THE BONDS FINANCING – AN FINANCING OPTION FOR THE FIRM

Assoc. Pro. Dorel BERCEANU, PhD
Prof. Ion TOMIȚĂ, PhD
University of Craiova, Romania

The financing through the capital market represent an efficient and flexible option for dinamic firms.

Together with the equity and the financing by means of bank loans, important sources of financing from outside the company are attracted appealing to the public savings that is the bond financing.

For any company, in some situations, the equity is insufficient to cover the financing needs, and its growth (by new cash subscription or by the incorporation of the reserves) may encounter difficulties, not only from the juridical point of view but mostly from the inherent risks related to the potential investor's trust in the issuer of shares and those related to the possibility of loosing control for the old shareholders. In addition to that, contracting bank loans implies for the company, sometimes, more restrictive conditions to be fulfilled. These are the reasons that determine the companies, especially the big ones that are marketable, to apply to bonds financing.

For the countries where this means of capital mobilization is an usual practice, the issue of bonds, as a means of attracting the public savings, is preferred mostly by small and middle companies unquoted on this market section, and the issue takes place by the association of these firms to contract bank loans in common name. In the latter case, the issue takes place by the association of many firms that guarantee the loan together, by means of some institutions and collective emplacement agencies, that allocate the attracted capital as loans for the issuing firms. There are situations when even the big firms use this technique, especially when they have relatively reduced financial needs and they don't wish to spend the confidence capital to the public through individual credits, reserving this option only to attract large amounts of money from the market.

At first sight, one might appreciate that a total capital growth by means of the issue of bonds has a bad influence on its financial structure toward the growth of the balance of debts in the total capital. But, in fact, such a procedure has a series of benefic effects over the firm because it connects it, in a durable way, to the capital market, with serious implications in the dynamic adjustment of the capital cost, in the dynamics of the capitals and in the transparency of the external image offering in the same time, new values to the programming of the production activity and to the investments.

There are several *conditions* to be fulfilled in order to have access to bonds financing market:

- it has to be a joint-stock company;
- the firm has to have at least two or three years of activity reflected in the balance sheet approved by the shareholders;
- the issue of bonds by public offer is made on the basis of a prospect of issue;
- the value of the subscribed bond financing has to be completely subscribed.

These requests are specified in the 31/1990 law regarding Commercial Firms republished and modified.

The bonds can be issued in a material form, on paper, on an abstract/unembodied form, by account subscription.

Therefore, as a specified form of the loan, the bonds loan supposes the materialization of the debentures over the issuing firms as securities called bonds.

Therefore, we can define the **bond** as a **securities** that proves that a medium or long term loan that the issuer obliges to repay in a determined period of time, that gives the right to its owner (the creditor of the firm) to a certain annual interest, during the whole period, no matter the economic or financial situation of the issuer.

In the sense of a better understanding of the mechanism of forming the capital through bonds and the financial consequences of the issue of bonds, there can be made a parallel with the mechanism of forming the capital through the issue of stocks. The shareholder of the company is the owner of a part of the company and he takes the risks and perspectives of profit. The bondholder, on the contrary, borrows the company for a definite period of time with an interest settled at the time of the issue, and in case of its bankruptcy, he prosecutes the recover of his rights. The shareholder has the right to vote at the General Shareholders' Meeting concerning the administration of the company and sharing the profit for dividends and/or capitalization, while the bonds' owner deliberates within the bonds' owners meeting, concerning his rights. So that, bonds give to their owner no power of decision within the respective company, and neither permit him to benefit from the company's growth, as it happens in case of stocks. Bonds' owners meeting, legally constituted can name a representative of the bonds' owners and one or more substitutes, with the right of representing them in front of the company and in the court law. Usually, the cost of procuring the bond credit is smaller than the subscriptions at the stockholders' equity.

