Development of Corporate Debt Market: A Comparative Analysis of Select Economies

[*]Shruti Aurora, [#]Dr. Rakesh Kumar Srivastava

[*]Research scholar, [#]Assistant Professor, [*,#]School of management, Gautam Buddha University, Greater Noida, India, [*]aurorashruti@gmail.com, [#]rakesh@gbu.ac.in

Abstract- Regulatory reforms play a significant role in building and enhancing the shape of financial markets. Although regulatory bodies have been trying to bring balance between equity and debt market, yet the progress is slow. However, reforms implemented so far, have brought major changes in the regulation, infrastructure and working of a bond market. The vibrant and liquid bond market fosters competitive pressures to lend to private sector. A well-developed liquid bond market channelizes the funds towards productive investments and is significant for the efficient capital market. We analyse the experience of reforms which have been put in place in other emerging and developed countries at a similar stage and capture the lessons from them with respect to the development of Indian corporate bond market. It was concluded that India needs to relax disclosure norms and increase tax incentives to various market participants so that more of public issues can be made by the companies which can draw the attention of both corporate and retail investors so as to deepen the market. Along with this, some innovative financial instruments should be introduced to provide more varieties and prospects for hedging.

Keywords: Corporate bond; Government Bond; Innovative financial instruments; Policies; Reforms; Tax incentives

I. INTRODUCTION

Financial markets also known as loanable markets are to be well developed for an economy to be growing. Although Indian markets boasts much about their equity market and is at par with the global markets, yet the bond market generically referred to as debt market is still in infancy stage. Developing countries like India and Republic of Korea have first developed their equity markets [34].

However, the overall development of financial market assumes the development of both equity and debt market. Shah, [32] describes the need for developing financial markets as an alternate route for capital formation. Mr. Alan Greenspan, former Chairman of Federal Reserve made a statement once that "the Asian Crisis would have less effect if the capital markets were well developed, particularly bond market". The Central bank of India commonly referred as RBI, is continuously trying hard to induce vibrancy and depth in the market. Since times, it has been focussing on building the resilience and increasing liquidity, as deeper and broader financial markets serve the objective of recuperating the efficiency of capital allocation and at the same time mop up the shocks and risks entailed in financing growth**.** In fact, the major objective is to open the different avenues of financing to the corporate. This also helps in efficient allocation of funds [16]. In this context, RBI is bringing the change in strategies and policies in bond market time and again. Although reforms have brought major changes in the regulation, infrastructure and working of a bond market, yet the progress is slow in nature.

One of the studies conducted by RBI on non-governmental non-financial companies found that such companies do not follow pecking order theory in India and analysis of trends in the sources of funds suggests that Indian corporate are dependent more on external sources of funds rather than internal equity [4]. This is just the opposite of what happens in advanced economies [34]. However, Indian companies are debt laden companies [5]. There are various types of debt taken by Indian companies, in which predominantly, the bank loans top the list amongst external sources. Indian financial system is dominated by banks [23], which is why the bank's balance sheets are deteriorating and the level of stressed assets are increasing at the same time. Given the stage of our economic development, there is a centrality of banks in our financial system, which is giving a risk to banking sector [15]. In such a scenario, there is a dire need to push up the other alternatives of corporate financing. The effect of heavy reliance on banks can be gauged from the different financial crisis that have taken place in the past, Asian financial crisis in 1997 and 2008 global financial crisis to name a few. It is only after the financial crisis 1997, the Asian countries including Korea realized the importance of corporate bond market. [36] Reports that, the global corporate bond market triples in size after the crisis.

As per the study conducted by RBI; it was found that for five year period of 2006-10, bank loans constitute up to the

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extent of 67.4% of total corporate borrowings, whereas only 7% was raised through debentures. These figures increased to 71% and 10% respectively in year 2010-11. This shows that bank borrowings have increased during that period and was continued to be a one of the significant sources of funds. In year 2015-16 (April -December), the resource mobilization in primary market has increased through public and rights issue as compared to 2014-15 [30]. 71 companies have raised approximately Rs. 51,311 crore through capital market in comparison to the corresponding period of last financial year, where 61 companies have accessed the capital market for raising Rs. 11,581 crore [7]. However, considering the debt market as whole, the domestic debt market is 67% of GDP at the end of March 2018. The share of outstanding government bond is 49.1 as a % of GDP which is almost at par with the other emerging and emerged countries, whereas a corporate bond as a % of GDP is 5.4 in March 2013 [3] (Asia Bonds Monitor), and is increased to 16.3% of GDP at the end of March, 2018, which is much lesser when compared to Malaysia (47%) and South Korea (73%). Though the number of issues and amount in corporate bond has increased in recent past [10], yet the share is miniscule. Table 1B provides an overview of resource mobilization in the primary market. The public issue through debt is vey less as compared to public issue of equity in year 2016-17 and 2017-18. The low share of public issues gives a spill over effect on secondary market also, which leads to low activity in the latter.

Table 1A: Resource Mobilization in the Primary Market through Debt and Equity (Rs. Crore)

Year	Equity				Debt				Total resources raised (Equity+Debt) (A+B+C+D)	Debt private placement as a % of total resources	Debt as a % of total resources
	Public & Rights issue (A)		Private Placement(B)		Public & Rights issue (C)		Private Placement (D)				
	No.	Amt (Rs. In bn)	No.	Amt (Rs. In bn)	No.	Amt (Rs. In bn)	No.	Amt (Rs. In bn)			
2008-09	46	147.19	NA	NA	1	15.00	NA	NA	NA	NA	NA
2009-10	70	324.27	49	367.18	3	25.00	2439	3065.6	3782.05	81.06	81.72
2010-11	77	376.27	19	136.70	10	94.31	1569	2247.2	2854.48	78.73	82.03
2011-12	51	128.60	6	51.60	20	356.10	852	2131.0	2667.30	79.89	93.24
2012-13	48	138.80	23	66.80	20	169.80	1011	3187.0	3562.40	89.46	94.23
2013-14	55	132.70	NA	270.10	35	423.80	NA	3626.4	4453.00	81.44	90.95
2014-15	64	97.90	44	287.50	25	97.10	2612	4177.0	4659.50	89.64	91.73
2015-16	87	240.00	21	194.20	20	338.20	2652	3889.8	4662.20	83.43	90.69
2016-17	118	325.20	24	137.00	16	295.50	3412	6534.0	7291.70	89.61	93.66
2017-18	227	1052.0	56	694.00	7	50.00	2518	6107.0	7903.00	77.27	77.91

Source: RBI Annual Report & SEBI

Table 1B: Resource Mobilization in the Primary Market through Public Issue (Rs. Crore)

