CBSE Class 12 Business Studies Question Paper 2022 with Solution PDF-Set 66/6/3 - Compartment

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) Questions Number **1 – 4** are of **2** marks. These are Short Answer Type Questions and are to be answered in 30 – 50 words.

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

(iv) Questions 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.

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

1. Identify and state the type of test in the selection process that measures the actual skills possessed by an employee. [2 marks]

Solution:

Concept:

- Staffing uses selection tests to obtain reliable evidence about a candidate's suitability for a job before appointment.
- A trade test measures the actual skills already possessed by a person, whereas an aptitude test measures the potential to learn new skills.

Step 1: Identify the test from the ability measured The question refers to the employee's "actual skills", so the required test is a **trade test**. It checks existing proficiency in performing work associated with a particular occupation or trade.

Step 2: State what the test establishes A trade test measures the level of knowledge and proficiency in the area of the profession or technical training. For example, asking a typist to type a passage checks typing speed and accuracy. Such a practical test establishes what the person can presently do, rather than merely what the person might be capable of learning after training.

Step 3: Conclusion The test is a **trade test**: a selection test that measures the actual skills, occupational knowledge and proficiency already possessed by an employee.

Quick Tip to Solve: Link "actual skills" with a trade test; link "capacity to learn" with an aptitude test.

2. 'Frequent transfer of employees often reduces the productivity of the organisation, still it is being used as a good source of filling the vacancies internally.' Why ? State any two reasons. [2 marks]

Solution:

Concept:

- A transfer shifts an employee from one job, department, branch or shift to another without a substantive change in status and responsibility.
- As an internal source of recruitment, a transfer uses employees already available in the organisation to fill vacancies or meet staffing needs.

Step 1: Explain how transfers balance staffing **Adjustment of surplus and shortage:** Employees can be moved from a department having surplus staff to a department facing a shortage. This fills vacancies internally and enables more balanced utilisation of the organisation's existing human resources without recruiting a new employee for every shortage.

Step 2: Explain how transfers develop employees **Training for different jobs:** Transfers expose employees to different jobs, departments and working conditions. Employees thereby learn a wider range of work and gain experience that makes them more versatile. Although frequent transfers may initially disturb productivity, this broader experience helps prepare employees to handle varied assignments effectively.

Step 3: Conclusion Transfers remain useful because they **adjust surplus staff against shortages** and **train employees through experience of different jobs**.

Quick Tip to Solve: For the usefulness of transfers, state two distinct benefits: balancing staff and broadening employees' job experience.

3. Identify and give the meaning of the function of management that helps in verifying whether the standards set are accurate and objective or not. [2 marks]

Solution:

Concept:

- Controlling is the management function that compares actual performance with planned standards and ensures that organisational activities lead towards the desired goals.
- By comparing results with standards and investigating deviations, controlling also helps managers judge whether the standards themselves are accurate and objective.

Step 1: Identify the management function The function is **controlling**. The reference to "verifying whether the standards set are accurate and objective" points to judging the accuracy of standards, an importance of controlling. It enables management to review standards in the light of actual experience rather than accept them unquestioningly.

Step 2: Explain the meaning of controlling Controlling means measuring actual performance, comparing it with predetermined standards, finding and analysing deviations, and taking corrective action where necessary. Through this process, management ensures that activities conform to plans and that resources are used towards achieving organisational objectives. Where a standard proves unrealistic or unsuitable, the comparison provides a basis for reviewing it.

Step 3: Conclusion The function is **controlling**, the process of comparing actual performance with standards and taking corrective action to ensure achievement of organisational goals.

Quick Tip to Solve: When a case mentions checking performance or judging the accuracy of standards, identify controlling and explain its comparison-and-correction process.

4. 'Training of intermediaries of the securities market' is a development function performed by Securities and Exchange Board of India. State two other development functions. [2 marks]

Solution:

Concept:

- Securities and Exchange Board of India (SEBI) performs developmental functions to promote the orderly growth and efficient working of the securities market.
- Developmental functions improve market practices and participants' knowledge; they are distinct from protective measures against malpractice and regulatory supervision.

