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Abstract

Developing corporate bond markets is an important policy task for Asian countries. In Korea, there is much room for expansion of the market. In Malaysia, corporate bond issues have increased since the Asian crisis. In Thailand, the corporate bond market is not yet matured in comparison with Korea and Malaysia. Regarding corporate financing, the corporate bond market expanded in Malaysia and the issuance of bonds has gained the same importance as bank lending. On the other hand, in Korea and Thailand, the dependence of the financial system mainly on the banking sector has not changed. In the corporate bond markets of the three countries, issuing size should be enlarged and issuers should be more diversified. For that purpose, the various governments involved and the Asian Bond Markets Initiative must continue their efforts to develop the markets, while respecting market mechanisms and the situation of the financial system in each country.

1. The Asian currency crisis and corporate bond markets

The development of bond markets in East Asia has been promoted mainly in order to prevent a recurrence of the currency crisis of 1997. Four concrete objectives can be pointed out; i) the formation of a domestic financial system balanced between banks and capital markets, ii) the reduction of so-called double mismatching (that of duration and currency), iii) the return of the domestic savings of Asian countries back into the Asian region, and iv) the promotion of regional financial integration.

In the Asian countries before the currency crisis, the financial system was dominated by banks, and the main method of financing for corporations was to borrow from banks both inside and outside the country. Under the high growth rates of the economies, rapid growth of bank lending led to excessive capital investment and a real estate bubble, which became one of the important causes of the currency crisis. Also, capital inflows from overseas expanded, the main composition of which was short-term lending, and that fact amplified the problems of double mismatching. Therefore, free-fall of the domestic currency caused the expansion of foreign currency debt, and the crisis became deeper and deeper. After the crisis, many people started to claim that, a domestic financial system balanced between banks and capital markets could be formed, and double mismatching reduced, by developing domestic bond markets.

After the crisis, investment decreased in Asian countries and excessive savings became general. Also, compared with the capital inflows from developed countries to Asian countries, mainly composed of relatively high-risk investment such as direct investment, the capital outflows from Asian countries to developed countries were mainly composed of investment to low-risk assets such as government bonds, and so on. Therefore, we can see a great difference between capital inflows and outflows. This phenomenon gave rise to the desire to unite Asian savings and Asian investments directly. The development of domestic bond markets became regarded as an important measure to realize a new route for financial intermediation.

Furthermore, in East Asia, because the regional integration of real economies is in progress, the financial system should also be integrated. The development of bond markets can be regarded as one of the measures to realize this. The expansion of investments into domestic bond markets from abroad can improve the liquidity of secondary markets and the information disclosure of corporations. Thus, the development of bond markets and the progress of financial integration are closely related.

As stated above, the expansion of bond markets has various effects. However, for those effects to be realized, not only government bond markets but also corporate bond markets must be expanded. In this paper, Asian bond markets will be surveyed with the main focus on corporate bond markets. The targets of the analysis are the relatively developed bond markets of Korea, Malaysia and Thailand. In Section 2, the present situation of Asian bond markets as a whole will be examined. After that, we will confirm the progress and the meaning of important initiatives such as the Asian Bond Fund by EMEAP (Executives' Meeting of East Asia-Pacific Central Banks), and the Asian Bond Markets Initiative by the ASEAN plus 3 Finance Ministers' Meeting. In Section 3, the three domestic bond markets will be surveyed, and in Section 4, changes in corporate financing in the three countries will be explained. In Section 5, the results of the analysis will be summarized.

2. The present situation of Asian bond markets and market fostering initiatives

2.1 The present situation of Asian bond markets

Following the currency crisis, the amount of Asian government bonds outstanding grew about 5.4 times from the end of 1997 to September 2005, and the amount of Asian corporate bonds outstanding grew about 2.6 times for the same period. According to Gyntelberg et al. (2005) and BIS (2006), the proportion of the amount of corporate bonds outstanding in proportion to GDP varies among Asian countries. The ratios of Korea and Malaysia are high even by global standards, and these are followed by Hong Kong, Singapore and Thailand. On the other hand, the ratios for the Philippines, Indonesia and China are very low, due among other things to strict market regulations such as limiting issuers of corporate bonds by imposing various conditions on them.

The amount of issued bonds outstanding in Asian countries at the end of 2004 was 1.5 trillion US dollars, which was about 4% of 40 trillion dollars, the world total. In addition, the ratios of the amount outstanding to GDP for advanced countries were 140.2% on average, compared with 42.6% for Asian countries. The issuers of corporate bonds are limited and a few large corporations account for most of the amount outstanding. Many of the issuers are financial institutions and public utility companies. Issuers' credit ratings are mostly BBB or above. These facts show that Asian bond markets still have plenty of room for growth through the further liberalization of regulations, and so on.

Among the measures taken to help develop corporate bond markets is an effort to utilize credit enhancements with securitization. For example, in Korea, ABSs (Asset Backed Securities) played an important role in increasing corporate bond issues after the crisis. Also, securitization is growing in Hong Kong and Malaysia. However, the banks have a great deal of liquidity and their capital adequacy ratios are high. Therefore, they do not have sufficient incentive to securitize their assets. Another way to increase issuers is to promote issuance by non-residents. The ratio of issues by non-residents is high in Hong Kong and Singapore. Maturing bond markets is an indispensable factor for the further increase of issues by non-residents.

