CBSE Class 12 Business Studies Question Paper 2022 with Solution PDF-Set 66/5/3

Question Paper with Solutions

Conducted by the Central Board of Secondary Education (CBSE)

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

General Instructions

(i) This 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. '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:

- Financial Markets: the Securities and Exchange Board of India (SEBI) regulates the securities market and protects investors.
- An objective states the purpose of the regulator, whereas a function describes an action it performs to achieve that purpose.

Step 1: Identify the regulatory body from the case The body is the **Securities and Exchange Board of India (SEBI)**. The clues are the need to "protect the interest of investors" and "regulate the securities market." These identify the securities-market regulator rather than a commercial bank.

Step 2: State one objective **Protection of investors:** SEBI aims to protect the rights and interests of investors, particularly individual investors, and to guide and educate them. This addresses the case's "various malpractices" and "investors grievances", which can undermine confidence in the securities market.

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

Quick Tip to Solve: Link securities-market regulation and investor protection with SEBI; state an objective as its purpose rather than listing an operational function.

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2. '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:

- Staffing: external recruitment seeks candidates outside the organisation and enlarges the pool of available talent.
- Its effect on morale depends on whether employees reasonably see the vacancy as an opportunity for their own promotion.

Step 1: Consider recruitment for a new enterprise **Setting up a new enterprise:** A newly established organisation must recruit from outside because it has no existing internal pool from which to fill its initial positions. External recruitment therefore does not take away the promotional opportunities of an established workforce.

Step 2: Consider expansion requiring new skills **Expansion or diversification requiring unavailable**

skills: An existing business may create new posts needing specialised qualifications or expertise not possessed by its present employees. Hiring suitable outsiders for such posts need not frustrate existing employees because these are not positions they are qualified to occupy through promotion. Existing employees' suitable promotion opportunities can still be retained.

Step 3: Conclusion External recruitment is appropriate when establishing a new enterprise and when expansion or diversification creates posts requiring skills unavailable among existing employees.

Quick Tip to Solve: For each situation, explain why hiring an outsider does not displace an existing employee's reasonable chance of promotion.

3. '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: estimating manpower requirements assesses both the number and the type of employees needed to perform the organisation's work.
- The qualitative aspect concerns the qualifications and experience required for each job; a headcount alone cannot establish job suitability.

Step 1: Determine the qualifications required **Educational and professional qualifications:** Identify the qualifications, training and skills needed to perform each job effectively. Different jobs require different competencies, so knowing only how many vacancies exist does not show what kind of people should be recruited.

Step 2: Determine the experience required **Relevant experience:** Specify the nature and level of experience needed for the job. A position involving complex responsibilities may require a person with prior practical exposure, whereas another position may be suitable for a beginner. The estimate must therefore describe the people required as well as their number.

Step 3: Conclusion Besides the number of employees, manpower estimation must determine their required educational or professional qualifications and their relevant experience.

Quick Tip to Solve: Read "not merely how many" as a prompt for the quality of manpower: what qualifications and experience the jobs require.

4. 'Analysing deviations' is an important step in the process of controlling. It is therefore important to bring significant deviations to the notice of the management which go beyond the permissible limit. Identify and give the meaning of the concept discussed above. [2 marks]

Solution:

Concept:

- Controlling involves comparing actual performance with standards, analysing deviations and taking corrective action where needed.
- Management by exception focuses managerial attention on significant deviations that cross the permissible limits, rather than on every small variation.

Step 1: Identify the concept from the controlling step The concept is **management by exception**. The decisive words are 'significant deviations' and 'go beyond the permissible limit'. These show that only exceptional departures from standards need to be brought to management's notice.

Step 2: Explain the meaning of management by exception Management by exception is the principle that attempting to control everything results in controlling nothing. Only significant deviations beyond the acceptable range should therefore be reported to management for attention and corrective action. Routine variations within the permissible range need not occupy senior management's time. This enables managers to concentrate their effort on matters that materially affect organisational performance.

