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Corporate Bonds Market in India

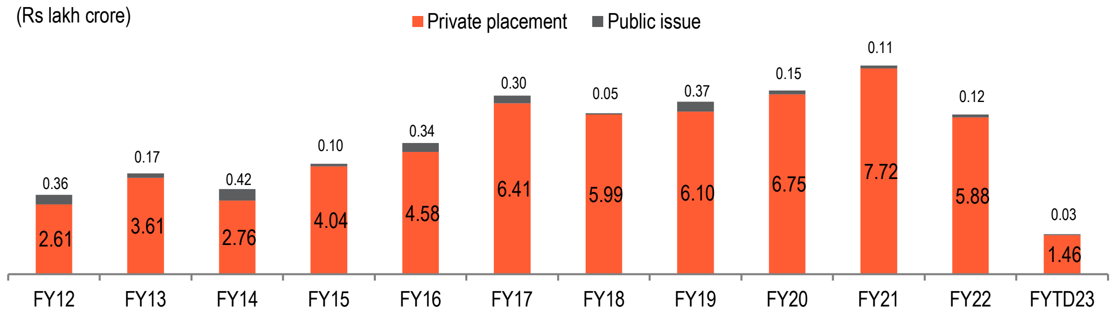
With the growing importance of investment for higher GDP growth, there is an urgent need for alternative sources of financing; and corporate bonds market can play an important role here. A well-developed and smooth functioning corporate bonds market serves as an important driver of economic growth as it provides an additional source of long term finance for industry. In fact, ideally there should be matching of long term projects with long term finance and the bond market offers an avenue for the same. In India, RBI and SEBI have taken various steps to develop and strengthen the corporate bonds market. However, while the size of the corporate debt market has expanded, it still remains relatively underdeveloped relative to the bank credit segment.

In this study, we discuss the development of the corporate bonds market in India in the last decade. We also compare the cost difference between corporate bonds and bank lending and find that only AAA rated companies tend to have an advantage when issuing bonds in terms of cost. Others may still have to rely on lower cost bank credit for their financing funding needs.

Overview:

Corporate bonds issuances have seen a steady uptick in the last ten years. From just about Rs. 3 lakh crores in FY12, they jumped close to about four-fold at Rs. 7.8 lakh crore in FY21, before moderating to Rs. 6 lakh crore in FY22. Higher borrowings through corporate debt in FY21 was driven largely by RBI's measures such as TLTROs. In FY22, corporate bond yields rose in line with G-sec yields amidst a higher than expected borrowing programme by the government, elevated oil prices and rising global yields. This could partly have come in the way of issuances as unlike bank loans where interest cost varies with the monetary regime, cost of capital gets locked in at the issuance rate for bonds. As a result, issuances of corporate bonds was also lower in FY22. In FY23 so far (Jul'22), corporate bonds issuances have increased by 14.1% on a YoY basis.

Figure 1: Corporate bonds issuances



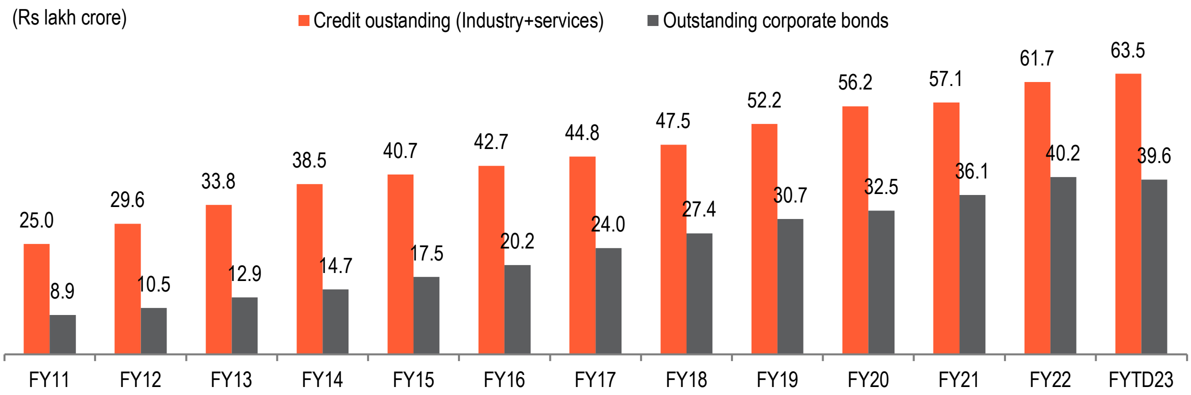
Source: SEBI, Bank of Baroda Research | Note: Data upto Jul'22

