

Business Studies 2019 Delhi - Set-2

General Instructions:

- (i) This question-paper contains **five** Sections – A, B, C, D and E.
- (ii) Section – A contains questions **1** to **8** carrying **one** mark each. Answer to these questions may be given in **one** word or a sentence.
- (iii) Section – B contains questions **9** to **13** carrying **three** marks each, answers to these questions may be in **50** to **75** words.
- (iv) Section – C contains questions **14** to **19** carrying **four** marks each. Answers to these questions may be in about **120** words.
- (v) Section – D contains questions **20** to **22** carrying **five** marks each. Answers to these questions may be in about **150** words.
- (vi) Section – E contains questions **23** to **25** carrying **six** marks each. Answer to these questions may be in about **200** words.
- (vii) There is no over-all choice in the question paper, however an internal choice has been provided in **3** questions of **one** mark, **2** questions of **three** marks **2** questions of **four** marks, **1** question of **five** marks and **1** question of **six** marks. You have to attempt only **one** of the choices in such questions.

Question 1

Beena has been using 'Klean', a famous detergent available in the market. On watching numerous advertisements in the television, she decided to try a new brand of detergent. When she went to the near-by store to purchase the same, she saw detergents of other producers making similar claims of whiteness and stain removing abilities. Hence she could not make up her mind as which detergent to purchase.

Name the objection of advertising being discussed in this case.

SOLUTION:

The objection of advertising that is being discussed in the question is that advertising 'confuses the buyers' by making similar claims.

Question 2

Give the meaning of 'Physical Distribution' as an element of Marketing Mix.

OR

What is meant by 'Marketing Management'?



SOLUTION:

Physical distribution refers to the process of making the goods and services available at the right place and at the right time so that the consumers can easily purchase the goods without any delay. It involves deciding the channels of distribution through which the products would be moved from the place of production to the place of consumption.

OR

According to *American Management Association*, marketing management is defined as 'the process of planning and executing the conception, pricing, promotion and distribution of ideas, goods and services to create exchanges that satisfy individual and organisational goals'. Activities involved in marketing management comprise planning, organising, directing and controlling.

Question 3

Define 'Workforce Analysis'.

OR

Define Selection'.

SOLUTION:

A workforce analysis refers to an estimation of the existing personnel in the organisation.

OR

The process of **choosing the right candidate** out of the gathered pool developed at the time of recruitment is known as selection.

Question 4

Appliances India Ltd. is engaged in manufacturing and distribution of home appliances since 1987. It has a good name in the market as the company is producing good quality appliances. It has separate departments for manufacturing, finance, sales maintenance services and technical services to achieve specialization.

Since the areas of operations of the company have increased and customers have become more demanding, the company decided to modify the existing principle of management to meet the changing requirements of the environment.

State the general principle of management which the company wants to modify to meet the changing requirements.

SOLUTION:

The principle of management that the company wants to modify is 'division of work'.

Question 5

How does Financial Market facilitate 'Price Discovery' of financial assets?

SOLUTION:

In financial markets, there are two players i.e. the households and the business firms. Here the households act as the suppliers of funds and the business firms make the demand. Now, we know that the price is determined when demand meets supply, so in such markets as well, wherever the demand meets supply, the price for that financial asset that is being traded in that market is determined.

Question 6

Biru Nandan, Chairman of Lalit group of companies founded 'Biru University' for undergraduate and postgraduate courses in diverse disciplines. The Information Technology department of the 'Lalit Power Ltd.', had few vacancies related to Cyber Security. The Human Resource Department of the Company decided to recruit fresh engineering graduates from 'Biru University' for the same. Identify the type of source of recruitment.

SOLUTION:

The source of recruitment that is being used is 'Campus Recruitment'.

Question 7

Varsha Jain after completing her fashion designing course from Indian Institute of Fashion Technology planned to enter into designer clothing venture. She had to address issues like her target customers, channel of distribution to be used, pricing policy etc. identify the type of plan that Varsha Jain needs to develop to provide direction and scope to her organization in the long run.

SOLUTION:

The type of plan that Varsha Jain should use is the strategy.

Question 8

State any two 'Developmental Functions' of Securities and Exchange Board of India.

OR

What is meant by 'Allocative Function' of Financial Markets?

