

ISC Class 12 Business Studies Specimen Paper 1

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Maximum Marks: 80 | Time Allowed: Three hours | Reading Time: 15 minutes

Section A is compulsory. Attempt any four questions from Section B and any one question from Section C.

General Instructions

Write your answers on the separate answer paper provided. The first 15 minutes are for reading the paper, and you may not write during that time. Section A is compulsory and carries 20 marks. From Section B you must attempt any four of the six questions, each of which carries 10 marks. From Section C you must attempt any one of the two questions, which carries 20 marks. Marks for each question, or part of a question, are shown in brackets. Where a question asks for a stated number of points, write that number and no more, since only the first points offered will be marked. In Section C the answer must be framed on the facts of the case given to you, and a general answer that could have been written without reading the case will not earn the marks for application. All working for numerical questions must be shown, and every money figure must be written with its unit. No tables, charts or organisation charts are printed in this paper, and where a question asks for one you are expected to draw it yourself in pencil and label it. This written paper carries 80 of the 100 marks for the subject, the remaining 20 being for the project work.

SECTION A (20 Marks)

Attempt all parts of Question 1 and all parts of Question 2.

Question 1 [10]

Each part carries 1 mark. For the parts that offer four choices, write only the option you choose. For the rest, answer in a single sentence or give the single term asked for.

- (i) Management is said to be both a science and an art. State one reason why it is regarded as an art.
- (ii) The principle of Fayol which requires that an employee should receive orders from one superior only is:
 - (a) unity of command (b) unity of direction
 - (c) scalar chain (d) centralisation
- (iii) Name the kind of plan that lays down the one way in which a recurring activity must always be carried out, step by step.
- (iv) The grouping of the activities of a firm into departments according to the lines of goods it makes is called:
 - (a) functional departmentation (b) divisional departmentation
 - (c) a matrix structure (d) a flat structure
- (v) State what is meant by the capital structure of a company.
- (vi) A treasury bill is best described as:
 - (a) a share carrying a fixed dividend (b) a long term bond issued by a company
 - (c) a short term instrument of borrowing issued by the government at a discount (d) a receipt for goods lodged in a warehouse
- (vii) Name the stage of the life of a product at which sales rise most steeply while the number of competitors entering the market also grows fastest.
- (viii) Giving a group of workers who have each been doing one small operation the whole of a job to do, with some say in how it is arranged, is:
 - (a) job rotation (b) job simplification
 - (c) job enrichment (d) job evaluation

- (ix) State one way in which an intrapreneur differs from an entrepreneur.
- (x) A company that publishes, each year, an account of the water it has drawn, the waste it has treated and the accidents at its plants is practising:
- (a) tax planning (b) internal audit
- (c) cost control (d) social and environmental reporting

Question 2 [10]

Each part carries 2 marks.

- (i) Explain, with one example of each, the difference between a policy and a procedure. [2]
- (ii) Explain why controlling is described as looking back and looking forward at the same time. [2]
- (iii) A company has an operating profit of Rs 9,00,000 and pays interest of Rs 1,50,000 on its debt. Calculate its interest coverage, and state in one sentence what the figure tells a prospective lender. [2]
- (iv) Distinguish between the money market and the capital market. [2]
- (v) Explain, with one example, what is meant by the segmentation of a market. [2]

SECTION B (40 Marks)

Attempt any four questions from this Section. Each question carries 10 marks.

Question 3 [10]

- (a) Explain the difference between the effectiveness and the efficiency of a manager. [3]
- (b) Explain any three reasons why management is called a profession only in a limited sense. [3]
- (c) Explain the coordinating function of management, and explain any three features of coordination. [4]

Question 4 [10]

- (a) Explain any three of Taylor's principles of scientific management. [3]
- (b) Explain Fayol's principle of the division of work and his principle of the scalar chain, and explain what the gang plank permits. [3]
- (c) Explain any four points of difference between the work of Taylor and the work of Fayol. [4]

Question 5 [10]

- (a) Explain any three steps of the planning process, in their proper order. [3]
- (b) Explain what is meant by a strategy, and explain the difference between a rule and a method. [3]
- (c) Explain any four points of importance of delegation to an organisation. [4]

Question 6 [10]

- (a) Explain any three decisions a finance manager must take. [3]
- (b) Explain what is meant by financial leverage, and explain one circumstance in which a high leverage benefits the equity shareholder and one in which it harms him. [3]
- (c) Explain any four factors that decide how much working capital a manufacturing company requires. [4]

Question 7 [10]

- (a) Explain any three functions of a financial market. [3]
- (b) Explain any three objectives of the body that regulates the securities market in India. [3]
- (c) Explain any four methods by which a company may issue its securities in the primary market. [4]

Question 8 [10]

- (a) Explain any three points of difference between training and development. [3]
- (b) Explain any three methods by which a manager who is to be prepared for a higher post may be trained, other than by sending him to a classroom. [3]

- (c) Explain any four non financial incentives by which an employer may motivate his staff. [4]

SECTION C (20 Marks)

Attempt any one question from this Section. The question carries 20 marks. Read the whole of the case before you begin, and frame your answer on the facts given.

Question 9 [20]

Shilpa Kataria is the managing director of Vanchal Looms, a firm of two hundred and forty employees that weaves cotton furnishing fabric at a single plant and sells it to furniture makers and to curtain shops in six states. She founded the firm eleven years ago and for the first six of those years she settled every matter of consequence herself: what was to be woven, what was to be charged, who was to be engaged and dismissed, which supplier was to be paid that week and on what terms a dealer was to be given credit. The firm grew, and she has kept the same habit. There are now four departments, weaving, dyeing, sales and accounts, each with a head, but the heads have authority to spend no more than Rs 10,000 without her signature, and none of them may alter a price, engage a worker or settle a customer's complaint.

Three things have gone wrong this year. A large dealer in a distant state cancelled a standing order worth about Rs 18,00,000 a year after waiting eleven days for a decision on a complaint about shade variation, a decision the sales head could have given in an hour had he been allowed to. The dyeing head, who had been with the firm nine years, resigned, telling Shilpa on his way out that he had come to feel like a clerk who signed muster rolls. And Shilpa herself, who now works from seven in the morning until nine at night, has twice postponed a visit to a new weaving plant she had meant to inspect with a view to a second unit, because she could not leave the plant for three days.

