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CORPORATE BOND MARKET IN INDIA: A REVIEW OF FACTORS LIMITING THE DEVELOPMENT

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Abstract

The corporate bond market helps the companies raise long-term finance, which is essential external source of capital. Indian corporate bond market is still in its early stages of development, and as a result, it lacks the depth found in more mature markets. The objective of this paper is to explain the components narrowing the growth of the Indian corporate bond market. In addition, the paper examines the requirements for market development, where the G-Sec's are doing quite well. The study tries to inquire previously initiated to elaborate current state of corporate bond markets. The research is limited to previous studies and secondary data. Based on the literature review from previous studies and recently available market statistics, the main factors that constrain the growth of this market are performance metrics, corporate governance, opacity to information and credit rating mechanism, financial infrastructure, and cost associated with issuance influence the corporate bond markets. The Indian government and Reserve bank have simultaneously tried to develop corporate bond market.

Keywords: Corporate bond, Market, Capital markets, Liquidity, Credit rating, Financial System

1. Introduction

Indian Financial System comprises of Banking and Capital Market. Banks have been performing the vital role of financial intermediation and Equity market performing very well. The Equity and Debt market balance's domestic capital market. Full-grown debt market helps a country to complete it's capital market. To take care of Financing needs of private businesses, a thriving market for long-term debt is essential, and this is truer than ever given the pressing demand for physical infrastructure in a modernizing economy. Bonds are means of capital rising for the government, corporate, and individuals as alternative to bank-based finance source that is present till today.
Multiple purposes are served by a vibrant corporate bond market. Corporate bonds can reduce the cost of long-term funding in addition to giving borrowers an alternative to bank financing. Due to the relative shorter tenor of their liabilities, banks are typically restricted from making long-term loans. An effective and affordable source of longer-term funds for corporations can be provided by a corporate bond market that is efficient, has lower costs, and issues bonds more quickly. It can also give institutions example, insurance firms, provident funds, and pension fund access to long-term financial assets (also known as a "preferred habitat"), assisting them in balancing the durations of their assets and liabilities. This article focuses on the Indian corporate debt market growth along with factor influencing corporate bond market development through previously studied data and the available data.

2. Statement of the Problem

Bonds are a fundamental demand of the corporate sector for the funding of assets. In developing nations like India, corporate bonds continue to struggle to fill the funding gap for long-term corporate requirements. Indian government trying to establish the balanced capital markets to strengthen the economic growth. The research is addressing the Indian Corporate debt market and obstacles to the growth of this market.

3. Literature Review

The importance of the debt market has increased as a source of capital for private corporations. The demand for corporate bonds in emerging markets is rising. Many developing market nations still have weak corporate debt markets. **(Luengnaruemitchai & Ong, 2005)**

Underdevelopment of the bond market may lead to serious distortions in the economy, without a market-determined interest rate, the true opportunity cost of funds totally will affect the financial system of the country (**Herring & Chatusripitak, 2006)**

Before WWII, the corporate and municipal bond markets were active on NYSE. When bonds were traded over-the-counter market in the mid-1940s the activity was slowed down **(Biais & Green, 2019)**

Poor growth of Asian Fixed-income market create complexity which required multiple concerns like Strong creditor's right, sound market infrastructure, improving regulatory design and enforcement, and a rethink on capital control and tax measures that limits foreign issuance and investor participation. The well-developed banking system and securities market provide a well-diversified financial system **(Eichengreen, 2006)**
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The external financing decision of a firm decides the banking or financial securities as source of funds. Healthy Economy depends on how active and well a financial Institution is running. **(Chakraborty & Ray, 2006)**

The bond market can compose a productive catalyst for healthier performance of government and non-government sectors. Local currency debt markets help economic efficiency by generating determining interest rates. Developing markets perform better via help of domestic denominated currency market. (**Committee on the Global Financial System, 2007)**

African countries depended on public debt for funding all expenses, internal debt market remained poor and many African markets depended on external market and bank-based financing. Corporate bonds have begun growing steadily as African countries focus on infrastructure and development as advanced economies **(Mu, Phelps, & Stotsky, 2013)**

