

FINANCIAL INSTRUMENTS: A STUDY ON CORPORATE BONDS ISSUES AND CHALLENGES IN INDIA

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INTRODUCTION:

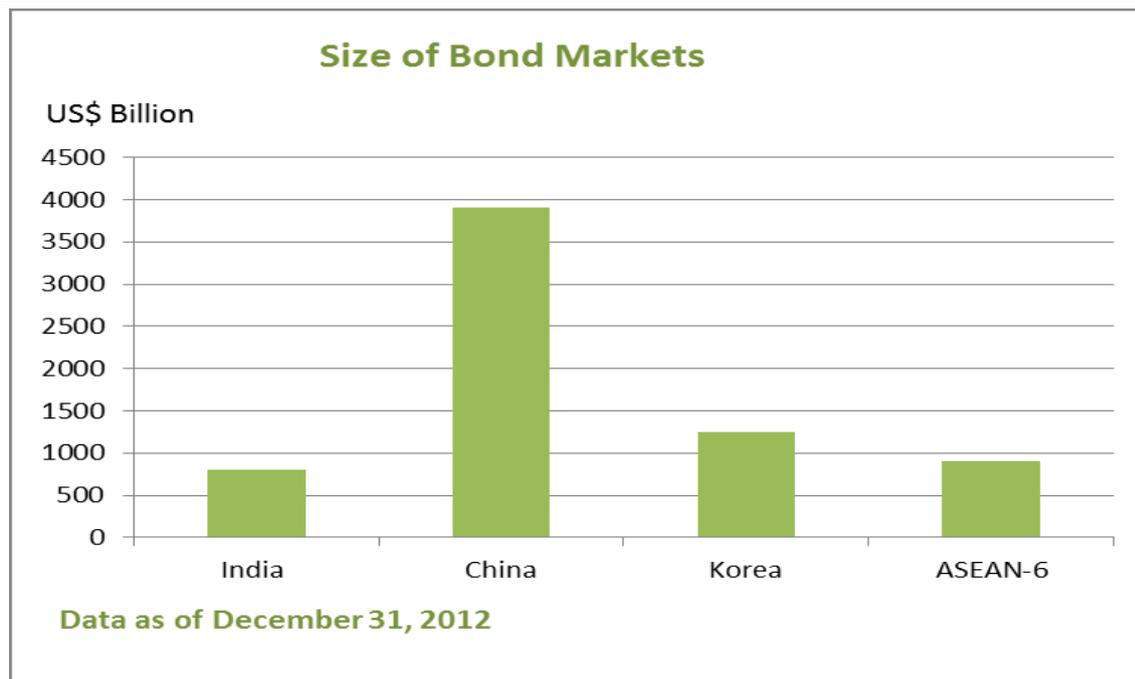
The corporate bond markets in India have seen little growth and development. Despite many measures to deepen and kick-start the market, it has failed to take off. A glance into resources mobilized from the primary market indicates a significant skew towards the equity market. Corporate bonds make up a small percentage of resource mobilization. This is in stark contrast to the developed world, especially the U.S., Germany and Japan, where bond markets contribute more than 80% of the financing needs of corporate firms. In contrast, in India, between 1993 and 2011, equity markets (covering equity and convertible commercial preference shares (CCPS)) played a predominant role, contributing more than 50% toward resource mobilization from primary market India has solid aggregate demand and a consumer-driven economy. At the international level, India has fairly diversified exports including software, iron ore, commodities and non-commodities merchandise like machinery and chemicals; however, the prevalence of a consumer-based economy gives the country a great advantage over many other emerging markets that are overly reliant on exports. Nevertheless, the depth of the Indian capital markets lags the mature markets.

Overview Of Indian Debt Market:

The Need for a Well-Developed Capital Market

India's growth over the last decade has contributed to the emergence of a large middle class. The availability of capital market instruments will assist in a) the growing pool of middle class savings being used to develop a more sustainable and solid foundation for the Indian economy and b) providing alternative investment vehicles that provide a greater return than that available on bank deposits.

For a number of reasons, the bond market should be the leading force in this important process. First, it would significantly help strengthen and grow the private corporate sector. Corporations currently rely heavily on banks as the major source for financing their businesses. Going forward this must change. Currently, due to a variety of reasons, the investor mindset tends to hold securities in a hold-to-maturity portfolio. An under-developed bond market gives the banking sector a quasi-monopoly position in the lending market. As a consequence, banks have less and more costly capital to lend to the small and medium-size enterprises.