The issue of bonds is settled by the general shareholders' meeting and not by the council of administration or by the company's manager, so that the legislator wanted to protect the bonds' subscriptors against the commercial companies that do not offer all guarantees necessary for the loan reimbursement. Besides, the legislator asks for maximum of information to be given to the future bondholders for him to take the decision of buying the bonds with full knowledge of the facts.

The public offer of selling the bonds takes place in a similar way with the stocks' selling. Just like the stocks, the bonds are emitted through public offer only through a specialized company of mediation, called Society of financial investments services (SSIF).

This has the role of coordinating all operations bond through financing through stocks:

- elaboration of the issue prospect based on the parameters established in accordance with the issuing company and with the data received from it;
- coordination of bonds' selling operations;
- elaboration the closing offer report;
- listing the bonds.

The issuing company of the bonds establishes, through consulting with the mediation company and based on the its own needs of financing the characteristics **(parameters) of the issue:**

- ***the par value of the bond*** equals the part of the landed amount/stock, represented by each bond. The par value, as mentioned before, is established by law. The bonds from the same issue must be of an equal value, to give the owners equal rights. *The par value of one bond cannot be smaller than 2.5 RON,* except for the par of the bonds convertible in stock, that have an equal value with the stock. The convertible bonds can be turned/changed in shares of the firm that issued them, in the conditions established in the public offer prospect. A small par value presents the advantage to bring foreword the transactions and the inconvenience of complicating the commercial data processing of the debts.

- ***the issue price*** represents the amount paid by the buyer to become the owner of the bond. In some cases, the issue price equals the par value, and in other situations, as, for example, the need to speed up the bond sale, there is a difference between the par value and the issue price (the par value may be bigger than the issue price), called *issue premium*. Sometimes, to make the bonds more attractive, or when the period is big, they are returned when due time at a bigger price than the par, the difference being called *returning/repayment premium* (returning premium - par).

The issuing and returning premiums, the payments concerning the bond issuing and the remuneration for the personnel that ensures the bond sale, decide a cost of the credit higher than the nominal interest.

When the issue of bond financing is *underpar*, and its return is at a higher value than the par, both a issue premium and a returning premium will appear.

- ***the numbers of bonds***;
- ***the total amount of the bonds financing,*** is obtained by multiplying the issue price with the numbers of bonds, i.e., practical, the amount which is financed the firm;
- ***the data of use*** is the date when the interest begins to flow;
- ***the data of regulation*** is the date when the investors deposit the amounts for the bonds financing;
- ***the amount of the interest.*** The issuer remunerates the borrowed amounts, with a periodic interest on a detachable bond coupon. The interest is determined by multiplying the par value (V_N) with the rate of interest established by the issue process (d). So, the average calculating operation is:

$$\text{Interest} = \frac{V_N \cdot d}{100} \quad (1)$$

- ***the life period, the frequency of payments and the returning modalities.***

In the financial practice, there are used many returning ways. A bond may have one or more specifications for amortization. Generally there are:

a) the normal amortization of the loan;

b) the amortization with specifications for the return with anticipation.

a) The normal amortization is always presented as a table, and can be made according to many methods, the most used being:

a_1) in equal portions (constant amortization);

a_2) constant annuities;

a_3) full amortization at maturity date.

The **annuity** of a loan is the total annual amount made up of interest and the credit rate (the amortization) that the issuers use to pay the debt.

a_1*) Equal portions amortization* infer the return of an equal number of bonds each year.

In this situation, the annuities are given by the relation:

$$A_i = \frac{D}{n} + D_i \cdot d\,, \quad i = \overline{1,n} \quad (2)$$

where:

A_i = the annuity to be returned in the “i” year;

D = the value of the bond credit;

n = the period of the credit;

$\frac{D}{n}$ = the credit rate (amortization)

d = interest rate (the percentage);

D_i = the value of the bond credit remaining to be reimbursed in the beggining of the year “i”.

a_2) *The amortization in constant annuities*

The annuity value is determined according to the formula:

$$A = D \cdot \frac{d}{1-(1+d)^{-n}} \quad (3)$$

where:
A = the annuity to be returned, that, in this case is the same for every year.

