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Chapter: Unit 3 & 4
Assignment 2

1. Liquidity Preference refers to the premium that wealth holders demand for exchanging ~~readin~~ ready money or bank deposits for safe, non-liquid assets such as government bonds. It refers to the relationship between the quantity of money public wishes to hold and the interest rate.
So, if higher interest rates are offered, investors give up liquidity in exchange for higher rates.
Example: If the interest rates are rising and bond prices are falling an investor may sell their low paying bonds and buy higher-paying bonds or hold onto the cash and wait for an even better rate of return.

2. Listing of several insurance companies in India is not likely to affect their dividend policy. Insurance industry is in growing stage in India. The insurance companies would prefer to invest into quality projects and grow rather than distributing profits. So, I think dividend policy will not be affected.
A Risk Management program can be affected.

by conflict of interest. Shareholders of the company would want to maximise their shareholder wealth and would desire the company to take more risks and grow by investing in risky projects. However, managers of the company and lenders would want to ~~to~~ be risk averse by investing in less risky projects. ~~Even the lenders~~ This is because managers want job security and lenders want short-term earnings so that company can pay off their debt. So, it affects risk management program of the company.

3. Factors influencing the dividend policy of a company:

1. Stock Market : They display significant adverse reactions to announcements of dividend cuts. Managers therefore tend to conservatism in good years, particularly in cyclical industries and for smaller companies. A change in dividend policy can have significant repercussions for a company's market rating and its capacity to raise finance.
2. Cash Reserves : Companies with large cash reserves that fear a takeover bid may well distribute generously to both encourage shareholder loyalty and limit the size of 'cash pile'. However, a 'cash pile' is seen as weakness by the shareholder.

3. Tax : Companies with a large proportion of non-tax paying shareholders may feel it appropriate to distribute a large proportion of earnings.

4. Growth opportunities: Companies in high-growth industries may find that the demands for capital investment to maintain competitive advantage exceed their capacity to borrow on satisfactory terms and may prefer to pay low dividends rather than making frequent rights issues.

5. Stability and consistency: Since companies with high dividend policies tends to attract investors who seek high payouts (and similarly for low dividends policies & preferences) any move from one category to the other will cause adverse market reaction as investors readjust their portfolios.

4. Major Types of business entities are - Sole Proprietorship, Partnership and ~~Corpora~~ Limited Company.

		Sole Proprietorship	Partnership	Limited Company
1.	Ownership	Single owners	Partners own business	Shareholders own business
2.	Liability	Unlimited	Unlimited	limited
3.	Legal Status	No	No	Yes

5. From the point of view of minimizing the tax amount, sole trader would be the entity that he should opt for because in sole trader only personal taxes have to be paid. For limited company, corporation tax has to be paid in additional to tax payments on personal share of profits.

6. Modigilani and Miller's irrelevance proposition: It states that the market value of a company is correctly calculated as the present value of its future earnings and its underlying assets and is independent of its capital structure. With certain assumptions in place, it is irrelevant whether a company finances its growth by borrowing, by issuing stock shares, or by reinvesting its profits.

7. Working Capital - Working capital is the difference between a company's current assets such as cash, accounts receivable/ customer's unpaid bills and inventories of raw materials and finished goods - and its current liabilities such as accounts payable and debts.
Fixed Capital - Fixed capital is the value of capital assets available for production at a given point in time. Example: dwelling, other building structures, machinery and equipment, weapon system, etc.

8\. Economies of scale : They are cost advantages reaped by companies when production ~~are~~ becomes effecient. This can be achieved by companies by "increasing production and lowering costs. A business" size is related to economies of scale - larger companies will have more cost savings and higher levels of production. Economies of scale can be both internal and external. Internal economies are caused by factors within ~~e~~ a single company while external factors affect the entire industry.

9\. If a pension fund has to report its financial position every year, it may be more ~~at~~ averse to very short-term investment losses rather than if it had opted for reporting only every three years. The consequences of this might be to force the fund to invest in less volatile assets in order to reduce the risk of having a 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.

10\. Option 2 because of Loss aversion. People are more sensitive to losses than gains of same magnitude. So, if ~~a~~ nothing happens then it would be better

11. Costs of holding buffer inventory / stock of goods :

1. Reduces available cash flow
2. Shifting of customer demand can lead to the buffer inventory being wasted.
3. Inventory takes up space. This leads to extra expense for the company
4. Reduces the potential returns that could have been provided if the cash was invested rather than for buffer inventory.