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Barclays suffered a massive impact with the crisis particularly on their shareholder's eyes even though operation wise they managed to preserve consistent results

Was Barclays under Financial Distress in 2008?

Crisis Impact



- **Exposure to U.S. Housing Market Collpase:** Barclays was vulnerable to the overall fallout from the U.S. housing market collapse. The resulting market instability and decline in asse value affected Barclay's financial standing
- **Stock Price Decline:** Barclays' share price, which was 700 pence in 2007, fell dramatically to 215 pence by October 12 in 2008
- **Global Financial Turmoil:** Barclays' international presence, particularly in the New York Exchange since 1965, made it especially susceptible to the sharp deterioration in global financial markets and investor sentiment

Liquidity Crunch



- **Freeze in the Interbank Lending:** As banks grew fearful of each other's solvency, interbank lending become more costly, creating a severe liquidity shortage across the banking system
- **Surge in LIBOR Spread:** The spread between central bank rates and three-month LIBOR widened dramatically from 72 basis points in September to 128 basis points by October, indicating escalating stress in short term funding markets
- **Dependence on Short-Term Funding:** Like many major banks, Barclays relied heavily on short-term financing. The liquidity tightening increased the pressure on Barclays to secure stable sources of funding amid volatile market environment



Financial Performance



- **Asset Write-Downs:** During the first half of 2008, Barclays recorder £2.8 billion in write-downs, reflecting declines in asset values tied to the global financial market turmoil
- **Ongoing Profitability:** Despite facing significant headwinds, Barclays maintained profitability in every quarter since the beginning of the financial crisis in mid 2007, distinguishing itself from many peers that reported heavy losses
- **CEO's Public Confidence:** CEO John Varley consistently conveyed optimism about Barclays' resilience, stating publicly that the bank did not require new capital injections from the government to survive the crisis

The Strategic Actions pursued by Barclays illustrates in fact their ability to both increase capital and pursued in initiatives with commitments of high resources

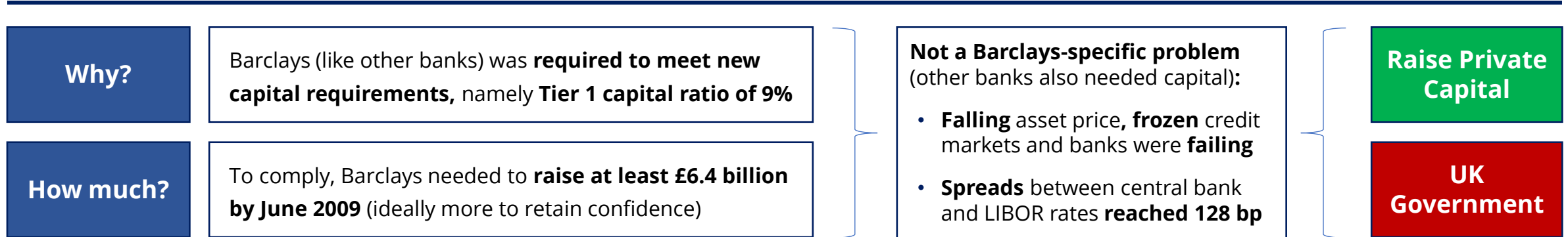
Was Barclays under Financial Distress in 2008?

Strategic Actions Taken 	Regulatory Pressure 
<ul style="list-style-type: none">▪ Capital Raising Initiatives: By June 2008, Barclays had proactively raised £4.5 billion in additional liquidity. This move helped bolster the bank's capital position and provided a buffer against worsening market conditions▪ Opportunistic Acquisition Attempt: In September 2008, Barclays made a strategic bid to acquire Lehman Brothers' North American operations after Lehman's collapse. This move reflected both confidence in its own stability and an opportunistic approach to expanding its U.S. business presence.	<ul style="list-style-type: none">▪ New Capital Requirements: In response to systemic risks, the UK government imposed stricter capital requirement, mandating the banks like Barclays raise their Tier 1 Capital ratios to enhance resilience against future financial shocks▪ Wider Industry Reforms: These regulatory actions were part of a broader shift towards tight supervision of financial institutions, aiming to strengthen the overall stability and health of the UK's banking sector

