## Financing 101: Bonds

In this guide, we will look at the use of bonds as a form of debt.

### The basics: Bonds

A bond is an "IOU" issued by a government or a company. Bonds are tradeable and generally pay a **fixed rate of interest**.

The basic structure of a transaction is that company A **issues** a bond to company B, who gives a sum of money to company A. The bond is an instrument that essentially says that company A owes company B the sum of money, plus interest.

This bond instrument is then tradable in a secondary market – company B can trade this bond to other people (often companies).

### The nitty gritty: Bonds

To issue a bond an issuer must have a **credit rating,** which is issued by an independent **rating agency.** Since the buyers of bonds do not have the time to do a detailed credit assessment of the issuer's ability to repay the bond (unlike a loan), the ratings indicate the credit worthiness of the bond.

A bond is issued with a **maturity date** – this is when the bond is due. Bonds can range from 90 days to 20 years.

Bonds of short durations are used for short-term investments whereas medium-term and longer-term bonds are used for larger and longer-term projects.

### Evaluation: Bonds

An important point to note is that positives/negatives for an issuer are different to the positives/negatives for a lender. E.g. the fact that interest payments can be higher than the general level of dividend payments is good for lenders but bad for the borrower/issuer.

| Positives | Negatives |
| --- | --- |
| Bonds are **less volatile** than stocks. | **Interest payments** can be higher than the general level of dividend payments and are mandatory. |
| Bonds are **tradeable** so it is easier to manage risk e.g. if a lender thinks that they are not going to make enough money on the bond, they can sell it to another party. | Bonds can become **volatile** depending on the credit rating of the issuer – which may be impacted by unforeseen events such as a pandemic. |
| There are **different types of bonds** fit for different purposes e.g. short term and long term. Also note **high yield bonds** are shorter term bonds with high interest rates, often using by companies looking to acquire another. | These transactions may involve **bondholder restrictions,** in the form of covenants in the contract, which may impose limits on what the company can and cannot do. |
| This is a way to raise money without **diluting** your company or **losing control.** | |