CBSE Class 12 Business Studies Question Paper 2022 with Solution PDF-Set 66/1/1

Question Paper with Solutions

Conducted by the Central Board of Secondary Education (CBSE)

Time Allowed: 2 hours **Maximum Marks: 40**

General Instructions

(i) This question paper contains **12** questions.

(ii) Question numbers **1 – 4** are of **2** marks. These are Short Answer Type Questions and are to be answered in **30-50** words.

(iii) Question numbers **5 – 8** are of **3** marks. These are Short Answer Type Questions and are to be answered in **50-80** words.

(iv) Question numbers **9 – 12** are of **5** marks. These are Long Answer Type Questions and are to be answered in **80-120** words.

(v) There is no over-all choice in the question paper. However internal-choice has been given in **1** question of **3** marks and **2** questions of **5** marks each.

(vi) This question paper contains Case/Source Based questions.

1. Identify and state the step in the process of staffing under which the charge of the job is given to the selected employee and he/she is introduced to his/her superiors, subordinates and colleagues.

[2 marks]

Solution:

Concept:

- Staffing involves obtaining and developing suitable employees and putting the right person on the right job.
- Placement and orientation follow selection: placement assigns the job, while orientation familiarises the new employee with the organisation and its people.

Step 1: Identify the staffing step The step is **placement and orientation**. The expressions "charge of the job is given" and "introduced to his/her superiors, subordinates and colleagues" identify the two connected activities performed after an employee has been selected.

Step 2: State the two activities **Placement:** The selected employee occupies the position or post for which he or she has been selected and is given charge of that job. **Orientation:** The employee is introduced to the organisation, its policies and work environment, and to superiors, subordinates and colleagues. This helps the employee become familiar with the workplace and begin work with confidence.

Step 3: Conclusion The required step is **placement and orientation**: giving charge of the job is placement, and introducing the employee to the people and organisation is orientation.

Quick Tip to Solve: Link "job charge" with placement and "introduction to people" with orientation; together they name this staffing step.

2. KLM Bank Ltd. is a leading bank with various branches across the country. On 27th Jan. 2022, it faced a sudden temporary shortage in cash balance in one of its branches. On the same day, it was decided by its directors to borrow funds from another bank for two days to maintain its cash reserve ratio.

Identify and explain the money market instrument used by KLM Bank Ltd. to meet its short term funds requirement.

[2 marks]

Solution:

Concept:

- The money market deals in short-term funds through instruments with a maturity of up to one year.
- Call money is short-term finance repayable on demand, used by banks for inter-bank transactions to manage temporary shortages and meet cash reserve requirements.

Step 1: Identify the instrument from the case The instrument is **call money**. KLM Bank Ltd. faces a "sudden temporary shortage in cash balance" and borrows "from another bank for two days" to maintain its cash reserve ratio. A very short-term inter-bank loan for this purpose is the characteristic use of call money.

Step 2: Explain call money Call money provides short-term finance that is repayable on demand, generally for a period ranging from one day to fifteen days. Banks use it to borrow from one another when their cash balances temporarily fall short of requirements. It enables a bank to maintain the cash reserve ratio prescribed by the Reserve Bank of India. The interest payable on these loans is called the call rate and varies with the demand for and supply of such funds.

Step 3: Conclusion KLM Bank Ltd. uses **call money**, a short-term inter-bank borrowing arrangement, to cover its two-day cash shortage and maintain the required cash reserve ratio.

Quick Tip to Solve: A temporary bank-to-bank loan for maintaining cash reserves signals call money; focus on the lender and the very short period.

3. Give the meaning of 'Communication' as an element of directing. [2 marks]

Solution:

Concept:

- Directing guides, instructs, motivates and leads employees towards achieving organisational objectives.
- Communication is the exchange of information between people so that the receiver understands the meaning intended by the sender.

Step 1: State the meaning of communication **Communication** is the process of exchange of ideas, views, facts, feelings or other information between two or more persons to reach a common understanding. It involves a sender conveying a message to a receiver through a suitable channel. The receiver interprets the message, and feedback helps the sender know whether it has been understood correctly.

Step 2: Explain it as an element of directing Through communication, a manager conveys instructions, explains duties and informs employees about what is expected of them. Employees can also communicate their suggestions, difficulties and responses to the manager. Thus, communication enables direction by creating shared understanding between the people involved. Merely sending words is insufficient if the receiver does not understand their intended meaning.

Step 3: Conclusion Communication, as an element of directing, means exchanging information, ideas and feelings between people to create a common understanding and guide their work towards organisational goals.

