Corporate Bonds
Analyzing the availability of the Swedish bond market

Bachelor thesis within Finance
Author: Carl Jarnegren
        Linn Höglund
        Rickard Peterson
Tutor: Gunnar Wramsby
Date: Jönköping 2006-05-30
Abstract

In the past, the Swedish bond market has been distinguished for its illiquidity and difficulties with retrieving information. This is the starting point of our thesis and the purpose is to analyze and describe the availability of the present corporate bond market for manufacturing firms in Sweden. In order to fulfill the purpose, a qualitative method was used and interviews with different operators of the market were conducted. Our respondents were sampled from large issuing companies, the major intermediaries and companies that have not tried bonds as a financing tool.

To fulfill our purpose, we analyzed subjects as credit rating, capital market segmentation, regulations and volume. We came to the conclusion that the Swedish corporate bond market is somewhat underdeveloped. This is due to the lack of public information regarding the bonds, such as prices, outstanding bonds and interest rates.

The availability for already active companies is good, mainly due to the important role the intermediaries play. The regulations set by authorities do not have great effect on the large companies in general, since they issue large amounts, the cost associated with the regulations do not affect them in a considerable way. One could rather see a positive side with the regulations, for example the increase of foreign issuers that entered the market the last couple of years and hence increasing the liquidity. A credit rating is sometimes beneficial but not always, it is not a necessity to enter the bond market.

As a matter of fact, it seems like volume is the most important reason to why medium-sized companies have limited access to the market. Since the minimum recommended volume to issue is 50 million SEK, many companies are excluded due to lack of financing need. Another important factor concerning medium-sized companies is that they do not have sufficient experience, knowledge or interest in the bond market. There are probably companies that would like to enter the bond market, who do not have the opportunity to do so, but this do not have anything to do with the lack of credit rating, rather the high cost associated with it.

The conclusion drawn is that it is hard to compare small and medium-sized companies with large already established actors. This is due to different need of capital and overall knowledge about the debt market.
# Table of Contents

## 1 Introduction

1.1 Historical Background .......................................................... 4  
1.2 US Comparison ......................................................................... 6  
1.3 Problem Discussion .................................................................. 6  
1.4 Research Questions ................................................................. 7  
1.5 Purpose ...................................................................................... 7  
1.6 Perspective ................................................................................ 7  
1.7 Delimitations ............................................................................ 8

## 2 Theoretical Framework

2.1 Bonds ...................................................................................... 10  
   2.1.1 Different Bond Structures ..................................................... 11  
2.2 Pricing ...................................................................................... 12  
   2.2.1 Interest Rate .................................................................... 13  
2.3 The Bond and Money Market .................................................... 13  
   2.3.1 The Primary & Secondary Market ........................................ 14  
2.4 Different Issuers of Bonds ......................................................... 15  
   2.4.1 Corporate Bonds ............................................................... 15  
2.5 Weighted Average Cost of Capital (WACC) & Capital structure ...... 16  
2.6 Credit Rating ............................................................................ 17  
   2.6.1 The Function of Credit Rating ............................................... 18  
2.7 Regulations in the Process of Issuing Bonds ............................... 19  
2.8 Capital Market Segmentation .................................................... 19  
2.9 The Investors ........................................................................... 20  
2.10 The Intermediaries ................................................................... 21

## 3 Method

3.1 Qualitative Techniques ............................................................. 22  
3.2 Sample Selection ......................................................................... 22  
3.3 Conducting the Interviews ......................................................... 23  
3.4 Determining Method .................................................................. 23  
   3.4.1 Validity ............................................................................. 24  
   3.4.2 Reliability ....................................................................... 24  
   3.4.3 Criticism of Qualitative Methods ............................................ 25

## 4 Empirical Findings

4.1 Intermediary Interviews ............................................................ 26  
   4.1.1 SEB – Fredrik Ektander ....................................................... 26  
   4.1.2 SHB - Jan Hernqvist ........................................................... 28  
   4.1.3 Swedbank – Fredrik Boklund ................................................. 29  
4.2 Issuer Interviews .......................................................................... 30  
   4.2.1 Holmen AB - David Timner ................................................ 31  
   4.2.2 SKF AB – Klas Iloson ......................................................... 32  
   4.2.3 Billerud AB - Kerstin Rendahl ............................................. 34  
   4.2.4 Autoliv AB - Robert Belkic ............................................... 35  
4.3 Interviews with Potential Issuers ................................................ 36  
   4.3.1 Firefly AB - Lennart Janson ............................................... 36  
   4.3.2 ITAB AB - Magnus Olsson ................................................ 36
1 Introduction

This chapter will give you an introduction to the topic of corporate bonds and the background for our choice of subject. We also will present the purpose of the thesis and finally we will clarify the delimitations of the research.

In order to grow, a company has to invest in many assets such as personnel, equipment and information. This investment stage is often very costly for the company, and the cash flow from the revenue-generating entities are seldom enough to finance all the new investments (Chorafas, 2005).

To be able to finance these investments, the company either has to borrow money from its shareholders (through a new share issue) or turn to independent investors. Examples of those types of financing sources can be banks, venture capitalists or simply private investors. A major task for the financing department is therefore to be able to borrow the money at the lowest possible cost (Bodie, Kane & Marcus, 2004).

To achieve this, an instrument that can be used to keep the company’s cost of debt down is by issuing bonds on the primary market. Those bonds can be bought by anyone and then sold on the secondary market, just like stocks or any other security. The bondholder is entitled to receive a certain return from the issuing company based upon the interest rate of the bond. But as always, when there is a return, there is also a certain level of risk the investor has to bear. The bondholder has to accept the risk that if the company defaults, it will not be able to carry out promised coupon payments or maybe even not able to repay the principal (Bodie et al., 2004).

“Bonds are the most elegant financing that a company can achieve. By being active in the trading of the bonds, the company can affect its effective interest rate.”


1.1 Historical Background

In the past, the Swedish market for corporate bonds has been distinguished for its illiquidity and the difficulty to retrieve market information (Oxelheim, 1996). Most of the transactions have taken place between institutional investors such as banks, mutual funds and pension funds with a long investment horizon.

In the early 1950s, the Swedish authorities introduced a stricter control in the bond market. As a result of those regulations, the market, both on the investor side and the issuer side, became entirely dominated by a few participants (Oxelheim, 1996). The supply side (the issuers) was regulated as well as the demand side (the investors) was controlled in terms of investment obligations as well as liquidity requirements. Also, the Swedish Central Bank (Riksbanken) introduced certain restrictions on the pricing of the bonds. At that time, the need of financing for the companies seemed to come at third hand. The financing need of the government and the
housing sector had to be fulfilled before the companies were allowed to issue bonds.

In Sweden, due to the increasing fiscal deficit in the middle of the 1970s, the regulations mentioned above were somewhat loosened and the authorities kept relaxing the regulations through the 1970s and 1980s (Oxelheim, 1996). During this period the outstanding stock of bonds (government, housing and corporate bonds) in Sweden increased by about 60% as a percentage of GDP and in 1990 the relative size of the Swedish bond market was similar to the one of the US bond market (Oxelheim, 1996).

Today, the largest actor on the Swedish bond market is the government. In 2004, the bonds issued by the government amounted to 50% of the entire stock of bonds, which is about 770 billion SEK. The second largest actor is the mortgage institutions and in 2004 they issued about 552 billion SEK worth of bonds. The non-financial companies, i.e. corporate bonds, was only about 110 billion SEK in 2004, a decrease of 10 billion SEK from previous year (Sveriges Riksbank, 2005). The structure of all bonds outstanding in Sweden is described in the chart below.

![Figure 1.1. Billion SEK of Outstanding bonds (Sveriges Riksbank, 2005)](image)

From late 1980’s until late 1990’s the corporate bond market experienced relatively low growth. From the chart below, one can see that the market started to grow significantly in 1998-1999, caused by the booming economy (Boisen & Karlsson, 1993). Although the market decreased as the IT-bubble burst in 2001, the corporate bond market remained on historically high levels.
The MTN-bond (Medium Term Note) market boosted in 2005 and, according to Swedbank Markets, it reached new record levels (Swedbank Markets, 2006). This is due to the booming economy in combination with the historically low interest rate levels. The overall market is good for borrowers since the interest rates are low and the need for investors to find good investment alternatives has increased. The total volume issued on the corporate bond market (financials and non-financials) 2005 was 132 billion SEK, an increase of 55 % from 2004. The forecast for 2006 is positive, even though Swedbank Markets do not predict the growth rate of bonds to be as high as previous year (Swedbank Markets, 2006).

1.2 US Comparison

Oxelheim (1996) argues that one reason for why Swedish corporate bonds only holds for a minor share of the entire bond market is that the market itself is only open to large companies which can afford to obtain credit rating. This could be compared to the US market where also medium-sized and even rather small companies issue bonds. After adjusting for GDP, the total US bond market is of similar size as the Swedish (BondsOnline Group Inc., 2006).

The US market, however, is dominated by corporate bonds compared to the Swedish market, where government and mortgage bonds comprise a majority of the outstanding bonds. If the Swedish companies would start to use bonds a source of financing to the same extent as American companies, we believe the Swedish corporate bond market would have a significant growth potential.

1.3 Problem Discussion

In a recent article in Dagens Industri (2006-02-17), Munkhammar presents corporate bonds as an alternative for those being afraid of the stock exchange of today. Munkhammar further claims that the corporate bond should be a good alternative since it both reduces the risk of the investor’s portfolio and offers a better rate of
return than either the regular bank account or an investment in a Swedish government bond. The article ends with the following sentence:

“That the major fund commissionaires have not come any further in their supply of simple standardized investment products for corporate bonds is a riddle” (Munkhammar, 2006-02-17)

This was a starting point for this thesis as it sparked our interest in the subject. Compared to the US market, the number of companies that issue bonds are very small and we wanted to analyze the structural foundations for this, which led us to the question to why not more companies in Sweden issue bonds and what the barriers to entry are. Hence, we wanted to analyze the availability to the market for companies that have issued bonds before and companies that could be potential issuers.

We chose this topic for several reasons; there has not been much research within the subject and also, it is a highly present topic, especially if the interest rates are to rise in a near future. Also, personal interest has influenced our choice of topic.

1.4 Research Questions

In order to narrow down, and focus our research, we formulated some research questions which would help us create the purpose:

- How is the liquidity for the secondary market and how does it affect the companies’ decision to choose bonds when searching for financing?
- To what extent is the size of the company and issuing volume a vital factor when issuing bonds?
- How does a low (or lack of) credit rating affect the availability for the company when issuing bonds?
- How does the issuers and potential issuers overall knowledge of bonds affect the usage of the bond market?

1.5 Purpose

The purpose of this thesis is to describe and analyze the availability of the bond market for Swedish manufacturing firms and to find possible barriers to entry.

1.6 Perspective

Since we have described and analyzed the availability of the Swedish bond market we needed to see what different factors affected the bond market. We decided to face this problem with the corporate bond intermediaries (i.e. banks) and the issuers as the essential base for our research. The model below is an overview of the perspective of this thesis. In order for a market to exist, there has to be a supply, and our task is to see what the potential problems there are when issuing corporate bonds.
There are many factors that influence and affect the availability of the corporate bond market. A company which would like to issue bonds turns to an intermediary, which in turn finds investors for the issuer. Factors that affect the issuer in this process can be regulations set by authorities (the government and Finansinspektionen), costs dependent on what volumes the company would like to issue, what credit rating the company has. The availability is also dependent on the size of the company. In order to examine and analyze the availability of the Swedish bond market we have to sort these factors out.

Since this subject is very wide and there are many different angles and aspects we decided to do some delimitations.

### 1.7 Delimitations

Since the market is very complex with a large number of actors, without delimitations, this topic would be an endless field of research. To completely narrate the market and all relevant factors would be an impossible task and therefore, we decided to limit the study in some aspects.