Her accountant has suggested that she raise the limit the heads may spend and let them answer for their own departments. Shilpa is unwilling. She says that she started the firm, that she knows its trade better than any of the four, that a wrong decision by a department head will cost the firm money she cannot recover, and that if anything goes wrong it is she, and not the head, whom the dealers and the bank will hold answerable.

- (a) Name and explain the concept of management that Shilpa has failed to apply, and explain the three elements of which it consists. [5]
- (b) Shilpa's objection is that responsibility cannot be passed away. Explain why her objection does not justify her present practice, and explain the relation between authority, responsibility and accountability that she has misunderstood. [5]
- (c) Explain, with reference to the three things that have gone wrong this year, the cost that Shilpa's practice has imposed on the firm, and set out the steps by which she should now reorganise the authority in her firm. [10]

Question 10 [20]

Teerth Naharia and his sister Ira run Naharia Spice Works, a firm their grandfather began, which grinds and packs turmeric, chilli and coriander powder under the name Teen Patti. The firm sells in loose form to wholesalers in the grain market of its own city, where it has been known for forty years, and in 200 gram packets to about three hundred grocers in the same city. Loose sales to wholesalers bring in about seventy per cent of its revenue, at a margin of about four per cent, and the packeted goods bring in the remaining thirty per cent at a margin of about nineteen per cent.

Two things have happened. First, three firms from outside the city have put their branded spice powders into the larger grocery shops and the two self service stores that have opened in the city, in printed pouches of 100 grams and 500 grams, with a window showing the colour of the powder, and they advertise on the local cable channel and on the hoardings at the two main crossings. The grocers tell Ira that customers now ask for those brands by name. Second, the firm's own loose sales have begun to fall, because two of its wholesalers have started buying from a mill in a neighbouring district that quotes twenty paise a kilogram

less.

Ira wants the firm to put its money behind the packeted line, redesign the pouch, add a 100 gram and a 500 gram size, print the date of grinding on each pouch and advertise. Teerth wants to hold on to the wholesale trade, which he says is the firm's foundation, and to meet the mill's price by buying cheaper raw turmeric. Their father, who still keeps the accounts, points out that the firm's name is known in the grain market but is not known in the new self service stores at all, and that the Teen Patti pouch has not been changed in eighteen years.

- (a)** Explain why the margin on the packeted line is so much higher than the margin on the loose line, and name and explain the elements of the marketing mix that account for the difference. [5]
- (b)** Teerth proposes to meet the neighbouring mill's price by buying cheaper raw turmeric. Explain the commercial objection and the ethical objection to that proposal, and explain what the firm should do about the loose trade instead. [5]
- (c)** Frame the marketing decisions you would advise the firm to take on the packeted line, dealing with the product and the pack, the brand, the price, the channel and the promotion, and give a reason drawn from the case for each. [10]

ANSWER KEY AND MARKING SCHEME

Full working is given for every numerical answer. Marks shown in italics are the step marks an examiner would award. No mark is deducted for a wrong option in Question 1. Where a question asks for a number of points, award the marks for the first points offered up to that number, and accept any other correct point of the same weight. In Section C the marks for application are to be awarded only where the answer uses the facts of the case, the figures and the names given in it, and an answer that states the textbook rule correctly but never touches the case is to be given no more than half the marks for the part.

Question 1 [10]

- (i) Management is an art because it rests on the personal skill and judgement of the manager in applying a body of principles to a situation that is never twice the same. The principles can be learned, but the knack of handling a particular man, of timing a decision or of carrying a reluctant department is acquired only by practice, and two managers with the same training will handle the same problem differently and with different success.

Personal skill and judgement in application, acquired by practice 1.

- (ii) (a) unity of command. Fayol held that where a man takes orders from two superiors the orders will sooner or later conflict, his discipline will suffer and the authority of both superiors will be weakened.

Correct option 1.

- (iii) A procedure, which sets out the chronological steps by which a recurring activity is to be performed, and which therefore prescribes the one accepted way of doing it.

Correctly named 1.

- (iv) (b) divisional departmentation. Each division is built round a line of goods and contains within itself the functions that line needs, so that its head can be held answerable for the result of that line.

Correct option 1.

- (v) The capital structure of a company is the composition of its long term finance, that is the proportion in which it is made up of owners' funds, being share capital and reserves, and of borrowed funds, being debentures, bonds and long term loans. It is usually expressed as the ratio of debt to equity.

Correct meaning, the mix of owned and borrowed long term funds being the point 1.

- (vi) (c) a short term instrument of borrowing issued by the government at a discount. It carries no interest as such, the gain to the holder being the difference between the discounted price he pays and the face value he receives at maturity.

Correct option 1.

- (vii) The growth stage. Sales climb quickly as the article becomes known and repeat purchases begin, and the profit now visible in the line draws in competitors, so the firm must spend to hold its place even while its sales are rising.

Stage correctly named 1.

- (viii) (c) job enrichment. The job is deepened rather than merely widened, the worker being given a whole and meaningful piece of work together with some discretion over how it is done, so that the work itself becomes the motivator.

Correct option 1.

- (ix) An intrapreneur does within an existing organisation what an entrepreneur does outside it. He develops a new line, a new process or a new venture using the firm's money, premises and name, so the risk of loss falls on the firm and not on him, and his reward is a salary, a bonus or a share in what the venture earns rather than the whole of the profit. The entrepreneur commits his own capital, bears the loss himself and owns the business.

One correct difference, in risk, in capital or in ownership 1.

- (x) (d) social and environmental reporting. The company is accounting to the public for the effects of its working on the community and the natural surroundings, over and above the financial account it owes its shareholders.

Correct option 1.