SOLUTION:

Two developmental functions of SEBI are as follows:

Training- Provides training and development to the intermediaries of the securities market so as to promote healthy growth of the secondary market.

Research- Conducts research in the important areas of the securities market so as to help investors and other market players make wise investment decisions.

OR

An important function of the financial market is known as the 'allocative function'. A financial market acts as a link between the savers and the investors. It provides a platform for the mobilisation of savings from the households to the investors. Thus, it allocates funds from households to investors.

Question 9

What is meant by 'Capital Structure'? Explain any two factors that affect the capital structure of a company.

OR

Explain any three factors that affect the working capital requirements of a company.

SOLUTION:

Capital structure is simply referred to as the combination of debt and equity used by a company for financing its fund requirements. Algebraically Capital Structure is equal to $\frac{\text{Debt}}{\text{Equity}}$ or $\frac{\text{Debt}}{\text{Debt}+\text{Equity}}$ or $\frac{\text{Debt}}{\text{Debt}+\text{Equity}}$.

Two factors which affect the capital structure of a company are:

1. Equity cost: The rate of return expected by the shareholders is directly related to the risk associated with their investment. As the financial risk faced by the company increases, the shareholders' expectation of rate of return increases and vice versa. Now, as the company increases the component of debt, the financial risk faced by it also increases. Therefore, the shareholders' expectation of rate of return increases. This relationship suggests that a company cannot increase the component of debt in its capital structure beyond a certain point.

2. Floatation cost: It refers to the cost of raising funds such as broker's commission and underwriting commission. The higher the floatation cost involved in raising funds from a particular source, the lower is its proportion in the capital structure. For instance, if public issue of shares involves higher floatation cost than debt, then the company would opt for more of debt and less of equity in the capital structure.

OR

The factors which affect the working capital requirements of a company are:

1. Fluctuations in business cycle: During a boom period, the market flourishes and thereby there is higher sale, higher production, higher stock and debtors. Thus, during this period the need for working capital by a company increases. As against this, in a period of depression, there is low demand, lesser production and sale, etc. Therefore, the requirement for working capital is also less.

Boom → Large working capital requirement



Depression→ Small working capital requirement

2. Inflation: A rise in the rate of inflation implies that the prices of raw materials, labour, etc. increase. This suggests that larger amount of funds would be required to maintain even the existing volume of production and sales. This in turn increases the requirement of working capital. On the other hand, a low rate of inflation implies less requirement of working capital for a business.

High rate of inflation→ Large working capital requirement

Low rate of inflation→ Small working capital requirement

3. Extent of availability of raw material: If the raw materials required by the company are such that they are easily available, then this suggests that the firm need not maintain a large stock of inventories of raw material. In such situations, the company requires less working capital. On the other hand, if the raw materials are not easily available or their supply is not smooth, then the company must maintain a huge stock of raw material to ensure uninterrupted operations, thereby requiring a large working capital.

Easy availability of raw material → Low working capital requirement

Difficulty in obtaining raw material → High working capital requirement

Question 10

'Co-ordination is needed at all levels of management and is the responsibility of all managers.' Explain.

OR

Explain any three reasons, which clarify that management is gaining importance day by day.

SOLUTION:

Yes, Coordination is indeed the essence of management. By Coordination, we mean a path through which the group functions are linked up. It binds the people of the organisation and their activities to ensure a smooth functioning of the work. It is that force which unites the working and efforts of the people of the organisation towards the common objective of the organisation. Coordination links the interrelated management functions. It is found at every level of management. It begins right from the stage of planning where goals and objectives are set for the organisation. Coordination is then required between the stage of planning and staffing so that right kind of people are hired for the execution of the plan. Next the functions of directing and controlling must also be coordinated with each other so as to realise the achievement of desired goals. Hence, we see that coordination is intrinsic and imperative for management. It is the 'essence' of management.

OR



The points which clarify that management is gaining importance day by day are explained as follows:

1. Achievement of goals: Management helps in the achievement of goals such that the efforts of all the individuals are organised and directed towards the common goals of the organisation.
2. Increases efficiency: An increase in efficiency implies minimising the costs and increasing the productivity through the optimum utilisation of resources. As management helps in optimum utilisation of resources, it helps in increasing efficiency.
3. Creates dynamic organisation: Management helps an organisation to adapt to the changes in external factors such as political, social, environmental and economical changes.