OBJECTIVES OF THE STUDY

Exploratory research has been done to:

- 1) Justify the need for a healthy corporate debt / bond-market
- 2) Analyze the present state of Indian corporate bond market vis-a-vis corporate bond market of the other developed & developing countries.
- 3) Find the reasons for under/ slow development of Indian corporate bond market.
- 4) To identify the constraints for growth of financial securities in India.

Research Methodology

The present study is of exploratory in nature. It attempts to explore the present state of Indian corporate bond market. For the purpose of fulfilling objectives of the study, secondary data from various sources have been collected and arranged to arrive at a conclusion. The various sources of secondary data are:

- Journals
- Research papers
- Official websites of various national & international regulatory bodies (RBI, SEBI etc.)

Data Base and Methodology

The study is primarily based on secondary data. Secondary data have been collected in two stages. In the first stage, data from publications of Government of India, Central Statistical Organization (CSO), Reserve Bank of India (RBI), Stock Exchanges, Securities and Exchange Board of India (SEBI) and from relevant reports, periodicals, and news papers are collected and analysed. In the second stage, For collected from the Firm level data have been collected from the annual reports and the analysed. Discussions have also been held with the share brokers, portfolio managers, officials of UTI capital markets, and professors and other experts in the field, to get an insight in to the problems of stock market investment.

A Government security is a tradable instrument issued by the Central Government or the State Governments. It acknowledges the Government's debt obligation. Such securities are short term (usually called treasury bills, with original maturities of less than one year) or long term (usually called Government bonds or dated securities with original maturity of one year or

more). In India, the Central Government issues both, treasury bills and bonds or dated securities while the State Governments issue only bonds or dated securities, which are called the State Development Loans (SDLs). Government securities carry practically no risk of default and, hence, are called risk-free gilt-edged instruments. Government of India also issues savings instruments (Savings Bonds, National Saving Certificates (NSCs), etc.) or special securities (oil bonds, Food Corporation of India bonds, fertiliser bonds, power bonds, etc.). They are, usually not fully tradable and are, therefore, not eligible to be SLR securities.

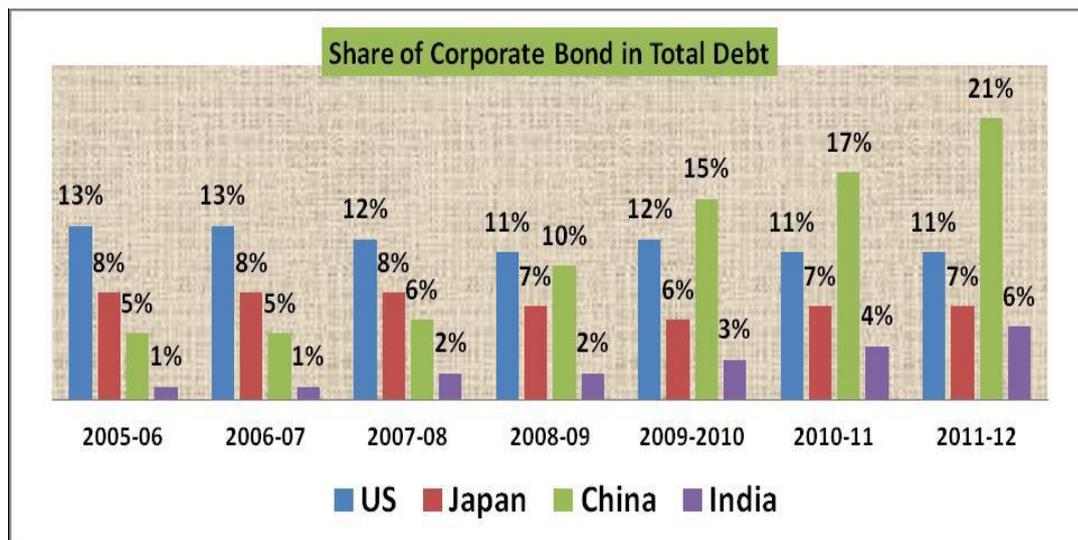
Top 10 issuers- Outstanding Corporate Bonds INR Billion	
Issuer	Total O/S
Power Finance Corporation	630
Housing Development Finance Corporation	469
Rural Electrification Corporation	454
National Bank For Agriculture and Rural Development	345
IDBI Bank Limited	313
India Railway Finance Corporation	298
LIC Housing Finance	298
State Bank of India	297
Power Grid Corporation of India	282
ICICI Bank	270
Total of above issuers	3656
Total Corporate bonds O/S in India	8895
Top 10 Issuers as % of total	41%

Source: NSDL

Corporate Bonds

Corporate bonds are longer-term debt instruments issued by companies to raise money for business expansion. These debt instruments usually have a maturity date of at least a year after issue.

