

Interest Intensifies in Corporate Bonds Designed for Individual Investors

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As the protracted period of low interest rates has been further prolonged, individual investors tend to pursue a higher return rate on their investment vehicles while seeking a certain degree of safety and stability. Since FY 1998, the issuing of these bonds has shown considerable activity, and in this report, we will focus our target on corporate bonds designed for individual investors. Here, we will examine recent movements of individual investors.

1. Recent Trends in Corporate Bonds for Individual Investors

Recently, the buoyant state of the market for individual investor corporate bonds has continued to prevail, and securities companies are selling corporate bonds limited to individual investors.¹ In FY 1998, the amount of corporate bonds designed for individual investors issued amounted to 787 billion yen. This is an increase of over 2.5 fold over the 314.5 billion yen in previous fiscal year. Looking at the number of issues, there has been an increase of over two-fold from the FY 1997 level of 18 issues to the FY 1998 level of 39 issues. Thus, we see that both the amount issued in monetary terms and the number of issues floated have increased. This upward surge has lost none of its momentum after entering 1999. In the first half of the year (January to June) the value of the amount issued reached 765 billion yen, a sharp increase of 2.6 fold over the same period in the previous year.

Table 1 Purchases of New Issues of Corporate Bonds by kinds of Investor

(Unit:%)

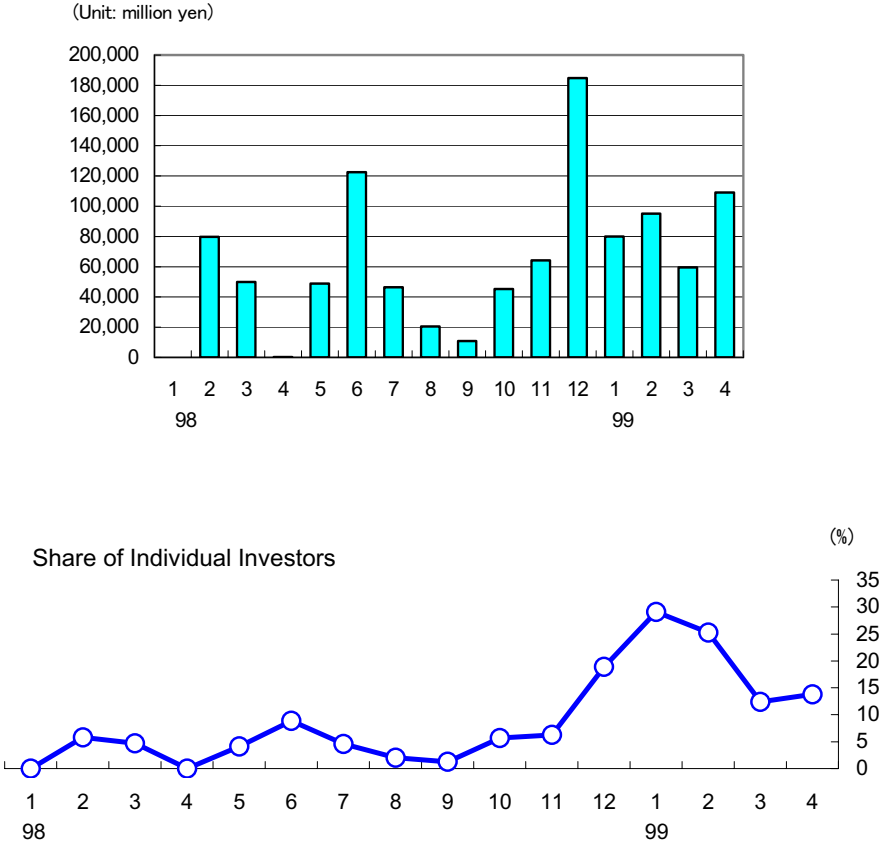
FY	Issue Volume (100 million yen)	Individuals	Major commercial banks (city banks) and long-term credit banks	Regional banks	Trust banks	Insurance	Norin-chukin BK & Agr. Coop.	Shoko-chukin BK & Shinkin Banks	Regional banks II and investment trusts	Others
1990	20,660	1.3	2.8	1.3	1.7	3.9	3.9	4.0	0.1	81.0
91	24,267	3.8	0.8	0.9	1.2	2.7	4.5	5.6	0.3	80.2
92	38,200	9.7	0.9	1.0	2.1	6.4	6.0	13.6	0.1	60.2
93	29,790	7.3	0.7	1.0	4.6	8.3	6.3	13.8	0.6	57.4
94	32,650	13.6	2.0	1.1	3.6	8.3	12.2	10.3	1.1	47.8
95	57,192	5.7	1.8	1.9	3.2	13.1	14.6	12.1	1.7	45.9
96	56,360	5.2	1.3	1.5	3.9	11.5	12.6	11.4	1.1	51.5
97	87,995	3.5	1.6	1.3	5.1	17.0	14.3	11.0	0.7	45.6
98	104,534	7.4	1.5	2.6	5.9	18.6	13.8	11.2	0.9	38.0