Regarding investors in Asian countries, the weight of banks whose investment is mostly buy-and-hold is high. However, diversification of investors is progressing gradually, due to the expansion of institutional and individual investors. Behind the diversification, there are ongoing pension reforms, increase in insurance penetration and growth of mutual funds. On the other hand, many of the banks are decreasing investments in government bonds and increasing lending. In Thailand and Indonesia in particular, commercial banks have greatly decreased investments in government bonds. However, the ratio of commercial banks among bond investors is above 50% on average, which is high internationally. High investor concentration often leads to low liquidity of the market and distortion of price formation. Therefore, diversification of investors is desirable. The ratio of foreign investors is 40.4% in Germany, 33.9% in the U.S., and only 2.3% in Asian countries, according to ADB (2004).

Liquidity of the secondary markets should be improved. The turnover ratio (transaction amount divided by average amount outstanding for that period) is improving only in some government bond markets, such as Korea, Singapore and Thailand. In these countries, effective policy measures were implemented in order to grow their secondary markets. For example, a re-opening system and primary dealer system were introduced in Korea in 2000, resulting in very much improved liquidity. On the other hand, improvement in the liquidity of its corporate bond market was not so apparent.

There are some reasons for the low liquidity of Asian bond markets. i) The size of the markets and each issue is small. There is an opinion that a market size of around 100 to 200 billion US dollars is necessary to form a liquid bond market. ii) Investor base has not become sufficiently diversified. Unless we have investors of various investment types, one-way transactions would prevail and a liquid market would not be formed. Further, dominance by buy-and-hold style also leads to few transactions. iii) There are insufficient hedging tools such as derivatives, and so on, and information infrastructure that guarantees the transparency of transaction prices is also lacking. iv) Regarding corporate bonds, insufficient information is provided regarding the credit risks of each issue. In addition to the financial statements made by issuers, the role of rating agencies is also important.

2.2 The progress and meaning of the Asian Bond Fund (ABF)

Under the ABF initiative, the foreign exchange reserves of 11 countries and regions of EMEAP (Australia, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand) were invested in Asian bonds. Two funds were established, namely, ABF1 (announced in June 2003) and ABF2 (announced in December 2004). These are bond mutual funds with passive management style, which invest in sovereign and semi-sovereign bonds of eight countries and regions of EMEAP, excluding Australia, Japan and New Zealand. ABF1 is a 1 billion US dollar fund invested in US dollar denominated bonds issued on international markets by Asian governments and government agencies. The main purpose of ABF1 was to learn by doing.

On the other hand, ABF2 is invested in local currency denominated bonds and is deeply involved in the development of Asian bond markets. It consists of the dollar denominated Pan-

Asia Bond Index Fund (PAIF) for cross-border investment in bonds of the eight countries and regions, which was about 1 billion dollars at the time of its establishment, and single-market funds with a combined value of about 1 billion dollars at the time of establishment. Private investors can buy ABF2 in the second phase. By April 2006, six funds including PAIF entered the second phase and the funds increased by about 0.4 billion dollars in total.

The purposes of ABF, as announced by EMEAP are, i) the improvement of recognition of Asian bonds by investors, and ii) the acceleration of market and regulatory reforms in each country in the region. These have been achieved to some extent. The market index introduced for ABF has become a management benchmark for Asian bonds. Also, in order to establish ABF2, each country advanced legal and tax reforms and the construction of market infrastructure. It is also important that ABF has contributed to the investment of foreign exchange reserves into the region and the improvement of their investment return. ABF played a great role in expanding investor base by providing new investment products, and in constructing market infrastructure.

2.3 The Progress of the Asian Bond Markets Initiative (ABMI)

ABMI was started in 2003, and six working groups were established whose main purposes were expansion of issuer base, diversification of issuing currencies, and construction of market infrastructure. Later, a reorganization plan named ABMI Roadmap was prepared, and a new phase started in May 2005. Further, three new tasks were agreed upon: i) The issuance of Asian Currency Basket Bonds. ii) Regular self-checking by each country, the purpose of which is to check for impediments to the investment in the domestic bond markets. The results of checking should be reported twice a year. iii) The introduction of the Asian Bond Standard. This means seeking the possibility of establishing regional bond markets in East Asia by adopting international standards for bond issuing procedures, and by constructing market infrastructure.

3. The corporate bond markets of Korea, Malaysia and Thailand

3.1 Korea

3.1.1 The primary market

In Korea, a law that promotes the development of capital markets was adopted in 1968 and the development of the corporate bond market started. Before the currency crisis, the corporate bond market was a main component of the bond markets. However, after the crisis, problems regarding credit risks arose several times, and the amount of outstanding corporate bonds has not been increasing (Table 1).

Table1. Amount Outstanding of Corporate Bond Issues

	1997	1998	1999	2000	2001	2002	2003	2004	2005
Korea	90.1	122.7	119.6	133.6	154.4	180.0	187.4	153.3	142.5
Malaysia	46,594	46,737	79,313	102,220	120,584	108,416	144,595	160,057	182,896
Thailand	187.6	177.6	402.0	501.2	538.1	543.4	607.3	548.3	659.9

Notes: Korea: trillion won, Malaysia: million ringgit, Thailand: billion baht.

Sources: Korea: BIS (2006), Malaysia: Bank Negara Malaysia, *Annual Report*, Thailand: Thai BMA website.

Companies can issue corporate bonds until the total amount reaches four times their equity capital. The main issuers are big companies that belong to Chaebols. In 1997, the composition by industry of the issued amount was 72.4% for manufacturing, 10.5% for construction, and so on. After the crisis, the weight of financial institutions increased, and according to ADB (2005a), in February 2005, the composition was 67.2% for financial institutions, 21.6% for manufacturing, and so on. Most of the corporate bonds are issued with a 3-year maturity.