While Korea is a good example for other countries to build their domestic debt market by expanding of their debt market. Korea developed an efficient government securities market to develop strong local bond market. Further Korea focused on establishing an essential infrastructure and institutional arrangements for developing efficient bond market. Korea started using electronic platform for exchange not only relied on over-the-counter market. Korea actively used asset-backed securities and guarantees for their borrowings. **(Park, 2008)**

As we have different structures and economies all over the world, every country has different nature of developing bond market one should take inspiration from the other who has successfully implemented the bond market.
Regional bond markets are more robust in nations having superior past economic record and robust legal systems (Burger & Warnock, 2006). It has been noted that bond markets assist banks and stock markets in expanding an economy's financial **markets (Thumrongvit, Kim, & Pyun, 2013)**

It is observed countries economic environment play a important role in boosting well-functioning financial markets and institutions. Further it is observed that unclear information, cost associate with issuance, type and degree of participants, market size and degree of demand, issuer actively participating in the market **(Braun & Briones, 2006; Thukral, Sridhar, & Joshi, 2015)**

Expansion of domestic currency debt markets is widely recognized in East Asian nations as a crucial need for fortifying the financial sectors after global economic downturn. Considering this drawback, Asian Countries need to maintain a sound monetary and fiscal policy, growing a wholesome sovereign debt market can be a benchmark for the corporate debt market, completing revolution of banking sector as a post-crisis plan, and building the bond market's corporate governance, improving the bond market's regulatory structure, and an overall improvement in the region's financial stability. centers for trading bonds **(Fabella & Madhur, 2003)**

It is observed that domestic funding was depended on banking which considered one of the reasons for 1997 financial depression in Asian economies. In 2008 global financial crisis as foreign banks withdrew the investment from Asia it leads to the concentration of liquidity in the private sector. Size of the economy, economic development, volume of banking sector, lending rate spillover are important antecedents for fixed-income market development in Asia **(Bhattacharyay, 2011)**

(**Gyntelberg, Ma, & Remolona, 2005**) observed that Asia has different size corporate bond markets. Primary market has opened for foreign issuers while many are relied on quasi-government issuers. corporate bonds issued in the primary market often suffer in secondary markets as illiquidity, narrow investors base, and opacity to information.
It is found that development of bonds skewed towards government bonds not in favour of corporate bonds. Credit quality and development of infrastructure bonds as an asset class in primary market and as far secondary market, developing effective mechanism to increase trade and transparency in information for enhancing liquidity in the market (Monetary and Economic Department, 2016)

East Asia's bond market reached USD22.8 trillion at the end of December 2021. Government securities resume control market by reaching USD14.3 trillion, accounting for 13.9% yoy growth, where as corporate debt down by 2.8% in fourth quarter 2021 from 3.1 per cent quarter-on-quarter in previous year to USD8.5 trillion **(ASIA BOND MONITOR, 2022)**

The nature of structure and development for corporate debt markets in mature markets and developing markets are totally different, discussion on Indian corporate market has been going since long. The paper tries to derive the present stand of debt market in India and the intermediaries limiting the growth of the corporate bond market in India. In addition, the paper examines the requirements for corporate bond market development. Section I explain overview of the development of the bond markets and the bond market in India. Section II follows the corporate bond market. Section III explains the factors influence the growth of corporate bond market and current standing of corporate debt market in India. Summary and conclusion discussed in section IV of the paper.

4. The bond market in India

During COVID pandemic the Indian financial sector came under stress. The Stock market or Equity segment in India is much larger than the debt market and banking sector has remarkable growth rate. Being largest market in Asia debt market in India is struggling. Still developing rapidly through introducing new instruments, increased liquidity, deregulation of interest rates and improving settlement system. Government bond or Government securities market dominates in Indian debt market as compared to corporate bonds market. A large part of raised funds through government securities goes to finance fiscal deficit of central government, while corporate bonds are issued by corporates aimed at financing the capital requirements of corporates. The major players in market are insurance companies, banks, provident fund Companies, Financial institutions, Mutual funds, and foreign institutional investors, and cash rich corporates.