Particulars	2016-17$		2017-18$	
	No. of issues	Amount (Rs Crore)	No. of issues	Amount (Rs. Crore)
A. Public Issues	80	48,407	138	68,037
i. Debt	10	23,893	4	3,896
ii. Equity				
IPO	70	24,515	133	64,128
FPO's`	0	0	1	13
B. Rights issue	5	1,298	14	4,521
Total equity Issues A(ii)+b	75	25,812	148	68,662
Grand Total	85	49,705	152	72,558

***Source**: Annual report 2017-18, Ministry of Finance [19], pp.xii*

$ indicates April – December of the respective financial year

Bond financing have several advantages over bank financing, which are listed below:

- Bond financing reduces the cost of capital for the companies as the intermediation cost is lesser as compared to bank financing
- Banks are restricted to lend for long term loans due to their asset liability mismatch, whereas bond financing can be done for longer duration and investors are well aware about the maturity profile and yields of all types of bonds.
- Market determined term structure is being provided by bond market which serves as a benchmark for other financial market instruments.
- Bond financing brings competition for the bank financing.
- Pooling of risk through securitisation is allowed by bond financing
- Well developed corporate bond market complements other financial markets such as derivative market, securities lending and borrowing market.

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[29] Highlights the argument of Allan Greenspan that "coexistence of domestic bond market and banking system help each other to act as a backstop for the other", and alludes to that "in a relatively open economy since non-bank intermediation may get located outside the country. Indian firms raise funds through international markets via ECB and FCCB route [24]. In fact, the domestic bond market helps in avoiding double mismatches of currency and maturity [31], [11].

The data in Table 1A suggests that companies have issued more of debt than equity. The only issue in this case which can be seen is the huge private placement of corporate bonds, which is hampering the liquidity of market to grow. There are various other issues as well which needs to be addressed in the corporate bond market [1]; issues such as supply side, demand side [21], regulatory, legal [17] and infrastructural. Political economy of regulation is equally important to understand so as to encourage the bond market [2]. Although Reserve bank of India through the recommendations of Patil committee, formed in 2005 had taken an initiative to work upon the corporate bond market, yet the effect of significant implementation is negligible. Although they had focus on increasing liquidity and building resilience [12] yet the effects are not significant. The detailed view of various steps taken by regulatory body is shown in Table 2.

Table2: Key Developments in Indian Bond Market

Year	Reform Initiated	Objectives and Outcome
January 1994	Securities Trading corporation of India was established. First time zero coupon bonds were introduced	An initiative to bring innovative financial instruments and to add additional financial intermediary
August 1994	Issue of Ad hoc treasury bills restricted to certain limit. This was done by making an agreement between RBI and GOI	Step taken to do away with automatic monetization so that cash management of Government can improve
March 1995	Introduction of market makers- Primary dealers	To add liquidity to the market which further brace the market intermediation.
July 1995	Delivery vs. payment system was introduced in the sovereign bond market	This is to reduce the settlement risk.
Sept. 1995	Floating rate bonds were introduced	So that new financial instruments can be added but it didn't work out
April 1997	FIMMDA was established	So that market practices and ethics can be developed and it improved also.
July 1997	FII's were allowed to invest in G-secs	To broaden the investors base
December 1997	Capital indexed bonds were introduced	So that investors can hedge themselves against inflation but couldn't work out
February 2002	Clearing corporation of India limited was established	This acts as a clearing agency in government securities market. This brought major stability in market.
October 2002	Trade data of Negotiated dealing system was made available on RBI	This was to improve transparency for all types of investors.
January 2003	Retail trading was started in G-secs market	To gain wider participation. Though it was not taken very well, yet it improved position up to an extent
February 2003	Participation in repo market was allowed	This step again widened the market.
June 2003	Interest rate futures were introduced	To bring hedging instrument in market, but didn't taken off.
August 2004	Straight through process was allowed	So that NDS members can get more efficient trading system
December 2005	R.H. Patil committee gave recommendations on corporate bonds and securitization	Objective was to highlight the need for a corporate bond market and securitization.
December 2006	SEBI permits BSE to set up reporting platform.	The step was taken to get all trading information about corporate bonds so as to enable efficient price discovery, reliable clearing and settlement system
January 2007	SEBI was responsible for primary and secondary market whereas, RBI would look for repo and reverse repo in corporate bond	This brought clarity with the roles of agencies on different segments of the corporate debt market.
January 2007	Trading started in corporate bonds on NSE and BSE for all types of investors.	So that existing infrastructure can be used efficiently and effectively.
April 2007	Both the stock exchanges were allowed to provide services for clearing and settlement of corporate bonds.	So that efficient transparent secondary market can be developed
April 2007	Both NSE and BSE were permitted by SEBI to to have in place corporate bond trading platform.	So that efficient price discovery mechanism can be developed and reliable clearing and settlement process developed. Here, the progress was slow as market dominated by private placement
April 2007	Tradable lots were reduced by SEBI	So that retail investors can participate
August 2007	Corporate Bonds and securitisation Advisory committee (CoBoSAC) set up to make recommendations to SEBI.	This was to advise for the development of corporate bonds and securitized debt instrument.
2008	Raghuram Rajan Committee was formed	
May 2009	Listing agreement was simplified by RBI	So that long and expensive issue process can be reduced.
August 2009	It became mandatory for mutual funds to port inter scheme transfers of corporate bonds	So that detailed information can be disseminated.
October 2009	SEBI mandated the clearing and settlement of all trades through National Securities Clearing Corporation (NSCCL) or the Indian Clearing Corporation Limited (ICCL).	Clearing and settlement of trades in this market to follow the International Organisation of Security Commissions (IOSCO) standards and the global best practices by way of well-established clearing and settlement procedures through recognised clearing and settlement agencies.
May 2012	SEBI permintted Qualified foreign investors to invest in corporate bonds either already listed or being sold through a public offer without any lock in or residual maturity in	To improve the investor base in corporate bond market.
April 2013	SEBI rationalises debt limits for FII- government securities- US $ 25 billion and corporate bonds US $ 51billion	
August 2013	SEBI eased the bond market investment norms for QFI by allowing them to directly purchase corporate debt securities that companies	To ease the bond market investment norms

