CBSE Class 12 Business Studies Question Paper 2022 with Solution PDF-Set 66/3/3

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. 'Gujarat Textiles Ltd.' needs to raise a fund of ₹ 80 crore. It cannot afford the cost of a public issue, so it was decided to allot its equity shares to institutional investors like LIC and some selected investors.

Identify and explain the method of floating new issues used by 'Gujarat Textiles Ltd'. [2 marks]

Solution:

Concept:

- Financial Markets: the primary market deals in new securities through which a company raises fresh capital from investors.
- Private placement is the allotment of securities by a company to institutional investors and some selected individuals rather than offering them to the general public.

Step 1: Identify the method from the investors approached The method is **private placement**. Gujarat Textiles Ltd. proposes to allot its equity shares to "institutional investors like LIC and some selected investors". This restricted group of investors, rather than the general public, is the decisive clue.

Step 2: Explain how private placement meets the company's need Under private placement, a company raises capital by directly placing its securities with institutional buyers and selected investors. It avoids the extensive formalities and substantial issue expenses associated with a public issue. Thus, this method suits Gujarat Textiles Ltd., which needs Rs 80 crore but "cannot afford the cost of a public issue".

Step 3: Conclusion Gujarat Textiles Ltd. is using **private placement**: it will raise the required capital by allotting new equity shares to institutional investors and selected investors instead of inviting subscriptions from the public.

Quick Tip to Solve: Link an issue to a selected group of institutions or individuals with private placement; an invitation to the general public indicates a public issue.

2. One of the functions of management completes one cycle of management process and improves planning in the next cycle in the light of the problems that were identified in the existing plans.

Identify and state the function of management discussed above. [2 marks]

Solution:

Concept:

- Controlling is the management function that ensures that activities in an organisation are performed according to the plans.
- Planning provides the standards for control, while information obtained through controlling helps managers improve future plans.

Step 1: Identify the function described in the statement The function is **controlling**. The clue is that it "completes one cycle of management process" and improves the next cycle's planning by revealing the problems in existing plans. Control supplies feedback about whether the intended results have actually been achieved.

Step 2: State the meaning of controlling Controlling means measuring actual performance, comparing it with predetermined standards, analysing deviations and taking corrective action wherever necessary. This process helps ensure that organisational resources are used effectively and efficiently for achieving predetermined goals. The problems and deviations identified through control also help managers revise standards and prepare better plans for the next cycle.

Step 3: Conclusion The function is **controlling**: it checks actual performance against planned standards and initiates corrective action so that organisational goals are achieved.

Quick Tip to Solve: When a case refers to checking results, correcting deviations or feeding information into the next planning cycle, identify controlling.

3. Give the meaning of 'Free Rein style of Leadership'. [2 marks]

Solution:

Concept:

- Directing: leadership is the process of influencing people's behaviour so that they willingly work towards organisational objectives.
- The free rein or laissez-faire style gives subordinates a high degree of independence in making decisions and carrying out their work.

Step 1: State the meaning of free rein leadership **Free rein leadership** is a style in which the leader gives subordinates considerable freedom to formulate their own objectives and decide how to achieve them. The leader makes little use of authority and allows group members to make decisions within the broad framework of organisational objectives.

Step 2: Explain the respective roles of the leader and the group Group members work largely on their own and assume responsibility for planning and performing their tasks. The leader supports their efforts by supplying information and resources, serving as a contact with the external environment and assisting when needed. Thus, the style involves a low degree of direct interference by the leader, rather than close supervision or the leader deciding every detail of the work.

Step 3: Conclusion Free rein leadership means allowing subordinates substantial independence in deciding goals and methods of work, while the leader provides support and facilitates their performance.

Quick Tip to Solve: Remember free rein as freedom with support: subordinates make decisions, while the leader facilitates rather than closely directs their work.

