The Growing Expectations for Bond Investor Relations on the US Corporate Bond Market

Masanobu Iwatani & Nasuka Hiramatsu

The Enron and WorldCom scandals, which sent shockwaves round the world, have made corporate bond investors acutely aware of credit risk, and a growing number are paying more attention to credit research and looking to open direct lines of communication with issuers. At the same time, a growing number of issuers, keen to respond to the needs of investors, are adopting a pro-active approach to bond investor relations. This report, the findings of which are based on interviews with both investors and issuers, looks at bond investor relations in the United States and their impact on the corporate bond market.

1. "Bond Investor Relations"

For the purposes of this report we shall define "bond investor relations" as "communications between issuers and either existing or potential corporate bond investors (i.e., portfolio managers and buy-side credit analysts) and sell-side credit analysts." The term "fixed-income investor relations" or "bondholder relations" is also used in this sense.

One of the reasons why both issuers and investors in the US corporate bond market (not to mention its less highly developed Japanese counterpart) paid relatively little attention to this activity until recently is that corporate bond investment tended to be considered less risky than equity investment. Just as investors paid relatively little attention to the creditworthiness of the bonds they invested in, issuers tended to be much less willing to talk about factors with negative implications for their debt (e.g., rising debt ratios and the risk of default) than about those with positive implications for their equity (e.g., growth and rising share prices). They also tended to be reluctant to brief investors (e.g., by means of road shows) unless they needed to raise capital in the corporate bond market. Another reason why both issuers and investors in the US corporate bond market paid relatively little attention to bond investor relations is that the research that is so important when investing in corporate bonds was left almost entirely to credit-rating agencies as investors felt there was no need for them to spend large sums on in-house credit research. Generally speaking, investors were content if their corporate bond portfolios were constructed in accordance with house investment rules and guidelines and not particularly concerned about which issues they invested

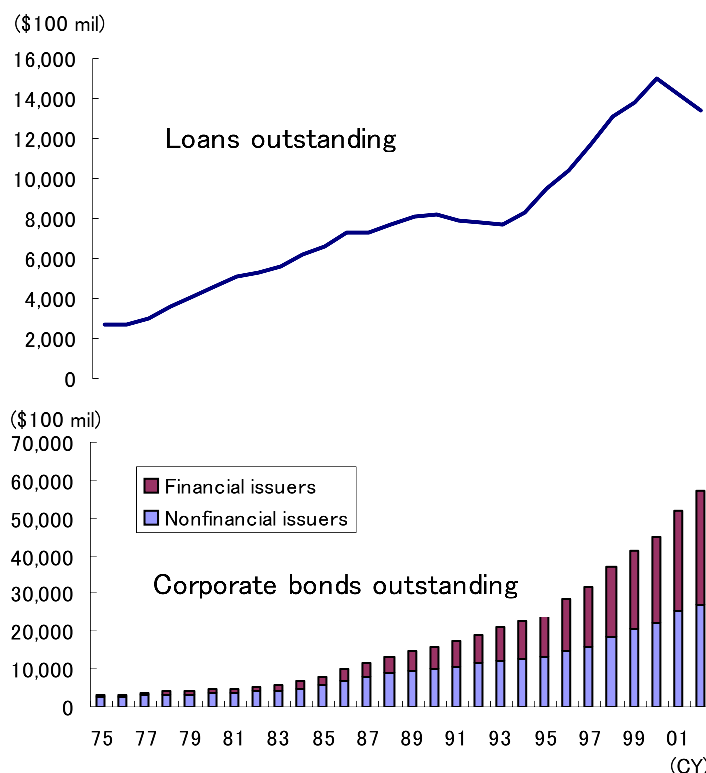
in so long as the credit rating was right. In the past few years, however, as corporate bond investment has become riskier and confidence in credit-rating agencies has declined, issuers have had to face growing demands for information (especially from investors).