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	intend to list on stock exchanges	
October 2013	Centralised database for corporate bonds/debentures	To give complete information to investors so that they can take the valued decisions
October 2013	Amendments were made by SEBI to simplify debt listing agreement	Objective is to bring transparency and to further develop the corporate bond market
November 2013	SEBI designated more FII categories as long term investors	This step was taken to develop infrastructure debt fund.
November 2013	RBI had permitted the FIIs and QFIs to investin credit enhanced bonds up to a limit of US $ 5 billion	
March 2014	SEBI prescribed that all OTC trades in corporate bonds should be reported only on any one of the reporting trading platforms within 15 minutes of the trade.	To develop the Securitised debt instrument market
June 2014	RBI allowed Indian companies to issue non convertible/redeemable debentures to Non Resident Indians	To improve the investor base in the market
March 2015	Amendments were made in Issue and listing of debt securities regulations by SEBI	To provide enabling provisions for consolidation and re-issuance of debt securities and right to call or redeem prior to maturity.
2015	Corporate bonds and securitisation advisory committee was formed	For enhancing liquidity in the corporate bond market

Source: *Compiled from various publications of RBI*

The situation of underdevelopment of corporate bond market is not restricted to India but to the whole of Asia. [8] Document that the slow development in Asia Market is due to positive correlation between the bond market capitalization and other variables such as larger country size, less volatile exchange rates, stronger institutions and more competitive banking sectors. As per his report, the region's structural characteristics, macroeconomic and financial policies explain the differences in bond market development between Asia and the rest of the world. In 2013, 92% of the global corporate bond market belongs to developed market [36].

In this paper, we focus on the comparative analysis of the state of the debt market of countries taken under study. However, The United States of America, South Korea, Malaysia are selected, where the former is chosen as it is a developed nation; and has passed through various phases of upswing and downswing, the study of this market reveals the strategies adopted by market of converting its illiquid market into one of the most liquid market of the world. The data availability of such a market is also easier. Whereas the other two countries are selected as both of them were affected by the Asian financial crisis and were heavily dependent upon the banking system before the crisis and could manage to cope up with the same by developing the corporate bond market. Indian economy is currently sailing in the same boat and is truly dependent upon the banking system, which is evident from the balance sheets of Indian companies. One should learn a lesson from them so as to avoid being trapped by any financial crisis in future. Therefore the selected countries are analysed so as to identify the factors which restricts the growth of Indian corporate bond market in terms of its size and depth and suggest reforms on the basis of an international experience which can make this market vibrant and corporate can make use of this source of funds as efficiently as possible and at the same time to make it an attractive investment avenue for wide array of investors.

Similar studies are conducted earlier as well where, [26] identified the factors that have influenced the development of corporate bond market in countries such as China, Singapore, Malaysia, South Korea and Latin America and suggested policy reforms. However, studying other countries reforms may pose technical challenges and political economy dynamics [35]. They argued that the policy initiatives are needed to take into account the intrinsic characteristics of developing countries. [18] Presented the discussion on developing corporate bond market in Asia where, the representatives from 11 countries met in China; Each one of them contributed by drawing the experiences of their own country. [15] Studied the experiences of countries like Malaysia, South Korea, Japan, Singapore and Brazil so as to have further improvements in Indian market.

II. EXPERIENCE OF OTHER COUNTRIES

Efficient capital markets and capital formation comes with the development of financial markets particularly corporate bond market. Since heavy reliance on banking sector have far reaching effects which was being suffered by certain countries and they modulated their regulatory policies to insulate their financial system. Hence, it becomes necessary to study the experiences of such countries and learn from the challenges which they faced during their change of patterns so that we can remain away from known pitfalls.

In light of this we look at the experiences of the USA, Malaysia, and South Korea; how such countries have traced their path of development. Though the select countries of study differ in their demographics, yet we can learn from their experiences which can help the Indian corporate bond market to grow. Although Malaysia and South Korea have made a reasonable progress in East Asia, yet the progress is tardy when compared to the USA and other developed nations.

Malaysian bond market

Malaysian bond market is one of the oldest Asian markets with a size of USD 299bn at end of Q3 2017(as per Asian development bank) and is 46% of GDP as of December 2017, this increased to USD 333 billion as on Q3 2018, out of this USD 158 billion were raised via corporate bond; took off its government bond market from 1970s. This was the time when private sector was heavily withdrawing the requirements of its funds from banking sector and the bank credit to GDP ratio of the country was close to 147%[1] in 1997. However, the bank deposit to GDP ratio was also as high as 154%[2] and hence the banks were able to carry out their lending operations from bank deposits. It was only after the Asian financial crisis when the economy realizes the importance of other sources of funds. This led to the

[1]https://www.sc.com.my/bond-market-development-in-malaysia/
[2]https://www.sc.com.my/bond-market-development-in-malaysia/

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realisation towards significance of risk diversification in the financial system which carved the way to the development of corporate bond market. Malaysian government retained self regulatory role for their exchange [6].

Many regulatory measures were taken to boost up the market. Issue procedure of corporate bonds used to take 9-12 months in Malaysia, which was later on improved by centralising the regulation of corporate bond market with the Securities commission. It then came out with 'guidelines on the offering of Private debt securities' in 2003. 'Guideline on the offering of Asset backed securities' and a 'Guideline on Islamic securities' were also issued to strengthen and streamline the issuance procedure further. The unique feature of this market is the presence of Islamic bonds, which comply with Shariah principle (guided by Islamic economics, which believes that all forms of interest are 'riba' and hence prohibited) and contributed to the huge success of the Islamic financial system [9]. This has created a niche market in global Islamic finance. Sukuk bonds are like participation certificates that share its asset returns with the investors, which comply with the Islamic prohibition of interest payments. In fact, these bonds are the major contributors for the development of Malaysia capital market [22]. The outstanding amount of sukuk in emerging East Asia was US $ 186.3[3] bn by end June 2015 as compared to US $ 59.9bn in 2008 with a cagr (compounded annual growth rate of) of 19.1%. from 2010 to 2017, the LCY bond issuances grew at a cagr of 11% p.a. Malaysia being the cynosure of sukuk market accounts for 86.55% share of the region's total sukuk stock at the end of June 2015. As per Moody's, sukuk bonds filled almost 80% of fiscal deficit financing needs of Malaysia. Sukuk bonds dominate corporate bond market with 72.1%[4] of aggregate corporate bond stock at end June 2015. Islamic bond market accounted for 40% of Malaysia's government bond sector and 71% of the corporate bond sector in 2015 end (Asia bond monitor, 2015). In 2017, 124.7Bn RMB was raised via corporate bond market. It has the largest stock of outstanding long term sovereign sukuk at US84$ billion in 2018. As per Malaysia international Islamic financial centre, internationally, Malaysia has been the largest sukuk issuer and accounts for 51.6% o of world's outstanding sukuk. The success of Islamic bonds is attributed to the policy initiatives taken by the government of Malaysia in 2000.

