CBSE Class 12 Business Studies Question Paper 2022 with Solution PDF-Set 66/5/1

Question Paper with Solutions

Conducted by the Central Board of Secondary Education (CBSE)

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

General Instructions

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

(ii) Question number 1-4 are of 2 marks. These are short-answer type questions and are to be answered in 30-50 words.

(iii) Question number 5-8 are of 3 marks. These are short-answer type questions and are to be answered in 50-80 words.

(iv) Question number 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 overall 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. 'Estimating manpower requirements is not merely knowing how many persons we need.' What else is needed while estimating manpower requirements ? State any two points. [2 marks]

Solution:

Concept:

- Staffing begins by estimating the number and types of employees required for different jobs in the organisation.
- Manpower estimation requires both workload analysis and workforce analysis; a headcount alone does not establish whether suitable people are available.

Step 1: Analyse the workload **Workload analysis:** Determine the number and types of human resources necessary to perform the various jobs and accomplish organisational objectives. This identifies the qualifications, skills and experience needed, as well as the volume of work to be done.

Step 2: Analyse the existing workforce **Workforce analysis:** Examine the number and types of employees already available in the organisation. Compare this supply with the assessed workload to identify whether there is a shortage, surplus or mismatch of personnel and to plan the appropriate staffing action.

Step 3: Conclusion The two requirements are **workload analysis** and **workforce analysis**. Together they identify both the people needed and the people presently available.

Quick Tip to Solve: Remember the distinction: workload tells us what staff are required; workforce tells us what staff are available.

2. 'Due to various malpractices and multiplied investors grievances the Govt. of India decided to set-up a separate regulatory body to protect the interest of investors and to regulate the securities market.'

(a) Identify the regulatory body set-up by Govt. of India for the above stated purpose.

(b) State any one objective of the regulatory body identified in (a) above. [2 marks]

Solution:

Concept:

- Securities-market regulation aims to ensure fair dealings and protect investors from malpractice.
- The Securities and Exchange Board of India, abbreviated as SEBI, is the regulatory body established for the securities market in India.

Step 1: Identify the regulatory body The body is the **Securities and Exchange Board of India (SEBI)**. The case links its establishment to "various malpractices and multiplied investors grievances" and to the need "to protect the interest of investors and to regulate the securities market". These clues identify SEBI.

Step 2: State an objective of SEBI **Protection of investors:** One objective is to protect investors' rights and interests, particularly those of individual investors, and to guide and educate them. Investor protection seeks to reduce their exposure to unfair practices and promote confidence in securities-market dealings.

Step 3: Conclusion (a) The regulatory body is **SEBI**. (b) One of its objectives is to **protect the rights and interests of investors** and guide and educate them.

Quick Tip to Solve: When a case connects investor grievances, unfair securities dealings and regulation, identify SEBI and state an investor-protection objective.

3. 'External sources of recruitment may lead to dissatisfaction and frustration among existing employees. They may feel that their chances of promotion are reduced.'

Give two situations when external sources may be used without dissatisfying the existing employees.

[2 marks]

Solution:

Concept:

- External recruitment brings candidates into an organisation from outside its existing workforce.
- It can reduce existing employees' promotion prospects, but is necessary where internal sources cannot supply the required personnel.

Step 1: Consider a newly established enterprise **Starting a new enterprise:** A newly established organisation has no existing workforce from which to fill its initial jobs through promotion or transfer. It therefore has to recruit from outside. Since no existing employees are being passed over for these initial appointments, the stated cause of dissatisfaction does not arise.

Step 2: Consider expansion requiring additional personnel **Expansion of an existing enterprise:** When a business expands, its requirements may exceed the number or types of employees available internally. External recruitment can fill the additional posts while retaining suitable promotion opportunities for existing employees. Thus, outside appointments meet additional needs rather than merely replacing their advancement opportunities.

Step 3: Conclusion External sources may be used when **a new enterprise is started** and when **an existing enterprise expands and requires additional personnel** beyond those available internally.

Quick Tip to Solve: Link acceptable external hiring to an absence or shortage of internal candidates: a new enterprise and expansion are the two standard situations.

4. 'The final step in the controlling process is taking corrective action, but when deviations are within acceptable limits no corrective action is required.'

When and why corrective action is required ? State. [2 marks]

Solution:

Concept:

- Controlling compares actual performance with predetermined standards and analyses deviations to keep activities directed towards organisational objectives.
- Corrective action is the final step: management removes the causes of significant deviations so that

actual performance conforms to the standards.

