Financial Case Study

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Unit III Case Study

**Describe what a crediting rate/score is. Should this be a factor in evaluating companies?**

A credit score is used to highlight one’s creditworthiness or even an organization, company, or institution that wants to borrow. This credit score can be shown in general terms or in relation to financial debt or obligation. It can be assigned to a person, a company, a corporation, or even a government. One can choose to use their internal scoring methods to assess the ability of a prospective borrower to repay before lending them (Ibtissem and Bouri, 2013). A crediting rate should apply when evaluating companies because it is regulated by the FCA, which guarantees excellent information to those who intend to lend on deciding who qualifies for which type of loan, the interest, time limit, and the likeliness of generating revenue.

**The firm will need to raise funds immediately for the acquisition, and debt will be used. Should the firm borrow on a long-term or short-term basis? Why?**

It is critical that a firm borrows on a short-term basis when dealing with acquisitions instead of borrowing on a long-term basis. When the firm borrows on a short-term basis, there are low interest rates on the firm's revenue, which will guarantee low debts incurred. Furthermore, there are minimal chances of defaulting loans acquired on a short-term basis as compared to long-term basis borrowing. Repaying loans on time maintains the crediting score of the borrowing company. Additionally, borrowing on a long-term basis requires a lengthy and complicated procedure, unlike a short-term loan that is easily accessed (Wood, 2018). This will come in handy in helping the firms acquire the assets they need to be operational.

**Explain the effect, if any, inflation rates will have on the purchase? How significant is this factor?**

There is a huge effect that inflation has on the purchasing power of products. The purchasing power highlights the value that a given currency has in relation to the number of services or goods that a currency unit can purchase. Inflation, however, reduces the value of a currency’s purchasing power. This causes an increase in the value of goods. If there is a prediction of inflation encourages investment as people spend more to stock goods for use in the future. The effect is seen as a positive thing because the firms will take advantage of the situation and buy when the prices are low to resale when they are high, which will be profitable.

**Define the relationship between yield curves and the term structure of interest rates**

A yield curve is a term used to describe the graph of the term structure of interest rates. The graph plots interest rates or bonds that have similar credit quality but different dates of maturity. The curve projects the future interest rates and the possible economic activities. It can occur in three types i.e., flat curve, upward sloping curve, and downward sloping curve (Malkiel, 2015).

**Explain what would happen to interest rates if a new process was developed that allowed automobiles to run off oil that was formulated based on lemonade? The technology used to convert this liquid to gas would be pricey but well worth it. What impact would this technology have on interest rates?**

The higher cost of implementing the technology would require high investment. Since the assets will be acquired through loans, it is evident that a long-term loan would be needed. The payback period will be longer hence a longer period before the benefits of the project are enjoyed. The interest rates will therefore be high due to the lengthy loan repayment period.

**Discuss what ratios should be used to assess the financial health of the potential acquisition?**

The viability of the investment done to the automobile company needs to be assessed to determine its profitability before making the acquisition decisions. The profitability ratio and liquidity ratios are key. The profitability ratio determines the viability of the project as well as gives a comparison of a firm’s performance in relation to other companies. The information can be used to obtain the profit of the company. The liquidity ratio provides information on the available assets that can be easily converted to cash if the firm wants to cover its debts. It also offers an overview of the financial health of a company. The information assists the company in identifying how easily it can obtain cash in case of a rising need (Saleh and Ahmed, 2005)

References

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