Loan Stock

An Information Paper

by Co-operative Assistance Network Limited, November 2013

1. **Definition**: Loan stock is stock issued in exchange for a loan. Since any corporate body is legally entitled to enter into a loan agreement with any individual or corporate body loan stock is simply a means of doing this in a way which:
    1. makes it simple, standardised and routine rather than re-inventing the wheel each time a loan agreement is negotiated with each individual
    2. breaks up the borrowing requirement into smaller chunks that supporters can afford
    3. ensures, transparently, that each investor gets the same deal
    4. It is issued for a fixed term (commonly 5 years)
    5. With a start date and an end date
    6. With a fixed rate of interest (sometimes optional... an investor can decide to forgo)
    7. Capital and interest repayable at the end of the loan – which is why it is often called "bullet stock" - at the end of the period the stock all falls due at the same time "firing a bullet" at the financial heart of the organisation.
    8. Therefore it is important to have a strategy in place – either the enterprise is capable of making (and saving) the profits required to be cash rich enough on that day to repay, or it must successfully issue more stock in advance of the maturity date or obtain other inward investment (never easy to raise debt to repay debt – even some nation governments have not been able to pull this off recently) or be sure that a significant proportion of the loan stock holders will be prepared to re-invest at the end of the period.
2. **It is completely legal** to issue loan stock provided that
    1. it is in compliance with the Rules or Articles of the corporate body concerned (they say you can do it)
    2. it is done in the right way (read on)
3. **Public or Private**: With any mechanism offering opportunity to invest, including loan stock, the first thing to consider is: is this a public issue (open to any) or a private issue (open only to an identifiable – preferable nameable – group of people with an identifiable reason why they might want to support the enterprise above and beyond merely wishing to make a profit)
    1. If it is to be public then the issuing enterprise has to advertise the opportunity, issue a prospectus, provide a business plan, answer questions from potential investors and generally spend a lot of time and money (but opens the investment opportunity up to a wider audience).
    2. If it is to be private then the market for the stock is much more constrained and (since the default is that the loan stock issue is public) the issuing enterprise should have written down and stated a good answer to the question "to whom is this private"
4. **Convertible or Unsecured**
    1. Convertible means that in the event of the issuing organisation not being able to repay the loan on the due date, or any other circumstances agreed in

advance or during the loan period, such as the accounts showing insolvency the loan is exchanged for something else. This is often shares in the business but potentially a lien or charge) on some other asset such as a license, a design, a building. Any such arrangement should be declared to the relevant regulator as a mortgage or charge against an asset.

2. Unsecured means that the loan has no security other than that offered to any trade creditor. So that, if the business fails it is liquidated and any remaining assets are distributed among the unsecured creditors when and if the better secured creditors have taken their due. In practice the cost of liquidation of a small company usually exceeds its asset value and there is nothing left for people holding loan stock.

5. **What you need to do.**

    1. Decide whether this is to be a public or private issue.
    2. Decide whether it is to be convertible or unsecured.
    3. If it is to be public and/or convertible then the sums and complexities involved mean that you should seek technical support for each individual case.
    4. If it is to be a private and unsecured issue:
        1. identify how much you need to raise, and how long it will take to accumulate profits with which to repay them. (see information paper “Business Plan”)
        2. identify the audience, the people who are the “community of interest” who have a legitimate connection or reason to support the enterprise or its particular project.
        3. Decide an issue date, early enough to be useful, far enough away to communicate to your audience.
        4. Decide what you will do in the event of there being more applications than you need (first come first served works well)
        5. Decide what you will do in the event of there being fewer applications than you need (remember that you have said that you will proceed with a business plan so going ahead on a wing and a prayer without the resources to follow that plan but instead employing some higher risk strategy with lenders' money should not be an option).
        6. Decide your promotional message, your sales pitch.
        7. Go through all the above and simplify all of it a lot
        8. Communicate your promotional message to your audience and make the business plan and any other relevant and really important documentation available to them. You may wish to make this subject to application and guarantee of confidentiality (see paper “confidentiality agreements”) or you may not.
        9. Accompany the promotional message with some mechanism (a reply paid envelope and a form works well) by which people can apply for stock.
        10. Issue the stock on the chosen date with a request for immediate payment.
        11. Continue to communicate with the stock holders, assure them that you are carrying out the plan and encouraging their ongoing support through purchasing, promotion, networking........... (well, it is their money).