Question 2 [10]

- (i) A policy is a general statement that guides thinking and marks out the limits within which decisions are to be taken, leaving the decision itself to the man on the spot. A firm's policy that no credit is to be given to a dealer who has been in default within the last year is an example, since it tells the sales staff where the boundary lies but does not tell them how to deal with any particular dealer. A procedure is a statement of the steps, in their order, by which a given activity is to be carried out, and it leaves no discretion as to the order. The sequence by which a returned consignment is received, inspected, entered in the register, reported to the sales head and credited to the dealer's account is an example.

Policy explained with a suitable example 1. Procedure explained with a suitable example 1.

- (ii) Controlling looks back because it can begin only after something has been done. It measures a performance that already exists, compares it with the standard that was set beforehand and finds the deviation, so every control report is a report on the past. It looks forward because finding the deviation is not the end of it. The deviation is analysed for its cause, and the corrective action that follows is directed at the period ahead, whether by altering the method, retraining the men, replacing a machine or revising the standard or the plan itself where the deviation shows the plan to have been wrong. In this way the control of one period becomes the planning of the next, which is why the two functions are said to be inseparable.

Looking back, through measurement of past performance against a standard 1. Looking forward, through corrective action and the revision of the plan for the period ahead 1.

- (iii) Interest coverage = operating profit divided by interest = $9,00,000/1,50,000 = 6$ times. The figure tells a prospective lender that the company's operating profit is six times the interest it has to pay, so there is a wide cushion and the profit could fall by a great deal before the company found itself unable to meet its interest, which marks it a safe borrower.

Coverage 6 times 1. Correct interpretation as the margin of safety for the lender 1.

- (iv) The money market is the market for funds lent and borrowed for short periods, up to a year, and its instruments are therefore of a short maturity, such as treasury bills, commercial paper, certificates of deposit and call money. It serves the day to day liquidity of banks, companies and the government, the dealings are chiefly between institutions rather than individuals, the sums in each dealing are large and the risk of a loss of principal is small. The capital market is the market for funds lent and borrowed for long periods or committed permanently, and its instruments are shares, debentures and bonds. It serves the fixed capital needs of companies and the long term borrowing of government, individuals as well as institutions take part in it, the sums in a single dealing may be small, and both the risk and the expected return are higher.

Money market correctly described by its short maturity and its instruments 1. Capital market correctly described and contrasted 1.

- (v) The segmentation of a market is the dividing of the whole body of possible buyers into smaller groups, each of which is made up of buyers who are alike in some respect that matters to the seller and who may be expected to respond in much the same way to what the seller offers, so that the firm may choose one or more of those groups to serve and shape its article, its price and its message to suit them rather than offering the same thing to everybody. A maker of hair oil, for example, may divide the market by income and by the kind of shop in which the buyer makes his purchase, selling a small sachet at a low price through village and roadside shops to buyers who cannot spend much at one time, and a larger bottle with a perfumed oil at a higher price through the self service stores of the cities.

Segmentation correctly explained as dividing buyers into groups alike in a relevant respect 1. A suitable example with the basis of division clear 1.

Question 3 [10]

- (a) Effectiveness means the completion of the task, that is the reaching of the end that was set, and it is judged by the result alone. A manager who was to despatch two thousand units in the month and despatched them has been effective, whatever it cost him. Efficiency means reaching that end with the least use of resources, so it is judged by the relation between what came out and what went in, in material, in labour, in machine time and in money. A manager who despatched the two thousand units but did it by running the plant on overtime, spoiling a quantity of material and wearing out a machine before its time has been effective and inefficient.

The reverse is equally possible, a manager who kept his costs beautifully low but despatched only fifteen hundred units being efficient and ineffective. Management must secure both, because a firm that is effective but inefficient will exhaust its resources, and one that is efficient but ineffective will not survive in its market however carefully it husbands them. In practice the two can conflict, and part of the manager's skill lies in judging how much extra cost the reaching of a particular target is worth.

Effectiveness explained as the reaching of the end 1. Efficiency explained as the relation of output to resources used 1. The possibility of one without the other, with an example, and the need for both 1.

- (b) First, as to entry, a profession is closed to anyone who has not obtained the prescribed qualification and been admitted to its roll, as medicine and law are, whereas anyone may manage a business, and does. Many successful managers hold no degree in management at all, and the holder of such a degree enjoys no exclusive right to a managerial post. Second, as to the body that governs it, a profession has a single association whose membership is compulsory and which can prescribe the course of study, lay down a code of conduct and strike a member off for a breach of it. There are associations of managers and they do publish codes, but membership is voluntary and they have no power to debar a man from managing. Third, as to the service motive, a profession is expected to put the interest of the client before the earnings of the practitioner, while a manager is appointed by and answerable to the owners and must earn them a profit, so that although he is expected to serve society he cannot subordinate the firm's purpose to it. A fourth acceptable point is that a profession rests on a systematic body of knowledge which is now true of management, so that this one test it does satisfy.

Three reasons, 1 mark each, each stated as a test of a profession that management does not fully meet 3.

- (c) Coordination is the orderly arrangement of the efforts of the different individuals and departments of an organisation so that they pull in one direction and together produce the result the organisation intends. It is not a separate fifth or sixth function to be performed after the others but the thread that runs through all of them, for the manager coordinates when he plans the work of two departments so that they fit, when he organises and assigns duties so that they do not clash, when he staffs, when he directs and when he controls. For this reason it is called the essence of management. First, coordination integrates group effort, bringing the separate and dissimilar tasks of many people into a single pattern of work. Second, it ensures unity of action, so that every department, however different its work, serves the common purpose and none pursues its own target at the cost of another's, as a sales department does when it promises a delivery the works cannot make. Third, it is a continuous process, since the need for it does not end with a single arrangement but recurs every time the work, the people or the circumstances change. Fourth, it is the responsibility of every manager at every level and not of any one of them, though its scope widens as one goes up. A fifth acceptable feature is that coordination is deliberate, in that a manager must set out to bring about the harmony and cannot assume it will happen of itself, even the willing cooperation of his people needing to be arranged and directed.

Coordination correctly explained as the function that runs through all the others 1. Three features, 1 mark each 3.