Step 3: Conclusion The concept is **management by exception**: bringing significant deviations beyond permissible limits to management's attention so that it can concentrate on exceptional problems and take corrective action.

Quick Tip to Solve: 'Beyond permissible limits' signals management by exception; a reference to monitoring key result areas signals critical point control.

5. 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:

- Staffing includes training and development to improve employees' abilities. Both are learning processes, but their scope and objectives differ.
- Training develops the knowledge and skills required for a particular job, whereas development concerns the overall growth of an employee's personality and capabilities.

Step 1: Identify and explain the first concept **(a) Training:** The statement 'improves the performance of employees on the current job or prepares them for any intended job' refers to training. Training is a process through which employees' skills, aptitudes and abilities to perform specific jobs are increased.

Its focus is on learning the knowledge and skills needed to perform a particular job effectively. Thus, the improvement is directly related to the requirements of the current or intended job.

Step 2: Identify and explain the second concept **(b) Development:** The statement 'not only improves the job performance' but also brings 'growth of the personality' refers to development. Development is the learning process through which employees grow in all respects. It develops their overall competence, attitudes, understanding and personality rather than limiting learning to the immediate requirements of one job. It consequently prepares them to handle wider responsibilities as well as improving present performance.

Step 3: Conclusion Statement (a) describes **training**, which increases the ability to perform a specific job. Statement (b) describes **development**, which promotes the employee's overall growth, including personality, along with better job performance.

Quick Tip to Solve: Link 'specific job' with training and 'overall personality growth' with development; development has a wider scope than training.

6. 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 issued by a company to raise fresh capital. Private placement and rights issue are methods of offering these new securities.
- The distinction lies in whom the company approaches: selected investors in private placement, and its existing shareholders in a rights issue.

Step 1: Explain private placement **Private placement:** This is the allotment of securities by a company to institutional investors and some selected individuals rather than offering them to the public at large. The company approaches a limited, identified group directly to subscribe to its new securities. It is useful when raising capital through a public issue would involve substantial expenses and regulatory formalities. Private placement can therefore help a company raise funds more quickly and at lower issue cost. Life insurance companies, mutual funds and other financial institutions may subscribe through this method.

Step 2: Explain a rights issue **Rights issue:** This is a privilege given to existing shareholders to subscribe to a new issue of shares in proportion to the number of shares they already hold. The company offers its existing shareholders the right to buy the new shares before offering them to others. For example, an offer of one new share for every four shares held gives a shareholder holding 100 shares the right to subscribe to 25 new shares. The shareholder can decide whether to exercise the right. By subscribing proportionately, existing shareholders can maintain their relative ownership in the company.

Step 3: Conclusion Private placement raises fresh capital from a selected group of investors, whereas a rights issue first offers new shares proportionately to existing shareholders. Both are primary-market methods because they involve a fresh issue by the company.

Quick Tip to Solve: Link "private" with selected investors and "rights" with the existing shareholders' proportionate entitlement to new shares.

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

Solution:

Concept:

- Controlling compares actual performance with predetermined standards, identifies deviations and ensures corrective action wherever needed.
- Its importance lies in keeping organisational activities directed towards planned goals and using resources effectively. The following are three points of its importance.

Step 1: State how controlling helps achieve goals **Accomplishing organisational goals:** Controlling measures progress towards organisational goals and brings deviations to light. By comparing actual performance with the planned standards, managers discover whether work is proceeding as intended. Corrective action then brings activities back on the right track, helping the organisation accomplish its objectives rather than merely identifying mistakes after the event.

Step 2: State how controlling evaluates standards **Judging accuracy of standards:** An effective control system enables management to check whether the standards set are accurate and objective. While examining deviations, managers may find that a standard needs revision because conditions have changed or its original basis was unrealistic. Reviewing standards in this way helps the organisation establish suitable benchmarks for future performance.

Step 3: State how controlling improves resource use **Making efficient use of resources:** Controlling seeks to reduce wastage and spoilage by ensuring that activities conform to predetermined norms. Employees know the performance expected of them and work accordingly. Timely detection and correction of deviations prevent avoidable loss of materials, time and effort, so resources are used effectively and efficiently.