Source: Compiled by Nomura Research Institute based on "Monthly Bond Review" by The Bond Underwriters Association and "Securities Sector Report" by the Japan Securities Dealers Association

¹ The first issue of corporate bonds for individual investors was made by Kinki Nippon Railway in June 1992.

In 1999, purchases of corporate straight bonds by individuals are buoyant. The share involved peaked in January at 29.1% and has subsequently continued to maintain a high level, running at a higher level than in the period from January to November 1998. (Figure 1)

Figure 1 Purchases of Corporate Straight Bonds by Individual Investors



Source: Compiled by Nomura Research Institute based on "Monthly Bond Report" by The Bond Underwriters Association of Japan and "Securities Sector Report" by the Japan Securities Dealers Association

Basically, the usual minimum purchase unit for corporate bonds for individual investors is one million yen.² Thus, compared to the corporate bonds for institutional investors with a unit lot of over 100 million yen, the cost of the transaction for the issuer has been higher in the case of individual investors. Due to this, the issue of corporate bonds for individual investors were limited to several firms such as electric power companies. Moreover, up to now, the trend has been to time the issues to come out mainly concentrated in June/July and December, the time when individuals are paid bonuses, to tap this potentially disposable income.

However, from FY 1998 onwards, many entities that have never before issued bonds aimed at individual investors, have started to do so. From May 1998 onward, issues have come out

² Some corporate bonds issued for individual investors have a purchase face value of 100,000 yen or 500,000 yen.

every month. Moreover, the value of the issues ranges between 5 billion yen and 45 billion yen, and some are worthy of the interest of institutional investors.

Some companies issue corporate bonds with incentive packages³ such as ANA (All Nippon Airways), BANDAI, and YELLOW HAT to stimulate the desire to buy of individual investors. (Table 2)

Table 2 Examples of Corporate Bonds Issued for Individual Investors (From January 1999)

	Issue Value	Term to maturity	Coupon	Rating	Reference
ORIX.	400	4 years	1.95	AA-(R,J)	
HIKARI TSUSHIN Hikari Tsushin, Inc.	100	3 years	2.35	A-(J)	
AIFUL	300	3 years	2.35	A-(R)	
BANDAI	50	3 years	2.00	A-(R)	With incentive package
YELLOW HAT	100	3 years	2.35	BBB+(J)	With incentive package (lottery ticket)
ACOM	100	4 years	2.25	A+(R)	
Asahi Breweries	100	3 years	1.60	A+(R)	
OSAKA GAS	100	3 years	1.25	AAA(R)	
SHIMIZU CORP	200	3 years	2.20	A(R)	
TOSHIBA	300	3 years	1.30	AA(R)	
ACOM	100	5 years	2.65	A+(R)	
SANYO SHINPAN FINANCE	100	3 years	1.85	A+(R)	
ORIX CORP.	300	3 years	1.38	AA-(R,J)	
ORIX CORP.	200	4 years	1.55	AA-(R,J)	
Kinki Nippon Railway	300	4 years	1.25	A(R)	Each unit lot comes with one lottery ticket
Sanyo Electric Credit	100	3 years	1.75	A+(J)	
Kawasaki Steel	200	4 years	1.45	A-(R)	
Marubeni	300	3 years	2.00	A+(J)	
TAISEI CORP.	300	3 years	2.30	A-(R)	
ITOCHU Corp	200	4 years	2.00	AA-(J)	
ITOCHU Corp	300	4 years	2.00	AA-(J)	
Marubeni Corp	450	4 years	2.00	A+(J)	
Shikoku Electric Power Co.	100	3 years	0.60	AAA(R)	
Sumitomo Realty & Development Co	350	4 years	3.00	BBB-(R)	
Mazda Motor Corp.	200	4 years	2.00	BBB(R)	
Sumitomo Realty & Development Co	300	3 years	2.35	BBB-(R)	
Sumitomo Realty & Development Co	100	4 years	2.65	BBB-(R)	
Sumitomo Realty & Development Co	400	5 years	2.95	BBB-(R)	
Nichimen Corp.	150	4 years	2.40	BBB(R)	

Note 1: (R) indicates 'Japan Rating and Investment Information, Inc.'