Question 4 [10]

- (a) First, science, not rule of thumb. Taylor held that every operation in a workshop should be studied, measured and reduced to the one best method, and that this method should replace the varying practices the workmen had picked up by habit and tradition. Even the simple matter of the size of a shovel load was to be settled by experiment and not by the opinion of the man holding the shovel. Second, harmony, not discord. Taylor held that the interests of the employer and of the workman are not opposed, since both gain by a larger output, and that management must bring about a complete mental revolution on both sides, the management giving up its secrecy and its arbitrary dealing and the workmen giving up their restriction of output and their suspicion of a new method. Third, cooperation, not individualism. Taylor would have the management and the workmen work as partners, each suggesting improvements, with the workmen consulted before a change is introduced and rewarded for a suggestion that is adopted, and with nobody dismissed because a better method has reduced the work. A fourth principle, equally acceptable, is the development of each person to his greatest efficiency, by selecting the worker scientifically for the work he is best fitted to and then training him in the method that has been established.

Three principles, 1 mark each, each named and explained 3.

- (b) Division of work means that the whole of the work of an organisation should be divided into the smallest convenient tasks and each entrusted to a person who does that task repeatedly. Fayol held that specialisation of this kind raises both the speed and the quality of the work, because a man who does one thing many times becomes expert in it and wastes no time changing from one kind of work to another. The scalar chain is the unbroken line of authority running from the highest post in the organisation to the lowest, along which every instruction passing down and every report passing up must travel, step by step, without any level being skipped. Fayol insisted on this because the superior who is passed over is thereby undermined and loses track of what his subordinates are doing. The gang plank is the exception Fayol allowed to his own chain. Where two people at the same level in different branches of the chain must deal with a matter urgently, they may communicate directly across, instead of sending the matter up one branch and down the other, provided that each of them has the permission of his own superior and that each tells his superior what was settled. It permits speed in an emergency without destroying the chain, since the authority to deal across is itself derived from the superiors and the chain is informed.

Division of work explained 1. Scalar chain explained 1. The gang plank and what it permits, with the condition that the superiors are informed 1.

- (c) First, as to the level at which each worked, Taylor's work was done at the level of the shop floor, among machines, materials and operatives, and he looked upwards from there, while Fayol's was done from the chair of a chief executive and he looked downwards over the whole undertaking. Second, as to the aim, Taylor sought to raise the productivity of the individual worker and of the operation he performed, through measurement and the standardisation of the method, whereas Fayol sought to improve the general administration of the undertaking, through principles about authority, unity and order. Third, as to the form in which each left his work, Taylor left techniques, that is definite devices such as time and motion study, the differential piece rate, functional foremanship and standardisation, which are to be applied as they stand, whereas Fayol left principles, that is general statements of guidance which a manager must adapt to his own situation and which are flexible by their nature. Fourth, as to the expertise each demanded, Taylor was an engineer and his contribution is called scientific management, resting on technical measurement, while Fayol was an administrator and his contribution is called the administrative or general theory of management, resting on experience of command. A fifth acceptable point is that Taylor's work applies chiefly to production and to specialised operations, while Fayol's claims to apply to every kind of organisation and to every level of it, so the two are better seen as complementary than as rivals.

Four points of difference, 1 mark each, each stated for both Taylor and Fayol 4.

Question 5 [10]

- (a) First, setting the objectives. The firm must state what it is that the plan is to achieve, and state it in terms definite enough to be checked afterwards, such as the raising of the despatches of a particular line by a stated quantity within a stated period, rather than in a general wish to do better. The objectives must be settled first because every later step is a means to them. Second, developing the alternative courses of action. Having settled the end, the planner lists the different ways in which it might be reached, since there is almost always more than one and the obvious way is not always the best, and he must cast about widely before narrowing the field. Third, evaluating those alternatives and selecting one. Each course is weighed against the others for its cost, the time it will take, the risk it carries and the resources it needs, and the one that promises the objective at an acceptable cost and risk is chosen. The setting of the planning premises, which comes after the objectives, the implementing of the plan and the following up of it are equally acceptable steps, and the order is what is to be credited.

Two of the three steps, each named and explained, 1 mark each 2. The third step named and explained, and the three given in a correct sequence 1.

- (b) A strategy is a comprehensive plan of a broad kind, settled at the top of the organisation, which fixes the long term direction of the business in the face of its competitors and its environment. It determines the markets the firm will serve, the lines of business it will be in, the way it will compete, whether on price, on quality or on service, and the way its resources are to be deployed to that end, and it is framed in the knowledge that rivals will react to it. A rule is a statement of what must or must not be done in a given situation, allowing no

discretion and no exception, such as a rule that no smoking is permitted in the godown or that no consignment leaves without a gate pass. It is the simplest and the most rigid kind of plan, and a breach of it is a matter for discipline. A method is the prescribed way of performing one particular step or task, chosen because experiment or experience has shown it to be the best way, such as the method by which a weld is tested or by which a dealer's creditworthiness is assessed. The difference is that a rule governs conduct and permits no judgement, while a method governs technique and may be departed from where the circumstances plainly require a better way, and a method is usually one component of a procedure whereas a rule stands by itself.

Strategy correctly explained as a broad long term plan framed against the environment 1. Rule explained as allowing no discretion 1. Method explained and distinguished from the rule 1.

- (c) First, delegation reduces the burden on the manager. By passing the routine and the repetitive decisions to his subordinates he frees his own time for the matters only he can attend to, the direction of the business, the dealings with its bankers and its largest customers, and the planning of its growth, so that the organisation gets the use of his judgement where it is worth most. Second, it develops the subordinate. A man learns to decide only by deciding, and the subordinate who has exercised a delegated authority, made a mistake and been corrected is being trained for the higher post in a way no course can accomplish, so the firm builds its own successors and is not left helpless when a senior man leaves. Third, it makes decisions quicker and better informed, because the matter is settled by the man nearest to it, who knows the customer or the machine at first hand, and no time is lost in referring the matter up and waiting for it to come down. Fourth, it makes growth possible. One man can personally decide the affairs of a small firm, but no man can personally decide those of a large one, so delegation is the device by which an organisation is enabled to add departments, branches and lines without the top becoming a bottleneck. A fifth acceptable point is that delegation raises the morale of the staff, since the authority given is a mark of the superior's trust and a recognition of the subordinate's competence, and a sixth that it establishes a clear structure of authority and responsibility, so that everyone knows who may decide what.

