Unless its context is clear, sender and receiver may attach different meanings to it. For example, 'value' could refer to price, usefulness or a moral principle. The receiver may therefore understand something different from what the sender intended.

Step 2: Explain a barrier caused by specialised terminology **Technical jargon:** Specialists often use technical words, abbreviations or expressions connected with their field. When they communicate with people who do not know that terminology, the message becomes difficult to understand. For example, an engineer using unexplained machine specifications while instructing an untrained worker may fail to convey the required action. Using familiar words and explaining necessary technical terms reduces this barrier.

Step 3: Conclusion Three semantic barriers are badly expressed messages, symbols with different meanings and technical jargon. Each obstructs communication by creating a gap between the meaning

intended and the meaning understood.

Quick Tip to Solve: Keep semantic barriers focused on language and meaning; distrust and fear belong to psychological barriers, rather than semantic ones.

17. 'Financial Market plays an important role in the allocation of scarce resources in an economy by performing various functions.' Explain any three such functions of financial market. [3 marks]

Solution:

Concept:

- Financial Markets: a financial market links savers who have surplus funds with borrowers and investors who need funds for productive activities.
- By mobilising savings, providing price information and making financial assets transferable, it supports the allocation of scarce financial resources in the economy.

Step 1: Explain mobilisation of savings **Mobilisation of savings and channelising them into productive uses:** A financial market brings together those who possess savings and those who require funds. It gives savers alternative investment opportunities and transfers their savings to enterprises that can employ them productively. Thus, money that might otherwise remain idle can finance business expansion and other productive activities.

Step 2: Explain the discovery of prices **Facilitating price discovery:** In a financial market, demand for funds comes from business firms and other users, while the supply comes from households and other savers. The interaction of demand and supply helps establish the prices of financial assets. These prices convey information to buyers and sellers, helping them make investment and financing decisions.

Step 3: Explain liquidity of financial assets **Providing liquidity to financial assets:** Financial markets provide a mechanism through which investors can buy and sell financial assets. An investor who needs cash can sell an existing investment instead of necessarily holding it until maturity. This ease of conversion into money makes investment more attractive and encourages savers to supply funds for productive uses.

Step 4: Conclusion Three functions are mobilisation of savings into productive uses, facilitation of price discovery, and provision of liquidity to financial assets. Together they help funds move from savers to those who can use them productively.

Quick Tip to Solve: Link each function to its effect: savings reach users, demand and supply determine prices, and resale provides liquidity.

18. State any three points of importance of consumer protection from the point of view of business.

[3 marks]

Solution:

Concept:

- Consumer Protection: protecting consumers means safeguarding their interests against exploitation and ensuring fair treatment in business dealings.
- From the business viewpoint, consumer protection is important because a business depends on satisfied customers and has responsibilities towards the society whose resources it uses.

Step 1: State the benefit to long-term business interests **Long-term interest of business:** A business benefits by satisfying its customers. Satisfied consumers are more likely to make repeat purchases and speak favourably about the enterprise to others. Protecting consumer interests therefore helps build goodwill, customer loyalty and a lasting market for the firm's products. Exploitation may provide an immediate gain but damages these long-term interests.

Step 2: State the duty arising from society's resources **Business uses society's resources:** Business enterprises use resources that belong to society, such as finance, materials and human effort. They consequently have a responsibility to supply products and services that serve society's interests. Protecting consumers is one way of acknowledging this responsibility rather than treating the use of these resources as a reason only for private gain.

Step 3: State the social responsibility towards consumers **Social responsibility:** A business has responsibilities towards different interest groups, including consumers. Consumers provide the revenue on which the enterprise depends, so their interests deserve particular attention. Supplying safe products, giving accurate information and dealing fairly with complaints are ways of fulfilling this responsibility towards them.

Step 4: Conclusion Three points are the long-term interest of business, its use of society's resources, and its social responsibility towards consumers. Each gives a business a reason to protect consumer interests in its decisions and dealings.

Quick Tip to Solve: Keep the viewpoint on business: explain its long-term interest, its obligation for using society's resources, and its responsibility to consumers.

19. Give the meaning of 'Investment' and 'Dividend' decisions of financial management. [4 marks]

Solution:

Concept:

- Financial management concerns the procurement and effective use of funds to maximise shareholders' wealth. An investment decision concerns the use of funds, whereas a dividend decision concerns the distribution of earnings.
- Funds invested in assets must earn a suitable return at an acceptable risk. Earnings may either be distributed to shareholders or retained to finance the business.

Step 1: Explain the investment decision **Investment decision:** It is the decision about how the firm's

funds are invested in different assets. The firm chooses the assets or investment proposals in which its available funds should be employed. The purpose is to obtain returns that contribute to shareholders' wealth.