4. Identify and state the step in the process of staffing which creates a pool of prospective job seekers for vacancies in the organisation. [2 marks]

Solution:

Concept:

- Staffing involves finding suitable people for organisational positions; recruitment is the step that attracts potential applicants.
- Recruitment means searching for prospective employees and stimulating them to apply for jobs in the organisation. It creates the applicant pool from which selection is made.

Step 1: Identify the staffing step The step is **recruitment**. The clue is the phrase "creates a pool of prospective job seekers". At this stage the organisation attracts people who may be suitable for its vacancies, rather than choosing the final employees.

Step 2: State what recruitment involves Recruitment is the process of searching for prospective employees and encouraging them to apply for jobs in the organisation. The organisation identifies sources of candidates and invites applications, thereby building a pool of applicants for its vacant positions. Selection follows recruitment and evaluates these applicants to choose the most suitable persons.

Step 3: Conclusion **Recruitment** is the staffing step that searches for prospective employees and stimulates them to apply, creating a pool of candidates for organisational vacancies.

Quick Tip to Solve: Link "attract applicants" or "create a pool" with recruitment; link "choose the best applicant" with selection.

5. Explain how controlling helps in 'making efficient use of resources' and 'improving employee motivation'. [3 marks]

Solution:

Concept:

- Controlling compares actual performance with predetermined standards, identifies deviations and enables corrective action.
- Its importance includes making efficient use of resources and improving employee motivation by clarifying performance expectations and evaluating achievement against them.

Step 1: Explain efficient use of resources **Making efficient use of resources:** Controlling requires activities to be performed according to predetermined standards. Managers compare actual use of resources and results with these standards, locate avoidable wastage or inefficiency and take corrective action. This helps prevent unnecessary consumption of materials, time, money and effort. Resources are consequently used effectively and efficiently instead of being wasted in activities that deviate from the plan.

Step 2: Explain the effect on employee motivation **Improving employee motivation:** Control standards tell employees clearly what they are expected to do and the level of performance on which they will be assessed. Employees therefore know the goals towards which their efforts should be

directed. When performance is evaluated against these known standards and suitable rewards are linked to achievement, employees are encouraged to perform better. Clarity about expectations and the basis of assessment improves their motivation to meet organisational targets.

Step 3: Conclusion Controlling improves resource efficiency by checking performance against standards and reducing wastage. It improves employee motivation by making expected performance and its assessment clear and linking achievement with appropriate rewards.

Quick Tip to Solve: For each importance of controlling, connect the control mechanism to its benefit: standards reduce wastage and clear assessment motivates employees.

6. The Human Resource Department of 'Oberoi's Airlines Pvt. Ltd.' has recently selected 11 pilots. The new pilots have to handle sophisticated equipment. For this, the Human Resource Manager wants to design an off-the-job training programme which will help them to improve their performance on their jobs.

Identify and explain the method of training that can be used by the company in the given situation.

[3 marks]

Solution:

Concept:

- **Staffing:** Training improves an employee's knowledge and skills for performing a particular job more effectively.
- **Off-the-job training:** Employees learn away from the actual work setting. Vestibule training is useful where employees must learn to operate sophisticated machinery and equipment.

Step 1: Identify the suitable training method The company should use **vestibule training**. The case states that the 11 newly selected pilots must handle "sophisticated equipment" and that the manager wants an "off-the-job training programme". These clues point to training in an environment resembling the workplace, rather than learning while operating an actual passenger flight.

Step 2: Explain how vestibule training works **Reproduce the work environment:** The equipment the employees will use on their jobs is provided in a separate training location, away from the actual work floor. The trainees practise operating it under the guidance of trained instructors. For the pilots, the training arrangement reproduces the relevant cockpit equipment and operating conditions so that they can learn the required procedures before undertaking their regular duties.

Develop skill without disrupting operations: Repeated practice enables the new pilots to become familiar with the controls and to improve the accuracy and confidence with which they handle the equipment. Since practice takes place outside the actual operating environment, training does not interrupt the company's normal flight operations or expose its operating equipment and passengers to the risks of inexperienced handling.