We have decided to focus on companies that have outstanding bonds and those who have not entered the bond market. All companies chosen are manufacturing companies and are listed on the Swedish stock exchange. We decided to do so since bonds and stocks are closely related. It is common that companies that issue, or would like to issue, bonds are already active in the securities market, hence it is easier to choose a trustworthy respondent. The third group of respondents consists of the intermediaries, and since there are a lot of active intermediaries, we made a selection here as well. The selection was based on the size of the intermediaries, and how active they are on the market.

Government and mortgage bonds are highly important for the Swedish bond market, but we are only briefly going to mention what they are to give an introductory
understanding to them. Since we wanted to focus the study on corporate bonds, we are not going to put any further emphasis on these types of bonds.

The corporate bond market can be divided into two parts, financial and non-financial corporations. We have decided not to take the financial companies into consideration and just focus on the non-financial ones due to the choice of manufacturing companies.

Moreover, all macro economical factors that affect the bond market have been ruled out because this thesis has its focal point within finance and not economics.

Since there are plenty companies and intermediaries to analyze and the time frame for this thesis is limited, we chose to not do any research from the investor perspective.
2 Theoretical Framework

Initially, this chapter will give you a presentation of some definitions and concepts that will be frequently used further on. Secondly, there will be a descriptive part about the Swedish corporate bond market and the theory suitable for this study.

2.1 Bonds

A bond is a security that is issued in connection with a borrowing arrangement. The borrower/issuer sells a bond to a lender for a certain amount of money (Bodie et al, 2000). When a bond is issued, the price paid by the holder is either at par, discount or premium. Buying a bond at par means that the lender pays the face value (returning amount) of the bond. At discount means that the holder pays less than par and premium means that the holder pays more than par. Regardless of the amount paid at issue, the lender will be given the face value back at closing date. The pricing of the bond has to do with rate of interest relative to the market. In order for a bond with a coupon rate of 7% to be interesting to the market, when the current market rate is 8% have to be sold below par. The investment must at least yield the current market rate. While the opposite conditions can also exist, the coupon rate is higher then the current market rate. In this case the bond would be sold at premium (Miller, 2001).

A coupon bond obligates the issuer of the bond to make interest payments to the holder, on specified dates for the life of the bond. These payments are called coupon payments. When the bond matures, the issuer repays the debt by paying the bondholder the bond’s face value. The coupon rate of the bond determines the interest payments. The annual payments equals the coupon rate times the bond’s face value. The payments are usually done semi-annually (Bodie et al, 2000). To illustrate this, a bonds face value is equal to 100 000 SEK the coupon rate is 8 % which gives an interest payment of 8 000 SEK a year. The holder of the bond receives 8 000 SEK a year throughout the life of the bond, e.g. 10 years, and also receives the face value of 100 000 SEK on maturity date.

There are, however, bonds called zero-coupon bonds, which do not give any interest payments during the life of the bond, but instead the bond is issued at discount, meaning that the issuer receives less money when the bond is issued. At maturity, the holder of the bond is paid face value and the income becomes the difference between the face value and the discount price paid when the bond was bought (Bodie et al, 2000).

Most bonds issued in the Swedish market today are called fixed-income securities. They are called so because they provide a fixed stream of income or a stream of income that is determined according to a specific formula. This type of bond is relatively easy to understand because the payment formulas are specified in advance (Bodie et al, 2000). The definition used in this thesis for certificates is a bond with time to maturity less than one year (Sveriges Riksbank, 2006).
2.1.1 Different Bond Structures

2.1.1.1 Callable Bonds

There are bonds with different features. Some corporate bonds are issued with a call provision (Miller, 2001). This means that the issuer is providing itself with the right at anytime call the bond back at a specified call price before maturity date (Bodie et al, 2000). This procedure is useful when the market rates have fallen considerably since the bond was issued. This allows the issuer to recall the bond and replace it with one of lesser coupon rate (Miller, 2001). The proceeds from the new bond issue are used to pay for the repurchase of the existing higher coupon at the call price. This procedure is called refunding. Callable bonds often come with a period of call protection; this is an initial time when the bond is not callable. This type of bond is referred to as deferred callable bonds (Bodie et al, 2000).

The option to recall a bond is valuable to the issuers as it is a protection from the fall of the market rate. But of course the benefit and gain the corporation has from this affect the holder of the bond. To compensate the holder of this risk, callable notes are issued with a higher coupon rate than non-callable bonds (Bodie et al, 2000).

2.1.1.2 Puttable Bonds

While a callable bond gives the right to the issuer to redraw or extend the bond, the puttable bond gives this right to the holder. If the coupon rate of the bond exceeds the current market rate the bondholder has the right to extend the bond’s life. If the bond’s coupon rate is too low it will be smart for the holder to reclaim the principal and invests in current yields (Bodie et al, 2000).

2.1.1.3 Convertible Bonds

The convertible bond gives the bondholder the right to exchange each bond for a specified number of shares of common stock of the firm. The number of shares given by each bond is determined by the conversion ratio (Bodie et al, 2000). This feature is often attractive to bondholder who wants to switch from being a creditor of the corporation to an owner of the company, especially if the stock of the company increases in value (Miller, 2001).

Convertible bonds provide their holder the ability to benefit of the increase in stock price but this benefit comes with a price. Convertible bonds is associated with lower coupon rates and stated or promised yields to maturity than nonconvertible bonds (Bodie et al, 2000).

2.1.1.4 Floating-rate Bonds (FRN)

The interest payments made on a floating-rate bond is tied to some measure of current market rates (Bodie et al, 2000). For example the coupon rate could be based upon the Stockholm Interbank Offered Rate (STIBOR) plus 2%. If STIBOR is 2%, the coupon rate of the bond would be 4% annually. Having a floating-rate bond would mean that the bond always pays approximately current market rate (Bodie et al, 2000).

The major risk with floating-rate bonds has to do with changing credit conditions. The spread of the yield is set for the life of the bond, which could be many years. If
the financial health of the company deteriorates, then a greater yield premium would be required than is offered by the existing bond. In this case, the price of the bond would fall. The floating-rate bonds adjust to changes in the market rates but they unfortunately do not take changes in the financial condition of the company into consideration (Bodie, et al, 2000).

2.1.1.5 Junk Bonds

A junk bond or speculative bond is the type of bond that includes a high credit risk. It is often associated with high yields and rated BB or lower by rating agencies (Chorafas, 2005). Sometimes junk bonds are referred to as high-yield bonds (Bodie et al., 2005). Until late 1970’s, vast majority of all junk bonds were originally issued at investment-grade rating but later became downgraded. This type of bonds is commonly denoted as “fallen angels” (Bodie et al., 2005).

2.1.1.6 Sinking Fund Bonds

The regular bond is associated, as mentioned previously, with a final repayment of the face value. This payment can become a source of cash flow problem for the issuer. By using a sinking fund bond this problem becomes less likely as the issuer spreads the final payment over several years (Bodie et al., 2005).

2.2 Pricing

The value of a bond is, just as the value of stocks, the present value of the promised cash flows discounted at an appropriate interest rate. When a company valuation is done, the discount interest rate is the expected interest from an alternative investment, but for a bond the interest rate used is one that reflects the default risk in the cash flows (Damodaran, 2002).

One example of using a discount interest rate is to simply discount at the risk-free rate of interest if there is no default risk. An example of a risk-free rate is that of government bonds since the government cannot default.

However, this is not the case for corporate bonds as there is always a possibility that a company will default its payments. Consequently, the price of a corporate bond (or any bond, for that matter) can be divided into three parts:

```
  Default Premium
     + Maturity Premium
     + Instantaneous Premium
     (Short-term Default-Free Rate)
  Interest Rate on Bond
```

Figure 2.1. Building Blocks for Interest Rates. (Modified from Damodaran, 2002)
Default Premium is related to the default risk for the bond and this is of high importance when it comes to corporate bonds (Damodaran, 2002). In order to estimate the default risk, which is difficult to measure, credit analysts such as Standard & Poor’s examine a company’s credit reliability to approximate the default risk, which will be further discussed in section about credit rating in 2.6.

Maturity Premium is the difference between longer-term default free rates and short-term rates. The maturity premium is generally positive, although at some occasions the long-term interest rates has been the same as the short-term or even lower (Damodaran, 2002).

Short-Term Default-Free Rate, also known as the risk-free rate of return, which is the current interest on a bond that carries no default risk (Damodaran, 2002). This is usually a short-term government bond, although in some politically unstable countries the default risk for the government might also be included in the risk-free rate of return. Compensation for inflation is also included in this part of the bond value (Wolff, 1997).

2.2.1 Interest Rate

The interest rate is the most important variable when managing bonds. How much return a bondholder can receive is decided by the rate of interest on a bond.

Most often, central banks are pointed to as the interest rate-decider. But, in reality, the government and central banks can only manipulate the short-term interest rate because in the long run, the market sets the rate. A movement in the interest rate caused by an announced increase or decrease by the central bank will instantly affect the outstanding bonds in the market. A decrease in interest rate will increase the value of outstanding bonds as the interest is fixed at the old interest rate (hence higher). But longer-term interest rates, which matter much more for investment and growth, escape the authorities’ control because the market value them according to how they think the future movements in interest will be (Chorafas, 2005).

2.3 The Bond and Money Market

The bond market is today a market for risk-averse investors who want a worry-free investment with modest but stable returns (Bodie et al., 2004).

The market for debt securities has gradually increased due to the different needs of financing. This growth has created a great flexibility and opportunity to borrow capital. In the primary market, capital is gained through issuing of debt securities for which banks or other financial institutions act as middlemen and buy the security to sell it on the secondary market (Håkansson, Lundquist & Rydin, 2001).

The bond- and money market has grown due to larger participants’ need for raising capital. The major issuers of debt security are the government, municipalities, mortgage institutions, larger industries and power plant corporations. Out of the
non-governmental bonds, 85% is issued by mortgage institutions (Wramsby & Österlund, 2005).

The investors are usually insurance companies, pension funds or fund companies. Unfortunately, the market today is dealing with too large volumes for private investors, usually the nominal value ranges from 100 000 SEK to 10 million SEK. Since the beginning of 1990’s private investors can turn to SOX which is the official secondary bond market (further described in chapter 2.3.1). The nominal value of those bonds is suited to fit the private investor and usually ranges from 1000 SEK (Håkansson et al., 2001).

Some of the most common alternatives for expanding firms, besides bonds, are to use regular bank loans or to issue stocks. What firms’ also take into consideration when issuing debt or equity is the capital structure. This structure is how much of the overall capital being debt and how much being equity (Wramsby & Österlund, 2005) and will be described more in depth below.

2.3.1 The Primary & Secondary Market

The primary function of the capital market is to transfer capital from surplus to deficit units. On one side we have independent investors or companies that have more capital than they need at the moment, on the other side, units that are in need of capital (Håkansson et al., 2001). When issuing bonds or shares this is done on the primary market. When an investor buys bonds on the primary market, they lend money to the issuers so they can fulfil their investment strategy (Strumeyer, 2005).

When a firm issues bonds, it can be done in several different ways. A common method to use is bidding which works as a common auction. Another way to issue on the primary market is that a seller sets a fixed price under a certain period of time (Andersson & Larsson, 2005). A third way is to use private placements, which is a proposal to a specific or a small number of investors in contrast to being publicly offered (Mondo Visione Ltd., 2006). The private placements are often done with a bank as the intermediary (Andersson & Larsson, 2005).

The secondary market, or after-sale market, is where investors buy or sell bonds. When buying a bond on the primary market, money is channelled to the issuer. However, this is not the case in the secondary market and no new money is raised. An investor provides liquidity to another that would like to turn their bond into cash (Strumeyer, 2005).

Many investors demand that there is a secondary market with decent liquidity before investing. This is because many investors do not feel comfortable with investing if they do not have the opportunity to cash the investment in the future (Andersson & Larsson, 2005). If there is a well functioning secondary market, the trading volumes create high liquidity which is a benefit of bonds, since they get more attractive for the investors, which in turn lead to decreased issuing costs for the investors on the primary market (Sveriges Riksbank, 2005).

