

Business Finance Assignment - 2

1.

Liquidity Preference - The premium that wealth holders demand for exchanging ready money or bank deposits for safe, non-liquid assets such as government bonds.

Example - 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 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.

Yes, listing on the Stock market does affect their dividend policy as Stock markets display significant adverse reactions to announcements of dividend cuts. If the stock market is focused on the short term, it is possible that investors will reward companies that pay high dividends with a high share price. Companies may then return too much to shareholders, rather than focusing on the payout ratio that best suits their business, which may be bad for the company's long-term prospects. A change of dividend policy can have significant repercussions for a company's market rating and its capacity to raise finance.

Conflict of interest refers to situations where the personal interests of employees, board members, or even contractors might go against that of the organization they work for, putting the company at a disadvantage. That means they might do something that somehow undermines your organization. With mutual trust as the foundation of the company-employee relationship, your organization should rightly expect employees to act in its best interest. When conflict of interest does occur, it can erode public and internal trust, damage the organization's reputation, hurt the business financially, and in some cases, even break the law.

3.

Factors influencing the Dividend Policy of a company -

1. **Stock Markets** - Stock markets 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
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 the 'cash pile'. A cash pile is seen by investors as a sign of weakness.
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 tend to attract investors who seek high payouts (and similarly for low dividend policies and preferences) any move from one category to the other will cause adverse market reactions as investors readjust their portfolios.

4.

The various forms of business entities are as follows:

1) **Sole Proprietorship -**

Ownership - A sole proprietorship (also known as individual entrepreneurship, sole trader, or simply proprietorship) is a type of an unincorporated entity that is owned by one individual only.

Liability - The sole trader has unlimited liability. This means that if a customer sues the sole trader (for breach of contract for example), the total personal wealth of the sole trader, including the sole trader's house and bank deposits would be available to pay off trading liabilities.

Legal Status - It is not a legal entity and simply refers to a person who owns the business, personally responsible for its debt.

2) Partnership -

Ownership - A partnership is a business which is owned by more than one person and is not a limited company.

Liability - The owners have unlimited liability. All the partners are jointly liable for any business debts.

Legal Status - It is not a legal entity and all partners in their individual capacity ought to additionally be part of as parties to the agreement to sell or to the conveyance deed and execute it in their individual capacity.

3) Limited Liability Companies -

Ownership - A limited company is owned by one or more 'members'. The owners of the company are called shareholders.

Liability - The owners' liability is limited to the fully paid value of their shares. If shares have been issued 'partly-paid' then, in the event of a liquidation, shareholders will only be liable to pay the outstanding instalments.

Legal Status - A limited company is a business which has a legal identity separate from the owners of the business.

4) Limited Liability Partnership -

Ownership - Any firm consisting of two or more members (not partners) engaged in a profit-making venture, may become a LLP.

Liability - Whilst the LLP itself is responsible for its assets and liabilities, the liability of its members is limited.

Legal Status - A Limited Liability Partnership is a business which has a legal identity separate from the owners of the business.

Only from the point of view of minimizing the tax amount, the individual should start as a sole trader because there is no tax for a profit of a particular amount. If he starts to earn greater profits after some time he can change his business entity to that of a limited company.

6.

Modigliani and Miller's irrelevance proposition was -

“Capital Structure (Financing Decision) doesn't affect the market value of the company, the MV (market value) of the company is affected by the Investment Decision that the Finance Manager would take.”

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.

8.

Economies of scale are cost advantages reaped by companies when production becomes efficient. Companies can achieve economies 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.

9.

Behavioral finance biases can influence our judgment about how we spend our money and invest. The most common pitfalls include mental accounting errors, loss aversion, overconfidence, anchoring, and herd behavior.

If a pension fund / investment company starts to report its financial position annually rather than triennially then people would not buy its shares or invest into the company as they would feel that the company is hiding something because Annual report can reveal the secrets a company wants to hide. In this case an investor can only find out about something fishy in the company after three years.

10.

I would prefer Scenario 2 in which neither of the events happen because I lost the opportunity to use or invest the Rs.2000 somewhere that day itself which could not be available the next day.

11.

Possible Costs of holding buffer inventory / stock of goods -

1. Having too much stock equals extra expense for you as it can lead to a shortfall in your cash flow.
2. If the products are perishable or have a shorter shelf life, then keeping the inventory could result in losses.
3. Creating and maintaining a buffer inventory can result in additional overhead costs.
4. Extra inventory also takes up additional space.