CORPORATE BOND MARKETS IN INDIA: A STUDY AND POLICY RECOMMENDATIONS

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Abstract
The objective of this paper is to address the urgent need to fast track development of Corporate Debt markets in India. It establishes the requirement for corporate debt markets and compares relevant regulatory frameworks of well-functioning and emerging economies. It also identifies the issues and challenges for development in India and suggests a few key policy changes.

Introduction
Corporate Debt 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 and even among emerging markets, India compares poorly against nations like China and Brazil. Increasingly, there has been a lot of focus on the development of debt markets in India and it has garnered a lot of policy and regulatory attention. Unfortunately, these initiatives have not had the desired impact and corporate debt markets have failed to take off. Therefore, there is an urgent need to fast track the development of corporate debt markets in India.

Excerpts from Global Peers

1. *USA:*
The US corporate bond market with a size of $4.5 trillion is the largest and the most liquid corporate debt market in the world.

Table 1: Overview of the bond market in the USA as on March 2013

	Municipal	Treasury	Mortgage Related	Corporate Debt	Federal Agency Securities	Money Market	Asset-Backed	Total	GDP
$	3,728	11,286	8,148	9,236	2,070	2,492	1,691	38,654	14,991
%	25	75	54	62	14	17	11	258	100

Source: Securities Industry and Financial Markets Association , March 2013

So, what led to the phenomenal growth of corporate debt markets in the US?
Igata, Taki, Yoshikowa (2009) believe that the primary reason the US corporate debt market is so large today is the comparative inaction by US banks from the early 70s to the mid-90s. This period was characterized by relatively high rates of inflation, resulting in high interest rates.

However, regulatory caps on interest payments prevented US banks from providing investors with attractive deposit options. The banks were further stripped of their ability to lend due to two other factors namely lowered credit ratings (stemming out of mounting NPAs) and stringent capital adequacy ratios. Meanwhile, the corporate debt markets continued to cater to the expanding funding requirements of corporations.
Finally, the US banks stopped competing for deposits. Instead they shifted their focus to mutual funds, who in turn invested primarily in money market and bond funds.

2. Korea

While the Korean corporate and government bond markets were relatively under-developed till 1997, the Asian currency crisis and the resultant drying up of credit from financial institutions forced companies to look toward bond markets for financing. This led to a huge surge in issuance of corporate bonds post the currency crisis. However, this sudden surge came with its own peril, which manifested itself in the bond market bust in 1999.

3. Malaysia

The Malaysian corporate bond market development is characterized by gradual development ushered in by strong institutional and regulatory frameworks, solid support from policy makers and incremental efforts to liberalize and attract foreign investors. BIS (2006) specifically describes, several policy initiatives in Malaysia which boosted the corporate bond market development such as the establishment of high quality, independent credit rating agencies, creation of National Bond Market Committee and Capital Market Masterplan (2001) that laid down the agenda for development of capital markets in the next decade and a host of other operational measures.

4. China

The Chinese experience, also, lends itself to a very unique and interesting study in institutional frameworks. China's bond market consists of two different segments: the inter-bank market and exchange market. The two work in tandem and complement each other. In the 10 years since its inception, the Chinese bond market has grown rapidly, keeping pace with the development of its economy. The China corporate bond market has a large variety and quantity of issuers and instruments, financial innovation and high liquidity in secondary markets.

Issues plaguing Corporate Debt Markets in India

1. Regulatory Structure Problems:

Corporate Bonds are regulated by SEBI, along with participants like brokers and mutual funds. Banks and primary dealers are regulated by the RBI, insurance companies by IRDA and provident/ pension funds by another independent regulator. Foreign investment has traditionally remained controlled with SEBI and RBI imposing periodic limits on foreign participation. The inconsistent, disorganized and overlapping institutional and regulatory framework has given rise to regulatory arbitrage with different market players reporting to different regulators depending on size and ownership.

2. *Legal Impediments:*

Armour and Lele (2009) observe several missing and inadequate legal structures in the context of corporate bond markets, the most prominent being those relating to enforcement contracts and corporate insolvency. In India, enforcement contract litigation is often embroiled in delays and deficiencies of India's overburdened court system, not the least of which are prohibitive costs. This lack of remedial opportunities increases the risk of corporate bond lending.

3. *Limited Number of Instruments:*

Anupam Mitra, (2009) focuses on the supply side issues hampering the development of corporate debt markets in India and lists the lack of diversity in instruments as a major factor. Internationally there are various types of instruments prevalent such as step up Bonds, step down bonds, deep discount bonds, reverse floater bonds, indexed bonds, currency bonds, etc. However, the Indian bond market is primarily dominated by fixed rate coupon bonds. Secondly, the average age of the bonds issued by Indian corporations is only 5 to 7 years in India.

4. *Underdeveloped Municipal Bond Market:*

Charan Singh (2012) observes that the municipal bond market in India is quite insignificant as compared to mature markets like that of the USA where municipal bonds are one of the key modes of financing urban infrastructure. As of March 2013, the US has over $3.7 trillion in municipal bonds outstanding, whereas in India there have been only 28 bond issues since 1997 amounting to just about Rs. 30 billion.