Step 1: State the research function **Conducting research:** SEBI conducts research and publishes information useful to market participants. Such research improves understanding of the securities market and helps its systematic development.

Step 2: State the flexible approach to market development **Promoting market activities through a flexible approach:** SEBI adopts a flexible and adaptable approach to activities that contribute to the development of the capital market. For example, permission for internet trading through registered stockbrokers supports more convenient access to the market.

Step 3: Conclusion The two other developmental functions are conducting research and publishing useful information, and promoting capital-market activities through a flexible and adaptable approach. These are additional to the training of intermediaries already stated in the question.

Quick Tip to Solve: For SEBI's developmental functions, recall training, research and flexible support for market development; do not substitute a protective function such as prohibiting insider trading.

5. Explain 'Offer for Sale' and 'Rights Issue' as methods of floatation of new issues in the primary market. [3 marks]

Solution:

Concept:

- The primary market deals with securities issued for the first time. A company can raise capital through different methods of floatation of new issues.
- Offer for sale uses an intermediary to reach the investing public, whereas a rights issue gives existing shareholders a preferential opportunity to subscribe.

Step 1: Explain offer for sale **Offer for sale:** Under this method, securities are not issued directly to the public by the company. Instead, the issuing company sells the entire issue to an intermediary, such as an issuing house or stockbroking firm, at an agreed price. The intermediary then resells these securities to the investing public at a higher price. Thus the intermediary undertakes the public offering and the company receives the agreed proceeds from the intermediary.

Step 2: Explain rights issue **Rights issue:** When an existing company issues additional shares, it gives its existing shareholders the right to subscribe to the new shares in proportion to the shares they already hold. The company specifies the ratio and terms of the offer. For example, a one-for-five rights issue entitles a shareholder holding 100 shares to subscribe for 20 new shares. This pre-emptive opportunity enables existing shareholders to maintain their proportionate ownership if they exercise their rights.

Step 3: Conclusion Offer for sale raises funds by selling the issue to an intermediary who subsequently offers it to the public. A rights issue offers additional shares first to existing shareholders in proportion to their existing holdings. Both are methods of floatation of new securities in the primary market.

Quick Tip to Solve: Identify the first recipient of the offer: an intermediary indicates offer for sale; existing shareholders receiving a proportionate entitlement indicate a rights issue.

6. Name and state the process which is job-oriented and is used to increase the skills and abilities of employees to perform a specific job. [3 marks]

Solution:

Concept:

- **Training:** In the staffing function, training improves an employee's knowledge, skills and abilities for the effective performance of a particular job.

- Training is job-oriented and concerns the requirements of the present job. Development has a broader scope and prepares an employee for overall growth and future responsibilities.

Step 1: Identify the process from the clues The process is **training**. The expressions "job-oriented" and "perform a specific job" show that the emphasis is on learning the skills needed for a particular assignment. Thus, the question refers to improving job performance rather than to the employee's general personal growth.

Step 2: State the meaning of training Training is the process of increasing the knowledge, skills and abilities of employees for doing a specific job. It involves organised learning through instruction and practice so that employees learn the correct method of performing their duties and can carry them out efficiently. For example, teaching an employee how to operate the machine used in the employee's assigned work is training: the learning is directly related to that job.

Step 3: Conclusion The required process is **training**, which develops the knowledge, skills and abilities necessary to perform a specific job effectively.

Quick Tip to Solve: Link "specific job" and "job-oriented" with training; link broader personal growth and future responsibilities with development.

7(a). Give the meaning of formal and informal communication. [3 marks]

Solution:

Concept:

- Communication is the exchange of information and understanding between people. Within an organisation, it may follow formally prescribed channels or arise through social interaction.
- Formal communication is based on the official organisation structure, whereas informal communication is based on personal and social relationships among its members.