2. The Reasons for the Growing Demand for Information

1) The growing risks facing corporate bond investors

The US corporate bond market has enjoyed a period of sustained growth, with the total value of bonds[1] outstanding at the end of 2002 estimated at $5.8 trillion[2] (see Figure 1).

Figure 1 Loans and Corporate Bonds Outstanding in the United States



Source: NRI, from FRB, "Flow of Funds Accounts of the United States."

The past few years have seen a decline in outstanding bank loans as low-margin loans to large companies have declined and a continued rise in the total value of

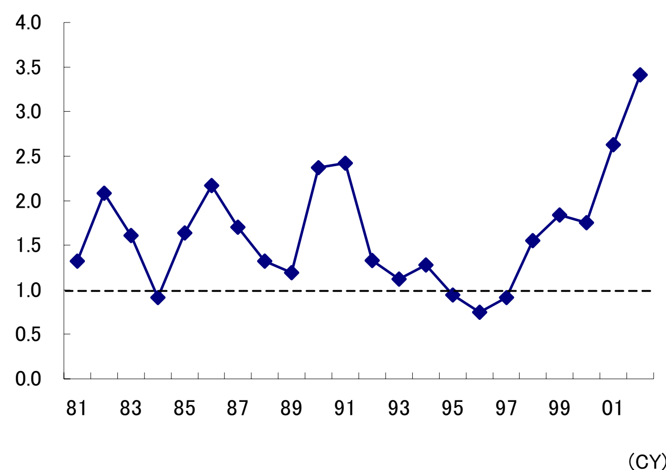
1 "Bonds" includes bonds, notes, debentures, mandatory convertible securities, long-term debt and unsecured debt.

2 The total value of Japanese corporate bonds outstanding as of the end of fiscal 2002 was estimated at $500 billion (at a rate of $1 = ¥120).

corporate bonds outstanding as companies have taken advantage of lower interest rates to raise capital. This is particularly true of financial companies, the value of whose outstanding bonds exceeded that of non-financial companies for the first time in 1999 and is now 27 times greater than it was 20 years ago.

However, it is not just the size of the corporate bond market that has increased: the risks facing corporate bond investors have also increased. In recent years an increasing number of companies have seen their credit ratings downgraded—whether as a result of the increase in financial leverage that many companies have experienced since M&A activity and share buybacks picked up in the mid-1990s or as a result of the economic slowdown and shrinking profit margins that have followed the bursting of the Internet bubble. Just as there has been an increase in the proportion of investment-grade (BBB or better) bonds with relatively low credit ratings, the number of downgrades has vastly exceeded that of upgrades (see Figure 2).

Figure 2 Downgrades versus Upgrades (Global)

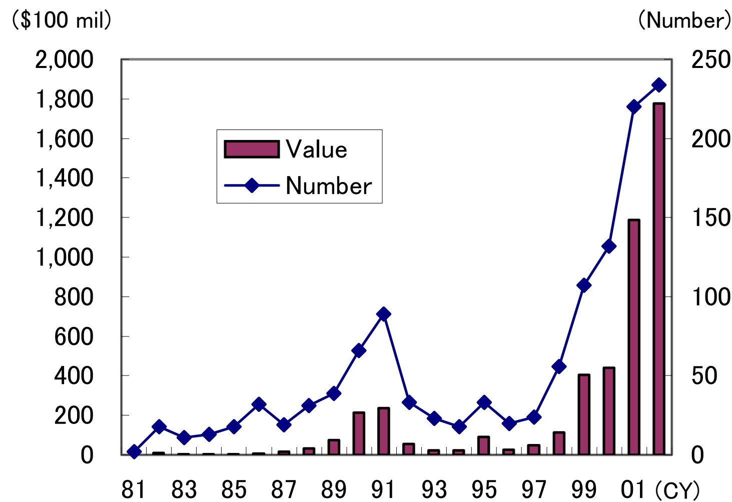


Note: Downgrades versus upgrades = number of downgrades/number of upgrades.
Source: NRI, from S&P, "Rating Performance 2002."

