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भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

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DRG Study No. 40 -
'A Study of Corporate Bond Market in India:
Theoretical and Policy Implications'

The Reserve Bank of India today released on its website the DRG Study titled, "A Study of Corporate Bond Market in India: Theoretical and Policy Implications". The study is co-authored by Prof. Sunder Raghavan, Professor of Finance, Embry-Riddle Aeronautical University; and Shri Ashok Sahoo, Director, Financial Stability Unit; Shri Angshuman Hait Assistant Adviser, Department of Statistics and Information Management; and Dr. Saurabh Ghosh, Assistant Adviser, Department of Economic and Policy Research, of the Reserve Bank.

The main objective of the study was to trace the reforms which have been put in place during the last decade in the corporate bond market in India and consequent developments. In addition, the study analysed the experience of other emerging and developing economies (EDEs) at similar stage of development, such as Japan, Korea, Singapore, Malaysia and Brazil, to capture lessons in relation to the development of Indian corporate bond market.

The study notes that although the reform process in the corporate bond market has been encouraging, the implementation of reforms has proceeded slowly. Companies continue to finance their investments through private placements and bank loans rather than through public issues and corporate bonds despite policies implemented to encourage retail and institutional participation, to streamline the issuance process and to create new and missing markets.

Major 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, rationalising the stamp duty structure across the country and fixing stamp duties based on tenor and issuance value to encourage public offerings of corporate debt.

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