Step 1: Explain formal communication **Formal communication:** It refers to communication flowing through the official channels designed in the organisation chart. It follows the prescribed authority and responsibility relationships and concerns the performance of organisational work. It may be oral or written, and may flow vertically between superiors and subordinates or horizontally between persons at the same level. For example, a manager issuing work instructions to a subordinate through the prescribed reporting relationship uses formal communication.

Step 2: Explain informal communication **Informal communication:** It refers to communication that takes place without following the formally prescribed channels. It arises from the personal and social interaction of people working in an organisation, such as employees discussing matters during a lunch break. Its network is commonly called the **grapevine**. It does not necessarily follow the chain of command and can spread across departments and levels. Its defining feature is the unofficial channel, rather than whether the message is spoken or written.

Step 3: Conclusion Formal communication follows officially prescribed organisational channels; informal communication arises through social relationships and flows outside those prescribed channels.

Quick Tip to Solve: Identify the channel: official reporting relationships indicate formal communication, while personal contacts and the grapevine indicate informal communication.

OR

7(b). Explain the first two steps in the process of controlling. [3 marks]

Solution:

Concept:

- Controlling is the management function of comparing actual performance with planned standards and taking corrective action wherever necessary.
- Standards provide the yardstick for appraisal, while measurement supplies reliable information about what has actually been achieved.

Step 1: Set performance standards **Setting performance standards:** The first step is to establish the criteria against which actual performance will be evaluated. Standards should be clear, specific and, wherever possible, measurable so that employees know the expected level of achievement. Quantitative standards may be expressed as units of output, cost, revenue or time. Where performance cannot be expressed numerically, qualitative standards, such as goodwill or employee motivation, may be used. Standards must be realistic and flexible enough to be modified when the business environment changes.

Step 2: Measure actual performance **Measurement of actual performance:** The second step is to find out the actual performance achieved, using methods such as personal observation, sample checking, performance reports and accounting information. Measurement should be objective and reliable. It should use the same units as the standards to make the later comparison meaningful. For example, if the standard concerns output per week, actual weekly output should be recorded. Performance is normally measured after a task is completed, but measurement during the task may help managers detect difficulties promptly.

Step 3: Conclusion Thus, the first two steps are setting performance standards and measuring actual performance. They establish the expected result and the actual result respectively; comparison and corrective action follow later in the controlling process.

Quick Tip to Solve: Remember the opening sequence as "set the target, record the result". Keep comparison separate: it is the next step after measurement.

8. Hemant is working as a Human Resource Manager in AO chain of hospitals in Mumbai. He had to appoint nurses for the hospitals. For this, he has conducted various tests and interviews and verified the information of the applicants. The final decision has been made in consultation with the heads of the nursing department.

Hemant still has to take some more steps to complete the process of appointment of nurses.

Name and explain these steps. [3 marks]

Solution:

Concept:

- Selection identifies the most suitable applicants through successive screening stages. A selection decision alone does not complete the formal appointment process.

- In the NCERT selection sequence, medical examination, job offer and contract of employment follow the selection decision.

Step 1: Arrange the medical examination **Medical examination:** After the selection decision, Hemant should arrange a medical fitness examination of the selected candidates. The job offer is given to a candidate found medically fit for the job. This establishes whether the selected nurse can meet the health and physical requirements of the work. The case states, "The final decision has been made in consultation with the heads of the nursing department." This identifies the completed selection-decision stage. Tests, interviews and verification are already complete, so these earlier stages need not be repeated.

Step 2: Make the job offer **Job offer:** Hemant should issue an offer of appointment through a letter to each medically fit selected candidate. The letter should specify the date by which the candidate must report for duty. A reasonable reporting time should be allowed, particularly if the candidate must obtain release from an existing employer. This is the formal communication of the hospital's offer; it follows the decision to select the applicant.