Globally there has been an increase in corporate bond defaults. In terms of both value and number, defaults in 2001 and 2002 reached record levels (see Figure 3). Many of these (including those by Enron, WorldCom and Qwest Communications) were on a massive scale (see Figure 4), and investors suffered accordingly.[3] Although there had been periods before (e.g., the early 1990s, when there was a wave of defaults on junk bonds, which had been used mainly to finance leveraged buyouts) when default rates had risen (see Figure 5), the sheer scale of the defaults meant that the impact on investors was unprecedented. This has made investors acutely sensitive to credit risk.

[3] The total number of defaults in the United States in 2002 was 128 (compared with 234 globally). However, in money terms defaults by US companies accounted for the bulk.

Figure 3 Value and Number of Corporate Bond Defaults (Global)



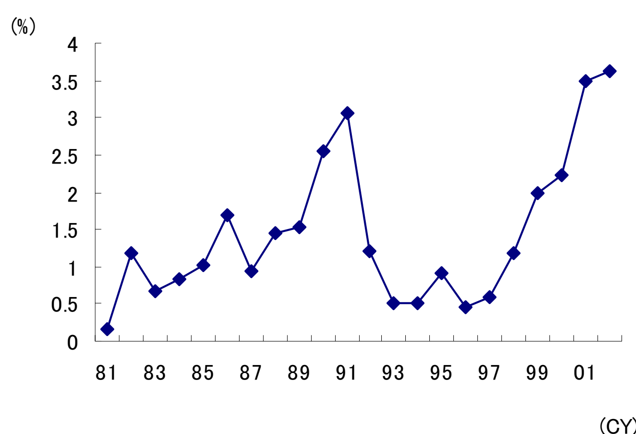
Source: NRI, from S&P, "Rating Performance 2002."

Figure 4 Major Corporate Bond Defaults in the United States (2001-2002)

Company	Sector	Outstanding amount ($100 mil)	Date of default
WorldCom	Telecommunications	307.8	7/15/2002
Qwest Communications Internationa	Telecommunications	155.0	12/20/2002
Enron	Energy, etc.	119.1	12/2/2001
Adelphia Communications	Cable TV	95.0	5/15/2002
Pacific Gas & Electric	Electric power services	81.1	1/17/2001
NTL Communications	Cable TV	80.6	3/28/2002
UnitedGlobalcom	Telecommunications	62.7	1/25/2002
Southern California Edison	Electric power services	57.0	1/15/2001
XO Communications	Telecommunications	51.8	12/1/2001
McLeodUSA	Telecommunications	46.4	1/1/2002
Federal-Mogul	Auto components	42.3	10/1/2001
FINOVA Capital	Finance	40.8	2/27/2001
Williams Communications Group	Telecommunications	40.8	4/1/2002
Kmart	Retail	38.8	1/22/2002
Exodus Communications	Telecommunications	29.8	9/26/2001
PSINet	Computer-related services	27.3	5/1/2001
Conseco	Life insurance	26.6	8/9/2002
Olympus Cable Holdings	Telecommunications	25.0	6/25/2002
Comdisco	Computer rental/lease	23.6	7/16/2001
NII Holdings	Telecommunications	23.3	2/1/2002
Winster Communications	Telecommunications	21.0	4/15/2001
Genuity	Computer-related services	20.0	11/27/2002

Source: NRI, from S&P, "Rating Performance 2001 and 2002."

Figure 5 Default Rate (Global)



Source: NRI, from S&P, "Rating Performance 2002."