Long-term and short-term investment: Long-term investment decisions, also called capital budgeting decisions, involve fixed assets such as a new factory, machinery or an expansion project. Short-term investment decisions concern current assets such as cash, inventory and debtors, and affect the firm's working capital and liquidity. Thus, deciding to purchase a machine and deciding how much stock to maintain are investment decisions at different time horizons.

Step 2: Explain the dividend decision **Dividend decision:** It is the decision about how much of the profit earned by a company, after payment of tax, should be distributed to shareholders as dividend and how much should be retained in the business. It therefore divides earnings between current distribution and retained earnings.

Distribution versus retention: The portion distributed provides shareholders with a current return. The portion retained becomes an internal source of finance for investment and future growth. For example, a company may distribute part of its earnings and retain the balance to finance expansion. The dividend decision must balance shareholders' expectations with the firm's future financial requirements.

Step 3: Conclusion An investment decision allocates funds among assets, while a dividend decision allocates after-tax earnings between dividends to shareholders and retention in the business. These are distinct but related financial decisions because retained earnings can finance future investments.

Quick Tip to Solve: Link investment with where funds are used, and dividend with how earnings are divided between shareholders and the business.

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20. Mega Ltd. was manufacturing water-heaters. In the first year of its operations, the revenue earned by the company was just sufficient to meet its costs. To increase the revenue, the company analysed the reasons of less revenue. After analysis the company decided

(i) to reduce the labour cost by shifting the manufacturing unit to a backward area where labour was available at a very low rate.

(ii) to start manufacturing solar water-heaters and reduce the production of electric water-heaters slowly.

This will not only help in covering the risks, but also help in meeting other objectives too.

(a) Identify and explain the objectives of management discussed above.

(b) State any two values which the company wanted to communicate to the society. [4 marks]

Solution:

Concept:

- Organisational objectives include survival, profit and growth. Survival requires earning enough revenue to cover costs; profit provides a surplus and helps the business meet risks.
- Social objectives recognise that a business is part of society. They include creating employment opportunities, particularly for disadvantaged groups, and using environmentally responsible

methods and products.

Step 1: Identify and explain the organisational objectives **Survival:** Mega Ltd.'s revenue was 'just sufficient to meet its costs'. This illustrates survival, the basic organisational objective of earning enough revenue to cover costs and continue operations. The company was meeting this minimum requirement in its first year.

Profit: The company wanted 'to increase the revenue' and decided 'to reduce the labour cost'. These decisions aim to create a surplus of revenue over costs, rather than merely break even. Profit is essential to meet business expenses beyond the minimum, provide a return and help the enterprise face risks. The case itself says the changes will help in 'covering the risks'. Thus, earning profit is another organisational objective shown here.

Step 2: Identify and explain the social objective **Social objective:** The firm decided to shift its manufacturing unit 'to a backward area' and 'to start manufacturing solar water-heaters'. Establishing production in a backward area creates employment opportunities there and contributes to its development. Solar water-heaters use renewable solar energy and reduce dependence on electricity. These decisions therefore also serve society through regional development and environmental responsibility. The lower labour cost is a business benefit, while employment in the backward area is its social contribution.

Step 3: State the two values communicated to society **Concern for the environment:** The shift towards solar water-heaters communicates conservation of energy and the use of a renewable source of energy.

Concern for balanced regional development: Locating the manufacturing unit in a backward area communicates a commitment to providing local employment opportunities and developing economically backward regions.

Step 4: Conclusion The case illustrates organisational objectives, particularly survival and profit, together with social objectives. The two values are environmental protection through solar energy and balanced regional development through employment opportunities in a backward area.

Quick Tip to Solve: Match covering costs with survival, creating a surplus with profit, and benefits to the community with social objectives; support each identification with the case wording.

21. Giving any four points, explain the impact of government policy changes on Business and Industry.

[4 marks]

Solution:

Concept:

- Government policy changes associated with liberalisation, privatisation and globalisation changed the conditions in which Indian business and industry operate.
- Their impact includes stronger competition, more demanding customers, rapid technological change and the need for enterprises to respond actively to the market.

Step 1: Explain the changes in competition and customer expectations

- **Increasing competition:** Liberal industrial policy and easier entry of foreign firms increased competition for Indian enterprises, especially in service industries. Domestic firms could no longer rely on a protected market; they had to improve quality, control costs and offer better service to retain customers.
- **More demanding customers:** Increased competition gave buyers a wider choice of goods and services. Better informed consumers began to expect improved quality, reasonable prices and dependable service. Firms therefore had to pay closer attention to customer needs rather than merely sell whatever they produced.

