

Most actives % gainers % losers term paper

[Business](#), [Company](#)



Business Financing and the Capital Structure

It can be a daunting task for any business to decide the best financing option when they are in need of capital to expand their businesses. There is variety of financial resources that businesses can utilize to expand. These categorized into two, the debt and equity. For the debt option, the business borrows money to be repaid back--for example the bank loan. Equity involves a business selling interest to investors in the company. There are several advantages of the debt option. When the lender write a check, he/she does not come back to claim the equity in business and the relationship ends immediately the money is paid back. Secondly, the lender does not have any direct claim on future profits in the business and is only entitled to the principal amount and the interest agreed. However, if the business has too much debts, potential investors will see the business as " high risk" and may fear from investing in the business in future. When the business rely too much on debt and is faced by cash flow problems, it will have trouble when repaying the loan back.

On the other hand, equity financing has its own share of advantages.

Because the money will not be paid back, it is a less risky option. Using equity is advantageous because, the business is able to tap investor's network, therefore adding credibility to the business. However, the investor writing a check will require some share of ownership in the business as well as profits. Before making a major business decision, the business must consult the investor. This may raise some disagreement, (Bates, 1990).

The success of relationship between the business owner and the investment banker mainly depend on two factors: the first is the stage of life of the

company and secondly the investment bank quality. Investment bankers are mainly interested in the companies that are already established and mature. For younger start-ups, the deal with investment banker might appear less beneficial for the owner of the business. Assuming mature company, one requires selecting top-rate investment banker. When selecting an investment banker, the business should look for the following: the relationship should be cordial. One can assess investment banker relationship by gauging their communication style, likeability as well as trustworthiness. The second thing is expertise. Generally, investment bankers are specialists in specific market sectors. The business owner needs to look for investment banker who is an expert in areas of businesses similar to the business in question. The more the investment banker knows about a business the easier it is to attract investors. Experience is another important thing for the business to look for in investment banker. Confident investment banker is able to bring the highest price in IPO (Jagannathan & Krishnamurthy, 2004).

Investors around the world have generally accepted that the higher the return on investment, the higher the risk involved. Most of the safer investments have lower rate of returns. There are different levels of risk involved in common and the preferred stock and corporate bonds. Generally, corporate bonds carry lower risks but they have low returns. However, common stocks have higher risks but have the potential of generating higher returns.

Assuming investor buys a one-year Treasury bills, yielding at 10 percent after holding them until maturity, then one is assured of the 10 percent monetary return before taxes. There is little possibility of loss. However, if

the same investor buys a stock in a local company for one year and anticipates getting 12 percent dividend return, there is increased possibility of loss than holding the Treasury bill. This is because; the market price of stock by the end of the year might be much lower making the investor to suffer a serious net loss. From empirical studies, there is a general relationship between the risk and the return. According to the research done by Ibbotson and Sinquefeld in 1979, common stocks/portfolio have for a long time provided a generous rate of return compared to Treasury bills in United States.

Investors will always avoid putting their money in only one investment. They will always have a well-balanced portfolio consisting different asset classes. This is diversification. Diversification among the risky portfolio and less risky portfolio is important. This is because different investments have different times of rise and fall. Therefore, diversification helps in smoothening out the inevitable difficulties within the markets and thus reduces the risks involved in investments. When investors distribute their money in different investments and different variety of asset classes, they reduce the risk of going at a loss because of poor performance of one of the investment (Malkiel, 1982). For instance, assuming that an investor had diversified in the companies below in November 21, 2014, his diversified investment would be as shown in the table below.

Source: Yahoo Finance

References

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