THE BASICS OF BORROWING

Treasurers must understand lenders, markets and instruments to help their companies raise debt, says Will Spinney

Lenders, markets and instruments are three key dimensions to consider when a company raises debt. This article should help you to understand who or what is in each list and why there is some overlap between them.

Lenders

Lenders to corporations are as follows:

- **GOVERNMENTS (AND AGENCIES)** – may support selected industries, usually at times of crisis.
- **SHAREHOLDERS** – may support their businesses, especially in intercompany situations.
- **BANKS** – still significant as lenders.
- **CUSTOMERS** – may pay in advance or finance certain assets.
- **SUPPLIERS** – give trade credit, often considered 'free'.
- **EMPLOYEES** – on a small scale, they may pay expenses in advance (also, they usually get paid monthly in arrears).
- **INDIVIDUALS** – may buy bonds (wealthy individuals who may also lend).
- **NON-FINANCIAL CORPORATIONS** – might participate in many types of debt-raising and seek security, liquidity or yield by investing in other non-financial corporations.
- **HEDGE FUNDS** – might lend to support a particular trading strategy.
- **PRIVATE EQUITY**, for example, 3i – might lend to support a long-term relationship with a company.
- **INSTITUTIONS**, for example, insurance companies and pension funds – these organisations are naturally long of investable cash and are long-term investors, hugely significant as lenders.
- **MONEY MARKET FUNDS** – as well as mutual funds (and equivalent).
- **PENSION SCHEMES** – are natural investors, especially in bonds, and are significant lenders.
- **SOVEREIGN WEALTH FUNDS** – in support of a long-term relationship with a company.

Banks and institutional investors are probably the largest and most important class of lender. It is useful to consider their relative importance, but this does vary geographically. In the US, institutional investors dominate lending, whereas the reverse is true in Europe (although in this decade, institutions are taking an unusually high proportion of corporate debt, a trend that is more likely to continue than not).

Markets

The concept of a 'market' in terms of borrowing can be quite confusing. Sometimes a 'market' is a fully operating public market, with two-way prices quoted by market makers in a very transparent way. Sometimes, however, it merely refers to the 'standard way' of doing things, or to the price for a product related to 'other current similar transactions'.

The most important markets for corporations are as follows:

- Bank market, comprising mostly lending banks, but some non-banks participate in different tranches of some bank loans. This operates worldwide.
- Bond market, including euro medium term notes (EMTN). This is mostly an institutional investor market. It operates predominantly in domestic (and the euro) arenas.
- Commercial paper market. This is a short-term institutional market and is focused on the US and Europe.
- Private placements, mostly US-based with insurance companies participating.
- Leasing, or asset finance, which is predominantly, but not totally, bank-led.
- Factoring and supply chain finance generally, which is broadly bank-originated.
- Convertibles, hybrids and payment-in-kind securities, plus others, form the rest of the lending markets.

Only the bond and commercial paper markets operate as fully public markets. All the others do operate as a 'market', but with less transparency. So if a borrower approaches several different banks for a loan, the quotes should reflect market conditions and, probably, be fairly similar.

Clearly banks as lenders operate in bank markets, but other lenders can be found in most other markets.

Bond markets

Bond markets are normally very liquid and large and so are important barometers of the appetite and price of credit generally. Supply and demand in the bond markets drive long-term interest rates and credit spreads, thus affecting the rate at which corporates can borrow. This spills over into the bank and other markets, leading borrowing and asset prices. Many valuations are driven from bond markets and equity valuations are also partly driven from them.

Instruments

Within each category of market, many different instruments are used. Within the bond market, for example, we see instruments such as:

- Fixed-rate bonds;
- Floating-rate bonds;
- EMTN; and
- Islamic instruments such as sukuk.

The bank market has an enormous variety of instruments, including:

- Term loans;
- Revolving credit facilities;
- Syndicated loans, both term and revolving;
- Overdrafts; and
- Bills and acceptances (for further discounting).

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