Quick Tip to Solve: Include both "exchange of information" and "common understanding" in the definition; transmission alone does not complete communication.

4. Identify and state the function of management which ensures that the organisational resources are being used effectively and efficiently for the achievement of pre-determined goals. [2 marks]

Solution:

Concept:

- Controlling is the management function that checks whether activities are being carried out according to predetermined plans and standards.
- It supports effective and efficient use of organisational resources by identifying deviations and ensuring that corrective action is taken.

Step 1: Identify the function The function is **controlling**. The clue is that resources must be used "effectively and efficiently" to achieve "pre-determined goals". Managers need to check actual performance against what was planned so that activities remain directed towards those goals.

Step 2: State its meaning Controlling means measuring actual performance, comparing it with predetermined standards, and analysing deviations so that corrective measures can be taken. If performance falls short of the standard, management identifies the cause and corrects it. This prevents waste of resources and helps the organisation achieve the results envisaged in its plans.

Step 3: Conclusion **Controlling** ensures that organisational activities conform to plans by comparing actual performance with standards and taking corrective action when needed.

Quick Tip to Solve: Link "pre-determined goals" and "efficient use of resources" with checking performance against standards: these are clues to controlling.

5. Nandita Srivastava is the Human Resource Manager of 'TM Infrastructure Ltd.' It is one of the largest construction companies in India. The company handles projects worth more than ₹ 18,000 crore.

The responsibilities of Nandita Srivastava include searching and hiring suitable people for different posts in the organisation.

To measure certain characteristics of potential candidates, who apply for various vacancies, she is required to conduct a series of selection tests appropriate for different posts. These tests will help her to predict for which job the applicant will be successful, if hired.

Explain any two types of selection tests that may be conducted by Nandita Srivastava to select the most suitable persons. [3 marks]

Solution:

Concept:

- Selection tests are instruments used to measure characteristics of potential employees. They help predict whether an applicant is likely to be successful in a particular job.
- Different tests assess different attributes, such as learning potential or existing job-related skills. The test chosen should match the requirements of the post.

Step 1: Explain aptitude tests **Aptitude tests:** These measure an individual's potential for learning new skills. They indicate the person's capacity to develop and help predict future success in a job after

suitable training. Nandita can use an aptitude test when a post requires candidates to acquire new technical or other job-related skills. A strong aptitude indicates learning potential; it does not by itself establish that the applicant already possesses the required skill.

Step 2: Explain trade tests **Trade tests:** These measure the existing skills and knowledge that an applicant already possesses in a particular trade or occupation. They assess the level of professional or technical proficiency and therefore help establish whether the candidate can perform the work required for the vacancy. For a suitable technical post in the construction company, Nandita can use a practical job-related test to assess present competence. Thus, unlike an aptitude test, a trade test focuses on acquired proficiency rather than the potential to learn.

Step 3: Conclusion Nandita may conduct **aptitude tests** to assess learning potential and **trade tests** to assess existing occupational skills and knowledge, selecting tests appropriate to the requirements of each post.

Quick Tip to Solve: Remember the distinction: aptitude tests ask what a candidate can learn; trade tests ask what the candidate already knows and can do.

6(a). What is meant by non-monetary incentives ? State any two non-monetary incentives. [3 marks]

Solution:

Concept:

- Non-monetary incentives are rewards that motivate employees by satisfying their psychological, social and emotional needs rather than by directly adding to their monetary income.
- Employees seek recognition, responsibility, belonging and opportunities to grow as well as financial rewards. A manager selects incentives according to the needs of the employees concerned.

Step 1: Explain the meaning of non-monetary incentives These incentives do not primarily take the form of money payments. They encourage employees through respect, appreciation, greater responsibility or personal development. For example, public appreciation of good performance can satisfy an employee's need for recognition and encourage continued effort.

Step 2: State two suitable non-monetary incentives

- **Employee recognition programmes:** Acknowledging and appreciating an employee's contribution, such as praising good performance in a meeting or presenting a certificate of merit, makes the employee feel valued. Recognition reinforces desirable behaviour and motivates the employee to maintain high performance.
- **Job enrichment:** Giving employees more challenging and meaningful work, greater responsibility and opportunities to use their abilities makes the job more satisfying. Such work provides scope for personal growth and a sense of achievement, encouraging employees to contribute willingly.

Step 3: Conclusion Non-monetary incentives motivate through the satisfaction of needs other than direct financial gain. Employee recognition programmes and job enrichment are two examples.