Question 11

JTM Ltd. launched 'Buddyline', an exercise book and comprehensive stationery brand name comprising of ball pens, gel pens and geometry boxes after identifying the target market and understanding the needs and wants of the consumers of that market. All their products were of good quality and eco-friendly but expensive. They wanted to distinguish their products from that of their competitors. They spent lot of efforts, time and money in creating the brand name, as they knew that without a brand name, they can only create awareness for the generic products and can never be sure of the sale of their products. The effort paid off and the demand for the products started growing. The customers liked the brand and became habitual to it. They did not mind paying a higher price. Over a period of time, it became a status symbol to buy 'Buddyline' brand because of its quality. The consumers felt pride in using them.

- (i) Identify the marketing management philosophy followed by JTM Ltd.
- (ii) Explain the advantages of branding to the marketeers highlighted in the above case

SOLUTION:

a. The marketing management philosophy that is being followed by JTM Ltd. is 'Societal Marketing Concept'. This is because it not only identified the needs and wants of the consumers but also delivered a good quality and eco-friendly product.

b. The following advantages of branding are being discussed:

1. Branding enables a firm to clearly **distinguish its product from the product of other firms**.
2. Branding enables consumers to clearly **distinguish the product from various other available products**.

Consumers see a good brand as a mark of authenticity and genuinity.

3. Good branding helps in creating loyalty and **habituality for product** among the customers. The firm can take advantage of this and **charge a different price** (generally a higher price) for its product. Also, a good brand name helps in providing an initial boost to the demand of the new product.

4. Established and famous brands act as **status symbols** for the consumers, thereby providing them psychological and social benefits.

Question 12



Mita has a successful ice cream business at Bikaner, namely "Smart flavours' ice creams are utterly delicious. She makes ice creams from fresh milk and the same are available in a wide range of flavours and packs. She sets viable business objectives and works with the same in mind in order to ensure that the customers will come back for purchasing.

Having the first mover advantage, her business was doing well. To earn higher profits, she started cutting costs. This would sometimes lead to delay in delivery and the ice cream was not reaching the market in time. Over a period of time, the demand for her ice cream declined and because of it the competitors entered the market. She lost some of her market share to competitors.

At the beginning of summer season, she got back to back order for supply of 4,000 ice cream packs of different flavours for special occasions. To ensure that the task was completed and orders delivered in time she hired additional workers. She was, thus able to produce and deliver the ice cream packs but at a high production cost. While completing activities and finishing the given task for achieving goals, Mita realized that she was ignoring one of the important aspects of management.

Identify the aspects of management that has been ignored by Mita. Also explain the same with the help of an example.

SOLUTION:

The aspect of management that is being ignored is 'efficiency'. This is because efficiency involves completing the task with the minimum possible cost and resources. Here as she was required to hire more workers to complete the task on time, she ignored the aspect of efficiency and only focused on effectiveness.

For example, if more workers are hired \Rightarrow task gets completed on time \Rightarrow then this is effective, but if more workers are hired \Rightarrow and cost increases in the form of increased salary \Rightarrow then it is not efficient. Similarly, if a task is carried out with the same number of workers \Rightarrow Less cost \Rightarrow then it is efficient, but if the task is carried out with the same number of workers \Rightarrow and there is a delay in completion of work \Rightarrow then it is not effective.

Question 14

Give the meaning of 'Informal Organisation'. State its any three advantages.

OR

What is meant by 'Delegation'? State any three points which highlight the importance of delegation in an organisation.

SOLUTION:

An informal structure is a network of social relationships that arises out of personal interactions among the employees of an organisation beyond their officially defined roles. In this regard, it can be said that an informal structure originates from within a formal organisation.

The following are the advantages of an informal organisation:

1. Faster flow of communication: As no definite path or channel of communication is followed in an informal organisation, information spreads faster.



2. Fulfillment of social needs: An informal organisation allows for personal communication beyond the officially defined roles. This enables the employees to interact with like-minded colleagues. This unofficial interaction provides a sense of belongingness among the employees towards one another and towards the organisation.

3. Fulfillment of organisational objectives: An informal organisation supports the working of a formal organisation and thereby helps in the fulfillment of the organisational objectives in a better manner. For instance, the managers can interact with the workers informally and assess their views on various matters.

OR

Delegation refers to the transfer of authority and responsibility by the superior to his or her subordinates.

