Journal of Accounting and Finance
Volume 32, No. 2
April 2018-September 2018

A Study on Factors Limiting the Growth of Corporate Bond Market in India

Cirappa. I.B and Punith Kumar. D.G.

Abstract

Indian Capital Market is well structured and well developed in terms of size, turnover and regulatory measures. While India boasts of a world class equity market, its bond market is still underdeveloped as compared to other countries. There are several policy related and market related factors which pullback the growth of bond market in India. The objective of this study is to analyse the limiting factors that hinder the growth of Corporate Bond Market in India and has found that there are various limiting factors such as influence of private placements, limited demand, less attractive yields, default risk, settlement risk, high benchmark on rating are several factors which are obstacles for the growth of Corporate Bond Market in India. Finally several suggestions have been made based on analyses such as introduction innovative instruments, establishment of separate settlement platform, mandating the bond financing etc.

***Keywords:** Corporate Bond Market, Limiting Factors, Investment Risk, Yield, Default Risk*

Introduction

Corporate Sector is acting as engine for developing economy of India. This corporate sector needs the fuel of finance. The scarcity of capital is one of the severe problems for large scale organisations. They require funds for both short and long term. While short term requirements are mainly fulfilled by borrowings from the banking sector and money markets, the long term funding requirements they approach the general investors who invest in their securities either as debt or equity capital. Multiple routes of financing such as equity, debt and bank borrowings also lessen the adverse effect of financial crises. In order to that, the debt market is a good alternative source of financing the long term requirements of funds after stock market.

Indian Capital Market is well structured and well developed in terms of size, turnover and regulatory measures. This has led the investors of whole world to keep their eye at Indian Capital Market. In India the bond market is playing an important role in development of

Dr Cirappa. I.B, Assistant Professor, Department of Studies and Research in Commerce, Davangere University, Davangere, Karnataka, India
Punith Kumar. D.G, Assistant Professor and Research Scholar, Government First Grade College, Bharamasagara, Chitradurga, Karnataka, India

ventures. As per the perception of investors the bonds are the risk free securities which bear interest as the return. They are also known as the fixed income securities issued by the Government and Private organisations for the purpose of creation of new ventures, expansion of existing business or purchasing of tools for the business activities. While India boasts of a world class equity market, its bond market is still underdeveloped as compared to other countries. There are several policy related and market related factors which pullback the growth of bond market in India.

Review of Literature

Varun Dawar1 has opined in his article that Corporate Bond market in India, unlike developed and other Asian counties, is relatively underdeveloped both in terms of depth and liquidity. Given the excessive reliance of corporate on bank funding, credit risks are fairly concentrated within the banking sector. Also the share of corporate issuances is abysmally low when compared to the same in government securities market. Globally bond markets are much bigger than the size of equity market whereas in India the size of corporate debt market has remained insignificant in comparison to that of equity. Although the equity markets in India have grown at a brazen pace fuelled by reforms and participation, bond markets have lagged and continue to remain plagued with various issues and unfavourable policy environment.

Ajeet Kumar Maurya and Onkar Nath Mishra2 has examined the influence of macro-economic variables on the corporate bond market in India covering the period of 23 years i.e. from 1990-91 to 2012-13. Macro-economic indicators reflect the state of economy and influence the issuance of fixed income securities by the corporate. The study provided the evidence that issuance in corporate bond market is significantly correlated with the foreign exchange reserves. Using multiple regression analysis, they arrived at the conclusion that all the selected variables but GDP and Trade openness, significantly explain the volumes of corporate bonds.

Rohini Tendulkar and Gigi Hancock3 in their research said that over the last decade or so, corporate bond markets have become bigger, more important for the real economy, and increasingly global in nature. Since the onset of the crisis in particular, corporate bond markets have begun to fill an emerging gap in bank lending and long-term financing and are showing potential for servicing SME financing needs. A search for yield is driving investment in corporate bond markets. A changing interest rate environment will create winners and losers. Secondary markets are also transforming to adapt to a new economic and regulatory environment. Understanding the nature and reasons for this transformation is the key in identifying future potential systemic risk issues and opportunities for market development.

Vikramaditya Khanna, Umakanth Varttil4, opined that the banks and equity markets are major dominating sources of fund for every business. In this paper they analysed that the causes and consequences of the underdevelopment of legal, economic, political and historical perspective. The absence of effective legal structure, lack of insolvency framework, lack of standardisation and transparency are major problems in the bond market are found by the authors. For this they suggested that the further reforms may be essential to the development of bond markets in the light of political and economic realities.

Need for the Study

Corporate Bond Market has been in existence in India since independence and one would have expected a flourishing market by now; yet, that has not been the case. Since last one decade, there has been a lot of focus on the development of bond market in India and it has gained a lot of policy and regulatory attention. Unfortunately, these initiatives have not had the desired impact and corporate bond markets have failed to take off. It also lagged behind in seeking the attention of retail investors. The review of the literature reveals that the corporate bond market has huge opportunities to growth. But due to some limiting factors still it has not developed well in comparison with markets of other countries. This tends to conduct a study to know the limiting factors which are hindering the growth of Indian Corporate Bond market.