Step 3: Complete the contract of employment **Contract of employment:** Once the offer is accepted, the candidate and the employer should complete the employment contract and the required documents. The contract sets out the terms and conditions of employment, including job title, duties, remuneration, working hours, leave, benefits and rules concerning termination. The necessary attestation and personal details are also obtained for the personnel record. Clearly recorded and mutually accepted conditions establish the employment relationship and avoid uncertainty about obligations.

Step 4: Conclusion The remaining selection steps are medical examination, job offer and contract of employment. Completing them converts the selection decision into the formal appointment of the nurses.

Quick Tip to Solve: Locate the last completed stage in the case: a final selection decision is followed by medical fitness, an offer letter and the employment contract.

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

(i) Right to be Informed

(ii) Right to be Heard [5 marks]

Solution:

Concept:

- Consumer protection safeguards buyers against unfair trade practices and gives them rights that enable informed purchases and effective representation of their grievances.
- The right to be informed concerns complete and accurate product information before purchase, while the right to be heard ensures that consumer interests and complaints receive consideration at appropriate forums.

Step 1: Explain the right to be informed **Meaning:** A consumer has the right to receive complete information about the goods or services purchased. This includes their quality, quantity, purity, potency, standard and price. Such information enables the buyer to judge whether the product meets the

intended need and whether the price charged is justified.

Information in practice: A manufacturer or seller should provide relevant details through the label, package or other appropriate means. For example, a packaged food label provides its ingredients, net quantity, manufacturing and expiry dates, maximum retail price and directions or precautions for use. These particulars help the consumer compare alternatives and use the product safely.

Protection provided: The consumer can make an informed choice rather than relying only on persuasive advertising or a seller's claims. Knowledge of the maximum retail price helps the buyer resist overcharging, while information about ingredients and expiry helps avoid unsuitable or expired goods.

Step 2: Explain the right to be heard **Meaning:** A consumer has the right to put forward a complaint when dissatisfied with goods or services, and to have consumer interests receive due consideration at appropriate forums. The consumer's grievance should be heard rather than ignored merely because the seller is more powerful.

Opportunity to complain: Consumers may approach the business's customer grievance machinery and the appropriate consumer redressal forum with their complaint. For example, a buyer whose defective appliance is not repaired despite a valid warranty can present the grievance and supporting documents for consideration.

Role of representation: Consumer organisations can help consumers express their concerns and represent their interests. Thus, the right is relevant both to an individual complaint and to ensuring that consumer interests are considered when decisions affecting them are made. Being heard provides an opportunity to present the case; the remedy is determined on its merits through the redressal process.

Step 3: Conclusion The right to be informed equips a consumer with complete product information for a reasoned purchase. The right to be heard ensures an opportunity to voice dissatisfaction and have consumer interests and grievances duly considered at the appropriate forums.

Quick Tip to Solve: Link "informed" to product facts before buying and "heard" to the consumer's voice when raising a grievance. Explain the meaning and a practical application of each right.

OR

9(b). Give the meaning of a 'Consumer' as per the Consumer Protection Act, 2019. Also discuss when are the 'State Commission' and 'National Commission' helpful in redressing the grievances of consumers. [5 marks]

Solution:

Concept:

- Consumer Protection concerns the protection of buyers of goods and users of services against defective goods, deficient services and unfair trade practices.
- The Consumer Protection Act, 2019 provides a three-tier redressal machinery: District, State and National Commissions. The appropriate commission depends on its jurisdiction; a higher commission also hears appeals from the commission below it.

Step 1: Define a consumer A consumer is a person who buys goods or hires or avails services for a consideration which has been paid or promised, partly paid and partly promised, or is payable under a system of deferred payment. The definition includes a user of such goods or a beneficiary of such services when that use takes place with the approval of the buyer or hirer.

It covers transactions made offline or online, including electronic means, teleshopping, direct selling and multi-level marketing. A person obtaining goods for resale or goods or services for a commercial purpose is excluded. However, using goods bought and used exclusively to earn one's livelihood through self-employment does not count as a commercial purpose.