Strong infrastructure with comprehensive regulatory framework with stability in politics and clear cut vision along with macroeconomic policies laid the stone for the key development of Malaysian bond market (See Table 3). Securities commission (SC) was established in March 1993 as a unified regulatory body for the promotion of capital markets. The tax policies in Malaysia for both issuer and investor are very conducive. Issuer enjoys a tax deduction on issuance cost and gets stamp duty exemption, whereas sukuk investors receive a tax exemption on income received.

[3] Asian development bank report 2015 Retrieved form 'https://asianbondsonline.adb.org/documents/abm_sep_2015.pdf' on 17/06/2016

[4] Asian development bank report 2015 Retrieved form 'https://asianbondsonline.adb.org/documents/abm_sep_2015.pdf' on 17/06/2016

To further fuel the growth in corporate bond market, and meet the above challenges Capital market master plan (See figure 1), established in 2001was divided into three phases having a total span of 10 years. This master plan was a strategic draft having the following objectives:

(i) To be the preferred fund raising centre for corporate
(ii) To provide conducive environment for investors
(iii) To develop strong and competitive environment for intermediation services
(iv) To ensure sound regulatory framework
(v) To promote the efficiency of market institutions
(vi) To establish Malaysia as an international Islamic capital market centre.

This was a comprehensive plan to support national economic growth and meet future challenges from regional competition and globalisation. CMP implementation took in phases as shown below in Figure 2. After all three phases of CMP were completed, the Islamic capital market tripled in size from 2001-2010. By the end of 2010[5], it is found out that half of Malaysia's capital market assets were Shariah-compliant. From 2011-2020, they planned for capital market plan II so as to develop further growth strategies for investor protection. Malaysia is an originator of sukuk bonds in 1990 and also an originator of global corporate sukuk in 2001 and has now taken a lead in issuing world's first green sukuk in 2017. As far as rating and maturity is concerned, Malaysian corporate bond market is dominated by high grade (90%) long term bonds (71%) as per BAPM 2017.

Learning from the Malaysian experience

India can draw conclusions from Malaysia's development growth story and learn from their experience as to how to make use of innovative ideas to place itself as a niche market. As Malaysia brought an idea of Islamic bonds to develop its bond market, similarly India can also market 'swadeshi bonds' which might give investors a patriotic feeling for the development of the economic infrastructure. Indian companies can issue Indian bonds/Swadeshi bonds/patriotic bonds to raise funds for the further development of infrastructure. These bonds should be designed in such a way that they are most suited for risk-averse investors, which can be issued at a lower cost. One should find innovative ways to involve more people into the market. Also, the country has more of long term bonds unlike India. The size of long term corporate bonds should be increased for long term sustainability. Malaysia has given various incentives both to the issuer and investors in terms of tax exemptions (refer table 3). India should also improvise the tax structure and provide tax exemptions to issuers so as to attract them for public issuances.

One innovative effort made by the government of India is the introduction of 'green bonds' to fund green projects. India's Intended Nationally Determined Contribution (INDC) document states that our country needs at least US $2.5 trillion (@ 2014—15 prices) to improve its contribution towards climate improvement and follow a path of low carbon. Therefore, to meet its goal by 2030, it issued tax free infrastructure bonds of US $ 794 million in

[5] IMF country report ''Malaysia Financial sector assessment program'' report no. 14/98, April 2014

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2015-16 so as to raise funds for renewable sources projects. Although the concept of green bonds is new to India, yet this was started by European countries and World Bank in year 2007.

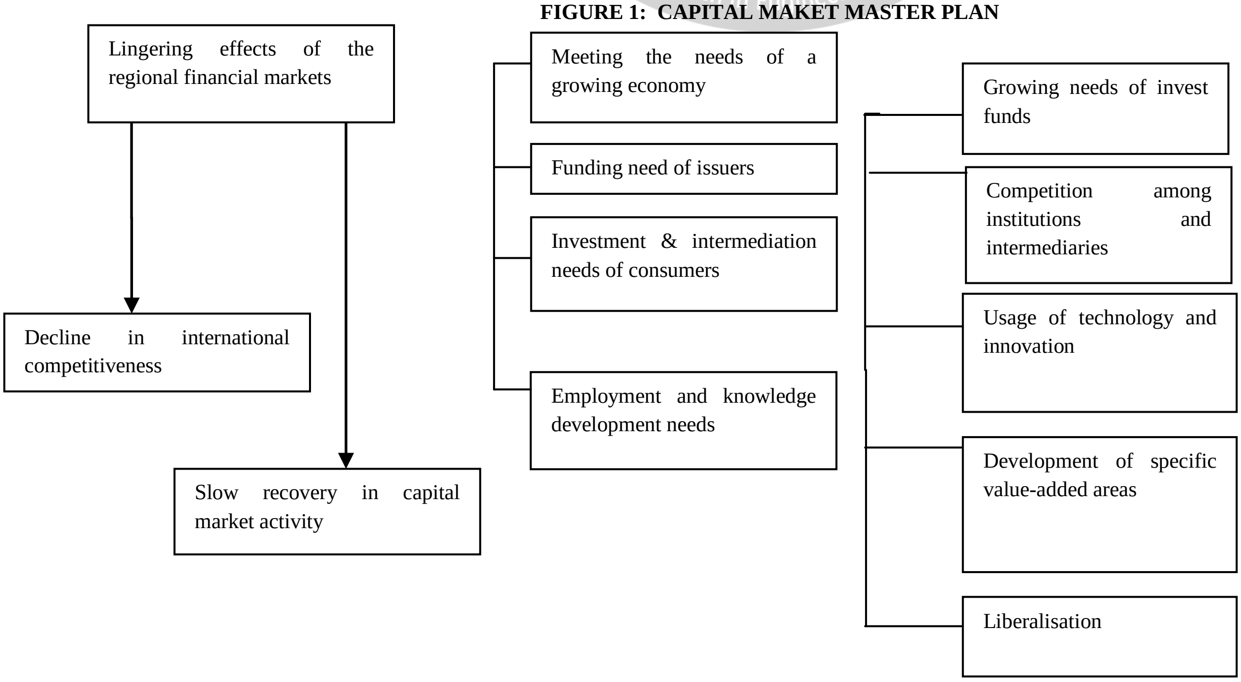
It is being tested quite late in India. The first green bond of 1000 crore, 10 year was issued by 'Yes Bank' in February 2015 to fund renewable energy projects. CLP India, the first Indian corporate issuer of green bonds raised Rs. 600 crore. EXIM bank and IDBI bank too raised the funds via green bonds.