SOX - Stockholm Obligation Exchange

Stockholmsbörsen has been a market place for securities for over 100 years, but it was not until 1994 that SOX was introduced as an official marketplace for bonds. Bonds traded at SOX are mostly suited for small and medium size investors. The
issuers are banks, mortgage institutions, the government and some companies (OMX AB, 2006).

Since one has the possibility to trade the bond through SOX, an investor do not need to hold the bond to maturity. If one would like to trade bonds on SOX one must go through an intermediary such as a bank. Another criterion is to have a certain account to place the bond in (OMX AB, 2006).

2.4 Different Issuers of Bonds

There are several types of bonds and to better understand and define what a corporate bond is, we include a sample of brief descriptions of the most prevalent bonds and related terminology;

**Government bonds** are the most common debt instruments in Sweden and are issued, hence the name, by the government. These bonds are fixed-income securities and have maturities of two to twenty years and have the lowest interest rate, as the default risk of the government is zero (Oxelheim, 1996).

**Mortgage bonds** are issued by mortgage institutions in order to loan money to individuals and corporations for housing purchases, land and other real assets where the asset can serve as collateral for the loan. This is a very common way of financing housing loans in Sweden (Oxelheim, 1996).

**Corporate bonds** are debt instruments issued by companies and are often issued in large nominal values, and are traded mostly between large investors, such as mutual funds and banks (Oxelheim, 1996). This is what we refer to as bonds further on in this thesis.

Other than these, the most common bond categories are bank bonds, bonds issued by banks, and premium bonds, which are issued by the government, and pays no returns except as premiums distributed as prize money in a lottery (Oxelheim, 1996).

2.4.1 Corporate Bonds

In general, the corporate bond way of financing the firm is when the capital is needed in a longer perspective for the purposes of investments, such as plants or equipment, as bonds in general have maturities of at least one, but often several years (Strumeyer, 2005). A corporate bond is an investment which gives a higher yield than a government or mortgage bond. This is due to the higher credit risk and lower liquidity (Föreningssparbanken AB, 2005).

Issuing a bond is one way of gaining long-term finance. Bonds are usually issued within a MTN-programme. The debt security either has a fixed set of interest or a floating rate construction (FRN) during the life of the bond. The floating rate construction is usually connected to a three month interest. The interest payments to the holder are done annually or with the periods applicable for FRN. The life of the bond varies from one to ten years. The price for a corporate bond with a fixed-coupon rate is quoted by an effective yearly interest rate, which is set by the market rate (Föreningssparbanken AB, 2005).
When companies issue bonds, they usually do not sell it directly to the public. They rather sell the entire stock of bonds to underwriters, which act as middlemen for the corporations. The intermediary, in turn, will sell the bond at a slightly higher price to the bondholder as a compensation for their service. After the middleman has sold the bond, they have nothing more to do with the bond (Miller, 2001).

Medium Term Notes
Medium Term Notes (MTN) is a form of bonds that are usually issued with about two to five year’s maturity. What distinguishes MTN from the regular bonds is that MTN is often not issued all at once, instead the company can issue them within an MTN-programme that could stretch for several years. During this programme, the company can issue MTN whenever there is a need for more capital (CIBC World Markets Inc., 1999). This is obviously a flexible solution for the company, and also for the investors, as they can easily change the duration of their investment portfolio. MTN are especially important for investors with a short investment horizon, because regular bonds often have a maturity of more than five years (CIBC World Markets Inc., 1999).

2.5 Weighted Average Cost of Capital (WACC) & Capital structure

Corporate bonds are used by the firm to borrow money and this decision is obviously influenced by the interest to be paid on the bonds (cost of debt) and if the firm finance investment with equity or debt (capital structure).

The capital structure of the firm is a key factor to take into consideration when evaluating a firm. Therefore, it has been widely discussed in academic literature, and a cornerstone upon which much research is based, is the irrelevance theorem by Modigliani and Millar (1958).

Although the theorem by no means completely explains or predicts the behavior of firm managers, it helps to explain the debt/equity ratio and relationship to firm value (Eiteman et al., 2004). Modigliani and Millar assumed that there were an efficient market with no taxes, no asymmetric information and no agency or bankruptcy costs. Obviously, this is not the case in reality, but with these assumptions the theorem states that the financial structure is irrelevant for firm value, Proposition I (Modigliani & Millar, 1958).

When introducing taxes to the model, the firm value will reach its maximum when the firm is entirely financed by debt because of the tax relief incurred. This is a somewhat surprising conclusion, as this is never the case in reality (Modigliani & Millar, 1963). Modigliani and Millar (1963) addressed this problem in Proposition II by stressing that increased leverage also increased the risk of bankruptcy, hence increasing risk of the firm’s shares and costs such as re-negotiating loans (Modigliani & Millar, 1963).

The overall goal for the firm, when deciding upon the level of leverage, is to minimize the Weighted Average Cost of Capital (WACC) (Damodaran, 2002).

WACC can be calculated as:

\[ K_{WACC} = K_a \times \frac{E}{E+D} + K_d \times (1-t) \times \frac{D}{E+D} \]
Where

\[ K_{WACC} = \text{Weighted average after tax cost of capital} \]
\[ K_e = \text{Risk adjusted cost of equity} \]
\[ K_d = \text{Before tax cost of debt} \]
\[ t = \text{Marginal tax rate} \]
\[ E = \text{Value of the firm’s equity} \]
\[ D = \text{Value of the firm’s debt} \]

(Eiteman et al., 2004)

We will not discuss further as how to calculate the cost of equity, as this lies outside this thesis’ research area although the most common models are the Dividend Capitalization Model and the Capital Asset Pricing Model (Damodaran, 2002). However, the WACC-formula clearly supports Modigliani & Miller’s theory about the financial structure, because in this model the cost of debt is tax-free.

To calculate the cost of debt normally requires a forecast of interest rates, proportions of various classes of debt that a company expects to use, and the corporate income tax rate (Eiteman et al., 2004). In order to minimize the cost of debt, an optimal debt portfolio, which is the firm’s composition of debt, has to be constructed where all possible funding alternative has to be taken into consideration (Eiteman et al., 2004). Debt has to be managed in a way that makes it flexible, if the financial conditions should change. Bonds could therefore be a very good option for a company as bonds can be tailored to suit the specific needs of the issuer (Chorafas, 2005).

### 2.6 Credit Rating

Bonds, in general, generate a fixed flow of income in the shape of cash payments (the coupons). This income, though, is not guaranteed as the issuing firm might default (Bodie, Kane & Marcus, 2005). In other terms, the income from the bond is dependent on the financial status of the firm. This is one of the major reasons for higher interest rates on corporate bonds compared to the government bonds that in general are considered a risk free investment. Though, this might not be the case in countries with high political risk.

Besides the market risk, the bondholder is exposed to the default risk, often called the credit risk. This risk is measured by credit rating agencies. Examples of large actors in the field of credit rating are; Standard & Poor’s Corporation (S&P), Moody’s Investor Services, Duff and Phelps and Fitch Investors Service. The tasks of those firms include providing financial information as well as offering quality rating of their clients (Bodie et al., 2005). The ratings of the two main credit rating agencies, S&P and Moody’s, are denoted in letters that are presented in the table below.
A bond rated with at least a BBB (S&P) or Baa (Moody’s) is considered as an investment grade bond and those bonds below this rating are labelled as a speculative bond or a junk bond. Bodie et al. (2005) argues that default on bonds rated CCC or below by S&P are not uncommon and almost half of the bonds with this bad rating grade have defaulted within 10 years.

Bonds are rated largely based on both the level and the trend of some financial ratios of the issuer (Bodie et al., 2005). The main ratios for this evaluation are:

- **Coverage ratios** - Issuers earnings to fixed costs. Examples of those ratios are EBIT (Earnings before income and taxes) and EBITDA (Earnings before income, taxes, depreciation and amortization).

- **Leverage ratios (Debt-to-equity ratios)** – Too high leverage ratio increases the possibility for the issuer to not be able to not satisfy its obligations on the bonds.

- **Liquidity ratios** – Current ratio (current assets/current liabilities) and quick ratio (current assets less inventories/current liabilities) are examples of those ratios.

- **Profitability ratios** – Indicates a firm’s overall financial health. Return on assets (EBIT/total assets) is one of the most used ratios of profitability. The higher ratios, the better credit rating.

- **Cash-flow-to-debt ratio** – Total cash flow to outstanding debt.

When setting a credit rating the credit rating agencies work mostly with public information (Sjögren, 1993). All those ratios have to be evaluated with respect to what industry the issuer are active in and the analysts put different weight to the ratios (Bodie et al., 2005).

### 2.6.1 The Function of Credit Rating

Sjögren (1993) claims that the credit rating agencies have developed from a private initiative which can be a sign that their informational services generate economic benefits. Most likely, those benefits are present at new issues of bonds and not as apparent in the secondary market trading (Sjögren, 1993). The setting of a credit rating on a company can very well decrease its interest costs of issuing bonds or other types of debt. In some cases the company might not even be able to issue bonds without credit rating.
Credit rating agencies also make the analysis for both sides (investor and issuer) and prevent the double work otherwise necessary (Sjögren, 1993). Other benefits from using a credit rating agency is that they have advantages from their size and also that they can supply expert knowledge in the field of valuating the firm and analyzing the firms’ creditworthiness.

Firms using credit rating agencies can also be seen as more open and honest as they voluntarily supply all relevant information to the agency in order to get the correct credit rating. The investors get what one can call some sort of guarantee against the possibility that the issuing company hides or attempts to camouflage the actual financial situation of the firm. As a result of this, the risk and the cost of the bond issue decreases, hence the value of the firm increases (Sjögren, 1993).

### 2.7 Regulations in the Process of Issuing Bonds

The Swedish law regulating the trade of financial instruments (Lag om handel med finansiella instrument, SFS 1991:980) was the main source when legally scrutinizing the process of issuing bonds. Hence, this is the main source for this section.

When issuing debt instruments (e.g. bonds), a prospect must be constructed if the issue is public and the issued amount exceeds 50 000 EUR (4§, SFS 1991:980). Though, there are some exceptions to those requirements. For example, when a public issue is aimed at only sophisticated investors (all exceptions are enumerated in paragraphs 4-7 in SFS 1991:980).

The prospect should include information about the persons responsible, an audit of the financial statements, terms of the contract and information about the issuer such as amount of equity, area of business, investments, board composition and future prospects. All the required contents and design of the prospect can be found in paragraphs 11-16 in SFS 1991:980.

Once the prospect is done, it has to be submitted for approval to the Swedish Financial Supervisory Authority (25-27§§, SFS 1991:980). Once approved, the prospect must be publicly published (28§, SFS 1991:980).

A directive from the European Union, 2003/71/EG, came in effect during 2004/2005 and has increased the requirements on both the content and documentation of the prospects described above. The objective of the direction is introduced to harmonize the regulations among the members of the European Union (Boisen & Karlsson, 2003).

### 2.8 Capital Market Segmentation

Compared to the largest capital markets in the world, the bond and stock market in Sweden is very small both in terms of volume and number of actors. How does this affect variables such as required return and risk?

No theory exists that completely explains this, but a partial explanation is given when the theory of *market segmentation* is applied on capital markets. According to Eiteman, Stonehill & Moffett (2004), if all capital markets are fully integrated, securities of comparable risk should have the same required return (after adjusting for foreign exchange risk and political risk). However, this is not always the case and
this could partly be explained by the theory of market segmentation. The theory is built upon that certain imperfections in the market separates (different required return for the same risk) different markets from each other, e.g. the Swedish and the American stock market. Eiteman et al. (2004) lists the most important market imperfections:

Asymmetric information between domestic and foreign-based investors, which simply means that the domestic investor has access to information which international investors do not have access to, and hence the valuation of securities will be different.