The constancy of the annuities is established by the decreasing variation of the debts and, compensatory, the on growing amortization variation (the credit rate)

a_3) *Full amortization at maturity date* is the most frequent case. The issuer returns the entire loan at the maturity date.

In this case, the annuities are determined according to the formula:

$$A_i = D \cdot d, \qquad i = \overline{1, n-1} \quad (4)$$

$$A_n = D + D \cdot d \qquad (5)$$

By using the amortization methods a_1) – a_3), the returning is made, generally, by parity, and the bonds to be returned are, in the most cases, established either by the drawing of lots of the series and numbers of the bonds, or they are bought back on the bond market at an equivalence of no more than half of the amount of amortization.

The reimbursement on stock exchange is interesting for the debtor firm when the quotation is inferior to the refund value.

b) The anticipated amortization

The reimbursement may be done anticipated, if this right was provided on issue. In this case, sometimes the firms covers the loan by another loan with a lower interest.

According to art. 176, law no. 31/1990 regarding the firms modified and republished, in our country, the bonds are reimbursed by the issuer at maturity date.

Before the maturity date, the bonds from the same issue and with the same value may be reimbursed, by drawing of lots, at a higher value than their par value, established by the firm and openly announced, with at least 15 days before the drawing of lots.

- ***the sale period of the bonds and their type (convertible or non convertible)***. The convertible bonds may be changed in shares at the firm of issue, in the conditions established in the public offer prospect.
- ***the warranty modality and the quotation on the organized market***

Based on these characteristics and on the information received from the issuing company, SSIF elaborates an official document of presenting the issuing company and the bonds that are to be sold, called **prospect of issue**

Through the elements included in the prospect of issue of the bonds there are:

- presenting the companies and the persons that have participated at the prospect elaboration;
- the informations about issuer (the name, the headquarters, and the duration of the society; the other issued bonds; the share capital and the reserves; the date of the publication in the Romania's Official Monitor of the completion of the registration and the modifications that were made to the constitutive document; the situation of the shareholders' equity after the last approved balance sheet; the categories of shares issued by the corporation; the assignments that are imposed on the tangible assets of the corporation);
- the informations about issued bonds and the attached rights (the numbers of the issued bonds, the par value of the bonds, the issue price, the means of repayment, the payments, their interest, to point out whether they are bearer or registred bonds, and weather they are convertible from a category to another or in shares, the warranty modality, the listening, the offer and the destination of funds);
- the informations about the activity of the issuing (operations, economical-financial performances, head quarters, research and development, law procedures, wage earners, investments, financing sources);
- the informations about the management, future perspectives, risk factors;
- the date when the decision for the issue of bonds of the extraordinary general assembly was published

The issue prospect has to be approved by the Romanian National Securities Commission (CNVM). Analog with stocks, bonds cannot be offered to be sold if this procedure had not been done. Also, according to the regulations in force it is recommended the bonds' guarantee with actives, especially in the case of new issues.

After the approval there takes place the official publicity of the offer, meaning its presentation in national newspapers and through other methods.

During the development of the offer, bonds are put on sale at distributors' head quarters – companies of financial investments services and banks with which the issuing company has concluded distribution contracts.

After the successfully closing of the offer, bonds are registered at CNVM, and after that these can be listed at Bucharest Stock Exchange(BSE).

The listing al BSE will be done in the sector "Credit titles" at one of the three categories. Fitting in a certain category will be done on the basis of the following conditions (table 1):

Bonds credits that are not emitted by entities from Romania fit in "International" and have to have a value greater than 200.000 euros.