Step 2: Explain the changes in technology and business orientation

- **Rapidly changing technological environment:** Greater competition compelled firms to adopt improved technology and develop new products. Technological improvements made production processes more efficient, but also required investment and continuous upgrading so that existing methods did not become obsolete.
- **Market orientation:** Business enterprises increasingly had to study the market before deciding what to produce. Instead of following a production-oriented approach and selling the output afterwards, they needed to identify consumer requirements first and then design products and marketing programmes to satisfy them.

Step 3: Conclusion Thus, government policy changes increased competition, made customers more demanding, accelerated technological change and encouraged market orientation in business and industry.

Quick Tip to Solve: For each impact, connect the policy change to a specific adjustment firms must make; a heading alone does not explain its effect on business.

22. How is training of employees beneficial 'for the organization' ? State any four reasons for the same.

[4 marks]

Solution:

Concept:

- Training is the systematic process of increasing employees' knowledge and skills for performing their specific jobs effectively.

- An organisation benefits when employees learn correct work methods, make fewer errors, use resources efficiently and can take up greater responsibilities.

Step 1: Explain how training improves efficiency and performance

- **Systematic learning reduces wastage:** Training provides organised instruction in the correct methods of doing a job. Employees learn faster than through an unsystematic process of trial and error. Fewer mistakes and less repetition of work reduce wastage of time, effort and materials, saving resources for the organisation.
- **Higher productivity and profitability:** Trained employees possess the skills needed to perform tasks accurately and efficiently. Their work improves in both quantity and quality. Better use of resources and improved output help lower operating costs and contribute to the profitability of the organisation.

Step 2: Explain how training supports future staffing and change

- **Preparation of future managers:** Training equips employees to shoulder greater responsibilities. When an existing manager leaves, retires or is promoted, the organisation has trained personnel who can take over. This develops an internal supply of capable people and supports continuity of operations.
- **Effective response to a fast-changing environment:** Training updates employees' knowledge and skills when technology, production methods or work requirements change. Staff can learn to operate new equipment and follow new procedures. This enables the organisation to adapt to changes instead of suffering disruption because its workforce lacks the necessary competence.

Step 3: Conclusion Training benefits the organisation through reduced wastage, higher productivity and profitability, a supply of future managers and a stronger ability to cope with environmental and technological change.

Quick Tip to Solve: Keep the answer focused on organisational gains: explain how each improvement in employee skill saves resources, raises output or strengthens the enterprise.

23. State any five limitations of planning. [5 marks]

Solution:

Concept:

- Planning means setting objectives in advance and deciding the course of action to achieve them. It provides direction, but it cannot remove every difficulty faced by a business.
- The limitations of planning arise from its fixed framework, the uncertain business environment, and the time and resources required to prepare plans.

Step 1: State the limitations affecting flexibility and creativity

- **Planning leads to rigidity:** A well-defined plan specifies what is to be done and how. Managers may follow the predetermined course even when changed circumstances require a different approach. Strict adherence can therefore restrict individual initiative and organisational flexibility.
- **Planning may not work in a dynamic environment:** Business operates amid changes in technol-

ogy, competition, economic conditions and government policies. Plans are based on assumptions about the future; unexpected changes can make these assumptions inaccurate and reduce the usefulness of the original plan.

- **Planning reduces creativity:** Planning is often undertaken by top management, while other managers and employees implement the plans. If they merely carry out instructions, they may neither develop their own ideas nor exercise independent judgement. This can discourage creativity and initiative.

Step 2: State the limitations involving money and time

- **Planning involves huge costs:** Collecting information, conducting research, evaluating alternatives and obtaining expert advice require expenditure. These costs must be justified by the expected benefits; an elaborate planning exercise can otherwise consume resources without proportionate gain.
- **Planning is a time-consuming process:** Managers need time to gather facts, consider alternatives and formulate detailed plans. When decisions are urgent, the opportunity may be lost while the organisation is still planning. Excessive time spent preparing plans may also leave too little time for their implementation.

Step 3: Conclusion Five limitations are rigidity, reduced usefulness in a dynamic environment, reduced creativity, huge costs and the time-consuming nature of planning. These limitations call for realistic, flexible plans and timely action rather than abandonment of planning.

Quick Tip to Solve: Recall three restrictions on action—rigidity, change and creativity—followed by the two resources planning consumes: money and time.

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24. Principles of Taylor and Fayol are mutually complementary. One believed that the management should scientifically select the person and the work assigned should suit his/her physical and intellectual capabilities, while the other suggested that the work can be performed more efficiently if divided into specialised tasks.

