# Debt Market @ Corporate India: Key Issues (Full Length Paper)

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## Abstract

*Debt is said to be the tax shield for an Indian company for all its financial needs. The mix of debt capital ensures a good leverage. This paper presents an overview of the debt market @ corporate India's practices & key issues bundled within. A study of the structure and the status of the corporate debt market along with the current policies initiated by Securities and Exchange Board of India, help to identify the associated structural problems in this segment. Based on a detailed analysis of these identified problems, this paper aims at suggesting certain steps, which can help to activate the corporate debt market and to become an important source of finance for the economy. There are several empirical / theoretical studies conducted out to bring developments and status of Indian Corporate Debt Market and to make suggestions to convert it into vibrant market. This paper has some of the following objectives:- Review regulatory and market related developments for the past years in India, Identify structural gaps or deficiency in the Indian Debt Market, States recent regulatory changes and their impact on the market, Make suggestions / recommendations to develop Indian Corporate Debt market as one of most vibrant / liquid transparent and efficient market places. The Driving Force – of the Study:- Regulators, policy makers, academicians and practitioners would anytime desire to have complete markets as they provide investors with opportunities to shift their investment across instruments over time depending on expectations and changes, In India for past several years, reforms have been initiated to develop debt market in general and corporate debt market in particular. Despite all this, corporate debt market in India still lacks depth and breadth. Therefore, the present study has been taken up to review the past developments, to identify weakness/gaps and suggest suitable measures to develop the market.*

## Introduction

- The debt market is much more popular than the equity markets in most parts of the world.
- In India the reverse has been true.
- This has been due to the dominance of the government securities in the debt market and that too, a market where government was borrowing at pre-announced coupon rates from basically a captive group of investors, such as banks.
- Thus there existed a passive internal debt management policy.
- This, coupled with automatic monetization of fiscal deficit

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prevented a deep and vibrant government securities market.

- The debt market in India comprises broadly two segments, viz.,

  (a) Government Securities Market and

  (b) Corporate Debt Market.

- The latter is further classified as Market for:

  (a) PSU Bonds and

  (b) Private Sector Bonds.

- The market for government securities is the oldest and has the most outstanding securities, trading volume and number of participants.

- Over the years, there have been new products introduced by the RBI like zero coupon bonds, floating rate bonds, inflation indexed bonds, etc.

- The trading platforms for government securities are the "Negotiated Dealing System" and the Wholesale Debt Market (WDM) segment of National Stock Exchange (NSE) and Bombay Stock Exchange (BSE).

- The PSU bonds were generally treated as surrogates of sovereign paper, sometimes due to explicit guarantee of government, and often due to the comfort of government ownership.

- The perception and reality are two different aspects.

- The listed PSU bonds are traded on the Wholesale Debt Market of NSE.

- The corporate bond market, in the sense of private corporate sector raising debt through public issuance in capital market, is only an insignificant part of the Indian Debt Market.

- A large part of the issuance in the non-Government debt market is currently on private placement basis.

- From a survey report of Handbook of Statistics on Indian Economy by RBI, it is clear that, on an average private placement accounts for little over one-third of the debt issuance.

- Unofficial estimates indicate that about 90 percent of the private corporate sector debt has been raised through private placement in the recent past.

- The amount raised through private placement has been continuously rising for the past five years which increased by more than 300 per cent over the five year period.

- The growth rate in the public issue processes is only about 80 per cent over the period, increasing from Rs. 20896 crore to Rs. 36466 crore (RBI – 2002).

- The listed corporate bonds also trade on the Wholesale Debt Segment of NSE.

- But the percentage of the bonds trading on the exchange is small.

- The secondary market for corporate bonds till now has been over the counter market.

- With the recent past guidelines issued by SEBI the scenario is expected to change.

## The Goal of the Study

There are several empirical / theoretical studies conducted out to bring developments and status of Indian Corporate Debt Market and to make suggestions to convert it into vibrant market. This paper has some of the following objectives:-

- Review regulatory and market related developments for the past years in India.
- Identify structural gaps or deficiency in the Indian Debt Market.
- States recent regulatory changes and their impact on the market.
- Make suggestions / recommendations to develop Indian Corporate Debt market as one of most vibrant / liquid transparent and efficient market places.

## The Driving Force of the Study

- Regulators, policy makers, acade micians and practitioners would anytime desire to have complete markets as they provide investors with opportunities to shift their investment across instruments over time depending on expectations and changes.
- In India for past several years, reforms have been initiated to develop debt market in general and corporate debt market in particular.
- Despite all this, corporate debt market in India still lacks depth and breadth.
- Therefore, the present study has been taken up to review the past developments, to identify weakness/ gaps and suggest suitable measures to develop the market.