The following points highlight the importance of delegation in effective organising:

1. Managerial efficiency: By delegating work to the subordinates, the managers can concentrate on priority areas and also venture into new areas. This freedom from the routine tasks enhances the efficiency of the managers.

2. Employee proficiency: As the subordinates are entrusted with the responsibility of completing a task, they get an opportunity to prove their abilities and apply their skills. This helps them to gain experience and improve their proficiency.

3. Motivation: Delegation provides the employees with psychological benefits, which motivate and encourage them to give their best to the organisation.

Question 15

Stock exchange acts as a regulator of the securities market. It creates a continuous market where the securities are bought and sold. It gives investors the chance to disinvest and reinvest. Through this process of disinvestment and reinvestment, savings get channelized into their most productive investment avenues. To ensure that the investing public gets a safe and fair deal in the market, the membership of the stock exchange is well regulated and its dealings are well defined according to the existing legal framework. It also ensures wider share of ownership by regulating new issues, better trading practices and taking effective steps in educating the public about investments.

Various functions performed by the Stock Exchange are discussed in the above para. By quoting lines from above para, state any four functions of stock exchange.

SOLUTION:

The functions performed by the Stock Exchange are as follows:

1. Provide liquidity and marketability - 'Stock exchange creates a continuous market where the securities are brought and sold'. It provides a ready platform for the trading of existing securities.

2. Spreading Equity Cult - 'Stock exchange takes effective steps in educating the public about investments'. It encourages wider ownership of securities.

3. Facilitates growth and development of the economy - 'It provides a platform for channelising the savings to the most productive use'. *It gives investors the chance to disinvest and reinvest.* Through this process of disinvestment and reinvestment, savings get channelised into their most productive investment avenues.

4. Ensures safety in transactions - '*It ensures that investing people gets a safe and a fair deal in the market, the membership of the stock exchange is well regulated and its dealings are well defined according to the existing legal framework*'.

Question 16

Differentiate between 'Advertising' and 'Personal Selling' on any four bases.

OR

Explain the following functions of marketing:

- (i) Marketing planning ; and
- (ii) Customer support services

SOLUTION:

The difference between 'Advertising' and 'Personal Selling' is given as follows:

Basis	Advertising	Personal Selling
Personal v/s impersonal	Impersonal form of communication, where the seller communicates with the customer through the media (television, newspapers, etc.).	Personal form of communication, where the seller directly interacts with the potential customer.
Reach	Broader reach, as an advertisement reaches a large number of people simultaneously.	Narrower reach, as only a few people can be contacted directly.
Flexibility	Inflexible, as advertisements are standardised and cannot be adjusted as per the requirements of different customers.	Flexible, as the seller, can adjust the message as per the requirements of different customers.
Target group	More suitable where marketing is to be done to attract a large number of consumers—for example, marketing for the end customer.	More suitable when marketing is to be done for a few selected consumers—for example, marketing for intermediaries and retailers.

OR

The functions of marketing are explained as follows:

1. Marketing Planning- This involves creating a market plan in order to accomplish the marketing goals and objectives of the organisation. Management have to develop a complete plan so that it covers all aspects of marketing such as increase in the level of production, storage and promotion relative activities etc.

2. Customer Support Services- It involves handling complaints and feedbacks of the



customers. This is done by developing customer care services such as credit, maintenance or technical services. These services help to increase customer satisfaction and this results in the creation of brand loyalty for the product.

Question 17

Mahinder Agro Ltd. started a new venture for distribution of harmful and chemical fertilizers free vegetables. They conducted a survey to find out consumer preferences for such vegetables.

They found that most of the consumers were concerned about the harmful chemicals being used in growing the vegetables. They found that 90% of the households were searching for its alternatives. The company contacted a group of agriculture experts to lay down the procedure for growing the vegetables by the farmers. They decided to train the farmers in new technology to grow chemical free vegetables according to new innovative methods. The experts also suggested soil management techniques through which farmers would be able to create an abundant and lasting harvest.

Identify and explain the two dimensions of business environment highlighted in the above para.

SOLUTION:

The two dimensions of business environment that is being highlighted in the given case are as follows:

- a. Technological environment- The technological environment comprises the technological improvements that provide new business opportunities for enterprises. In the given situation, the new technique to grow chemical fertilizers relates to the technological dimension of the business environment.
- b. Social environment- The social environment comprises of factors such as beliefs, traditions, social trends, etc. that affect the demand for goods in the society. Here in the question since, consumers were concerned about the harmful chemicals being used and were looking for other alternatives, so this relates to the social environment of the business.