Before the crisis, most of the corporate bonds were guaranteed by financial institutions such as commercial banks, merchant banks, securities companies and guarantee corporations. After the crisis, many banks suffered a management crisis and became unable to underwrite corporate credit risks. It became difficult to borrow money from banks, and the guarantees for corporate bonds decreased. Since 2003, less than 1% of issues have carried guarantees. In 1985, KIS (Korea Investors Service) was established as the first rating agency. After that, NICE (National Information and Credit Evaluation) and Korea Management and Credit Rating Corporation, an affiliate of the Korea Development Bank, were established. Publicly placed bonds without guarantees must be rated by more than two agencies. Because the number of bonds without guarantees has increased, the role of rating agencies has become more important than before.

3.1.2 Investors and the secondary market

According to Asian Bonds Online, the composition of government bond investors is 63.6% for financial institutions, 28.2% for government agencies, and 8.2% for corporations and individuals. Banks and trust accounts of banks are surely important investors. The transaction amount and the turnover ratio of government bonds increased dramatically in 1999, owing to the increase of the amount outstanding, interest rate reduction, and the introduction of the primary dealer system (Table 2).

Table2. Turnover Ratios of Bond Markets

(Number of times)

		1998	1999	2000	2001	2002	2003	2004	2005
Korea	Government Bonds	0.93	2.65	4.56	5.87	4.22	4.39	3.88	3.34
	Corporate Bonds	1.25	1.67	1.08	1.36	0.85	0.74	0.63	0.54
Malaysia	Government Bonds	n.a.	n.a.	n.a.	2.48	2.39	2.28	1.82	1.85
	Corporate Bonds	n.a.	n.a.	n.a.	1.05	0.93	1.10	0.78	0.80
Thailand	Government Bonds	0.22	0.64	1.58	1.65	1.70	1.63	1.73	1.89
	Corporate Bonds	0.04	0.17	0.49	0.37	0.31	0.42	0.26	0.23

Source: Asian Bonds Online

Most of the transactions of the secondary market were over the counter. However, in order to improve transparency, transactions in the Korea Exchange were promoted. As a result, the ratio of transactions over the counter decreased to 80.1% in 2005. The management of the secondary market and the provision of information are implemented by the Korea Securities Dealers Association.

Regarding the investor composition of the corporate bond market, previously ITCs (Investment Trust Companies) were dominant, but the ratio has greatly decreased, and securities companies, insurance companies and other financial institutions such as mutual savings banks, and so on, have become more important (Table 3). Other financial institutions have a strong investment appetite for BBB rated corporate bonds, because of the balance of credit risks and investment return (BIS (2006)).

Table3. Investor Composition in Korean Corporate Bond Market

(%)

	1998	1999	2000	2001	2002	2003	2004	2005
Banks	5.3	4.9	8.1	12.8	12.8	14.3	12.2	11.5
Bank Trusts	10.3	10.4	7.4	6.4	8.1	6.3	5.5	4.4
Investment Trust Companies	62.4	60.2	29.5	20.8	18.7	11.9	15.3	13.9
Securities Companies	8.7	12.3	15.0	13.8	15.5	20.0	21.0	23.0
Insurance Companies	2.1	1.5	5.5	7.2	8.9	11.8	11.8	11.8
Pension Funds	0.0	5.6	9.2	10.7	10.4	9.1	6.0	5.3
Mutual Savings Banks, Credit Unions, Individuals, etc.	11.2	5.0	25.3	28.4	25.6	26.5	28.0	30.1

Note: End of September for 2005.

Source: BIS (2006)

Original: Korea Securities Depository

Since 1999, the transactions of corporate bonds and the turnover ratio have decreased mainly due to the decrease of transactions of lower rated issues. This was because, in July 1999, the Daewoo Group went bankrupt and confidence in the corporate bond market was damaged. Also, the transparency of price formation was insufficient.

3.1.3 Problems of the corporate bond market

Before the currency crisis, ITCs had been utilized by the government as vehicles to develop the corporate bond market, and for that reason ITCs had many problems. New entry to the industry was limited, management of ITCs was dominated by the Ministry of Finance and Economy, and ITCs were utilized for political purposes. The securities in the funds were not evaluated at market prices, and the return of the funds was sometimes guaranteed to the customers. After the crisis, borrowing from banks became difficult, and from 1998 to the first half of 1999, issues of corporate bonds soared and the amount outstanding of ITCs increased very rapidly. In this situation, financing became very easy for big companies, and that fact prevented corporate restructuring. A symbolic incident was the bankruptcy of the Daewoo Group in July 1999. At that time, large amounts of money went out of ITC funds and bond prices declined. The government had to take measures to stabilize bond prices, to prevent money from leaving ITCs, and to encourage management reform of ITCs by dealing with non-performing loans and by making rules concerning the evaluation of securities at market prices.