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: Remember the three links: compare performance to reach goals, review standards for accuracy, and correct deviations to reduce waste.

OR

7(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 so that they contribute to organisational objectives.
- Its importance lies in converting plans into action, coordinating people's efforts and encouraging employees to use their abilities fully.

Step 1: Explain how directing starts and unifies work The following are two points of importance of directing:

- **Initiates action:** Plans and organisation provide a framework, but employees must actually perform the assigned work. Through instructions, guidance and supervision, directing enables employees to start their jobs and turns managerial decisions into action towards the desired objectives.
- **Integrates employees' efforts:** Different employees perform different activities and may have different personal interests. By guiding their work towards common objectives, directing combines their individual contributions. It helps employees work together so that the performance of the organisation as a whole improves.

Step 2: Explain how directing develops employee contribution

- **Realises employees' potential:** Motivation, effective leadership and suitable guidance encourage employees to apply their knowledge and skills fully. Managers identify employees' capabilities and guide them towards better performance. Employees therefore contribute more effectively than they might without such encouragement and support.

Step 3: Conclusion Three points of importance of directing are that it **initiates action**, **integrates employees' efforts** and **helps employees realise their potential** in achieving organisational objectives.

Quick Tip to Solve: For an importance question, name each contribution of directing and then explain how it improves work; do not merely list its elements such as supervision and motivation.

8. 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 satisfy psychological, social and emotional needs such as esteem, belongingness, growth and recognition rather than providing only direct monetary rewards.
- Status, organisational climate and career advancement opportunities are distinct non-financial incentives. The specific features mentioned in a case reveal which incentive is being described.

Step 1: Identify Agrima's and Arunima's preferred incentives

- **Agrima — Status:** The case refers to "more authority for fulfilling her duties" and "recognition, rewards, perquisites and prestige of job". Status is the position or rank a person holds in the organisational hierarchy. The authority, responsibility, recognition and prestige associated with the position help satisfy esteem needs and motivate the employee.

- **Arunima — Organisational climate:** The case specifically mentions "autonomy, reward orientation, consideration to employees, risk taking etc." Organisational climate is the set of characteristics that describe an organisation and distinguish it from others. These characteristics influence the behaviour of individuals; a supportive climate can motivate employees to perform better.

Step 2: Identify Avika's preferred incentive

- **Avika — Career advancement opportunities:** Her preference is for "appropriate skill development programmes and sound promotion policy". Employees are motivated when they have opportunities to develop their abilities and advance to higher positions. Training, skill development and a sound promotion policy encourage employees to improve their performance in order to achieve career growth.

Step 3: Conclusion Agrima is referring to **status**, Arunima to **organisational climate**, and Avika to **career advancement opportunities**. Each is a non-financial incentive addressing a different employee need.

Quick Tip to Solve: Match prestige and rank with status, workplace characteristics with organisational climate, and training plus promotion with career advancement opportunities.

9(a). Explain the following rights of a consumer as provided by Consumer Protection Act, 2019 :
(i) Right to Seek Redressal
(ii) Right to Consumer Education [5 marks]

Solution:

Concept:

- Consumer Protection: consumer rights protect buyers against unfair trade practices and give them the knowledge and remedies needed to safeguard their interests.
- The right to seek redressal concerns relief when a consumer suffers harm; the right to consumer education concerns awareness of rights, responsibilities and available remedies.

Step 1: Explain the right to seek redressal

- **Right to obtain relief:** A consumer has the right to seek redressal against unfair or restrictive trade practices and unscrupulous exploitation. When goods are defective or services are deficient, the consumer can make a complaint and seek an appropriate remedy rather than merely accept the loss.
- **Remedies for the grievance:** The relief depends on the nature of the complaint. It may include removal of the defect in the goods or deficiency in the service, replacement of the defective product, refund of the price paid, or compensation for loss or injury suffered. Thus, redressal aims to put right the harm caused to the consumer.
- **Access to redressal machinery:** The consumer can approach the appropriate consumer commission to have the grievance considered and settled. For example, a buyer supplied with a defective appliance may seek its repair or replacement, or a refund, as appropriate. The right therefore makes consumer protection enforceable through a remedy.

