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**CORPORATE BONDS AS A SOURCE OF RUSSIAN COMPANIES'
FUNDING**

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Abstract

Any company definitely faces a problem of business funding. The main source of funding is traditionally a bank loan in Russia. Meanwhile, apart from traditional bank lending, an alternative method of raising borrowed funds for economic entities is a corporate bonds' issue. The fact that Russian companies become more interested in business funding by bonds' issue can be defined by several legal and institutional reasons. These days, market conditions enable all bond market participants to reduce funding costs to a great extent. In addition to, now there is an unprecedented rise of a number of private investors in the bond market: the adoption of monetary policy in Russia partly has led to inflation expectations' growth which in turn has made private investors close bank deposits because of negative real return and break into the bond market searching for new ways and opportunities of investing. However, despite the fact that companies have a huge experience in borrowing by bank lending, the majority of Russian companies, in particular issuers from small and medium-sized businesses, face with financing through bonds' issue in the first time. In this article authors consider main external sources of companies' funding. The main aims which a company issuing bonds is able to fulfil were set by authors. There were analyzed major advantages and disadvantages of companies' funding by bonds' issue. Also, there were defined main criteria of the contemporary corporate bond market in Russia.

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1. Introduction

Obviously the main aim of a company issuing bonds is funding. By corporate bonds' issue in order to raise investment, an issuer is able to tackle such problems as eliminating a short-term deficit of monetary funds for maximum and more efficient use of production capacity; current assets recovery; balancing of assets; and also eliminating a medium-term and long-term deficit of monetary funds for the purpose of financial support of investment outlay. At the same time, bonds' issue enables companies to deal with other significant challenges as regards accompanying and separate problems: business reorganization, marketing, financial engineering, gaining publicity.

For instance, financing of business reorganization through bonds' issue allows companies:

- to change ownership structure;
- to put out unprofitable types of business of operation;
- to stimulate investments as an instrument to be competitive;
- to dissolve companies without a business outlook;
- to make financial restructuring: to transfer wasting assets into securities and to provide them with

liquidity, debt rescheduling and other.

Marketing objectives which are accomplished by corporate bonds' issue are:

- to attract attention to a company;
- to promote products free of charge;
- to occupy positions in the financial and product markets;
- to include in stock indices;
- to take into account the publicity while evaluating a company by financial analysts.

A high demand of an issuer in financial engineering is a reason for bonds' issue in practice:

- adoption of financial technologies for satisfying company's requirements in monetary sources;
- risk, yield, liquidity management within financial management of an issuer;
- reduction of an amount of borrowing by managing debt portfolio;
- making calculative instruments/

For the purpose of organizing optimum terms for financing while creating public and stock credit reputation it will be able to handle following problems:

- creation of a company's image;
- achieving maximum information disclosure, making a bond credit and stock indices' reputation;
- reflection of efficient corporate management.

Corporate bonds as an instrument of business funding have following obvious advantages:

1. Issuers concentrate in their hands the control under a company's management. Corporate bonds' issue is a method of business funding, where ownership is not redistributed and because of this which is quite popular among companies' owners. Debt securities' holders using this way of funding do not own a share of a firm and the right for management.

2. Issuers have an opportunity to make cheaper and to lengthen borrowing. The bond loan is a counterpart of a bank loan, but its servicing is cheaper in comparison with a bank loan. The loan servicing cost is an interest rate, the cost of corporate bonds' servicing is their yield.

Bonds' servicing causes a less number of costs for companies within any types of loans as regards their duration. This is connected with the fact that there is no intermediary in cash flow. If there is a bank loan, cash flow is made through a bank intermediary. They are paid for making services which leads to a rise of the borrowing cost. When a company itself issue bonds, there is no an intermediary. Investors make funding of a company-lender in a direct way.

In real terms companies apply to services of investment banks and other specialized firms, which ensure bonds' issue. Expenses, linked to such services, are usually not such vast as the same of banks, which are included in accredit interest. Thereby, if a company do not use bank services, this provides it with a more cheaper cost of a loan taken out by corporate bonds' issue, than applying for a bank one (Massa & Zhang, 2020).