These actions were mostly successful. However, the large amount of corporate bonds issued since 1998 started to mature from mid-2000, and it was difficult to roll them over, lower rated bonds in particular, because the size of ITCs had become smaller and the investors were avoiding credit risks. The government had to take action again[1]. Furthermore, in March 2003, due to the accounting scandal of the SK Group and the deterioration in the management of credit card companies, the corporate bond market was damaged again. Money went out of the Money Market Funds of ITCs, and the financing condition of the corporate bond market deteriorated notably. In particular, credit card companies could no longer isuue bonds. A great deal of liquidity was provided by the Central Bank, and further government action was announced. Among the measures were the increase of capital and the issuance of subordinated bonds for credit card companies, and the acquisition of non-performing assets by KAMCO

[1] The government introduced P-CBOs (Primary Collateralized Bond Obligations) that securitized lower rated corporate bonds. Part of these were guaranteed by public credit guarantee funds, and the government also established the 10 trillion won Bond Fund financed by financial institutions for the purpose of digesting lower rated corporate bonds and P-CBOs. Furthermore, a one-year temporary underwriting scheme was implemented.

(Korea Asset Management Corporation), the public asset management company.

After the crisis, ABSs have played an important role in the corporate bond market. In 1998, a law governing issues of ABSs was passed. In 2000, more corporations became eligible to issue ABSs. Under the prevalence of financial and corporate restructuring, KAMCO actively issued ABSs, and the amount of issues increased quickly. In 2000, Asset-Backed Commercial Papers and Collateralized Loan Obligations were introduced for the purpose of financial restructuring and new financing.

However, since March 2003, due to the problems of credit card companies, most of the financial institutions stopped buying ABSs, and the ABS market shrank. The amount of issues peaked in 2001 at 34.2 trillion won, and then decreased to 17.7 trillion won in 2005. This is equivalent to 41% of the issued amounts of corporate bonds as a whole. Also, the Korea Housing Finance Corporation, established in 2004, has started to issue Residential Mortgage-Backed Securities.

3.1.4 Summary

In Korea, until shortly before the crisis, most corporate bonds were issued with guarantees from financial institutions. Also, policy efforts to grow the corporate bond market were implemented by utilizing ITCs. These were serious problems for the market. In addition, the credit card company crisis in 2003 made investors more cautious toward the credit risks of corporate bonds. That is why investor flight to quality increased, resulting in the buying of more government bonds, and shrinkage of the corporate bond market. As these events show, active involvement of the government in the development of the market resulted in destabilization of the financial system. In the future, the government should decrease involvement as much as possible, and corporate bonds directly reflecting the creditworthiness of corporations should be issued.

Also, the investor base should be expanded. Pension funds and insurance companies should actively invest in corporate bonds. The amount of public pension funds has been increasing since its establishment in 1987. It is necessary to increase long-term corporate bonds that fit the investors' appetite, and the investors should improve their ability to analyze credit risks. Furthermore, investment from abroad is rare, and it should be increased by developing bond markets.

3.2 Malaysia

3.2.1 The primary market

The PDSs (Private Debt Securities) market started to develop in the mid-1980's because, since that period, a policy to make private sector the engine of economic development was adopted, and market expansion promoted.

In December 1988, the Central Bank issued guidelines concerning the issuance of PDSs, prescribing the qualifications of issuers (minimal capital, highest limit of debt ratio, and so on) and the minimal issuing amount (25 million ringgit). In May 1992, it was decided that all PDSs must have a rating above BBB for long-term bonds, and above P3 for short-term bonds. In May 1999, in order to promote corporate debt restructuring after the crisis, the lower limit for long-term bonds was eased to BB, and in July 2000, the ratings limit was completely abolished. Also, due to the damage caused by the crisis, many PDSs were downgraded, and the credit risk limits for investment in PDSs by commercial banks and insurance companies were eased. As for rating agencies, RAM (Rating Agency Malaysia Berhad) was established in November 1990, and MARC (Malaysia Rating Corporation Berhad) in October 1995.

Before the crisis, many PDSs were issued with bank guarantees, for example, 45% of the issued amount in 1995 (Suto (2001)). This was because minimum rating limits still existed, and because the investment regulations for institutional investors included a clause that limited the investment to bonds with bank guarantees. Since 1998, banks have become cautious toward credit risks, and bank guarantees have mostly disappeared. Also, in 1995, 86.7% of the issued amount was privately placed, namely, the number of investors was no more than 10 (Suto (2001)). It seems that the issuance of PDSs was very close to bank lending in character. Another reason for the high ratio of private placement was the time-consuming procedures for public placement (Bank Negara Malaysia (1999)). Also, the principal amount of PDSs issues was, on average, small. In 1995, the average principal amount was 138 million ringgit, and 86.7% of the issues were no more than 200 million ringgit.

In July 2000, the issuing procedures for PDSs were simplified by the SC (Securities Commission) as follows. i) The authority to approve the issuance was concentrated in the SC. ii) Preliminary examination by the SC of the merit of the issuance was abolished. iii) It was decided that the approval for issuance must be given within 14 days after application. iv) A shelf registration scheme was introduced.

Partly due to these changes, issues of PDSs have been increasing, and the pace of increase is higher than that of government bonds. After the crisis, other factors also contributed to the increase, such as interest rate reduction, replacements of financing source from bank lending, and many new projects that emerged from the revived economic environment. Danaharta (the governmental organization for the purpose of acquiring non-performing loans) and Danamodal (the governmental organization for the purpose of injecting new capital into banks) also issued bonds for financing. Furthermore, due to the above simplification of issuing procedures, issuing PDSs became easier, and PDSs became more important as a financing tool.

Regarding the composition of PDSs by industry, during the early periods, the purpose of the development of the PDSs market was to finance privatized development projects. Thus, the ratio of construction and that of electricity, gas and water were high (Table 4).

