23/02/2022

BUSINESS FINANCE

ASSIGNMENT

Ans 1) i) Liquidity preference is a concept/ theory developed by Keynes which states that investors prefer liquidity and hence demand higher interest rate on long term securities as opposed to short term securities with lower interest rate ~~as~~ owing to demand for money (cash being the most liquid asset). Thus demand for money is driven by preference of liquidity. It has three main motives:-

1) Transactionary Demand
2) Precautionary Demand
3) Speculative Demand.

Eg: A Short-term security pays 3%. interest while a long term security pays 8% interest.

Ans 2)
- As listed companies, the key goal of the company is to maximise shareholders' wealth through dividends and capital appreciation
- To be profitable, ~~companies~~ insurance companies invest the money obtained from policyholders to increase their profits.
- ~~While the~~ To satisfy the shareholders, the company must maintain a consistent dividend policy which fulfills the expectation of shareholder while maintaining the financial health of the company.

- A conflict of interest may arise as the insurance company may arise as the insurance company may want to maintain reserves to meet unforseen risks while Shareholders ~~res~~ will resent that as they are not earning from their investment.

- Distribution of dividends may also lead to lesser investment opportunities which may affect claim settlement & hence policyholders.

- Moreover owing to the varying nature of risks involved, the dividend policy consistency is affected.

- The policyholder may want lower prices & higher benefits while shareholders are opposed to that.

Ans3) • If the rate of return provided by alternate investment opportunities for investors is higher than the company's rate of return, then the company should not ~~return~~ plough back profit.

- Companies with high-growth rates and high capital investment often need to plough back profits & pay low dividends. Hence nature of business concern influences dividend policy.

- If the shareholders are receiving tax benefits & exemptions, companies will pay higher dividends.

- Companies with high cash reserves distribute profits ~~to~~ in fear of takeover bid.

- A change in dividend policy / dividend payouts can have extreme reaction in the market. Thus it needs to be taken into account while making dividend decision.

Ans 4) ① Sole proprietorship

Ownership :- It is owned by a single person who is bearer of all profits and losses.

Liability :- The trader has unlimited liability which means that the business assets & personal wealth can be used to pay off liabilities.

Legal req. :- There are no documentation required to establish the firm. Income tax return will be filed by the trader.

② Joint Hindu Family

Ownership :- It is owned by a family (with at least two members).

Liability :- The liability of ~~ott~~ karta is unlimited while liability of co-parceners is limited.

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Legal:- It is governed by provisions of Hindu Succession Act, 1956.

③ Partnership

Ownership:- It is owned by more than one person/partner. It can have maximum 50/100 partners.

Liability:- The partners have unlimited liability and are 'jointly' & 'severally liable' for all liabilities & deficiencies.

Legal:- They must have a partnership agreement & ~~file~~ pay Income tax every year.

④ Joint stock company.

Ownership:- It is owned by shareholders who own stake by shares in the company.

Liability:- Each shareholder is liable to extent of fully paid-up value of their shares.

Legal:- Each company should be registered with Companies house & have a Memorandum of Association & Articles of Association.

⑤ Limited liability partnership.

Ownership:- Owned by two or more members

Liability:- The liabity of its members is limited

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- Legal :- It is governed by a partnership agreement & taxed like partnership firms.

Ans 5) ~~He should opt for a limited company because:-~~
- ~~The tax rate is fixed at 30%~~. Thus as the company grows an

Ans 5) He should opt for a sole propreitorship:-
- The business income and personal income are ~~the~~ declared as same and hence it taxed as personal income tax
- The process is quite simple & convenient.
- They are taxed once only, while shareholders are often ~~asked~~ taxed twice due to separation of entity and ownership.
- Sole proprietor is taxed on profits only & taxed as per appropriate income slab unlike company.

Ans 6) Modigilani & miller's irrelevance propositions:-
→ Capital structure does not affect the market value of the company is not ~~true~~ true in real life scenario

→ Debt is cheaper than equity - Relying on greater debt is favourable to overall cost of funding the business (i.e it is lower). Also equity will expect higher retur

Ans 7) Fixed capital - Fixed capital is that part of capital invested in long-term assets such as machinery, equipment, land etc. that is used in production of goods and services.

Working capital - Working capital is that part of capital which is used in operational business functions. It indicates liquidity.

Working capital = Current asset - Current liabilities

Ans 8) Economies of Scale

When a ~~co~~ business firm is able to increase its production and thereby reduce the cost of production. Thus improving the efficiency is improved with the same resources helping in achieving more volume ~~thus de~~ in lesser costs. It can be ~~d~~ differentiated

* Internal - It is the factors that can be controlled by company
* External - It is out of control of the company.

Ans 9)
- It helps investors to make informed investing decision and analyse various opportunities
- Due to the high volatility of the market, the investors should be presented with financial position more often ~~than~~ ~~usual~~ to make proper decisions.
- Various valuation ratios such as P/E ratio indicates future growth in earnings.

- It helps in investors to track & analyse their business income.

Ans 10) I would prefer scenario 2 because :-

- losing out on money today might lead to miss out on an investment opportunity today
- Owing inflation & time value of money Rs 2,000 today is worth more than Rs 2,000 tomorrow.
- Inflation can also affect savings & investment & future financial requirements.

Ans 11) Cost of holding stock/inventory :-

→ It includes cost associated with storage and maintainence of unsold goods.
→ It can lead to short fall in cash flow
→ It can lead to deterioration the stock
→ It also includes insurance & labour costs.