Step 3: Conclusion Vestibule training is the appropriate method: the new pilots can practise with equipment in a separate setting that resembles their actual workplace, thereby developing the skills needed to perform their jobs effectively.

Quick Tip to Solve: Link "sophisticated equipment" plus "off-the-job" to vestibule training: the workplace is reproduced in a separate training setting.

7(a). What is meant by financial incentives ? State any two financial incentives. [3 marks]

Solution:

Concept:

- **Directing and motivation:** An incentive is a stimulus offered to encourage employees to improve their performance and contribute to organisational objectives.
- **Financial incentives:** Monetary rewards, including benefits measurable in money, help satisfy employees' financial needs and motivate them to work better.

Step 1: Define financial incentives **Meaning:** Financial incentives are incentives which are in direct monetary form or can be measured in monetary terms. They serve to motivate employees for better performance by increasing their earnings or providing them with benefits having a money value. Such incentives may be offered to an individual employee or to a group, depending on the work and the organisation's reward policy.

Step 2: State two financial incentives **Bonus:** A bonus is an incentive offered over and above the wages or salary paid to employees. It is an additional monetary reward and may be linked to individual or organisational performance. The prospect of receiving this extra payment can encourage employees to put in greater effort.

Profit sharing: Under profit sharing, employees receive a share in the profits of the organisation. It connects their monetary reward with the organisation's financial results. Employees therefore have an incentive to contribute to higher productivity and better overall performance, since an improvement in organisational profits can also increase their reward.

Step 3: Conclusion Financial incentives are rewards paid in money or measurable in money. Bonus and profit sharing are two examples that encourage employees to improve their performance.

Quick Tip to Solve: For a financial incentive, check that the reward is money or has a measurable money value; name the incentive before stating how it rewards employees.

OR

7(b). State any three benefits of training to employees. [3 marks]

Solution:

Concept:

- Training is the systematic development of employees' knowledge and skills so that they can perform their assigned jobs effectively. Its benefits accrue to employees as well as to the organisation.
- Benefits to employees include better career prospects, increased earnings and greater safety. These describe how training improves the employee's own working life.

Step 1: State the benefit to career prospects **Better career prospects:** Training improves employees' knowledge and skills. A trained employee becomes more capable of handling the present job and is better equipped to take up more responsible work. This improvement in competence helps the employee obtain better career opportunities and advancement in the organisation.

Step 2: State the benefit to earnings **Increased earnings:** The skills acquired through training enable employees to work more efficiently and improve their performance. Better performance can help them earn more remuneration. Thus, training benefits employees by improving their earning capacity through more effective work.

Step 3: State the benefit to safety **Greater safety:** Training teaches employees the correct methods of handling machines, equipment and materials. Familiarity with safe procedures reduces mistakes and the likelihood of accidents at work. Employees can therefore perform their jobs with a lower risk of injury and greater confidence.

Step 4: Conclusion Three benefits of training to employees are better career prospects through improved skills and knowledge, increased earnings through improved performance, and greater safety through correct handling of equipment and materials.

Quick Tip to Solve: When asked for benefits to employees, connect each point to the worker's career, earnings or safety, rather than listing only savings or higher output for the employer.

8. State any three factors affecting dividend decision of a company. [3 marks]

Solution:

Concept:

- A dividend decision determines how much of the company's profit is distributed to shareholders and how much is retained in the business for future use.
- In deciding the dividend, management considers the profit available for distribution, the cash available to make payment and the funds needed for future investment.

Step 1: Explain the amount of earnings **Amount of earnings:** Dividends are paid out of current and past earnings. Therefore, the amount of earnings available is an important determinant of the dividend decision. Other things remaining the same, a company with higher earnings has greater scope to declare a higher dividend, while limited earnings restrict the amount it can distribute.

Step 2: Explain the cash-flow position **Cash-flow position:** Payment of dividend involves an outflow of cash. A company must therefore have sufficient cash to pay the dividend, even if it has reported an accounting profit. A sound cash-flow position makes payment of a higher dividend easier; a shortage of cash may require the company to keep its dividend low.