The Reserve Bank's role in the development of corporate bond markets is indirect and is governed by its interest in monetary policy transmission and in the stability and efficiency of the financial sector as a whole. Besides, banks, whose financial health is the responsibility of the central bank, have a large exposure to the corporate bond market with more than 80 per cent of such investments being in privately placed corporate securities. Activity in the secondary market is thus rather thin. As the non-transparent practices in this market is a matter of concern, Reserve Bank issued guidelines in June 2001 specifying the due diligence to be undertaken, disclosures to be obtained and credit appraisal to be made by investing banks. Subsequently a Working Group set up by RBI (February 2002) went into the detailed disclosure norms and data collection measures on private placements. Currently, RBI and SEBI are working together to devise a regulating mechanism for the issuers of private placements which will address issues of quality, transparency, end-use of funds and listing of such bonds.



The different types of bonds in the Indian bond market can be categorized into the following:

- Government bonds: issued directly by the government of India, the so called G-Sec;
- Borrowing by state governments: made by single states within India;
- Tax free bonds: issued directly by quasi-sovereign companies allow market expansion for investors and, in particular, embody retail interest into the market;
- Corporate bonds: this market must be further developed as proved by the ratio of outstanding government bonds to total outstanding bonds;
- Banks and other financial institutions bonds: they are underperforming;
- Tax-savings bonds: issued directly by the government of India, they provide investors with tax rebates, in addition the normal rate of interest;
- Tax-saving infrastructure bonds: issued directly by infrastructure companies approved by the government, they offer tax rebates along with a decent rate of interest.

Instruments on the basis of rate interest

Fixed Rate Bonds – These are bonds on which the coupon rate is fixed for the entire life of the bond. Most Government bonds are issued as fixed rate bonds.

- ❖ **Floating Rate Bonds** – Floating Rate Bonds are securities which do not have a fixed coupon rate. The coupon is re-set at pre-announced intervals (say, every six months or one year) by adding a spread over a base rate. In the case of most floating rate bonds issued by the Government of India so far, the base rate is the weighted average cut-off yield of the last three 364- day Treasury Bill auctions preceding the coupon re-set date and the spread is decided through the auction. Floating Rate Bonds were first issued in September 1995 in India.
- ❖ **Zero Coupon Bonds** – Zero coupon bonds are bonds with no coupon payments. Like Treasury Bills, they are issued at a discount to the face value. The Government of India issued such securities in the nineties, It has not issued zero coupon bond after that.
- ❖ **Capital Indexed Bonds** – These are bonds, the principal of which is linked to an accepted index of inflation with a view to protecting the holder from inflation. A capital indexed bond, with the principal hedged against inflation, was issued in December 1997. These bonds matured in 2002. The government is currently working on a fresh issuance of Inflation Indexed Bonds wherein payment of both, the coupon and the principal on the bonds, will be linked to an Inflation Index (Wholesale Price Index). In the proposed structure, the principal will be indexed and the coupon will be calculated on the indexed principal. In order to provide the holders protection against actual inflation, the final WPI will be used for indexation.

- ❖ Bonds with Call/ Put Options – Bonds can also be issued with features of optionality wherein the issuer can have the option to buy-back (call option) or the investor can have the option to sell the bond (put option) to the issuer during the currency of the bond.