## Structure of Indian Debt Market

The microstructure of Corporate Debt markets in India can be classified in two broad categories:

1. Primary Corporate Debt Market (PCDM)
2. Secondary Corporate Debt Market (SCDM)

### 1. Primary Corporate Debt Market (PCDM)

The PCDM consists of the following basic components and they are:

(a) Issuers

(b) Instruments

(c) Processes

(d) Intermediaries

(e) Investors

(f) Rating Agencies and

(g) Regulatory Environment

The following are the remarks and comments on the various PCDM components as for as Indian scene is concerned:

| PCDM Component | Remarks |
|---|---|
| ISSUER | Private Sector Corporate, Public Sector Corporate, Financial Institutions, Banks and SMEs. |
| INSTRUMENTS | Plain Vanilla Bonds, PCDs, FCDs, ZCBs, FRNs, SPNs etc., |
| PROCESS | In India most popular route to access the market is Private placement, and followed by Public issues. |
| INTERMEDIARY | Two popular modes of intermediaries (a) Brokers and (b) Investment Bankers (or) Merchant Bankers. |
| INVESTORS | Institutional Investors, Banks, Financial Institutions, Pension Funds etc., |
| RATING AGENCY | CRISIL, CARE, ICRA, FITCH etc., As for as India has a well developed credit rating agency system in vogue. |
| REGULATORY | RBI & SEBI in consultation with MoF. |

## Structural Weakness of PCDM

- Lack of large and diverse investors
- Lack of dedicated intermediaries
- Heavy tilt towards private placement
- Lack of investors awareness
- No big focus to develop the PCDM by the government

### 1. Secondary Corporate Debt Market (SCDM)

The SCDM consists of the following basic components and they are:

- Trading Platform
- Clearing & Settlement Mechanism
- Instruments
- Investors
- Regulatory Environment

The following are the remarks and comments on the various SCDM components as for as Indian scene is concerned:

| SCDM Component | Remarks |
|---|---|
| Trading Platform | In India WDM–NSE–NEAT System; Two sub-markets (a) Continuous Automated Market and (b) Negotiated Market. |
| Clearing & Settlement Mechanism | ● Each settlement is unique ● Rolling settlement is in vogue ● T+0 to T+2 range of settlement period |
| Instruments | G-Sec, T-Bills, PSU bonds, Pvt. Sector bonds, Floating Rate Bonds, SLR / Non-SLR bonds, ZCBs, CD's and Commercial Papers etc., |
| Investors | Large Investors – Informal Market – only recently after WDMs aggressive moves transparency has increased. Many investors as like PCDM. |
| Regulatory Environment | SEBI and RBI plays a vital role in regulating the environment with the support of MoF. |

## Structural Weakness of SCDM

- Absence of Clearing Corporation.
- Dedicated trading platform.
- Exclusive, well capitalized and professional intermediaries.
- Lack of reliable and up to date information.

**After Reviewing Functioning of Debt Market in Some Other Markets And In India, The Following Issues Have Been Identified As Some Of The Major Aspects Affecting The Market:**

The major aspects affecting the market are as follows:

## (a) Poor Quality Paper

- Quality of paper refers to regular payment of coupon and repayment of principal at the right time.
- Companies that do not default on these two counts are said to be issuing high quality paper.
- High quality paper issued in the market does not create problems / issues for investors, regulators and issuers.
- The question of private placement vs. public issue and institutional investors vs. retail investor are of less significance and almost no consequence in the market, if the quality of the paper is good.
- It is the poor quality paper with a possibility of non-payment of coupon and principal that poses threat to the development of the market and hence stringent regulatory norms are warranted.
- Imposition of additional regulatory provisions, though has its opportunity cost, therefore, it is essential to strike a balance between regulatory protection and disclosure based regulation.
- Further, in an emerging market / developing market the incidence of industrial sickness is relatively high.
- This high industrial sickness generally translates into default of companies and their obligations.
- The bond paper issued by companies turns worthless and creates problems in the minds of investors.
- Since most retail investors, who invest in bonds, hold for maturity and also hold their investment in a fewer number of companies, any default will wipe out their savings and security for the post retirement / old age requirements.
- Therefore, defaults in fixed income securities market attract more attention of the public and the regulators.

## b) Inadequate Liquidity

- Secondary Market for Corporate Debt lacks liquidity in India.
- Hardly few trades take place, that too, in a limited number of issues.
- There is a chicken and egg problem.

