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BUSINESS FINANCE

ASSIGNMENT 2

Q.1. Liquidity Preference - When higher interest rates are offered, investors give up liquidity in exchange for higher rates. As an example, if interest rates are rising and bond pricing 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.

Example: A three-year Treasury note might pay a 2% interest rate, a 10-year treasury note might pay a 4% interest rate and a 30-year treasury bond might pay a 6% interest rate. For the investor to sacrifice liquidity, they must receive a higher rate of return in exchange for agreeing to have the cash tied up for a longer period of time

Q.2. Companies pays dividends to distribute profits to shareholders, which also signals corporate health and earnings growth to investors. Because share prices represent future dividend streams are incorporated into the share price, and discounted dividend models can help analyze a stock's value. After a stock goes ex-dividend, the share price typically drops by the amount of the dividend paid to reflect the fact that new shareholders are not entitled to that payment

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There are certain strategies that can be employed to mitigate the risk in a stock market. The strategies are as follows:
1) Follow the trend of the market
2) Portfolio Deversification
3) Stop Loss.

Q.3. The factors that ~~affe~~ can influence the dividend policy of a company are -
1) Maintainance of Reserve.
2) Existence of Earned Surplus
3) Cash needs of a Company
4) Need for Growth and Expansion
5) Steady and stable Dividend Policy
6) Goverment Taxation Policy
7) Legal Restrictions.
8) Dividend Restrictions by Creditors
9) Fixed asset Replacement Provision.

Q.4. Sole Proprietor -
a) Business is owned by 1 person
b) Flexibility to further invest or withdraw money from business
c) Unlimited Liability
d) No legal documentation required to register as a sole trader but need to file timely tax filings.

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Partnership-
a) Business is owned by 2 or more peoples
b) Active, Sleeping and investing Partners
c) Unlimited liability
d) Partnership deed between partners to define the overall business arrangement - rights and duties
e) In UK, Taxed in the hands of Individual partners ~~vise~~ visa firm taxed in India.

Limited Companies-
a) Separate Legal Identity.
b) Separation of Ownership & Management
c) Shares need to be purchased to become Owner and dividends are paid as return.
d). Limited Liability to the Investment Amt.

Limited Liability Partnership-
a) Mix of a Company and a Partnership
b) 2 or more members
c) Separate Legal Entity
d) Members have limited liability
e) Partnership deed between members to define overall business arrangement rights and duties of partners, term, PSR.

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Q.5. Two possible choices are the Sole Proprietorship and Limited Liability Company.
- Liability issues -
Legally, a sole proprietorship and its owner share an identity. You are personally liable for any liabilities or debts the business incurs.
- Tax issues -
Because the internal Revenue Service does not view a sole proprietorship as a separate entity, it considers your business earnings as personal income
- Participants. -
If you operate a sole proprietorship, you are the only participating owner and there are no other members.
- Tax-Returns -
IRS form 1040 is used for sole proprietorsh and LLC's taxed as sole proprietorship.

Q.6. Modigliani - Miller Theorem.
This theorem argues that the option or combination of options that a company choose has no effect on its real market value.
Merton Miller, one of the two originators of the theorem, explains the concept behind the theory with an apology in his book, Financial Innovations and Market Volatility.
"Think of the firm as a gigantic tub of whole milk. The farmer can sell the whole milk

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as is. Or he can separate out the cream and sell it at a considerably higher price then the whole milk would bring. (That's the analog of a firm selling low-yield and hence high-priced debt securities). But, ofc, what the farmer would have left would be skim milk with low butterfat content and that would sell for much sell than whole milk. That corresponds to the levered equity. The M and M proposition says that if there were no costs of separation, the cream plus the skim milk would bring the same price as the wholemilk".

Q.7. → Fixed Capital includes the assets or investments needed to start and maintain a business, like property or equipment. Working Capital is the cash or other liquid assets that a business uses to cover daily operations, like meeting payroll and paying bills. While both fixed and working capital are necessary for running a successful business, they are two distinct types of capital.

→ Working Capital-
It is a difference between a company's current assets (what you have) and liabilities (what you owe). This figure measures how efficiently you're operating, your company's liquidify and its short-term financial health.

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Q.8. Economics of scale are cost advantages reaped by companies when production becomes ~~d~~ efficient. Companies can achieve economics of scale by increasing production and lowering costs. This happens because costs are spread over a larger number of goods. Costs can be both fixed and variable. A business's size is related to whether it can achieve an economy of scale - larger companies will have more cost savings and higher production levels.

Q.11. The accepted total cost of holding inventory is roughly 20 to 40% of the cost of your merchandise inventory. That leaves every company with an important calculation. The answer to that question depends on your business, Supply and demand are in an eternal push and pull with risk and cost, Business owners will forever straddle that line. Inventory management is the science of dealing with uncertainty, and the variables it considers can never be completely controlled. Keeping stock levels at the optimal levels is valuable and worth paying a high warehouse manager salary for. Consistent decision making based on a de understanding of risk level and cost is what success looks like. You also need to conduct a regular inventory audit to avoid safety stock becoming dead stock.