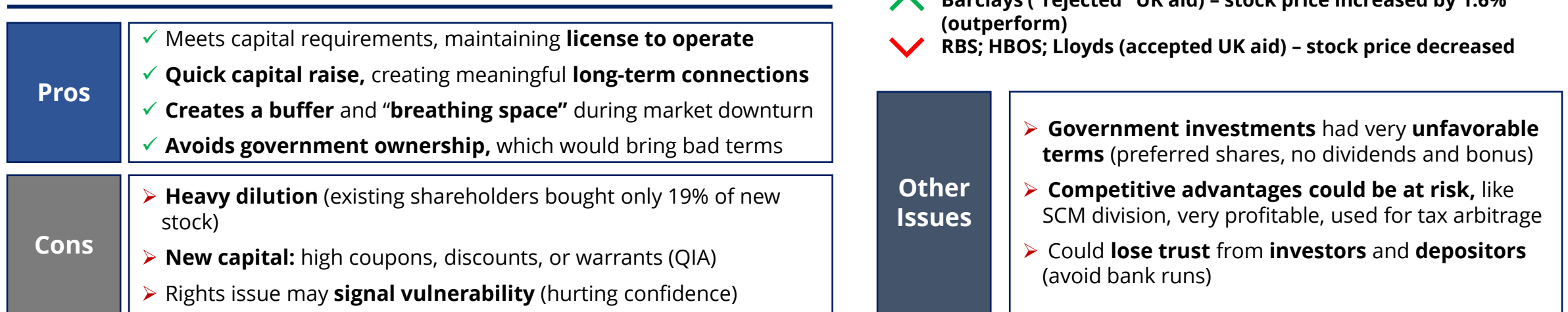
In short, while Barclays proved resilient during the crisis, new capital requirements forced a strategic realignment to ensure future stability.

Barclays raised £6.5 billion from private investors to comply with higher capital, successfully avoiding government control, but with heavy dilution and expensive terms.

Need to raise capital in late October 2008?



Raise Capital through Equity



The £4.5 billion equity raise improved Barclays' capital ratios and enabled the Lehman asset purchase before crisis, but left existing shareholders diluted and exposed to unfair pricing

Was the capital increase a good idea?

Yes

- Raise an **outstanding amount of £4.5b of equity** during a market downturn, circumventing a government bailout with abusive terms
- **Increased capital ratios**: Core Tier 1 to 7.3% and Tier 1 to 7.9% (were 5% & 7%)
- **Allowed to acquire a big part of Lehman Brothers' Assets in North America** - rare growth move, specially during a financial crisis
- Given this, **stock price increased by 1.6%**, with Barclays outperforming peers that opted for UK Government support, for which stock price had decreased

But...

- **Capital increase** was **not sufficient** to deal with further capital pressures during the crisis
- For **compliance**, capital ratios still needed to **increase to 9%**
- Barclays needed to **raise more capital again** later that year

Winners

- **Barclays (as a firm)**: was able to **increase capital quickly** and to create **long-term relationships** with sovereign wealth funds
- **Sovereign funds and wealth investors**: got 81% of new shares at a **discount** (282£/share against the 292£/share)
- **Barclays Management**: Preserved independence and strategy freedom, **avoiding government funds** and **unfavorable terms**

Losers (existing shareholders)



- Suffered from **heavy dilution**, since only took up 19% of new shares, with new investors getting better prices and warrants
- Suffered from the **unfair price discrimination** (they had 19% of new shares at 292£/share, more than new institutional investors)
- Suffered from **management decisions** which **disregarded shareholder dilution**, revealing **conflict of interests**

Principal-Agent Problem?

Market perceptions combined with bank autonomy concerns and Basel rules limit the possibility of using only equity to fund government help

Why the options on the table are not just pure equity?



