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Debt Market in India

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Abstract*: The debt market is one of the most critical components of the financial system of any economy and acts as a leverage tool in a financial system.*
The debt market comprises of two segments: government securities market and corporate debt market. Indian debt market is dominated by government securities as compared to corporate debt securities.
Indian corporate bonds market is very underdeveloped and illiquid in comparison with the Government securities market and mostly depends on highly safe AAA rated bonds for both issuance and trading.
This paper presents an overview of the corporate debt market in India. It is concluded that Indian corporate debt market has shown growth trend in primary market and secondary market as well.
There are a lot of challenges available in the market which are major obstacles in the development of the market like lack of information among the investors, high stamp duty charges, lack of innovative debt instruments etc.
Existence of well-developed government (govt.) debt market is critical for investors, market participants and policy makers. Administered interest rates, artificially low coupon rates were some of the dominant features of the market until 1990. Starting 1992, Reserve Bank of India (RBI) has taken several reform initiatives to build a vibrant liquid, competitive and integrated govt.
Debt market with the purpose of:
1.providing a benchmark yield curve whose information content could guide policymakers and investors.
2.making transmission mechanism of monetary policy impulses effective.
3.making a constant source of government borrowing to finance the fiscal deficit. Over the past two decades, the govt. debt market has demonstrated a steady improvement in terms of liquidity and infrastructure enhancements which should convince the investors that it does not function under the manipulation of RBI. The study by Kanjilal (2011) shows that movements in govt. debt market are still a reflection of RBI's policy change. Separation of 'debt management' from 'monetary management', widening both domestic and foreign investors' base and consolidation of regulatory bodies are some vital steps to make govt. debt market globally competitive

Keywords: debt market

I. INTRODUCTION

A debt market is a marketplace for debt instruments and securities. This market deals in debt instruments only—equity and other financial instruments cannot be traded here.
There is a fundamental difference between equity and debt markets; equity offers ownership, and debt securities do not. Debt securities are loans—investors offer loans to a corporation or government. In return, the borrower pays a coupon rate to the investor (till maturity).
Before venturing further, let us quickly define debt. Debt is the practice of borrowing a tangible item, primarily money. The borrower could be an individual, business, government, financial institution, or state. The lender is often referred to as a creditor. The loan could involve cash, mortgage etc.
Individuals, corporations, and governments borrow funds to purchase products, properties, assets, and services or meet a need that would otherwise be unmet. The borrower agrees to return the amount within a specified time frame. In most cases, this involves periodic interest payments. The debt is classified into secured, unsecured, or guaranteed, depending on the collateral.

Debt markets are considered safer than equity markets. In equity markets, investors need to know about the company they are investing in. But not all investors have the time or access to conduct thorough research. As a result, a stock market crash can disrupt an equity investment for a long period. Fortunately, this is not the case with the debt market.

The debt market of India is one of the largest in the Asian continent. Also, US treasury bills are considered the safest form of investment. It is highly unlikely that the US government will default; thus, investors receive safe long-term returns. The debt market offers a steady income for ten or twenty years. Usually, investors receive a coupon in a semiannual system (once every six months).

This marketplace also benefits corporations; they can sell bonds to investors with adequate knowledge of the capital markets. But unfortunately, the private debt market is highly leveraged and mostly unrated.

Objectives

Preservation of principal amount and getting modest returns is the main objective of the debt funds. Investors look for both short-term and long-term investments. There are many instruments available in the market so one can choose easily any or mix of instruments according to its requirements. The main objectives of debt instruments are:

Safety of the principal amount.

Guaranteed returns for the investors. Currently 8-9% interest per annum are quoted for medium to long-term deposits whereas it is 6-7% returns for short-term deposits.

Some of these instruments also qualify for tax rebates under Section 80C.

There are three main features of debt instruments;

Maturity: Maturity refers to the date on which the bond matures. It is the date on which the borrower agrees to repay the principal amount. Term-to-maturity refers to the number of years remaining for the bond to mature. It changes every day from the date of the issue to the maturity of the bond. It is also called the tenure or term of the bond.

Coupon: Coupon Rate refers to the periodic payment of interest made by the issuer of the bond to the lender of the bond. Coupons are declared either by stating the number (example: 8%) or with a benchmark rate (example: MIBOR+0.5%). It is usually represented as a percentage of the face value or the par value of the bond.

Principal: It is the amount which is borrowed. It is the face or the par value of the bond. The product of the coupon rate and principal is the coupon.

For example a GS CG2008 11.40% bond refers to a Central Government bond maturing in the year 2008, and paying a coupon of 11.40%. Since Central Government bonds have a face value of Rs.100, and normally pay coupon semi-annually, this bond will pay Rs. 5.70 as six- monthly coupon, until maturity, when the bond will be redeemed.

The term to maturity of a bond can be calculated on any date, as the distance between such a date and the date of maturity. It is also called the term or the tenor of the bond. For instance, on February 17, 2004, the term to maturity of the bond maturing on May 23, 2008 will be 4.27 years. The general day count convention in bond market is 30/360 European which assumes total 360 days in a year and 30 days in a month. There is no rigid classification of bonds on the basis of their term to maturity. Generally bonds with tenors of 1-5 years are called short-term bonds; bonds with tenors ranging from 4 to 10 years are medium term bonds and above 10 years are long term bonds. In India, the Central Government has issued up to 30 year bonds.

II. ADVANTAGES OF DEBT MARKET

1. The debt market capitalizes and mobilizes the funds in the economy.
2. This market gives a platform to the government, companies, and other bodies to raise funds.
3. Sometimes raising equity becomes very costly for the corporate. In such a situation, raising money through the debt market is the best possible option.
4. This market gives fixed returns to investors with lesser risk. Government Debt Market securities are less risky than Corporate Debt securities.
5. In absence of any other sources of finances, the Central/State Government takes the help of this market. It saves the Government bodies from suffering from any cash crunch.
6. Debt Market securities backed by assets get the preference as compared to other unsecured and business debts at the time of liquidation.