Step 2: Explain the role of the State Commission **Original complaints:** Under the original pecuniary limits of the 2019 Act used in this textbook framework, the State Commission entertains complaints where the value of goods or services paid as consideration exceeds Rs 1 crore but does not exceed Rs 10 crore.

Appeals: A consumer dissatisfied with an order of the District Commission can appeal to the State Commission. Thus, it provides both a forum for complaints within its jurisdiction and a higher forum for review of district-level decisions.

Step 3: Explain the role of the National Commission **Original complaints:** Under the original pecuniary limits of the 2019 Act, the National Commission entertains complaints where the value of goods or services paid as consideration exceeds Rs 10 crore.

Appeals: It hears appeals against orders of State Commissions. These commissions can order appropriate relief, such as removal of defects, replacement of defective goods, refund of the price, removal of deficiencies in services and payment of compensation for loss or injury. Their purpose is to provide an effective remedy rather than leave the consumer dependent on the seller's willingness to cooperate.

Step 4: Conclusion A consumer is an eligible buyer or approved user of goods, or hirer or approved beneficiary of services, for consideration. The State and National Commissions redress complaints within their respective jurisdictions and provide appellate remedies against the decisions of lower commissions.

Quick Tip to Solve: State the meaning of consumer first; then give each commission's original jurisdiction and its appellate role separately. The value paid as consideration decides pecuniary jurisdiction.

10. Explain 'Commercial Paper' and 'Certificate of Deposit' as instruments of 'Money Market'.

[5 marks]

Solution:

Concept:

- The money market deals in short-term funds through monetary assets with a maturity of up to one year. Its instruments meet temporary financing needs and provide avenues for investing surplus funds.
- Commercial paper and certificates of deposit are unsecured, negotiable instruments. They differ chiefly in their issuers and the financing purpose they serve.

Step 1: Explain Commercial Paper **Meaning and form:** Commercial Paper (CP) is an unsecured promissory note with a fixed maturity period. Since it is unsecured, no specific asset is pledged as collateral. It is negotiable and can be transferred by endorsement and delivery.

Issuers and maturity: Large, creditworthy companies issue CP to raise short-term funds at rates generally lower than market borrowing rates. Its maturity normally ranges from 15 days to one year. The financial strength and creditworthiness of the issuing company give investors confidence in repayment.

Purpose: CP provides an alternative to bank borrowing and is commonly used for working-capital needs. It may also provide bridge financing: a company can meet expenditure such as issue expenses while awaiting the proceeds of a proposed long-term securities issue. Thus, it connects an immediate need for funds with a later source of finance.

Step 2: Explain Certificate of Deposit **Meaning and form:** A Certificate of Deposit (CD) is an unsecured, negotiable instrument issued in bearer form by commercial banks and development financial institutions. It acknowledges a deposit for a specified period and can be transferred in the money market.

Issue conditions: CDs can be issued to individuals, corporations and companies during periods of tight liquidity, when the growth of bank deposits is slow but the demand for credit is high. They help the issuing institutions mobilise a large amount of money for a short period.

Purpose and distinction: A CD enables a bank or financial institution to obtain short-term resources to meet its funding requirements. A CP, in contrast, is a company's short-term promissory note used for corporate financing. Both belong to the money market, but a CD represents funds deposited with an eligible financial institution, while a CP represents borrowing by its issuing company.

Step 3: Conclusion Commercial Paper is a company's unsecured, negotiable promissory note for short-term finance, whereas a Certificate of Deposit is an unsecured, negotiable bearer instrument issued by commercial banks and development financial institutions to mobilise short-term funds. Both facilitate the movement of short-term surplus funds to those requiring them.

Quick Tip to Solve: Remember the issuer first: Commercial Paper points to a creditworthy company's borrowing; a Certificate of Deposit points to a bank or development financial institution raising deposits.