Lack of transparency. An example of this is how easy it is to obtain information about a security and how much information a company reveal to the public (Eiteman et al, 2004).

High transaction costs which often are due to the small quantities traded and an old-fashioned way of trading (e.g. use of telephone compared to computers).

Foreign exchange risks. Small currencies are often very volatile, which means that a potential return could be “eaten up” by fluctuations in the currency. To protect themselves from this, international investors require a higher rate of return (at a certain risk level) for a Swedish security compared to an otherwise similar domestic security (Eiteman et al, 2004).

Political risks are risks associated with an unstable government or civil unrest which is not a factor to consider when evaluating the Swedish market.

Corporate governance difference is the different philosophies of how to run a company.

Regulatory barriers are the legal obstacles raised in cross-country investments (Eiteman et al, 2004).

Note, however, that market imperfections do not necessarily mean that the security market is inefficient. For a market to be efficient, security prices in that market reflect all available, relevant information and adjust quickly to new information (Eiteman et al., 2004). The market may still be segmented from an international perspective.

Finally, empirical tests show evidence that there might be segmentation in capital markets, especially in small countries. An example of this is Larsson & Åkerholm (1998), whose study empirically shows that there are signs of capital market segmentation in the Swedish bond market pre-1996.

### 2.9 The Investors

The dominating holders of bonds are the institutional investors. Examples of those can be insurance companies, pension funds, banks and mutual funds (Strumeyer, 2005). The institutional investors normally buy large amounts of the issue and the bonds left become available to the private investors (Strumeyer, 2005).

When comparing the firm’s stockholder with the bondholders there are some differences. First, the bondholder has a priority claim over the firm’s assets (Strumeyer, 2005). This implies that the issuing firm has to pay interest to its bondholders before any dividends could be distributed among the stockholders, with exception of preferred stock holders, if any. Interest is not the only income the buyer
could retrieve, but also a possible gain or loss realized either on maturity of the bond or when the bond is sold before maturity (Strumeyer, 2005).

2.10 The Intermediaries

There are many active intermediaries within the field of finance. They could be divided into two groups, the ones that act as intermediaries on the securities market and the ones that create their own financial products and markets (Daltung, 1999). The first group is often called agents; brokers, dealers and market makers are included in this group. Brokers bring buyers and sellers together while dealers both bring them together and make transactions for their own account. A market maker guarantees the market and sets prices. The two types of intermediaries fill different functions, and the function of agents is to increase the efficiency of the market and decrease information and transaction costs. Banks are very diverse and offer different services, and could be classified as both types of intermediaries (Daltung, 1999).

Banks’ role as an intermediary is both to find investors for an issuing company and to set prices as a market maker. This is illustrated in the figure below. One important piece of their role as an intermediary is to guarantee the investor to close the position, which means that they buy the bond back from the investor (Andersson & Larsson, 2005).

![Figure 2.2. Model of the Intermediaries’ role.](image_url)
3 Method

This section will describe our choice of research method in order to achieve a good result for the thesis. Further on we will motivate our choice of method and present some criticism on the choice.

After deciding on a topic and purpose for this thesis, we determined a proper way of how to address the problem. According to the research literature there are several ways to approach a research problem. Research can be described as a systematic and organized effort to describe and analyze a problem and find a solution to it (Sekaran, 2000). The decision of choosing the right research method can be viewed as a choice of the right tool from a toolbox. The proper tool, or research method, is one that has evolved from the problem (Sekaran, 2000).

In this case, we faced a problem in an area that is not completely explored. Ghauri, Gronhaug & Kristianslund (1995) states that a research problem, where one wants to uncover and understand a relatively new phenomenon or subject, is a typical example of a problem that requires a qualitative research. From this, we started to discuss the implications of using a qualitative method for this thesis.

As mentioned earlier, the thesis is based upon a relatively unexplored subject, and hence is of a somewhat descriptive nature. This is well suited for a qualitative research, as there are only a limited number of actors in the market with a lot of knowledge. A way to describe this is what Ghauri et al. (1995) calls a "thick description" and hence, a qualitative approach is preferable.

3.1 Qualitative Techniques

One of the most significant differences separating qualitative from quantitative research techniques is the sample of data used. According to Darmer and Freytag (1995), one must be able to compare all the respondents’ answers when gathering and analyzing data for a quantitative research. The questionnaire, or any similar instrument, should be well structured and tested before taken into use. Darmer & Freytag (1995) states that it is important that the answers in this type of study is based on the previous question, hence, the dialogue between researcher and respondent is what gives the data value. Moreover, Darmer & Freytag (1995) describe the researcher using qualitative technique as a person standing on the inside trying to understand the phenomena through his or her presence.

One of the most common examples of qualitative research methods is an interview, which is the topic of the chapter 3.3. Though, before conducting the interviews, we had to make a sample selection.

3.2 Sample Selection

Given that this thesis used a descriptive approach to address the purpose, we were in need of respondents that could answer our questions properly. In order to get an accurate picture of how the Swedish bond market works and how the actors perceive the availability of the market, we had to find suitable interviewees. We wanted different opinions from different segments of the market, therefore we chose to
start by contacting the different intermediaries; the major banks. The intermediaries introduced us to companies that are major actors in the Swedish bond market and contact persons at those companies.

This selection is what Dahmström (1991,2000) refers to as a snow-ball selection where one uses a respondent to get contact information for other respondents. However, the intermediaries only have contact information for companies that issue bonds, not the companies that have yet entered the market. Therefore, we searched the website of Nordnet AB, more specifically the lists Nordic Growth Market (NGM) and Nya Marknaden (“Emerging Market”), to find potential respondents for companies that would suit our purpose well; hence medium-sized manufacturing firms with some amount of leverage (i.e. need to borrow money). Then, from those suitable companies, we made a self selection, which is when the respondents select themselves by responding (Dahmström, 1991,2000).

3.3 Conducting the Interviews

Since much of the market information is clustered around a few people, the easiest and most effective way to get a clear and accurate picture of the problem, in this case the availability of the market, is to conduct in-depth interviews (Ghauri et al., 1995). Ghauri et al. (1995) holds interviews as the most valid method to get a picture of a respondent’s position and/or behaviour.

Since the respondents had positions that differ from each other (e.g. they do not have exactly the same work functions) the interviews could not be standardized, especially considering the fact that each respondent have their own view of the market and why the market actors behave differently (Ghauri et al., 1995).

However, it was too difficult for us to analyze completely unrelated facts and answers. To deal with this problem, the interviews were carried out in a manner that Darmer (1992) describes as semi-structured where we used a sort of a “check-list” to ensure that we lead the interview in the right direction and ensure appropriate retrieval of information. This implied that we had to balance between leading the interview in the right direction and letting the respondent answer the questions in a free manner, without restrictions.

The interviews were done on telephone or through mail, the reason for not visiting the respondents was the distance and cost limitations. This could be a drawback, since the interaction might be negatively affected, but we still believe the telephone interviews and mail interactions, with the possibility to get back to the respondents for further questions, gave us a good source of empirical data.

3.4 Determining Method

When choosing method, one must be certain that it will generate a usable result. In order for a method to be valid it has to be reliable (Stone, 2004). Those aspects will be scrutinized on the following two sections, starting with the validity.
3.4.1 Validity

Validity is the ability of a test or other selection technique to measure what is set out to measure (Stone, 2004). A test is valid if it measure what it is supposed to. How valid a test is depends on its purpose (Georgetown University Department of Psychology, 2006).

In order to research, one must clearly identify the criteria that distinguish a successful method from an unsuccessful. Moreover, one must use only predictive measures that are reliable and valid. Without a systematic approach that examines the reliability and validity, no relationship between the selection of method and predictors can be made. The stronger the relationship between the criteria and the predictor, the more accurate the choice of method is (Stone, 2004).

3.4.2 Reliability

Reliability has to do with the quality of measurement, it is the consistency or repeatability of our measures (Trochim, 2006). Reliability is the ability of a test or other selection technique to produce similar results or scores for an individual on separate occasions (Stone, 2004).

For example, one can say that a ruler is reliable. If one measure something with a ruler several times, one is very likely to get the same result. On the other hand, a hand span is not reliable. Measure something with a hand span several times and the results are likely to be different. When a method lacks reliability, little confidence can be placed on the outcome of the research and it will be regarded as untrustworthy (Stone, 2004).

A test of reliability and validity can be both reliable and valid, one or the other, or neither (Georgetown University Department of Psychology, 2006). This is explained in the figure below.

![Figure 3.1. Reliability and validity](image)

In order to write a good thesis, one must see to that the purpose is fulfilled. Is the thesis measuring what it is supposed to and did we manage to use a reliable and valid method?
Since we chose to use interviews to gather facts, we cannot be certain that the result is both reliable and valid. It all depends on the respondents and the possibility that the answers are biased. One cannot be certain that we would have been given the same answers if we would ask the same questions again and this is a potential source of low reliability. Additional criticism is presented in the next chapter, 3.4.3.

### 3.4.3 Criticism of Qualitative Methods

The choice of a qualitative research method implies a trade-off between width and depth of the study (Darmer & Freytag, 1995). This implies that because of time constraints, our selection of respondents might be narrow which could lead to a somewhat different focus than originally intended. Marshall & Rossman (1999) calls this “to miss the forest while observing the trees” and claims it to be a common weakness in qualitative research methods, especially if the study is based upon interviews. To avoid this, we tried to lead the respondents into the area of bond market availability.

This brings us to another possible weakness of qualitative research; the interpretation problem. If the background of the respondents and interviewers differ, the interpretation of what the respondents want to tell can be incorrect. As we come from an academic environment, an example of a bias could be to focus too much on details because some of these details are described in academic literature. These biases are hard to overcome, but in order to do so we recorded our interviews and reviewed them again to discover what the respondent found most interesting and important.

It is important with skilled interviewers in order to truly involve the respondent in personal interaction, cooperation is an essential task (Marshall & Rossman, 1999). An unskilled interviewer will often fail to get the respondent to elaborate on important issues and hence the quality of data will suffer. As we carefully prepared the interviews we hopefully overcame this sufficiently.

Conclusively, one could say that although there are some weaknesses associated with a qualitative research method based on interviews, but still, we feel that this approach is the most appropriate as it gives a lot of information to analyze. However, one should remember that the data is based on the respondents’ perspective of the problem and therefore it may not be possible to generalize conclusions to other companies and markets (Marshall & Rossman, 1999).
4 Empirical Findings

The empirical findings will summarize the interviews conducted with the intermediaries and the issuers and will be the foundation of the analysis. The questions asked are found in the appendices.

4.1 Intermediary Interviews

4.1.1 SEB – Fredrik Ektander

All information, if nothing else mentioned, in the following chapter is from a telephone interview with Fredrik Ektander, SEB Capital Markets, conducted on April 25, 2006.

Introduction
SEB is one of the leading intermediaries of corporate bonds in Sweden and was therefore one of our primary interviewees. The respondent at SEB, Fredrik Ektander, employed in SEB since 1964, has an extensive experience of the Swedish capital market and works at the Department of Credit Origination at SEB Capital Markets in Stockholm. SEB is one of the major actors in the capital market and was the largest issuer in Sweden with bonds worth 33 billion SEK issued in 2005.

Interview summary
SEB cannot give any typical description of companies that use corporate bonds. Instead, they claim the vast majority to be considerably large firms, those listed on the A-list in the Stockholm Stock Exchange, and a few smaller firms having a large need of capital (at least 500 million SEK). The industry, SEB explains, can be any kind, but today the manufacturing industry, retail business and the mortgage sector dominates the bond market.

The most important advantages of using bonds are that it is a rather simple construction and a flexible source of financial resources at a rather low cost compared to other alternatives. The cost is between 0.01-0.02 % for a normal issue, but for a public issue, the cost for road shows etc can be rather costly.