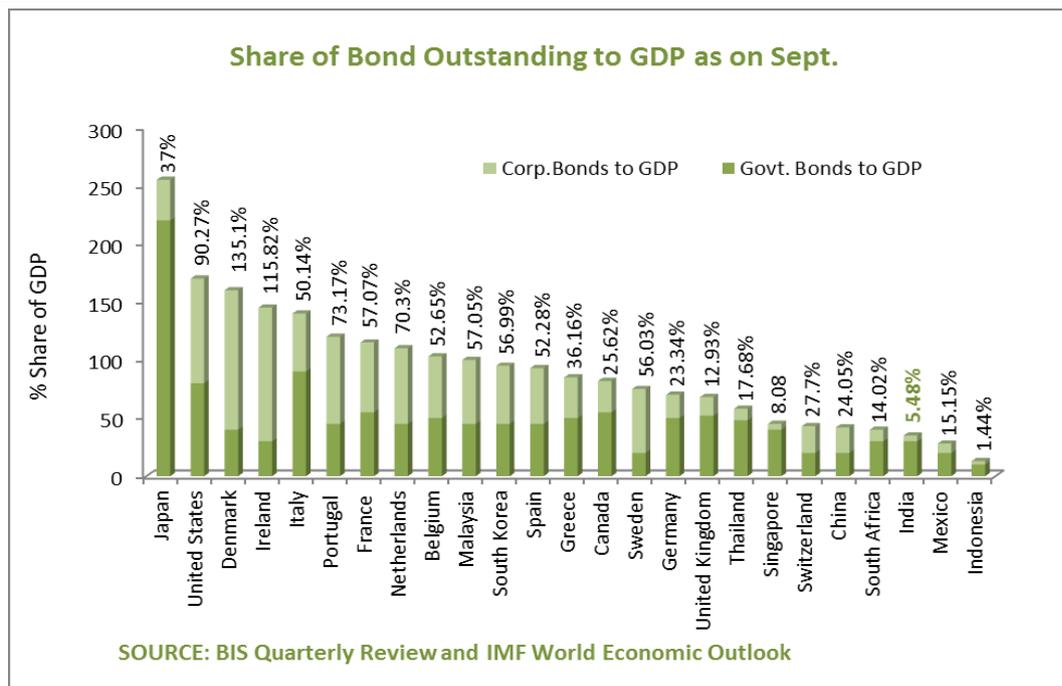
Corporate Bond Market: Global Scenario

Global bond market stood at US \$ 98 trillion as of 2012 out of which 70% were constituted by domestic bonds. The US was the largest market with 38% of the value outstanding, followed by Japan 20%. Government bonds accounted for 59% of the outstanding value of domestic bonds in 2012. Since 2001, the US corporate bond markets have been an important source of capital for issuers, with daily trading volume of \$16 bn and more than 400 mutual funds across the world are investing in US high yield bonds. Increasing fear over the ability of some governments' to repay their debt has resulted in a significant widening of government bond yields. Recently, 10- year Spanish government bonds reached the 6% mark, which is considered very high. In relation to the size of the economy, in Europe, public sector debt is highest in Greece (134% of GDP) followed by Italy (119%), Portugal (91%) and Ireland (87%). Recently Greece's credit rating has been downgraded by a number of times. Other countries with high budget deficits such as Portugal, Ireland, Turkey, Italy and Spain have also experiencing downgrades in government debt. However, net government debt in emerging markets is set to improve in the next few years due to the high level of projected government borrowing in many countries. On the other hand, private bond market capitalisation as a percentage of GDP is high in case of U.S. (128% of GDP) & Spain (90%); India (5%) is lagging behind. After 2008, (Post Crisis period) the share of corporate debt as a percentage of GDP has been declining in the developed countries like U.S. and Japan. On the other hand, share of some emerging market like China and India is gradually increasing due to increasing trend of corporate approach towards the market. However, during the period 2005-06 to 2011-2012 the share of corporate bond in total debt showing a declining trend in developed countries (U.S., Japan) as compare to emerging market economy (China, India).

Globally corporate bond markets are OTC (Over the Counter Exchange) markets. Over the counter (OTC) and/or the telephonic market rather than exchanges extensively used by the institutional investors and professional money managers for bond market transaction. In Japan, for instance the value of bonds traded on the exchanges accounted for a mere 5% of the total traded value of bonds. Internationally corporate bond markets are primarily wholesale markets. Retail interest is not likely to be noteworthy in corporate bond market. Unlike in the case of equity where scope of upside appreciation is high, the scope for such upside gain is limited in case of bonds while there is a significant downside risk due to

A cross country analysis shows that the domestic debt securities outstanding is very high (as a proportion of GDP) in case of the USA, Italy, Japan and Korea (more than 100 per cent). The relative size has increased in recent years in almost all the developed countries which have faced the crises. However, the size of domestic debt market is low in India and China. Despite the crisis, when all countries went for fiscal stimulus and monetary easing, the ratio has remained mostly stable in India the USA, South Korea and Italy. This is very low for India. Among the developed countries, the UK is having a very low ratio. However, in case of China, this has increased from a low of 13 percent in 2005 to 25 percent by 2011.

The share of FIs and corporate in the total outstanding domestic debt securities is very high in countries like the USA and South Korea (more than half of the total domestic debt securities). It is low in case of Japan and UK. The share is declining in US, Germany, Japan and UK, which could be attributed to the fiscal and monetary stimulus undertaken by these countries in the aftermath of the global financial crisis. In case of China and India, this share is increasing consistently. Excluding FIs, the share of corporate in the total outstanding domestic debt securities is very low (except in case of South Korea). It has been increasing consistently in case of China.