Although government debt market is well developed but still suffering from illiquidity, Government of India and Reserve bank trying to develop quality of infrastructure and boosting investor base by launching schemes for retail investors participation. It is observed in SBI report march 2022, 10yr government bond yield increased to 6.8% in February 2022, from 6.7% in January 2022 and 6.5% in December 2021.
Source: SEBI

The corporate bonds trading volume is minimum as compare to government bonds in India. Though relatively less liquid, is fast developing. Table I signify the turnover and trades for corporate bonds market.

Since from 2008 trading of corporate bonds are increasing but not at extraordinary rate. Banking finance, coupled with equity markets and external borrowing are preferred funding source for business. Above table shows the data for 2021-2022 trading of corporate bonds in different platforms where we can see corporate bonds turnover is minuscule as compare to equity market as well as government bond market (Sengupta & Anand, 2014). As in Table MCX-SX is newest platform for trading founded in October 2008 which has zero corporate bonds trading so far in the year 2021-2022.

Table 1 Total Corporate Bonds Trade for the Year								
	Year 2021-22							
	BSE		NSE		MCX-SX		Grand Total	
Date	**No. of Trades**	**Amount (Rs. cr)**	**No. of Trades**	**Amount (Rs. cr)**	**No. of Trades**	**Amount (Rs. cr)**	**No. of Trades**	**Amount (Rs. cr)**
Apr-21	7236	60888.55	4940	90992.76	0	0.00	12176	151881.31
May21	6259	54135.76	4925	79923.94	0	0.00	11184	134059.70
Jun-21	8007	61390.57	5665	91924.45	0	0.00	13672	153315.02
Jul-21	6745	48404.69	5099	66672.29	0	0.00	11844	115076.98
Aug21	7356	55957.11	5758	88259.38	0	0.00	13114	144216.49
Sep21	7886	63765.97	6038	126974.72	0	0.00	13924	190740.69
Oct-21	7224	49075.25	5423	97201.37	0	0.00	12647	146276.62
Nov21	6303	39177.13	4583	71902.03	0	0.00	10886	111079.16
Dec21	7396	51214.41	5468	94733.69	0	0.00	12864	145948.10
Jan-22	7322	45282.34	4804	82333.56	0	0.00	12126	127615.90
Feb-22	7841	60639.96	4886	81448.21	0	0.00	12727	142088.17
Mar-22	10745	77798.28	7712	133288.00	0	0.00	18457	211086.28
Total	90320	667730	65301	1105654	0	0	155621	1773384

Source: SEBI

5. Corporate Bond Markets

For business investment debt capital is generally considered to be suitable for long-term financing. Developing vibrant market for long-term debt is difficult for fulfilling capital needs of private business. Even though lot of initiatives have been taken to develop the corporate debt market in India but still not reached where it needs to be.

Table 2 Debt issues and Equity issues (Rs. crore)						
Year	**Equity issues (Rs. Crore)**	**Debt issues (Rs. Crore)**			**Share of debt in total resource mobilization (in per cent)**	**Share of private placement in total debt issues mobilization (in per cent)**
		Public	**Private Placement**	**Total**		
2007-2008	85,427.00	1,603.00	1,18,484.64	1, 20,088	58	99
2008-2009	14,720.00	1,500.00	1,73,281.18	1,74,781.18	92	99
2009-2010	55,055.00	2,500.00	2,12,634.92	2,15,134.92	80	99
2010-2011	58,158.00	9,451.00	2,18,785.41	2,28,236.41	80	96
2011-2012	12,857.00	35,610.71	2,61,282.65	2,96,893.36	96	88
2012-2013	15,473.00	16,982.05	3,61,462.00	3,78,444.05	96	96
2013-2014	13,269.00	42,382.97	2,76,054.18	3,18,437.15	96	87
2014-2015	9,789.00	9,713.43	4,04,136.50	4,13,849.93	98	98
2015-2016	24,054.00	33,811.92	4,58,073.48	4,91,885.40	95	93
2016-2017	32,520.00	29,547.15	6,40,715.51	6,70,262.66	95	96
2017-2018	1,05,097.00	5,172.56	5,99,147.08	6,04,319.64	85	99