Objectives of the Study

- To know the current scenario of Indian Bond Market.
- To analyse the limiting factors that hinder the growth of Corporate Bond Market in India.

Scope of the Study

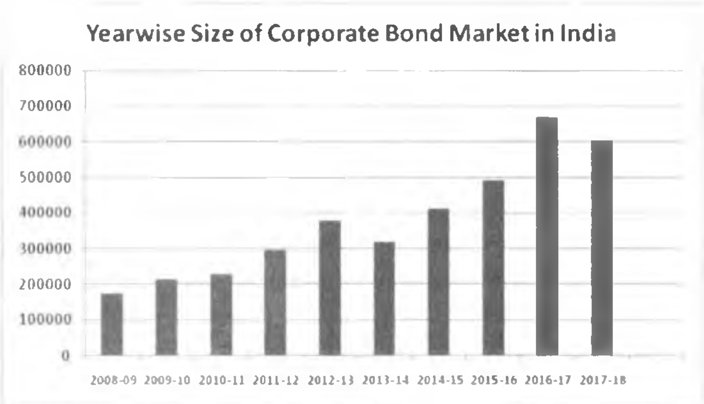
This study is majorly focusing on the present condition of the Corporate Bond Market in India and the study is confined to determine and analyse the limiting factors which are impeding the growth and operations of bond market in India. The study is based on data available for the period of last ten years since 2008-09.

Research Methodology

The present study is in empirical nature and based on secondary data. The data required is collected from official publications of SEBI, NSE, BSE and NSDL. The collected data is analysed, re-tabulated and presented as per requirement

Corporate Bond Market

A well-developed capital market consists of equity and bond market. A sound bond market with a significant role played by the corporate bond market segment is considered to be important for an efficient capital market. The corporate bond market ensures that funds flow towards productive investments and market forces exert competitive pressures on lending to the private sector. While India boasts of a world class equity market, its bond market is still underdeveloped as compared to other Asian countries (e.g. South Korea).



Source: SEBI

The above chart depicts that there is substantial growth in the market size of corporate bond in India since last 10 years but the pace is comparatively slow when compared to other contemporary countries. In India the Corporate Bond Market has contributed up to 14% of GDP. But when compared to other developed countries it relatively low.

Limiting Factors for the Growth of Corporate Bond Market In India

a. Most of the Issues are Private Placements

Nowadays most of the Corporate Bond issues are through Private Placements rather than Public Issue. The following table show the quantum of Corporate Bond issues

Year	*Total Issue (Cr.)*	*Public Issue (%)*	*Private placement (%)*
2008-09	174781.18	0.86	99.14
2009-10	215134.92	1.16	98.84
2010-11	228236.58	4.14	95.86
2011-12	296893.35	1.20	98.80
2012-13	378444.05	4.49	95.51
2013-14	318437.15	13.31	86.69
2014-15	413849.93	2.35	97.65
2015-16	491885.40	6.87	93.13
2016-17	670274.10	4.41	95.59
2017-18	604100.13	0.81	99.19
2018-19	151690.88	12.57	87.43

Source: SEBI

From the above table it is observed that the private placements are dominating the public issues. The reason may be the private placement offers less requirement of disclosures, quick process and the less cost of issue induce both the issuer and the investors to prefer the private placements than public issues. This resulted in lack of potential investors which reduced the market demand for the corporate bonds.

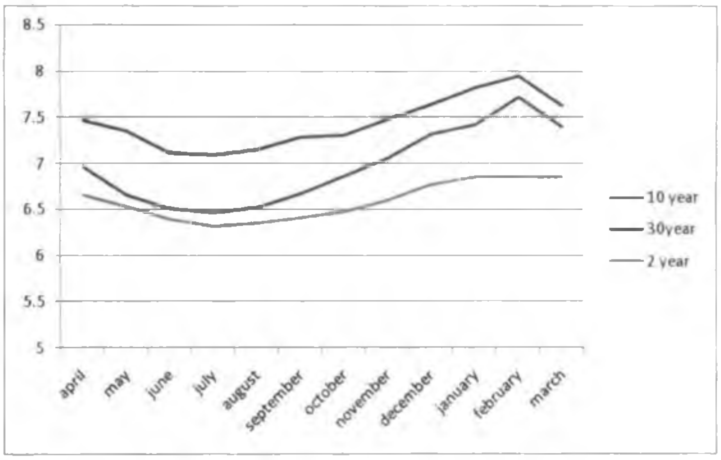
b. Limited Demand for the Corporate Bond Finance

Majority of the companies choose the external finance as a mixture of equity and debt. When it comes to the part of debt the companies prefer the bank finance to meet the financial requirement of the business than financing through bonds. This due to complexities and difficulties in raising funds by issuing bonds which lead to the limited demand for the corporate bond market.

