

## THE EVOLUTION AND CHARACTERISTICS OF CONSORTIUM FINANCING

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**Abstract:** *The results of this structural analysis of the loan portfolio, by activity sectors, by terms and granting currency, allows the identification of the bank's financing priorities. Consortium or syndicated loan represents a variety of bank credit, which is granted by a group of banks brought together in a banking consortium or syndicate. In this paper are presented: the historical evolution, classification and characteristics of consortium loans. The main advantages of consortium lending over other lending facilities are addressed. Banks participating in consortium on syndicated loans do not face systemic risk. The following scientific research methods were used for this analysis: data collection, classification, systematization, comparison, analysis and synthesis, induction and deduction, generalization, scientific abstraction. In Romania, the consortium or syndicated loan market is expanding.*

**Key words:** *consortium or syndicated loan, banking consortium, commercial banks, systemic risk, loan portfolio*

### INTRODUCTION

Consortium or syndicated loans are a very important source of financing, both international and national, proving to be an efficient and at the same time a flexible resource for risk distribution.

The historical evolution of syndicated loans proves once again that large projects and large-scale investments that require a large volume of capital can be obtained only through the unitary support of banks, brought together in a banking consortium or syndicate. Thus, through a syndicated financing solution, the entire source of funds necessary for business development can be obtained at lower costs for the company.

Banks participating in a syndicated loan agreement also enjoy the advantage of dispersing bank credit risk, as well as a more consistent gain in interest and fees, in a single transaction, given that the amount provided is much higher than the average of the classic loans granted individually [3].

In Romania, the consortium or syndicated credit market is expanding. The acute capital needs of customers to meet the increasingly sophisticated requirements for the development of large-scale business, involves different types of financial institutions. They must make available to customers very large amounts of money.

The following important stages are distinguished in the historical evolution of syndicated or consortium loans [13]:

➤ *The beginning of the 19th century – first syndicated lending transactions*

In the 19th century, companies' development projects became more and more complex, thus determining an increase of the costs of these projects which led to a greater need for financing. At one point, banking institutions had to declare themselves unprepared to meet the demands to cover individually and directly the requests of their customers. Thereby came the idea of associating some banks to grant a loan of higher value. In the beginning, several loans were granted in a divisible manner and secured by a joint mortgage, these mortgage loans representing the primary form of the multi-creditor loan developed in the form of split mortgage loans.

➤ *The end of the 19th century – the spatial landmark in the emergence of syndicated loans*

In Europe, London can be considered the main spatial landmark in the emergence of syndicated loans. At the end of the 19th century, out of the world's 25 largest banks, 10 originated in the UK, based in London, and in a ranking of the largest banks in the world by the size of their own capital, London City & Midland Bank held the first position, due to the fact that at that time the United Kingdom was the epicenter of the industrial revolution. Among the banks that grant such loans were the so-called London merchant banks, which in the rest of Europe were found under the name of “private banks”.

In the United States, the emergence of large real estate projects, which required substantial capital infusions, over a financing period of at least 10 years, has generated an association of several banks in order to be able to offer integrated financing and to disperse the risk of a large loan among creditors.

➤ *The years 1929 – 1930- appear the first problems in the banking system*

Between 1929 and 1930, the Great Economic Crisis caused the first problems in the banking system, with a setback on syndicated loan. The real estate sector developed and financed by loans provided by associations between banks has decreased greatly, both in market value and in assets that generated substantial revenues. Due to the destabilization created by the Great Depression, in the '40s and '50s, the main consumers of syndicated loans were the States.

➤ *The 1970s – increasing demand for syndicated loans*

Around the '70s, the growing demand for syndicated loans allowed commercial banks to associate in so-called business banks. Thus in 1977, there were 7 syndicated loans whose individual value was equal to or exceeded 1 billion dollars.

➤ *The 1980s – strengthening supply and demand*

In the '80s, the global syndicated credit market skyrocketed to approximately 500 billion dollars. However, the banks were faced with further attempts due to default, rescheduling or even write-offs of debts contracted by States through syndicated financing.

Towards the end of the 1980s, banks began to reorient themselves towards the borrower, so that if in 1983 sovereign states were the main consumer of syndicated loans, corporate loans were not a significant component of the market, at the end of the decade, the corporate sector represented 90% of the total credit facilities employed.

