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Business Finance - 1 Assignment - 2

1) Define the following terms along with appropriate examples.

(i) Liquidity Preference

Ans:- Liquidity Preference is a preference of an investor to demand a higher interest rate or premium on securities with long term maturities that carry greater risk due to his loss of ~~choosing~~ choosing cash or highly liquid holdings.

5) Tax implications on Sole proprietorship:-
Since there is no seperate legal entity, the owner of the business ~~is~~ ~~the~~ has the entire claim on profits and has unlimited liability. He pays income tax that is proportionate to his earnings.

Tax implications on LLC:-
Directly or indirectly, the ~~owner~~ shareholder of the company is taxed twice (corporate tax and income tax) when he decides to take dividend. He can chose to (if he ~~is~~ is a majority shareholder) ~~to~~ have capital gains instead of dividend. The ~~company~~ interest paid on debt is tax deductible and with appropriate gearing measures, the shareholder can enjoy the benefits of trading on equity.

3) The factors that affect the dividend policy of a Company are:-

1) Tax effects:-

2) Cash reserves:-

3) Stock markets:-

4) Growth opportunities:-

5) Stability and Consistency:-

4) Types of business entities :-

1) Sole proprietorship

2) Partnership

3) Limited Liability Company

4) Limited Liability Partnership

	Sole Proprietorship	Partnership	LLC	LLP
Ownership:-	~~Part~~ Single owner	Owned by group of partners	Owned by group of ~~members~~ Shareholders	Owned by group of members
Liability:-	Unlimited	Unlimited	Limited	Limited
Legal Status:	Combined entity	~~Not~~ Combined entity	Seperate entity	Seperate entity

6) Modigliani and Miller (MM) stated that capital structure (or gearing) is irrelevant as increase in debt is compensated by rise in cost of equity.

The following are MM irrelevance propositions :-

1) The market value of any firm is independent of its capital structure.

2) The expected rate of return on the common stock of a leveraged firm increases in proportion to the debt-equity ratio, expressed in market values.

7) <u>Working Capital</u> :-

Working Capital is the amount of an organisation's current assets, which include cash, marketable securities, accounts recievable, and inventory. These current assets are called liquid because they can be quickly converted into cash.

<u>Fixed Capital</u> :-

Fixed Capital is the capital invested in fixed assets. It describes an organisation's investment in long term assets (relatively permanent). In accounting terms, fixed capital assets are usually defined as assets that are not intended to be used up or exhausted within one accounting year.

8) Economies of Scale :-

One of the main motives of mergers is to reduce costs and achieve economies of scale. In microeconomics, economies of scale are the cost advantages that enterprise obtain due to their scale of operation i.e a proportionate saving is costs by increasing level of production. It is generally observed as a result of horizontal mergers and seldom in conglomerate mergers.

10) I personally prefer scenario 2 i.e neither of the event happens. This is because in scenario 1 there first is a negative cashflow of ₹ 2000/- immediately and an uncertain future positive cashflow of ₹ 2000/- the next day. Here for undertaking a risk, there is no return or reward at all. So, there is no gain at all by following scenario 1 but rather a loss due to opportunity cost.

11) Costs of holding buffer inventory / stock of goods

1) Storage Costs
2) Protection Costs
3) Insurance costs
4) Transportation Costs
5) Possibility of loss of quality
6) Indirect loss of working Capital.