Table4. Composition by Industry for Issuing Amount in Malaysian PDS (excluding Cagamas Bonds)

（%、million ringgit）

	1987 ～1993	1994 ～1997	1998	1999	2000	2001	2002	2003	2004	2005
Agriculture and Mining	9.0	1.2	0.0	0.0	0.2	0.2	3.6	2.3	0.0	4.3
Manufacturing	16.8	21.8	1.2	6.8	6.2	8.0	6.7	21.2	11.6	7.8
Construction	23.6	18.1	13.6	22.6	8.9	10.5	8.2	14.1	31.5	17.9
Electricity, Gas and Water	13.5	13.5	4.9	0.3	15.3	32.0	5.1	8.0	28.0	19.6
Transport, Storage and Communications	7.8	18.1	0.0	37.6	34.1	12.0	34.1	20.1	2.8	7.4
Finance, Insurance, Real Estate and Business Services	8.9	18.3	71.1	29.7	21.5	16.3	20.7	19.6	17.0	36.8
Government and Other Services	2.9	1.2	9.2	0.0	0.0	20.2	17.4	14.7	4.7	3.2
Wholesale, Retail Trade, Hotels and Restaurants	17.5	7.7	0.0	3.0	13.8	0.8	4.2	0.0	4.4	3.2
Total	11,611.3	42,561.9	10,831.8	22,132.5	22,549.9	31,502.4	26,660.4	42,790.4	28,049.9	35,656.1

Note: Cases exceeding 20% have been highlighted.

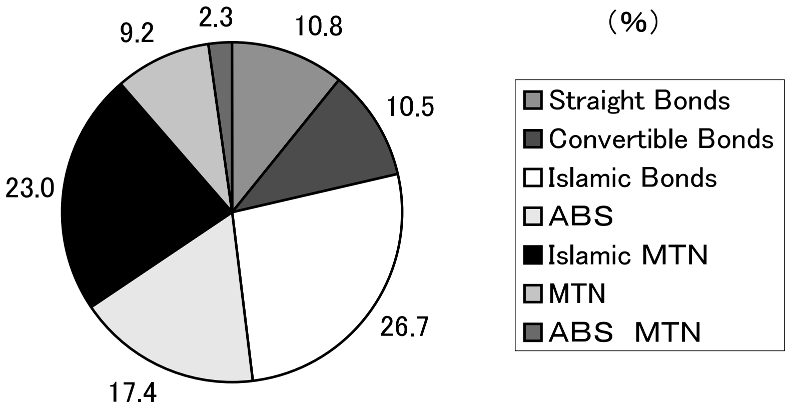
Source: Bank Negara Malaysia, *Monthly Statistical Bulletin*

Before the crisis, manufacturing and finance, insurance, real estate and business services increased their weight. After the crisis, the issues by manufacturing companies decreased, but finance, insurance, real estate and business services maintained the amounts issued. Recently, infrastructure-related industries have again become important, and issues by electricity, gas and water, and those by transport, storage and communications are expanding. In summary, corporations of infrastructure-related industries and financial institutions are the main issuers of PDSs. Manufacturing companies are currently not very active issuers.

The maturity is mostly within 10 years. In 2005, however, interest rates declined and issues longer than 10 years reached 29.7%, compared with the previous year's 11.5%. The ratings are mostly above A. The interest rate spreads between A bonds and BBB bonds are wide and it is not easy to issue bonds under BBB.

The issuers have also diversified. In 2004, capital controls were eased so that the issues of ringgit-denominated bonds by international institutions and multi-national corporations became possible. After this change, the Asian Development Bank issued a ringgit-denominated bond in November 2004, the International Finance Corporation in December 2004, and the World Bank in May 2005. Also, in 2005, eight ABSs were issued, including two RMBSs by Cagamas MBS Berhad. The total issued amount of ABSs was seven billion ringgit, which amounted to 19.6% of the total issued amount of PDSs (Figure 1). At the end of 2005, the composition of underlying assets for the amount outstanding of ABSs was 45.3% for property and mortgage receivables, 24.0% for loans, 3.8% for PDSs and 26.9% for others.

Figure1. Amount of Bond Issues in 2005 (excluding Cagamas Bonds)



Note: 7.4% of ABS and 1.6% of ABS MTN were issued under the Islamic scheme.
Source: Bank Negara Malaysia, *Annual Report* 2005

An Islamic corporate bond was issued for the first time in 1990. In 2004, the SC issued a guideline, and it became possible to issue various types of Islamic bonds. The reasons for recent market expansion are, i) the investor base is wide because not only Islamic investors but also other investors can invest in Islamic bonds, ii) the development of the Islamic bond market is one of the important purposes of the Capital Market Masterplan (see below.3.2.3), and the government issues Islamic government bonds in order to establish benchmarks.

3.2.2 Investors and the secondary market

The investor composition of the government bond market at the end of 2005 is 58.2% for EPF (Employees Provident Fund), 14.4% for banks, 8.9% for insurance companies, and so on[2]. This composition has not changed much since the crisis. However, the ratio of the banks has decreased a little, which implies that the banks have increased investment in PDSs due to the reduction in interest rates. In 1998, comprehensive capital controls were adopted and investment from abroad decreased. Since 2004, due to the abolition of the withholding tax on non-residents, investment from abroad has increased and this ratio has become 4.8% at the end of 2005. In 1998, transactions in the secondary market increased due to the expansion of issues and interest rate reduction. In 2001, because of the expectation of interest rate reduction, the interest of investors concentrated on government bonds, and the value of transactions increased by 150% compared with the previous year. However, since then, transactions and the turnover ratio have not increased.