11. Riya was working as a manager in a hotel. During COVID-19 she lost her job. Now she has started her own restaurant which was providing immunity-boosting food. Her restaurant was a success and she was earning a good profit. To benefit the people of other areas with her immunity-boosting food, she thought of starting three restaurants in three different cities. For this, she appointed three managers. She told all the managers that to be successful it is necessary that they should guide the people working in their respective teams about the work to be done by them, when they should do it and how they should do it. She also added that mere transfer of views or information is not sufficient, it is necessary that their instructions are implemented in the proper perspective, so that the organisation may achieve its objectives. To improve the performance level of employees, she suggested that they develop insights into causes of behaviour of people. They have to make subordinates act in a desired manner to achieve organisational goals.

(a) Identify and state the function of management discussed in the above para.

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

Solution:

Concept:

- Directing is the management function of instructing, guiding, counselling, motivating and leading people to achieve organisational objectives.
- Directing brings plans into action through people. It includes supervision, motivation, leadership and communication, rather than merely passing information to subordinates.

Step 1: Identify and state the function in part (a) The function is **directing**. It refers to the process of instructing, guiding, counselling, motivating and leading people in the organisation to achieve its objectives. The case says managers should "guide the people working in their respective teams" about what, when and how to do their work. Riya also stresses that instructions must be implemented and that managers must make subordinates "act in a desired manner to achieve organisational goals". These clues concern influencing people and getting work performed, which identifies directing.

Step 2: State three points of importance for part (b)

- **Initiates action:** Directing initiates action by employees towards attaining organisational goals. Planning, organising and staffing prepare the organisation for work, but directing guides people to carry out the assigned activities. Instructions become actual performance through this function.
- **Integrates employees' efforts:** Directing integrates individual efforts so that every employee's contribution supports organisational performance. Managers guide employees towards common objectives and coordinate their activities, preventing separate efforts from working at cross-purposes. This enables the organisation to obtain better collective results.
- **Realises employees' potential:** Directing helps employees realise their potential and capabilities. Appropriate motivation and effective leadership encourage employees to use their abilities fully and improve performance. Guidance also builds confidence and helps them contribute more effectively to organisational goals.

Step 3: Conclusion (a) Riya is describing **directing**, the process of guiding and influencing people to achieve organisational objectives. (b) It is important because it initiates action, integrates employees' efforts, and helps employees realise their potential and capabilities.

Quick Tip to Solve: Link "guide", "instructions implemented" and "make subordinates act" to directing; then state each importance point as a separate heading with its effect on performance.

12(a). 'A.M. Motors Ltd.' is a leading company in car manufacturing. Due to the changing environment and initiatives taken by the Government of India, the company wants to enter into manufacturing of e-cars also. For this project the company requires ₹ 2,000 crore. But before purchasing the machines and other assets, the finance manager has to assess the degree of risk involved in the project as this type of decision affects the earning capacity of the business over the long run. Besides this there are various other factors which may affect this decision of the finance manager.

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

(ii) State any two factors that may affect the decision of the finance manager identified in (i) above.

[5 marks]

Solution:

Concept:

- **Investment decision:** Financial management decides how the firm's funds should be invested in different assets so that the investment earns a suitable return and contributes to shareholders' wealth.
- **Capital budgeting:** Investment in long-term assets, such as plant and machinery for a new project, is a long-term investment decision. It involves large funds, affects future earning capacity and can be difficult to reverse.

Step 1: Identify and state the decision in part (i) The decision is a **long-term investment decision, also called a capital budgeting decision**. It concerns allocating funds to long-term assets or projects that will yield benefits over a number of years.

A.M. Motors Ltd. proposes to enter e-car manufacturing and invest Rs 2,000 crore in the project. The references to "purchasing the machines and other assets" and affecting "the earning capacity of the business over the long run" establish that the issue is investment in fixed assets. The manager must evaluate the project's benefits and risks before committing funds. The amount required alone does not make this a financing decision: the question concerns whether to invest in the project, rather than which sources should provide the funds.

