

BUSINESS FINANCE

ASSIGNMENT 2

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

E.g If 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.

3. Factors influencing the dividend policy of a company:

- stock market reaction eg adverse reaction to dividend cuts, competitors' policies
- cash reserves – cash-rich companies might give a generous dividend or might buy back shares; cash-poor companies might give no dividend or perhaps a scrip dividend
- tax – investors prefer dividends if they are taxed at a higher rate on capital gains
- growth opportunities – if these exist it may be better to retain profits
- stability and consistency with previous dividend policy
- investor preferences eg need for cash, better opportunities to invest elsewhere.

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

	SOLE PROPRIETORS HIP	PARTNERS HIP	LIMITED COMPANIES	LIMITED LIABILITY PARTNERSHIP
OWNERSHIP	Owned, managed, and controlled by an individual	It is a business which is owned by	It is a business which has a separate	In this two or members engage in a profit-

	who is the recipient of all profits and bearer of all risks.	more than one person. Can be owned in equal or unequal amounts by partners.	legal identity from the owners. Shareholders are owners of the company.	making venture. There are no directors and shareholders. The company has a separate legal identity.
LIABILITY	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	Most partnerships have a	These must have:	No MOA or AOA required.

	establish such a business. Income tax returns need to be filed.	partnership agreement- consists of rights of individual partners.	- Memorandum of Association : This records the intentions of the people concerned to form the business -Articles of Association : This includes details of the internal rules for running the company.	LLP is governed the partnership agreement that may already be in force within an existing partnership
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5. He/she should choose 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.
6. Modigliani and Miller's irrelevance propositions suggests that market value of any firm 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.
7. 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. Fixed capital is used to acquire non-current assets that would serve the business for more than one accounting period.

On the other hand, working capital is used to serve the business on a day-to-day basis fulfilling the requirement of everyday production and operation.

8. 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.
9. 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.
10. Scenario 2 is preferred over 1 as in the first case we will lose out on the time value of money even if its for a very insignificant amount of time and also the worry of the losing money is there. We can rather invest the 2000 rupees and earn some amount in that one day even if it's a small amount of time.
11. 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