Business Finance - 1
Chapter : Unit 1 and 2
Assignment - 1

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Q1. 4 medical practioners are planning to set up their own practise, compare and contrast Traditional partnership ~~w~~ vs LLP. Give your suggestions :

Ans Traditional Partnership : It's partners have unlimited liability over business debts. So, even if one partner takes wrong decision, other partners will also be liable and all the assets of the partners can be seized. This is the reason for capital raising being difficult for traditional Partnership. Further, partnership does not form separate legal entity. It is easy to form and might have a formal partnership document to decide the percent share of each partner in ~~pa~~ profits and other terms.

LLP (Limited Liability Partnership) : As the name suggests, the members of limited liability Partnership have limited liability over the business debts. This means that a partner could loose only upto amount invested in LLP nothing more than that. Hence, it becomes easier to raise capital. LLP is a separate legal entity and requires Certificate of Incorporation to set up. It also has to do Accounting Audit.

Suggestions:

It would be better for the 4 medical practioners to enter into LLP.

This is because the four members of LLP would have limited liability over their business debts. So, if any one of the member makes wrong decisions ~~er~~ all member's assets would not have risk of being seized. Further it would be easier to raise finances as investors would not have to do ~~exe~~ excessive checking. They could join as member to the LLP.

Q 2. Mr. Darshan Lodha, the new CFO is ~~th~~ of the perspective that shareholders give more value to corporations which have higher earnings. What is your opinion about his views?

Ans I do not agree with Mr. Darshan Lodha's views. Shareholders do not give more value to corporations which have higher earnings. Rather, shareholders give more importance to the corporations which have added value to themselves.
This is because a company can show higher profits by cost cutting and not spendingon maintainence and employee training. The company might look profitable but in the longer run this cost cutting reduces performance of the company.
When ~~we~~ shareholders consider value addition, they look at company having projects that earn more than the opportunity cost of capital. This value addition helps the corporation to perform well and sustain in the longer run.

Q3. As an investor in a start up suggest that Mr Kevin must subscribe to ESC, PSC or Convertibles?

Ans Amongst Equity Share Capital, Preference Share Capital and convertibles, Mr Kevin, as an investor in a start up must subscribe to Convertibles.

Reason:

Convertibles are unsecured loan stocks that ~~have~~ offer additional opportunity to the Investor, Mr. Kevin to earn higher returns while giving security like a bond.

The investor, Mr. Kevin can expect zoom up in the equity of the company so that bond ~~is~~ converted to ordinary shares can give higher return. If the startup fails, still Mr. Kevin has the loan stock and does not compulsorily have to convert to to ordinary equity.

In case of Equity Share Capital and Preference Share Capital if it's highly volatile in market price and also has higher risk of default & loss of invested capital in a start up.

Q 4 Explain the differences between private Ltd and public Ltd.

Ans Public limited companies: A limited company is public limited company when it has an issued share capital of more than £50,000 and ~~which~~ whose name ends with 'public limited company'. A Public company must be registered with registrar of companies and must have audited accounts. Each issued share capital must be paid upto one-fourth of its par value plus premium on it. However a public limited company need not be in public sector. It In reality, most of public limited companies are from private sector.

Private limited companies: A Private limited company cannot issue shares. It's name must end with 'Ltd' or limited.

Q5. Mr. Mohit feels that setting up a proprietorship business is best suitable to him. Explain him the pros and cons.

Ans: Pros:

- Propriotorship is easy to set up. It doesnot require any documentation. The legal costs are limited only upto obtaining license of the practise.
- It gives complete control over decision. Proprietor can pool into and pool out capital at his discretion.
- It gives the proprietor flexibility of working hours.
- No separate tax has to be paid. The proprietor has to only file his personal income tax.

Cons:

- In Proprietorship, Proprietor holds unlimited liability over business debts. This means that all his assets have risk of being seized.
- There is no separation of ownership from management. It causes short life of business. Without proprietor, the business would lose its customer base.
- For a proprietor, it is difficult to raise large ~~fun~~ capital.
- Proprietorship flourishes only if the proprietor is highly committed.

Q 6. Delta corp wishes to raise short term funds for working capital needs. Suggest suitable methods.

Ans Methods to raise short term funds for working capital needs:

1. Bank Overdraft: Delta corp can draw amount ~~f~~ out of its current account to raise funds for working capital needs, such that the account balance is negative. The interest charged on bank overdraft is higher than the corresponding loan and the bank can ask delta corp is repay at without any prior notice.

2. Commercial Paper: As Delta corp is a large company, it can issue commercial paper, a bearer document, which can be used to raise large denomination. It is issued at discount and redeemed at par. The effective rate of interest will be slightly higher than risk-free investment (treasury bill)

3. Bills of Exchange: It is a two name document having name of drawee and drawer (Delta corp) and the name of accepting bank. It can be endorsed if the holder puts his signature on back of bill (endorser) and also the person to whom it is transfered endorsee. Delta corp will pay back to that person.

Q7 Explain operating and Financial lease

Ans: Leasing is a method of medium-term finances where the good or machinery is leased by the ~~leasor~~ lessor to the leassee without any ~~ex~~ transfer of ownership. It is an agreement to give right to use asset in return of regular series of payments.

Operating lease : It is a type of lease where the period of time of lease is less than the life of the good or machinery or property. Here, the risk of the good is bore by the lessor.

Financial lease : It is a type of lease where the period of leasing is almost equal to the life of the asset. Here the lessee bears the risk associated with the asset. It is just like purchasing the asset in installment rather than outright, with lump sum payment. The lessee can buy the asset at end of the period of leasing for the remaining value of the asset. But its not compulsory to exercise this option.

Q 8 Explain
(i) Convertible
(ii) Warrant
(iii) Why a convertible must normally trade at a higher price than equity stock?
(iv) Why the running yield of convertible must be greater than Equity.

Ans
(i) Convertibles are unsecured loan stocks or preference shares which gives the right to holder to convert into ordinary date shares at a later date. The investor does not have to pay additionally to convert into ordinary shares. If the share price of the company zooms up, then the investor converts into ordinary shares to earn a higher return. If the share price of the company zooms down, then investor will keep it as loan stock. Convertibles are a package of bond and warrant.

(ii) Warrant is an instrument that allows or gives right to the investor of a convertible to convert the loan stocks or preference shares into ordinary stocks in order to earn higher returns on their investment without paying any additional capital for the conversion

(iii) A convertible is a package of bond and warrant. Bond offers security to the investor and warrant offers the right to investor to convert ~~to~~ bond to equity shares at later date. So, Convertible offer security plus opportunity to earn higher return from investment.

They generally provide higher income as compared to equity shares.

They are less volatile.

However, equity is volatile. Hence there is lower income compared ~~to~~ equity ~~shar~~ to convertibles.

Hence, a convertible must normally trade at a higher price than equity stocks.

(iv) Running yield is the annual income on an investment divided by its current market value.

From investor's point of view, an investor will convert his ~~b~~ loan stock into ordinary stocks only if the equity stocks outperform the return earned by loan stock. For the period (on whole), the bond initially generated higher return than equity when the ordinary shares were not performing well. At a later date, the investor will exercise his right of converting into equity or keeping as loan stocks, wherever return would be high. So, overall investor earns well.

For equity, initially they gave low returns, at later date, they may or maynot generate

higher return. So, on a whole, for entire period, its return would be lower.
Hence, running yield of convertible must be greater than equity.