Step 3: Explain growth opportunities **Growth opportunities:** A company with attractive growth and investment opportunities requires funds to finance them. It may retain a larger part of its earnings to meet these requirements instead of distributing that part as dividend. Consequently, growing companies often pay a lower dividend than companies with fewer investment opportunities, other things being equal.

Step 4: Conclusion Any three factors affecting a company's dividend decision are the amount of earnings, its cash-flow position and its growth opportunities. They determine the profit available, the ability to make the cash payment and the need to retain funds respectively.

Quick Tip to Solve: Keep earnings and cash flow separate: profit determines the scope for a dividend, but sufficient cash is needed to pay it; growth opportunities explain why profit may be retained.

9(a). Explain the following rights of a consumer as per the Consumer Protection Act, 2019 :

(i) Right to seek redressal

(ii) Right to safety [5 marks]

Solution:

Concept:

- Consumer protection safeguards consumers against defective goods, deficient services and unfair trade practices. The Consumer Protection Act, 2019 recognises rights that consumers can exercise when buying and using goods and services.
- The right to seek redressal provides a remedy when a consumer suffers a loss or injury, whereas the right to safety protects the consumer against goods and services hazardous to life and health.

Step 1: Explain the right to seek redressal **Right to seek redressal:** A consumer has the right to seek relief against unfair trade practices, restrictive trade practices or unscrupulous exploitation. A consumer who suffers because of defective goods or deficient services can approach the appropriate consumer commission with a complaint and seek a suitable remedy.

The relief depends on the facts of the case. For example, the seller may be directed to remove a defect, replace the defective product, refund the price paid or pay compensation for the loss or injury suffered. A service provider may be required to remove the deficiency in service. Thus, the right gives the consumer an effective means of obtaining justice rather than merely accepting the loss. The consumer should preserve the bill and other evidence to support the complaint.

Step 2: Explain the right to safety **Right to safety:** A consumer has the right to be protected against the marketing of goods and services which are hazardous to life and health. Products such as electrical appliances, medicines and food items must be safe when used for their intended purpose and according to the prescribed instructions.

For example, an electrical appliance with faulty insulation can cause an electric shock, so the consumer is entitled to protection against such an unsafe product. Consumers should purchase products conforming to applicable safety standards, look for suitable quality certification such as the ISI mark on electrical goods, and read warnings and directions for safe use. The right concerns protection from physical harm; it is distinct from the remedy that can be sought after a loss has occurred.

Step 3: Conclusion The right to seek redressal enables a consumer to obtain appropriate relief for defective goods, deficient services or unfair exploitation. The right to safety protects the consumer's life and health from hazardous goods and services. Together, they provide protection against harm and a means of obtaining a remedy when consumer interests are violated.

Quick Tip to Solve: Link redressal with remedies such as replacement, refund or compensation; link safety with protection of life and health. Give a relevant example for each right.

OR

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

Solution:

Concept:

- Consumer protection is effective when consumers know their rights and also fulfil their responsibilities while purchasing, using and consuming goods and services.
- A responsible consumer makes an informed choice, preserves evidence of the transaction and takes appropriate action against unfair trade practices rather than accepting exploitation silently.

Step 1: Be aware of available goods and services **Be an informed consumer:** Be aware of the various goods and services available in the market before purchasing. Compare their quality, price and suitability so that the purchase is an intelligent choice based on actual needs. Such awareness reduces dependence on a seller's claims and helps the consumer avoid being misled into buying an unsuitable product.

Step 2: Purchase standardised products **Look for quality certification:** Buy standardised goods because recognised certification provides an assurance about the prescribed quality standards. For example, look for the ISI mark on relevant electrical appliances, the AGMARK on relevant agricultural products and the Hallmark on jewellery. The consumer should check the appropriate mark for the product rather than treating attractive packaging as proof of quality.