Market Perception

- Government equity injections are usually seen as signs of **weakness**, leading banks like Barclays to reject Gov funds
- Banks like RBS (-11.3%), Lloyds (-18.6%), and HBOS (-29%) saw sharp **drops** after accepting government aid further confirming this thesis.
- **Preference shares** or **private capital** is better to prevent stock dilution, preserving **market credibility**.



Independence and Control

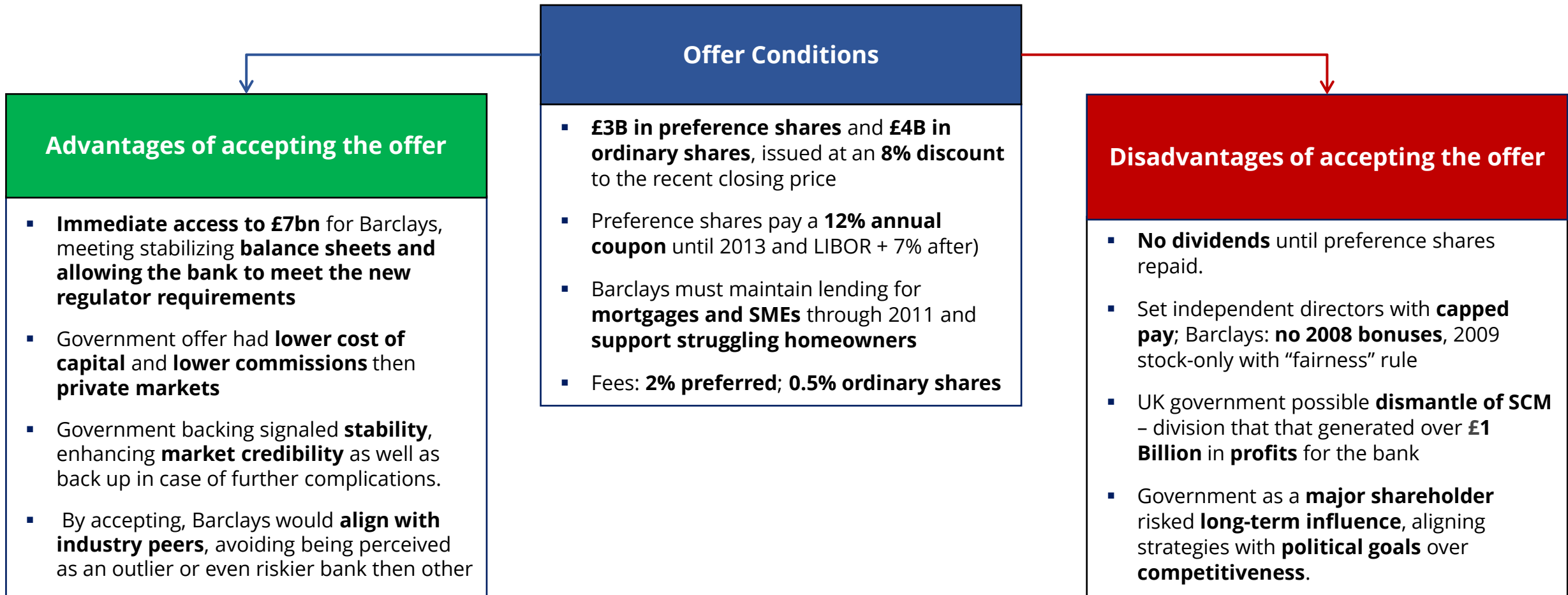
- Pure equity injections, significantly reduce **managerial autonomy** and **shareholder influence so banks likely decline**.
- Barclays was also concerned that the UK Government would be placed in a position with the potential for future conflicts of interest and use its ownership in the bank for political reasons



Constraints

- UK Companies Act 2006 gave shareholders **pre-emption rights**, slowing **urgent capital raises** as Barclays noted.
- Pre-emption rights delayed **critical funding**, hindering timely capital boosts.
- Basel rules limited **preference shares** to **50%** of Tier 1 capital, with RBS at **40%**, curbing further use.