Table 3: Key Developments in Malaysian Bond Market

Year	Initiatives	Purpose
1990	Rating agency Malaysia was established	To provide independent opinion on the potential default risk of debt issuers
1995	Malaysian Rating Corporation Berhad (MARC) was established	To provide independent and timely information to investors about the potential default risk of the debt issuers
1996	Bond Dealers association was formed	To represent industry views and work with regulatory authorities to promote bond market.
September 1996	fully automated system for tendering (FAST)	To enhance cost effectiveness ,efficiency and speed up securities tendering
1997	Bond information and dissemination system started	To facilitate efficient trading and promote transparency of information related to domestic debt securities
July 1999	Real time gross settlement system was started	To reduce settlement risk
1999	National bond market committee was formed	To oversee the policy direction for the development of the Capital market Master plan (CMP)
2001	Capital market master plan was unveiled	To enhance fund raising process,
2001	Securities lending and borrowing started	To promote lending of to the central bank
September 2004	Islamic Interbank Money market was launched	To provide transparency of information on Islamic financial products
October 2004	Institutional securities custodian programme was launched	To promote lending of securities to Central bank
2005	Tax legislations provide exemptions for banking and Islamic securities for sale, purchase and lease of assets	To increase liquidity
2006	Allowance of non-RM sukuk issuances by foreign entities	
2007	Exempted stamp duty on investing and trading sukuk	
2010	Tax deduction on expenses incurred in the issuances of corporate sukuk under the principles of Musharakha, Mudarabah, ijarah and istisna until year of assessment 2015	
2011	Tax deduction on expenses incurred in issuances of corporate sukuk under the principle of wakalah until year of assessment 2015	
2013	Islamic financial services act 2013 launched	
2014	Tax deduction on expenses incurred in issuances of corporate sukuk under the principle of wakalah until year of assessment 2015 extended to 2018	
2015	SC lodge and launch framework	
2016	Tax deduction on expenses incurred in the issuances of retail sukuk structure	
2017	Tax deduction on SRI (sustainable and responsible investment) sukuk until 2020	
2018	Income tax exemption for green SRI sukuk social grant receiver	

Source: *Compiled from various publications-[13]*

FIGURE 1: CAPITAL MAKET MASTER PLAN



Source:*http://www.sc.com.my/wp-content/uploads/eng/html/cmp/CMPNEAC050702.pdf, visited on 18/6/2016*

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Figure2: PHASES OF CAPITAL MARKET MASTER PLAN

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011-20
Strengthen domestic capacity, and develop strategic and nascent sectors										Address is to evolve challenges
			Further strengthen sectors and gradually liberalise market access							To make capital market growth strategies
					Further expansion and strengthening of market processes and infrastructure towards becoming a fully-developed capital market, and enhancing international positioning in areas of comparative and competitive advantage					Governance strategies to protect investors
Phase 1			Phase 2		Phase 3					Capital market master plan II

***Source**: http://www.sc.com.my/wp-content/uploads/eng/html/cmp/CMPNEAC050702.pdf, visited on 18/6/2016*

http://acraa.com/doc/5%20Malaysia%20Bond%20Market.pdf

South Korean bond market

One of the vigorous bond markets in terms of size and growth in Asia is the South Korean bond market. It is argued that the major cause of the rapid economic development of the country is its South Korean bond market. The outstanding amount of Korean Local Currency bonds reached KRW 2021 trillion (USD 1.7 trillion)[6] in 2015 and has increased to KRW 2224 trillion (USD 2 trillion[6]) at the end of Q3, 2018. This is the second largest LCY bond market in emerging East Asia with size of USD 1720 billion. In all markets other than Republic of Korea, the size of Government bond market is much larger than the size of corporate bond market and accounted for 59.3%[7]share of economy's total bond stock at the end of December 2015.

This is one of the markets which realised the importance of sound corporate bond market in early years i.e. somewhere around 1960's and framed the regulatory policies which are in line with the push to corporate bond market. In light of this, they passed a Capital Market Promotion Act.1968 whose main aim was to build an investor base in both equity and bond market. Until 1960's both public and private sector in South Korea were drawing their funds either from overseas or local banks rather than using bond market. Financing from foreign sources were 13.6% in late 1970's whereas bond financing was mere 3.3% in the same period [33]. The government used to intervene in the bank credit allocation practices by regulating interest rates and direct bank ownerships. This has resulted in strengthening the position of South Korean banks. It was only after the Currency crisis in 1997, the local bond market gained its size along with the structural changes. Before this, from late 1980's there was a slowdown in Government bond market because of the continual current account surpluses; however, Quasi g-sec used to be issued with monetary and exchange rate stability.

Despite the improper infrastructure with almost no experience, the South Korean government determined to lay out the strategy for bond market development. They devised a plan covering to create a demand among investors and encourage them to buy bonds through credit enhancements for corporate bonds so that investor base can be built up. With the introduction of Investment trust companies, there was a spurt in the size and growth of contractual type fund asset and reached to 3.6 trillion[8] won in 1983. Pension funds and insurance companies significantly contributed as the institutional investors in channelizing the funds to the corporate bond market.

On the other side, when banks were allowed to act as trust companies; they become popular amongst investors as they were giving more returns/interest to their clients as compared to the deposit accounts. Moreover, being floating rate dividend products, banks were giving fixed rate along with the principal which gave a sense of safety and satisfaction to the investors. This was the reason why bank trust accounts increased until 1997. These trust accounts used to hold a sizeable portion in corporate bonds; hence they were equally contributing to the growth of the corporate bond market. Further, to bring and increase investor's confidence in bond market, South Korean government devised a strategy of guaranteeing the bonds. This led to the emergence of bond guarantee scheme. However, this scheme worked well until 1997 financial crisis broke out. They comprised close to 85-90%[9] of corporate bond market before the crisis. The Financial crisis resulted in increased bankruptcies leading to increased risk to bond guarantors. Many guarantors left the market. Few realized that they were holding more risks than the rewards they were expecting. In fact, some of them were offering guarantee at a very high rate, but that was unacceptable to bond issuers and the guaranteed bond market was shrunken.