Four points of importance, 1 mark each, each named and explained 4.

Question 6 [10]

- (a) First, the investment decision, also called the capital budgeting decision, by which the finance manager determines where the long term funds of the firm are to be put: which plant to buy, which line to add, which branch to open, and whether a proposal will earn enough over its life to justify the money sunk in it. These decisions are large, they are difficult to reverse once the money is spent and they shape the earning power of the firm for years, so they are the most important of the three. Second, the financing decision, by which he determines where the money is to come from, in what proportion it is to be raised from the owners and from lenders, in what form, and at what cost, weighing the cheapness of debt and the saving of tax on its interest against the fixed obligation it creates and the risk that goes with it. Third, the dividend decision, by which he determines how much of the profit earned is to be distributed to the shareholders and how much retained in the business, having regard to the shareholders' expectation of a steady dividend, the firm's own need for funds to grow and the alternative cost of raising those funds outside. The decision on how much working capital to carry and in what form, which is sometimes treated as a fourth decision, is equally acceptable.

Three decisions, 1 mark each, each named and explained 3.

- (b) Financial leverage is the use of borrowed funds, on which the return is a fixed rate of interest, in the capital structure of a firm, so that the earnings available to the equity shareholders move by a larger proportion than the earnings of the business itself. It is measured by the proportion of debt to equity, or by the ratio of the earnings before interest to the earnings after it, and a firm with much debt is said to be highly levered. A high leverage benefits the equity shareholder where the business earns a return on its total funds that is higher than the rate of interest it pays on the borrowed part. The surplus between the two belongs entirely to the equity, since the lender gets no more than his agreed interest however well the business does, so a firm earning twenty per cent on its funds while paying eleven per cent on its debt makes the equity shareholder better off the more it borrows. A high leverage harms him where the return on the total funds falls below the rate of interest, because the whole of the shortfall falls on the equity, the interest having to be paid in full whatever the business earns. In a year in which the business earns eight per cent while paying eleven per

cent on its debt the equity receives less than it would have if the firm had never borrowed, and if the earnings fall far enough the interest may not be covered at all, so the firm must borrow again or draw on reserves merely to pay it.

Financial leverage correctly explained 1. The favourable case, with the return exceeding the rate of interest 1. The unfavourable case, with the whole shortfall falling on the equity 1.

- (c) First, the nature of the business and the length of its operating cycle. A firm that buys raw material, processes it over several weeks and then waits for a customer to pay has a long cycle and must find the money to carry the material, the work in progress and the debt for the whole of it, whereas a trading firm that buys and sells for cash needs far less. Second, the scale of operations and the level of activity. The larger the output and the sales, the greater the stock of material, of stores and of finished goods that must be held and the greater the sum owed by customers at any moment, so working capital rises with the size of the business and rises again when the business is expanding. Third, the terms of credit on both sides. Where the firm must sell on long credit to hold its dealers, its money stands locked up in book debts, and where its own suppliers insist on payment against delivery it gets no corresponding relief, so a firm that gives much credit and gets little needs a large working capital, and the reverse needs little. Fourth, the seasonal character of the trade. A firm whose sales or whose purchases are crowded into a few months of the year must build a large stock before the season or carry heavy debts during it, so its requirement at the peak is far above its average and must be provided for, often by a seasonal borrowing arrangement. The availability and the cost of the raw material, the rate at which the stock turns over, the degree of competition and the general level of prices are equally acceptable factors.

Four factors, 1 mark each, each named and explained 4.

Question 7 [10]

- (a) First, a financial market mobilises savings and channels them into productive use. The savings of a great many households, each too small by itself to build a plant, are gathered and placed at the disposal of the firms and the governments that need large sums, so that money which would have lain idle or been held in an unproductive form is put to work. Second, it allocates those savings among the competing claims upon them, directing them towards the firms that can use them best. The market prices the securities of a firm according to what it is judged able to earn, so that a well managed firm can raise funds cheaply and a poorly managed one dearly or not at all, which is a continual discipline upon management. Third, it provides liquidity to the holder of a financial asset. Because there is a market in which a share or a bond can be sold at a known price on any working day, the investor is willing to part with his money in the first place, which he would not be if his holding could not be turned back into cash before maturity. A fourth acceptable function is that it reduces the cost of a transaction and of information, since buyers and sellers find each other in one place, at published prices, without each having to search out the other and investigate him.

Three functions, 1 mark each, each named and explained 3.

- (b) First, the protection of the interests of investors. The regulator exists because the saver who puts his money into securities is at a disadvantage against those who issue and deal in them, knowing far less about the issuer and about the state of the market, so the regulator requires that a company disclose fully and truthfully what an investor needs in order to judge it, prescribes the manner of an issue and the handling of the money collected, and provides a means by which an investor's complaint may be taken up and redress obtained. Second, the development of the securities market. The regulator works to widen and modernise the market by permitting new instruments and new kinds of intermediary, by requiring that dealings and the holding of securities be put in electronic form so that settlement is quick and certain, by lowering the cost of a transaction and by educating investors, so that more savings are brought into the market and more firms are able to raise funds from it. Third, the regulation of the market and of those who work in it. The regulator registers and lays down the obligations of the stock exchanges, the brokers, the merchant bankers, the depositories, the registrars and the mutual funds, inspects them, audits them and may fine or debar one that breaks its rules, and it prohibits and punishes fraudulent and unfair practices such as insider dealing and the manipulation of prices.

Three objectives, 1 mark each, each named and explained 3.