It can be observed from the chart above that almost all of these issuances have come from private placements as opposed to public issues. Furthermore, there has been no change in this trend in the last 10 years. Notably, while private placement accounted for 88% of the total corporate bonds issuance in FY12, its share has risen to 98% in FY22. A major reason for this is that companies do not wish to undertake the cumbersome processes involved in case of a public issue. On the other hand, private placements provide a number of advantages to companies including lower costs, quicker turnaround time and better price discovery.

Outstanding corporate bonds:

Resources mobilized through the corporate bond market have increased steadily over the years. Stock of corporate bonds outstanding has shown a remarkable improvement from just Rs. 10.5 lakh crore in FY12 to Rs. 39.6 lakh crore in FY22, a four-fold jump (Figure 2). In contrast, while credit outstanding by SCBs (industry and services) has remained higher than corporate bonds outstanding, incremental credit by SCBs has been far more sluggish. From Rs. 29.6 lakh crore in FY12, outstanding credit by SCBs has increased to Rs. 61.7 lakh crore, or a two-fold increase.

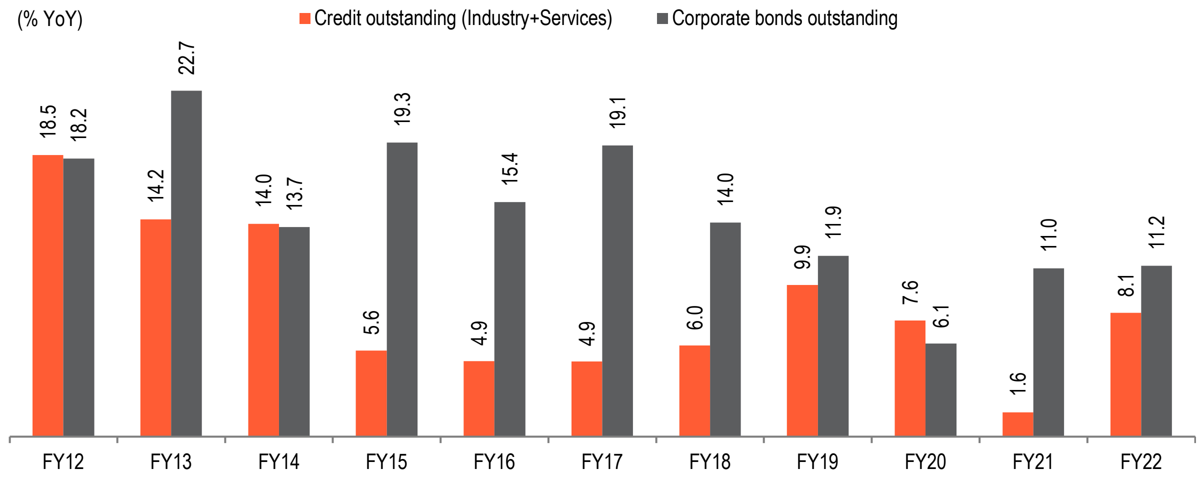
Figure 2: Corporate bonds outstanding versus bank credit



Source: SEBI, CEIC, Bank of Baroda Research | Note: Data for credit o/s upto Jul'22, Data for corporate bonds o/s upto Jun'22

Even in terms of growth rate, while both credit outstanding by SCBs and corporate bonds started at a similar level of ~18% in FY12, corporate bonds have witnessed higher momentum in all the years thereafter, barring FY20. Even in FY21, while SCB credit growth moderated sharply to 1.6% from 7.6% in the previous year, growth in corporate bonds outstanding improved to 11% (6.1% in FY20). In FY22 as well, outstanding corporate bonds have increased by 11.2%, while growth in SCB credit has been lower at 8.1% (Figure 3). This is a positive sign for the market that it is being accessed by both issuers and investors in higher numbers.