Step 1: State when corrective action is required Corrective action is required when deviations go beyond the acceptable range. Small deviations within permissible limits may be ignored, but significant deviations need managerial attention after their causes have been identified.

Step 2: Explain why action is necessary Action is taken to remove the causes of the deviation and prevent its recurrence, bringing performance back in line with the planned standard. For example, inadequate worker skills may call for training. If the standard itself is unrealistic, it may need revision.

Step 3: Conclusion Corrective action is required for deviations beyond acceptable limits, to eliminate their causes and ensure achievement of planned organisational objectives.

Quick Tip to Solve: Separate the answer into the trigger (deviation beyond tolerance) and the purpose (remove its cause and restore planned performance).

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5. Agrima, Arunima and Avika are pursuing MBA from a reputed institution. Now it is the time of their placement.

Agrima wants to work in a company which would provide her more authority for fulfilling her duties and will give recognition, rewards, perquisites and prestige of job.

Arunima wants to work in an organisation in which behaviour of individuals is influenced by its characteristics like autonomy, reward orientation, consideration to employees, risk taking etc.

Avika wants to join the organisation which has appropriate skill development programmes and sound promotion policy that encourages employees to exhibit improved performance.

Identify and state the incentives about which Agrima, Arunima and Avika are talking about. [3 marks]

Solution:

Concept:

- Non-financial incentives meet employees' psychological, social and emotional needs, such as esteem, recognition and personal growth, rather than motivating through direct monetary payments alone.
- Status, organisational climate and career advancement opportunity are distinct non-financial incentives in the directing function of management.

Step 1: Identify Agrima's incentive **Status:** Agrima seeks a job giving her "more authority" as well as "recognition, rewards, perquisites and prestige of job". Status means an employee's ranking or position in the organisation. The authority, responsibility, recognition and prestige associated with a position satisfy esteem needs and motivate the employee to perform well.

Step 2: Identify Arunima's incentive **Organisational climate:** The clues are "autonomy, reward orientation, consideration to employees, risk taking". Organisational climate means the characteristics that describe an organisation and distinguish it from others. These characteristics influence the behaviour of individuals; a supportive climate encourages employees to contribute and perform better.

Step 3: Identify Avika's incentive **Career advancement opportunity:** Avika wants "appropriate skill development programmes and sound promotion policy". These provide employees opportunities to develop their skills and progress to higher positions. The prospect of advancement motivates them to

improve their present performance and prepare for greater responsibilities.

Step 4: Conclusion Agrima seeks **status**, Arunima seeks a favourable **organisational climate**, and Avika seeks **career advancement opportunity**.

Quick Tip to Solve: Link prestige and authority to status, workplace characteristics to climate, and skill development plus promotion to career advancement.

6(a). State any three points of importance of 'Controlling' function of management. [3 marks]

Solution:

Concept:

- Controlling means comparing actual performance with established standards, identifying deviations and taking corrective action so that activities produce the desired results.
- The importance of controlling can be stated through its contribution to goal achievement, evaluation of standards and efficient use of resources.

Step 1: State its contribution to organisational goals **Accomplishing organisational goals:** Controlling measures progress towards organisational goals and brings to light deviations from planned performance. Managers can identify where activities are going off course and take corrective action. Thus, it guides the organisation and keeps its work directed towards the goals for which the plans were made.

Step 2: Explain how it tests standards **Judging accuracy of standards:** An effective control system helps management verify whether the standards set for performance are accurate and objective. By comparing results with standards and considering changes in the environment, managers can review and revise standards when necessary. Standards therefore remain realistic measures of the performance expected.

Step 3: Explain how it improves resource use **Making efficient use of resources:** Controlling requires employees to perform their work according to predetermined standards. Actual use of material, money, time and effort is checked against what was planned. This reduces wastage and spoilage and helps ensure that resources are used in the most effective and efficient manner.

Step 4: Conclusion Three points of importance of controlling are accomplishing organisational goals, judging the accuracy of standards and making efficient use of resources.

Quick Tip to Solve: For an importance question, name each benefit first and then explain how controlling produces that benefit; do not merely list the steps of the control process.

OR

6(b). State any three points of importance of 'Directing' function of management. [3 marks]

Solution:

Concept:

- Directing is the management function of instructing, guiding, counselling, motivating and leading people towards the achievement of organisational objectives.
- Its importance lies in turning plans into action, integrating individual efforts and helping employees realise their capabilities.