Step 2: Explain the right to consumer education

- **Right to acquire knowledge and skills:** A consumer has the right to acquire the knowledge and skills needed to be an informed consumer throughout life. This includes knowing consumer rights and responsibilities, understanding product information, and learning how to make sensible purchasing decisions instead of being misled by an attractive claim alone.
- **Awareness of protection and remedies:** Consumer education makes buyers aware of the relief available and the procedure for seeking it. Government, consumer organisations and educational institutions help spread this awareness through educational programmes, publications and mass media. An educated consumer is more likely to check labels and quality information, keep purchase records and take action against exploitation.

Step 3: Conclusion The **right to seek redressal** entitles a consumer to seek appropriate relief against exploitation or a defective good or deficient service. The **right to consumer education** enables the consumer to acquire the awareness and skills required to make informed choices and use consumer-protection remedies effectively.

Quick Tip to Solve: Link redressal with a remedy for a grievance, and consumer education with knowledge before buying and awareness of how to complain.

OR

9(b). Give the meaning of 'Consumer' as per Consumer Protection Act, 2019. Also state when can a consumer complain directly in the 'State Commission' and 'National Commission' ? If the consumer is not satisfied with the decision of 'State Commission' and 'National Commission' where can he/ she appeal ? [5 marks]

Solution:

Concept:

- The Consumer Protection Act, 2019 protects a person who buys goods or hires or avails services for consideration. It provides a three-tier consumer dispute redressal machinery: District, State and National Commissions.
- Original jurisdiction determines where a complaint is filed directly; appellate jurisdiction determines where an order already passed can be challenged. The monetary limits refer to the value paid as consideration for the goods or services.

Step 1: Define a consumer of goods and services **Consumer of goods:** A consumer is a person who buys goods for consideration which has been paid or promised, partly paid and partly promised, or under a system of deferred payment. The definition includes a user of those goods with the buyer's approval. It excludes a person obtaining goods for resale or a commercial purpose. However, buying and using goods exclusively to earn one's livelihood through self-employment is not treated as a commercial purpose.

Consumer of services: It also means a person who hires or avails services for such consideration, including a beneficiary using them with the hirer's approval, but excluding services availed for a com-

mercial purpose. Purchases and services through online transactions, electronic means, teleshopping, direct selling and multi-level marketing are covered too.

Step 2: State where a complaint can be filed directly **State Commission:** Under the original monetary limits of the Consumer Protection Act, 2019 used in this syllabus, a consumer can complain directly where the value of goods or services paid as consideration exceeds Rs 1 crore but does not exceed Rs 10 crore.

National Commission: Under those original limits, a consumer can complain directly where that value exceeds Rs 10 crore. Thus, exactly Rs 10 crore falls within the State Commission's original jurisdiction, whereas an amount above it falls within the National Commission's.

Subsequent jurisdiction rules: The 2021 Rules revised these limits to above Rs 50 lakh and up to Rs 2 crore for the State Commission, and above Rs 2 crore for the National Commission. These revised limits should be distinguished from the original 2019 Act limits asked in this textbook context.

Step 3: Identify the appellate authorities **Appeal against the State Commission:** A consumer dissatisfied with its decision on a complaint originally filed there may appeal to the National Commission.

Appeal against the National Commission: A consumer dissatisfied with its decision on a complaint originally filed there may appeal to the Supreme Court of India. The next appellate authority is therefore determined by the level whose original decision is being challenged.

Step 4: Conclusion A consumer buys goods or avails services for consideration, subject to the exclusions stated above. Under the original 2019 Act limits, direct complaints lie before the State Commission for consideration above Rs 1 crore and up to Rs 10 crore, and before the National Commission above Rs 10 crore. Appeals from their original orders lie respectively to the National Commission and the Supreme Court of India.