The duration which banks give loans for, as a rule, is not more than five years. The corporate bonds' issue enables companies to raise money resources for more duration, which in turn leads to business expansion due to capital intensive investments. Nevertheless, there is a definite requirement such as a stable financial position for companies which plan to start bonds' issue. Bond loans must be provided by companies' assets. Moreover, the advantage of bonds over bank loans is in the fact that bonds have liquidity. In this way liquidity means an ability to sell bonds and receive for them cash without any losses. Making operations with their own bonds, companies are able to manage their debt in a flexible way.

Another benefit of issue is that a debtor becomes less dependent to another bank. The whole market, but not the one loan holder in this way grants a credit to a company. Apart from all mentioned above, bond loans contribute to establish credit reputation and a ratio in the financial market. The result is a company's awareness, which goes to the growth of opportunities in new loans' issue on more favourable terms. As a consequence, companies' costs for an access to borrowing funds become smaller.

3. Interest expenditures are included in a cost, and this enabled companies to reduce a tax base. The bond essence in the fact that a debtor is obliged to pay a coupon and to return a nominal value to a loan holder at the end of maturity of a bond. The accrued coupon with the aim of taxation of profits is regarded to the non-operating incomes of the investor. Respectively an issuer includes the sum of bonds' interest payments into non-operating incomes, which enables tax base deduction. The fact, that companies-issuers are aware of and use the advantages of bond loans over other funding forms and also take into account the current market performance, is justified by the dynamics of Russian bond loans. Specifically the reduction of key rate of the Bank of Russia to its historical minimums and also unprecedented cash flows from investors-individuals underpinned the expansion of corporate loan market values and influenced interest rates. Within 9 months of 2020 the growth of a number of new bond issues turned out to be 25% more in comparison with the same period of 2019 (425 new bond loans; the corporate bonds' market volume reached 11,32 trillion rubles) (Nikonov & Mitrofanov, 2020).

2. Problem Statement

Core elements of the cost-benefit analysis of a past and current company's performance and its investment and financial strategy formulation are the cost of the company's capital in the use and the cost of the capital (in relative terms, such as the rate of return), which is raised from the market. The capital cost of a company is considered in corporate finance as a hurdle rate of return, which must be reached through

management decisions (operational, investment, financial), in order to help a firm to develop and raise the capital further. An increased competition in different markets, including capital markets, a high level of interest rates' volatility, a substantial demand of Russian companies in updating their assets remain a reason to call for factors having an impact on the loans' cost (Teplova & Sokolova, 2019).

3. Research Questions

This case study originates from a number of policy issues. First of all, how did the economic stagnation influence the dynamics of bond loans of Russian companies-investors? In which extent did the reduction of key rate of the Bank of Russia to its historical minimums and unprecedented cash flows from investors-individuals underpin the expansion of corporate loan market values and influence interest rates? How did the spreads in relation to risk-free assets (federal bonds) change for companies-issuers with a different credit rating? What is the industry structure of companies-debtors which took part in funding in 2020? What extra problems do medium and small companies-issuers face with in the current context? What catalyst for growth for the corporate loans' market can be?

4. Purpose of the Study

The principal purpose of the study is identification of opportunities for companies-issuers, in particular for medium and small ones, borrowing costs' reduction or otherwise declining trend in risk premiums. From our point of view, the main problem for such companies is information ignorance for potential investors and the unavailability of any significant market indicators. The point is that the segment of small and medium companies-issuers almost is not mentioned in credit ratings. Due to that there is a huge disproportion as regards levels of interest rates for one sector which has a similar profile of issuers in a fundamental way.

Because of the problem of a small number of references in credit ratings, there is the investors' underestimation of risks and the issuers' overestimation having credit ratings lower than the level "ruBBB+", but closer to it. The level "ruBBB+" is a starting point for securities of the category "investment grade" as exactly from that point issuers have an access to a wide range of institutional investors and also have an opportunity to be in a premium listing. Furthermore, many bonds with ratings of the category "ruBBB" are issued at the level, similar to the one of other securities of the segment of high-yield bonds without ratings. Because of the fact that issuers receive the status "an issuer of high-yield bonds", which also include securities without ratings, they are able to be judged by investors in a biased manner. Securities with credit ratings, which are the part of high-yield bonds' segment, are perceived by investors in the same way as securities of the same segment without credit ratings, which are able to have more latent risks.

