Module 1

The Role of Global Capital Markets

The Debt Market
(Where the company lenders meet…)

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Borrow first

Most companies would have accessed debt markets before issuing equity.

Why?

- Family/friends loans
- Bank intermediated loans and credit, and
- Money market – short-term direct loans
- Bond market – long-term direct loans.

Debt instruments

Money market instruments include:

- Bank Accepted Bills
- Treasury Notes
- Certificates of Deposit
- Commercial Paper.

Bonds include:

- Government (Treasury) bonds
- Semi-government bonds
- Corporate bonds.

Distinguished by issuer, risk, duration.

Two-tiered market

Money market instruments are short-term instruments (up to 1 year to maturity) that pay the investor (the lender).

- The face value of the loan at maturity.

Bonds are long-term instruments (beyond 1 year to maturity) that pay the investor:

- A regular series of interest (coupon) payments over the life of the bond; and face value of the loan at maturity.

How is debt issued?

When the company borrows directly:

- Commercial banks, dealers, brokers
- Prospectus – due diligence (rating agencies)
- Road show – marketing to investors
- Issue yield (“price”) and allocation (quota) determined in auction or through book build
- Company receives the funds from investors.

What do rating agencies do?

Just as external auditors assess the accuracy of the company’s accounts for the benefit of shareholders,
rating agencies assess the solvency and liquidity of the company for the benefit of bond holders.

Standard & Poors, Moody’s…

What happens once debt is issued?

Debt markets are mostly **Over-The-Counter (OTC)** wholesale markets where dealers act as market makers:

1. Once issued, debt instruments can be traded on the secondary market
2. Where dealers/brokers bring customers (investors) together
3. Investors contact brokers/dealers who quote buy/sell prices.

Although there are now (limited) retail corporate bond market trading platforms.

How is debt different to equity?

- 'Continuous' price discovery provides an opportunity for debt holders to sell their debt instrument at a fair and transparent price.
- Debt instruments have a finite life as the company repays debt.
- Debt holders don't share in profits, **but** still care about the financial health of the company.

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