Financial Case Study

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Unit III Case Study

A crediting rate is the interest gained from the value of a contract and is mainly regarded as an annual yield. It is applied as a stabilizing mechanism by lowering the book value of investment losses and profits to protect investors from the negative effects of short-term changes in the market value. It encourages the principal to preserve the primary capital investment and prevent huge losses in case of any changes in the market by making regular payments at contract value. Crediting rate should be a factor in the evaluation of companies because it will enable the investors to make informed choices after considering the repayment behavior and risks that are potentially likely to occur. That is, they establish a connection between the return and risks expected. It also does quantitative and qualitative analysis of a prospective borrower’s creditworthiness, which will help decide the best type of loan they are qualified to receive. Crediting rate is essential in evaluating companies because it helps gives a clear image of the companies and where they stand financially and whether they are worthy of borrowing (Melicher, & Norton, 2019).

For a firm to raise funds for acquisition purposes, it must borrow on a short-term basis. This is advantageous because the firm will have low-interest rates on its revenue, translating to low debts. Additionally, it is rare to default on loans that have been acquired on a short-term basis as opposed to a long-term basis. If a firm repays their loans as agreed and on time, that maintains their crediting score. Long-term borrowing may also mean that the firm goes through lengthy procedures to get their loans approved, and if the funds are for acquisitions, that kind of borrowing may not suit it. So, short-term borrowing readily presents necessary funds for the acquisition of assets that a firm needs to operate. (Wood, 2018).

Inflation greatly affects the purchasing power of products. This power shows the value of a currency to the number of goods or services its unit can buy at a given time. When inflation occurs, the currency's value subsequently goes down, and so does its purchasing power. This means there is an increase in the good’s value. If there is an expected inflation occurrence, investors start spending more to acquire goods and stocking them to resale when the prices go up in the future. This prediction is positive to firms and investors because they take advantage of the current situation and buy when prices are low to sell when they hike and make profits.

The structure of interest rates graphs is described by yield curves. This graph shows the interest rates with different maturity dates but is similar in their credit quality. The yield curves predict the interest rates in the future and the prospective economic activities. This curve can be highlighted in upward sloping curve, downward sloping curve, and also flat curve (Malkiel, 2015).

In the case of converting lemonade into gas, the implementation cost of the technology would need high investments. The most likely source of these funds is the acquisition of loans which means that long-term loans would be best suitable. This also means that there will be longer payback periods before the profits from the projects start coming in. That translates to interest rates being high because of the long loan repayment time.

The liquidity and profitability ratios are essential in accessing the financial health of the potential acquisition. The profitability ratio is key to determining the project’s viability and comparing the firm and other competitors in terms of performance. This information is also vital in obtaining the company’s profit. On the other hand, liquidity ratios give information on the assets that are readily available that can be converted to cash should a need to cover debts arise. This shows the company’s financial health (Saleh and Ahmed, 2005)

References

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