Step 3: Read product labels carefully **Check information and instructions:** Read the label before purchase to check details such as price, net weight, manufacture and expiry dates. Also read and follow the instructions for safe use and the warnings about risks associated with the product. This helps the consumer avoid expired or unsuitable goods and use the purchased product safely in the intended manner.

Step 4: Obtain proof of every purchase **Ask for a cash memo:** Obtain a cash memo or bill for the goods or services purchased and preserve it. It is evidence of the purchase and the amount paid. If the goods are defective or the service is deficient, this documentary proof supports the consumer's claim when seeking replacement, compensation or another appropriate remedy.

Step 5: Complain against unsatisfactory goods or services **File a complaint when justified:** When dissatisfied with the quality of goods or services, make a complaint through the appropriate consumer redressal mechanism. Do so even if the amount involved is small. Taking action against a genuine grievance discourages unfair practices and protects other consumers as well; the consumer should present the facts honestly and keep supporting evidence.

Step 6: Conclusion Five consumer responsibilities are to be aware of the goods and services available, purchase standardised products, read labels and safety instructions, obtain and preserve a cash memo, and file a justified complaint against defective goods or deficient services.

Quick Tip to Solve: Recall the purchase sequence: compare, check the quality mark, read the label, keep the bill and complain if necessary. Explain each as an action the consumer should take.

10. Explain 'Commercial Paper' and 'Treasury Bills' as Money Market Instruments. [5 marks]

Solution:

Concept:

- The money market deals in short-term funds through highly liquid financial instruments. Commercial paper and treasury bills help borrowers meet temporary financing requirements, but differ in their issuers and credit risk.
- Commercial paper is an unsecured short-term corporate debt instrument. A treasury bill is a short-term borrowing instrument of the Government of India, issued by the Reserve Bank of India on its behalf.

Step 1: Explain commercial paper **Meaning and form:** Commercial paper is an unsecured promissory note issued by large, creditworthy companies to raise short-term funds. Being unsecured, it is not backed by a charge on particular assets; investors rely on the issuing company's creditworthiness. It is negotiable and transferable by endorsement and delivery.

Maturity and issue: Its maturity generally ranges from 15 days to one year. It is normally issued at a discount and redeemed at its face value, with the difference representing the investor's return. Companies with a strong credit standing can obtain funds directly from investors through this instrument rather than relying entirely on bank borrowing.

Purpose: Commercial paper meets short-term needs such as working capital and seasonal requirements. It may also provide bridge finance: temporary funds to meet expenditure such as flotation costs while a company awaits the proceeds of a longer-term securities issue. The funds must be repaid at maturity, so the issuer must plan its cash flows accordingly.

Step 2: Explain treasury bills **Meaning and issuer:** Treasury bills are short-term instruments used by the Government of India to borrow funds, generally for periods of less than one year. They are issued by the Reserve Bank of India on behalf of the government. They are also called zero-coupon bonds because they do not carry a separately stated periodic interest payment.

Discount and redemption: A treasury bill is sold at a price below its face value and repaid at face value on maturity. For example, if an investor buys a bill with a face value of Rs 1,00,000 for Rs 96,000 and holds it until maturity, the difference of Rs 4,000 is the return. This example illustrates the discount mechanism, rather than a fixed interest rate applicable to every bill.

Safety and liquidity: Treasury bills are considered very safe because repayment is backed by the government. They are highly liquid and readily marketable, making them suitable for investing temporary surplus funds. They are issued in a minimum amount of Rs 25,000 and in multiples thereof.

Step 3: Conclusion Commercial paper enables creditworthy companies to obtain unsecured short-term finance, whereas treasury bills enable the government to borrow short-term funds. Both are money market instruments commonly issued at a discount and redeemed at face value; treasury bills carry government backing, while commercial paper depends on the corporate issuer's credit standing.

Quick Tip to Solve: Remember the issuer first: a creditworthy company issues commercial paper, while the government issues treasury bills through the RBI. Then explain maturity, discount and the purpose of each instrument.