2) The damage to the credibility of credit-rating agencies

Investor confidence in credit ratings has been shaken, especially as a result of the fact that only a few days before Enron filed for Chapter 11 bankruptcy in December 2001 its bonds were still rated "investment-grade" by the major agencies. The Enron scandal elicited a number of criticisms, including the following: that the agencies had failed to predict Enron's collapse; that they had been slow to downgrade the company even when the risk of its defaulting had increased; that they had failed to assign the company an appropriate rating because they relied heavily on fee income from issuers; and that the credit-rating business was the monopoly of a handful of agencies which assigned ratings on the basis of inadequate information and analysis in the absence of proper competition.[4] Although this was not the first time that the credit-rating agencies had come in for criticism, the Enron scandal meant that issues such as whether credit-rating agencies had behaved appropriately, what their role should be and how they should be regulated were all debated by the Congress, where they attracted public attention.

The Securities and Exchange Commission, which regarded a solution to these issues as essential if confidence in the country's securities markets was to be restored, investigated the agencies under Section 702(b) of the Sarbanes-Oxley Act and issued a report on its findings in January 2003.[5] The report covered issues such as the role of the credit-rating agencies in US securities markets; the obstacles facing the agencies in assigning an appropriate credit rating; the ways in which the agencies could improve their dissemination of information; the obstacles to entry to the credit-rating business; and the conflicts of interest faced by the agencies. In June 2003 the

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4 In February 2003 the Securities and Exchange Commission added a fourth credit-rating agency (the Toronto-based Dominion Bond Rating Service) to its list of nationally recognized statistical rating organizations.

5 SEC, "Report on the Role and Function of Credit Rating Agencies in the Operation of Securities Markets," http://www.sec.gov/news/studies/credratingreport0103.pdf.

Commission published a concept release based on these findings and covering 56 related issues on which it invited public comment, including issues such as whether the system of Nationally Recognized Statistical Rating Organizations (NRSRO) should be abolished.[6]

3) Need to reduce reliance on credit rating and to improve in-house credit research

Ever since the Securities and Exchange Commission approved a number of credit-rating agencies as NRSROs in 1975, the ratings assigned by these agencies have been extremely influential, serving as a benchmark in both Federal and State laws, government agency regulations and private contracts such as loan agreements. The inclusion of such restrictions in house investment rules and guidelines has meant that corporate bond investors have tended either to base their investment decisions on them or to be heavily influenced by them. However, the sharp increase in the number of defaults that has accompanied the growth of the corporate bond market and the growing awareness of the shortcomings of the existing system have meant that fund managers can no longer expect clients to let them off the hook simply because they have based their investment decisions on credit ratings. As a result, in the past few years a growing number of (especially, major) fund management companies have been building up an in-house capability in this area mainly in order to reduce the default risk of their bond portfolios.

Fund management companies with teams of 10 or more credit analysts tend to adopt the following approach to credit research.

(1) In-house credit ratings

Each analyst generally covers several sectors, and the team has primary responsibility for producing in-house credit ratings. In some fund management companies analysts are also responsible for assigning "strong," "mixed" or "weak" ratings to the performance of companies within their sectors as well as to the sectors themselves and for constructing the necessary database.

Large fund management companies with their own credit research teams regard ratings provided by credit-rating agencies as only one source of information on which to base their investment decisions. Nevertheless, the fact that a downgrade from "investment grade" to "non-investment grade" will inevitably increase a company's cost of capital and perhaps trigger a default means that investors must still keep up to

[6] SEC, "Rating Agencies and the Use of Credit Ratings under the Federal Securities Laws," http://www.sec.gov/rules/concept/33-8236.htm.

date with how credit-rating agencies assess the outlook for a company and with any changes in actual ratings.

(2) Cooperation between credit analysts and equity analysts

The in-house credit research team and equity research team tend to cooperate. For example, there are numerous opportunities for them to exchange information and views. Similarly, it is not uncommon for credit analysts to accompany their colleagues to analysts meetings organized especially for equity analysts. Just as they are likely to have common interests and approaches in some areas, they are also likely to have different interests and approaches in others. Within the overall research effort their different approaches should help to improve the process of piecing together the pieces of the jigsaw puzzle.