Further, SEB describes another advantage for the issuing firm whereas the bonds do not come with the same obligations as stocks do. Examples of those obligations are dividends and increasing financial performance. The bondholder only cares for that the coupon is retrieved and that the initial amount is repaid at maturity. The possible drawback of bonds is that the bond is not guaranteed and there is a need to find an investor before the bond can be issued, SEB argues.

From SEB’s point of view, corporate bonds are a good way of earning money as an intermediate without bearing any credit risk or taking any debt into its balance sheet. SEB explains that, in short, the bank reduces its exposure by issuing bonds, but still earns money on the margin, often denoted as the spread.

The bank only act as an intermediary and provides the potential issuer with all information needed. SEB also believes that the actively issuing companies in general have sufficient knowledge about bonds. Due to the last decade’s good performance
among Swedish firms, the intermediating bank often only provides advice when and how to use bonds to improve its clients financing. The last decade, this role has become more important as many of the largest firms in Sweden has experienced good results and built up massive cash reserves. Moreover, SEB ensures that the companies benefit greatly by issuing bonds in good times to be prepared for the future, and possible worse times. In this sense, SEB claims bonds to be a great way of getting a rather flexible low-cost financing.

The Market
SEB says that the market of corporate bonds has grown constantly since 1997-1998. Further, SEB argues that the Swedish issues has declined and that foreign players, for example General Electrics, Ford and Volkswagen have increased its presence in the Swedish bond market lately. One reason for this, SEB claims, is the new international accounting rules (IAS39) which makes it harder to swap between different currencies. In combination with the decreasing need of capital among Swedish major players in the capital market, foreign issuers presently uphold the market.

Another factor is the banks’ situation. When the banks’ have a surplus of money they need to lend it and SEB argues that corporations are the ones borrowing this excess. Concerning the future of corporate bonds, SEB believes that the market will continue to grow but one must bear in mind that this development fluctuates with several factors, especially the interest rate level and the cash reserves of the issuers.

Since the great majority of the investors buying the bonds are institutional investors, such as pension funds and insurance companies with restrictions not letting them invest in non-listed bonds, the majority of the bonds are listed. Though, some of the Private Placements, with smaller amounts of capital issued through bonds, are not listed.

Credit Rating
The credit rating predominant in SEB is Standard & Poor’s and Moody’s. This rating cost around 0,5 million SEK and SEB believes this to be one of the major reasons why small firms do not get the same access to the bond market as the larger corporations do. The credit rating gives both the investor and the intermediary an objective external view of the potential issuer but is not always necessary. For example, companies where the government has a vast interest can issue bonds without any credit rating. Also NCC AB and Skanska AB are examples of firms issuing bonds without any credit rating. The last couple of years, the level of credit rating has decreased along with the companies getting larger cash reserves but if the times get worse, SEB argues, this level will possibly rise.

Problems with bond issuing
SEB explains that being an intermediary is a work built upon trustworthiness and good business ethics. If SEB would let a company with a pessimistic financial future issue bonds, its trustworthiness would be harmed if the issuing company defaults. Therefore, the one reason for not letting a potential company issue bonds is that the bank simply do not want the firm as a client. The belief of SEB is that companies that do issue bonds are predominantly satisfied and the bank often manages to make both the investors and the issuers happy.
4.1.2 SHB - Jan Hernqvist

All information, if not mentioned otherwise, was retrieved from an e-mail interview with Jan Hernqvist at SHB, conducted on May 3, 2006.

Introduction

Hernqvist is Head Syndicate at SHB, with 15 years of experience in the bond market. SHB claims that the typical company that wants to issue bonds has relatively large need for capital and also wants to diversify their way of acquiring debt, hence an alternative to bilateral or syndicated loans at banks.

The advantages of issuing bonds, according to SHB, are that the market sets the price on the loan, the company can have “quick access” to the cash and you can borrow large volumes in short time.

The Market

SHB intermediated about 13 billions SEK worth of bonds last year and the demand to issue corporate bonds is growing again after a few years of consolidation in Swedish companies, SHB argues. The size of each issue varies a lot, although 50 million SEK is at the low end of the scale and goes up to what SHB refers to as “any size” (in the Swedish market, this could be a little bit above 4 billion SEK). In recent years, this minimum volume has decreased while the maximum has increased and hence the span has been enlarged.

Credit Rating

Standard & Poor and Moody’s are used for rating the companies as they dominate the market and are trusted among investors. In order to issue bonds, companies should preferably have a credit rating of at least BBB- (Baa-) although there is a high yield market for bonds with rating BB or less. But as a general rule, SHB wants to issue bonds that they believe are of good creditworthiness. An example of this is that they do not recommend their clients to invest in Icelandic credit risk at the moment because SHB does not consider it worth the risk.

When informing a company that is considering a bond issue the most important information to the company regards the price structure and SHB tells that, after a dialogue with them, the issuing company has all the knowledge it needs to use bonds effectively. SHB, very rarely, rejects a company that wants to issue. If they do, it is usually because the price of the loan will be too high to be profitable.

Most of the bonds (about 98%), whether it is a public issue or a private placement, ends up being listed on a market such as the Stockholm Obligation Exchange (SOX). Only a very small portion of the bonds do not get listed. The liquidity, however, varies a lot once the bonds are out on the market which means that the bid/ask spread differs, and often small private placements have a larger spread which means that it will be more expensive to trade the bonds. Though, SHB always guarantee to act as a counterpart if an investor wants to exit.

Generally, SHB believes that the companies are satisfied with the services SHB provides as an intermediary and that the major reason for companies to use other sources of financing is the price.
4.1.3 Swedbank – Fredrik Boklund

All information, if nothing else mentioned, in this section is retrieved from a telephone interview with Fredrik Boklund, Swedbank Markets on April 28, 2006.

Introduction
Swedbank Markets (SWB) is together with SEB, one of the leading intermediaries of corporate bonds in Sweden. Being this, they appeared to be an obvious respondent for our intermediary interviews. The respondent at SWB, Fredrik Boklund, has been working with the company for seven years and has been working within the corporate bond market for five years. More specific, Boklund has the head responsibility for the contacts with companies that issue bonds and the issuing procedure as a whole.

Interview Summary
According to SWB, one cannot give a general picture of companies that issue bonds as they differ prominently. But one can say that the companies that are most active on the bond market are the very large Swedish companies, the ones that can issue large volumes. The most common reason and advantage with issuing bonds is the diversity, SWB argues. When a company is taking on more debt, it is an advantage to diversify the risk of the debt. Since a lot of companies do not want to be dependent on banks, they choose to issue bonds as an alternative to an ordinary bank loan. Companies that only have bank loans are more dependent on the bank, SWB explains. The bank tends to lock the customer to them and put certain demands on the loan taker. This is not the case with bonds. Bond issuing companies are not just connected to one or a few banks, instead they are more dependent on the investors.

To attract potential customers, SWB is putting emphasis on their marketing on the diversity of debt. SWB believe this is a very good reason for the company to commence issuing bonds and often, those companies start off on the certificate market. The certificate market is a market for short-time debt and in general a less expensive alternative than the bond market. When the companies get the advantage with the certificate market they often tend to become increasingly interested in the bond market. SWB is convinced that issuing companies in general have the knowledge that the process of issuing bonds demands. The big actors often have a well functional financial department and are holding the same information and knowledge as the intermediaries, but at the same time, SWB points out that the really small issuers probably do not have the necessary competence.

The Market
The total MTN-market volume in 2005 was 132 billion SEK and SWB acts as intermediary for approximately 50 billion SEK of this. The total market increased by 55 % from the previous year and the reason for this large increase is due to the general growth in the economy in combination with the historical low interest rates, SWB believes. Further on, SWB claims that the forecast for 2006 is still a strong MTN-market, but recons that the growth in the market is going to decrease a bit. One reason for entering the bond market today is the possibility to buy a company and then pay its debt with the cash reserves in order to decrease the buying company’s possibility to be bought. The most interesting issuers from the banks point of view are among the big actors, SWB claims. Vattenfall, Fortum, other utility
companies and automotive financing companies such as Volvo, Scania and Toyota Finance are some examples of those interesting issuers mentioned above.

Today, SWB cannot see any problems with the liquidity on the market, though there have been some difficulties in the past. It all depends on whether the market is in a boom or recession, and if it will get worse, it is going to be hard to maintain the stability in the liquidity, SWB believes.

The respondent at SWB, Boklund, has been working with the bond market for five years and according to his knowledge, no bonds dealt by them have been issued on SOX. Only about 1% of all bonds issued through SWB are listed on SOX and SWB argues that there is basically no need for the companies to list them there. One can say that most of the transactions done are private placements. This statement, though, is strongly dependent on how private placement is defined, SWB continues.

Credit Rating
The credit ratings used by SWB is Standard and Poor’s (S&P) and Moody’s, hence they are the major actors in the credit rating business. S&P are more common in the Nordic countries in general and Moody’s are more used among banks.

SWB do not put much emphasis on what credit rating the companies have when they want to issue bonds. Their corporate strategy is to help all companies, no matter what credit rating. According to Boklund’s knowledge and experience within SWB, they have never turned a company down in the process of issuing bonds. Even so, the credit rating is very important to the investors when choosing what companies to invest in. This obligates SWB to clearly state what financial position and tentative risk, i.e. credit rating, the issuing companies are holding. SWB also declares that it is very seldom that potential issuers with credit rating below investment grade even ask the question. One reason for this is that the issuer might experience the interest rate to be too high compared to regular bank loans. SWB approximates that 500 million SEK out of the 50 billion SEK they act as intermediaries for are issued by high-risk corporations. The market of today have more high risk companies than usual due to the good economy when more companies with low credit rating wants to issue bonds at lower interest rates.

Problems with Bond Issuing
In order to issue bonds, a company needs to be of a certain volume, a critical mass. Otherwise, the transaction costs will be too high. For example, if a company borrows 100 million SEK, the costs of SWB conducting a financial analysis and the legal matters associated in relation to the money borrowed, rapidly gets too high. If a company has decided to enter the bond market, SWB recommends it to have an MTN-programme. The cost for such a programme is approximately 0.5 million SEK and if you want to issue large amounts of money, it is also beneficial to the issuing company to have a credit rating, SWB argues. The cost of this rating is around 0.5 million SEK plus annual fees.

4.2 Issuer Interviews
In order to find out how companies that issue bonds perceive the availability of the bond market we have made semi-standard interviews with them which are presented briefly below.
4.2.1 Holmen AB - David Timner

All information, if nothing else mentioned, in this section is from a mail interview with David Timner, Holmen, conducted on April 20, 2006

Introduction
Holmen is a Swedish manufacturing company and their business area is the paper and pulp industry. Holmen manufactures printing paper, cardboard and merchandise made by wood. Their manufacturing sites are located in three different countries. Five out of seven producing units are located in Sweden while the other two are situated in Spain respectively England. 90 % of Holmen’s products are exported to European companies and the net sales 2005 was approximately 16.3 billion SEK and they presently employ about 4900 people and have a balance sheet total of about 32 billions SEK (Hall, 2006).

Holmen is a public company and their shares are traded on the Swedish stock exchange. Their shares, Holmen A and Holmen B, are listed on “A-Listan” listing the stocks most traded. The company is characterized by high profitability and return and their financial position is and will remain strong, according to their own saying (Hall, 2006).

The contact with Holmen AB and David Timner was mediated through Bengt Stening at SEB, since they issue bonds as a financing tool with SEB as one of their intermediaries. David Timner is working as Group Treasurer at Holmen and he has been working within the wooden industry for 10 years.

The Market
Holmen started to issue bonds when their need for capital increased and they had to increase their long-term debt and spread the risk. The company saw that opportunity with bonds and thought it was a good alternative to previously used resources. Even so, Holmen do see some drawbacks with bonds. They recognized that there is a limited set of documentation about the bond available, but on the positive side they have the possibility to choose the amount to issue, just to fulfill that certain need.