6. As per bank of korea and edaily bond web
7. Asia Bond Monitor report, March 2016, Retrieved from https://asianbondsonline.adb.org/documents/abm_mar_2016.pdf?src=spotlight, visited on 19/6/2016

[8] Study on Korea's Corporate Bond Market and Its Implications on China's Bond Market Development, World Bank Country Study Paper, January 2004, Retrieved from http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2004/11/02/000090341_20041102111538/Rendered/PDF/302460CHA0KorBond.pdf , visited on 19/6/2016

[9] Study on Korea's Corporate Bond Market and Its Implications on China's Bond Market Development, World Bank Country Study Paper, January 2004, Retrieved from http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2004/11/02/000090341_20041102111538/Rendered/PDF/302460CHA0KorBond.pdf , visited on 19/6/2016

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The collapse of bond guarantee though was heartbreaking for the economy, yet it brought new learning experience for it. This brought fresh opportunity for the financial market and business then turned towards corporate bond market, which was supported by South Korean government as well by raising commercial code ceiling from twice their net assets to four times net assets. Declining interest rates and elimination of foreign investment restriction further favoured the non guaranteed bonds and market grew to $168.06bn in 1998 from $68.15 billion in 1997. Lower interest rates once again built a confidence in channelizing the funds to ITC, but this did not continue for long and Daewoo crisis (the third largest conglomerate in South Korea) eroded the confidence of investors in corporate bond market. The corporate bond market shrunk after the crisis, the yield spread increased for AA- or above rated bonds. The South Korean government took several measures such as introduction of bond stabilisation scheme, creation of incentives to invest in ITC, launching new products with tax breaks, execution of structural reforms, providing stimulus package and permitting the write-off of ITC's non-performing assets to bring back the investors' confidence. Another remarkable difference which can be observed after the crisis is the growing emergence of credit rating agencies as the new products now introduced were free from guarantee.

Lot of structural reforms took place (See Table 4) after the crisis such as new issuance procedure was adopted which was functional in developed countries. In fact, the structure of interest rate (governed by inflation rate and economic growth) changed and risk premium started playing the major role in fluctuation of interest rates. Primary dealers were selected to make the market. Dutch pricing rule was adopted instead of conventional multiple pricing rule. Also, with the introduction of two acts-asset securitisation act and mortgage securitisation act, the ABS and MBS market got a boost. The proportion of corporate bond amount outstanding was as high as 30% with respect to the total borrowings from bond market even after the crisis of 1997. Although it declined after 2000 and proportion of bank loans increased yet the corporate bonds could maintain 14.8% by end of April 2014 after the credit crunch of 2008.

Lessons from the South Korean market experience

South Korean market experience tells us that building/widening an investor base alone cannot help the bond market to sustain for long. Development of market infrastructure is equally important for the long term market to develop so that balanced growth can be achieved. Korean government for the sake of getting the investors into the bond market created an artificial security in terms of bond guarantee, which later on collapsed. India should try to find ways to widen its investor base but bond guarantee can't be the solution. Number of financial institutions may be increased; transparency, reliability, accessibility, timeliness and market diversification should improve.

RBI in one of its circulars (RBI/2008-09/79 DBOD.No.Dir.BC.18/13.03.00/2008-09 dated July 1, 2008) specifically denied banks from guaranteeing any debt laden instruments, otherwise it can have far reaching effects. However, many a times the news regarding the Indian banks to act as a guarantor for bonds has been aired. Although it can give a sense of relief to the Indian investors initially, yet it can't be successful in long term as can be seen in case of Korea. Foreign investors should be encouraged, which is recently done by SEBI.

Table 4: Key Developments in South Korean Bond Market

Year	Initiatives	Purpose
1950	Started the bond market with the government securities	To fund post war reconstruction
1956	Stock exchange was opened	
1963	First short term maturity convertible corporate bonds were issued and were heavily dependent on bank guarantee by Ssangyong cement	
1968	Capital Promotion market act was passed	To promote equity and bond market
1969	Securities and investment business act (SITBA) introduced the contractual investment trust as a vehicle to mobilize domestic capital	To make payment guarantees for corporate debt securities, analysing and financing securities on the basis of collateral
1972	SITBA also authorized the South Korean Investment Corporation (KIC) to engage in the investment trust business as the sole guarantor of bonds	To restore economic activity by stimulating investment demand and to release burden on overextended firms.
1974	KIC investment trust function was transferred to the newly established Korea investment trust company	To persuade and further push the growth of investment trust companies and contractual type fund.
1976	Korea Guarantee insurance company was established	To act as a guarantor in bond guarantee scheme
1983	Commercial banks opened bank trust accounts	To bring competition in Investment trust companies; banks were allowed
1984	Plan was unveiled by Ministry of Finance to promote development of bond market	To institutionalise the OTC markets and make an improvement to asset management methods of investment trust
1986	The Ministry of Finance further announced to raise funds through capital markets	To promote issuance of corporate debentures, right offerings and corporate disclosures
1989	Five more ITC's were launched	
1990	Market opened for foreign investors	
1993	Plans were laid down to advance the bond market	To develop the real time disclosures of yields and adoption of a dealer system
1997	1. East Asian Crisis began 2. Government restricted bond guarantee and limits the exposure of banks and ITC 3. Markets were fully liberalized; government relaxes corporate ability to issue bonds and eliminated any foreign investment restrictions in domestic bond market	Commercial code ceiling on bond issuance was raised to 4 times net assets
1998	1. Korea Guarantee insurance company along with Hankook Fidelity and Surety company became insolvent	To unify oversee of securities, banking, insurance and thrift aspects of Korean Finance

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	2. Financial supervisory commission was established 3. Interest rates were declined sharply forcing the companies to issue bonds at a high coupon rate of non guaranteeing 4. Stimulus plan was announced 5. Arbitrary control of bond issuance was demolished	
1999	1. Daewoo crisis created pressure on corporate bond market; led to the erosion of faith of investors in corporate debt market. This also brought the ITC under pressure to redeem funds in bond type certificates 2. Stabilisation fund for bonds were established 3. Inter-dealer market (IDM) was set up 4. Primary dealer system was enacted 5. Government Bond futures were brought into the market 6. Delivery vs. payment system was started 7. Financial supervisory service was established	To respond in line with the requests raised by the investors for redemption of funds
2000	1. Inter dealer broker (IDB) was introduced 2. Primary dealers were given the facilities for securities financing 3. Implementation of Dutch auction system from multiple price auction was implemented	
2002	Mandatory exchange trading requirement for benchmark issues	
2003	1.strengthening obligations of primary dealers Unifying interest rate payment dates in preparation of STRIPS	
2005	STRIPS were introduced	
2006	20 years government bond issued, inflation indexed bonds were issued, design products for retail investors	
2009	Measures to improve the efficiency of the secondary market for bonds were announced	

Source: *compiled from Study on Korea's Corporate Bond Market and Its Implications on China's Bond Market Development, World Bank Country Study Paper, January 2004 and Raghavan et. al, A study of corporate bond market in India: Theoretical and policy implications, development research group, RBI, study no. 40*

Another step which can be taken up by Indian government is to introduce more of hedging instruments such as credit default swaps (CDS) as these financial instruments can provide the investors with the sense of relief. Since investment in bond market is attached with the risks involved. Therefore investors' scope can be widened by providing them with the instruments which can hedge risks. Though RBI has already introduced CDS, yet not much progress is seen in this regard. Residential mortgage backed securities (RMBS) is also introduced to promote the development of secondary market in the same. This can provide credit enhancements for residential mortgages.