Identify and explain the principles of Fayol and Taylor referred to in the above para. [5 marks]

Solution:

Concept:

- Taylor's principle of Development of Each and Every Person to His or Her Greatest Efficiency and Prosperity emphasises scientific selection and development of workers.
- Fayol's principle of Division of Work emphasises specialisation through division of an activity into tasks. The two principles complement each other by improving the suitability and efficiency of human effort.

Step 1: Identify and explain Taylor's principle **Development of Each and Every Person to His or Her Greatest Efficiency and Prosperity:** Taylor advocated scientific selection of workers rather than selection by guesswork. Each worker should be assigned work suited to his or her physical, mental and intellectual capabilities. The case points to this principle through the words "scientifically select the person" and "work assigned should suit his/her physical and intellectual capabilities".

- **Scientific selection and suitable placement:** Management should determine the abilities required by a job and select a person with the appropriate aptitude and capabilities. Matching the worker to the task makes effective performance more likely.
- **Training and development:** Workers should receive the training needed to learn the best method of doing their assigned work. Developing each person's abilities helps that worker attain greater efficiency and prosperity and also improves the organisation's performance.

Step 2: Identify and explain Fayol's principle **Division of Work:** Fayol suggested dividing work into specialised tasks and assigning them to suitably trained people. The evidence is the statement that work can be performed more efficiently "if divided into specialised tasks".

- **Specialisation:** Instead of one person performing every activity, each person concentrates on a particular task or a limited group of related tasks. Repeated performance develops skill and expertise.
- **Greater efficiency:** Specialised work enables employees to produce more and better output with the same effort. It avoids unnecessary changes between unrelated tasks and applies to both technical and managerial activities.

Step 3: Explain how the principles complement one another **Combine suitable people with specialised tasks:** Fayol explains how work should be divided; Taylor explains how people should be selected, placed and developed for that work. Specialised tasks are performed effectively when capable, trained workers undertake them. Thus, the principles reinforce rather than contradict one another.

Step 4: Conclusion The principle of Fayol is **Division of Work**, and the principle of Taylor is **Development of Each and Every Person to His or Her Greatest Efficiency and Prosperity**. Together they combine specialisation of tasks with scientific selection and development of the people performing them.

Quick Tip to Solve: In this case, link "scientifically select" and "capabilities" to Taylor; link "specialised tasks" to Fayol's Division of Work.

25. Differentiate between 'Capital Market' and 'Money Market' on the basis of the following :

(i) Safety

(ii) Expected Return

(iii) Investment outlay

(iv) Participants

(v) Duration [5 marks]

Solution:

Concept:

- Capital and money markets are segments of the financial market, distinguished primarily by the maturity of the funds and securities they deal in.
- Capital-market securities finance medium- and long-term requirements; money-market instruments

meet short-term funding needs. Their maturity, liquidity and risk explain the differences in safety, return and participation.

Step 1: Identify the scope of the two markets The capital market mobilises funds for investment over longer periods through instruments such as shares and debentures. The money market deals in short-term instruments such as treasury bills, commercial paper and certificates of deposit. Compare the markets on each of the five bases specified rather than merely listing their instruments.

Step 2: Compare the five specified bases

Basis	Capital Market	Money Market
(i) Safety	Securities generally carry greater risk, including fluctuations in market price and the issuing company's performance. They are relatively less safe.	Instruments are generally safer because of their short maturity and the financial standing of their issuers. Default risk is generally low.
(ii) Expected return	Expected returns are generally higher because investors bear greater risk and commit funds for longer periods.	Expected returns are generally lower because the instruments involve relatively low risk and short investment periods.
(iii) Investment outlay	Investment need not require a huge outlay: securities can be purchased in relatively small units, making the market accessible to small investors.	Transactions usually require a large investment outlay because instruments are commonly traded in large denominations.
(iv) Participants	Participants include financial institutions, banks, companies, foreign investors and individual or retail investors.	Major participants include the Reserve Bank of India, commercial banks, financial institutions and companies; institutional participation predominates.
(v) Duration	Deals in medium- and long-term funds, generally for periods exceeding one year; equity shares have no fixed maturity.	Deals in short-term funds and instruments with a maturity of up to one year.

Step 3: Conclusion The capital market primarily meets longer-term investment needs with relatively higher risk and expected return, while the money market meets short-term funding needs through relatively safer instruments generally traded in large amounts.

Quick Tip to Solve: Start with duration: longer-term capital financing explains higher risk and expected return; short-term institutional money-market dealings explain greater safety and larger transaction sizes.

26. What is meant by 'Physical Distribution' ? Explain its major components. [5 marks]

Solution:

Concept:

- Physical distribution is the marketing function concerned with the actual physical handling and movement of goods from the place of production to the place of consumption.
- Its purpose is to make the right goods available at the right place and time. Its major components

are order processing, transportation, warehousing and inventory control.