Question 18

Mega Ltd. holds an Annual Management Programme every year in the month of March in which the top managerial personnel formulate plans for the next year by analyzing and predicting the future to meet future events effectively.

As they are responsible for providing direction to the organization, facts are thoroughly checked using scientific calculations. Detailed plans are prepared after discussion with professional experts. Preliminary investigations are also undertaken to find out the viability of the plan. Since it is an intellectual activity requiring intelligent imagination and sound judgement so it is mainly done by the top management. Usually rest of the members just implement the plans. Middle level managers are neither allowed to deviate from the plans nor are they permitted to act on their own. The top management ensures that the expenses incurred in formulating the plans justify the benefits derived from them.

State any two limitations and any two features of planning discussed above.



SOLUTION:

The features of planning which are discussed in the given situation are:

(1) Planning is a mental exercise - "Since it is an intellectual activity requiring intelligent imagination and sound judgement so it is mainly done by top management". It requires application of mind and sound judgement. Since planning defines what is to be done in future, it requires sound thinking rather than doing.

(2) Planning is futuristic - "The top management formulate plans for the next year by analyzing and predicting the future to meet future events effectively". Planning is futuristic in the sense that it foresees the future, thereby helping to prepare for uncertain future events.

Limitations

(1) Planning reduces creativity - "Middle level managers are neither allowed to deviate from the plans nor are they permitted to act on their own". Plans are made by only the top management, and the lower levels of management are not allowed to deviate from the pre-defined course. Thus, in the process, lower level managers tend to lose their creativity.

(2) Planning involves huge costs - "The top management ensures that the expenses incurred in formulating the plans justify the benefits derived from them". As planning is based on future predictions, it requires much thought, analysis, scientific calculations, etc., which are to be used for formulating a course of action. This involves high costs.

Question 19

Vinber Ltd. set up a manufacturing unit at Bhiwadi in Himachal Pradesh to manufacture electric geysers and supply them to dealers all over the country. Their production target was 500 geysers per week. It was decided by the management that variation in production upto 10 units would be acceptable.

At the end of the first week, the production was 450 geysers. The next week, production increased to 470 geysers. A week later, production was 460 geysers. On investigation, it was found that fluctuation in production was due to irregular supply of electricity.

(a) The above para discusses some of the steps in the process of one of the functions of management. Explain these steps.

(b) Also, state the step(s) that have not been discussed in the above para.

SOLUTION:

a. The steps in the controlling process that are being followed are as follows:

i) **Setting standards:** The first step in the process of controlling is to develop the standards or benchmarks for performance as against which the actual performance would be measured. The standards can be set in both qualitative and quantitative terms.

Line: 'Their production target was 500 geysers per week'

ii) **Measuring actual performance:** Once the performance standards are set, the next step is to measure the actual performance. This may be done through various techniques such as personal observation and performance reports. Performance can be evaluated after the completion of an activity as well as while it is in progress.

Line: 'At the end of the first week, the production was 450 geysers and a week later, it was 470 geysers'

iii) **Comparing the performances:** Performances once measured are then compared with the set standards. Such a comparison helps in assessing the deviations in performance. In regard to this, comparisons in quantitative terms are much easier than in qualitative terms.

Line: 'On investigation, fluctuations was...'

iv) **Analysing deviations:** Every organisation faces deviations in the actual performance as against the pre-defined standards. It is important for managers to find the deviations that are beyond the permissible range. Once the deviations are recognised, it is necessary to identify the cause for it. There can be a number of factors *causing deviations in* performance such as infeasible standards, deficiencies in process, under-utilisation of resources and changes in business environment.

Line: 'On investigation, it was found that fluctuations in production was due to irregular supply of electricity'

b. The step which was missing is: Taking Corrective measures. When deviations go beyond the admissible limits, there arises a need for the manager to take corrective actions. This is the final step in the controlling process which aims at correcting the deficiencies of the organisation so that such deviations do not occur again. Since, nothing has been mentioned about the corrective actions so the missing step is the last step of corrective actions.