- (c) First, the public issue through a prospectus, by which the company invites the general public by an advertised document, setting out its objects, its promoters, its accounts, the risks and the terms of the issue, and allots shares to those who apply. It raises the largest sums and gives the widest ownership, but it is the slowest and the costliest route, since the document must be filed with the regulator and the issue must be underwritten, advertised and administered. Second, the offer for sale, in which the company sells the whole issue to an issue house or a firm of brokers at an agreed price, and that firm then offers the securities to the public at a slightly higher price and keeps the difference. The company is paid in one sum, receives its money quickly and is spared the trouble and the risk of a public offer, but it parts with the margin the intermediary takes. Third, the private placement, in which the securities are offered not to the public at all but to a selected group of institutions or wealthy investors by direct negotiation. It is quick and cheap, no prospectus being required in the same form, and it suits a company that needs money in a hurry or is too small to interest the public, but the ownership stays concentrated and the terms may be harder. Fourth, the rights issue, in which a company that already has shareholders offers the new shares first to them, in proportion to the shares they already hold and usually at a price below the market price. It is the cheapest route of all, since no new investors need be found or persuaded, and it protects the existing holders from having their proportion of the company reduced, but it raises money only from those who are already shareholders and only as much as they are able and willing to put in. The issue of shares to the employees under a stock option scheme and the issue of bonus shares out of reserves are also acceptable, provided the candidate notes that a bonus issue raises no fresh money.

Four methods, 1 mark each, each named and explained 4.

Question 8 [10]

- (a) First, as to its object, training is directed at the particular job the employee holds or is about to hold, and its object is to give him the skill and the knowledge that job requires, whereas development is directed at the person himself, and its object is to enlarge his general capacity and his outlook so that he may be fit for responsibilities not yet defined. Second, as to the period in view, training looks to the present and the immediate future, often to a change already announced such as the installation of a new machine, while development looks to the long term growth of the man and of his career over many years. Third, as to the people to whom each is chiefly applied, training is given to the operative and the technical staff in the main and is job specific, while development is applied chiefly to managers and to those marked out for managerial posts, and deals in judgement, in the understanding of the business as a whole and in the handling of people. A fourth acceptable point is that the result of training can be measured fairly soon and fairly precisely, in output, in rejections or in time taken, whereas the result of development shows itself slowly and cannot be measured in the same way.

Three points of difference, 1 mark each, each stated for both training and development 3.

- (b) First, understudy or the assistant to position. The man is attached to a senior manager as his assistant or deputy, sits in on his meetings, handles a part of his correspondence and his decisions and stands in for him when he is away, so that he learns the content of the higher post by watching and doing before he holds it, and the firm has a tested successor ready. Second, job rotation, by which he is moved in turn through several different departments, spending a period of some months in each, so that a man who has risen through the works comes to understand the sales, the purchase and the accounts as well, and has the view of the whole business that a general manager must have. Third, committee assignment, by which he is appointed to a standing or a special committee, perhaps one examining a proposal to add a line or to revise the wage structure, where he must study a problem outside his own department, hear the views of people from other departments and defend a recommendation, which teaches both the subject and the handling of colleagues. Fourth, a planned transfer or a promotion to an acting charge at a smaller branch or unit, where he carries the whole responsibility on a scale at which a mistake is survivable. Coaching by his own superior, and the handling of a special project reporting to the top, are equally acceptable methods. Case study, role playing, business games and sensitivity training are to be given no marks, since the question excludes classroom methods.

Three methods, 1 mark each, each named and explained 3. A classroom method offered in place of one of the three earns no mark for that point.

- (c) First, status and recognition. A man values the standing his work gives him among his colleagues and in his family, and the firm can satisfy this by a designation, a place in the structure, the trappings that go with a post and, most cheaply of all, by acknowledging good work when it is done, in front of others, instead of noticing only what goes wrong. Second, participation in the decisions that affect his work. Where a man is consulted before the method, the layout or the shift pattern of his own section is changed, he not only brings his knowledge to the decision but accepts the outcome as partly his own, so he works to make it succeed rather than waiting for it to fail. Third, the opportunity to grow, by training and by promotion. A man who can see a path ahead of him in the firm, and sees the firm spending on fitting him for it, has a reason to stay and to do well that no single payment can give, whereas a man who believes he has reached the end of his road loses interest in the work. Fourth, security of employment and of income. The fear of losing the job occupies a man's mind and keeps him from committing himself to the work or to the firm, so an assurance that his post is safe while he does it honestly, together with the usual benefits in sickness and old age, removes an anxiety and frees him to attend to the job. Job enrichment, so that the work itself is interesting and whole, good physical conditions and sound supervision, and a known procedure for the hearing of grievances are equally acceptable incentives.

Four non financial incentives, 1 mark each, each named and explained 4.

Question 9 [20]

- (a) The concept Shilpa has failed to apply is delegation of authority. Delegation is the entrusting by a superior of a part of his own authority to a subordinate, so that the subordinate may take decisions within a defined field on the superior's behalf, while the superior remains answerable to his own superiors for the result. Shilpa has created four departments and appointed four heads, which is organising, but she has not accompanied the posts with the authority they need, so the heads hold responsibility without the power to discharge it, and every decision of any consequence still comes to her desk. A spending limit of Rs 10,000 in a firm of two hundred and forty employees, and a prohibition on altering a price, engaging a worker or settling a complaint, leave a department head with almost no field in which he may decide anything at all. Delegation consists of three elements. First, the assignment of responsibility, that is the duty of performing the task entrusted, which is what Shilpa has given her four heads. Second, the grant of authority, that is the right to take the decisions and to commit the resources the task requires, without which the duty cannot be performed, and this is what she has withheld. Third, the creation of accountability, that is the answerability of the subordinate to his superior for the use he has made of the authority and for the result he has achieved, which cannot fairly arise at all where no authority was given.

Delegation of authority correctly named 1. Delegation correctly explained, and the failure located in the facts, the Rs 10,000 limit or the four powerless heads 1. Responsibility explained as an element 1. Authority explained as an element 1. Accountability explained as an element 1.