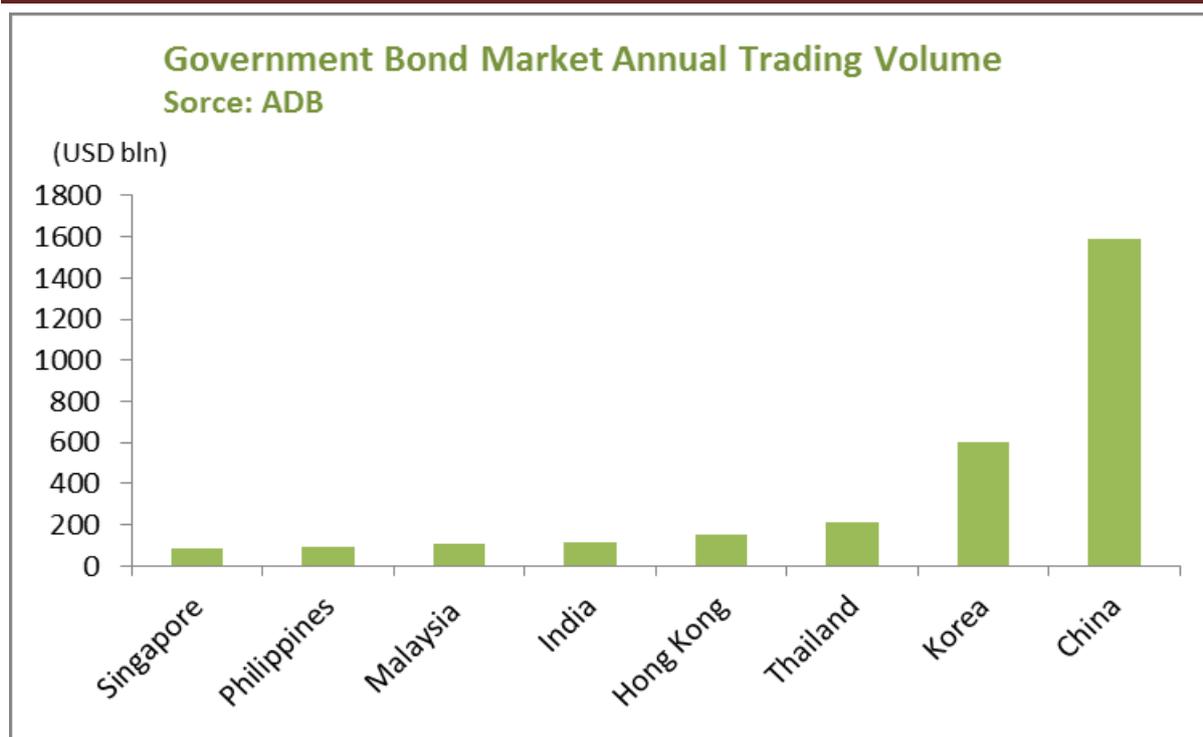


INITIATIVE/ACTION PLAN TO IMPROVE CORPORATE BOND MARKET : SEBI:

Action Plan Developed By Sebi For Development Of Corporate Bond Market

The Action plan developed by SEBI for the further development of corporate bond market comprises of the following

- Giving mandate to BSE to implement the proposed project of setting up a unified exchange traded corporate debt market elaborating the scheme with a road map.
- Making it mandatory for all entities to report trades undertaken in the corporate 21 debt market and also simultaneously requesting other regulatory agencies to issue guidelines to all entities regulated by them on the need for reporting all trades in corporate bonds in the specified manner.
- Making it mandatory to undertake trades in corporate bonds only through the assigned trading platform for the purpose.
- Seeking guidance from the proposed Corporate Debt Market Development Advisory Committee. This Committee could meet at regular intervals to advise on other SEBI related areas where further action is required, to develop a vibrant and dynamic corporate debt market in this country.



Banks and Bond Markets

In India, the banking system which incidentally has been dominated by the public sector, played a pioneering role in initiating growth of mutual funds, merchant banking and other financial services. Structurally, banks have been permitted to operate through subsidiaries as asset management companies, PDs, merchant banks and mutual funds. The Development Financial Institutions also played a role but they dominated in promoting credit rating agencies, sponsoring national stock exchanges, depositories, etc. In regard to Government Securities segment of the market, which accounts for about 75 per cent of the stock, about 60 per cent of the stock is held by the banking system. As regards the corporate debt segment, both private placement and public issue, over half of the issuance is by banks and financial institutions.

Credit Rating Agencies

In India, there are four Credit Rating Agencies (CRAs) and each of them has collaboration with internationally renowned CRAs to supplement the local knowledge and skills. The RBI prescribes a number of regulatory uses of ratings. Of those related to the money and debt markets, a corporate must get an issue of Commercial Paper rated and may issue such paper subject to a minimum rating. Securities and Exchange Board of India (SEBI), which is the regulator of CRAs has stipulated that ratings are compulsory on all public issues of debentures with maturity exceeding 18 months. Pension funds can only invest in debt securities that have high ratings, as per the stipulations of Government.

RBI AND GOVT.