7. The money raised through this market helps the companies to boost their expansion and growth plans.
8. The debt market helps the Government authority to boost infrastructural projects.
9. The debt market has a wide range of choices when it comes to the types of instruments, the categories of issuers, and the debt funds available
10. You can choose to invest in fixed-income securities like government securities (G-secs), State Development Loans (SDLs), treasury bills and cash management bills, commercial paper, Certificate of Deposit (CD), fixed-rate bonds, floating rate bonds, fixed interest debentures, market-linked debentures, tax saving infrastructure bonds, zero-coupon bonds, etc.
11. You also have the option of selecting issuers of debt instruments as per your risk appetite and preference. These instruments are issued by the central government, state governments, government entities and bodies, public sector undertakings, corporate entities, banks, non-banking financial companies, and other financial institutions.
12. Unlike the windfall returns and slowdowns of equity funds, debt funds deliver a regular return. Investments in debt funds can be made to earn a monthly income. For this purpose, investors can invest in a Systematic Withdrawal Plan (SWP) that pays them in the form of regular dividends.
13. The debt market is ideal for conservative investors who are risk-averse in their investment decisions. While government-issued instruments are entirely safe, even corporate bonds have a preferential claim over equity investors. Besides, the debt market also helps high-risk-taking investors diversify their portfolios and manage risks better. This diversification is even useful for investors who invest in less risky stocks. Because of its safety, equity investors invest a portion in the debt market as a hedge against market fluctuations and equity underperformance.

III. DISADVANTAGES OF DEBT MARKET

1. One of the biggest disadvantages of this market is that it provides fixed returns to investors and completely ignores the inflation rate. The inflation can make the actual return falls down to a record low.
2. The second disadvantage is that in the case of premature withdrawal or sell-off in the market, the investor gets the current market bond's price and not the principal amount invested. It is possible that the company might lose its credibility, and the bond prices might have fallen down.
3. The investors will get a fixed interest rate return only, irrespective of an increase in the interest rate in the market.
4. For issuing authority, it becomes very difficult to get a good credit rating. This becomes the biggest task to meet all requirements of credit rating agencies.
5. When you work with a lender, the rules are pretty clear. You must pay back the loan at the terms agreed upon. That means, even if your business goes under, you still have to make payments. Since most lenders require you to guarantee the loan, your assets could be sold to satisfy your debt.
6. Eligibility requirements vary among lenders, but generally you need to have a strong credit history, meet arevenue threshold, and be operational for a minimum number of years. Consider all your debt financing options to figure out what's best for your business so you don't have to waste time applying for capital that you may not meet the requirements for.
7. Unfortunately, predatory lenders exist and the techniques they use to rope in unsuspecting small business owners are getting more and more sophisticated. It's definitely not unique to debt financing, but it is something to be aware of. Instead of disclosing the true cost of a loan, some unscrupulous lenders will use methods other than APR. Make sure you are working with a lender who practices transparency and will give you honest numbers. Know both your loan APR and your loan payment and compare it to your original balance.
8. Each loan you take out for your small business will be noted on your credit rating. Beware, this can cause your scores to drop. So before you apply for a loan, check with your lender to determine if the credit check performed to prequalify will affect your score.

IV. CONCLUSION

The debt market is one of the important markets place, which keeps the economy running. It channelizes the funds in a productive way and benefits the issuer and the investor. Starting from Government to Corporate uses this market as a source of finance. For investors, it acts as a fixed-regular source of income. it often overlooked area of the investing world. While it may not provide the same excitement as the stock market, it provides investors with a stable and safe investment option. Whether you're a risk-averse investor, looking for guaranteed returns, or simply want to park your money without worrying about fluctuations in price, the debt market is worth considering. With a basic understanding of the market and its workings, you can start exploring the various investment options available and begin building a diversified portfolio that includes debt instruments. India is finally moving forward to promote domestic currency debt markets to facilitate infrastructure investment. Given the gap in debt funding, the ability to meet infrastructure investment target of USD 1 trillion would ill critically depend on two factors. First, the government's ability to successfully increase reliance on the bond market as an alternative source of financing to bank loans and, second, their ability to implement fiscal consolidation as a means of freeing up bank lending and reducing upward pressure on interest rates. India will need to borrow increasingly in the domestic debt market if it is to meet this target. Development of domestic debt market in India should be planned and implemented on a long-term basis with a realistic policy sequence. It needs to be in sync with the banking sector reforms in order to alleviate systematic risk. Steps towards improving the transparency, reliability, accessibility, timeliness, and market diversification would help develop the bond market. India should broaden the investor base by increasing the number and size of financial institutions that can invest in corporate bonds. It is crucial to note that market liquidity is a consequence of active participation of market players. New financial products and instruments are required to be designed to cater to funding and hedging needs of the market participants. They should be created in such a way that they do not result in risks in financial stability and do not jeopardize the interest of the ultimate end users/customers. The lack of market interest, if any, must be introspected and debated seriously to draw up remedial action plan. To evolve a vibrant domestic debt market that is able to meet the growing financing requirements of the country's dynamic private sector, there is a need for effective co-ordination and co-operation amongst all the market participants. Further, a sound management of public debt could result in a decline in the debt requirements of the government, which in turn can offer greater market space and create greater demand for corporate debt securities. Obviously, systematic development of a well-functioning domestic debt market in India is likely to be a gradual process as experienced in several other countries.

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