Also, to encourage participation in non guaranteed bonds, securitisations, partial guarantees through collateralised bond obligations and collateralised loan obligations can be taken up. They can be backed by independent credit ratings and better disclosures. However, efforts can be made to further enhance the credibility of rating agencies.

Another major conclusion which can be drawn from the Korean market is the role of government in creating the required infrastructure. The policy initiatives play an important role in developing the bond market. The Korean experience shows that strong government securities market is a pre requisite for the strong local currency bond market. Other than this, improved technological system like electronic trading system brings a transparency and liquidity in a system. Significance of securitisation and credit guarantee mechanism can be gauged from the financial crisis. These are necessary for credit spread risk and overcome credit quality gaps.

The United States of America bond market

The US bond market dates back its history in 1776, when debt securities were first issued. Since then, the first secretary of the Treasury Alexander Hamilton restored US credibility in global financial markets. The highly illiquid and speculative debt market could transform itself into the safest and liquid securities of the world on the basis of sound policies and principles of the debt management. However, just after the great depression, net debt has risen to $42.8 billion or 44.2% of GDP by the end of 1940, which further increased to 108.6% of GDP by the end of fiscal year 1946[10]. This was reduced to 23.8% in 1974. From mid 1970s to mid 1990s, net debt to GDP ratio was substantially higher and reached to its zenith at $3.773 trillion at the end of fiscal year 1998. As of March 31, 2001, bills, notes and bonds were outstanding worth of $3 trillion. The total amount outstanding in US in case of corporate bond was $21 trillion. Total debt securities outstanding amount as on Q1 of 2016 is USD 40218.3[11] billion (includes open market paper, treasury securities, agency and GSE backed securities, municipal securities, corporate and foreign bonds). The depth and advancement of the US market can be gauged from these figures. The US market is biggest not in terms of amount outstanding but in terms of annual turnover as well. They have strong regulatory framework. Exchanges in US are primary regulator of their securities market [6].

The market has whole lot of variety of instruments such as treasury bonds, federal agency securities, municipal bonds, corporate bonds, mortgage backed securities, asset backed securities which are absorbed by investors like financial institutions, banks, insurance companies, pension funds. Other than domestic investors, foreign investors play an equally important role in stimulating the demand. There are specific securities which are issued for retail investors in developed countries. The market has well developed asset backed securities which provides relief to balance sheets of banks [28].

[10] Budget historical s 7.1, Retrieved from https://www.whitehouse.gov/omb/budget/Historicals, visited on 21/06/2016

[11] Financial accounts of the United States, first quarter 2016, federal reserve statistical release, pp.115

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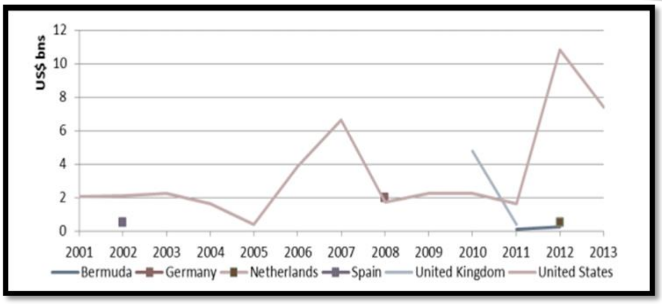
There are certain firms in United States which issues corporate bonds especially for retail investors. These are structures as per the needs, requirements and profile of retail investors, whereas generally the corporate bonds are structured for institutional investors. It is seen in the figure 3 that retail bonds are available in US market and have huge market since 2001, having value of USD 2 billion and peaked to USD11 billion in 2012. As per sources (Dealogic), these bonds are issued generally for a period of long term and medium term. No short term bond issuances have been seen in this case till 2013.

It has been observed that usually government securities market is larger in size as compared to the corporate bond market, but in US, the size of outstanding volume in treasury securities is almost equal to the size of corporate bonds and MBS together. As per Q1 2016[12], the size of treasury securities is USD 1021.1billion, Agency and GSE backed securities is USD 8178 billion, Municipal securities USD 3746.9 billion and corporate and foreign bonds is USD 11894.9 billion

Lessons learnt from the experience of US market

The Indian bond market is miniscule as compared to the US bond market. They have much more financial instruments available which are currently non-existent in Indian market. India should also widen the scope of investment avenues for the investors by introducing at least those products which are successful in the other country. Also, there is hardly any retail participation in India as far as bond market is concerned. We can also introduce specific securities especially for retail investors. Indian markets can introduce some hedging instruments so that investors can hedge their products. Development of US market suggests that ABS market existed even before the introduction of corporate bond. Well-developed asset backed securities market gives a relief to the balance sheets of banking sector and give them an opportunity to further leverage the monetary base enabling it to support economic growth. See Table 5, which gives the cross country comparison of asset backed securities as a percent of bank lending.

Figure 3 : Issuances for Retail Investors in US



***Source**: Tendulkar R & Hancock G., 2014 'Corporate bond markets: a global perspective, staff working paper of the IOSCO research department*

Table5: Cross Country Comparison: ABS as a% of Bank Lending and GDP (2012)

Rank	Country	ABS/Bank Lending	ABS/GDP
1	United States	0.5401%	1.2384%
2	South Korea	0.0017%	0.0029%
3	Malaysia	0.0008%	0.0011%
4	India	0.0003%	0.0003%
5	Spain	0.0001%	0.0003%
6	China	0.0001%	0.0001%

***Source**: Readers digest: development of corporate bond markets in India: Global lessons, February 2014, Volume 2, issue 2*

Indian Corporate Bond Market

As stated earlier Indian bond markets are lagging in terms of development and infrastructure and are dominated by the government securities (refer table 6). However, the existence of developed G-secs market is crucial for providing a benchmark yield curve for bond pricing [16], but on the other side, lower sovereign borrowings can accelerate the demand for corporate bonds [15]. The financing pattern of the companies states the existence of underdevelopment of corporate bond market, where they are borrowing funds through commercial banks rather than bond market [21]. Although regulatory bodies are taking various measures for opening and broadening the bond market, yet little progress can be seen in this front.