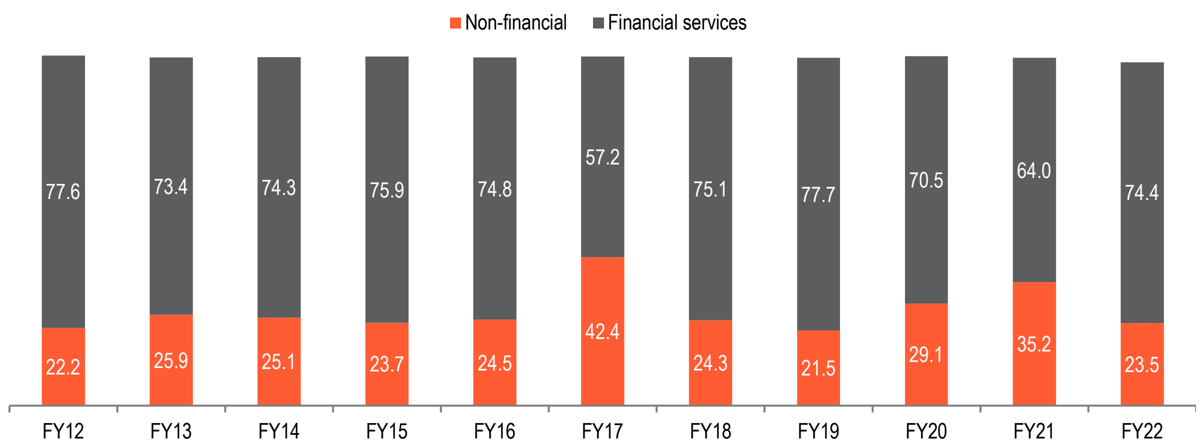
Figure 3: Growth in credit outstanding by SCBs and corporate bonds outstanding



Source: SEBI, CEIC, Bank of Baroda Research

However, this data must be viewed with caution. A close look at the funds raised through corporate bonds issuances shows that it is dominated by the financial services. In fact, financial services account for more than 70% of the funds raised through corporate bonds. Within this, banks, mutual funds and asset financing firms are the major players. For this segment funds are their raw material for business and hence the bond market becomes the preferred source of finance. Most of these larger companies also tend to have a rating of AA and above which makes it cheaper for them to access this market.

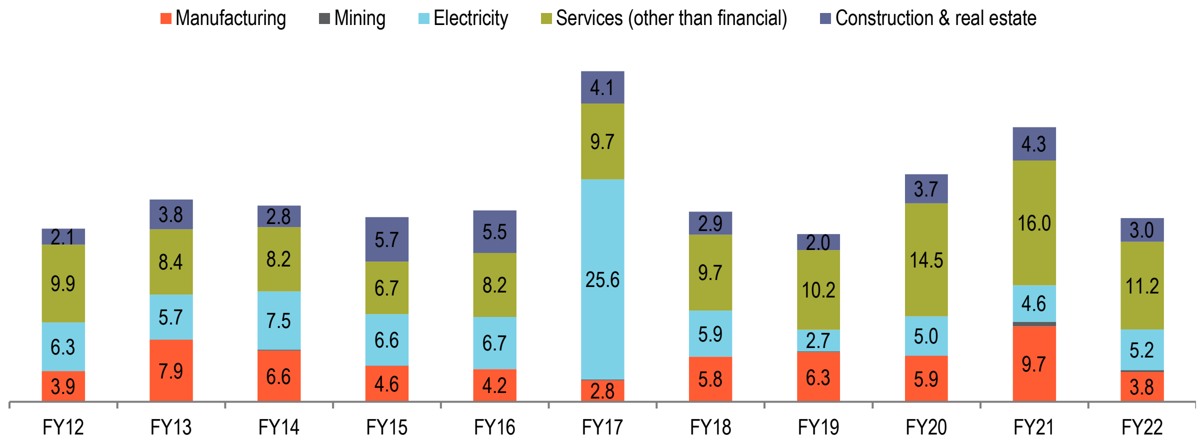
Figure 4: Sector-wise funds raised through corporate bonds market



Source: CMIE, Bank of Baroda Research

On the other hand, in the non-financial segment, funds raised by manufacturing sector (Figure 5) by tapping the corporate bonds market has remained low and averaged about 5.6% between FY12 to FY22. On the other hand, share of services sector has averaged about 10% between FY12 to FY22. In the same period, share of electricity has averaged close to 7%.