As a result, most of the budgets of urban bodies are subsumed in the departmental budgets of the state government. This increases the burden on government borrowings further accentuating the problem of crowding out of the private sector.

5. *Private Placements:*

The following table analyzes funds raised through bond issues under 2 major heads – public issues and private placements.

Table 2: Private placements of corporate bonds

Issues	2010-11		2011-12	
	Amount of Issue (Rs. bn)	% of total issues	Amt. of Issue (Rs. bn)	% of total issues
Public Issues	95	4.7	356	12.4
Private Placement	1,922	95.3	2,154	87.6
Total Issues	**2,017**	**100**	**2,870**	**100**

Source: Indian Securities Market : A Review 2011-12, NSE

Two significant trends emerge from the above data. Firstly, most corporate bonds continue to be placed privately, resulting in low availability of bonds for trading in secondary market.

Secondly, government borrowing dominates both public and private sources of bond financing in India.

6. Limited and Non-diversified Investor Base:

The investors in the Indian corporate debt markets can be essentially categorized into banks (Indian, Foreign and primary dealers), trading members and others (MFs, FIs, Corporates). This clearly indicates a lack of diversity required for a potentially vibrant corporate debt market. Banks are the largest group of investors in corporate debt markets in India; however, they continue to be highly regulated by RBI. Hence participation by banks in secondary trading is limited, stunting the depth and liquidity in secondary corporate bond markets.

Recommendations

1. Participation from Insurance Companies and Pension funds:

A portfolio comparison of LIC with that of US insurance companies throws up a stark contrast. Almost 46% of the portfolio of US insurance companies is invested in corporate bonds whereas the same for LIC is barely 13% (non PSU). According to the Board of Governors of the Federal Reserve System (2012), US life insurers owned 17.8% of all corporate and foreign bonds, as of 2012 Q3.

Insurance companies inherently face the problem of asset liability mismatch and are on a constant tight rope to balance assets and claims and withdrawals. Therefore, it is imperative that they invest in instruments with wide ranging maturities that can only be provided by corporate bond markets in India.

2. Creation of Corporate Bond Indices:

A bond index should be created to measure the performance of corporate bonds issued in the country. Single or multiple indices can be created and bonds of similar maturity or rating can be grouped together to allow investors to gauge the performance of bonds. These indices should also be made investible so that investors can invest in a basket of bonds.

3. Measures for attracting retail investors:

Regulators and policymakers, especially SEBI have consistently focused on ensuring retail participation in equity markets and have achieved a fair amount of success in the same. Similar measures need to be implemented to draw retail investors to corporate bond markets. This is bound to be a time consuming process; adapting whole markets for retail participation is not possible overnight. Meanwhile, it will also be beneficial to explore the possibility of carving out a specialized retail bond market.

4. Public issue and listing of corporate bank borrowings:

In the private equity market, funds invest in strong private companies for a period of 4-5 years and help the companies achieve their potential growth. At the end of their investment horizon, the funds typically achieve their exit and make gains through a public issue of the shares of the investee company. An attempt can be made to replicate this model in the corporate debt market. The listing of bank loans will help banks reduce their exposure to certain corporates or corporate groups, if desired, and also release liquidity to lend at higher yields to other borrowers.

5. ***Developing municipal bond market in India:***
There is a huge untapped potential for the municipal bond market in India. Various measures can be undertaken to meet urban infrastructure financing through capital markets such as creating a national body that can act as financial intermediary and issue municipal bonds on behalf of its members (local urban bodies), remove the fixed cap on coupon rates and allow bonds to be issued at market rates.

6. ***Enactment of new robust bankruptcy laws:***
India needs to setup robust bankruptcy laws similar to Chapter 11 of the United States Bankruptcy Code which will allow financially distressed companies to anticipate insolvency and attempt a turnaround before it gets worse. The current insolvency infrastructure under BIFR applies only to industrial companies and is plagued by poor enforcement mechanisms. Inevitably, this has slowed down liquidation of hopelessly insolvent companies and resulted in institutional creditor losses. Therefore, India needs a bankruptcy law which will help such companies turn around faster.

Conclusion

Though it is reasonable to infer that once the set of recommendations above are implemented the problems plaguing corporate debt in India would be eliminated, paving the way for a vibrant bond market, it is easier said and done. There have been numerous academic and government reports dedicated to the issue, and possible recommendations have been accepted by one and all. The issues covered here are neither exhaustive nor exclusive in explaining the lacunae in the corporate debt markets in India; our focus is to harp on a few recommendations which we believe are crucial in the entire reform process. While a few of them are independent, in light of recent developments, the others represent critical proposals that have not received the required amount of policy attention in recent times. However, we believe that a consistent and dedicated effort on the lines mentioned above will bring a significant change in the corporate debt market space in India.

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