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BUSINESS FINANCE

Assignment-2

Q1. Liquidity preference refers to the preference of investors to hold liquid assets rather than securities or long-term interest-bearing investments.

> E.g. Investors often tend to demand a higher interest rate or premium oon securities with long term maturities that carry greater risk; investors prefer cash or other highly liquid holdings.

Q3. Factors influencing the dividend policy of a company:

- Stock market: Significant adverse reactions to announcement of dividend cuts can be displayed. Thus, in cyclical industries and for smaller and newer companies in the market, managers tend to conservatism in good years.
- Growth opportunities: Companies in that project major growth potential may have high demands for capital investment to remain in competition. This demand may exceed their borrowing abilities and hence they prefer to pay low dividends rather than making frequent rights issues.
- Cash reserves: Companies having large cash reserves accumulated overt he years fear a takeover bid and hence may wish to distribute these profits thereby increasing shareholder loyalty and limit the size of cash pile.
- Stability and consistency: Companies with high dividend policies attract investors seeking high payouts and vice-versa. Any changes in this policy could lead to adverse market reactions in the sense that investors will now have to readjust their portfolios.
- Tax: Non-tax paying shareholders will prefer that companies distribute a large proportion of earnings in the form of dividends, rather than re-investing in projects.

Q4. Different types of business entities are: Sole proprietorship, Partnership, Limited companies, Limited liability partnerships

	SOLE PROPRIETORSHIP	PARTNERSHIP	LIMITED COMPANIES	LIMITED LIABILITY PARTNERSHIP

OWNERSHIP	Owned, managed, and controlled by an individual who is the recipient of all profits and bearer of all risks.	It is a business which is owned by more than one person. Can be owned in equal or unequal amounts by partners.	It is a business which has a separate legal identity from the owners. Shareholders are owners of the company.	In this two or members engage in a profit-making venture. There are no directors and shareholders. The company has a separate legal identity.
LIABILTY	Unlimited liability- if sued the total personal wealth of the sole trader can be used to pay off debts	Unlimited liability- All partners are jointly liable and liable to the full extent of their personal wealth for the deficiencies in the business.	The owner's liability is limited to the fully paid value of their shares. If company becomes insolvent, creditors cannot claim further payment from the owner's personal wealth beyond the fully paid values of their shares.	Liability of its members is limited. Actions can be taken on individual members who are found to be negligent and fraudulent.
LEGAL STATUS	No specific documentation required to establish such a business. Income tax	Most partnerships have a partnership agreement- consists of rights of	These must have: - Memorandum of Association: This records	No MOA or AOA required. LLP is governed the partnership

	returns need to be filed.	individual partners.	the intentions of the people concerned to form the business -Articles of Association: This includes details of the internal rules for running the company.	agreement that may already be in force within an existing partnership

Q5. The individual should opt for sole proprietorship instead of floating a limited company as the former pays less taxes. This is because a corporation is treated as a separate entity meaning that it has to pay state as well as federal taxes on the money it earns.

Q6. Modigliani and Miller's irrelevance propositions suggests that market value of a company is independent of its capital structure. They believe that the market value of a company is determined by its investment decisions and not by its financing decisions.

Q7. Working capital is the cash or other liquid assets that a business uses to cover day to day operations like paying bills and payrolls of employees. It is the difference between a company's current assets and its liabilities.

Fixed capital includes the assets or investments needed to start and maintain a business like plant, equipment, property etc.

Q8. Economies of scale refers to the proportionate savings in costs gained by an increased level of production. This can be done by buying inputs required for the production process in bulk or hiring more skilled and experienced managers to overlook the production or using advanced and better technology and getting rid of the obsolete ones.

Q9. If a pension fund or investment company must report its financial position every year, it may be more averse to very short-term investment losses than if it had to report only every three years. The consequence of this might be to force the fund to invest in less volatile assets to reduce the risk of having to report a poor financial position. It might therefore result in the fund investing less heavily in equities, and possibly also less heavily in long-term bonds.

Q10. Scenario 2 is preferred over 1 as in the first case we're potentially losing out on the time value of money even if its for a very insignificant amount of time. In the second scenario we can potentially invest the 2000 rupees and earn some amount in that one day even if it's a small amount of time.

Q11. Holding costs are those associated with storing inventory that remains unsold. The costs could include:

- Price of damaged or spoiled goods
- Storage space
- Labor
- insurance