Bonds business plan

[Finance](), [Investment]()

A bond can be defined as a contractual promise to repay a principal sum of money together with the interest, also known as coupons, at given maturity dates. Bonds are debt instruments that are issued for a period usually more than a year with the intention of raising capital. When investors purchase bonds, they became creditors of the issuer. The fair value of a bond is determined by the present value of cash flows that are to be generated from the bond in future at a given discount rate. Hence, the price of a bond is calculated using the present value formula at a specified discount rate. Price of the bond is calculated by the formula:

$P = (C/‹1+i› + C/‹1+i›^{2} \ldots + C/‹1+i›^{n}) + M/‹1+i›^{n}$

Where; P is the price of the bond, C is the periodic interest payment or the coupon payments, if is the given discount/interest rate, n is the number of payments and M is the value of the bond at maturity (Faerber).

Bonds are issued as a means of raising funds from external sources to invest in long term projects or investments that will take a relatively long period before the returns on the investment are realized (Banks). Bonds are issued by the federal government, cities, states, municipalities, public companies and credit institutions

Both stocks and bonds are long term securities. The main difference between the two is that stockholders are the owners of the company with rights to attend annual general meetings and other general meetings of the company and vote in such meetings whereas bondholders are lenders of the company. Another variation is that all bonds, apart from consol bonds, have a specified maturity date whereas stocks remain outstanding as long as the company is a going concern (Banks). Corporations may prefer to issue bonds other than stocks to minimize their tax liability because the interest paid is a tax allowable deduction on their income tax returns whereas dividends paid on stock is not tax allowable deduction on their income tax returns. Corporations may also want to avoid dilution of ownership interest since bonds do not vest ownership interest to the holders (Banks).

Coupon is the periodic interest payments made to bond holders. Coupon value is computed by multiplying the stipulated interest rate with the par value of the bond (Faerber). Maturity date is the date which the bond issuer must repay the principal amount. After the maturity date, the bond issuer does not have any more obligations to bond holders provided that the issuer has paid the principal amount with any outstanding interest. Bonds normally have a maturity period of more than one year since they are a long-term source of finance (Faerber). Face value is the usually sum of money that must be repaid when the bond matures. However, some structured bonds have a different redemption value other than the face value. These are bonds that are linked to the performance of certain assets at the time of maturity such as commodity index, a stock, a fund or foreign exchange Face value is also the value that forms the basis of computation of coupon payments to be made by the issuer (Faerber).

Bonds are also issued at a discount when it has a coupon yield that is less than the prevailing market interest rate. Bond issuers will therefore be forced to issue the bond at an amount less than the face value to make them attractive and equate the coupon yield with the prevailing market interest rates. For zero coupon bonds investors pay less than the face value of the bond. Zero coupon bonds are bonds that do not pay regular interest. They are issued at discount on the par value so that total interest is rolled up to when the bond matures as the bond holder will receive the face value amount in full (Banks). Bonds are also issued at a premium when it has a coupon yield that is more than the prevailing market interest rate. Bond issuers will therefore take advantage of the higher market interest rates to raise more funds by issuing the bond at an amount higher than the face value and equate the coupon yield with the prevailing market interest rates (Banks).

Works Cited

Banks, Erik. Finance: The Basics. 2, illustrated. New York: Taylor & Francis, 2010.

Faerber, Esmé. All about bonds and bond mutual funds: the easy way to get started. revised. New York: McGraw-Hill Professional, 2005.