Business Finance Assignment - 2

Q.1 Liquidity preferred refers to investors preferring cash now than on a future date, hence to compensate for this interest is paid.
Eg: ~~Interest~~ Investors demand higher interest on long term bonds than on short term loans, due to liquidity preference

Q.2 Listing on stock exchange will adversely affect dividend policy, as the prior dividend policy, the company may need to ~~red~~ readjust it as per industry standards and investors expectation

Conflict of risk between stockholders and lenders affects risk management. Lenders prefer no additional ~~stock~~, risk, while stockholders prefer higher gearing due to benefits of debt capital over equity. If the risk is increased, it affects their job security.

Q.3 Dividend Policy is affected by:

a. Growth Prospect: Companies in high growth industries may have high growth opportunities, but may need high demands of investment ~~due~~ to remain in competition. But excess borrowing may cross their ability, thus pay low dividend.

b.) Tax: If there are more non-taxpaying shareholders, then company would distribute more dividend.

c.) Stock Market: Any changes in dividend policy adversely affects to market value of company. Any dividend cut, reduces price

d.) Stability & Consistency: If there is change in dividend, it could lead to adverse market situation, as investors may leave and readjust portfolio.

e.) Cash Reserves: Large cash pile calls for take over bid. Thus dividend is paid to reduce it and build shareholder loyalty.

Q.4 A. Sole Proprietorship: One person own, manages, controls the whole business. Can hire employees, withdraw funds
· liability: Unlimited liability. hence, in case of de assets not sufficient to pay liability, personal wealth can be attached
· legal status: No separate legal entity. No documents to start.

B. Partnership: When 2 or more people together run the business, called as partners.
· liability: Unlimited liability; each partner severally liable for all liabilities of the firm
· legal Status: No separate legal entity. Formed by Indian Partnership Act, 1932 and runs as per partnership agreement.

C. Limited Company: Owned by shareholders.
· liability: Limited liability, each shareholder liable only to fully paid up value of their shares
· legal status: Needs to be incorporated and has separate legal entity

D. LLP: Owned by 2 or more members engaged in profit making venture (No partners)
· liability: Limited liability of each member
· legal status: LLP is separate legal entity governed by partnership deed already may in existence

Q.5 He should choose Sole Proprietor instead of ~~to~~ limited company as no separate legal entity as he will be taxed only once, and then In limited company, one pays co-orporation tax, due to separate entity income tax on profit.

Q.6 Modigilani and Miller said that companies market value is independent to the capital structure of it. It is determined by investing decisions and not financing decision.

Q.7

- Working capital is difference between current assets and current liabilites. It is the money needed to carry out daily expenses like bills payrolls etc.
- Fixed Capital includes fixed assets used in profit making activity

Q.8 Economies of scale is when average cost per unit / overall cost of production falls due to mass production or on large scale. Better savings in cost gained by increased production. Can be done by buying inputs required in bulk, hiring more skilled manager to overlook production or use advance technology.

Q.9 Pension fund needs to report financial position every year, thus, may be more prone to short term losses. Consequence would be to force the fund to invest in less volatile/riskier assets to reduce risk of having poor financial position in that year. May result in investing less heavily in equities and long term funds.

Q.10 Scenario 2 is preferred over 1 as, there is a loss on time value of money. This money could have been invested somewhere else. No emotional feel/pressure of loosing money or worrying about investing it.

Q.11 Holding costs are those associated with slow inventory that remains unsold. It means having some tied up money. These Costs Include: i) price of damaged / spoiled good.

- Storage Space
- Labour
- Insurance

Q.1

Q.2