Quick Tip to Solve: Link each example to the need it satisfies: recognition gives appreciation, while job enrichment provides challenge, responsibility and achievement.

OR

6(b). State any three benefits of training to the organisation. [3 marks]

Solution:

Concept:

- Training is a systematic process of increasing employees' knowledge and skills for performing a particular job. It improves their ability to carry out the work assigned to them.
- The benefits to an organisation arise when trained employees use resources effectively, improve performance and prepare to take on greater responsibility.

Step 1: Relate training to organisational performance Organised training gives employees the methods and practice needed to perform their jobs correctly. Instead of relying entirely on trial and error, employees learn the required procedures systematically. The organisation benefits through better use of its resources and a workforce capable of meeting its needs.

Step 2: State three benefits to the organisation

- **Economy and reduced wastage:** Training is a systematic approach to learning and is better than learning only by trial and error. Employees learn correct methods of handling work and resources, reducing the wastage of time, effort and materials.
- **Higher productivity and profitability:** By improving employees' skills, training enables them to produce better-quality work and increases their output. More effective performance contributes to higher productivity and, consequently, greater profitability for the organisation.
- **Preparation of future managers:** Training equips employees with the knowledge and abilities needed for greater responsibilities. It helps the organisation develop personnel who can take over managerial positions when a need or emergency arises, supporting continuity of operations.

Step 3: Conclusion Training benefits the organisation by reducing wastage, improving productivity and profitability, and developing employees who can take up future managerial responsibilities.

Quick Tip to Solve: Keep the focus on the organisation: mention economy in resources, improved performance and a supply of capable future managers, rather than only personal career benefits.

7. State any three factors affecting working capital requirements of a company. [3 marks]

Solution:

Concept:

- Working capital finances day-to-day business operations, such as holding inventories, allowing credit to customers and paying operating expenses.
- Its requirement depends on the time and amount of funds tied up in current assets. A longer operating cycle or a larger scale generally requires more working capital.

Step 1: State the effect of the nature of business **Nature of business:** A trading concern usually needs less working capital than a manufacturing concern. A manufacturer must hold raw materials and work-in-progress as well as finished goods, whereas a trader primarily holds finished goods for

resale. Service businesses generally hold little inventory and therefore require comparatively less working capital.

Step 2: State the effect of the scale of operations **Scale of operations:** A company operating on a larger scale requires a larger absolute amount of working capital. It has to maintain more inventory, support a larger volume of credit sales and meet higher day-to-day operating expenses. A smaller business generally needs a smaller amount to finance these activities.

Step 3: State the effect of the production cycle **Production cycle:** The longer the period between acquiring raw materials and completing production, the greater the working capital requirement. Funds remain invested in raw materials and work-in-progress until the goods are finished and sold. A shorter production cycle releases funds sooner and reduces the amount tied up in operations.

Step 4: Conclusion Three factors affecting working capital requirements are the nature of business, scale of operations and length of the production cycle.

Quick Tip to Solve: Link each factor to funds tied up in inventory, receivables or daily expenses, and state whether it raises or lowers the requirement.

8. Explain how controlling helps in 'accomplishing organisational goals' and 'judging accuracy of standards'. [3 marks]

Solution:

Concept:

- Controlling is the management function of comparing actual performance with predetermined standards and taking corrective action when necessary.
- It checks whether activities follow the plan and provides feedback about both performance and the suitability of the standards themselves.

Step 1: Explain accomplishment of organisational goals **Accomplishing organisational goals:** Controlling measures progress towards organisational goals by comparing actual results with the standards established in planning. It brings deviations to management's notice so that corrective action can be taken before the deviations seriously obstruct the plan. For example, if output falls below the planned level, managers investigate the cause and take suitable action to restore performance. In this way, controlling guides activities back towards the intended results and helps the organisation accomplish its goals.

Step 2: Explain judgement of the accuracy of standards **Judging accuracy of standards:** An effective control system enables management to verify whether its standards are accurate and objective. When actual performance is compared with a standard, an apparent deviation may reveal that the standard was unrealistic or based on unsuitable assumptions, rather than that employees performed poorly. Managers review the standard in the light of changes in the organisation and its environment. If necessary, they revise it to make it realistic. Thus, controlling keeps standards relevant and allows fair assessment of future performance.

Step 3: Conclusion Controlling helps achieve organisational goals by identifying deviations and prompting corrective action. It also tests the accuracy of standards and supports their revision when

they no longer provide a realistic basis for comparison.