2018-2019	18,235.00	36,679.40	6,10,317.61	6,46,997.01	97	94
2019-2020	3,06,327.00	15,068.37	6,74,702.88	6,89,771.25	69	98
2020-2021	2,29,786.00	10,588.02	7,71,839.98	7,82,428.00	77	99
2021-2022	2,41,584.00	11,589.41	5,88,036.94	7,83,429.39	93	75

Source: SEBI

Table 2 highlights private placement demonstrates that the most popular method for raising capital through corporate bonds is private placements, contributing to the market's overall illiquidity. Bank financing options for the corporate sector have been considerably constrained by regulatory restrictions on individual or group borrower lending due to subjective constraints. The urge for corporate bonds has been further pressured by banks' statutory subscriptions to sovereign debt.

Provided corporate debt markets are often less liquid than their sovereign counterparts, it will be challenging to establish a liquid corporate credit market. Having said that, a moderately liquid corporate bond market would lower borrowing costs for businesses and make bank funds available for other purposes.

6. The elements affecting the expansion of the Indian corporate bond market

India is considered to have a mixed economy due to its status as a developing country, the combination of the public and private sectors, and its reliance on foreign trade. With rapid movement is start-ups and industries financial stability is required to give the acceleration. Banks are playing well in the Indian financial system but not fulfilling the required funds for the corporate. Channelizing corporate securities and developing a good base for the trading of corporate bonds required some more attention in developing countries like India. Poor liquidity, lack of awareness and credit rating mechanism and weak regulatory framework indicates the underdevelopment of market.

In an effort to pinpoint and address problems that were limiting the expansion of Indian corporate bonds, the R.H. Patil Committee, a high-level panel, was formed in accordance with the budget announcement for 2005–2006.

The elements affecting the expansion of the Indian corporate bond market are covered in the next section.

7. Inadequate financial framework

Financial system problems have the potential to complicate financial transactions, reduce the effectiveness of monetary policy, exacerbate depressions, cause capital flight and put pressure on exchange rates, as well as raise the cost of saving collapsing financial institutions.

The committee suggested that in order to develop debt market, the establishment of an appropriate structure that supports market-making by primary dealers and investment banks be put in place. It was proposed to obtain permissions to carry out repos under corporate bonds. (Patil, 2005)

8. The credit evaluation procedure

Credit rating gives an opinion on the creditworthiness and reliability of the instrument. Assessing the securities creditworthiness and giving the ratings is important part in securities market and the rating for securities determine trading. The credibility of the information is highly influenced by the variations between local and foreign rating organisations, such as Standard & Poor's, and this hinders the growth of the corporate bond market.(Gyntelberg et al., 2005).

9. Bonds Issues

As we can see in Table 2 bonds are issue via private placement rather than public issue which hampers the liquidity because the private placement issue bond will not be traded in secondary market which definitely make corporate market illiquid.

10. Demand and supply of corporate bonds

Debt securities demand in an economy is heavily influenced by local institutional investors. The majority businesses choose external financing that combines debt and equity. When it comes to the percentage of debt, businesses consider bank financing over financing through bonds in order to meet their financial needs. This is because it is complicated and challenging to raise money by issuing bonds, which results in less need of debt market. The substantial demand for corporate bond markets in India has decreased as a result of the institutional changes on institutional investors to invest in the government securities. Additionally, the legislation requires parking assets in investable securities, which prevents institutions from investing in securities with different credit ratings.