➤ *The 1990s – rethinking risk standards*

In the 1990s, due to the debt crisis, banks reconsidered more complex risk standards applicable to large corporations in industrialized countries, which intensified their need for syndicated loans. This form of financing has been a flexible source of funds that can be obtained in a relatively short time and on which they can rely to complement other sources of external financing such as shares or bonds [14].

➤ *The 2000s – new compliance requirements*

The emergence of a new debt crisis in the euro area, political and economic tensions in North Africa and the Middle East in 2011 have shaken the syndicated loan market. Obviously, in the current political and economic context, the lending sector is also affected by the implementation of the new Basel III agreement, since 2013 [2]. It imposes new compliance requirements on banks. As a result, the lack of appetite for credit and the tightening of lending policies will mean that prices will continue their upward trajectory, and the demand for syndicated loans will continue downward.

## MATERIALS AND METHODS

The following scientific research methods were used for this analysis: data collection, classification, systematization, comparison, analysis and synthesis, induction and deduction, generalization, scientific abstraction.

In the research carried out, the characteristics of the consortium loan were identified, systematized, compared and analyzed. The classification criteria, as well as the types of consortium loans granted by commercial banks were identified. The advantages offered by financing through these types of syndicated or consortium loans are also highlighted for both companies and financial institutions.

### *Characteristics of syndicated or consortium loans*

The main characteristic of the consortium loan is the direct legal relationship with the debtor of each member of the banking syndicate, which participates in granting the financing. Even if there is only one credit agreement and the negotiation is carried out only by the leader – the coordinating bank, each participant in the group who contributes to the borrowed amount, will receive an interest fraction proportional to the allocated amount. The coordinating bank is mandated by the client to collect from the market the amount necessary for the requested financing, in the terms and conditions imposed by him [1].

All participants, including the main managing institution, report their share of the loan granted to the debtor to the balance sheet assets.

*The classification of syndicated loans* can be done according to several criteria, respectively:

1. *From the point of view of the coverage area*, syndicated loans can be:

- National syndicated loans;
- International syndicated loans.

The difference between national and international syndicated loans is that the premiums do not involve very large amounts and have fewer banks in their composition, also the documentation is easier to prepare, given that all banks are part of the same jurisdiction.

2. *From the point of view of destination*, syndicated loans can be:

- Fixed-term syndicated loans for working capital;
- Syndicated loans for acquisitions with the provision of working capital.

3. *In terms of the time limit for granting*, syndicated loans are classified into the following categories:

- Term loan facility;
- Revolving or renewable loan facility.

The *term loan facility* provides the applicant entity with a sum of money for a period of 3, 6 months or 1 year, after which this amount is reimbursed at maturity.

The *revolving loan facility* is a very flexible form and often responds better to customer's needs, so it can be structured in various forms and can be likened to a corporate credit card. In this case, the loan can be used in installments.

Syndicated or consortium loans can be granted in lei and currency (euro, USD, or another currency, depending on the needs).

*The advantages of granting syndicated or consortium loans* can be addressed in two areas, respectively: for companies and for financial institutions.

*For companies*, the advantages of accessing a syndicated loan are as follows:

▪ *Ensures a good business with a professional team.* Attracting consistent funds in conditions that are as favorable as possible for its clients, actively involves the coordinating bank in planning the collaboration process with banking partners, from the initiation of the framework contract, until the availability of the funds.

▪ *Provides funding from a single source.* As the need for financing increases, the

administration of loan agreements becomes more laborious and expensive. If the financing is combined under a single loan agreement, the companies can simplify their management, benefiting from a uniform approach and predictability in long-term financing [12].

- *Allows financing for growing businesses.* Developing the business of corporate companies involves a high demand for liquidity. In order to have funds at hand whenever needed, companies simply access sources of financing for working capital at the coordinating bank (leader) as a banking partner. Thus, the expanding financial stability of companies for their investments and large projects is ensured [6].

- *For financial institutions,* the advantages of granting a syndicated loan are:

- *Allows the bank to avoid the risk of a commitment.* The main benefit of the syndicated loan from the lender’s perspective is that it allows the bank to avoid the risk of a too high commitment to a single borrower, so it is dispersed between the banks participating in the syndicate. Sometimes loans are so large that the borrower's failure to pay the debt would undermine the financial stability of a single banking institution [10].