Quick Tip to Solve: Separate the two benefits: correcting performance helps achieve goals, while reviewing the benchmark helps judge the standard itself.

9(a). Explain the following consumer rights provided under the Consumer Protection Act, 2019 :

(i) Right to safety

(ii) Right to be informed [5 marks]

Solution:

Concept:

- Consumer protection recognises rights that safeguard buyers against unsafe products and unfair business practices. The Consumer Protection Act, 2019 provides both the right to safety and the right to be informed.
- Safety protects the consumer's life and health; information enables the consumer to assess a product and make an informed choice before buying or using it.

Step 1: Explain the right to safety

- **Protection against hazards:** A consumer has the right to be protected against the marketing of goods and services that are hazardous to life and health. Products should not expose the user to avoidable danger when used as directed.
- **Assurance of quality and safety:** Consumers should purchase quality-marked products, such as electrical appliances carrying the ISI mark. Such quality certification helps the buyer identify goods conforming to prescribed standards. For example, a safe electrical appliance should protect its user against risks such as electric shock.

Step 2: Explain the right to be informed

- **Complete product information:** A consumer has the right to information about the quality, quantity, potency, purity, standard and price of goods or services. This information protects the buyer against unfair trade practices and enables a reasoned purchase decision.
- **Disclosure through labels:** A product's label should provide relevant details such as its ingredients, net weight, price, date of manufacture, expiry date and directions or precautions for use, wherever applicable. For example, a buyer of packaged food can check the ingredients and expiry date before purchase.
- **Informed comparison and use:** These disclosures help consumers compare alternatives, know what they are paying for and use the product properly. A seller should not conceal material information that the buyer needs to judge the product.

Step 3: Conclusion The right to safety protects consumers against goods and services hazardous to life and health. The right to be informed gives them the product and price details needed to choose intelligently and guard against unfair trade practices.

Quick Tip to Solve: Link safety with protection from hazards and quality marks; link information with label details such as ingredients, quantity, price and expiry date.

OR

9(b). State any five responsibilities that should be kept in mind by a consumer while purchasing and using/consuming goods and services. [5 marks]

Solution:

Concept:

- Consumer protection is effective when consumers exercise their rights and also discharge their responsibilities while buying and using goods and services.
- A responsible consumer makes an informed purchase, checks quality and product information, and preserves evidence of the transaction for seeking redressal if necessary.

Step 1: Follow these responsibilities while selecting and buying

- **Be aware of available goods and services:** Find out about the different products and services available in the market. Compare their price, quality and suitability so that the purchase is an intelligent choice rather than a decision based only on an advertisement or a seller's persuasion.
- **Buy standardised goods:** Prefer products carrying appropriate quality certification marks, such as ISI on electrical goods, the Hallmark on jewellery and AGMARK on agricultural products. Checking the relevant mark helps the consumer obtain an assurance of the prescribed quality for that category of goods.
- **Read labels carefully:** Examine the label before purchasing. Check the price, net weight or quantity, manufacturing and expiry dates, ingredients where relevant, and other product particulars. This helps the consumer avoid expired products and assess what is actually being purchased.

Step 2: Use the product safely and keep proof of purchase

- **Learn about risks and follow instructions:** Find out the risks associated with the product or service, read the manufacturer's instructions and use it safely. Observe the recommended method of operation and precautions instead of using the product carelessly or in a manner for which it was not designed.
- **Ask for a cash memo:** Insist on a cash memo or bill at the time of purchase and preserve it. It is documentary proof of the transaction and supports a complaint when the goods are defective or the service is deficient; without such evidence, establishing the purchase may be difficult.

Step 3: Conclusion Five consumer responsibilities are to be aware of market choices, buy standardised goods, read labels carefully, follow safety instructions and insist on a cash memo. Together these precautions support informed buying, safe consumption and effective redressal.

Quick Tip to Solve: Organise the answer as three checks before buying (choices, quality mark and label) and two duties linked to use and redressal (safety instructions and the bill).

10. State any five functions of a 'Stock Exchange'. [5 marks]

Solution:

Concept:

- A stock exchange is an institution that provides a platform for buying and selling existing securities. Its functions support investors as well as the flow of savings into productive investment.
- Trading on a stock exchange takes place within a regulated framework. Prices reflect the interaction of demand and supply for securities in the market.