Quick Tip to Solve: Separate direct filing from an appeal: first identify the monetary jurisdiction, then move one level upward for an appeal from an original order. Keep the original Act limits distinct from the revised 2021 Rules.

10. State the difference between 'Capital Market' and 'Money Market' on any five basis. [5 marks]

Solution:

Concept:

- Financial markets channel savings towards productive uses. The capital market provides medium- and long-term finance, whereas the money market provides short-term finance.
- Compare the markets on the same basis in each row: their maturity period, instruments, participants, investment outlay and safety. A market's classification depends on the nature and maturity of the funds, rather than on whether transactions occur in a physical building.

Step 1: Identify the financing needs served by each market The capital market brings together suppliers and users of medium- and long-term funds. It includes the primary market, where new securities are issued, and the secondary market, where existing securities are traded. The money market deals in monetary assets with a maturity of up to one year and helps organisations meet

temporary shortages of funds. Thus, raising long-term investment finance and managing short-term liquidity serve different needs.

Step 2: Compare the markets on five bases

Basis	Capital Market	Money Market
Duration	Deals in medium- and long-term funds, generally for periods exceeding one year. Shares represent ownership and have no fixed maturity.	Deals in short-term funds and monetary assets with maturities of up to one year.
Instruments	Main instruments are equity shares, preference shares, debentures and bonds.	Main instruments are treasury bills, commercial paper, call money, certificates of deposit and commercial bills.
Participants	Participants include financial institutions, banks, companies, foreign investors and individual or retail investors.	Major participants are the Reserve Bank of India, commercial banks, financial institutions and finance companies; large corporations also participate.
Investment outlay	Securities can be purchased in comparatively small amounts, making investment accessible to small savers and individual investors.	Transactions generally require large sums, so the market is dominated by institutions and large investors.
Safety	Investment is relatively riskier because returns may be uncertain and security prices can fluctuate substantially over longer periods.	Instruments are generally safer because of their short duration and the financial standing of issuers, though all instruments are not entirely risk-free.

Step 3: Conclusion Capital and money markets differ in duration, instruments, participants, investment outlay and safety. The capital market supports medium- and long-term financing and permits wider retail participation, while the money market primarily meets short-term funding and liquidity needs through large transactions in relatively safer instruments.

Quick Tip to Solve: In a distinction answer, use one shared basis per row and write directly comparable statements in both columns. Remember the one-year maturity boundary and pair shares and debentures with capital markets, treasury bills and commercial paper with money markets.

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 finding the right people for the right jobs. It includes estimating manpower requirements, recruitment, selection, placement, training and development.
- The quality of an organisation's human resources determines how effectively it can achieve its goals. Personal relationships cannot replace a proper assessment of an applicant's knowledge, skills and suitability for a job.

Step 1: Identify and state the function in part (a) The function is **staffing**. It is the process of filling and keeping filled the positions in the organisation structure by identifying workforce requirements, recruiting and selecting suitable persons, and placing, training and developing them for their roles.

The case states that Asha "felt the need of additional personnel", but appointed relatives instead of selecting people for their suitability. They were not providing "satisfactory service leading to lower productivity". These clues concern obtaining competent employees, which is staffing. Asha needed to assess the jobs and choose people with the required culinary and service skills rather than appointing them simply because they were relatives.

Step 2: State three benefits for part (b)

- **Obtaining competent personnel:** Staffing helps an organisation discover and obtain competent people for different jobs. Recruitment creates a pool of candidates, while selection assesses their suitability. This would help Asha obtain personnel capable of carrying out the work required in her expanding sweets business.
- **Higher performance through the right person in the right job:** Matching a person's abilities with the requirements of a job improves performance and productivity. Proper placement would help avoid the unsatisfactory service and deterioration in product quality described in Asha's case.
- **Optimum utilisation of human resources:** Staffing avoids overstaffing and understaffing by assessing the number and type of employees required. It also helps prevent the interruption of work by identifying shortages in advance and arranging suitable replacements or additions when

needed.

