Financial instruments

Finance

Financial instruments Financial instruments Introduction Apples Ltd is raising capital and trying to decide whether to issue redeemable, cumulative preference shares or convertible notes. The company is close to breaching relevant debt ratios with their lender. There are various factors that the company needs to consider in making their decision such as the cost of capital. The company should consider the interest rate paid for cumulative preference shares or convertible notes. In this case, the cheapest source of finance is cumulative preference shares (Henderson, Peirson & Harris, 2003).

The company should also consider the financial risk involved in the source of finance. For instance, debt financing bears high financial risk due to high leveraging of the company and this may lead to legal action and bankruptcy proceedings in case of default on interest payment (Henderson, Peirson & Harris, 2003).

The company should consider the risk of losing control since convertible notes providers may request for directorship position in order to protect their interests in the firm. The best source is cumulative preference shares since dividends will be paid when the company finally makes profits (Henderson, Peirson & Harris, 2003).

The company should also consider the flexibility and availability of the source of finance. For example, it is easy to issue redeemable preference shares since it is readily available and can be redeemed in the future. The company should also consider the tax implications of the source of finance. For instance, debt payments are tax deductable and thus it should use debt financing when the tax rate is high in order to protect the company income from the high taxes (Henderson, Peirson & Harris, 2003).

The company should also consider the growth rate of the firm. For instance, the company should use debt financing during high growth cycles since the high revenues will offset the interest payments (Henderson, Peirson & Harris, 2003).

Reference:

Henderson, S., Peirson, G & Harris, K. (2003). Financial Accounting Theory: Its nature and development. London: Prentice Hall.