Holmen has had a functional MTN-program for a long time but they have only been using it actively for the last two years. Holmen claims bonds to be a good complement to their other sources of financing and it is fulfilling their expectations. Presently, a total of 40 % of Holmen’s debt is financed through bonds.

Since Holmen already have a well functional way of financing through bonds they cannot see any important difficulties with the regulations set by the Swedish Financial Supervisory Authority (Finansinspektionen), and the administration concerning the issuing procedure. Since issuing of bonds and shares are closely related they have a financing department that takes care of both procedures. One advantage when issuing bonds is to have a credit rating and Holmen has the rating BBB+ set by Standard & Poor’s.

When deciding on which bond to issue the intermediaries’ advice is good to take into consideration, Holmen states. The intermediary also mediates the requests from the investor side concerning time of the bond, interest level and volumes desired, which is highly important in the issuing procedure. Holmen mostly use FRN-bonds, which is a bond with a floating interest but they also use bonds with a fixed
interest. At a couple of occasions Holmen also used the callable bond. The regular 
bond was mixed with an option and they had the possibility to buy the bond back 
within a certain time or when it reached a certain level. Holmen finds it quite ex-
pensive with the costs associated with the issuing procedure, but still worth the 
money. The primary costs related to the issuing procedure are:

- Updating the prospect related to the bond (done once a year).
- Fees to VPC (Värdepapperscentralen)
- Fees to intermediaries.
- Fees to Stockholmsbörsen for listing the bond
- Administration

Holmen is using different intermediates when they issue their bonds, they practi-
cally uses all the large middlemen on the market, SHB, SEB, SWB, Danske Bank 
and Nordea. This gives them the possibility to use all the contacts established by 
each intermediary.

When asking Holmen if they think a well functioning secondary market is impor-
tant, the answer is no. This could be due to the fact that their need is already ful-
filled through the intermediaries. When the intermediaries have found investors for 
the bonds issued, Holmen do not care about who actually holds the bond. Holmen 
thinks the liquidity on the secondary market is good for certain issuers but generally 
there are few bonds that make it to the secondary market. Most investors tend to 
hold the bond to maturity.

Problems with Bond Issuing
Holmen can not really see any problems with issuing bonds, the only thing they re-
gard as a bit problematic is how to put pressure on the investors. They want to bor-
row money at the lowest interest rate possible and still find interested investors 
which will buy the bonds issued.

4.2.2 SKF AB – Klas Iloson

Unless otherwise stated, all information in this section is from a mail interview with 
a supplementary telephone interview with Klas Iloson, SKF, conducted on April 
26, 2006.

Introduction
With an annual turnover of almost SEK 50 billions, SKF is one of the most well 
known Swedish companies and is the leading global supplier of the rolling bearing 
and seals (SKF AB, 2006). Iloson has worked in the company since 1994 and is re-
sponsible for external borrowing and is also Chief Dealer, which means that he is 
dealing with internal financing and foreign currencies in SKF. According to Iloson, 
there is enough knowledge within SKF about bonds.

SKF has been issuing bonds since the Swedish market started, and has outstanding 
bonds in both the US and in Europe. Today, SKF is a company with very small 
debt for a company their size, and this debt consists of bond issues, bilateral bank 
loans and syndication agreements with banks. Those syndication agreements are 
used as a sort of a back up if the there is a sudden need for cash. As a matter of 
fact, most of the company’s debt is bonds because of the low leverage in the com-
pany.
The Market
SKF has a strict policy for what intermediary banks to use. Since SKF is a global corporation, the intermediaries have to be present and able to serve SKF’s needs wherever and whenever needed. Therefore, SKF has a group of ten core banks with which they cooperate.

At the moment, SKF has three outstanding bond issues (USD 100 millions in USA and EUR 350 millions in Europe). The credit rating of SKF is A- at Standard & Poor’s and A1 using Moody’s rating scale, which is a proof of their superb financial position. One advantage of using bond as a financing tool is that they are a good complement to bank loans as you move away from the, sometimes limited, bank loans and turn to other investors. SKF argues this source of financing sometimes makes it easier to borrow the amount they need compared to regular bank loans. Another benefit is that bonds can be used as a sort of advertising, as it makes the market aware that SKF is an active company. Before every bond issue SKF conducts a “road show” where they travel and meet potential investors and present the bond issue and SKF as a company.

Moreover, SKF has started to investigate the possibilities to construct bonds with the possibility to buy back the bond. Examples of this can be callable or convertible bonds. With the large cash reserves of today, SKF believes this could be something used in a near future, but is not used today.

Concerning the secondary market, the respondent lacks sufficient knowledge to give an answer whether it is efficient or not, but states that there is a need of it. The investors sometimes have requirements of exits, hence a well functioning secondary market with high liquidity is a benefit for SKF as it makes it easier to buy back bonds.

Problems with Bond Issuing
SKF believes it is expensive to issue bonds, and that the intermediary bank earns large amounts of money on the spread. Still, SKF is aware of the costs and that the added value with issuing bonds makes it worth those extra expenses. Therefore, bonds are considered a “luxurious commodity” by SKF. Also, it is easy for SKF to raise money in the bond market because of their solidity, and because of their high rating they can issue bonds at relatively low interest rate.

Another indirect cost is the compilation of information that is required in order to be allowed to issue bonds. Especially the US market has extensive regulations which require a lot of information and should be presented in a way that forces SKF to consult legal experts. Also, should SKF’s rating decrease, it will be a lot harder to find buyers for the bonds. Another problem with a drop in rating would be that investors that bought the bonds at a higher rating feel “swindled” by the SKF’s promises prior to the issue and will be remembered next time SKF wants to raise capital in a road show.

Concerning the role of the intermediary, SKF points out that the bank does not have anything to do with the decision whether the global ball bearing manufacturer should issue debt or not. Also, SKF believes the intermediaries to be suppliers of good and up-to-date knowledge and information about recently changed documentation, regulations and security matters and can assist SKF in a good way when issuing bonds.
4.2.3 Billerud AB - Kerstin Rendahl

If nothing else mentioned, all information in this chapter is retrieved from a mail interview with Kerstin Rendahl, Billerud AB, conducted on May 4, 2006.

Introduction

Billerud AB (Billerud) manufactures and sells packaging paper and the main products of the company are kraft paper, containerboard and market pulp (Billerud AB, 2006). Presently, Billerud has around 2600 employees in 11 different countries. In 2005, the turnover of Billerud was 6833 million SEK and the balance sheet total was 7757 million SEK in 2005 (Billerud AB, 2006).

The respondent, Kerstin Rendahl, works as Head of Finance at Billerud. Rendahl has been working within the field of finance and paper industry for 18 years.

The main reason for Billerud to start using bonds was that the company wanted to use its syndicated loan as a backup for the corporate certificates. Bonds seemed to be a good complement for this kind of solution, she continues. Billerud has used bonds since 2002 and presently about 60% of the company’s total debt is bonds. The other share of the debt consists of a syndicated bank loan and corporate certificates mentioned above.

Billerud has decided to not use any official credit rating because of the vast need of reporting and ongoing analyses on top of what is done today. Billerud also believes it to be very costly and that it would not add any specific value. Since Billerud is a relatively transparent company compared to more complex companies like SCA and Stora Enso, Billerud believes that banks and other stakeholders can analyze the company themselves.

The Market

Billerud uses bonds of various maturities as well as private placements when hunting capital. Billerud do not have any experience of the many different types of bonds such as callable bonds and convertible bonds. This is because other, possibly more complicated bonds, simply would not add value to the firm. Moreover, Billerud has a philosophy to not make things more complicated than necessary if it does not add any value.

When it comes to the end of the process, Billerud gets proposals from its intermediaries (banks) and accept those that look interesting. In fact, Billerud has not experienced any difficulties in getting good proposals, but rather have been able to choose from the competition arisen from the investors.

The opinion of Billerud, concerning the secondary market, is that this market works sufficiently well for Billerud and the company has not had any problems because of the efficiency and liquidity of the secondary market. Billerud also claims that the liquidity is good enough and does not affect Billerud when issuing bonds.

Advantages and Problems with Bond Issuing

Billerud believes bonds with different maturities to be a good complement and previous issues have been very beneficial. The most important advantages are; the predetermined maturity of the bond, the non-existing requirements of securities and financial covenants.
Possible drawbacks of bonds are that bonds are harder, and probably more expensive to buy back than other sources of capital might be. The costs of issuing bonds consist of two parts. First, the use of external expertise when controlling the legal aspects of the contracts, and second, the fee to the intermediaries which is pending between 0.01-0.02 % of the amount issued. Since Billerud has not had any reasons for producing any prospects, this cost has not yet affected Billerud in the process of issuing bonds.

Moreover, Billerud presently does not see any obvious difficulties or obstacles with issuing bonds.

4.2.4 Autoliv AB - Robert Belkic

All information, if nothing else mentioned, in this chapter is retrieved from a mail interview with Robert Belkic, Autoliv AB, on April 26, 2006.

Introduction

Autoliv AB (Autoliv) is one of the world’s leading manufacturer of automotive safety products (Autoliv AB, 2006). The two main products manufactured are airbags and safety belts. The company currently has around 40 000 employees and a turnover of more than 49 billion SEK in 2005 (Autoliv AB, 2006). The credit rating of Autoliv, using Standard & Poor’s, is A-. The balance sheet total of Autoliv was 40.1 billion SEK in 2005.

Robert Belkic, works as Assistant Treasurer at Autoliv and is the respondent for our interview with the Swedish manufacturer of air bags and safety belts. Autoliv has been using bonds since 1997. The major reason for Autoliv to start raising capital through this channel was that short-term borrowing became more and more difficult through banks because of weak balance sheets. The short-term financing also was less flexible and more expensive and long-term financing, such as bonds, was the solution of these problems.

The Market

Bonds are excellent products and Autoliv’s primary source of financing. Regular bank loans are only considered to be a complementary source of capital. This is obvious when scrutinizing the debt structure of Autoliv of which 40% of the company’s debt is long-term bonds denominated in SEK and EUR.

Moreover, Autoliv uses different structures on the bond issues depending on the situation. For example, the variations can be using fixed or floating interest rates and various terms of amortization of the bonds. Autoliv uses bonds denominated in both SEK (MTN-program) and EUR. The company also has short-term programs (certificates) in the Swedish and American capital markets. The debt issued in SEK is intermediated by SEB, Nordea and Den Danske Bank, which are three major actors in the capital market in Sweden. Those intermediaries have great influence on Autoliv’s bond financing and act as the ears of Autoliv towards the Investors. They also supply Belkic and his colleagues with feedback throughout the process of issuing, Belkic says.

Concerning the Swedish secondary market and its efficiency, Autoliv claims it to be of very low interest as Autoliv does not trade in the market and have no comment on its possible lack of liquidity.
Advantages and Problems with Bond Issuing
The major benefit from bonds is the flexibility and the increased width and depth of the capital market. Another reason for choosing a bond issue over a regular bank loan is that the present capital requirements of the banks is an obstacle hard to overcome, which makes bank loans less accessible and bonds more beneficial for Autoliv.

Autoliv is very clear on the topic of possible problems when issuing bonds and cannot think of any difficulties. Autoliv states that, once you have the documentation and rating at hand, it becomes more of a routine, used when needed. Also, Autoliv does not believe lacking knowledge to be a problem when issuing bonds.

4.3 Interviews with Potential Issuers

4.3.1 Firefly AB - Lennart Janson
All information, if nothing else mentioned, in the following chapter is from a mail interview with Lennart Janson, Firefly AB, conducted on May 8, 2006.

Introduction
Firefly is working within the fire protection sector, their ambition is to be the leading supplier of preventive protection systems towards fire and explosion in process-based industries. Firefly’s net sales for 2005 were about 56 million SEK and they have delivered more than 4000 systems to the process industry worldwide (Firefly AB, 2006).