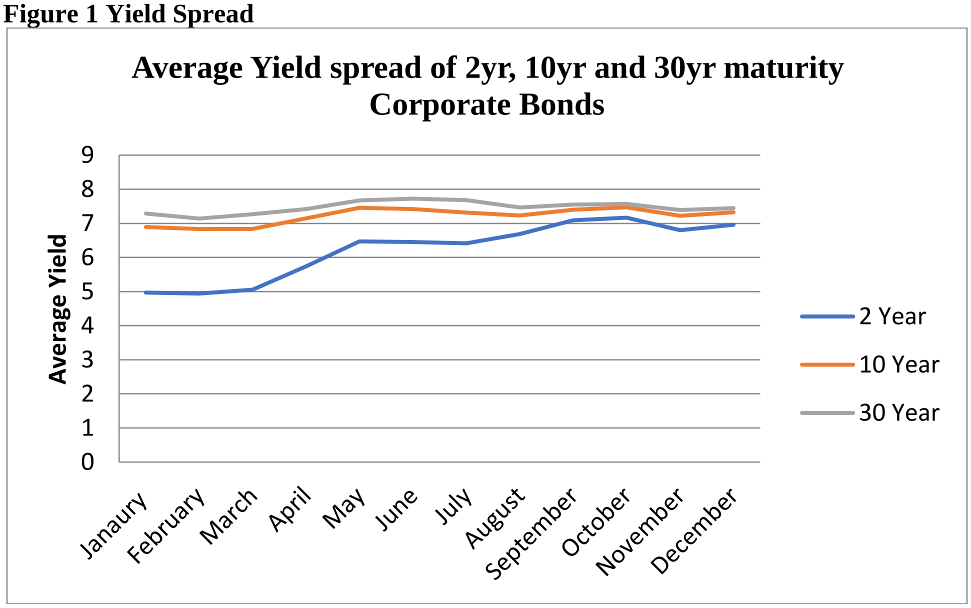
11. Retail Participation

The absence of individual investment leaves a big gap in present debt market. It is found that the primary cause may be a lack of awareness or information regarding the risk and return mechanism. Despite being generally seen as secured asset, Investors essentially steer clear of the corporate debt market as a result of the harsh way that any issues with debt instruments are addressed.

12. Yield Spread

Investors who are risk Takers usually hope for attractive return. Debt Market is known for the fixed return, obviously with decent risk-free returns. Comparing the yield from the Indian bond market to other investment options like mutual funds, ELSS, etc., it is relatively lower. The yield spread for corporate bonds with varying maturities is displayed in the following chart.

Figure 1 Yield Spread



Source: Investment.com

The Above chart illustrates that the yield will increase as the maturity time does, with corporate bonds with a 30 year maturity period producing a better return than those with a 2 year and a 10 year maturity period. While the rate of return is not particularly high in comparison to other investment options, the long term maturity time will result in liquidity risk.

13. Settlement Risk

Since transactions in the market are settled bilaterally among participants, there is no central counterparty to lower clearing risk. One of the obstacles to trading in corporate bonds is this. To facilitate centralized clearing and settlement for corporate bonds, SEBI is now contacting the stock exchanges.

Table 3 No of Corporate Bonds Trade and Settlement

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
2018-19	105150	84421	80.29
2019-20	127957	100347	78.42
2020-21	823689	115164	13.98
2021-22	798955	135921	17.01

Source: SEBI

From the data above, it can be concluded that a small percentage of trades are settled compared to all trades. Despite continuous growth, a higher standard needs to be attained to boost investor trust.

14. Issuance Costs

High Issuing costs are accompanied with the corporate bonds makes corporate to fall far commercial banks and equity market. As we can see the bonds market is particularly sensitive to the nation's tax legislation. Trading norms are different while we compare to other markets.

15. Suggestions

- If there are strong rules to protect investors' interests and preserving the integrity of the markets, investor confidence can grow.
- The stock exchanges would be the greatest place to build a tracking mechanism which manages the dataset like issuance and trading. This may contain the appropriate interfaces with credit agencies to assess any changes in credit ratings.
- Building a proper mechanism for corporate bonds to enhance participation from issuers and investors by reducing the dependence on private placement.
- Creating the awareness about debt market to encourage retail investor’s participation.

16. Conclusion

In this study, we have looked at the factors that have contributed to the sluggish growth of the Indian corporate bond market. According to the study, there are a number of impediments to the growth of the Indian corporate bond market, like effect of private placements, a lack of demand, unattractive yields or returns, solvency risk, and a high standard of rating. These challenges must be taken into consideration by policymakers, who must also quicken the expansion of the vital Indian Corporate Bond Market. However, there are still a lot of other elements at play, such tax complications, unclear regulations, limits on foreign investors, etc., which raise the possibility of further research.

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