Private-debt investing

Lenders of first resort

Investors are increasingly eager to lend to European firms directly

EAT, a British sandwich chain, was looking for £13m ($20m) last year to tart up its stores. It knew conventional banks would be hesitant to provide such a loan, given its existing debt. Worse, it would soon need to borrow more, to fund a rapid expansion. So it turned to Ardian, an investment firm, which lent it £40m, not just for the refurbishments, but also to refinance its existing debt and to open 90 new stores.

Although Ardian is charging a heady 15% interest rate, says Strahan Wilson of EAT, it is much less bureaucratic and more flexible than a bank. That has allowed EAT to expand 12-18 months faster than it otherwise could have. What is more, he adds, "Now that we've established this relationship with Ardian, if we need more capital we need only ask."

The easiest way for institutional investors to lend to companies is to buy bonds. Many also buy loans originated by banks and repackaged into securities, or invest in funds that purchase non-performing loans from banks. Before the financial crisis American funds began investing in private debt, as opposed to the sort available publicly on the bond markets. This involves providing credit directly to firms that either cannot borrow from banks and bond markets or do not like the terms.

It is in Europe that private debt funds have been proliferating recently (see chart). European businesses depend heavily on banks, but changes in capital rules have made it relatively expensive for banks to lend to them. Securitisation, meanwhile, earned a bad name during the financial crisis. S&P, a rating agency, estimates that middling European firms will need around €3 trillion ($3.3 trillion) in new loans over the next five years.

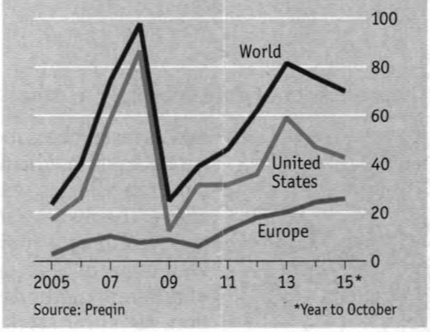
Money managers are eager to fill the gap: $70 billion has already been raised for private debt this year, says Preqin, a data provider ($2.2 billion of it by Ardian). Pension funds and insurers like private debt because returns tend to be much higher than in the bond markets; Pitchbook, a data provider, says yields of 9-12% have been typical in recent years.

That cannot last. For one thing, the market has yet to be tested by widespread defaults. Interest in private debt in America has waned in recent years as intense competition has driven down returns. "We're getting better returns in Europe than in America for taking on the same risks," says Jim Blakemore of GreenOak, which lends to property developers. But Europe seems to be heading the same way. The average fund raised this year is three times bigger than in 2008. Smaller, specialist funds are also springing up in niches such as healthcare or aeroplane finance.

It does not help that most lending so far has been to firms backed by private equity, such as EAT. Many of the conservative, family-owned European companies that are short of credit still would not dream of borrowing from anything but a bank. How fast that changes will determine the industry's fortunes. ■

European dawn

Capital raised by private debt funds, $bn



Source: Preqin

*Year to October

Credit unions

Winning converts

A venerable form of banking comes back into fashion

THERE is a proselytising feel to the credit-union movement. Believers talk of a "social mission": to serve communities, not the false gods of the stockmarket. Today, this creed is winning more converts than ever before. Globally, the number of people in credit unions has doubled since 2000, from 108m to 217m. Savings are up by 130% in real terms (see chart).

Credit unions first appeared in 19th century Germany. Like banks, they took deposits and made loans. But, crucially, they were owned by their members, who shared a "common bond", such as a profession or place of residence. Earnings were returned to members in the form of better interest rates.

In Europe, most of these early institutions evolved into co-operative networks, such as DZ Bank in Germany and Rabobank of the Netherlands, which are still owned by members but no longer serve a particular group. Elsewhere, the requirement for a common bond endures: Partners Federal Credit Union, for example, is open only to employees of Walt Disney and their families. Fully 39% of American adults belong to a credit union, up from 36% a decade ago—an increase of 14m. In Australia, another stronghold, 24% do.

Three forces are driving the growth of credit unions. The first is simple: they offer higher rates than banks to savers and lower rates to borrowers. American credit unions charge an average rate of 2.66% on a three-year used-car loan, against 5.13% for banks, according to SNL Financial, a research company. Credit unions also outscore banks in customer satisfaction surveys in America, Canada and elsewhere.

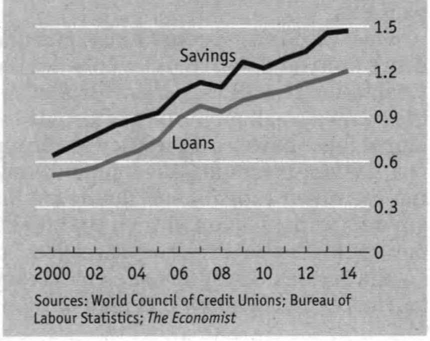
A second factor is the financial crisis. Some credit unions failed; "corporate" ones, which pool and reinvest the funds of individual credit unions, were especially badly hit. But, in general, credit unions were more resilient than banks, says a report published in 2013 by the International Labour Organisation. Without the same pressure to chase short-term profit, they took fewer risks. As the big banks were hit by failure and scandal, credit unions presented themselves as a more wholesome alternative. That boosted membership, especially among the young.

The third cause of growth is more lasting, argues Bill Hampel of the Credit Union National Association, an American industry group. In America, legal changes have allowed for multiple "common bonds", helping credit unions to merge. Big credit unions are now professional operations with nationwide ATM networks and a wide range of products: the Navy Federal Credit Union, which serves American sailors and soldiers, has nearly 6m members. All this makes credit unions easier to join, and more convenient to use.

This brings them into closer competition with banks. In America, bankers complain loudly about credit unions' exemption from federal income tax. But even in Australia, where they don't enjoy the same tax breaks, credit unions still offer competitive rates, according to data from Canstar, a research company. Happily for banks, though, the very thing that makes credit unions different also hampers their growth: they cannot raise equity. ■

Blessed union

Global credit unions, 2014$ trn



Sources: World Council of Credit Unions; Bureau of Labour Statistics; *The Economist*