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RESEARCH & ADVICE

Dirty Profits III – Methodology Note

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1 Methodology

This note describes the methodology used for collecting and analysing the financial information used for the Dirty Profits III study. The research focused on 25 controversial companies determined by Facing Finance, and 26 commercial and public banks.

1.1 Types of financing relationships

Banks can be involved in financing companies by providing corporate loans, by assisting companies with share- and bond issues, and by (managing) investments in shares and bonds of these companies. Below, these financing relationships are discussed in more detail:

1.1.1 Corporate loans

The easiest way to obtain debt is to borrow money. In most cases, money is borrowed from commercial banks. Loans can be either short-term or long-term in nature. Short-term loans (including trade credits, current accounts, leasing agreements, et cetera) have a maturity of less than a year. They are mostly used as working capital for day-to-day operations. Short-term debts are often provided by a single commercial bank, which does not ask for substantial guarantees from the company.
A long-term loan has a maturity of at least one year, but generally of three to ten years. Long-term corporate loans are in particular useful to finance expansion plans, which only generate rewards after some period of time. The proceeds of corporate loans can be used for all activities of the company. Often long-term loans are extended by a loan syndicate, which is a group of banks brought together by one or more arranging banks. The loan syndicate will only undersign the loan agreement if the company can provide certain guarantees that interest and repayments on the loan will be fulfilled.

1.1.2 Share issues

Issuing shares on the stock exchange gives a company the opportunity to increase its equity by attracting a large number of new shareholders or increase the equity from its existing shareholders.
When it’s the first time a company offers its shares on the stock exchange, this is called an Initial Public Offering (IPO). When a company’s shares are already traded on the stock exchange, this is called a secondary offering of additional shares.
To arrange an IPO or a secondary offering, a company needs the assistance of one or more (investment) banks, which will promote the shares and find shareholders. The role of investment banks in this process therefore is very important.

1.1.3 Bond issues

Issuing bonds can best be described as cutting a large loan into small pieces, and selling each piece separately. Bonds are issued on a large scale by governments, but also by corporations. Like shares, bonds are traded on the stock exchange. To issue bonds, a company needs the assistance of one or more (investment) banks which underwrite a certain amount of the bonds. Underwriting is in effect buying with the intention of selling to investors. Still, in case the investment bank fails to sell all bonds it has underwritten, it will end up owning the bonds.

1.1.4 (Managing) shareholdings

Banks can, through the funds they are managing, buy shares of a certain company. This provides the company with new equity, and gives the bank a direct influence on the company's strategy. The magnitude of this influence depends on the size of the shareholding.

1.1.5 (Managing) investments in bonds

Banks can also buy bonds of a certain company. The main difference between owning shares and bonds is that owner of a bond is not a co-owner of the issuing company; the owner is a creditor of the company. The buyer of each bond is entitled to repayment after a certain number of years, and to a certain interest during each of these years.

1.2 Data collection and analyses

Data was gathered from financial databases (Thomson ONE Banker, Bloomberg) on the loans, underwriting, shareholding and bondholding for the selected companies from January 2012 to August 2014.
For loans and underwriting, the amounts financed per bank had to be calculated if these were unknown in the source data. If the amounts per bank were known, these amounts were used. If the amounts were unknown, an estimate was used. The estimates are based on the following rules of thumb:

- In the case of loans (corporate loans or revolving credit facilities), 40% of the total amount is committed by bookrunners and 60% by other participants of the syndicate. If, however, the amount of bookrunners is (almost) equal to, or higher than, the amount of participants, the reverse is used: 60% for the bookrunners and 40% for the arrangers. So if there are for example 5 bookrunners and 4 participants and the amount of the loan is € 100, the estimate will be that the bookrunners commit 60% (€ 12 each) and the participants 40% (€ 10 each). The amount provided by bookrunners is always higher than the amount provided by participants;
- In the case of share- and bond issuances, 75% of the total amount is committed by bookrunners and 25% by other participants of the syndicate. The amount provided by bookrunners should always be higher than the amount provided by participants.
- In the case of share- and bondholdings, the amounts are always known, so no estimate was needed.

The analysis focused on the financiers selected by Facing Finance, other financial institutions were removed from the analysis.