Interview Summary
Lennart Janson is the CEO of Firefly and he has been working within the company for more than 25 years. Firefly is a small company with organic growth, listed on the stock exchange. They have high profitability and a strong cash flow, when the company is in need of more capital they use their listing and turn to their shareholders, to issue more shares.

Firefly is very satisfied with their way of financing and can not see any need for renewing their sources. Due to Firefly’s current source of financing, the company never thought of issuing bonds, hence they never saw the need. They also lack the necessary knowledge of the availability of the bond market, and the knowledge of how to use bonds. Firefly has never thought about if a well functional secondary market is important, since they do not have any need of it. Even though the company does not need a credit rating for issuing bonds, they have an AAA rating by Standard & Poor’s.

4.3.2 ITAB AB - Magnus Olsson
All information, if nothing else mentioned, in this section is from a mail interview with Magnus Olsson, ITAB AB, conducted on May 8, 2006.

Introduction
ITAB AB (ITAB) is a company within the manufacturing industry. ITAB’s main office is located in Jönköping and had an annual turnover of 953 billion SEK in 2004 (ITAB AB, 2006). The business of ITAB is manufacturing and developing
store furnishing and equipment for different store types and the main focus is on project management, design, development, manufacturing, purchase and sales (ITAB AB, 2006).

**Interview Summary**
The interview with ITAB was conducted with the CFO, Magnus Olsson, who has had his current position since 2004. Before that, he was working within a different branch of the company. ITAB is financed through ordinary bank loans and convertible debt instruments. They are currently very satisfied with their financing and they can not see any reason for changing them. The respondent stated that ITAB has never had a thought of issuing bonds, and they do not have any particular need of doing so either.

Since bonds never have been an issue to them, ITAB does not have the necessary knowledge to use bonds and they do not have any knowledge about the availability of the market, he explains. Whereas ITAB can not see any reason for getting a credit rating, this is not something ITAB cares for. Since ITAB is satisfied with their current sources and types of capital, and the fact that the company has never used bonds, they have never thought of what significance a well functioning secondary market for bonds could have. Basically, ITAB is not interested in corporate bonds and what positive effects they might bring.
5 Analysis

This section will combine the theoretical framework and the empirical data in order to analyze the subject according to our purpose. We will use a funnel approach and start by describing the market to give the reader a review and then work downwards by describing the issuers and then finally the focus of this thesis, the availability to the market for the companies.

5.1 The Market

The bond market in Sweden seems to be a bit underdeveloped when it comes to access to present information about the bonds such as prices, amount of outstanding bonds and interest rates. This could possibly be a result of the fact that the Swedish bond market has been dominated by a few actors (Oxelheim, 1996), which was confirmed by SWB who claims that there are only about 30 major investors which largely control the market. Another proof that the secondary market, and hence the need for up-to-date information, is relatively small and inefficient, is that most of the bonds are purchased by institutional investors and most often held to maturity, according to SEB. This may have led to a lack of knowledge about bonds at financing departments, especially within the smaller companies. This argument can be supported by the fact that the companies which have not issued bonds do not even consider them as a financing option (Firefly & ITAB).

Issued bonds are almost always sold directly to investors through the intermediary, which acts as the market maker, ensuring that investors can close their position if they want to. However, the liquidity is harmed when the bank acts as a market maker as the spread increases the total cost of the issue.

According to SEB and SWB, the market on the issuer side is all about the large companies which comprise a staggering 64% of the Swedish corporate bond market (Swedbank Markets, 2006). If the small companies, listed on the stock exchange, want external financing they either turn to their bank for a bilateral or convertible loan or to their shareholders to issue new shares. An interesting note is that many financial institutions that have these companies as clients issue MTN in order to raise the money themselves and then, in turn, lend it to the companies (Swedbank Markets, 2006). This suggests that to issue bonds on their own could be an interesting alternative for these companies.

One might raise the question whether the banks have a conflict of interest, since they not only want to issue the companies bonds, but also lend money from their strong balance sheets, according to SEB. Therefore, the banks may not advertise the bonds in a way that would attract new issuers, but this will be further analysed in the discussion about availability (5.3).

Another deficiency in the Swedish market is the lack of a junk bond market where companies with a credit rating of BB (S&P) or less (speculative/junk bonds). SHB refers to this as the high yield market where those companies can issue bonds, but these issues occur rarely. SWB supports this and claims it to be a rare occurrence that these companies even ask the question to issue bonds.
5.1.1 Capital Market Segmentation in the Swedish Bond Market

A possible explanation for why the corporate bond market appears underdeveloped could be the theory of Capital Market Segmentation (CMS); i.e. the Swedish market is segmented from, for example, the European and the US market. Our empirical data shows that the volume issued in Sweden is highly dependent on the general economic trend in Sweden and, obviously, the interest rate. Many of the market imperfections that could be correlated with CMS are evident on the Swedish bond market. Examples are; the lack of transparency and the high transaction costs. Note that we cannot prove if the Swedish bond market is segmented or not since it would require statistical tests on a large sample of data.

CMS would help to explain certain actors’ behaviour, especially if there is asymmetric information between domestic and foreign actors. Foreign companies constituted 32% of bonds issued in Sweden 2005, and American General Electric is the largest issuer at Swedbank with 19% of the market (Swedbank Markets, 2006). Although the increase in SEK-denominated bonds from foreign companies could partly be traced to the new accounting standards, called IAS39, that complicates currency swaps, according to SEB, the market must still look attractive to foreigners since a number of new foreign companies entered the market in 2005. (Swedbank Markets, 2006). This suggests that the Swedish companies see the Swedish bond market as a more expensive way of financing than foreign companies do.

It would not be surprising if the Swedish market is attractive to foreigners as the interest rate in Sweden is substantially lower than in, for example, the US where the T-bond rate is 5.08% compared to the Swedish 3.90% on May 19, 2006 (Nordnet AB, 2006). However, the Swedish companies, according to SHB, might not consider the interest rate good since they are used to borrow cheap from the banks and therefore the development might historically have been moderate.

5.1.2 Effects of the Economic Trend

After interviewing the intermediaries, we believe the bond market to be closely connected to the economic trend. In good times, the issuers build up substantial cash reserves and the need of new capital decreases. Despite this, SEB claims that those dominating actors (issuers) tend to take advantage of the company’s strong financial situation and issue bonds at low interest rates to be prepared for possible worse times in the future. According to SWB, future recessions would affect the liquidity negatively. SHB believes the liquidity to vary essentially once the bonds are out on the market. Hence, the bid and ask prices differs largely and in the worst case, there are no potential buyers at all. To protect the investors from this risk, SHB guarantees the investors to buy back the bond in a market with insufficient liquidity.

The majority of the issuers interviewed have not expressed very much interest of liquidity in the secondary market. The major benefit, stated by Holmen and SKF, is that a good liquidity makes the buy-back of bonds easier, but this is presently not any problem. The general opinion is that the liquidity is presently not a problem from the issuers’ point of view.

Moreover, if the liquidity would decrease, the spread would increase as the intermediaries would bear a higher risk for not finding willing investors, in the case they
have to act as market makers for other investors that wants to exit. In short, the liquidity is connected to the business cycle and a decreasing liquidity would increase the costs of issuing bonds. This would, in turn, be a possible drawback in a future recession.

5.2 The Issuers

5.2.1 Different Types of Bonds

After interviewing the respondents, we understood that the most common bonds used are fixed rate and floating rate bonds. When the respondents are deciding on which bond to issue, they listen to the intermediaries’ advice and look for the need from the investors. According to our respondents at Holmen and SKF they already tried, or are in the process of examining the possibility, to use other structures than fixed and floating rate bonds. The alternatives they presently are evaluating or using are callable or convertible bonds. Billerud have not used other types than the ones mentioned earlier, because they believe that the “regular” structures are the best one. They do not believe they get value added for complicating the structures, while Autoliv are very satisfied with using different types of bonds and issue bonds to fit every situation.

When starting to reflect on the different views of what bond to issue, it gets you thinking. The respondents are approximately the same size, or at least they are all classified as large companies, and all active in the manufacturing industry, and still they do not have the same opinion. It could be due to lack of knowledge that Holmen, SKF and Billerud mostly use fixed rate and FRN-bonds. Billerud states that they do not have sufficient knowledge about these structures, but at the same time they claim them not to add any value. This is a bit odd, since they do not have the necessary knowledge about what extra benefits those structures could give. We believe that Billerud should do a thorough examination about the benefits that are associated with different structures.

Holmen sometimes use callable bonds and SKF are investigating the possibility to use other structures. With these facts, one could say that they do not yet have the necessary knowledge, even thought they have well functioning financial departments. Based on the information we got, one could say that Autoliv is the most developed company within the bond area. They are issuing bonds to suit each situation, hence they really could utilize all benefits associated with bonds.

A reason for these companies not having the necessary knowledge could be due to the intermediaries. Since all of the companies are listening to the advice from the banks on what to issue, one reflection could be that they do not inform them on all the possibilities with bonds.

5.2.2 WACC & Debt Flexibility

To maximize the value and profitability of the company, one way is to minimize the Weighted Average Cost of Capital (WACC). A step to achieve this is to ensure that the Cost of Debt is kept at a minimum by an efficient management of the company’s debt portfolio. Chorafas (2005) argues that a flexible and diversified debt portfolio is a prerequisite for cost minimization. This was affirmed by our empirical
data as a majority of our respondents claimed that a major reason for issuing bonds is that “It is not a bank loan”, as SEB put it.

Another notion from our empirical data is that most of the companies issue bonds with various maturities and sometimes different structures for different situations. This would strongly support the perception that bonds are used to not only decrease the WACC, but also as a diversifying instrument to easily handle and, if necessary, change leverage and debt composition.

Finally, bonds are priced by the market, which is a good complement to bank loans. An advantage of this is the case when the market and the bank could evaluate the expected default risk differently which result in different prices. Such a situation could easily occur for a company such as Billerud, which has no official credit rating and hence each possible lender have to evaluate the risk. Also, companies, especially the big ones such as SKF, sees added value in having more stakeholders beside banks. The reason for this is perhaps less pressure from the lenders if the debt is shared by many investors instead of one large bank or a syndication of banks.

5.3 Availability

Concerning the availability of corporate bonds in Sweden, there can be many explanations to the prevailing market. The dominating issuers interviewed have expressed none or a few minor obstacles when issuing bonds. Contrary, the smaller companies interviewed has put forward what can be interpreted as low interest, lack of experience and knowledge about the bond market. The major barriers of entry to the bond market found, without mutual order, are:

- Need for Credit Rating
- Volume & Costs
- Rejection of Issuers
- Knowledge
- Regulations and Documentation Requirements
- Added Value

5.3.1 Need for Credit Rating

The empirical study shows that a credit rating is sometimes beneficial, but not always. The major credit rating agencies used are Standard & Poor’s and Moody’s, simply because they both are the dominating ones. SEB explained that the cost of this rating is around 0.5 million SEK, which makes the issue rather expensive if the issue, is of 50 million SEK or less. We believe this to have large effect on the potential issuer and the volume/cost trade-off to be one of the major reasons making the bank loan more beneficial for the company when raising new capital. This if further scrutinized below, in the section about volume.

Swedbank does not put too much emphasis on the credit rating of the potential issuer, but tries to help all companies, no matter what credit rating. Still, SWB explained that it is very seldom that a company with a credit rating below investment grade even asks the question. Only 1% of the bonds issued at SWB are of rating below investment grade. SWB also claimed that the credit rating is important from the investor’s point of view.
Moreover, SEB claimed the credit rating to give both the investor and the issuer an objective view of the issuing company, but is not always necessary. SHB prefer issuers with credit rating of at least BBB- (Baa-) as a rule of thumb, but occasionally SHB mediates issues with lower rating, in the high yield market. From those answers, we found that the major intermediaries, in general, wants and gets mainly well rated issuers but now and then mediate what is denoted as speculative/junk bonds.

