

TYPES OF BONDS AND THEIR DIFFERENTIATION

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Abstract: Knowledge and differentiation of types of bonds is an important topic related to the financial awareness and literacy of the population in the country. This article provides the reader with information about what a bond is, the different types of bonds, and their characteristic features.

Keywords: bond, interest rate, government bonds, corporate bond.

Before getting acquainted with the different types of bonds, it is important to know what bonds are. According to the definition, "A bond is a fixed-income instrument representing a loan provided by an investor to a borrower." Often companies and municipalities issue bonds, and investors buy these bonds as a savings and investment option. Bonds have a predetermined maturity and a certain interest rate. Upon maturity, the issuer must return the funds, including interest, to the investor.

Bonds usually have two main participants: bondholders and bond issuers. Bond issuers are organizations that borrow to finance new projects or repay existing debts. Investors are known as bondholders, who buy bonds or other securities from issuers. Bond issuers undertake to pay periodic interest to these investors and repay the initial amount upon expiration of the bond term.

The five main types of bond issuers are:

- Firms
- Countries
- Interethnic organizations
- Special-purpose enterprises

In a sense, bonds are a type of relationship where the issuer receives the amount of money necessary for the implementation of its project or operational activities, and investors receive income from excess capital by investing in bonds of this type.

Bonds are one of the important elements of the capital market, and there are many types of them. The purposes served by each species are different and have different levels of income and risk. Below we will familiarize ourselves with their most common types:

Corporate bonds. Bonds issued by companies are considered loans to the enterprise by investors by purchasing them, and in return, the company undertakes to pay interest on the principal debt and, in many cases, repay the principal debt upon maturity of the bond.

To better understand bonds, let's compare them with stocks. For example, when you buy ordinary shares of a company, you own a certain share in that company and receive income in the form of dividends for the shares you bought, but when you buy a company's bond, you cannot own any share in that company, meaning you only have a debt, and you won't receive additional income from the company's high returns or when the market price of its shares increases. You will continue to receive income in the form of interest only in the amount specified in the bond. In the event that the company finds itself in a difficult financial situation, they are obligated to return the established interest and funds to the bondholders on time. During a financial crisis, bondholders' claims for ownership of the company's assets are satisfied earlier than shareholders' claims for ownership.

Corporate bonds were divided into three types depending on the maturity date.

- ✓ Short-term (less than 3 years)
- ✓ Medium-term (from 4 to 10 years)
- ✓ Long-term (more than 10 years)



Usually, long-term bonds have a high level of risk, but at the same time, the interest rate is also high.

Government bonds. These are debt securities issued by the government to attract capital for various government expenditures and projects. These bonds represent a loan promised to the investor by the government with predetermined interest. One of the safest investment options available on the market is government bonds. Unlike corporate bonds, government bonds are securities with a fixed yield, and government bonds are characterized by government support and make them virtually default-free.

Types of government bonds

✓ Treasury bills: These are short-term securities with a maturity of less than one year, usually 91, 182, or 364 days. Credit bills are issued with a discount against their face value and do not pay fixed interest. Instead, the difference between the purchase price and the face value represents the percentage received.

✓ Government securities: These are medium and long-term bonds with a maturity of 5 to 40 years. They pay fixed or variable interest rates.

✓ Floating-rate bonds: Unlike authorized interest-bearing bonds, these securities offer fluctuating interest rates.

✓ Inflation index bonds: These bonds protect investors from inflation by linking the principal amount to the inflation index. Principal debt and interest payments adjust to inflation while maintaining purchasing power.

Zero-coupon bonds are bonds that do not pay interest during their validity period. Instead, investors buy zero coupon bonds with a discount from their face value. Zero-coupon bonds typically have long maturities, with most being ten, fifteen, or more. Since zero-coupon bonds are not subject to interest, their market price fluctuates more than other types of bonds, and government bonds of this type are subject to tax benefits.

Convertible bonds are a flexible financing option for companies. A convertible bond offers investors a hybrid type of security with bond characteristics such as interest payments, while also providing the opportunity to own shares. These bonds have a conversion ratio, and this ratio means how many stocks you can own from converting one bond. For example, a ratio of 6:1 means that one bond becomes six shares of common stock. Ordinary bonds and convertible bonds differ in that they are similar to each other. First, holders of convertible bonds have the opportunity to own the company's capital, while holders of ordinary bonds simply own debt securities. Investors in convertible bonds have the opportunity to profit from the increase in the price of the company's shares. Second, Convertible bonds usually have a low interest rate due to the possibility of subsequent ownership of the company's capital. Because ordinary bonds do not have this option, their interest rates are high.

Conclusion. Bonds are a financial instrument based on trust between investors and issuers. Each type of bond presents its own specific profits and risks. Their diversity with different needs and risk tolerance levels creates different opportunities for investors. Understanding the types of bonds is important for making the right investment decision.

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