Figure 5: Non-financial sector

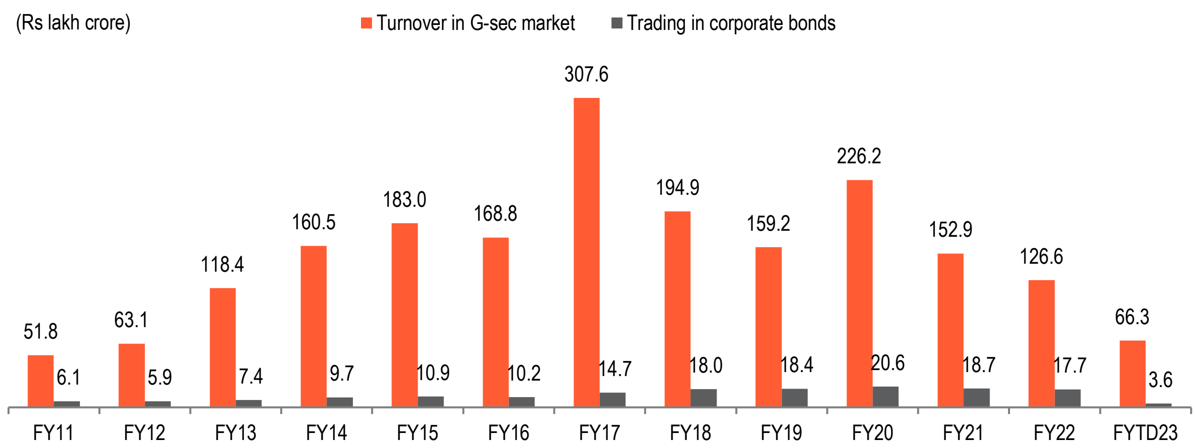


Source: CMIE, Bank of Baroda Research

Corporate bonds versus G-Secs in the secondary market:

There has been considerable progress in the development of the corporate bonds market in India as can be gauged from rising issuances. However, trading in the corporate bonds market has been limited when compared with the G-sec market. In fact, the turnover in Indian G-sec market was Rs. 126.6 lakh crore in FY22 or about 7-times of the trading in corporate bonds. While G-sec bonds have a well-developed secondary market, the same does not hold true for corporate bonds. Introduction of market makers, as was done for GSecs in the corporate bond market can provide some impetus in the secondary segment.

Figure 6: Trading in corporate bonds vis-à-vis G-sec market turnover



Source: SEBI, RBI, Bank of Baroda Research |Note: Data for G-sec upto 26 Aug 2022, Data for corporate bonds upto Jun'22

Banks versus Corporate bonds:

The table below compares the cost of borrowing between banks and corporate bonds. For banks, the 1-year MCLR has been taken as the benchmark as most lending rates are pegged to it. Furthermore, a distinction has been made between Public Sector Banks (PSBs) and Private Sector Banks (PVBs), as the latter tend to have higher rates. Juxtaposing this data with the corresponding yields on corporate bonds of different ratings for a 10Y maturity period, we can infer that in case the MCLR is lower than the corresponding yield on the corporate bond, the borrower would prefer the lower cost bank borrowing and vice-versa. It must be noted that corporate bond yields closely track the movement in government bond yields. As a result, corporate bond yields across ratings and tenors rose sharply up to Jun'22 in line with higher G-sec rates, amidst inflationary concerns. However with easing commodity prices in Jul'22 and Aug'22, G-sec yields have softened. Consequently, corporate bond yields have also moderated.