The removal of tax deduction at source (TDS) on Government Securities resulted in ending the practice of voucher trading in the Government Securities market and thus removing pricing distortions in the market. The amendments to the Indian Stamp Act, 1899 have exempted debt instruments dealt in demat form from the applicability of stamp duty (Government Securities as such are exempted from the stamp duty). This encouraged demat holding/transactions in debt instruments, as also trading in debt instruments.

The recent amendments to Section 47 of the IT Act, facilitating securities lending and borrowing operations will ensure safe and smooth settlement through the recently established CCIL. The recent notification issued by Central Board of Direct Taxes (CBDT), Government of India in bringing about rationalisation in the tax treatment for the deep discount bonds (where marked-

to-market gains are to be reckoned for tax purpose), apart from removing the distortions will keep the market in readiness for the development of STRIPS in Government Securities and facilitate a zero coupon yield curve.

Volume in Government Bonds Market		
Year	Primary Issuances* (billion)	Secondary Market Trade \$ (billion)
2005-06	1,527	8,648
2006-07	1,668	10,215
2007-08	2,238	16,539
2008-09	3,911	21,602
2009-10	5,821	29,139
2010-11	5,410	28,710
2011-12	6,686	34,882
*Gross for Central and State Governments. \$ Single-Side Volume		
SOURCE: RBI		

Issues Of Concern – Limiting The Further Development Of Corporate Bonds Market

- **Inadequate Liquidity:** In India, secondary corporate bond market has tended to be illiquid given the buy and hold strategies followed by most institutional participants, lack of proper market infrastructure and the inability of small- and medium-size enterprises to access the debt markets. As a result, the turnover in corporate bond segment is miniscule compared to Government securities market (Turnover in Corporate bond segment has been 10% of turnover in Government securities market over the past few years).
- **Lack of Risk management market:** One of the main reasons for Indian corporate bond market to have failed to pick up is absence of interest rate/ credit derivatives which can efficiently transfer the risks arising out of interest rate movements and default probabilities. This has resulted in limited participation of banks in interest rate futures and swap markets and hence derivatives market in corporate bonds has failed to pick up. Also the CDS guidelines for corporate bond issued by RBI lately will be slow to take off given the restriction on participation and absence of central counterparty.
- **Higher rated Companies dominate Corporate issuance:** In Indian corporate bond markets almost 70% of the bonds outstanding by value are rated AAA. This indicates that the number of sub investment grade issues is minimal and the proportion below AAA is small. Given the fact that only the largest corporations are likely to achieve an AAA rating, others are thus excluded from the bond market and obliged to rely on bank finance.
- **Private Placement issues:** Small and medium corporate issuers generally raise resources through the private placement route given the cost considerations, ease of issuance, greater institutional demand and less retail interest. This leads to creation of multiple small issuances, which results in fragmentation and a deterrent to liquidity. In India, over 95% of issuances are through private placements.
- **Absence of Longer maturity Bonds:** Given the underdeveloped structure of Indian corporate bond market, the term structure (Asset Liability management) needs of investors such as Insurance companies are not met. The longest maturity bond available in Indian corporate bond market is of 25 years tenure whereas given the liabilities structure of long term investors require higher tenure bonds so as to mitigate the reinvestment risk in their portfolio. This serves as big lacunae in participation of long-term investors in corporate bond market vis-à-vis government securities market.
- **Tradability/Liquidity of Zero coupon bonds:** Given the asset liability structure and need for mitigation of reinvestment risk, low liquidity of zero coupon bonds inhibits long term investors to adequately hedge/cover asset liability mismatch.

- **Corporate bonds repo:** Corporate bonds have been made eligible for undertaking repos with maturity of repo ranging from 1 day to 1 year. However this market has failed to take off given that repos are permitted only in instruments having an original / residual maturity of 1 year (bulk of the activity happens in the less than 1 year segment).
- **Lack of bonds issues database:** In Indian market, there is no single database which captures the issuance of corporate bonds as also the credit rating actions affecting those bonds. Even statistics provided by SEBI/RBI are only restricted to new issuances and does not cover credit events or total outstanding bonds.
- **Lack of universal conventions:** Globally bond market conventions such as standardized day count in lieu of calculation of accrued interest have facilitated the smooth trading of corporate bond markets and reduce the time needed in negotiation. In Indian corporate bond market, absence of such conventions has constrained the development of corporate bond market given the difficulty in terms of negotiation given the practice of different day counts.