c. Less Attractive Yields

The yield from the Indian bond market is relatively less compared to other investment options such as mutual funds, ELSS etc. The following chart shows the yield spread of corporate bonds of different maturity period for the

Average Yield spread of 2 year, 10 year and 30 year maturity Corporate Bonds



Source: investment.com

The above chart depicts that higher the maturity period higher will be the yield as the Corporate bonds with 30 years maturity period are yielding more return than bonds with 2 years and 10 years maturity period. This long duration maturity period will result in Liquidity Risk and the rate of return is also not comparatively high with respect to other investment avenues.

d. Indian Corporate Bond Market Changed The Direction Towards High Rated Debt Instruments.

Most of the Indian regulators have set the minimum grade of "AA" but currently the Corporate Bond Market is rated "BBB". So the number of issues and investments in corporate bonds are minimal. So the Indian Wholesale Debt Market is moving towards high rated debt instruments.

Ratings Assigned to Corporate Debt Securities (Maturity ≥ 1 year)

Year	*Investment Grade*				*Non-Investment Grade*	*Total*
	Highest Safety (AAA)	*High Safety (AA)*	*Adequate Safety (A)*	*Moderate Safety (BBB)*		
2010-11	244	267	249	579	1,843	3,199
2011-12	256	380	267	710	2,793	4,406
2012-13	204	449	313	648	2,558	4,172
2013-14	169	303	187	422	1,351	2,432
2014-15	201	354	246	292	703	1,796
2015-16	178	309	214	151	100	896
2016-17	244	418	252	173	117	1,204
2017-18	126	244	139	340	1,025	1,874

Source: SEBI (CRISIL,CARE & Various rating agencies)

The above data shows that more than 50% of the issued Corporate Bonds are rated as non investment grade and are not traded in secondary platform. This is because of high benchmark set by the regulators. This deviate retail investors and issuers to towards other high rated debt securities.

e. Corporate Bonds Trading Through OTC

The corporate bonds are traded in the OTC. The OTC transactions norms regarding contract enforcement are differ from other major stock exchange which leads counterparty risk also known as default risk. This risk perceived as the greater threat for OTC transactions. The BSE and NSE are providing an opportunity to post trade reporting but this is not occurring very often.

f. Settlement Risk

In the Corporate Bond Market the transactions are settled between the counterparties bilaterally so there is an absence of Central counterparty to reduce the clearing risk. It is one of the barriers to the trading in corporate bonds. SEBI is currently consulting the stock exchanges to introduce centralised clearing and settlement for corporate bonds.

Year	*Total Number of Trades*	*Total Number of Trades Settled*	*% of Trade Settled*
2009-10	38230	9386	24.55
2010-11	44060	32662	74.13
2011-12	51533	37613	72.99
2012-13	66383	44317	66.76
2013-14	70887	47135	66.49
2014-15	75791	53852	71.05
2015-16	70123	53856	76.80
2016-17	88495	71444	80.73
2017-18	91404	73332	80.23

Source: SEBI

From the above data it can be inferred that the percentage of trades settled to the total number trades is relatively low. Even though it is increasing yearly a higher benchmark need to be reached to raise confidence among investors.

Suggestions

1. Regulators should mandate the Corporate Companies to source there debt fund requirement at least 25% from Corporate Bonds. This will reduce their dependence on bank finance for larger extent.
2. There is a urgent need of development innovative bond instruments which yield attractive returns.
3. Regulators should revise their benchmark for classification of Corporate Bond securities as investible and non-investible category.

4. NSE and BSE should establish separate settlement platform rather than post trading reporting system.

Conclusion

In this paper we have examined the reasons for the retarded growth of Corporate Bond Market in India. The study has found that there are various limiting factors such as influence of private placements, limited demand, less attractive yields, default risk, settlement risk, high benchmark on rating are several factors which are obstacles for the growth of Corporate Bond Market in India. The policy makers need to look on these issues and increase the pace of growth of Indian Corporate Bond Market which very essential. Still there are many other factors such as tax complexities, lack regulatory clarity, restrictions foreign investors etc are falling in this way which provides scope for further study.

References

Varun Dawar, Development of Corporate Bond Market in India - Challenges and Reforms, IOSR Journal of Business and Management (IOSR-JBM), ISSN: 2278-487X. Volume 4, Issue 4 (Sep-Oct. 2012), PP 46-50.

Ajeet Kumar Maurya and Onkar Nath Mishra, The Macro-economic Determinants of Corporate Bond Market in India, Pacific Business Review International, Volume 1, Issue 1, June 2016.

Rohini Tendulkar and Gigi Hancock, Corporate Bond Markets: A Global Perspective, IOSCO.

Vikramaditya Khnna, Umakanth Vrattil, Developning Corporate bonds in India.

www.sebi.gov.in/statistic

www.nseindia.com

www.bseindia.com