Out of all the issuers interviewed all had an official credit rating except Billerud. Billerud claimed that the reason for not having any rating was that the company gets no added value from an official credit rating.

5.3.2 Volume & Costs

After interviewing several intermediaries and large issuers, the volume and cost relationship seems to be a major reason for the firm not to enter the bond market. The minimum amount of issue, for bonds to be a beneficial source of capital is about 500 million SEK (SEB & SWB). The initial credit rating fee is around 0.5 million SEK plus annual expenses. Due to this, a regular bank loan is often more competitive and cost efficient, when not issuing larger amounts. SWB mentioned a critical mass, in order for bonds to be profitable a company need to reach a certain volume. Once you have reached those volumes, bonds have quite a lot of benefits. One major reason mentioned by SKF and Autoliv is that each time the company chooses to issue, they can decide on what amount to issue, suiting their capital need for the moment.

Since the volume is a major matter, one must have a high financing need, when thinking of bonds. While large companies, hence our respondents are talking about their issuing procedure and all the benefits with bonds they can not see any problem associated with the critical mass. On the other side companies like Firefly and ITAB could never reach that level, hence it becomes an expensive way of financing.

5.3.3 Rejection of Issuers

The intermediaries agreed that they seldom or never reject a potential issuer. SEB explained that an important aspect for rejecting a potential issuer is the bank’s reputation. SEB states they do not mediate an issue they do not believe in, hence a company they would not want as a customer. The reason for this is if the issuing company later on defaults, SEB would be worse off the next time visiting the disappointed investors. SWB, on the other hand, seems to have a more open-minded view upon this and cannot recall that SWB has rejected any company recently.

It is hard to say if the intermediaries’ way of acting has any impact on the companies, concerning a potential rejection. The policy of Swedbank is to help all companies no matter what credit rating, SEB and SHB are a little more concerned about their reputation, and simultaneously they all agree that there are not many companies that request to issue bonds which cannot fulfill it.
5.3.4 Knowledge

SEB, SWB and SHB all believe that, in general, all issuing companies have sufficient knowledge of the process of issuing. Similar answers were given by Autoliv and SKF who claimed that knowledge was not a problem, besides the legal expertise sometimes needed in the process. Holmen also claims to have necessary knowledge to deal with bonds. Both FireFly and ITAB have little or none knowledge about bonds.

One can say that the overall knowledge among the intermediaries and large issuers is good. The larger issuers have almost similar knowledge as the intermediaries, hence they have much and long experience within the security markets. This differs considerably when comparing to the small and medium-sized companies. They do not possess sufficient knowledge about the market or bonds in general. We believe this is mainly due to their lack of interest in the market in combination with their insufficient need of cost efficient volumes.

5.3.5 Regulations and Documentation Requirements

As briefly described in chapter 2.7, the process of issuing bonds involves some regulations and documentation requirements. The fact that the issuing company is required to construct a comprehensive prospect, if the issue exceeds EUR 50 000, makes the bond market a bit less accessible for companies with a small need of capital. Although there are some exceptions to this requirement, we believe these regulations to be somewhat hindering the Swedish bond market. A possible increase of the 50 000 EUR-limit could make bonds more attractive for the firms with smaller needs of capital.

Another possible legal obstacle is a directive from the European Union, 2003/71/EG, which was introduced in 2004/2005. This directive have increased the requirements on the content of the prospect described above and most likely affected the issuing process in making it more expensive and time-consuming. Though, as the directive became effective only about two years ago, we believe it is still too early to draw any conclusions on how it has affected the Swedish bond market.

SEB explained that a set of new international accounting standards (IAS39) has affected the bond market recently. An example of this, he mentions, is that those regulations has made it more difficult to swap between different currencies. As a result of this, the foreign actors have increased their presence in the Swedish bond market.

5.3.6 Added Value

A major argument for using bonds, according to SKF, is that it incurs an added value, e.g. creating awareness in investors for SKF outside of Sweden by doing a road show before new bond issues. Our respondents that issue bonds all have different motivation for paying the relatively high price, such as Billerud’s argument of knowing the maturity and interest of the loan in beforehand, which could be seen as creation of added value.

“Bonds are a commodity for us” (SKF, personal communication, 2006-04-26)
One might question, however, if small or medium-sized companies could take complete advantage of those added values. Many of the benefits associated with issuing bonds only appears when certain criteria is fulfilled; e.g. large enough volume to keep costs low, enough intermediary trust for the company to issue the bonds by underwriting etc. Many companies may not even realize that there are added benefits by using bonds which could be illustrated by the fact that Firefly has a credit rating of AAA, and still do not use bonds, although the interest rate would be rather low because of the very low default risk.

6 Conclusions

This section will review the most important findings of the analysis and try to conclude the thesis with a brief discussion about the availability of the Swedish bond market. The chapter will end with some suggestions for further research.

One can draw the conclusion that the Swedish bond market in general is a bit underdeveloped, due to the lack of public information regarding the bonds, such as prices, outstanding bonds and interest rates. The market is dominated by a few large actors, who issue bonds and the investors usually hold the bonds until maturity. Most issuers are not concerned about the liquidity in the market and it does not seem to affect the decision of whether to issue bonds or not.

The bond market is closely connected to the business cycle, when there is a boom the liquidity is good, while in recession the liquidity is worse. Today the market is really good, 2005 is seen as one of the best years in a long time, according to SWB. At the moment the market is attractive enough to even catch the attention of foreign investors who constitutes a significant portion of the market. To summarize, the market situation is experiencing growth and the banks believe this trend to remain.

Small fish in a big sea

When focusing on the availability of capital through the bond market for companies, we got the impression from the empirical observations that it is hard to compare companies of different sizes. Large companies which have a history of using bonds considered it to be an efficient source of financing. Those companies have great access to the market, often through the use of multiple banks, and can extract added value such as diversification of debt, quickly borrow large amounts and other benefits such as SKF’s road show.

In the medium-sized companies, however, it is a completely different lay of the land. Although our selection is small and the interviews with the non-issuing companies relatively short, the notion we got from them was further strengthened by the interviews with the intermediaries. The intermediaries made it abundantly clear that it is all about the big mammoths in the market, since they provide volume.

As a matter of fact, it seems like volume is the most important reason to why medium-sized companies have limited availability to the market. With a recommended minimum issue of 50 millions SEK, many companies are excluded because they
simply do not have that large borrowing need. Also, start-up costs such as getting a credit rating and the required documentation might seem expensive and/or time consuming to a smaller company. Credit rating is often a good feature to possess, but it is not always necessary to access the bond market. An additional matter of concern is that for the credit rating to be beneficial when issuing bonds it should be of a rather high grade and meet the requirements of the intermediaries, otherwise it is just a waste of money.

Moreover, one can say that the general knowledge about bonds, among large issuing companies is good. On the contrary, we found a lack of knowledge in non issuing companies, which could partly be explained by the insufficient information given by the intermediaries. We believe the banks rather set up a beneficial bank loan than a complicating and time consuming bond issue, and hence there could be a conflict of interest. The large companies do not have any problem with knowledge and it does not affect the availability to the market, while it is a big factor to why smaller companies do not have similar access.

Finally, the market is constructed in such a way that once you are a “big fish”, you can enjoy all benefits of the bond market while the “small fish” often have to resort to the banks for financing needs.

6.1 Further Research

With the limited time, we could not analyze the bond market from all perspectives. We believe, with this in mind, it would be interesting to scrutinize the investors’ opinion of the availability further. An especially interesting topic could be to dissect what the small private investors’ level of interest is like and if there is a lack of products matching those possible needs.

Moreover, the legal matters and regulations are an important factor with large impact on the availability to the Swedish bond market, hence an interesting field of further in-depth research.

It could also be interesting to analyze and compare the US and UK market to the Swedish market in terms of size, structure, regulations and the impact of historical aspects.
References


Appendix 1 – Intermediary Interviews
SEB, SHB & Swedbank

Hur länge har du arbetat i banken och hur länge har du arbetat med obligationsmarknaden?

Hur ser det typiska företaget ut som använder sig av företagsobligationer/certifikat?

Vad finns det för fördelar med att emittera obligationer i jämförelse ett vanligt banklån?

Om man som företagare vill emittera obligationer, hur ser tillgången på information ut och vilken är den viktigaste informationen som företagaren informeras om vid en potentiell emission?

Upplever ni det som att de företag som använder sig av obligationer har tillräcklig kunskap inom ämnet?

Hur stora volymer emitteras idag genom er? Hur har utvecklingen varit det senaste decenniet?

Vilken kreditrating använder ni er av och varför?

Har ni något minimikrav på rating för att ett företag ska få emittera företagsobligationer/certifikat? Om ja, vad har ni för krav, t.ex. storlek, lönsamhet, emissionsbelopp m.m.?

Har denna ”ribba” sänkts eller höjts genom åren?

Vilka är de vanligaste orsakerna till att ni nekar en kund emission?
Små företag: Kunskap, rating, likviditet, emissionsbelopp
Exempel på företag?

Hur bedömer du att efterfrågan från emittentens perspektiv ser ut på företagsobligationsmarknaden idag?
Ser ni någon ökning av efterfrågan?

Hur ser kostnaderna ut för att emittera obligationer?

Ungefärlnigen, hur stor del av de obligationer ni emitterar kommer ut på SOX och hur stor del sker som Private Placements?

Ser ni några problem med sekundärmarknaden i Sverige, t.ex. likviditetsproblem? 
Upplever ni att de flesta företag som emitterar obligationer är nöjda? Vid sidan av bristande behov av kapital, vad är de vanligaste orsakerna till att företag väljer andra former av finansiering?
Appendix 2 – Issuer Interviews
Autoliv, Billerud, Holmen, SKF

Vilka olika finansieringsformer använder ni er av?

Vilken erfarenhet har ni av företagsobligationer?
- Hur länge har ni använt er av dem?
- År ett bra komplement till andra former av finansiering?
- Har tidigare emissioner motsvarat era förväntningar?

Hur stor del av era skulder är obligationer i dagsläget?

Vad har ni för kreditrating?

Vilken var huvudanledningen att ni började emittera obligationer? Var det något speciellt behov som behövdes fyllas el. dylikt?

Vilka fördelar/nackdelar ser ni med obligationer kontra banklån som finansieringsform?

Finns det några svårigheter (administration/regler/tid m.m.) med att emittera obligationer?

Väljer ni alltid samma typ av obligation, eller använder ni olika strukturer på obligationerna beroende på lånebehovet?

Vilken/vilka intermediär använder ni er av?

Vad har ni för kostnader i samband med emittering? Upplever ni att ni får valuta för pengarna?

Hur stor effekt/påverkan har intermediärerna (bankerna) för era emitteringsbeslut?

Anser ni att ni har tillräcklig kunskap om företagsobligationer för att tillgodogöra er fördelarna?

Hur viktigt är en fungerande andrahandsmarknad för er?

Hur upplever ni handeln/likviditeten på den existerande andrahandsmarknaden i Sverige?

Vilka problem och hinder upplever ni vid en emission av företagsobligationer?
Appendix 3 – Interviews with Potential Issuers
Firefly & ITAB

Hur länge har du arbetat i företaget?

Vilka olika finansieringsformer använder ni er av?

Är ni nöjda med era finansieringsformer?

Har ni något behov av att förnya ert sätt att låna pengar?

Har ni någonsin funderat på att använda er av obligationer som finansieringsform (om nej, varför inte)?

Har ni försökt att emittera obligationer? Om ja, varför gör ni det inte idag?

Om ni har haft det i åtanke, vad gjorde att ni inte valde det som finansieringsform? (begränsningar)

Hur anser ni att tillgängligheten till obligationsmarknaden är?

Vad har ni för kreditrating? Om ingen, varför?

Anser ni att ni har den kunskap som krävs för att emittera/handla med obligationer?

Skulle ni kunna tänka er att ställa ut en obligation på SOX eller annan marknad?

Vad har ni för intresse av en fungerande andrahandsmarknad?