FINDINGS OF THE STUDY ARE:

- ✓ The analysis indicates that among the various factors that have influenced development of corporate bond market, the growth of the Government bond market has had positive influence on the development of the corporate bond market in India as in the case of other countries such as South Korea.
- ✓ The financing of Government deficit spending as reflected in the domestic credit extended by the banking sector has exerted a negative effect on its development. One reason for the negative impact of domestic credit provided by the banking system in the corporate bond market in countries such as India may be because banks are required to finance the Government budget deficit by holding Government securities.
- ✓ Other factors such as the size of the economy, openness, size of the stock market and institutional factors like corruption have had little or no impact on the development of the corporate bond market.
- ✓ According to the pecking order theory, profitable firms tend to finance through internal sources first and then access external sources. Among external sources, companies tend to finance with debt or issue of corporate bonds first and then equity. Companies in India, however, tend not to follow the pecking order theory and have instead depended more on external sources rather than on internal sources. Among the external sources, bank loans seem to dominate the borrowings for these companies.
- ✓ One of the reasons for the bank finance being preferred by corporations is due to the prevalence of cash credit system in banks in which the cash management of the corporations is actually done by the banks. This indicates that the corporate bond market still has a long way to go before becoming a viable source for companies to finance their investments.
- ✓ The retail investors' presence in the corporate bond market in India is still shallow despite specific reforms, such as, reducing the size of trading lots and the recent increase in foreign investor's limits in the corporate bond market. According to the study, India needs to explore innovative ways to attract retail investors.
- ✓ There is scope for further improvements in certain areas, such as, rationalizing the stamp duty structure across the country and fixing stamp duties based on tenor and issuance value to encourage public offerings of corporate debt.

Recommendations of R. H. Patil report (Reasons for underdeveloped corporate bond market in India)

Following the recommendations of the High Level Expert Committee on Corporate Bonds and Securitization, The committee highlighted the following issues that the regulators should further push for having a Vibrant bond market:-

- ▲ Non-existence of a standardized trading platform and a central clearing house.
- ▲ Stamp duty is complex and variable between locations leading to increased cost of stamp duty. The stamp duty for a typical debt issuance is 0.25% of the total issue size. In addition, the taxes are non-uniform across the states. The level and complexity of stamp duty also encourages an arbitrage-based approach and hence, the investment decisions by the investors at times are purely driven by tax considerations.
- ▲ Retail participation remains low due to lack of knowledge and understanding of bonds as an asset class.
- ▲ Life insurance companies and pension funds, which have incentives in investing for longer tenor, are governed by strict investment norms.
- ▲ Lack of risk management/hedging products, the interest rate derivative market is not well developed due to existing regulations. There is a need for the introduction of a CDS market to hedge/manage the credit risk.

Suggestions And Recommendations Policy Prescriptions For Development Of Corporate Bond Markets In India

- FII participation: The prevailing withholding tax on interest earned on corporate bond holdings acts as a deterrent for most FIIs (Foreign Institutional Investors). Given that most of the long-term investors internationally are non-tax paying entities (like pension funds), they are not able to set-off/tax credits in their home jurisdiction and thus WHT results in significant lowering of investment returns. To rectify this anomaly and encourage more active participation from FIIs, exemption of WHT on interest earned on their corporate bond holdings in India should be discovered.
- Risk Management: To enable FIIs to manage their currency risk in respect of their investment in Corporate Bonds, they should be allowed rebooking of Foreign exchange hedges and also hedging of expected coupons over and above their initial investment amount in corporate bonds. This would enable derisking of future cash flows and thereby wider participation corporate bond market.
- PF participation: Presently PF (Provident Funds) trusts are not allowed trading in their portfolios, which leads to reduction in floating stock in the market, thereby impacting the secondary market liquidity for bonds. Hence, allowing PFs to churn their portfolios for maximization of returns would lead to deepening of corporate bond markets. Also PFs should be allowed greater allocation towards bonds issued by private sector.
- Retail participation: To ensure wider retail participation, particularly the High net worth individuals, the face value of bond instruments may be reduced from Rs. 10 lakhs currently to Rs. 50,000 or Rs. 1 lakh. Also fiscal incentives should be on listed corporate paper such as waiver of tax on capital gains or interest Income, so as to create level playing field with investments in equity.
- Market trading platform infrastructure: In line with integrated trading and settlement system that exist for Government securities (NDS), similar platform is proposed for corporate bonds to ensure anonymous trading and efficient trading of securities among market participants. Furthermore market participants must be allowed to take intraday calls (moving from DVP I to DVP III system), on similar lines with Government securities.
- Reporting of Trades: As per prevailing regulations, only entities regulated by RBI and SEBI are required to report and settle their trades through the exchange-based or FIMMDA platforms. To ensure efficiency and transparency in flow of market information, it should be made mandatory for all participants to report all trades.
- Corporate Bonds Repo: As per RBI guidelines, repo in corporate bonds can be done only in instruments having an original / residual maturity of 1 year. This has resulted in lackluster volumes in corporate bonds repo market given the fact that bulk of the activity happens in the less than 1 year segment (as mutual funds are significant player in the corporate bond market). To kickstart the corporate bond repo market,

instruments having original / residual maturity of less than 1 yr, say with a residual maturity of at least 1 month should be allowed for repo. Also, CP and CDs should be considered as eligible instruments for repo.