Question 20

Nisha Sethi was working as a Human Resource Manager in a famous consultancy firm, KLI Global Services. Her job included preparing job descriptions, recruitment, developing compensation and incentive plans and facilitating employee learning. They had entered into alliances with institutes to ensure continuous learning of their employees. With the jobs becoming more and more complex, KLI Global Services invested large amount of money in making the employees learn the skills necessary to complete the jobs.

State by giving any five points, how this investment is likely to benefit the organisation?

SOLUTION:

The process of making the employees learn the skills necessary to complete the jobs is called training.

The following points highlight the benefits of training to organization:



- a. Less wastage:** As training involves systematic learning of tasks, it helps reduce wastage of time and money, thereby ensuring the optimum utilisation of resources.
- b. Higher profits:** Training enhances the productivity and efficiency of the employees, thereby raising the profits of their company.
- c. Improved managerial efficiency:** Training prepares the employees to face new challenges and enables them to respond to various situations effectively. Thus, training helps an organisation prepare future managers.
- d. Reduced absenteeism:** Effective training serves to boost the morale of the employees and thereby reduce the rate of absenteeism and employee turnover.
- e. Helps in adapting changes:** Effective training helps the organization and its employees to adapt quickly and obtain an effective response to a changing technological and economical environment.

Question 22

Voltage fluctuations have been common and quite high in India. They harm our electrical appliances like televisions, refrigerators and air conditioners, often leaving them in a permanently damaged condition. N-Guard Company decided to manufacture stabilizers for North India where the voltage fluctuation ranges from 220 V to 230 V. Once the demand for North India was taken care of, they decided to launch stabilizers of varying voltages from 90 V – 260 V for meeting the requirements of voltage fluctuations in other regions of India also. Three engineers were appointed for South, West and East regions of India, as the voltage was different in all the three regions. Though all the engineers were appointed to manufacture stabilizers but the product differed from region to region.

- (a) Identify the organisational structure of N-Guard Company.
- (b) State any two advantages and two limitations of the structure identified in the above para.

SOLUTION:

(a) The divisional structure is followed by N-Guard Company. N-Guard Company decided to appoint different engineers for all the regions. Though all the engineers were appointed to manufacture stabilizers but the product differed from region to region. In the divisional structure activities are grouped on the basis of *products or services* offered by the business.

(b) The advantages of a divisional structure are:

(i) **Managerial efficiency:** A divisional structure provides numerous opportunities for the development of skills and knowledge of the managers. The head of each division gains experience as he or she deals with a variety of functions simultaneously. This enables the division head to grow professionally and improve proficiency.

(ii) **Measurement of performance:** In a divisional structure, the performance of each of the divisions is judged on the basis of its profit and loss during a particular period. This type of assessment of performance is easier and helps in taking appropriate and timely corrective action in case of poor performance.



The limitations of a divisional structure are :

(i) Departmental conflicts: Sometimes conflicts may arise among different divisions with regard to various decisions and actions of the organisation such as those relating to allocation of funds and resources.

(ii) Increase in cost. As there exists a similar functional structure under each division, the same set of functions are performed under each department. Thus, there is high probability of overlapping of activities, which results in a rise in cost for the organisation.

Question 23

'Determining the overall cost of capital and the financial risk of the enterprise depends upon various factors.' Explain any six such factors.

OR

You are the Finance Manager of a newly established manufacturing company. Explain any six factors that you will consider while determining the fixed capital requirements of the company.

SOLUTION:

The factors affecting the capital structure are:

a. Position of cash flow: The cash flows (the inflows and outflows of cash) of a company should be such that it is able to cover its various payment obligations (such as interest payments and normal expenses of the business) and is left with some surplus as well. In this regard, the company opts for debt capital only in a position of strong cash flow. This is because in case of debt, cash is required to pay the interest as well as the principle amount on the debt.

Strong Cash flow ⇒ More debt

Low Cash flow ⇒ More Equity

b. Debt-Service Coverage Ratio (DSCR): This ratio shows the cash payment obligations of the company as against the availability of cash. That is, it reflects the cash flow position of the company.

Higher DSCR ⇒ Higher cash flow ⇒ Company can increase the proportion of debt in its capital structure.

c. Equity cost: The rate of return expected by the shareholders is directly related to the risk associated with their investment. As the financial risk faced by the company increases, the shareholders' expectation of rate of return increases and vice versa. Now, as the company increases the component of debt, the financial risk faced by it also increases. Therefore, the shareholders' expectation of rate of return increases. This relationship suggests that a company cannot increase the component of debt in its capital structure beyond a certain point.