5. Research Methods

As the major methodological approach in this study, there was used a systematic approach. The use of this method made it possible to define the role of corporate bonds in the system of company's funding sources. Strengths and shortcomings of the bonds' use not only reveal the perspectives of their use as a source of a company's funding, but also the bond market as a whole. As the key instrument in this study,

there were used the patterns of functional and systematic approaches, and also scientific common methods of cognition (analysis and synthesis, induction and deduction, abstraction) and instruments of statistical analysis, which enabled to deepen the system of knowledge, describing the role of corporate loans in the process of companies' funding. There were analyzed the card of bond market with a representative curve and a disproportion of bonds' listing with several credit ratings and duration of maturity of bonds, while defining spreads of issuers' yield as regards to a benchmark – a curve of federal bonds' yield.

6. Findings

The key measure for a company-issuer is the borrowing cost – the coupon rate of interest which is accrued at the issued bond. The borrowing cost is definitely linked to the credit rating of a company-issuer. Thus, according to the position of an issuer in the credit rating and the liquidity of bonds issued by them, the domestic corporate bonds' market is divided into three levels:

- the first level features the high credit quality and liquidity, and also there are included just the large strategic companies in different branches of the economy in Russia (for instance, Russian Railways, LUKOIL, TNK, Gazprom, VEB). The bonds of the first level have the credit rating of the leading international rating agencies and a large trading turnover;

- the second level specifies the lower credit quality of issuers and the middle liquidity. They include the local and industry-specific leaders (for example, “Bashneft”, “Enel Russia”, “Lenenergo”), which are far below the first ones regarding the scope.

- the third level contain small- and medium-sized companies, featured by a surge (further SMEs), which pursue investment policies only by borrowing. Frequently such companies are unable to pay off all the debts, which leads to significant risks, connected with these bonds' purchasing. That's the reason why an issuer has to pay the more substantial returns (the risk payment as a spread to a risk-free asset' interest rate – federal bonds), than the issuers of the first two levels.

During the first half of 2020 102 Russian companies issued 1382 billion rubles worth of 253 stock bonds. 76,34% of funds are raised by issuers of the first level, 20,18% - by issuers of the second level and 3,47% - by issuers of the third level. Meanwhile, according to a number of issues, 182 ones are made by the first level's issuers, 43 - by the second level's issuers and 28 - by the third level's companies.

At the end of the second quarter 2020, the volume of stock outstanding corporate bonds reached 14054 billion rubles for the entire corporate bond market, of which 79% relates to the first level's issuers, 17% - to the second level's issuers, and 4% - to the third level's ones. In total 342 Russian issuers issued 1580 stock bonds, whereas 762 bonds of them, which are issued by 210 issuers, are liquid totaling 5 976 billion rubles.

More than a third of bond issues (57%) traded are accounted for by oil and gas companies (34%) and banks (23%). Moreover, such sectors of the economy as transport and logistics (6%), finance (5%) and mortgages (5%) are in among the top five biggest borrowers in the bond market. The remaining 27% are related to 16 other sectors, where the largest ones are telecommunication, energy and leasing. Nearly a half (49,6%) of a traded bonds' volume is accounted for just six biggest issuers: Rosneft (28%), Sberbank (7%), Russian Railways (5%), DOM.RF IA (4%), VEB (4%), DOM.RF (2%). The remaining 50,4% are accounted for 336 issuers. Almost a half of the bond market volumes (44%) is led by two sectors among

the traded bonds of the third level's issuers: construction and development (28%), banks (16%). Also, mortgages (14%), finance (11%), retail chains (7%) are in the top five biggest sectors. In this way, the remaining 16 sectors concentrate 56% of the total volume (Smart-Lab, 2020).