- (b) Shilpa is right in the proposition and wrong in the conclusion she draws from it. It is perfectly true that responsibility cannot be passed away: a superior who delegates remains answerable to those above him and outside for what is done under his authority, so Shilpa will indeed continue to answer to the dealers and to the bank whatever she devolves on her heads. But that is an argument for delegating with care, not for refusing to delegate. What she has misunderstood is that authority can be passed down although responsibility cannot be passed away, and that the two must be kept equal at every post. Her four heads bear the responsibility for their departments and have none of the authority, so the responsibility is empty, while she holds all the authority and is the only person who can be held to account, which is exactly the position she complains of when she says it is she whom the dealers will hold answerable. Accountability is the third term she has left out. When authority is delegated the subordinate becomes accountable to her for the use he makes of it, so a wrong decision by the sales head is not a loss she must simply bear, as she fears, but a matter on which she can call him to account, review his judgement, set a tighter limit or replace him. Her practice removes that discipline instead of creating it, because a man who has never been allowed to decide can never be judged on his decisions, which is what the dyeing head meant in calling himself a clerk who signed muster rolls. The risk of a wrong decision is also better met by defining the field than by keeping all of it: she may fix the limits within which a price may be moved or a complaint settled, require a report on each, and keep to herself only the decisions whose size genuinely warrants her attention.

Her proposition conceded as correct 1. The distinction that authority is delegated while responsibility is not passed away 1. Authority and responsibility must be kept equal, applied to the four heads 1. Accountability explained as what delegation creates and her practice destroys 1. The answer to her fear, that the risk is controlled by defining the field and holding the head accountable 1.

- (c) The cost to the firm appears under three heads, one for each of the things that have gone wrong. First, the firm has lost business it had already won. A standing order worth about Rs 18,00,000 a year was cancelled because a complaint about shade variation waited eleven days for an answer, and the case states that the sales head could have settled it in an hour had he been allowed to. The loss is therefore not a loss of judgement but purely a loss of time, and the time was consumed by the journey of the matter to Shilpa's desk and back. Every other complaint from a distant dealer is exposed to the same delay, so the loss is likely to be repeated, and a dealer who cancels after waiting eleven days tells other dealers why. Second, the firm has lost a trained man and will lose more. The dyeing head left after nine years, and his parting remark that he had come to feel like a clerk who signed muster rolls identifies the cause exactly: the post carried no authority, so it offered him nothing to grow into and no decision by which he could show his worth. The firm must now find and train a dyeing head, which costs money and time and risks the quality of the dyeing meanwhile, and the three heads who remain have heard him say it. Third, and most expensive of all, Shilpa's own time is being spent on the wrong work. She works fourteen hours a day on matters a head could settle, and the visit to the new weaving plant, on which a decision about a second unit depends, has been postponed twice because she cannot leave the plant for three days. The firm is therefore paying for her judgement about the growth of the business and getting her judgement about complaints and petty purchases instead, and the opportunity of a second unit may pass while she is occupied. The steps by which she should reorganise are these. First, she should settle for each department, in writing, the decisions its head may take alone, and in particular raise the spending limit to a figure that bears some relation to the size of the firm, give the sales head authority to settle a dealer's complaint and to move a price within a stated band, and give each head authority to engage and to discipline the staff of his own department within a sanctioned strength. Second, she should keep to herself only the decisions whose size or whose effect on the whole firm genuinely requires her, such as capital expenditure above a stated figure, the opening of the second unit, the appointment of a department head and any change in the list of main suppliers. Third, she should put in place the reporting by which she will hold the heads accountable, a monthly statement from each department of its output, its cost, its complaints and its spending against budget, with an immediate report on anything out of the ordinary, so that she learns what has been decided without having to decide it herself. Fourth, she should accept that the heads will make some mistakes and treat an occasional mistake as the price of their training rather than as a reason to take the authority back, reviewing it with the head concerned and tightening a limit only where the pattern justifies it. Fifth, she should begin with the sales department, where the loss is already proved and the remedy is plainest, and extend the arrangement to the others as it answers. Sixth, having freed her own time, she should use the first of it to make the visit to the weaving plant she has twice postponed.

The loss of the Rs 18,00,000 order traced to delay in referral and not to judgement 2. The resignation of the dyeing head traced to the absence of authority in the post, with his own words used 2. The cost of Shilpa's own time, with the twice postponed visit and the second unit 2. The defining in writing of each head's field of decision, with at least one concrete power named 2. The reservation to herself of the genuinely large decisions, and the reporting by which the heads are held accountable 2. Where the answer sets out the steps correctly but without reference to the sales head, the dyeing head or the postponed visit, award no more than 5 for the part.

Question 10 [20]

- (a) The margin on the packeted line is about nineteen per cent against about four per cent on the loose line because the two lines are not the same business. On the loose line the firm sells an undifferentiated commodity to a wholesaler who knows the trade as well as it does, can weigh and judge the powder himself and can buy the identical article from any mill, as two of the wholesalers have just shown by moving to a mill quoting twenty paise a kilogram less. Where the buyer can see no difference between one seller's goods and another's, the only ground on which he chooses is price, and the margin is driven down to the little that is left after the grinding. On the packeted line the firm sells to a grocer and through him to a household that cannot test the powder, does not know what turmeric should cost a kilogram and is buying 200 grams at a time, so a few rupees on the pack is a small matter to the buyer while it is a large matter to the firm's margin. The

elements of the marketing mix that account for the difference are these. First, the product, which on the packeted line includes the pack itself, the fixed weight, the cleanliness and the assurance that the powder is unadulterated, and could include the window showing the colour and the date of grinding that Ira wants to print. None of this is present in loose powder scooped from a sack. Second, the brand, which is part of the product decision. Teen Patti is a name the buyer can ask for again, and a name carries the firm's reputation and makes the article something other than mere turmeric, whereas loose powder carries no name at all once it leaves the firm's sack. Third, the price, which the firm itself fixes on the packeted line and prints on the pouch, while on the loose line the price is settled by the wholesale market and the firm must take what is quoted. Fourth, promotion, which is possible only for a branded packeted article, since the firm can advertise a name and a pouch a buyer will recognise but cannot advertise an anonymous powder, and the three outside firms are doing exactly this on the cable channel and the hoardings. Place also contributes, in that the packeted line reaches a grocer who serves a household, which is further along the chain and therefore carries a larger margin than a sale to a wholesaler.