Step 1: Explain how directing starts work **Initiates action:** Directing helps to initiate action by people in the organisation towards the attainment of desired objectives. Planning, organising and staffing prepare the conditions for work, but employees must be guided and instructed to perform it. Through supervision and communication, a manager tells subordinates what to do and how to proceed, thereby translating plans into actual performance.

Step 2: Explain how directing unifies efforts **Integrates employees' efforts:** Individual employees perform different activities and may have different interests. Directing integrates their efforts so that every individual effort contributes to organisational performance. Managers guide employees towards common objectives and coordinate their work, helping the organisation obtain the benefits of a unified team rather than disconnected individual actions.

Step 3: Explain how directing develops capability **Realises employees' potential:** Directing guides employees to fully realise their potential and capabilities by motivating them and providing effective leadership. Appropriate guidance helps them understand their work, while encouragement creates willingness to contribute their best. Employees are thus supported in using their abilities for the achievement of organisational goals.

Step 4: Conclusion Three points of importance of directing are initiating action, integrating employees' efforts and enabling employees to realise their potential and capabilities.

Quick Tip to Solve: Link each point to a result: directing starts action, combines efforts and brings out potential. Keep these benefits distinct from its elements such as supervision and motivation.

7. Explain 'Private Placement' and 'Rights Issue' as methods of floatation of new issues in the primary market. [3 marks]

Solution:

Concept:

- The primary market deals in new securities. Funds raised through a new issue move from investors to the issuing company.
- Private placement and rights issue are methods of raising funds in this market. They differ in the investors to whom the securities are offered.

Step 1: Explain private placement **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. The company approaches a limited group of investors who can subscribe to the issue. It avoids the expense of making a public issue and the associated formalities. Thus, a company can raise capital relatively quickly and at lower cost; this is particularly useful when a general public offer would be costly or difficult.

Step 2: Explain rights issue **Rights issue** is an offer of new shares to the company's existing shareholders, giving them the privilege of subscribing in proportion to the shares they already hold. The company first offers these shareholders the opportunity to buy the additional shares instead of inviting the public directly. For example, a one-for-five rights offer gives a shareholder holding five shares the right to subscribe to one additional share. Existing shareholders can thereby maintain their proportionate ownership if they take up the offer.

Step 3: Conclusion Private placement raises new capital from selected institutional and individual investors, whereas a rights issue offers new shares to existing shareholders in proportion to their present holdings. Both are methods of floatation in the primary market.

Quick Tip to Solve: Identify the recipient of the offer: selected investors indicates private placement; existing shareholders in a fixed proportion indicates a rights issue.

8. Name and give the meaning of the concepts that are highlighted in the following statements :

(a) It improves the performance of employees on the current job or prepares them for any intended job.

(b) It not only improves the job performance of the employees but also brings about growth of the personality. [3 marks]

Solution:

Concept:

- Training and development are parts of staffing that improve the capabilities of employees. Both involve learning, but their scope and focus differ.
- Training emphasises job-related knowledge and skills, whereas development includes the overall growth of an employee's personality and abilities.

Step 1: Identify and explain the concept in statement (a) **(a) Training:** The words "improves the performance of employees on the current job or prepares them for any intended job" indicate training. Training is the process by which the aptitudes, skills and abilities of employees to perform specific jobs are increased. It provides the knowledge and practice needed to carry out assigned work effectively. Its focus is a particular job and the employee's ability to perform that job; for example, learning to operate a machine improves a specific work skill.

Step 2: Identify and explain the concept in statement (b) **(b) Development:** The words "not only improves the job performance" but also brings about "growth of the personality" indicate development. Development refers to the learning opportunities designed to help employees grow. It is a broader process concerned with the employee's overall growth, including conceptual understanding, attitudes and the ability to assume greater responsibilities. Its benefits therefore extend beyond the immediate

tasks of the present job and prepare the individual for future roles.

Step 3: Conclusion Statement (a) highlights training, which increases the skills and abilities required for a specific job. Statement (b) highlights development, which improves job performance while promoting the employee's overall personal and professional growth.

Quick Tip to Solve: Link a specific job or skill with training; link overall personality, wider abilities and future responsibilities with development.

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

(i) Right to Safety

(ii) Right to be Informed [5 marks]

Solution:

Concept:

- Consumer Protection recognises rights that enable consumers to obtain safe goods and services and make informed purchase decisions. These rights place corresponding obligations on producers and sellers.
- The right to safety protects the consumer's life and health, whereas the right to be informed ensures access to complete and accurate information about the product or service.