It is not easy to obtain correct data regarding the investor composition of PDSs, but at least, one can say that financial institutions such as commercial banks, and so on, social security agencies such as EPF, and so on, and insurance companies are important. According to data from the Central Bank, the total holding weight of these investors is estimated to be 60 to 70%. The liquidity of the PDSs market has not greatly improved, because the principal size is small, and many investors hold their bonds to maturity.

3.2.3 Summary

In Malaysia, the Capital Market Masterplan was adopted in 2001. It is a comprehensive 10-year plan beginning from 2001 regarding the strategic position and the future directions of capital markets. Under the active easing of regulations, bond markets have been growing continuously. However, low liquidity is a serious problem and must be improved. For that purpose, it is necessary to establish benchmarks by regularly issuing government bonds, and to construct market infrastructure. Regarding issuers, before the crisis, minimum rating limits for PDSs existed and the issues relied upon bank guarantees. This meant that market formation did not directly reflect the creditworthiness of corporations. Even now, the ratings of the issuers are mostly above A, and it seems that this situation reflects the policies adopted historically.

Regarding investors, improving market liquidity by nurturing the fund management ability of institutional investors and by expanding investor base is indispensable. According to the Capital Market Masterplan, various reforms are in progress, such as easing of regulations regarding the asset allocation of EPF, outsourcing of the management of EPF, and so on. In the future, investment in PDSs from abroad should also be increased.

3.3 Thailand

3.3.1 The Primary market

In 1992, the Securities and Exchange Act was passed and the issuance criteria for corporate bonds were decided. Before then, only public limited companies could issue corporate bonds. The new act made it possible for private limited companies to issue corporate bonds with the approval of the Securities and Exchange Commission. This change caused a large increase in the number of issues. Because of the crisis, the issuing of corporate bonds stopped for a while, but restarted in the latter half of 1998. In 1999, issues jumped mainly due to issues by banks. Since then, interest rate reductions have prompted corporations to replace their borrowings with lower interest rate financing, and thus corporations have increased issues of bonds in exchange for bank lending. Issues of corporate bonds have continued against this background. However, amounts outstanding have not greatly increased. In Korea and Malaysia, the amounts outstanding in government and corporate bonds are almost the

[2] To EPF, employees contribute 11% of their salaries and employers 12%. About half of the laborers participate in the scheme. Most of its assets had once been invested in government bonds, but this ratio had decreased to 36.9% by the end of 2005.

same, but in Thailand, the former is about twice as large as the latter. At the end of 2004, the amount outstanding of corporate bonds in proportion to GDP was 21.1% for Korea, 38.2% for Malaysia, and 11.8% for Thailand.

The special features of the Thai corporate bond market are, firstly, that issuers are limited. Most Thai corporations are small and medium sized, and there are few big companies that have sufficient credibility to issue corporate bonds[3]. About 10% of the issued bonds are not rated, and 97% of rated bonds are above BBB (ADB (2005)). Regarding the composition by industry, the main issuers have been financial institutions such as banks, finance companies, insurance companies and leasing companies (Table 5).

Table5. Composition by Industry for Issuing Amount in Thai Corporate Bonds

(billion baht)

	2000	2001	2002	2003	2004	2005	Total
Listed Companies	127.9	85.2	81.1	139.0	120.7	178.6	732.5
Agribusiness	7.2	7.0	0	0	6.0	4.3	24.5
Banking	27.0	15.3	10.0	40.4	10.0	18.4	121.1
Construction Materials	43.7	0	10.0	21.9	20.1	24.0	119.7
Petrochemicals and Chemicals	0.7	7.4	3.0	12.0	0.2	12.6	35.9
Communication	10.0	27.0	36.5	3.3	2.4	0	79.2
Energy and Utilities	14.5	6.6	1.2	22.5	39.8	53.7	138.3
Finance and Securities	11.2	3.9	13.5	17.4	8.4	20.6	75.0
Property Development	6.0	2.7	1.1	6.1	15.4	13.8	45.1
Paper and Printing Materials	0	10.0	0	0	0	10.3	20.3
Transportation and Logistics	0	0	0	12.5	15.0	15.0	42.5
Non-listed Companies	26.8	21.5	20.0	58.4	24.0	49.9	200.6
Foreign Juristic Person	0	0	0	0	0.1	9.9	10.0
Total	154.7	106.7	101.1	197.4	144.8	238.4	943.1
(Number of issuing companies)	48	26	30	52	47	63	266

Notes: Only industries with a total issuing amount exceeding 10 billion baht between 2000 and 2005 are included in the table. Cases exceeding 50 billion baht in total have been highlighted.

Source: SEC, *Capital Market Report*, First Quarter 2006

In recent years, bonds have also been increasingly issued by corporations in industries such as construction materials, communication, energy and utilities, among others. Foreign companies are also found among bond issuers. However, the diversification of issuers is insufficient. The issuers should include more corporations from the industries such as manufacturing, and so on.

Secondly, most of the corporate bonds were once privately placed. This was because the issuance criteria for publicly placed bonds were very strict. In the case of private placement, the issue was approved almost automatically and detailed information disclosure was not necessary. On the other hand, in the case of public placement, the ability of the issuer to repay was strictly examined, and the issuer was required to obtain a rating and provide detailed information disclosure. In order to avoid these cumbersome procedures, issuers tended to choose private placement. In 2001, the regulation was changed so that information disclosure and documentation in the case of private placement became as strict as that of public placement. At the same time, the rationalization of the issuing procedures in the case of public placement was implemented, such as the adoption of a shelf registration scheme, and so on.

