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As Virus Hobbles Economy, Companies Race to Tap Credit and Raise Cash

The clamor for corporate funding is raising concerns about a financial reckoning reminiscent of 2008.

By Kate Kelly and Peter Eavis

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In a single week in March, as financial markets convulsed and major parts of the economy began shutting down, banks made over $240 billion in new loans to companies — twice as much in new lending as they would ordinarily extend in a full year.

Brian Foran, an analyst at Autonomous, a research firm that did the calculations, initially thought it was a typo. "That's really an unprecedented figure," he said. "I've never seen anything like it."

American companies are reeling from the body blow dealt by the pandemic. As revenues dwindle, travel slows and production lines halt, companies have begun to furlough or lay off employees, slash investment in operations and buy less from their suppliers. With no way to tell when the economy will restart, they are racing to conserve money and tap as much credit as possible.

The new reality, say bankers and analysts, will be tough for companies that had grown accustomed to the easy money of the past decade. Enticed by ultralow interest rates, they borrowed trillions of dollars in new debt in the belief that banks would keep lending and the debt markets would always be open. Now many indebted companies, even those whose business has not taken a direct hit from the outbreak, are finding that they have to adapt to an era in which cash is suddenly much harder to raise.

Carlos Hernandez, the chairman of JPMorgan Chase's investment banking business, recently told clients and colleagues that the economic shutdown caused by the pandemic could prompt the sort of brutal reckoning for corporate America that banks went through after the 2008 financial crisis.

Mr. Hernandez, from his perch at the nation's biggest lender, is seeing the potential crisis unfold firsthand, as his bank and others get bombarded with loan requests from companies stocking up on cash. Banks are still lending, but these are bloodcurdling times for corporations.

Consumers "are not spending money on a long list of things," said Susie Scher, co-head of the financing group at Goldman Sachs. "If you sell or service that long list of things, if you had a weaker balance sheet to begin with, you're going to find yourself in a deteriorating liquidity position as the economic crisis goes on," she said, referring to a position from which obtaining cash is difficult.

Already, a divide among haves and have-nots is emerging in corporate America, tied to how cheaply and easily companies can get credit. Seeing this, Congress moved quickly in recent legislation to funnel emergency loans into the United States economy. Still, some types of companies could be shut out entirely from a multitrillion-dollar loan program lawmakers just set up, unless the Federal Reserve relaxes its own rules.

Companies that are rated investment grade — meaning that they are the least likely to default on their debts — are having an easier time borrowing from banks or by selling bonds directly to investors via the public markets. Among those, Exxon, Disney and McDonald's have all ventured into the turbulent markets to sell bonds to public investors recently.

But companies with lower credit ratings, which make up a significant share of all big companies and include household names like Ford and Macy's, could find the public markets more expensive. Yum Brands, which has a relatively low, or "junk," credit rating, set its interest rate at 7.75 percent on the corporate bonds it sold Monday, nearly twice what it was paying a month ago.

Yum, which owns KFC and Taco Bell, expanded its offering to $600 million from the originally planned $500 million based on strong investor demand, but it may be among the lucky ones. Lower-rated companies play a huge role in the economy. Half of the 1,148 companies in the Russell 3000 stock index that have ratings are below investment grade, according to calculations based on data from CapitalIQ. Last year, these companies employed more than six million people and had revenue of $2.7 trillion.

To shore up their cash flow, hundreds of companies have chosen to draw from credit lines that banks agreed years ago to make available. Ford, which is still paying back a loan from the federal government made over a decade ago, last week tapped a $15 billion credit line; General Motors has said it would draw down $16 billion. Both have halted North American car production but are repurposing plants and workers to manufacture emergency batches of ventilators to undersupplied hospitals. Macy's, which said it would furlough most employees, drew down a $1.5 billion credit line in March.

Even as Mr. Hernandez and other longtime Wall Street executives predict a seismic shift in the way corporations handle financing, their banks — which reduced their own dependency on borrowed money and bolstered their access to cash as a result of new regulations enacted after the financial crisis — continue to lend.