(3) An emphasis on qualitative analysis

While quantitative analysis of factors such as a company's stockmarket standing and its ability to service and repay its debt, and to raise capital is an important part of the credit analysis process, qualitative analysis of factors such as industry developments, a company's competitive position and the quality of its management are also extremely important. It is particularly important to be able to assess the quality of a company's management; but it is difficult to do this without a direct line of communication. Therefore in the past few years credit analysts have been given more access to members of senior management such as the chief financial officer.

As fund management companies try to improve their in-house credit research capabilities in this way, issuers face a growing demand for information and for access to their senior management from them.

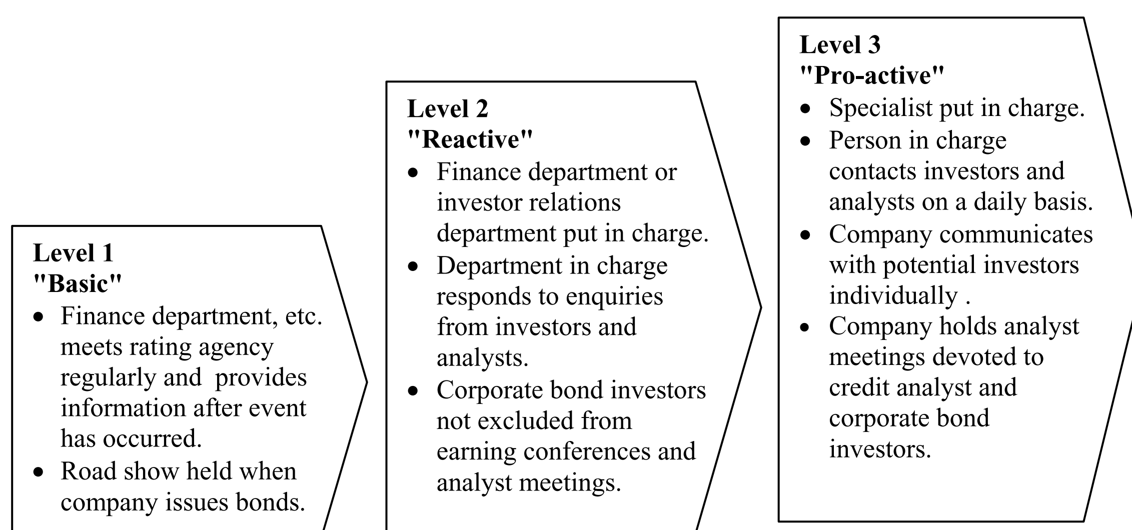
3. Bond Investor Relations in the United States

1) The different stages of bond investor relations

Even before the Enron and WorldCom scandals some US companies had begun to show a serious commitment to bond investor relations. In the past few years, however, even issuers that had shown relatively little interest have begun to realize their importance as investors have built up their credit research teams. Nevertheless, not all issuers have accepted the importance of bond investor relations, and some appear to be more committed than others.

"Bond investor relations" is a broad concept. Although our definition at the beginning of this report did not include providing information to credit-rating agencies, many issuers actually devote more effort to maintaining and improving their credit ratings than to any other aspect and attach great importance to maintaining good relations with the rating agencies. This aspect should therefore be included in "bond investor relations" in the broad sense of the term. Moreover, most issuers put on road shows for investors when they come to market. If we take this level of commitment as basic ("Level 1"), we can distinguish three different levels of commitment to bond investor relations (see Figure 6).

Figure 6 Levels of Commitment to Bond Investor Relations



Source: NRI.

The second level of commitment to bond investor relations ("Level 2") is what is referred to as "reactive bond investor relations." This describes a level of commitment where, for example, the bond investor relations specialist from a company's finance department answers questions from corporate bond investors and sell-side credit analysts and where credit analysts and corporate bond investors are also invited to briefings for equity investors.[7] The basic attitude in such cases is to provide information if corporate bond investors request it, and a growing number of issuers in the United States now belong to this category.