11. The Human Resource Manager of Alfa Ltd., a leading air-conditioner manufacturer requires employees for various posts. He wanted to opt for a source of recruitment where background of potential candidates is sufficiently known. He knew that applicants introduced by present employees or their friends and relatives may prove to be a good source of recruitment.

(i) Identify the external source of recruitment discussed in the above paragraph.

(ii) State any four advantages of external sources of recruitment. [5 marks]

Solution:

Concept:

- Staffing involves finding suitable people for organisational jobs. Recruitment searches for prospective employees and encourages them to apply, creating a pool from which selection can be made.
- External recruitment seeks applicants from outside the existing workforce. Recommendations of employees are one such source: present employees introduce applicants whose background is sufficiently known.

Step 1: Identify the source from the case **(i) Recommendations of employees.** The case says that applicants are "introduced by present employees or their friends and relatives" and that the manager wants candidates whose background is "sufficiently known". These clues identify recommendations of employees as the external source of recruitment. Although an existing employee makes the recommendation, the recommended applicant comes from outside Alfa Ltd.; hence this remains an external source rather than an internal transfer or promotion.

Step 2: State the advantages of external recruitment **(ii) The four advantages are:**

- **Qualified personnel:** External recruitment enables management to attract qualified and trained people from outside the organisation. Applicants with the qualifications and experience needed for the vacant posts can enter the recruitment pool, helping the organisation meet its staffing requirements.
- **Wider choice:** A large number of applicants may apply from outside. The enterprise is therefore able to compare a wider range of candidates and select suitable people instead of restricting its choice to employees already working in the organisation.
- **Fresh talent:** People recruited from outside may bring new ideas, experience and different ways of doing work. This provides a broader base of talent and helps overcome the limitation of relying only on existing employees, particularly when the enterprise is growing or its work requires new skills.
- **Competitive spirit:** External recruitment creates a competitive atmosphere among existing employees. Knowing that capable people can be brought in from outside encourages them to improve their performance, develop their abilities and demonstrate their suitability for organisational responsibilities.

Step 3: Conclusion Alfa Ltd. is considering **recommendations of employees**. The four advantages of external recruitment are access to qualified personnel, wider choice, fresh talent and a competitive spirit among existing employees.

Quick Tip to Solve: When existing employees introduce outside applicants whose background is known, identify recommendations of employees. Classify recruitment by where the applicant comes from, not by who introduces the applicant.

12(a). NB Ltd. is India's largest manufacturer of cement. Its operations are spread throughout the country with 17 modern cement factories. It has a work force of 9,000 persons.

Since its inception, the company has been a trendsetter for the cement industry. The company is planning to grow in the long-run and wants to double its capacity in the next 3 years.

For this the Finance Manager has to decide about the quantum of finance to be raised from various long-term sources. For this he needs to identify various available sources of funds and the proportion of funds from each source.

(i) Identify the financial decision to be taken by the Finance Manager.

(ii) State any four factors which would affect the decision identified in (i) above. [5 marks]

Solution:

Concept:

- Financial management includes a financing decision: deciding how much finance should be raised from different available sources and the relative proportion of each source.
- Long-term finance may be raised through owners' funds, such as equity, or borrowed funds, such as loans and debentures. The financing mix should balance cost, risk and the company's ability to meet its obligations.

Step 1: Identify the decision from the case The decision is the **financing decision**. The Finance Manager must decide the "quantum of finance to be raised from various long-term sources" and the "proportion of funds from each source". These words concern the sources and mix of finance for NB Ltd.'s expansion. They do not concern selecting the assets in which the money will be invested or distributing profits to shareholders.

