Merit enterprise corp essay

a. Discuss the pros and cons of option 1, and prioritize your thoughts. What are the most positive aspects of this option, and what are the biggest drawbacks? The option 1 looks at getting a loan of 4 billion from a consortium of bankers including J. P. Morgan with whom Merit has good business relationship and has served Merit with its short term as well as long term funding requirements in the past. The pros of this option are * The well established relationship between J. P.

Morgan and Merit will facilitate ease of transactions and negotiations for the 4 billion loan. * Since the consortium of lending bankers will consist of J. P. Morgan , it could better explain the creditworthiness and credibility of Merit to the other bankers and facilitate in obtaining such a large amount of loan. * With additional funding of 4 billion being met by debt alone the ownership pattern and voting rights will remain impact. * Debt carries lower cost compared to equity. * The tax advantage of debt can be utilized by the company to improve earnings.

The higher financial leverage can give the company higher profits if return form invested 4bn gives higher returns than the cost of debt. The drawbacks of option 1 are: * With increased reliance on debt the financial risk increases and the debt servicing burden of Merit will increase. * With increase in Debt/equity ratio cost of the loan will increase as now Merit has higher financial leverage. * This could result in chances of bankruptcy in periods of uncertainty or slowdown. * The consortium of bankers will lay down restrictive covenants which will impose restrictions on further form of funding. There will be a lot of interference from the bankers in the form of periodic assessments and financial disclosures such as periodic cash flows and financial statements. * This could create agency problems as there will be conflict of interest between the stakeholders, management and the lenders. b. Option 2 calls for a public issue of shares to fund $ 4bn requirement. The pros of this option are: * The requirement of $ 4bn can be adequately met by a primary issue of shares. * The good financial performance of the company over the past years can command a premium for the stock in the primary market. There will not be any fixed financial obligations in case of an equity issue and hence if the $ 4bn investment has large risk this form of funding will be suitable. * Merit can reward its employees and retain them by offering stock options and other incentives. * The brand image of the company improves giving better visibility and acknowledgement. The drawbacks of the issue are: * Merit will now change from a privately held to public limited firm which will change the ownership pattern of the company along with dilution of control. Primary issue of shares is more time consuming and involves a lot of procedures such as hiring of merchant bankers, registrars, etc. * It is a more costly form of funding * There will be higher disclosures required as it will be a listed company * There will also be higher regulations by the regulators such as SEC , Stock exchanges, etc * Since the stock will be traded in the secondary market, there could be large investments by individuals or institutions. c. Which option do you think Sara should recommend to the board and why?

I think Sara should recommend option 2 to the board as: * As the company is on a growth trajectory there could be continuous demand for funds which cannot be met by retained earnings and debt alone, hence keeping the future in perspective equity issue will be a good decision. * The final objective of any company is to improve performance, growth and shareholder wealth which can be met by growing in size unless these objectives are superseded by management control as a private company will have a growth limited by the funds available for investment. Though cost of equity is high there are no fixed financial payments linked to it. * Even though Merit will require larger financial and other disclosures this will only bring in more transparency and better corporate governance in the company. * Though both equity and debt have its pros and cons an equity issue also increase the debt capacity of the firm as the firm can resort to higher debt in future. * Today we are in a global market competing not just with local peers but also international players , hence going public gives better visibility , brand image, larger investor base and recognition.