Regarding ratings, TRIS (Thai Rating and Information Services) was established in 1993

[3] According to a study by JBIC (Japan Bank for International Cooperation) in 2001, the ratio of medium and small size companies (whose value of fixed assets is under 200 million baht) was 97.9% in Thailand.

as the first domestic rating agency, under the leadership of the Central Bank. However, many of the corporations chose private placement and did not obtain a rating. Even in the case of the corporations that obtained a rating, during the period of the crisis, many of them avoided being rated in order not to be downgraded. In April 2000, obtaining a rating became an obligation even in the case of private placement. In February 2001, Fitch Ratings (Thailand) Ltd. was established as the second rating agency.

3.3.2 Investors and the secondary market

In Thailand, the Thai Bond Dealing Centre had played the role of providing information on the secondary market, and of formulating market rules as a Self-Regulatory Organization. In September 2005, it was reorganized as the Thai BMA (Thai Bond Market Association). Most secondary transactions had been implemented over the counter before 2004, when BEX (Bond Electronic Exchange) was established in the Stock Exchange of Thailand. In June 2005, government bonds started to be traded in BEX, in addition to corporate bonds. The establishment of BEX made it possible for individuals whose transaction value is small to participate in bond trading. Thai BMA also covers the market information for BEX.

Regarding investor composition in government bonds, the ratio of financial institutions, including commercial banks, decreased from 81.4% at the end of 1999 to 32.4% at the end of 2005. On the other hand, the proportion of insurance companies and other investors (institutional investors such as pension funds, non financial companies and individuals) increased. One of the reasons that other investors have increased is that the ratio of individuals increased because of the issues of government bonds targeted for individuals. Transactions of government bonds in the secondary market increased greatly in 1999 and 2000, reflecting an increase in the amount outstanding and interest rate reductions. However, market liquidity has not shown much improvement since that time. Transactions are mainly of short-term bonds and agency bonds, rather than of medium and long-term bonds.

The investor composition in corporate bonds at the end of 2005 was 36.2% for institutional investors, and 52.6% for retail investors (corporations and individuals). The increase in individual investors is remarkable (Table 6).

Table6. Investor Composition of Thai Corporate Bond Market

(%)

	2002	2005
(Institutional Investors)	43.6	36.2
Commercial Banks	12.5	6.9
Governmental Banks	4.8	3.2
Insurance Companies	4.7	7.4
Mutual Fund	7.0	6.0
Contractual Saving Funds	14.6	12.7
(Retail Investors)	42.2	52.6
Corporation	9.8	4.6
Individual	32.4	48.0
(Others)	14.1	11.3

Notes: 1. “Contractual Saving Funds” includes government pension fund, provident fund and social security fund.

2. “Others” includes the government sector, foundation, cooperatives, temples, and so on.

Source: Thai BMA website

In order to stimulate transactions in the secondary market, corporate bond investment by institutional investors should be expanded. Institutional investors in Thailand are generally immature, but the assets of insurance companies and mutual funds are growing rapidly, and the expansion of provident funds is expected because of the progress of aging.

The transactions of corporate bonds in the secondary market peaked in 1996, but had decreased to a very small number by 1998. They increased again following that, but there has been little improvement in liquidity. The ratio of corporate bonds in transaction values in the Thai BMA decreased from 5.7% in 2001 to 2.3% in 2005.

3.3.3 Summary

It can be said that the Thai bond market has greatly expanded in a short period of time following the crisis. Most of the corporate bonds were private placement by small and medium size companies. One of the future policy tasks is how to deal with the private placement market. As stated above, obtaining a rating became an obligation in 2000 even in the case of private placement. In 2001, the regulation was changed so that information disclosure and documentation in the case of private placement became as strict as that of public placement. From the standpoint of developing the corporate bond market, stricter regulations for private placement might be damaging.

Another policy task is to expand the investor base. Regarding institutional investors, limitations on assets that can be invested and those on asset allocation should be eased, and new asset management businesses should be developed. Many of the institutional investors in Thailand initiated a full line of business in the 1990's, and are generally small in terms of size. They are, however, expanding rapidly, and are expected to contribute to the development of bond markets.

An increase in individual investors is also important. Necessary conditions for that purpose are providing market information, strengthening investor education, and expanding mutual funds. Furthermore, in January 2005, the withholding tax on non-residents regarding investments in government bonds and agency bonds was abolished. The increase of investments from abroad is expected in the future.

4. Changes in corporate financing

4.1 Korea

Before the crisis, lending by banks and non-banks played an important role, and financing from capital markets, bond markets in particular, had also been expanding[4]. Due to the crisis, there was a large decrease in the total financing amount. Even now, it has not recovered to the same level as before the crisis. However, the financing amount increased greatly in 2005. According to the Central Bank, this was because of increases in financing demand for working capital by companies whose sales market is mainly domestic, and by small and medium size companies (The Bank of Korea, *Quarterly Bulletin*, Jun. 2006).

The financing structure drastically changed after the crisis. i) Equity financing increased tremendously. This was because corporations were required to decrease their debt ratios for political reasons, and because equity prices soared against a background of interest rate reductions. ii) Financing from abroad decreased greatly in 1998, but quickly recovered with the increase in foreign direct investments. iii) Many merchant banks were closed and the issues of CPs decreased because they were handled by merchant banks. iv) The issues of corporate

[4] This analysis is based on Bank of Korea, *Flow of Funds*, various issues.

bonds increased greatly in 1998, but net financing became a minus in 1999. This was because of the bankruptcy of the Daewoo Group. Looking at the market situation since 2000, corporate bond issues have not become a stable way of financing. v) The increase of the amount outstanding for bank lending became almost zero in 1998 reflecting the deterioration in the management of banks. However, since 1999, bank lending has recovered nicely. On the other hand, the non-bank lending amount outstanding decreased after 1998 because their size diminished. However, this has also recovered since 2002.