Note 2: (J) indicates 'Japan Credit Rating Agency, Ltd.'

Source: Compiled by Nomura Research Institute based on "Capital Increase White Paper" by The Commercial Law Center, Inc etc.

3 The first issue of corporate bonds with an incentive package was the Tokyo Dome Bond in 1995. It included vouchers for using the group's hotels.

2. The Background to the Buoyant Market for Corporate Bonds Issued for Individual Investors

1) Factors on the Individual Investor Side

Conventionally, corporate bond issues have been mostly intended for institutional investors. However, the following points are relevant to the massive issue of corporate bonds for individual investors.

The first is that the prolonged era of low interest rates continues to prevail, and there is no way of knowing when it will end. There is an upsurge in the enthusiasm of individual investors to buy corporate bonds as they are fed up with interest rates near zero (zero interest). Even corporate bonds issued for individual investors such as the triple rated three-year type issued by Shikoku Electric Power Company have a coupon of only 0.6%. When this is compared with the 3-year time deposits (up to 3 million yen) of the major commercial banks (city banks) of 0.15 to 0.20%, the corporate bonds do offer a higher yield, relatively speaking, and this is attracting attention.⁴

The second point is that if corporate bonds are held to maturity, assuming that the firm issuing them does not fail, the holder is assured of interest and the redemption of the principle paid at the time of purchase. In this point, corporate bonds are quite different to financial products such as investment trusts which require the purchaser to make a decision based on past performance. Thus, it is easy to understand why these factors such as stability and safety of corporate bonds are basic reasons for individual investors to choose these instruments.

The third point is that, in addition to relatively speaking advantageous yield from the viewpoint of the holder, not a few companies decide to issue bonds with incentive packages as one way of enhancing their IR activities aimed at individual investors.

For example, ANA first issued corporate bonds for individual investors in December 1998. As these bonds carried an incentive package in which 20 people to be picked out of the lottery would get a trip to Hawaii, they attracted considerable interest. Subsequently, firms such as BANDAI and YELLOW HAT issued similar corporate bonds with an incentive package. (Table 3) In the autumn of 1994, sales of time deposits with an incentive package were started, and they attracted large amounts of funds. Based on this and other experience, by adding an incentive package similar to the shareholder special benefit plans, the issuers are seeking to develop a broad spectrum of investors, and this corporate tactic is proving to be successful.

4 The purchasers of corporate bonds have to accept the credit risk attendant on the issuing company. The rating companies publish a list showing the ratings based on their screening. Generally speaking, the lower the rating of the corporate bond, the higher the coupon at issue is. Even when firms have the same rating, the longer the time to maturity of the corporate bond is, the higher the coupon is. When straight corporate bonds are issued without collateral, the condition used to be that they must be able to get a rating of triple B or better. (issue standards) However, from January 1996, this standard was scrapped. Thus, the issuing standard based on ratings for corporate bonds was abolished.

Table 3 Recent Examples of Corporate Bonds with Incentive Packages

Issuing firm	Timing of issue	Content
ANA	December 1998	<ul style="list-style-type: none"> • The firm's first issue of corporate bonds for individual investors • Winners of the lotteries can obtain a trip to Hawaii (20 winners), free return tickets to fly on domestic routes (50 winners), and half price airline tickets (1, 500 winners) • For every purchase of corporate bonds with a face value of one million yen (one unit), ANA sends the purchaser an application form for the incentive prize
Sega Enterprises	December 1998	<ul style="list-style-type: none"> • The name of the bond, "Dreamcast Bond" carries an association with the Sega-home-use game machines "Dreamcast" • Winners of the lottery can obtain a "Dreamcast" game machine (Machine set/100 winners). All purchasers receive a special QUO card worth 500 yen.
BANDAI	February 1999	<ul style="list-style-type: none"> • The firm issued a corporate bonds for individual investors called "Wonder Swan Bond" which carries an association with the portable game machine "Wonder Swan", sales of which started on March 4, 1999. • Winners of the lottery can obtain a "Wonder Swan" game machine (machine and one game software /100 winners). All purchasers receive a children's product voucher worth 500 yen.
YELLOW HAT	February 1999	<ul style="list-style-type: none"> • The firm issues an "Oil Members Card" to people who request one. (Free oil change and oil element change) • 1,400 winners of the lottery can obtain a product voucher (Two types worth 50,000 yen or 30,000 yen)
Kinki Nippon Railway	April 1999	<ul style="list-style-type: none"> • The firm floated a corporate bond issue for individual investors called "Parke Espana Bond" which carries an association with the theme park "Parke Espana", operated by the Kinki Nippon Railway Group. • This carries an incentive travel package voucher for 1,500 people selected by lottery. The travel package consists of a ticket voucher to travel free on the Kinki Nippon Railway for 2 persons and a "Parke Espana" passport, also for 2 persons. • One lottery raffle voucher for each purchase of corporate bonds with a face value of one million yen. (One unit)