The loose line explained as an undifferentiated commodity sold on price, with the twenty paise defection used 1. The packeted line explained by the buyer's inability to judge and the small absolute sum 1. Product and pack, with the pack or the window or the date of grinding named 1. Brand, with Teen Patti named 1. Price control and promotion, with the rivals' cable and hoarding advertising used 1.

- (b) The commercial objection is that the proposal cannot win and would cost the firm its position even if it did. The firm's disadvantage against the neighbouring mill is twenty paise a kilogram, and the only way to find that from cheaper raw turmeric is to buy a poorer grade. Wholesalers in a grain market are expert buyers who handle the powder, judge its colour and its smell and compare it against what they have bought for years, so the drop in grade would be noticed almost at once, and the firm would then be selling an inferior article at the same low margin against a mill that may well cut its price again. The firm would have spent its forty year reputation in that market to buy a few months of volume. Worse, the same powder goes into the Teen Patti pouches, so a reduction in the grade of the raw turmeric would damage the one line that earns the firm nineteen per cent, in order to defend the line that earns it four. The ethical objection is that adulteration or the substitution of a poorer grade in a food article, passed off to a buyer at the same description and without telling him, is a deception, and in a spice powder it is a deception the buyer cannot detect for himself. The household that buys the pouch takes the firm's word for what is in it, and the firm would be trading on a trust its grandfather built while quietly withdrawing the thing that trust was given for. It is also a matter of the buyer's health, since the cheap turmeric of the trade is cheap for a reason and may carry more foreign matter, so the firm would be exposing people who eat its powder every day to a risk they never agreed to. What the firm should do about the loose trade instead is to stop trying to meet the mill's price and change the basis on which it competes. It should hold its grade and its weight, make the consistency of its powder its argument with the wholesalers who value it, and let go the two who have left rather than chase them down, since a wholesaler won on twenty paise will be lost on twenty paise. It should treat the loose line as a declining business to be kept profitable rather than defended, supplying those wholesalers who will pay for the grade, holding the volume steady rather than growing it, and moving the money and the attention it would have spent on a price war into the packeted line, where the margin is nineteen per cent and the firm is not yet beaten. It may also use the loose trade as a source of cash flow while that shift is made, since the grain market pays and turns over quickly.

The commercial objection, that the drop in grade will be detected by expert wholesalers and will not hold the trade 1. The further commercial point that the same powder goes into the pouches and would damage the nineteen per cent line 1. The ethical objection, deception in a food article the buyer cannot test, with the firm's reputation or the buyer's health raised 1. Competing on grade and consistency rather than price, and letting the two wholesalers go 1. Treating the loose line as a business to be kept profitable while the money moves to the packeted line 1.

- (c) On the product and the pack, the firm should redesign the pouch, which has not been altered in eighteen years and is being compared on the same shelf with printed pouches that have a window in them, and should add the 100 gram and the 500 gram sizes Ira wants. The reason drawn from the case is that the rivals offer exactly those two sizes, so a grocer who stocks Teen Patti in 200 grams alone cannot serve the customer who wants a small trial pack or the household that buys in bulk, and the firm loses both to the brand next to it. It

should print the date of grinding, because freshness is the one claim a local grinder can make that a firm bringing its powder from outside the city cannot, and because the rivals' window showing the colour of the powder is an invitation to a comparison the firm should be glad to accept if it holds its grade. On the brand, it should keep the name Teen Patti rather than invent a new one, since the name has been in the city for forty years and the family's standing is attached to it, but it should put the family name, Naharia Spice Works, and the fact that the firm grinds in the city on the front of the pouch, because the father's observation is that the name is known in the grain market and not known in the new self service stores, and the new buyer must be told who stands behind the pouch. On the price, it should not undercut the outside brands. Its advantage is freshness, local grinding and a name the city knows, and a price below theirs would invite the buyer to assume the powder is inferior, which is the opposite of what the firm is saying. It should price at or very near the rivals and hold the margin, which the case shows to be about nineteen per cent, since the whole purpose of the shift is to earn that margin on a larger volume. If it wants a price weapon it should use an introductory offer on the new 100 gram size rather than cut the price of the line. On the channel, it must get into the two self service stores and the larger grocery shops, which is precisely where the three outside firms have gone and where the firm is at present absent. That means approaching those stores directly, accepting that they will want a margin and a display allowance and perhaps credit, and it should at the same time hold and strengthen the three hundred grocers it already supplies, who are its existing strength and who are the ones telling Ira that customers now ask for the new brands by name. A grocer who is given a better pouch, the two new sizes and a reason to recommend them is the firm's cheapest salesman. On promotion, it should advertise on the local cable channel and take hoarding space, because that is where its rivals are reaching the city's households and because an advertisement for a local grinder, which is what the firm is, costs it no more than it costs them while carrying a claim they cannot answer. It should put its money chiefly behind the two things the rivals cannot say, that the powder is ground in this city and that the date of grinding is printed on the pouch, and it should support the advertising at the shop, with a display at the self service stores and a sampling or a demonstration where the customer can see and smell the powder, since the case shows the buyer is at present choosing by the name she has heard rather than by the article. Lastly, since the firm's money is limited and seventy per cent of its revenue still comes from the loose trade, it should make these changes in order, beginning with the pouch, the sizes and the three hundred grocers it already has, which cost least and can be done at once, and taking up the self service stores and the advertising as the packeted volume begins to pay for them.

Product and pack: redesigned pouch, the two new sizes and the date of grinding, each with a reason from the case 2. Brand: Teen Patti retained with the reason, and the firm's name and local grinding added, with the father's observation used 2. Price: priced at or near the rivals rather than below, with the reason, and the nineteen per cent margin held 2. Channel: the self service stores and the larger grocers entered, and the three hundred existing grocers held 2. Promotion: the local cable channel and the hoardings, with the local grinding and the date of grinding as the message, and support at the shop 2. Where a decision is given without a reason drawn from the case, award 1 instead of 2 for that decision.