Step 3: Conclusion (a) Asha should have used **staffing**, the function of filling and keeping filled positions with suitable people. (b) Its benefits include obtaining competent personnel, securing higher performance by placing the right person in the right job, and ensuring optimum utilisation of human resources.

Quick Tip to Solve: When a case links recruitment or selection with employee competence, identify staffing; then state distinct benefits rather than listing its stages.

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: the dividend decision concerns the allocation of earnings between dividends paid to shareholders and profits retained in the business.
- Retained earnings provide internal finance. The finance manager balances shareholders' current income with the company's need for funds for future investment and growth.

Step 1: Identify and state the decision in the case **(i) Dividend decision:** The finance manager has taken a dividend decision. It is the decision about how much of the profit earned by the company is to be distributed to shareholders as dividend and how much is to be retained in the business. The words 'retain the profit instead of distributing it among shareholders' show that the manager is choosing between these two uses of earnings. Choosing retention is itself a dividend decision, even though the company does not distribute the profit.

Step 2: State three factors affecting the dividend decision **(ii) The following three factors affect this decision:**

- **Amount of earnings:** Dividends are paid out of current and past earnings. Consequently, the amount of earnings is an important determinant of the dividend decision. Other things being equal, a company with higher earnings has greater capacity to declare dividends. Ananta Ltd.'s increasing profit is relevant to this capacity, but does not by itself require all earnings to be distributed.
- **Stability of earnings:** A company with stable earnings can predict its future income more confidently and is therefore in a better position to pay higher dividends. A company whose earnings fluctuate generally retains more to avoid committing itself to a dividend level it may be unable to maintain.
- **Growth opportunities:** A company with good growth opportunities needs funds to finance expansion and investment projects. It may retain a larger part of earnings to meet these needs and, therefore, distribute a smaller dividend. This factor explains why a company may prefer retention even when its earnings have increased; the case does not establish that Ananta Ltd. actually has a

particular expansion project.

Step 3: Conclusion The decision is the **dividend decision**: allocating profits between dividends and retained earnings. Three factors affecting it are **amount of earnings, stability of earnings and growth opportunities**.

Quick Tip to Solve: When a case contrasts paying profits to shareholders with retaining them, identify the dividend decision. State factors affecting that allocation rather than factors determining the debt–equity mix.

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:

- Financial Management: the financing decision concerns the sources from which an enterprise will raise the funds needed for its business.
- Debt and equity have different costs and obligations. The financing mix must balance the overall cost of funds with the financial risk of meeting fixed payments.

Step 1: Identify the financial decision from the case The decision is the **financing decision**. Ravi wants to arrange the required funds through a 'mix of debt and equity', and the case says that this mix determines the 'overall cost of capital and the financial risk of the enterprise'. These are the clues that he is choosing the sources of finance, rather than deciding where to invest funds or how much profit to distribute.

Step 2: State the meaning of the decision A financing decision involves deciding the amount of finance to be raised from various long-term sources. It determines the proportion of owners' funds, such as equity share capital, and borrowed funds, such as loans or debentures, in the capital structure. For MTA Ltd., it concerns how the required rupees one crore should be raised through these sources.

Step 3: State three factors affecting the financing decision

- **Cost:** The cost of raising funds from different sources differs. The enterprise should compare the cost of the available sources and prefer an economical financing mix, while also considering its risk and other requirements.
- **Risk:** Debt carries greater financial risk because interest and repayment obligations must be met irrespective of profits. Equity does not carry a compulsory dividend or repayment obligation of this kind. The company must consider how much fixed financial commitment it can safely undertake.
- **Cash flow position of the company:** A stronger cash flow position makes it easier to meet interest

and repayment commitments, so the company may use more debt. If cash flows are weak or uncertain, excessive borrowing can create difficulty in meeting these obligations.

Step 4: Conclusion Ravi suggests a **financing decision**: deciding how much finance to raise from different long-term sources, including debt and equity. Three factors affecting this decision are **cost, risk and the company's cash flow position**.

Quick Tip to Solve: A case about choosing debt versus equity tests the financing decision; link fixed interest and repayment commitments to risk and cash flow.