At the time being (March 2008), for the financial instrument "Corporative bonds" we have four issues of the companies from Romania and two international ones. These are presented in table 2

Table 1

Conditions\Category	Category 1	Category 2	Category 3
Corporative bonds must be public distribute at least	1000 persons	100 persons	-
The total value of bonds credit	>200.000 EUR	>200.000 EUR	>200.000 EUR

Source: BSE

Table 2

Symbol	Name	Total number of bonds	Par value (RON)	The total value of the issuing (RON)	Issuing date	Quotation date	Maturity date	Convert
Issued by firms from Romania								
Category I								
No financial instrument quoted at this category								
Category II								
BCR09	Romanian Commercial Bank	2.428.278	100	242.827.800	28.11.06	29.03.07	28.11.09	No
YTLS10	International Leasing	48.000	100	4.800.0000	05.01.06	21.02.07	05.01.10	No
Category II								
BCC09	Carpatica Commercial Bank	367.992	100	36.799.200	30.06.06	23.10.06	29.05.09	No
PRCR09	Procredit Bank SA Bucharest	80.500	500	40.250.000	23.03.06	12.02.07	15.02.09	No
International								
EIB14	European Bank of Investment - Luxemburg	3.000.000	100	300.000.000	10.05.07	08.06.07	10.05.14	No
IBRD09	IBRD	525.000	1000	525.000.000	18.09.06	19.10.06	18.09.09	No

Source: BSE

An issuing company of bonds, through public offer, will have to fulfill a series of obligations of reporting to the institutions of the capital market and to the investor public: financial reports, communiques with the events that affect the bonds' owners, interests' payments etc.

Resorting to the bond financed has both advantages and a series of limits:

As *advantages* we can cite:

- it allows the procurement of some important amount of money to make some large scope investments;
- putting aside the banks and the expenses to remunerate them in the process of getting the equity for production;
- obtaining a bigger net result than the one that would have been obtained if the bond financing value had been the result of the shareholder's equity growth (the gain of net profit equals the savings from the income tax for the interest paid for the bond financing, that are deductible), with direct implications over the relative cost of the bond financing;
- the debt cost is absolutely limited, and the creditors do not take part of the profit growth except for some situations;
- the bonds give the holder no power of decision inside the enterprise, the shareholders not being forced to share the control when they use the debt financing;
- the possibility to withdraw the old bonds, when the possibility of a new bond issue with a lower interest rate;
- the possibility to ransom on the exchange markets their own bonds at the market price (if the ransom price is lower than the par, the enterprise would gain profit).

The *limits* refer to:

- no matter the firm situation, the debts from the bond financing are a fixed expense, the firm paying periodically the interest obligatorily;
- it has a higher risk than other financing forms;
- the annuities that have to be refunded have an exact maturity date, a moment when the enterprise might be caught on the wrong foot as far as liquidities are concerned, and even if they do exist their diminution inevitably takes place;
- in the case of an economic recession, the bond financed firm would have big difficulties to make the payments as compared to the case of share issue financing;
- the contractual relation on a short and medium term inherent to a bond issue imposes much more restrictive specifications in comparison with the share issue or the case of the short term loan/credit;
- the risk of not subscribing the bonds, and, as a consequence, the loss of the investment opportunities might drive, sometimes, to difficulties for the enterprise and, why not, to its bankruptcy.

As for Romania, we consider that we can speak only theoretically about a bond market, because :

- the securities market where the bonds are issued and circulate is insufficiently developed, having a lot of syncope, not functioning continuously as a very active market in this direction;
- people's lack of trust in firms, because even firms that believed themselves to be very solid were bankrupt;
- the people's habit to work with banks (more than that, there is the guarantee of collecting an amount of money as refund in the established guaranteed limit if bankruptcy occurs) and the temptation of currency investment and state titles in the last few years. But, once with the drastic deflation of the deposits interest rates and with the sinuous evolution of the exchange rate we can also expect a sense of direction of the firms and natural person towards the types of investment like shares and bonds.

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