- *Commissions and interest due to banks.* Banks that are attracted to syndicated credit agreements obtain various commissions after exercising their role in the process of syndicating the loan [15]. The commission is in addition to the interest or other fees that the bank may obtain from participating in the union. A successfully arranged and concluded syndicated credit agreement can increase reputation over other lenders, as well as current and future customers of the bank.

- *Obtaining state guarantees.* Sometimes there is the possibility of granting guarantees from the state, if the investment project is one of major importance for citizens.

Syndicated or consortium loans are included in the category of corporate banking products, in the banking products and services portfolio of commercial banks.

## RESEARCH RESULTS

**Table 1.**

### Comparative analysis between syndicated loan and other types of loans

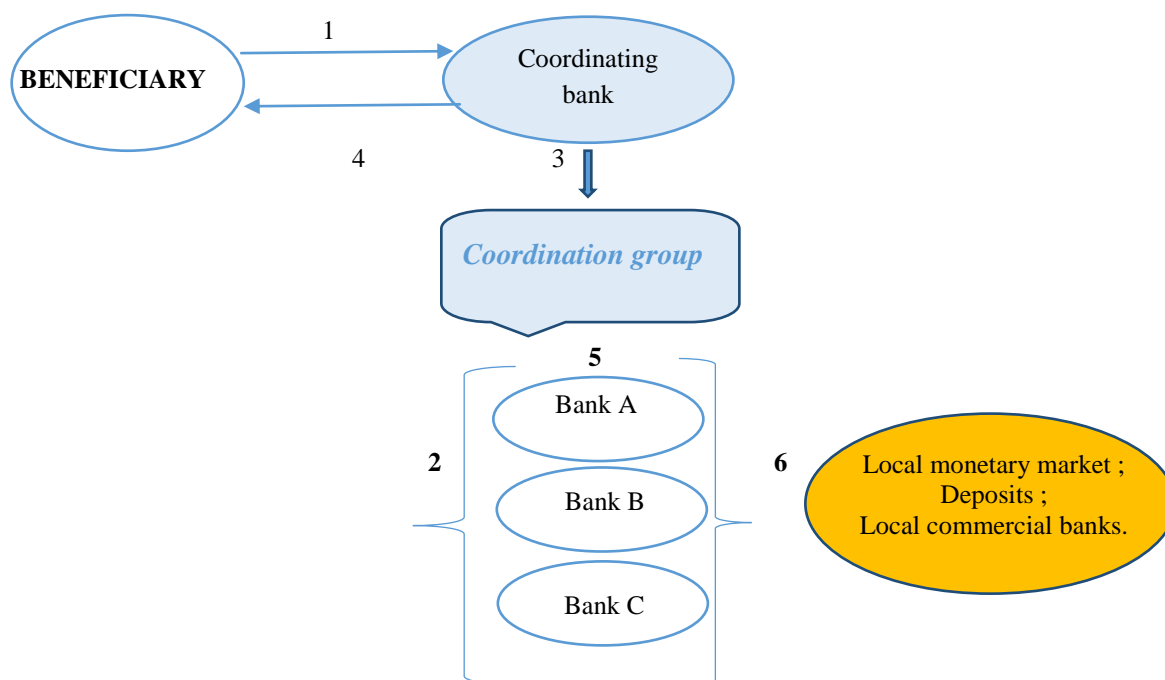
Syndicated loans	Other loans
<p><b>The Contracting Parties</b></p> <ul style="list-style-type: none"> <li>- The arranger or the bank authorized by the client to organize the financing.</li> <li>- The syndication agent or the bank acting on behalf of all banks participating in granting the loan.</li> <li>- Creditors - banks that commit to provide the funds made available to the borrower.</li> <li>- The borrowe</li> </ul>	<p><b>The Contracting Parties</b></p> <ul style="list-style-type: none"> <li>- The lender - the bank that provides the loan financing.</li> <li>- The borrowe</li> </ul>
<p><b>Loan granting</b></p> <ul style="list-style-type: none"> <li>- The loan is granted by a banking consorciu</li> </ul>	<p><b>Loan granting</b></p> <ul style="list-style-type: none"> <li>- The loan is granted by a single ban</li> </ul>
<p><b>Loan value</b></p> <ul style="list-style-type: none"> <li>- Allocation of financial resources with a very large volume for the needs of companie</li> </ul>	<p><b>Loan value</b></p> <ul style="list-style-type: none"> <li>- The financial resources allocated are weighted for companie</li> </ul>
<p><b>Dispersion of banking risk</b></p> <ul style="list-style-type: none"> <li>- The bank risk is divided between the banks participating in the allocation of fund</li> </ul>	<p><b>Dispersion of banking risk</b></p> <ul style="list-style-type: none"> <li>- Bank risk is the responsibility of a single ban</li> </ul>
<p><b>By the coverage area where the loan is used</b></p> <ul style="list-style-type: none"> <li>- national loan</li> <li>- international loan</li> </ul>	<p><b>By the coverage area where the loan is used</b></p> <ul style="list-style-type: none"> <li>- national loan</li> </ul>