Step 1: State the meaning of physical distribution **Meaning:** Physical distribution refers to the activities and decisions concerned with the physical movement of goods from producers to consumers. After a product is manufactured, it must be handled, stored and delivered so that customers can obtain it conveniently. Physical distribution therefore creates place and time utility and helps fulfil the promise made to the buyer.

Step 2: Explain the major components

- **Order processing:** This includes receiving and recording the customer's order, checking its details and arranging for accurate and timely execution. Speed and accuracy matter because a delayed or incorrectly processed order can delay delivery and cause dissatisfaction or lost sales.
- **Transportation:** Goods must be moved from the place of manufacture to the points where buyers require them. The firm selects suitable modes of transport by considering factors such as cost, speed, reliability and the nature of the product. Without transportation, goods cannot reach geographically dispersed markets.
- **Warehousing:** Goods are stored until they are needed for sale or use. Warehousing bridges the time gap between production and consumption and maintains the availability of products, including those produced or demanded seasonally. The number and location of warehouses affect both delivery service and distribution cost.
- **Inventory control:** The firm decides the quantity of stock to maintain and when to replenish it. Adequate inventory helps fulfil orders promptly and avoids loss of sales through stock-outs. Excess inventory ties up capital and raises storage, insurance and obsolescence costs, so the firm balances customer service against the cost of holding stock.

Step 3: Conclusion Physical distribution ensures the actual movement and availability of goods for consumers. Efficient order processing, suitable transportation, appropriate warehousing and balanced inventory control work together to provide timely delivery at a reasonable cost.

Quick Tip to Solve: Follow an order's journey: process the order, transport the goods, store them until needed and control the stock available for the next order. These are the four major components.

27(a). Explain the following functions of marketing :

(i) Marketing Planning

(ii) Product designing and development

(iii) Pricing of products

(iv) Standardisation and Grading [6 marks]

Solution:

Concept:

- Marketing management involves identifying customers' needs and carrying out activities that create and deliver satisfactory products. Its functions extend from planning the offering to deciding its price and maintaining its quality.

- Marketing planning, product design and development, pricing, and standardisation and grading perform different but related roles in making the offering suitable for its target market.

Step 1: Explain planning and development of the offering

- **(i) Marketing planning:** The marketer develops an appropriate marketing plan to achieve the organisation's marketing objectives. The plan specifies what is to be achieved and the programmes of action needed to achieve it. For example, a firm seeking a larger market share decides how to increase production, promote its products and improve their availability. Planning coordinates these activities rather than allowing them to proceed independently.
- **(ii) Product designing and development:** The marketer decides the product's design, shape, size, style and other features so that it satisfies customers' needs. A good design improves performance or usefulness and makes the product more attractive. Development turns the proposed design into a suitable offering and may improve existing products. A well-designed product can therefore provide a competitive advantage and encourage customers to choose it.

Step 2: Explain price determination and quality classification

- **(iii) Pricing of products:** Pricing means deciding the amount customers must pay for the product. The marketer considers production and marketing costs, customers' demand, competitors' prices, the firm's objectives and other relevant constraints. Price affects both demand and the firm's revenue, so it must help achieve the marketing objectives while remaining acceptable to the target customers.
- **(iv) Standardisation and grading:** Standardisation means producing goods of predetermined specifications concerning quality, size, weight and other characteristics. It helps ensure uniformity, reduces the need to inspect every unit and builds buyers' confidence. Grading means sorting goods into classes or groups according to important characteristics such as quality, size or variety. It is especially useful where natural variations occur, as with agricultural produce. Different grades make comparison and suitable pricing easier.

Step 3: Conclusion Marketing planning sets the objectives and action programme; product design and development shape the offering; pricing determines the payment sought; and standardisation and grading ensure uniform specifications and meaningful quality categories.

Quick Tip to Solve: Keep standardisation and grading distinct: the first sets uniform specifications, while the second sorts goods into classes according to their characteristics.

OR

27(b). 'Though advertising is one of the most frequently used media of promotion of goods and services, yet it attracts lot of objections.' Explain any four such objections. [6 marks]

Solution:

Concept:

- Advertising is an impersonal, paid form of promotion by an identified sponsor. It informs and persuades a large audience, but its influence on consumers and the cost of promotion also attract criticism.
- The question asks for objections to advertising. Each objection should explain the alleged adverse effect rather than merely name it; these criticisms do not mean that every advertisement necessarily has that effect.