Step 1: State the functions relating to trading and prices

- **Providing liquidity and marketability to existing securities:** A stock exchange provides a ready and continuous market in which investors can buy and sell securities already issued by companies. An investor who needs funds can sell the investment rather than wait for its maturity. Thus, an investment can be converted into cash without withdrawing capital from the company that issued the security.
- **Pricing of securities:** The forces of demand and supply determine the prices of securities through stock-exchange trading. These prices provide information about the value of investments. Investors can use the quoted prices to assess their holdings and decide whether to buy or sell, while the market's valuation also guides the allocation of funds.

Step 2: State the functions relating to safety, growth and ownership

- **Safety of transactions:** The dealings of a stock exchange are conducted within a well-defined legal framework. Listed companies must comply with its rules and regulations, and trading is subject to regulatory oversight. This promotes fair dealing and protects investors against malpractices; it does not mean that market prices cannot fall.
- **Contributing to economic growth:** Through the buying and selling of securities, funds are directed towards investments that investors consider more productive. The process of disinvestment and reinvestment facilitates capital formation and improves the allocation of resources, thereby contributing to economic growth.
- **Spreading of equity cult:** A stock exchange encourages people to invest in shares by educating the investing public, regulating new issues and promoting better trading practices. By making equity investment more accessible and familiar, it broadens share ownership among the public.

Step 3: Conclusion Five functions of a stock exchange are providing liquidity and marketability to existing securities, pricing securities, ensuring safety of transactions, contributing to economic growth, and spreading the equity cult.

Quick Tip to Solve: Recall the functions through five headings: liquidity, prices, safety, growth and equity ownership. Give a short explanation of each rather than listing the headings alone.

11. Gautam Natarajan is the founder of 'Brewed Beans Coffee', a famous chain of 21 outlets in South India, selling high quality filter coffee.

He is known for his leadership and vision. He believes that human resources, are the most important assets of an organisation. He often quotes, "The right people can help you take your business to the top, the wrong people can break your business." This is the reason he considers the function of management that fills the various positions in the organisation structure to be the most critical and fundamental to organisational performance.

(a) Identify the function of management that has been emphasised by Gautam Natarajan.

(b) State any four points of importance of function identified in (a) above. [5 marks]

Solution:

Concept:

- Staffing is the managerial function of filling and keeping filled the positions in an organisation structure. It places suitable people in the jobs required to achieve organisational objectives.
- The importance of staffing follows from its concern with human resources: competent employees must be identified, selected, developed and retained so that other resources are used effectively.

Step 1: Identify the function from the case **(a) Staffing.** Gautam Natarajan emphasises the function that "fills the various positions in the organisation structure". This directly describes staffing. His belief that "human resources are the most important assets" and his emphasis on the "right people" also point to obtaining and maintaining a suitable workforce for Brewed Beans Coffee.

Step 2: State four points of importance **(b) The importance of staffing is as follows:**

- **Obtaining competent personnel:** Staffing helps an organisation discover and obtain competent people for its different jobs. A sound recruitment and selection process identifies people with the abilities and qualifications required for the positions to be filled.
- **Higher performance through the right person on the right job:** Matching an employee's abilities with the requirements of the job improves performance. Employees can contribute more effectively when the work assigned to them suits their competence.
- **Continuous survival and growth:** Staffing provides for the development of managers through management succession planning. Preparing suitable people to assume future responsibilities helps maintain continuity and supports the organisation's growth.
- **Optimum utilisation of human resources:** Staffing helps avoid both overstaffing and understaffing. By maintaining an appropriate number of employees and assigning work according to their capabilities, the organisation uses its available human resources more effectively.

Step 3: Conclusion Gautam Natarajan is emphasising **staffing**. It obtains competent personnel, improves performance by placing the right person on the right job, supports survival and growth through succession planning, and ensures optimum utilisation of human resources.

Quick Tip to Solve: Link "filling positions" with staffing. For its importance, distinguish obtaining suitable people, matching them to jobs, preparing successors and using the workforce optimally.

12(a). **Anurag Tiwari is a famous news reader. He has recently started a news company 'Axis Media Corporation Ltd.'. The aim of this company is to launch a 24-hour Hindi news channel to broadcast latest news from India and around the world.**

For this new venture, the company will have to decide how to invest funds in different assets. The purchase of few assets like equipment, computers, vehicles, etc. will involve committing the finance on a long-term basis. It will affect earning capacity of the business in the long run. Therefore, the company needs to take the decision to invest in such assets with utmost care.

(a) Identify and state the type of investment decision discussed in the above paragraph.