Between March 11 and March 18, bank lending surged by $243 billion to a total of $4.1 trillion, according to Mr. Foran, the analyst, who added that the increase occurred as companies tapped the credit they were already entitled to receive from banks as part of prior agreements. Consumer discretionary companies — coffee shop chains, shoemakers, car companies and other nonessential service providers — constituted by far the single-largest proportion of businesses borrowing money from banks, Autonomous noted in a recent report, a direct consequence of the sudden slide in their revenue from virus containment efforts. Industrial companies and real-estate firms, the firm reported, were the second- and third-largest users.

During the week ending March 18, the most recent week for which data is available, JPMorgan was the most active provider of financing, playing a leading role in an estimated $78 billion worth of credit facilities that were drawn down, according to figures tracked by Standard & Poor's and Autonomous. Bank of America lent from an estimated $31 billion pool of credit. The companies appear to be putting the cash they draw down back in the banks.

Still, some banks have balked at the raft of requests, say market participants — especially those coming from apparently healthy companies with high credit ratings that appear to be drawing down lines of credit largely to burnish their balance sheets in case of future problems.

The revolving lines of credit that many companies have "are there as a theoretical safety net," said David Topper, a senior adviser at the private equity firm General Atlantic and former capital-markets executive at JPMorgan. "You're not supposed to draw them."

Banks are encouraging corporate clients to avoid drawing on bank credit and instead look to public-market financing, Mr. Topper added. "They've said, 'Look, we know you need money, and we're willing to lend to you, but let's do it on market terms,'" he said. In other words, banks are pushing companies to consider bond offerings — which cost companies more, both in interest payments to investors and banking fees — instead of drawing their credit lines, for which they pay the banks far less. Companies are willing to take that advice, Mr. Topper said, because they want to preserve relationships with lenders.

Nonetheless, some companies are both drawing on credit lines and raising cash through the public markets in preparation for the uncertainty that lies ahead. McDonald's, for one, has drawn down $1 billion in credit from JPMorgan and other banks and also sold $3.5 billion in public bonds to counter the fact that "the negative financial impact to our results cannot be reasonably estimated" but may be "material," according to a regulatory filing.

On Tuesday the embattled cruise operator Carnival Corporation began a $6 billion effort to raise cash from sales of stock, bonds and other securities. In a reflection of its current straits, Carnival, which has already drawn on bank credit lines, was selling some of those bonds with a suggested 12.5 percent interest payment to investors.

Congress's recent rescue package may fail to close the gap opening up between top-rated companies and those further down the credit scale, making it harder for the economy to recover and for hiring to bounce back. Also, the fraying economy could wallop companies before government agencies can get vast new loan programs set up — a process widely expected to take until mid- or late April, if not longer, for some programs.

The legislation gives the Fed backing from the Treasury Department to provide an estimated $4 trillion of financing to corporations and other borrowers. It does not explicitly rule out lending to companies with ratings below investment grade, but restrictions on the Fed could lead to that outcome. Companies receiving an emergency loan from the Fed can't be insolvent, and the central bank has to make sure that it has sufficient collateral to back its loans.

The Fed can create some leeway by tweaking rules written after Congress overhauled the emergency lending laws in 2010, some Fed scholars say. One rule — which requires a company to be current on "undisputed debts" in the 90 days before an emergency loan program — would disqualify many companies right now because they've stopped paying some bills to stay afloat, said Peter Conti-Brown, assistant professor at the Wharton School of the University of Pennsylvania.

"The Fed has to violate its own regulations or turn down the very businesses that are most in need of its interventions," he said. "The good news is the Fed can abandon that rule."

The Fed tries to avoid taking any losses on its loans, a real risk when lending to lower-rated companies — although sufficient protection from the Treasury against any losses might make it easier for the central bank to lend to such companies.

When deciding whether to lend to more fragile industries, the Fed must also contend with criticism from Congress that it is bailing out groups of companies with self-inflicted wounds and opening taxpayers up to the risk of big losses. The central bank could shield against losses and criticism by taking significant equity stakes in risky companies, said Skanda Amarnath at Employ America, a left-leaning group that seeks to influence the Fed.

“The question is whether the Fed is feeling aggressive enough to exercise its authority or afraid of the politics and the blowback,” Mr. Amarnath said.

Jeanna Smialek contributed reporting.