Step 1: Explain the objections concerning cost and social values

- **(i) Adds to cost:** Critics argue that advertising involves substantial expenditure. This expenditure becomes part of the cost of marketing and may be passed on to buyers through a higher price. Consumers may therefore pay for persuasive publicity in addition to the product itself. The objection is particularly strong where heavy expenditure does not lead to enough additional sales to reduce the cost per unit.
- **(ii) Undermines social values:** Advertising is criticised for promoting materialism by encouraging people to judge happiness or success through the possession of goods. It can stimulate dissatisfaction with what people already have and persuade them to desire products they do not really need. Such appeals may encourage excessive consumption and divert attention from non-material values and relationships.

Step 2: Explain the objections concerning choice and buyers' understanding

- **(iii) Confuses the buyers:** Several brands may make similar claims of being the best or superior to their rivals. Faced with repeated and competing claims, buyers may find it difficult to decide which product actually meets their needs. Instead of giving a clear basis for comparison, such advertising may complicate the purchase decision and prevent an informed choice.
- **(iv) Encourages sale of inferior products:** An advertisement may highlight attractive claims while failing to present the product's limitations accurately. Buyers who rely on these claims may purchase a product whose quality or performance is below what the advertisement led them to expect. Thus persuasive promotion can initially induce purchases of inferior products, especially when buyers cannot assess quality before buying.

Step 3: Conclusion Four objections are that advertising adds to cost, undermines social values, confuses buyers and encourages the sale of inferior products. These criticisms concern its possible economic and social effects and the quality of information available to consumers.

Quick Tip to Solve: For each objection, connect the advertising practice to its effect on the buyer: higher cost, materialistic wants, confusion or an inferior purchase.

28(a). Explain any four points which highlight the importance of controlling. [6 marks]

Solution:

Concept:

- Controlling is the management function of comparing actual performance with planned standards, analysing deviations and taking corrective action so that organisational activities remain directed towards objectives.
- Its importance lies in making plans effective and improving the way organisational resources and people are managed. The following four points explain this importance.

Step 1: Explain how control supports goals and standards

- **Accomplishing organisational goals:** Controlling measures progress towards organisational objectives and brings to light deviations from the plan. Managers identify the causes of significant deviations and take corrective action. For example, if actual production falls below the planned target because of machine breakdowns, arranging repairs helps restore output. Thus, controlling guides activities towards the desired results instead of allowing departures from the plan to continue unnoticed.
- **Judging accuracy of standards:** An effective control system helps management verify whether the standards originally set were accurate and realistic. Comparison with actual performance, together with examination of changes in the business environment, can reveal that a standard needs revision. Managers then review the standard rather than blindly treating every difference as employee inefficiency. This keeps the basis for performance appraisal relevant and useful.

Step 2: Explain how control improves resources and motivation

- **Making efficient use of resources:** Under controlling, each activity is performed according to predetermined standards. Monitoring resource use and correcting deviations reduce wastage and spoilage. Employees are encouraged to use materials, time and equipment carefully, so the organisation can obtain better results from the resources available to it.
- **Improving employee motivation:** When employees know the standards against which their performance will be assessed, they understand what is expected of them. Clear targets and objective appraisal help them work purposefully. Recognition and rewards linked to satisfactory performance encourage employees to improve their contribution and work towards organisational goals.

Step 3: Conclusion Controlling is important because it helps accomplish organisational goals, tests the accuracy of standards, promotes efficient resource use and improves employee motivation. It converts performance information into timely managerial action.

Quick Tip to Solve: For an importance question, name each benefit in a heading and explain how comparing performance with standards produces that benefit; do not merely list the steps of control.

OR

28(b). Explain the relationship between planning and controlling. [6 marks]

Solution:

Concept:

- Planning decides in advance what is to be done and sets objectives and standards. Controlling compares actual performance with those standards, analyses deviations and initiates corrective action.
- Planning and controlling are inseparable functions of management: plans provide the basis for control, while control helps ensure that plans are implemented and supplies information for future planning.

Step 1: Establish why the two functions depend on each other

- **Planning provides the basis for controlling:** A plan specifies the objectives and the standards of performance to be achieved. The control process uses these standards as the yardstick for measuring actual results. Without a planned target, a manager cannot judge whether performance is satisfactory or determine the extent of a deviation. Controlling is therefore blind without planning.
- **Controlling makes planning meaningful:** Merely drawing up a plan does not ensure its achievement. Controlling checks whether activities are following the plan and enables managers to correct significant deviations. A plan without subsequent measurement and corrective action remains only a statement of intention. Planning is therefore meaningless without controlling.