- Bank participation: Banks should be allowed to run trading positions in corporate bonds and such trading book positions may be considered for certain relaxation from overall single entity borrower limits. This would help smaller banks to participate in the corporate bond market actively, who are currently constrained by such limits. The regulator should also consider exempting borrowings through repo in corporate bonds from CRR/SLR requirements in line with repo transactions in Government securities. This would further help kick-start the repo market for corporate bonds by encouraging participation from various banks.
- Credit Enhancement: In India where there is a lacuna in terms of long term funds for Infrastructure sector, domestic corporate bond markets can play a significant role in its development. To address this lacuna, the regulator should allow banks and domestic financial institutions to extend credit enhancement for bonds and debentures issued in the onshore market by companies engaged exclusively in the development of infrastructure or by the Infrastructure Finance Companies, subject to such instruments having an average maturity of at least 5 years. Also, such instruments should not have any prepayment and call / put options before 5 years.
- Universal Conventions Currently there are no standardized conventions with respect to day count, face value and shut periods which leads to confusion among participants with regards to deals reported. Standardization of above parameters would help in improving secondary market liquidity and also ensure efficient flow of information and trade reporting.
- Issuance patterns: Currently, reissuance of corporate bonds is governed by funding and timing requirements of issuers, thereby resulting in variance in coupons and dates of issuances. Reissuance of corporate bonds should be allowed under the same ISIN (International Securities Identification Number), thereby ensuring consolidation of issuances. This will ensure large floating stock of each issuance thereby improving secondary market liquidity and better price discovery mechanism. Also the shut period of bonds should be reduced from 15-30 days currently to 1 day in line with Government securities market thereby ensuring market liquidity.

The GoI, RBI and SEBI have initiated several reforms in the Government and corporate bond market to address the factors impeding the corporate bond market in India. Several committees such as the High Powered Expert Committee on the corporate bond market (Patil Committee), Committee for Financial Sector Reforms etc. have made recommendations to improve the corporate bond market. The recent reforms undertaken by the GoI, RBI and SEBI have focused on addressing the recommendations of the various committees on corporate bond market. Substantial progress has been made in addressing the problems which have hindered the development of the corporate bond market in India.

Conclusion

The study has analysed the various stages of the development of corporate bond market in India, with a cross-country comparison. This study has found that the corporate bond market of India is not deep. In Indian context, a combination of factors such as Small investor and trader base Higher costs, Only partially convertible rupee, Lack of a credit default swap (CDS) market, Lack of awareness among retail investors, Regulatory barriers Transparent reporting platform, Clearing and settlement, Repo in corporate bonds, and classification, Primary dealers procedural hassles, legal issues, and preference of the corporates for private placement in issuance is not helping the cause of the corporate bond market. Finding ways to make public offerings more attractive will help to bring in the retail investors, and address the liquidity problem in the secondary market of this segment. The concern for developing corporate bond market has been strongly felt in recent years, due to massive infrastructure investment needs,

which can be only financed, if we were to have a robust market for corporate bonds. FIIs have been lured to invest in this segment to bring in the much needed foreign funds at a time when the current account deficit is abominably high. Hopefully, these developments will propel policymakers to expedite the development of a mature corporate bond market. Like the equity, foreign exchange, and government securities market, which have all been nudged, and forced to develop, due to the occurrence of some event or crisis, the corporate bond market will also go through the same phase of development.

The sub-prime crisis in the U.S. has shattered the complacency of regulators dependent on the banking system. Thankfully, there is awareness at the highest echelons of political and economic policymaking for the dire need to develop the corporate bond market. Coordinated steps are also being taken in this regard by the HLCC (High Level Co-ordination Committee). Each step will undoubtedly incrementally incentivize the corporate bond market. But, instead of small steps, a big leap is needed to develop a strong corporate bond market in India.

Although a plethora of reforms have been initiated in Indian corporate bond markets since 1992, the size of the corporate bond market in India has remained miniscule compared to both global markets and Asian peers. In India where 95% of issuances are through private placement, reforms are required on market structure, tax related issues and streamlining issuance and settlement process so as to ensure wider investor participation. To ensure vibrancy and liquidity in bond markets, bold reforms need to be implemented so that corporates reliance on bank lending goes down and credit risks gets diversified in the economy.

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