In summary, in Korea, equity financing increased after the crisis, and bank lending also recovered without a long slump. On the other hand, financing with corporate bonds has not increased. Regarding amounts outstanding after the crisis, bank credit, corporate bond issuance and equity capitalization all increased in proportion to GDP (Table 7).

Table7. Amount Outstanding by Financing Type

(% GDP)

		Bank Credit	Bond Issuance	Equity Capitalization
Korea	1997	44.2	23.4	15.7
	2004	80.4	63.4	56.9
Malaysia	1997	102.8	37.6	129.6
	2004	104.7	53.4	161.3
Thailand	1997	126.1	6.0	23.9
	2004	73.2	13.7	68.4

Note: Bond Issuance is composed of issues by corporations and financial institutions.

Sources: Various.

4.2 Malaysia

Before the crisis, financing with equities and corporate bonds increased gradually, but the ratio of bank lending was high[5]. Because of the crisis, total financing amount and bank lending decreased greatly. On the other hand, financing from capital markets remained plus, and recovered after 1999. As a result, the ratio of corporate bond issues increased, and that of bank lending decreased. Since 2002, bank lending has recovered and both bank lending and corporate bond issues have been increasing. The ratio of equity financing has changed little.

In Malaysia, corporate bond financing has become as important as bank lending. Regarding the amounts outstanding after the crisis, bank credit has stayed almost the same, and corporate bond issuance and equity capitalization have increased in proportion to GDP (Table 7).

4.3 Thailand

In Thailand, the ratio of bank lending was very high before the crisis. Corporate bonds and equities were issued constantly, but the amount was smaller than bank lending[6]. Due to the crisis, total financing amounts became minus in 1999 and 2000, and bank lending decreased greatly. On the other hand, corporate bond issues increased, and became more important than before as a method of financing. However, since 2002, bank lending has recovered quickly and the increase has been much larger than that with corporate bond issues. Equity financing increased considerably in 1999, and has been maintaining that level since then. Financing

[5] This analysis is based on the Bank Negara Malaysia, *Annual Report*, various issues.

[6] This analysis is based on the National Economic and Social Development Bureau, *Flow of Funds*, various issues.

from abroad has been minus since 1999, mainly because of the repayment of bank lending.

In Thailand, following the crisis, the decrease in bank lending was compensated by financing from capital markets. Before the crisis, the amount outstanding in bank lending was more than 10 times larger than that of corporate bond issues, and shrank to just about twice as large at the end of 2004. However, judging from the recent recovery in bank lending, it cannot be said that corporate bond issuance has become as important as bank lending as a method of financing. Regarding the amounts outstanding after the crisis, bank credit decreased, and corporate bond issuance and equity capitalization increased in proportion to GDP (Table 7).

4.4 Summary

Looking at the relative importance of financing methods, corporate bond issuance has become most important in Malaysia. Next is Thailand, and last is Korea. According to BIS (2002), during periods when banks are weakened, corporate bond issuance becomes an alternative to bank lending as a method of financing. On the other hand, during ordinary periods, in developing countries where financing demand is strong, there is generally a positive correlation between the amounts outstanding of private bank credit and corporate bond issues.

5. Toward the development of corporate bond markets

In this last section, the analysis given in this paper will be summarized. In Korea, the active involvement of the government to develop the corporate bond market caused it to expand. This attitude of the government later led to the destabilization of the financial system. In the future, the involvement of the government should be decreased, and corporate bond issues that directly reflect the creditworthiness of corporations should be increased. It must be added that, as in the U.S. and Japan, corporate bond issues sometimes decrease due to economic recession or credit risk expansion. In Malaysia, the amount of corporate bond issues has expanded continuously since the crisis, mainly due to the easing of regulations. In the future, the market should be further developed. Diversification of the industries involved and ratings of the issuers should be promoted, and the investor base should be expanded.

In Thailand, many of the corporate bond issues were private placement by small and medium size corporations. From the standpoint of developing the corporate bond market, stricter regulations for private placement, which have been adopted since 2000, might be damaging. In the case of small and medium size corporations that are trying to issue public placement bonds in the future, they should utilize private placement at first, in order not only to finance medium and long-term money but also to improve their investor confidence and reputation. Needless to say, this discussion is based on the assumption that the issuing regulations for private placement bonds can be eased again.

Regarding the importance as a financing tool, equity financing and bank lending have been increasing in Korea, and the weight of corporate bond financing remains rather small. Compared with this, in Malaysia, corporate bond issues have increased and have become as important as bank lending as a financing tool. In Thailand, during the periods of serious banking crisis just after the currency crisis, corporate bond financing played an alternative role to bank lending. However, after bank lending recovered, it has become clear that the financing structure has changed little.

In conclusion, the development of the corporate bond market has progressed most in Malaysia, due to the active easing of regulations. In Korea and Thailand, heavy dependence of the financial system on the banking sector has shown little change. In addition, in Korea and Thailand, we can see increases in equity capital ratios for corporations[7]. In order to decrease duration mismatching, not only corporate bond financing but also equity financing is greatly effective.

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[7] Regarding this point, see Mieno (2007).