Step 1: Explain the right to safety **Protection against hazardous goods and services:** A consumer has the right to be protected against the marketing of goods and services that are hazardous to life and health. For example, a defective electrical appliance may cause an electric shock or fire. A manufacturer must therefore supply a product that meets the applicable safety standards, rather than expose the buyer to avoidable danger.

Assurance of quality and safe use: Consumers should obtain products that conform to prescribed quality and safety standards and should be able to use them safely when the stated instructions are followed. For example, the ISI mark on electrical goods helps the consumer identify products conforming to the relevant standards. The buyer should prefer quality-marked products and follow the manufacturer's safety instructions. This right covers protection from unsafe services as well as unsafe physical goods.

Step 2: Explain the right to be informed **Complete product information:** A consumer has the right to receive complete information about the quality, quantity, potency, purity, standard and price of goods or services. Such information enables the consumer to compare alternatives and protects the consumer against unfair trade practices, including misleading descriptions or concealment of important facts.

Disclosure through labels and other particulars: The consumer should be able to know relevant details such as ingredients, net quantity, date of manufacture, expiry date, maximum retail price and directions for use, wherever applicable. For example, the label on a medicine should disclose its contents, expiry date and precautions so that the buyer can judge whether it is suitable and how to use it. A consumer can then make an informed choice instead of relying only on the seller's claims.

Step 3: Conclusion The **right to safety** protects consumers against goods and services dangerous to life and health. The **right to be informed** gives them the material facts needed to choose and use a product or service intelligently and to guard against unfair trade practices.

Quick Tip to Solve: Link safety to protection from physical harm and information to facts on the label: a quality mark illustrates the first, while ingredients, expiry date and price illustrate the second.

OR

9(b). State any five responsibilities of a consumer under Consumer Protection Act, 2019. [5 marks]

Solution:

Concept:

- Consumer protection becomes effective when consumers are aware of their rights and also discharge their responsibilities while buying and using goods and services.
- A responsible consumer makes an informed choice, observes quality and safety requirements, and preserves evidence of the purchase. These practices help prevent exploitation and support a genuine complaint.

Step 1: State the responsibilities before choosing a product The following are responsibilities of a consumer:

1. Be aware of available goods and services: A consumer should know the different goods and services available in the market so that an intelligent and wise choice can be made. Comparing relevant alternatives reduces dependence on a seller's claims and helps the buyer select a product suited to the actual need.

2. Buy only standardised goods: A consumer should buy standardised goods because recognised quality certification provides an assurance of quality. For example, look for the ISI mark on electrical goods, the FPO mark on fruit products and the Hallmark on jewellery, as applicable. The consumer should check the appropriate mark rather than relying merely on attractive packaging.

Step 2: State the responsibilities while purchasing and using goods **3. Read labels carefully:** The consumer should examine the label for information such as price, net weight, manufacturing and expiry dates, contents and instructions. This helps check that the product is suitable, within its usable period and being offered on the stated terms.

4. Learn the risks and follow instructions: The consumer should learn about the risks associated with a product and follow the manufacturer's instructions for safe use. Using an article carefully and as directed protects the user and others from avoidable harm.

5. Insist on a cash memo: The consumer should ask for and retain a cash memo or other proper proof of purchase for goods or services bought. It records the transaction and can serve as evidence when seeking redressal for a genuine defect or deficiency.

Step 3: Conclusion Any five consumer responsibilities are: being aware of market alternatives, buying standardised goods, reading labels carefully, following safety instructions, and insisting on a cash memo. Together, they promote informed buying, safe use and effective redressal.

Quick Tip to Solve: Organise responsibilities around the purchase: compare alternatives, check certification and the label, follow safe-use instructions, and keep the bill.

10. What is meant by financial market ? State any four functions of financial market. [5 marks]

Solution:

Concept:

- A financial market is a market for the creation and exchange of financial assets, such as shares and debentures. It connects those who have surplus funds with those who need funds.
- Financial markets allocate savings to productive investment. Their principal functions concern mobilisation of savings, price discovery, liquidity and the reduction of transaction costs.

Step 1: Define the financial market A financial market is a market for the creation and exchange of financial assets. Households and other savers supply funds, while business enterprises and other users obtain funds for investment. The financial assets exchanged represent claims on future income or repayment. Thus, the market channels money from surplus units to deficit units rather than dealing in ordinary goods and services.