- Poor liquidity is attributable to inadequate number of good papers and lack of sufficient investor base in terms of quantity as well as diversity.

## c) Investor Base

- In many markets the number of investors in fixed income securities market runs into thousands and their variety include mutual funds, insurance companies, pension funds, endowments, private banking institutions, banks and retail investors.
- In India, we have primarily mutual funds investing in bond funds and their investment requirements are one sided, if money starts coming in all mutual funds will get in large quantities and if it starts going out it will go in huge quantities thus creating storms in the market.
- Insurance funds and pension funds are the long term investors.
- Any short term shocks can be absorbed by these long term players. Insurance companies in India till recently were limited in number and they were investing to hold till maturity.
- Individual investors generally hold for maturity.
- Now that we have more private sector and joint sector players, their presence in the primary as well as in the secondary market can be felt in the time to come.
- Pension funds are very limited today.
- Banks do invest in the primary market and their activity in the secondary market is almost nil.

## d) Reculatory Arbitrate (additional costs on listed companies)

- Companies operating in India can be broadly divided into two categories on the basis of regulatory jurisdiction: Listed and Unlisted.
- All companies are, by and large, administered by the Companies Act, 1956 and the regulatory administration is carried out by DCA, Ministry of Finance.
- Listed companies are overseen by SEBI through Listing Agreement of exchanges.
- Listed companies are required to follow elaborate corporate governance principles, accounting and disclosure standards, continuous disclosure standards and hence incur additional costs.
- Unlisted companies, thus, enjoy regulatory arbitrage over listed companies.
- There is a perception that listed companies seek delisting owing to perceived regulatory arbitrage.

## e) Debt Versus Equity : Cost and Risk

- By design and necessity debt has finite life sometimes, very short whereas equity is said to have perpetual life.
- Therefore, debt paper is offered and reoffered quite frequently by companies.

- In falling interest rate scenario, as has been the case in India for the past few years, corporates tend to borrow for shortest possible period thus restoring to repeated issue costs and interest rate risks.
- High regulatory and compliance costs add to cost of resources.
- Therefore, corporates might innovate new methods of raising capital.
- Either way, the corporate debt market will be affected adversely.

## f) Incomplete Access to Information

- One of the most important issues is lack of sufficient, timely and reliable information on bonds and on bond markets to the investors. Information on bond issue, size, coupon, latest credit rating, trade statistics are sparsely available.
- If the investors have access to the relevant information more frequently then it may be possible for them to assess the quality of the paper and take decisions.
- In addition, there is no one place in India where one can have all the data pertaining to corporate debt issues.
- No one knows exactly how much debt is outstanding on any given date and different agencies have incoherent estimates for the same.
- A survey says that annual public issue amount averages around Rs. 40,000 crore for the past 3 years.
- If the entire 5 year period is considered roughly Rs. 170,000 crore was raised through public issue.
- However, the amount of debt outstanding for trading at NSE excluding government securities and treasury bills comes to roughly Rs. 100,000 crore.
- There is a wide gap between publicly issued amount and that which is admitted for trading even if one considers average maturity period of five years. Generally bonds have longer maturity.
- Hence, any regulatory action either becomes ineffective or misdirected leading to unintended results target.
- Therefore, there is an urgent need to launch a survey and prepare a comprehensive database and bring in transparency.
- Transparency ensures confidence which in turn ensures liquidity. Sudden shocks can be mitigated.

## g) Interest Rate Structure

- Very skewed interest rate structure exists in India.
- Corporates with “AAA” rating offer lower coupon than soverign rate offered on certain instruments such as public provident fund, National Saving Certificates.
- Individual investors, therefore, have almost nil or no interest in coupon debt market, both primary as well as in

secondary, unless they are accom panied by some fiscal concessions resulting in net higher return compared to above cited instruments.

Now let us discuss about the suggestions / recommendations for the development of debt market in India.

## Suggessions / Recommendations

The following are various suggestions and recommendations made for a strong, vibrant & healthy corporate debt market in India:

- Increased disclosures;
- Increased frequency of disclosure;
- Provision of reliable information;
- More public issues / wide distribution;
- Improvement in quality of paper.
- Bringing in a concept of "Bond Manager" or "Debt Manager" to replace or assist the merchant bankers, who lack knowledge of debt market.

## Conclusion

- **"There is no minimum at the start and there no maximum at the end".**
- This article is an attempt to explore the existing structure and point out the structural deficiencies and suggest and recommend for a vibrant corporate debt market in India.

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