Source: Lending rules of commercial banks (own processing)

If we make a comparative analysis between the syndicated loan and other categories of loans, from the perspective of the contracting parties, the method of granting, the loan value, the dispersion of banking risk and the coverage area where the loan is used, the situation is as in the Table 1.

As can be seen, syndicated loans have applicability to a smaller category of companies, in this case to the corporate ones, which have a large volume of turnover and need a lot of funding, compared to the other loans that can be granted for companies with lower turnovers and moderate financing needs [9].

The stages of a syndicated loan are presented in the Figure 1.



**Figure 1. Stages of the syndicated loan**

*Source: Lending rules of commercial banks (own processing).*

Legend:

- 1 - Concluding a credit agreement with a prestigious bank - coordinating bank;
- 2 - Establishment of the banking consortium;
- 3 - Establishment of the coordination group;
- 4 - Establishing credit conditions;
- 5 - Establishing the amounts subscribed by the banks in the banking consortium;
- 6 - Attracting money from the monetary market, deposits, private investors or commercial banks.

The coordinating bank has a major role to play in carrying out a syndicated or consortium loan, mainly in setting up the banking consortium.

The research carried out, following the analysis of the corporate loan portfolio, shows the following elements which are set out in the Table 2.

According to the monthly reports sent to the National Bank of Romania by the commercial banks in Romania, the table presented above shows the sector of activity with the highest share of syndicated loan financing. This is trade, and the predominant currency in which this loan is granted is the national currency, respectively Lei.

**Table 2.**  
**Corporate loan portfolio at a commercial bank from Romania on 31.10.2019**  
 million

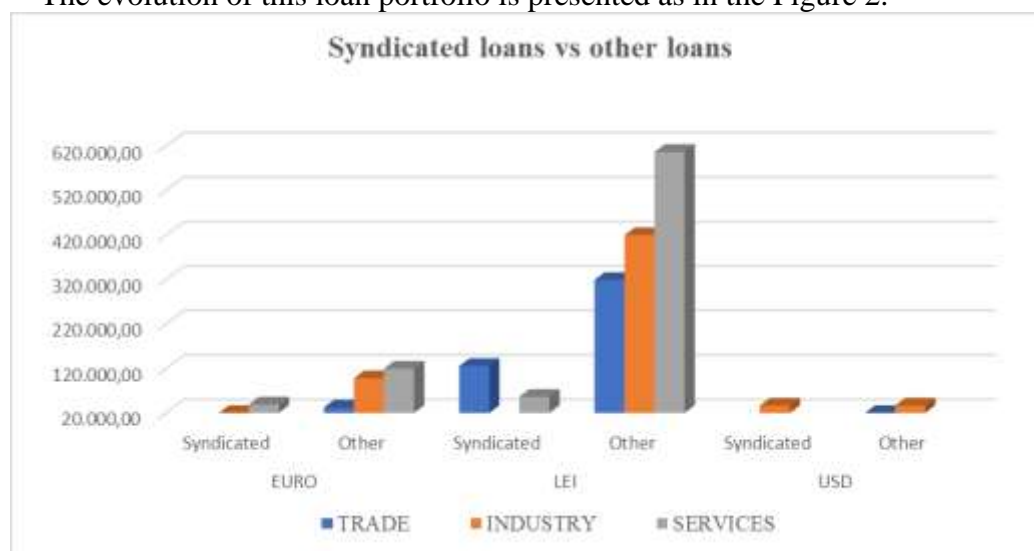
Loans to Legal Entities Activity sector	EURO		LEI		USD	
	Syndicated	Other	Syndicated	Other	Syndicated	Other
<b>TRADE</b>		<b>32,299.32</b>	<b>125,434.51</b>	<b>318,947.47</b>		<b>895.14</b>
long term		8,606.47	87,258.42	124,231.63		
medium term		5,002.14	7,518.80	34,669.67		
short term		18,690.71	30,657.29	160,046.17		895.14
<b>INDUSTRY</b>	<b>9,276.23</b>	<b>98,129.36</b>		<b>419,831.53</b>	<b>36,616.24</b>	<b>36,778.79</b>
long term	5,427.00	30,858.65		69,721.83	21,272.73	21272.73
medium term		38,836.32		134,298.47	9,540.18	9540.18
short term	3,849.23	28,434.39		215,811.23	5,803.33	5965.88
<b>SERVICES</b>	<b>39,114.96</b>	<b>119,704.77</b>	<b>56,250.00</b>	<b>606,970.28</b>		
long term		54,338.47		136,928.43		
medium term	39,114.96	60,073.90	56,250.00	407,253.65		
short term		5,292.40		62,788.20		
<b>GRAND TOTAL</b>	<b>48,391.19</b>	<b>250,133.45</b>	<b>181,684.51</b>	<b>1,345,749.28</b>	<b>36,616.24</b>	<b>37,673.93</b>