Higher financial risk ⇒ Greater expectation of rate of return on equity ⇒ High cost of equity ⇒ Difficult to opt for equity

Lower financial risk ⇒ Lower expectation of rate of return on equity ⇒ Low cost of

equity ⇒ Easy to opt for equity

d. Condition of stock market: In situations of a good stock market, a company can easily opt for equity share capital. As against this, in case of poor stock conditions, it becomes difficult for the company to opt for equity share.

Good stock market condition ⇒ Easy to opt for equity

Poor stock market condition ⇒ Difficult to opt for equity

e. Interest Coverage Ratio: It refers to the number of times the 'earnings before interest and tax' (EBIT) is able to cover the interest obligations of the company. The higher this ratio, the higher is the number of times that the company would be able to meet its interest obligations and the lesser is the financial risk. Thus, the company can opt for a higher proportion of debt in the capital structure and vice versa.

High interest coverage ratio ⇒ Low financial risk ⇒ Higher proportion of debt

Low interest coverage ratio ⇒ High financial risk ⇒ Lower proportion of debt

f. Floatation cost: It refers to the cost of raising funds such as broker's commission and underwriting commission. The higher the floatation cost involved in raising funds from a particular source, the lower is its proportion in the capital structure. For instance, if public issue of shares involves higher floatation cost than debt, then the company would opt for more of debt and less of equity in the capital structure.

OR

The Finance Manager of a manufacturing company considers the following points while determining the fixed capital requirements of the company

1. *Type of business:* The amount of fixed capital required by a company depends, to a large extent, on the type of business that it deals in. Organisations that deal in services or trading (having a small operating cycle) require less fixed capital. In contrast, a manufacturing firm involving a large operating cycle would require large amount of fixed capital.

Service or trading organisations → Small fixed capital requirement

Manufacturing organisations → Large fixed capital requirement

2. *Scale of operations:* Higher scale of operations implies that a larger amount needs to be invested in plants, land, building, etc., and thereby it requires large fixed capital and vice versa.

High scale of operation → Large fixed capital requirement

Small scale of operation → Small fixed capital requirement

3. *Alternative techniques of production:* An organisation can opt for either capital-intensive techniques or labour-intensive techniques of production. Organisations that follow capital-intensive techniques require higher investment in plants and machineries. Therefore, they require a larger amount of fixed capital. In contrast, organisations that follow labour-intensive techniques require lower amount of fixed capital.

Capital-intensive techniques → Large fixed capital requirement
Labour-intensive techniques → Small fixed capital requirement

4. *Growth prospects*: Higher growth and expansion of a company is associated with higher production, more sales, more inputs, etc. This requires higher level of machinery and equipments. Thus, organisations with high growth prospects require higher amount of fixed capital and vice versa.

High growth prospects → Large fixed capital requirement
Low growth prospects → Low fixed capital requirement

5. *Regular upgradation of technology*: Organisations having machinery or equipments that are prone to becoming obsolete frequently require higher investment in fixed capital. This is because regular replacement of obsolete equipments requires large investment in fixed capital.

6. *Available alternatives for financing*: One of the alternatives for financing can be obtaining the assets on lease. If leasing facilities are easily available in the financial market, then it is more feasible for the company to obtain the assets on lease rather than purchasing it. In this way, the need to invest a huge sum in fixed assets considerably reduces, which in turn reduces the fixed capital requirements.

Easy availability of leasing facility → Low fixed capital requirement
Difficulty in obtaining assets on lease → High fixed capital requirement

7. *Possibility of collaboration*: At times, business organisations undergo collaboration with each other and jointly establish certain facilities. In such cases, an individual organisation's requirement for fixed capital reduces.

Question 24

"Sound Financial Planning is essential for the success of any enterprise." Explain this statement by giving any six reasons.

OR

Explain the three major decisions that finance manager has to take while performing the finance function.

SOLUTION:

"Sound Financial Planning is essential for the success of any enterprise." The following points explain the importance of financial planning:

1. Helps in facing eventual situations: Financial planning helps in forecasting the future situations. In this way, it prepares an organisation to cope with adverse situations in a better manner.