Although the UK Government would provide Barclays with immediate capital, the bank would face stock dilution, government influence and numerous covenants if accepting



The middle east offer would offer 6 of the 7 billion that Barclay's need to comply with the higher capital requirements but it is very expensive and will result in shareholder dilution

The offer

Reserved Capital Instruments

- **3 billion** in **Reserved Capital Instruments** with an annual coupon of **14%** until June 2009 and **13,4% + Libor** from then onwards.
- **1.5 billion** in **warrants free of charge** allowing for conversion of the RCI's in common stock at a price of **197,775**

Mandatory Convertible bonds

- Emitted **4.3 billion** in **MCB's** of which the Qatari Investor acquired **2.8 billion**
- Pre-tax **coupon of 9,75%**
- **22% discount** from current stock price

Advantages and disadvantages

Pros

- ✓ Meets capital requirements, maintaining **license to operate**
- ✓ More flexible terms **without** any **operational and financing restrictions** allowing for more **strategic and operational flexibility**
- ✓ **Positive** market **signal**

Cons

- **Heavy dilution** (existing shareholders bought only 19% of new stock) what could increase even more if warrants are used
- **Very expensive** deal with **high commissions** and **high coupons**, way above market value
- **Controversies** and **legal problems**

From the boards perspective dilution of existing shareholders is not problem, thus the main con of the middle east offer doesn't exist

Recommendation as a board member

Which option is better for the board?



- **Loss of control and Independence**, accepting the **government money** would result in a lot of **loss of flexibility** and partial nationalization, allowing the government to have a **lot of influence over big decisions**
- **Limits on lending** strategies, as well as mandatory lending and **capped payments** and bonuses to executives
- **Negative market perception**, fear of being labelled as a “**weak bank**” which would damage customer trust and share price

How to convince shareholders?



- Middle East offer despite expensive **maximizes long run** value and allows for a **faster and more flexible recovery**
- There would be **increased risk** due to mandatory lending, as in times of financial distress Barclay's would need to lend to the economy increasing its capital needs when there is a crisis thus **increasing Barclay's Beta**
- **Restricted Dividends** (in the other situation of government aid)

From the **board's perspective** going with the **middle east** offer allows for more **independence, reputation, flexibility, and shareholder value**.

The analysis from the shareholders perspective will take into account both the impact on the firm's value and the impact on their share of ownership

Vote as a Shareholder

Operational Standpoint



- Analyse **how each option impacts** Barclays' strategic **flexibility**, **regulatory burden**, and **future growth opportunities**, particularly focusing on geographic expansion versus regulatory constraints.

Share of Ownership



- Assess the **degree of ownership dilution**, **dividend restrictions**, and **how each financing option** alters **shareholder value** and **control** dynamics.

$$\text{SHAREHOLDERS VALUE} = \text{COMPANY'S OVERALL SHARE} \times \text{SHARE OF OWNERSHIP}$$

The Middle Eastern offer is more attractive overall due to stronger growth potential and less demanding covenants, despite higher commissions and dilution

	Government Offer	Middle East Offer
Constraints & Growth Opportunities	Maintain lending to mortgage market and to the SMEs at 2007 levels. Besides, the Structured Capital Markets division will be scrutinized	New opportunities in the Middle East and Gulf region are likely to become available diversifying and scaling the company's activities
"Preferred Shares"	12% coupon for 5 years with an additional 7% premium over the 3month LIBOR thereafter	Reserve Capital Instruments (RCI's) paying a 14% coupon but tax deductible
Common Equity	Purchase at a 8% discount to the market price and suspension of dividends	Mandatory Convertible Notes (MCNs) offering 9,75% pre-tax coupon and conversion at a 22.5% discount + 1,5 billion in warrants
Commissions	2% on the preferred shares principal 0,5% on the value of issued preferred shares £ 80 million overall fees	2% for the RCI's 4% for the MCNs £ 300 million overall

From a shareholder's perspective, the decision would ultimately depend on individual priorities: **either growth potential with Middle East offer, or protection against dilution in the government offer**. Still, we assume that the advantages of the **Middle Eastern offer outweigh those of government offer**, besides the fact that the latter would imply **very unfavourable covenants**, such as **freezing dividends**, with **SCM division at risk**