Step 2: Explain their shared time orientation and feedback

- **Planning is forward-looking:** It involves selecting a future course of action and deciding the results to be achieved. Managers anticipate future conditions and specify what people should do to reach the desired position.
- **Controlling is backward-looking:** It examines actual performance that has already occurred and compares it with the standards fixed earlier. This review identifies where performance has departed from the plan.
- **Controlling is also forward-looking:** The purpose of identifying past deviations is to take corrective action and prevent their recurrence. The information obtained helps managers improve future operations and revise future plans, rather than merely criticise past results.
- **Planning also looks back through experience:** Future plans are prepared in the light of past experience and information supplied by control. Thus, both functions are backward-looking as well as forward-looking. For example, a shortfall against a sales target may lead to corrective selling efforts and also provide feedback for setting a more realistic target in the next planning period.

Step 3: Conclusion Planning and controlling are interdependent and form a continuous cycle. Planning sets the standards, controlling checks their achievement, and control feedback improves subsequent planning. Both functions use past information to improve future performance.

Quick Tip to Solve: Link the answer in a cycle: plans set standards, control compares results, corrective action follows, and feedback enters the next plan. Explain both time orientations rather than treating either function as concerned with only one period.

29(a). With the help of any four points, explain the importance of 'Delegation' in an organization.

[6 marks]

Solution:

Concept:

- Delegation is the transfer of authority from a superior to a subordinate to enable the subordinate to perform assigned duties. It comprises assignment of responsibility, grant of authority and creation of accountability.
- A manager can delegate authority but remains accountable to the superior for the results. Delegation therefore distributes work while retaining managerial oversight.

Step 1: Explain effective management and employee development

- **Effective management:** Delegation enables a manager to share routine work with subordinates. With a lighter personal workload, the manager can concentrate on important activities such as planning, policy decisions and coordination. The work is performed more effectively because managerial attention is directed to the matters that most require it.
- **Employee development:** When employees receive authority to handle tasks, they gain experience in decision-making and problem-solving. They learn to exercise judgement and accept responsibility for results. Their abilities develop through actual practice, preparing them to perform more demanding jobs in future.

Step 2: Explain motivation and facilitation of growth

- **Motivation of employees:** Giving authority demonstrates the superior's confidence in the subordinate. Employees feel trusted, recognised and important when they are allowed to make decisions concerning their work. This satisfaction encourages initiative, commitment and better performance rather than mere dependence on instructions.
- **Facilitation of growth:** Delegation develops a pool of capable managers who can take responsibility for new departments, products or locations. An enterprise can therefore expand its activities without every decision having to be handled by the existing top managers. Trained subordinates are available to shoulder new responsibilities as the organisation grows.

Step 3: Conclusion Delegation supports effective management, develops employees, motivates them through trust and recognition, and prepares the enterprise for growth. These four benefits explain why authority should be shared with responsibility while the superior retains ultimate accountability.

Quick Tip to Solve: Explain each benefit as a cause-and-effect link: sharing work frees the manager, while receiving authority develops and motivates the employee.

OR

29(b). 'Organizing involves a series of steps in order to achieve the desired goals.' Explain these steps. [6 marks]

Solution:

Concept:

- Organising translates plans into action by defining work, grouping related activities and establishing authority relationships. It creates a structure through which people can work together towards common objectives.
- The process has four connected steps: identification and division of work, departmentalisation, assignment of duties, and establishment of reporting relationships. Each step builds on the preceding one.

Step 1: Identify work and group related activities

- **Identification and division of work:** First identify the activities required to implement the plan. Divide the total work into manageable jobs so that no necessary activity is left out and the same work is not needlessly duplicated. Repeated performance of a specialised task enables employees to develop proficiency and makes the workload easier to handle.
- **Departmentalisation:** Group similar or related jobs into larger units or departments. The grouping can be based on functions, such as production, marketing and finance, or on products, according to the enterprise's requirements. Bringing related activities together facilitates specialisation and coordination within each department.

Step 2: Assign duties and establish reporting relationships

- **Assignment of duties:** Allocate the different jobs to individuals best suited to perform them, taking their qualifications, abilities and experience into account. Define each person's duties clearly so that employees understand the work expected of them. A proper match between the person and the job improves performance and makes responsibility identifiable.
- **Establishment of reporting relationships:** Clearly specify who will report to whom and who has authority to give instructions. Provide the authority needed to carry out the assigned duties. These superior-subordinate relationships establish the managerial hierarchy, clarify accountability and enable coordination among individuals and departments without confusion over commands.

Step 3: Conclusion Organising proceeds from dividing the required work to grouping jobs, assigning them to suitable people and defining reporting relationships. Together, these steps turn the plan into an orderly arrangement of duties and authority directed towards the desired goals.

Quick Tip to Solve: Remember the sequence as work, departments, people and relationships: identify the jobs before deciding who performs them and who supervises them.

