Debt Market : An Indian Perspective

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Abstract

The investment horizon has been widening. It is never the same. Many new financial products are being introduced. All traditional methods of raising funds and utilizing it are changing. However, one form of financing still needs to be thoroughly analyzed in India. Debt instruments hold lower amount of risk in comparison to equities, even then people are quite hesitant towards the market. The cost of debt financing is determined by taking into consideration various issues of the organizations and macro variables like default risk, liquidity risk and inflationary risk. How is the investment scenario? How is the cost of debt financing for different companies associated with different level of risk? In our study, we are trying to analyze the current debt market functioning in global and Indian market perspective.

Keywords: Debt Market, Credit Rating, Investments

1. Introduction

Debt market is form of financial market where fixed income securities are traded. It can be primary or secondary market. It is also termed as "Bond Market ", "Fixed Income Security market ". Debt market is mainly considered to be a reliable source of long term financing for large corporate houses and government. They issue bond, debentures and hybrid securities with certain percentage of coupon rate or dividend and raise their funds as per their requirement.

Since certain percentage of debt in the capital structure is quite beneficial for a company to save their tax expenses, the debt market is another major option for the active investors. Traditionally, the bond market was largely dominated by USA, but today America holds about 44 % of total stake. AS of 2009, the size of the worldwide bond market (total debt outstanding) is an estimated $ 82, 2 trillion of which the size of the outstanding US bond market debt was $31.2 trillion. Nearly all the trading takes place between broker-dealers, Institutional investors. OTC (over the counter) market. Only small portions, primarily corporate, are listed on exchanges. Bond market usually refers to the government bond market because of its size, liquidity, relative lack of credit risk and therefore sensitivity to interest rates.

Issue of debentures is one of the major ways to finance the funds requirement. However, it is not that popular in medium and small-scale business. For example in Nepal, medium scale business rarely issues bond or raise debt capital. Only government agencies are using debt capital in the form of development bonds and to regulate the money supply in the economy, it issues treasury bills. Retail investments in the global debt market are relatively lower than the institutional investment. It shows that, the public interest as well as the public awareness towards the bond market is not that well developed.

Numbers of studies have been conducted on this particular topic. Many organizations for the sake of their investment issues or for the general purpose; have been doing timely studies of the debt market. Many financial authors such as I.M Pandey, Brigham and Huston have published their studies about the debt market in their books. Barrie and Hibbert has explained in their research that The

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role of liquidity in determining asset prices is the subject of a vast research literature spanning a period of more than thirty years

2. Purpose of the Study

The study is carried out with the following purposes:

a) To know about the global bond market scenario.
b) To realize the different perspectives towards the Indian as well as global debt securities

3. Credit Rating Agencies

One of the key players of the debt market is credit rating agencies. They ultimately communicate the investors about the credit worthiness of the organization. Various credit rating agencies rate the organizations on the basis of their ability to pay for the fixed interest amount and the principal repayment at the time of redemption; accordingly risk premium and thus the whole interest rate is determined. The company with high credit worthiness is rated AAA (i.e BLUE CHIP) companies. They have less chances of default of interest or principal payment. Thus lower risk premium result in lower required coupon rate. People are very much interested in investing in blue chip companies than AA rated or BBB rated or Junk bonds. Many credit rating agencies like Standard and Poor , MOODY's index publish their rating of various agencies .

Standard and Poor: As a credit-rating agency (CRA), the company issues credit ratings for the debt of public and private corporations. It is one of several CRAs that have been designated a nationally recognized statistical rating organization by the U.S. Securities and Exchange Commission. The company traces its history back to 1860, with the publication by Henry Varnum Poor of History of Railroads and Canals in the United States. This book compiled comprehensive information about the financial and operational state of U.S. railroad companies. In 1868, Henry Varnum Poor established H.V. and H.W. Poor Co.

Moody's Investor Services: Moody's Investors Service, often referred to as Moody's, is the bond credit rating business of Moody's Corporation, representing the company's traditional line of business and its historical name. Moody's Investors Service provides international financial research on bonds issued by commercial and government entities and, with Standard & Poor's and Fitch Group, is considered one of the agencies. The company ranks the creditworthiness of borrowers using a standardized ratings scale which measures expected investor loss in the event of default. Moody's Investors Service rates debt securities in several market segments related to public and commercial securities in the bond market. These include government, municipal and corporate bonds; managed investments such as money market funds, fixed-income funds and hedge funds; financial institutions including banks and non-bank finance companies; and asset classes in structured finance.[1] In Moody's Investors Service's ratings system securities are assigned a rating from AAA to C, with AAA being the highest quality and C the lowest quality.

Thus, these are the most reliable rating agencies in the world. On the basis of which investors put their money in the market. Companies set their prices of debt securities accordingly.

4. Indian Bond Market

Institutional investors dominate Indian Debt market, like any otherworld market. Retail investment is not that major contributor in the market.

Many privately owned and government owned mutual fund try to finance the various industrial and public development project with the debt securities.

SBI (State Bank of India) has been providing funds to various organizations in the requirement. It purchases the bonds issued by them and helps to raise funds and also plays significant role to improve their credit rating. SBI Dynamic Bond and Debt Recast Packages to Kingfisher are the examples of debt financing of SBI.

Various organizations that have been issuing debt securities in the market are as follows:

(a) Central Government
(b) Public Sector Units
(c) Indian Corporates
(d) Banking and Financial Institutions

The most distinguishing feature of the Indian debt instrument is that the return is fixed. Most organizations prefer fixed return bonds than the floating ones. G-SEC (Government Securities) has the highest market capitalization in India. It consists of central and state government securities.

The biggest advantage of investing in Indian debt market is its assured returns. The returns that the market offer is almost risk free. Although there exist some form of risk, normally it is assumed that their exist no risk in investing in debt instruments as the returns are fixed. As there are several advantages, there exist some disadvantages as well. As the returns here are risk free , those are not as high as the equity market at the same time . So, at one you are getting assured returns, but on the other hand you are getting less return at the same time.

Although, the debt instruments are not the first choice for the Indian marketers, we can assume that, when cost of funding through debt comes to the lower level, many organizations will be more than happy to raise credit from the general public. From the investors perspectives as well, debt instruments should also be treated as one of the best way of investment as the risk associated are minimized with the market information and information from rating agencies .

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