Issuing In The Bond Market – The Basics

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Before joining the ranks of management consultants, I had spent many years working with corporate and structured bonds, and one of the most common discussions with management teams was the attractiveness of the capital markets. My experience has been that large, highly-rated companies contract most of their debt through public markets (bonds and commercial paper), and limit their use of bank credit to treasury or risk management products, ECAs or bridge loans which will be refinanced later in the bond market. Other companies do not meet the requirements to access the capital markets and have no choice but to rely on shareholders and banks to finance their operations and investments. But the vast majority of companies that I meet are somewhere in the middle, and either use (or should use) a combination of bank financing and capital markets activity to fund their capital structure.

The bond market is well developed and can provide efficient long term financing while freeing up credit capacity at banks. The advantages of the bond markets are clear. The most obvious of these are the cost and the tenors available:

- Pricing - Except in rare situations, bonds are cheaper for the company to issue compared to bank loans. For the most part, pricing will depend on the credit profile of the issuer and the bond's tenor, but also general market sentiment, expected liquidity, etc.
- Tenor - Banks seldom lend money to companies beyond three or five years, whereas bond investors match investments to their own expected outflows, allowing for terms usually up to 10 years, but sometimes more.

However, bonds can be more restrictive compared to bank debt, given their nature as publically traded instruments.

- More difficult to renegotiate or restructure - While it is never easy to modify the terms of any long term financing, it tends to be less cumbersome with banks since they can negotiate for themselves. A bond is owned by many investors with diverse opinions about the best course of action. Furthermore, it is not always easy to coordinate timely action with bond investors given layers of brokers, custodians, asset managers, etc.
- No prepayments - The option to amortize the bond before maturity (if it even exists) tends to be expensive, because bond investors generally want certainty with respect to the timing of their cash flows. Banks tend to be more flexible on this point, and usually allow voluntary prepayments with certain conditions.

For a first time issuer in the capital markets, the process of getting ready can require considerable time and effort. Bond investors and market regulators will require initial as well as periodic detailed public disclosure from the issuer. The investment bankers (and their lawyers and other experts) will review financial, legal and operating information in detail. The issuer will also be expected to adhere to accepted corporate practices in terms of governance, ethics, decision-making, transparency, etc. In addition, it is customary to have the credit quality rated by a third party, and the rating agencies will require considerable information as well, both initially and on an ongoing basis. The basic premise is that investors can make their own decisions about whether or not the bond is a good investment, but they must be made fully aware of the elements that can affect the value of the bonds, including possible risks.

Typically when a company decides to invest in preparing itself for the capital markets, it plans to issue more than one security over time, either debt or equity or a combination of both. The nature of the company and its capital structure as well as market conditions will dictate how often and under what conditions it can access bond or equity investors, but the decision will have been made to integrate the capital markets into its strategic planning. Frequently, a first bond placement is a step on the road to executing an IPO strategy.

Finding balance between the different markets for funding a company's capital structure is more of an art than a science, and a decision to initiate a capital markets presence should not be taken lightly by management. It must be part of a larger strategy to diversify funding sources and strengthen the capital structure. Although issuing securities allows the world to observe management's performance and its strategic decisions, there are enormous efficiencies to be gained.

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