Based on this, we can make the following observations:

- Companies with credit rating of "A and lower" generally have higher rates than bank rates. This hold true for both PSBs and PVBs. Hence, these corporates would benefit from bank borrowings as borrowing through bonds would be expensive.
- It holds true for "A+" rated companies to a large extent. However, in some cases like FY17, FY20 and FY21, bond yields have been lower than the corresponding MCLR for PVBs.
- For debt rated "AA-", barring FY17, PSB rates are generally lower than the bond yields, hence intuitively, PSBs remain a favorable option for finance. For PVBs however, lending rates have been typically higher till FY22. In FY23 there has been a change with MCLR for PVBs being lower, hence these companies can now look at financing through PVBs also as a viable option.
- In case of companies with credit-rating of "AA and AA+", PSBs can be preferred as they offer lower rates than corresponding bond yields. However, when compared with PVBs, bonds offer a cheaper finance option.
- For companies with the highest credit-rating i.e. "AAA", while historically bond issuances was the preferred source of lending due to lower rates, there has been a change in the last few months, mainly with respect to PSBs. While PVBs rate continue to be higher than bond rates, PSBs actually offer lower rates than bonds. However, admittedly the difference is very small to make a tangible effect on the funding decision.

Table 1: Comparison of corporate bond yields with bank lending rates

	1Y MCLR (PSBs)	1Y MCLR (PVBs)	10 Y G-sec	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB-
FY17	9.25	9.58	6.95	7.86	8.29	8.44	8.80	9.40	9.95	10.20	10.59	10.89
FY18	8.45	9.00	6.93	7.79	8.15	8.31	8.68	9.31	9.87	10.29	11.08	11.42
FY19	8.62	9.23	7.67	8.64	9.04	9.20	9.27	9.95	10.58	11.14	11.93	12.24
FY20	8.43	9.27	6.69	7.86	8.39	8.49	8.58	9.03	9.81	10.58	11.27	11.65
FY21	7.47	8.69	5.97	6.88	7.41	7.63	7.76	8.21	8.98	9.76	10.45	10.82
FY22	7.28	8.26	6.33	6.95	7.44	7.73	8.14	8.59	9.36	10.14	10.82	11.20
Apr-22	7.25	8.33	7.08	7.29	7.70	8.05	8.85	9.30	10.07	10.85	11.54	11.91
May-22	7.35	8.35	7.34	7.65	8.03	8.39	9.12	9.57	10.35	11.12	11.81	12.18
Jun-22	7.43	8.35	7.49	7.85	8.24	8.58	9.30	9.75	10.52	11.30	11.99	12.36
Jul-22	7.55	8.50	7.39	7.74	8.12	8.45	9.15	9.60	10.38	11.15	11.84	12.22
Aug-22	7.65	8.53	7.25	7.66	8.09	8.39	9.03	9.48	10.25	11.03	11.71	12.09

Source: Bloomberg, RBI, Bank of Baroda Research

Concluding remarks:

Credit demand in the economy has gathered steam in recent months amidst a pickup in economic activity. In Jul'22, bank credit rose by an impressive 15.1% on a YoY basis. With capacity utilization rates picking up (75.3% in Q4FY22), the demand for credit is likely to see a further pickup. While external borrowings in the form of ECBs played an important role in supplementing the domestic financing needs of companies in the past, with the global backdrop of higher rates and depreciating currency, their relative attractiveness has diminished. As a result both companies and banks are likely to tap the corporate bond market in the later part of the year to meet the increasing demand for credit. In recent days, several leading banks have raised funds by issuing bonds.

The above analysis has shown that while the corporate bond market in India has seen a healthy growth, it remains highly constrained due to a number of factors. First, absence of an active secondary market for corporate bonds which diminishes their attractiveness for retail investors due to lower liquidity than equities or government bonds. Second, a major share of corporate bond issuances take place through the private placement route and in the absence of a secondary market may not be available for retail investors. Third, the corporate bond market is heavily skewed towards higher rated papers. As per RBI, 80% of issuances in value terms in FY22 were rated AAA, and another 15% were rated AA. Our analysis also shows that while AAA rated companies may be able to source cheaper funds through the bonds market, this does not hold true for others.

There have been several working groups that have suggested ways to make the market more buoyant which have been implemented. As only higher paper find favour with investors, there is need to enhance the rating of lower rated paper through specific policy measures. Making CDS mandatory for lower rated paper can possibly help to reinvigorate the market. A major limitation in the financial sector space is dealing with default. Banks have structures to deal with NPAs and the risk gets defrayed over the entire loan portfolio. For debt paper, the legal route is the only one available which is time consuming. Hence most investors are deterred from investing in lower rated bonds. Work needs to be done on this aspect too in parallel to make this market more buoyant.

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