Source: Compiled by Nomura Research Institute based on data from the Nippon Securities Newspaper

2) Factors on the Issuing Firm Side

The reason for the positive attitude towards issuing corporate bonds for individual investors may well be due to the fact that this allows them to raise funds at lower cost than by issuing bonds for purchases by the institutional investors. A senior executive of YELLOW HAT, Mr. Fujioka, commented that, "The coupon was more than 1% lower than in the case of issuing corporate bonds for institutional investors."⁵

As previously mentioned, individual investors tend to base their decision to purchase corporate bonds on the difference in yield between corporate bonds and bank time deposits maturing in a similar time span of 3 to 5 years. On the other hand, institutional investors adopt a different stance to the individual investors as they have an extensive arsenal of management instruments and they are experienced in managing funds.

For the issuing firm, it is possible to issue bonds with a lower coupon for individual investors than for institutional investors, and this is a factor in the increase of these issues for the individual investors. Naturally, the issuing firms tend to want to raise funds at a low cost.

5 Nikkei Shimbun, May 5th, 1999

However, they also want to diversify their fund procurement options. Among the firms that issue corporate bonds for the individual investors, some companies also issue corporate bonds for the institutional investors at the same time.

These days, a lot of firms with no previous experience of this kind of issue try to issue issuing corporate bonds for individual investors. There is a marked incidence of issues by non-bank entities such as ORIX Corp., AIFUL and ACOM. This is because the ban on issuing corporate bonds by non-bank entities was lifted on May 20. The law enforced on that day is called the "Financial Companies Lending Operations Corporate Bond Issuance Law", usually known as the Non-Bank Corporate Bond Law. This resulted in a massive flood of corporate bond issues by the non-bank sector. The movement to lift the ban on the issue of corporate bonds is not limited to the non-bank sector. It is intended to lift the ban on the issue of straight corporate bonds by Japan's city banks and regional banks in October 1999. At the time of the lifting of this ban, it will be initially limited to the issue of straight corporate bonds for institutional investors. However, sometime in the future, there is a possibility that studies will be made on lifting the ban on the issuing of corporate bonds by this sector for individual investors. Thus, it is probable that a greater range of options will come into existence in the corporate bond market.

3) Factors on the Securities Firm Side Underwriting Corporate Bonds

It should also be noted that, the fact that the securities firms are actively handling these corporate bonds for individual investors is having a beneficial effect, and this making the market for them buoyant. The securities firms are eager to attract the financial assets of individuals, said to amount to 1,306 trillion yen (As of end of March 1999). Many of these securities firms have positioned corporate bonds for the individual investors as of their core products for attracting these funds. As previously mentioned, corporate bonds are seen as a stable instruments that allows the purchaser to definitely known the yield and redemption amount on maturity at the time of purchase. Consequently, psychologically it is easy to move funds from bank time deposits to these products.

Conclusion

As we have seen here, the reason for the buoyant activity in the corporate bonds' market for individual investors is the result of the effective combination of the three factors we have examined (individual investors, issuing firms and securities firms' factors).

In the background to the increased interest in corporate bonds for individual investors we can find the presence of the individual investors who seek to gain a reasonable return on their investments while stressing the safety angle. From the latter half of 1997, there were numerous failures of major financial institutions, and the anxiety regarding the financial sector could not be expelled. Consequently, the behavior of the individuals when selecting areas to invest their financial assets has shifted from financial institutions, which were relatively speaking quite safe, to the purchase of financial products with a high degree of safety. However, as the prolonged low interest era continues to prevail, individuals have

started to turn their gaze on investment products with a slightly higher risk such as corporate bonds for individual investors.

Attention is focused on whether individual investors will select more of these investment products designed to generate profits as time goes by. We should take into consideration the fact that a large amount of time deposit type postal savings will reach maturity in the period from 2000 to 2001. Another factor is that in April 2001, the government guarantee covering bank deposits, etc., will be limited to 10 million yen per person in any single banking company.

Thus, the conditions needed for a massive movement of individual financial assets are in place.