Source: [www.bnr.ro](http://www.bnr.ro) (own processing)

Regarding the financing term, long term syndicated loans predominate, which indicates that the implementation of long-term, reliable projects with a long execution time is desired.

The industry sector in our country is more focused on financing with other types of loans for current activity or investments [11]. Syndicated loans are relatively little accessed by this sector, which shows us that the industry is not so well organized in holdings, it does not have large-scale joint projects that require large financial resources.

The evolution of this loan portfolio is presented as in the Figure 2.



**Figure 2. The evolution of syndicated loans compared to other categories of loans for legal entities**

Source: [www.bnr.ro](http://www.bnr.ro) (Own processing according to the data in Table 2)

The figure above shows that the largest share in the loan portfolio is occupied by loans granted in lei, outside the financing consortia, followed by syndicated or consortium loans in lei. Loans granted in Euro or USD have a much smaller share in the total loan portfolio managed by the bank.

This structural analysis of the loan portfolio, by activity sectors, by terms and granting currency, allows the identification of the bank's financing priorities.

### CONCLUSIONS

Consortium or syndicated loans are transactions with a large volume of cash resources. These transactions require high exposure, so prestige and publicity are natural consequences of banks' participation in this type of agreement.

A successfully arranged and concluded consortium loan agreement can increase the reputation over other lenders in the market, as well as current and future customers of the bank [7]. Any member of a successful syndication will strengthen his image by being part of a respectable group of lenders.

Participation in a syndicated loan is also a good opportunity for some banks to reduce their advertising costs, by being able to expose themselves in countries or sectors that do not belong to their field of expertise or where they do not have an establishment.

Even if the Romanian legislation does not contain express provisions regarding syndicated loan agreements, they are drafted in English. The contracts regarding the guarantee on the debtor's and the guarantor's assets located on the Romanian territory will be constituted according to the Romanian law.

The risk dispersed on each bank participating in the syndicated loan makes this corporate lending facility for corporations safer [4]. Thus, banks participating in consortium in syndicated loans do not face systemic risk [5].

The lending rules for consortium or syndicated loans also comply with the regulations of the National Bank of Romania, regarding the maximum exposure to a single debtor. A credit institution's exposure to a customer or group of connected customers represents a high exposure if its value is equal to or exceeds 10% of the credit institution's own funds [8].

It is not at all negligible that by getting involved in creating a syndicated loan, its members can form long-term business relationships between themselves. A good business relationship between an arrangement with a significant market share and a bank participating in the financing consortium may give the latter the opportunity to be invited to take part in other future arrangements.

Syndicated or consortium loans represent important sources of financing offered by commercial banks within the Romanian banking system.

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