**EFFECTIVE FINANCIAL MANAGEMENT**

**Learning Outcome 4: ACTIVITY 8**

**Loan financing**

Loans are a major source of debt finance for many businesses. This form of debt financing is an external source of finance. Loans can be both short-term and long-term in nature.

Liqui and Meifing’s business is a limited company. A local businessman owns 45% of the shares in the company. The rest of the shares are owned by 30 other investors, who include Liqui and Meifing.

Remember that Liqui plans to expand operations into mainland China. Liqui intends to finance this expansion using a loan from a local bank.

Consider that Liqui plans use a $100,000 bank loan at an interest rate of 10% per year. The loan is repayable in equal annual instalments over five years.

#### In small groups

1. Identify the elements of the cost of loan financing.
2. Calculate the annual repayment amount on the loan that Liqui is considering. Remember that this can be found by dividing the amount of the loan by the cumulative present value (also known as the annuity) factor at the relevant rate of interest.
3. List the components of the WACC. Identify how these components are incorporated into the formula for the calculation of the WACC.
4. Identify and explain the advantages and disadvantages of each of the following types of loan financing:
   1. Subordinated loan
   2. Term loan
   3. Loan notes
   4. Mortgages
5. Prepare a short presentation on your findings.