30(a). Explain the following as factors affecting the requirements of fixed capital :

(i) Scale of operations

(ii) Choice of technique

(iii) Technology upgradation

(iv) Financing alternatives [6 marks]

Solution:

Concept:

- Fixed capital is the investment in long-term assets such as land, buildings, plant and machinery. These assets support production over several operating cycles rather than being consumed in one cycle.
- The fixed-capital requirement depends on the size of the business, the production method, the speed at which assets become obsolete and whether assets must be purchased or can be used through another arrangement.

Step 1: Explain scale of operations and choice of technique

- **(i) Scale of operations:** An organisation operating on a large scale generally needs more fixed capital than a small organisation carrying on similar activities. Greater output requires a larger production facility, more machines, more storage capacity and supporting infrastructure. A business with a smaller volume of operations can manage with fewer and smaller assets. The comparison therefore concerns the capacity needed to carry out operations, not merely the amount of day-to-day cash held.
- **(ii) Choice of technique:** A capital-intensive technique uses relatively more machinery and automation and therefore requires a larger investment in fixed assets. A labour-intensive technique relies relatively more on human labour and needs less investment in plant and machinery for comparable operations. Thus, the technique selected affects the amount committed to long-term assets; spending on wages under the labour-intensive method is an operating requirement rather than the purchase of fixed assets.

Step 2: Explain technology upgradation and financing alternatives

- **(iii) Technology upgradation:** In industries where technology changes rapidly, machinery and equipment become obsolete sooner even when they remain physically usable. Such businesses need funds to replace or upgrade assets frequently and therefore have a greater fixed-capital requirement. For example, equipment used in a business dependent on rapidly changing technology may need earlier replacement than equipment in an industry with relatively stable production methods.
- **(iv) Financing alternatives:** When a business can obtain the use of an asset through leasing, it need not commit the full purchase price to that asset at the outset. The availability of leasing and similar arrangements consequently reduces the amount of fixed capital that must be invested in owning assets. If the business must purchase the equipment outright, its initial fixed-capital requirement is higher. Lease rentals remain payable, so leasing reduces the initial investment rather than making the asset's use free.

Step 3: Conclusion Larger operations, capital-intensive production and rapid technological obsolescence generally raise fixed-capital requirements. The availability of leasing can reduce the initial investment needed to obtain the use of fixed assets.

Quick Tip to Solve: For each factor, link it to the amount invested in long-term assets: capacity, machinery intensity, replacement frequency and purchase versus lease.

OR

30(b). Explain the following as factors affecting the dividend decision :

(i) Stability of dividend

(ii) Shareholders' preference

(iii) Access to capital market

(iv) Legal constraints [6 marks]

Solution:

Concept:

- The dividend decision determines how much of the profit available to equity shareholders is distributed to them and how much is retained in the business for future requirements.
- Management considers continuity of dividend, shareholders' income needs, the firm's ability to raise funds externally and the legal rules governing distribution before deciding the payout.

Step 1: Explain stability of dividend and shareholders' preference

- **(i) Stability of dividend:** Companies generally follow a policy of maintaining a stable dividend per share. Shareholders value a reasonably dependable income, so management does not normally change the dividend merely because earnings fluctuate temporarily. An increase in dividend is generally made when the company is confident that the higher earnings can be maintained. Thus, a temporary rise in profit may be retained rather than immediately distributed as a permanently higher dividend.
- **(ii) Shareholders' preference:** Management takes account of whether shareholders prefer regular dividend income or capital appreciation through retention and reinvestment of profits. If shareholders depend on current income and favour dividends, the company is likely to consider a higher payout, subject to its other requirements. If they prefer profits to be reinvested for future growth, the company may retain a larger share of earnings. The preference influences the decision but does not remove the need to assess the company's funds and investment needs.

Step 2: Explain access to capital market and legal constraints

- **(iii) Access to capital market:** Large, established companies with a good reputation can generally raise funds from the capital market more easily. They may therefore distribute a larger proportion of profits as dividends because external finance can be obtained for future needs. A company with limited access to the market is more dependent on retained earnings as an internal source of finance and is likely to retain more profit and pay a lower dividend.
- **(iv) Legal constraints:** The law lays down conditions governing the declaration and payment of dividends. A company must comply with these conditions, including the rules concerning the profits legally available for distribution and required provisions such as depreciation. Management therefore has to determine the distributable amount under the applicable company law before deciding the payout. A desire to reward shareholders cannot justify declaring a dividend that breaches these legal restrictions.

Step 3: Conclusion A stable payout policy, shareholders' preference for current income, easier access to external capital and the legally distributable profits together influence the dividend decision. The company balances these considerations while deciding the portion of earnings to distribute and retain.

Quick Tip to Solve: Explain each dividend factor through its effect on payout or retention, and remember that shareholder preferences operate within legal limits.