The size of total bond market in India is US $812 billion as of March 2014, (Asian development bank report) comprises government bond of $ 569 billion (30.4 % of GDP) and corporate bond is of $ 242.5 billion (13% of GDP). Indian firms are highly levered when seen across the emerging countries. Domestic credit to corporate continues to increase due to growth in lending by public banks, especially for infrastructure projects. The majority of corporate bonds in India are issued by finance companies and infrastructure/manufacturing companies are taking recourse to bank loans and are moving at a very low pace for tapping the corporate bond market [22],[20]. Along with this, the exte rnal commercial borrowings rose by 107 percent[13] between March 2010 and March 2014. Corporate leverage also increased as there were very few equity issuances during this period. Hence, the average debt to equity ratio of Indian non-financial companies increased from 40 percent (2001) to 81 percent in 2013.

Table 6: Resource mobilization in debt markets by Government and Corporate sector

Year	**Government Securities**		**Corporate Securities$**	**Government sec. as a % of total amount**
	Central Government (Rs. Bn)	State Government*(Rs. Bn.)	Rs.in bn.	
2008-09	3,186	1181.38**	1758.27	71.29
2009-10	4924.97	1311.22	1834.777	77.27
2010-11	4794.82	1040.39	2016.763#	74.32
2011-12	6004	f1588	2871	72.56
2012-13	6885	+1773	3688	70.13
2013-14	7005	1967	3133	74.12
2014-15	7412	2408	4659	67.82

[12] Financial accounts of the United States, first quarter 2016, federal reserve statistical release, pp.115

[13] IMF Report, march 2015

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2015-16	4559	2594	5179	58.00
2016-17	4268	3427	7375	51.06

****Includes Rs 120,000 million dequestered from the MSS cash account during 2008-09**

*** Gross and net borrowings include MSS de-squestering**

 # Includes NDS-OM turnover

$ Includes public issue and private placements both

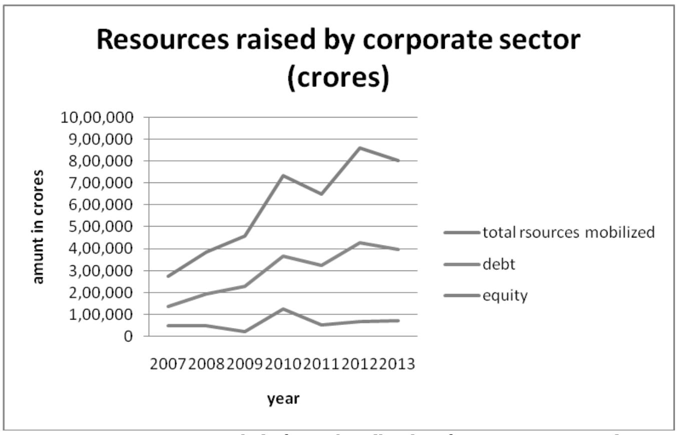
Source: ISMR, NSE (2017)

This shows that the Indian companies avoid issuing debentures and fixed deposits and prefer to institutional lenders and commercial banks, which puts a burden on the balance sheets of commercial banks leading to mismatch of asset and liability. At the same time, the financial performance of these corporate is worsening, and is evident from the balance sheets of banks, where the level of stress loans have increased in a recent past. Many companies debt equity ratio is more than 2:1 and as per the IMF report, January 2015, such companies account for more than 31% of borrowing by Indian corporate.

Recently, the corporate sector is taking recourse more to the debt market as can be seen from the graph1 and figure 1. Indian firms have raised approximately 4 lakh crores[14] from the market in 2014. Majority of these funds (approx. 83%) have been gathered from the most preferred route of corporate, which is debt market. This is evident from the fact that bank credit grew 9.5%[15] on year on year in the fortnight ended March 20, 2015. Though, both, number of issues and amount has increased in the recent past in the corporate bond market, yet the share is miniscule in comparison to government securities market.

There are several issues on the supply side and demand side-insufficient supply, lack of variety of financial instruments, lack of hedging instruments, biasness for private placements [15], weak role played by primary dealers/market makers are the issues under supply side whereas, demand side majorly include the restrictions put by the different regulatory authorities and the tendency of the investors to buy and hold the securities. There is hardly any participation of the retail investors. Regulatory, infrastructural issues also exist as far as Indian corporate bond markets are considered [17], [25]. Several steps have been taken as shown in appendix A, which are there to address the issues.

Graph 1: Resources raised by corporate sector



***Source**: Compiled from handbook of statistics on Indian securities market, 2013*

Conclusion

Every country has their own journey in development of their financial markets. India can learn various lessons from their experience which are as follows-

- The South Korean market reveals that it is important to develop the government securities market first before the development of any other market. India fulfils this criterion. However, Government policy initiatives and the reforms can help in stimulating the demand, creating necessary infrastructure and improving the overall transparency and liquidity in the corporate bond market as well.
- India may consider innovative ways to attract investors and draw their attention towards the bond market as sukuk bonds were introduced in Malaysia and established itself as a niche market in the world. Favourable tax benefits to both issuers and investors can help boost the market. Hence, attract investors as well as companies by providing them with variety of tax benefits.
- India should widen the scope for retail investors as can be seen in case of US market. US market has varied instruments, which are covering the hedging instruments as well. The norms should be further relaxed with respect to the hedging instruments. Though swap market was opened in India, yet it could not take off till now. Another way to broaden the scope of retail investors is to encourage fund management industry by creating more of mutual funds.
- Though foreign institutional investors limit is increased, yet more participation from them can be encouraged by easing regulations with respect to the disclosure requirements and also give tax incentives to them.
- Previous study and current data relates that the private placement dominate the market. Therefore, measures should be taken to encourage public issues by easing disclosure requirements. As disclosure norms were relaxed in Malaysia, similar kinds of arrangements can

[14]http://articles.economictimes.indiatimes.com/2014-12-28/news/57462613_1_debt-market-debt-route-lakh-crore
[15]http://www.business-standard.com/article/finance/more-corporates-seen-tapping-bond-markets-ahead-of-rbi-action-115040601310_1.html

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be made in India which reduces the time period of listing the bond. Along with this, steps should be taken to rationalise the stamp duty, which is one of the biggest hurdle in the growth.

To summarize, Although, several initiatives have been taken by RBI, SEBI and GOI to accelerate the growth of Indian corporate bond market till now, yet there is a long way to go. Some of the reforms include-

a) The role of different regulatory bodies has been clarified so as to avoid conflicts and enhance the process with smooth functioning of issuances and sorting out legislative issues.
b) The cost and the length of the issuance process is simplified.
c) Trading lot sizes have been reduced to Rs.1 lakh to encourage the retail participation.
d) New debt instruments are introduced such as corporate repos, credit default swaps, floating rate bond.
e) Transparency in secondary market is enhanced.

Still, Efforts are required for widening the investor base, streamlining issuances, increasing foreign participation by providing conducive climate to them, focussing on tax policies and introducing innovative instruments. The reform process will help the market to further gain strength in world financial markets.

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