Step 2: State the four functions

- **Mobilisation of savings and channelising them into the most productive uses:** A financial market facilitates the transfer of savings from savers to investors. It gives savers a choice among investments and helps direct their funds towards productive business activities, thereby supporting capital formation.
- **Facilitating price discovery:** The interaction of the demand for and supply of financial assets helps establish their prices. Savers supply funds and business firms demand funds; their interaction in the market determines the price of the financial asset being traded.
- **Providing liquidity to financial assets:** Financial markets facilitate the purchase and sale of financial assets. Investors can convert their investments into cash when required, giving them an exit opportunity and making investment in such assets more attractive.
- **Reducing the cost of transactions:** Financial markets provide valuable information about the securities being traded. This saves buyers and sellers the time, effort and money they would otherwise spend searching for one another and obtaining information before a transaction.

Step 3: Conclusion A financial market creates and exchanges financial assets. Its four functions are mobilisation and productive allocation of savings, price discovery, provision of liquidity, and reduction of transaction costs.

Quick Tip to Solve: Recall the four functions as savings, price, liquidity and cost. Explain the specific contribution of each instead of listing examples of financial institutions.

11. Asha is living in a small village of Rajasthan. Her mother has good culinary skills. Inspired from her mother she joined a course of 'Food and Beverages Production' in Jaipur. After completing her course she asked her mother to open a sweets shop in Jaipur, to which her mother agreed. The business was doing well and had started growing. To expand her business she felt the need of additional personnel. Instead of selecting personnel from any other source she thought of helping her relatives and appointed five of them. But after doing all efforts she found that none of her relatives were providing satisfactory service leading to lower productivity. Also, the quality of the products started deteriorating.

This made Asha to realise that the ability of an organisation to achieve its goals depends upon the quality of its human resources. This was ignored by her at the time of selecting the personnel for her expansion programme.

(a) Identify and state the function of management which could have helped Asha at the time of fulfilling her need of additional personnel in the organisation.

(b) State any three benefits of the function identified in (a) above. [5 marks]

Solution:

Concept:

- Staffing is the management function concerned with obtaining, developing and retaining suitable people for the various positions in an organisation. It puts the right person in the right job.
- The quality of human resources affects an organisation's performance. Recruitment, selection, training and development must therefore be based on the requirements of the job and the competence of the individual.

Step 1: Identify and state the function in part (a) The function is **staffing**. It means finding the right people for the right jobs and ensuring that the organisation has a competent workforce. It begins with estimating manpower requirements and includes recruitment, selection, placement, training and development, appraisal, promotion and compensation.

Asha felt the "need of additional personnel", but "appointed five" relatives simply to help them. The fact that "none of her relatives were providing satisfactory service" shows that she did not match their abilities with the work required. A proper staffing process would have assessed the jobs and selected people with the necessary skills for the sweets shop.

Step 2: State three benefits in part (b) **1. Obtaining competent personnel:** Staffing helps an enterprise discover and obtain competent people for different jobs. Asha could have recruited and selected employees with the culinary and other abilities needed by her expanding business, instead of treating family relationship as the basis of appointment.

2. Higher performance through the right person in the right job: Proper selection and placement match an employee's qualifications and abilities with the position. This improves performance and productivity. It directly addresses the case's "lower productivity" and the fact that "the quality of the products started deteriorating".

3. Optimum utilisation of human resources: Systematic manpower planning and staffing prevent overmanning, understaffing and the appointment of unsuitable employees. They help the business use its employees' abilities effectively and avoid unnecessary labour costs. Asha would first assess how many people and which skills her expansion actually required.

Step 3: Conclusion (a) The required function is **staffing**, which obtains and maintains a suitable workforce by placing the right people in the right jobs. (b) Its three benefits are obtaining competent personnel, achieving higher performance through appropriate placement, and ensuring optimum utilisation of human resources.

Quick Tip to Solve: In a staffing case, link the need for people to recruitment and selection; then explain each benefit through competence, job fit or manpower utilisation.

12(a). Ananta Ltd. is a company dealing in ready-made garments from last many years. Recently the profit of the company have started increasing. The finance manager decided to retain the profit instead of distributing it among shareholders.

(i) Identify and state the financial decision taken by finance manager in the above case.