Market conditions of 2020 enabled all Russian companies-issuers to reduce funding costs to a great extent. Meanwhile, spread to risk-free yield rates were different for issuers of the various categories of the quality. There is a general downward trend for the first and second levels' issuers during the whole year, and in particular this is quite remarkable for the issuers with the rating "ruAA-" and higher. Thus, in 2020 companies-issuers of the second level could hold the position, with respect to borrowing rates, which could be occupied by companies-issuers of the first level the previous year: if in October 2019 it was 6,88% and 7,12% respectively, in October 2020 – 5,86% and 6,53% (Nikonov & Mitrofanov, 2020). The fluctuations of borrowing rates and spreads to federal bonds (a benchmark) have been minimal for issuers with the rating "ruAA-" and higher since the end of June 2020. As regards issuers with the rating in the "ruA+"-"ruBBB", there was some increase of credit spreads from 100 basis points in January 2020 to 160 basis points at the end of October. Such an increase of spreads obviously is attributed by the return of geopolitical premium in the Russian market and the wish of issuers to prolong the duration and to increase the volume of transactions by raising a premium to risk-free rates, but to preserve the funding cost at record lows.

The overall picture for companies, which are related to the segment of high-yield bonds as regards their performance, which is mostly consisted of SMEs' representatives, is different. The main criteria for relating to high-yield bonds is the 11% coupon rate and the absence of restrictions on the issue volume. At the end of the second quarter 2020 there were 319 traded stock bonds' issues of the third level, of which just 165 securities were liquid and available for purchasing for the Moscow stock exchange' private investor (FINAM, 2020). As regards the third level there is the growth of issue volumes: bonds' issue volume worth 350 million rubles in the 2d quarter 2020 amounted to 3,1 billion rubles. The average coupon rate of the third level's high-yield issues reached 12,7%. The dynamics of high-yield bonds' yield was similar to the dynamics of the securities' yield of large issuers, but the spread to federal bonds for these categories of issuers showed a more considerable fall, which was caused by a rise of a number of investors-individuals.

Today the segment of SMEs consists of issuers without ratings or companies with the rating on the level "ruBBB" and lower, meanwhile many companies of the SMEs' segment raise money on the level of those rates, which the issuers of the category "ruAA" paid two years ago.

Many analysts classify the SMEs' segment as the key one, as there are new entities, more active investors-individuals and there are the basis for the growth of Russian bond market diversification and its liquidity. If the segment's issuers conducted 18 transactions in the first time in 2018, in 2019 the number was 41, and during the 10 months of 2020 there were about 30 ones. The largest borrowings in the first half of 2020: "Legenda" obtained loans totaling 2 billion rubles (March 2020), "SoftLine Trade" – 1,35 billion rubles (April 2020), "G0Group" – 2 billion rubles (June 2020). According to the data of the Moscow stock exchange, nearly 17% of the volume of corporate and stock bonds' issues and 11% of the trading volume on the secondary market respectively was related to individuals.

The analysis of the bond market card by category of the credit quality demonstrates that the high-yield issuers' segment is the market which operates without any restrictions. For instance, making an analysis of the issuers' yield curve regarding the first level, there is a general slope of the curve which is in

conjunction with the benchmark: rates are split evenly along the whole curve and feature slight fluctuations (about 1 percentage point) regarding the definite company, duration and level of the credit rating. Overall, the borrowing cost determination can be easily forecasted as regards the credit rating for such companies-issuers. In contrast, the card of the high-yield segment market and bonds without ratings, which mostly consists of SMEs, is characterized by the absence of a systematic approach in the part of the distribution of the yield to maturity. Listings are split unevenly, which does not provide with the representative bonds' yield curve without the rating; in the period of 1-1,5 years the spreads among issuers reaches 600 basis points or approximately 1,5 of the key rate of the Bank of Russia. Because of the absence of the reliable benchmark, companies-borrowers and investors do not have any indicators how to define the fair yield levels of securities without ratings (41% of the SMEs segment does not have any credit ratings), hence the decision has to be made just by the rate eligibility (Nikonov & Mitrofanov, 2020).