Step 2: State two factors affecting the decision in part (ii)

- **Cash flows of the project:** A project involves cash outflows for investment and generates cash inflows during its life. The amount and timing of these flows must be carefully assessed before making the capital budgeting decision. For the proposed e-car project, the finance manager should assess the initial expenditure on machines and other assets and the expected future net cash inflows from operations. An investment must be judged over its useful life; a large prospective sales figure alone does not establish that its cash inflows justify its cash outflows.
- **Rate of return:** The expected rate of return from the project is an important criterion in selecting an investment. It must be assessed along with the risk involved and the return required from the investment. The finance manager should evaluate whether the e-car project is expected to earn a satisfactory return on the funds committed. When comparing suitable investment alternatives, the relative returns help the firm select the most beneficial proposal, subject to its risk and other investment criteria.

Step 3: Conclusion A.M. Motors Ltd. is considering a **capital budgeting or long-term investment decision**: committing funds to long-term assets for the e-car project. Two factors affecting this

decision are the **cash flows of the project** and its **expected rate of return**.

Quick Tip to Solve: Identify the use of funds before naming a financial decision: buying long-term assets points to capital budgeting, while choosing the sources of those funds points to financing.

OR

12(b). 'R.K. Fertilisers Ltd.' has planned to set up a plant for manufacturing urea fertiliser which has very high market potential as there is excess demand as compared to supply. The company is planning to operate at a higher scale which will require a bigger plant, more space, etc. The company has also planned to replace its plant and machinery as the same are prone to obsolescence with the change in technology. To meet the growing demand of fertilisers that may result in increase in profits, the company is also planning to diversify its operations. It wants to enter in the area of cement manufacturing. Thus, it is a capital intensive project involving an investment of ₹ 3,000 crore.

Identify and state any five factors affecting the fixed capital requirements of 'R.K. Fertilisers Ltd.' discussed in the above para. [5 marks]

Solution:

Concept:

- Fixed capital refers to funds invested in fixed assets such as land, buildings, plant and machinery that serve the business over a long period.
- Fixed capital requirements depend on the nature and scale of business, technological changes, growth prospects and diversification plans. Identify each factor by linking the textbook term with evidence from the case.

Step 1: Identify the nature and scale of operations

- **Nature of business:** R.K. Fertilisers Ltd. plans to set up a plant for "manufacturing urea fertiliser" and describes its project as "capital intensive". A manufacturing concern needs plant, machinery and other production facilities. It therefore requires substantial fixed capital, unlike a trading concern that does not manufacture its products.
- **Scale of operations:** The company plans to operate "at a higher scale" requiring "a bigger plant, more space, etc." Large-scale operations require a larger production facility and more fixed assets than small-scale operations, increasing the fixed capital needed.

Step 2: Link technology and growth prospects to investment

- **Technology upgradation:** The company plans to "replace its plant and machinery" because they are "prone to obsolescence with the change in technology". When technology changes rapidly, a business must provide funds for replacing outdated machinery and acquiring suitable equipment. Such replacement raises its fixed capital requirements.
- **Growth prospects:** Urea has "very high market potential" because demand exceeds supply, and the company expects "growing demand of fertilisers". Favourable growth prospects encourage a business to invest in additional production capacity to meet future demand. This requires more funds in fixed assets and hence more fixed capital.

Step 3: Explain the effect of diversification

- **Diversification:** The company wants to "enter in the area of cement manufacturing". Adding this new line of business requires investment in additional production facilities, plant and machinery appropriate for cement manufacturing. Diversification therefore increases fixed capital requirements because the firm must finance fixed assets for an additional activity alongside its existing fertiliser business.

Step 4: Conclusion The five factors are nature of business, scale of operations, technology upgradation, growth prospects and diversification. In this case each factor points towards a substantial requirement of fixed capital for production facilities, capacity expansion, replacement and the new cement business.

Quick Tip to Solve: Match each case clue to a separate factor: manufacturing to nature, bigger plant to scale, replacement to technology, rising demand to growth, and cement entry to diversification.