(ii) State any three factors affecting the decision identified in (i) above. [5 marks]

Solution:

Concept:

- Financial management includes the dividend decision: deciding how much of the profit earned by a company should be distributed to shareholders and how much should be retained in the business.
- Retained earnings provide an internal source of finance for future requirements, while dividends provide current income to shareholders. The decision therefore balances distribution with the company's financing needs.

Step 1: Identify the decision from the case **(i) Dividend decision:** The finance manager has taken a dividend decision. The case states that the manager decided to "retain the profit instead of distributing it among shareholders". This directly concerns the allocation of the company's profit between dividends and retained earnings, rather than raising new funds or selecting an investment project.

Step 2: State the meaning of the decision A dividend decision determines the proportion of earnings to be distributed to shareholders as dividend and the proportion to be retained in the business for reinvestment. Here, Ananta Ltd. has chosen retention of profit rather than its distribution. The rising profit is relevant to the amount potentially available, but it does not by itself require the company to distribute all its earnings.

Step 3: State three factors affecting dividend decisions **(ii) Any three factors are:**

- **Amount of earnings:** Dividends are paid out of current and past earnings. A company with higher earnings can generally declare a higher dividend, whereas limited earnings restrict the amount available for distribution.
- **Growth opportunities:** A company with good growth opportunities needs funds to finance expansion. It may retain a larger portion of its earnings and consequently declare a lower dividend so that internal funds remain available for future investment.
- **Cash flow position:** Payment of dividend involves an outflow of cash. Even a profitable company needs sufficient cash to pay dividends; a sound cash flow position permits distribution, while a cash shortage may require greater retention.

These are factors that influence the decision generally. The case establishes increasing profit and the decision to retain it; it does not establish that Ananta Ltd. has a particular cash shortage or expansion project.

Step 4: Conclusion The decision is the **dividend decision**, which allocates earnings between distribution to shareholders and retention in the business. Amount of earnings, growth opportunities and cash flow position are three factors affecting it.

Quick Tip to Solve: Look for the choice between distributing profit and retaining it: this identifies a dividend decision. Explain each factor by showing how it changes the amount available or desirable for distribution.

OR

12(b). Ravi has joined as a finance manager in MTA Ltd. He had to arrange funds of rupees one crore for the company. The Chief Executive Officer of the company wants to arrange the funds by a public issue whereas the finance manager wants to have a mix of debt and equity as this will determine the overall cost of capital and the financial risk of the enterprise.

(i) Identify and give the meaning of the financial decision suggested by the finance manager in the above case.

(ii) State any three factors affecting the decision identified in (i) above. [5 marks]

Solution:

Concept:

- A financing decision concerns the amount of finance to be raised from different long-term sources, principally debt and equity, to meet the enterprise's funding requirements.
- Debt carries a contractual obligation to pay interest and repay principal, whereas equity represents owners' funds. Their relative use affects the cost of capital and financial risk.

Step 1: Identify and explain the decision The decision suggested by Ravi is the **financing decision**. It involves deciding how much finance should be raised from various long-term sources and choosing an appropriate proportion of debt and equity. The case says that Ravi wants "a mix of debt and equity" because it determines "the overall cost of capital and the financial risk of the enterprise". These words directly identify the choice of sources of finance. Ravi must decide the composition of the funds required; the case does not ask him to select an investment or determine the distribution of profits.

Step 2: State three factors affecting the financing decision

- **Cost:** The cost of raising finance from different sources differs. The finance manager should compare these costs and prefer the least costly appropriate source. Debt generally has a lower cost than equity because lenders bear less risk and interest is a tax-deductible expense. However, cost must be considered together with the enterprise's ability to meet its obligations.
- **Risk:** Debt is riskier for the business because interest and principal repayments must be made as scheduled, irrespective of whether profits are earned. Equity does not create these fixed payment commitments. A higher proportion of debt therefore increases financial risk, influencing the mix Ravi should choose.

- **Cash flow position of the company:** A stronger cash flow position enables a company to meet interest payments and repayment obligations and can support a greater use of debt. If expected cash flows are weak or uncertain, the company should be cautious about taking on fixed debt-servicing commitments and may rely more on equity.

Step 3: Conclusion Ravi proposes a **financing decision**: choosing the proportions of debt and equity used to raise the required funds. Three relevant factors are the **cost of funds, financial risk and the company's cash flow position**.

Quick Tip to Solve: Link "mix of debt and equity" to the financing decision; link purchase of assets to investment and retention or distribution of profit to the dividend decision.