Analyzing the assignment of SMEs issues, apart from general financial risks which are connected with a small size of companies and their high level of sensitivity to any problems it should be noticed that there is low information transparency, quality of reports, corporate management and the systematic regular communication with investors. Due to the absence of an opportunity of the analysis of a company-borrower, its risks, investors require too high premium which could not be paid. Many SMEs are not suitable for IFRS-based statements and the work with qualified audit (Bertrand et al., 2020). It is of great importance that for the past year there was a significant progress in the part of providing the SMEs segment with the greater transparency due to the work of market infrastructure players: there were formulated rating requirements for listing on the Moscow stock exchange, stimulating issuers to reveal even the lowest ratings (MoEx, 2020). The organizers of issues provided the extension of practice of preparing and disclosure of the IFRS statements, procedures of the stock exchange's revisions, and also the work with rating agencies and encouraged issuers to make the business more restructured and to achieve the more transparency. However, there is enough which should be done in order to make improvements in all these spheres, and it can be seen that there is a big difference between the issuers' risks and their evaluation.

The fact that companies-issuers frequently cannot deal with the debt burden is proved by the statistics of defaults of bond issues. Thus, at the end of the 2d quarter 2020 there were 381 issues traded of 108 issuers of the second level and 393 issues of 213 issuers of the third level. During the first half of 2020 there were 21 issuers went into default: 6 companies of the second level (for example, "Region-Invest", "Invest-Development", "FInStandard"), 14 companies of the third level (for instance, "Digital Invest", "Samaratransneft-terminal", "IFK Union", "Eurofinance-Properties"), and also the company of the first level "Otkritie Holding" went into default in the first time. As a result the default risk was 3/7% at the first level, 4,2% - at the second level, at the third level – 1,2%. The issuers of the third level (126 companies) have been gone into the majority of defaults since 2017, and most of these companies perform in the finance sphere (Smart-Lab, 2020).

7. Conclusion

How are the companies-issuers able to reduce the funding costs? Obviously and first of all, this is mostly linked to the SMEs sector's companies which can reduce the funding costs by cutting the risk premium. Our opinion is that all market infrastructure participants should strive to increase the information

transparency of companies-issuers, to use the practice of the systematic approach to corporate management, to achieve the business restructuring and to expand the rating (Abad et al., 2020). With respect to issuers breaking into bond market, it is much vital to prepare the IFRS-based statements before the issue. Making initial public offering, it is essential to do pre-marketing, during which a company-issuer arranges meetings with prospective investors where they are able to reveal the overall strategy, operational and financial indicators, market positions, aspects of corporate managements, sources of loans' repayments. This increases the level of corporate integrity and its transparency.

While the SMEs segment is closed and not transparent, high-yield bond market will remain very risky for retail investors. The expansion of the SMEs rating coverage and the disclosure of a full risk profile of issuers, in particular with low ratings, are supposed to streamline the market yield card, and in this way more reliable issuers will be able to reduce the funding costs. Additionally, the growth of information transparency of the SMEs sector is likely to make institutional investors interested in making transactions with companies having lower ratings than "ruBBB+" and in this way the financial institutes' breaking into the segment of bonds with higher yield with middle ratings makes it possible to reduce the borrowing rate for issuers. Undoubtedly, the method of funding by bond issue has its own frequent and obvious shortcomings: extra expenses on information disclosure; a high level of regulatory costs; big expenditures for preparing and issuing borrowings; a long period of preparing the money raise and etc.

The obligation of information disclosure of data about a borrower makes a company public as regards the disclosure of information (Salomatina, 2021; Salomatina & Lebedeva, 2021). On the one hand, this has a favourable impact on a company's performance, as the interest of prospective creditors is growing, but on the other hand, this leads to the interest growth of competitors which can afterwards lead to acquisitions. Bond issue leads to the duty to pay the tax on securities' transactions. Bond issues for a company-issuer are closely linked to high regulatory costs. Because of the fact that it is difficult enough to make the first issue and there is no information about an issuer and its stock instruments' reputation, this causes large expenses for paying interests on financial intermediation. The preparation for bond issue takes a lot of time. Current projects, which are carried out in order to make improvements, are not still suitable. Thereby, the corporate bond issue as an instrument of funding has its own advantages and disadvantages. The first ones force companies to use that method, and the last ones, in contrast, makes it challenging to use such a source of funding.

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