Step 2: State four factors affecting the financing decision

- **Cost:** The cost of raising finance from each available source must be compared. Other things being equal, the company should prefer a cheaper source so that the financing cost does not unnecessarily reduce its earnings. The decision therefore requires evaluating the cost of the proposed combination of sources, rather than merely the amount that can be raised.
- **Risk:** The risks associated with different sources must be assessed. Borrowed funds involve compulsory payment of interest and repayment of principal, creating financial risk. Equity does not impose the same fixed payment obligation. NB Ltd. should choose a mix whose financial risk it can bear while expanding capacity.
- **Floatation costs:** Raising funds involves expenses such as brokers' commission, underwriting charges and other issue expenses. These costs differ across sources and affect the net funds available to the company. A source with high floatation costs becomes less attractive, other things remaining the same.
- **Cash flow position of the company:** A stronger expected cash flow position makes it easier to use debt because interest and principal repayments must be made when due. If cash flows are weak or uncertain, relying heavily on borrowed funds can create payment difficulties. The company must assess its ability to meet these obligations before selecting the mix.

Step 3: Conclusion The Finance Manager is taking a **financing decision** for NB Ltd.'s proposed expansion. Four factors affecting it are **cost, risk, floatation costs and the company's cash flow**

position. These factors help determine how much should be raised from each source without imposing an unsuitable financing burden.

Quick Tip to Solve: Look for whether the case asks where funds will come from or where they will be used. Sources and their proportions indicate a financing decision; choosing assets or projects indicates an investment decision.

OR

12(b). Myra Ltd., manufacturing televisions, is planning to expand its business and requires ₹ 250 crore for the same. A number of projects are available to the company to invest in and each project has to be evaluated carefully. The Finance Manager of the company, has assessed the projects in terms of the rate of return from each project and wanted to select the one with the higher rate of return. But before selecting the project he has to take into consideration other factors also.

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

(ii) Explain two other factors that the Finance Manager should consider before selecting the project.

[5 marks]

Solution:

Concept:

- **Investment decision:** Financial Management involves deciding how the firm's funds should be invested in different assets. A long-term investment decision is called a capital budgeting decision.
- **Project evaluation:** Capital budgeting requires comparing the cash flows, expected rate of return and investment criteria of available projects. A high expected return alone is not a complete basis for selecting a project.

Step 1: Identify and state the financial decision The decision discussed is the **long-term investment decision, or capital budgeting decision**. It concerns the allocation of the company's funds to long-term assets and projects that will generate benefits over several years. Here, Myra Ltd. is "planning to expand its business" and "a number of projects are available to the company to invest in". The manager must therefore decide which project should receive the funds required for expansion. This is different from deciding the sources from which those funds should be raised. The case also says that projects have been assessed by their "rate of return", which is one factor affecting capital budgeting.

Step 2: Explain the cash flows of the project **Cash flows of the project:** When a company invests large funds in a project, it expects a series of cash receipts and cash payments throughout the life of that investment. The Finance Manager should carefully analyse both the amount and the timing of these cash flows before selecting a project. In Myra Ltd., the initial investment for expansion must be compared with the expected cash inflows and subsequent cash outflows. This helps the manager assess the project's ability to generate cash over its useful life. A project should not be judged merely by an attractive stated rate of return while ignoring when its cash receipts and payments occur.

Step 3: Explain the investment criteria involved **Investment criteria involved:** The Finance Manager must apply appropriate capital budgeting techniques to evaluate the available investment proposals. These techniques consider the investment required, the expected cash flows and the rate of return

associated with each proposal. They provide a systematic basis for comparing projects and deciding which proposal is worthwhile. Myra Ltd. should therefore evaluate the competing expansion projects using suitable investment criteria rather than automatically selecting the project that advertises the highest rate of return. The decision should rest on a careful assessment of the complete investment proposal.

Step 4: Conclusion Myra Ltd. is making a **capital budgeting (long-term investment) decision**: choosing how to invest funds in long-term expansion projects. Besides the rate of return already considered, the Finance Manager should assess **the cash flows of each project** and **the investment criteria involved** before selecting the project.

Quick Tip to Solve: For capital budgeting, remember the three NCERT factors: cash flows, rate of return and investment criteria. If the case already gives one, explain the other two.