2. Helps in avoiding surprises and shocks: Through financial planning, an organisation can detect situations of shortage or surplus of funds that may arise in future. Therefore, it prepares the managers in advance for such situations.

3. Improves coordination: Through financial planning, various business activities such as sales and production are coordinated in a better manner. Such coordination ensures smooth functioning of the business.

4. Reduces wastages and duplicity: Financial planning clearly defines the policies and procedures for working, which in turn helps to reduce duplication of work as well as avoid wastage of time and efforts.

5. Helps in optimum utilisation of funds: It ensures that situations of inadequate as well as excess funds are avoided, thereby ensuring the funds are properly and optimally utilised.

6. Link between the present and the future: Financial planning acts as a link between the present and the future. This is done by providing such information as future availability and requirement of funds.

OR

The following are the three broad categories of financial decisions to be taken by the financial manager of an organisation:

a. Investment Decision: They refer to the decisions regarding where to invest the funds so as to earn the highest possible returns on investment. These decisions can further be bifurcated into two categories, namely long-term investment decisions and short-term investment decisions.

1. Long-term investment decisions: These are those decisions that affect a business's long-term earning capacity and profitability. For example, investment in a new machine and purchase of a new building are such decisions. They are also known as 'Capital budgeting decisions'.

2. Short-term investment decisions: These are those decisions that affect a business's day-to-day working operations. For example, decisions regarding cash or bill receivables are two such decisions. These decisions are also known as 'Working capital decisions'.

b. Financing Decision: They refer to the decisions regarding the identification of various sources of funds (as debt and equity) and deciding the best combination among them. These decisions are taken on the basis of risk and profitability of various alternatives.

Factors Affecting Financing Decision

1. Cost of raising funds: Those sources of funds are preferred that involve minimum cost.

2. Risk involved: Sources of funds that involve moderate risk are preferred over those that involve high risk. For instance, debt or debentures involve the risk of default payment which must be carefully analysed before taking the debt.

c. Dividend Decision: They refer to the decisions regarding the distribution of profit or surplus of the company. The profits can either be distributed to the shareholders in the form of dividends or retained by the company itself.

Factors Affecting the Dividend Decisions

1. Amount of earnings: As a firm pays dividends out of its own earnings (either current or past), it can be said that companies with higher earnings are in a position to pay a

higher amount of dividend to its shareholders and vice versa.

2. Stable earnings: A company with stable and smooth earnings is in a position to distribute higher dividend as compared to those that have an unstable earning.

Question 25

'VOICE' is an important consumer organization. It organized workshops in the months of December in Delhi/NCR for consumers. The theme was 'Organic Food – From Farm to Plate', to spread awareness on the importance of organic farming and to encourage consumers to switch from conventional food, that contains chemicals and pesticides to organic food. Expert speakers from farmers' community explained the harmful effects of usage of pesticides in farming and the importance of organic food.

People were informed that the organization regularly tests samples to detect adulteration like presence of heavy metals or pesticides. The results of the tests are published in their monthly magazine 'Consumer Voice' to make people aware of quality of different products. It also provides aid and legal advice to the consumers in seeking a remedy.

State the functions performed by the Consumer Voice for the protection and promotion of consumer interest by quoting lines from the above para.

SOLUTION:

The following functions are being performed by consumer organization:

a. Consumer Education: NGOs and consumer organisations conduct various training programmes and workshops to educate the consumers about their rights and responsibilities.

Line: 'The theme was 'Organic Food – From Farm to Plate', to spread awareness on the importance of organic farming'

b. Publish Journals: They regularly publish journals and periodicals to spread knowledge and awareness about various consumer problems, legal remedies available and other such matters.

Line: 'The results of the tests are published in their monthly magazine 'Consumer Voice'

c. Legal Assistance: They also provide legal assistance to the consumers and help them in seeking suitable redressal.

Line: 'It also provides aid and legal advice to the consumers in seeking a remedy. '

d. Encourage Protests Against Exploitation: They encourage consumers to protest against any form of exploitation and unfair trade practices.

Line: 'encourage consumers to switch from conventional food, that contains chemicals and pesticides to organic food'

e. Test the Quality of Products: They conduct quality tests for various products in laboratories and publish the results.

Line: ' People were informed that the organization regularly tests samples to detect adulteration like presence of heavy metals or pesticides.'