(b) State any three factors which affect the decision identified in (a) above. [5 marks]

Solution:

Concept:

- An investment decision concerns the allocation of the firm's funds to different assets. A long-term investment decision is also called a capital budgeting decision.
- Capital budgeting involves committing funds to fixed assets for a long period. Such decisions influence the earning capacity and profitability of the business over many years and generally involve substantial funds and risk.

Step 1: Identify the decision from the case **(a) Long-term investment decision or capital budgeting decision:** Axis Media Corporation Ltd. must choose how to invest in equipment, computers and vehicles for its news channel. The phrases "committing the finance on a long-term basis" and "affect earning capacity of the business in the long run" identify capital budgeting. It means deciding the amount of funds to be invested in long-term assets or projects. The company must evaluate such commitments carefully because the funds remain tied up for a long time and an unsuitable investment can affect future profitability.

Step 2: Explain the factors affecting capital budgeting **(b) The following three factors affect this decision:**

- **Cash flows of the project:** An investment generates a series of cash receipts and payments over its life. Axis Media must assess the expected cash inflows and outflows, including their timing, before committing funds. The size and timing of these flows help determine whether the investment is financially worthwhile.
- **Rate of return:** The expected return from each investment proposal must be assessed along with the risk involved. Other things being equal, the company should prefer the proposal offering a higher rate of return. The return should justify the funds committed and the risk assumed.
- **Investment criteria involved:** Capital budgeting requires consideration of the amount of investment, interest rate, cash flows and rate of return. The company applies appropriate capital budgeting techniques to evaluate alternative proposals against these criteria and select the most suitable investment.

Step 3: Conclusion The decision is a **long-term investment or capital budgeting decision**: investing funds in assets that affect the business over the long run. Its three principal factors are the **cash flows of the project, rate of return and investment criteria involved**.

Quick Tip to Solve: A decision about buying long-term assets is capital budgeting. A decision about the mix of debt and equity is a financing decision; identify what the company is choosing before listing factors.

OR

12(b). 'Reliable Labs Ltd.' is a trusted name in diagnostic services with seven branches spread across the city of Pune. The directors of this company have projected that with the rise in health consciousness in the society and the rising burden of chronic diseases, the demand for diagnostic tests is expected to grow in future. Considering this, they decided to open branches of their diagnostic labs in Ahmedabad.

It was estimated that it will require ₹ 100 crore of additional funds. The directors have to take the decision about how much funds should be raised from equity capital and how much from debt. It will affect the overall cost of capital and the financial risk of the company.

(a) Identify and state the financial decision discussed in the above paragraph.

(b) State any three factors that should be kept in mind by the Board of Directors of 'Reliable Labs Ltd.', while taking the decision identified in (a) above. [5 marks]

Solution:

Concept:

- Financial Management concerns procuring and using funds effectively. A financing decision determines the sources from which a business raises the finance it needs.
- The choice between owners' funds, such as equity share capital, and borrowed funds, such as debt, determines the company's capital structure. Each source has its own cost, repayment obligations and financial risk.

Step 1: Identify and state the financial decision The decision is the **financing decision**. It concerns the amount of finance to be raised from different long-term sources, particularly the proportion of owners' funds and borrowed funds. Reliable Labs Ltd. needs additional funds for its Ahmedabad expansion, and the directors must decide "how much funds should be raised from equity capital and how much from debt." This choice of sources, rather than the purchase of particular assets, is what identifies the financing decision.

Step 2: State three factors affecting the choice of finance

- **Cost:** The costs of raising funds from different sources differ. The directors should compare the cost of equity with the cost of debt and choose an appropriate combination that minimises the overall cost of capital. A source must be evaluated on its cost rather than selected merely because it is readily available.
- **Risk:** Debt creates a fixed obligation to pay interest and repay principal, so it carries financial risk for the company. Equity does not involve compulsory interest payments or repayment in the same manner. The directors should ensure that the debt component does not expose the business to excessive fixed financial commitments.
- **Cash flow position:** A strong cash flow position makes it easier to use debt because interest and principal must be paid when due. If cash flows are weak or uncertain, greater reliance on equity is safer. Reliable Labs should assess the expected availability and timing of cash flows before committing itself to debt servicing.

Step 3: Conclusion (a) Reliable Labs Ltd. is taking a **financing decision**: choosing the sources and proportions of finance, especially equity and debt. (b) Three relevant factors are **cost, risk and cash**

flow position. Together, these help the directors select a suitable financing mix for the expansion.

Quick Tip to Solve: Choosing where funds come from signals a financing decision. Link debt to its cost, fixed payment risk and the cash needed to service it.