The third level of commitment ("Level 3") is what is referred to as "proactive bond investor relations." This describes a level of commitment where issuers, for example, organize meetings specifically for credit analysts and corporate bond investors and, instead of simply waiting passively for investors' queries, make a point of developing

[7] Since the enactment of Regulation Fair Disclosure (FD) in 2000, company briefings for the benefit of equity analysts in the United States have been open to the public, thus giving corporate bond investors access to the same information.

regular contacts with investors and offer to visit investors in order to create new demand. In many cases, such issuers will have a specialist to look after their bond investor relations and will make a list of investors by themselves.

However, even in the United States only a minority of issuers exhibits this degree of commitment. This is because any decision by an issuer to devote more resources to bond investor relations depends on how strong the demand is from corporate bond investors for such a service. For example, issuers that rely heavily on the bond market or have a question mark against their creditworthiness and are therefore under pressure to provide such information are more likely to devote the necessary resources.

Such companies are likely, for example, to be large and frequent issuers and therefore keen to improve their relations with investors, to have a greater need to raise capital as the result of a merger or some other change in management strategy and to have had their credit rating downgraded (and therefore to be unable to issue commercial paper and more dependent on the bond market).

The automotive, financial, telecommunications and cable media sectors have a relatively high proportion of companies actively engaged in bond investor relations. Similarly, companies whose debt is non-investment-grade tend to devote considerable resources to cultivating relations with investors while well-known companies with good ratings and relatively little need to issue bonds tend to be less willing to do so.[8]

2) Differences between bond and equity investor relations

The fact that bond and equity investor relations differ with regard to their aims and the nature of their investors means that they also differ slightly in approach and focus (see Figure 7).

[8] For example, ExxonMobil, whose straight bonds are rated AAA, has not issued any bonds recently and therefore does not feel immediate necessity to engage proactively in bond investor relations. The company's treasurer is responsible for dealing with credit-rating agencies and any enquiries from investors. Similarly, Procter & Gamble, feels that its high credit rating, its policy of actively disclosing information by means of SEC filings and on its website, and its high standing with investors mean that it does not need to cultivate relations with corporate bond investors on a regular basis. The company's finance department is responsible for dealing with credit-rating agencies and organizing road shows when the company comes to market. (Based on interviews with both companies.)

Figure 7 Comparison of Bond and Equity Investor Relations

	Bond investor relations	Equity investor relations
Aims	・ Reduce cost of capital ・ Broaden and consolidate investor base	・ Optimize share price ・ Broaden and consolidate investor base
Investor concerns	・ Risk ・ (Re-)payment of principal and interest	・ Profitability ・ Growth prospects
Focus of investor interest	・ Issuance and redemption schedules ・ Risk of downgrade ・ Details of covenants ・ Flow and use of cash ・ Company strategy and quality of management ・ Risk of individual projects	・ Earnings outlook ・ Profitability indicators (PER, ROE, etc.) ・ Company strategy and quality of management
Investor characteristics	・ Often "buy-and-hold" ・ Less sensitive to news headlines than equity investors ・ Small investor base	・ High turnover ・ Highly sensitive to news headlines ・ Large investor base
Approach	・ Mainly road shows and information for rating agencies ・ Long-term commitment largely passive	・ Daily contact with both buy and sell side ・ Active participation in sell-side conferences

Source: NRI.

Let us take the differences in approach first. In the case of bond investor relations, it is rare for issuers to make an effort to contact investors unless they either plan to come to the market with a very large issue or have a large question mark against their creditworthiness. In the case of equity investor relations, on the other hand, issuers are usually keen to maintain close contact with investors. Equity investors also tend to approach companies more often with requests for information.

These differences can be explained by the fact that, whereas equity investors react to any news that could affect company profits, corporate bond investors tend to adopt a buy-and-hold strategy and are mainly concerned about whether an issuer is going to be able to (re-)pay principal and interest. As result, they tend to be less interested in a company's short-term profits than their equity counterparts.

As far as the differences in focus are concerned, equity investors tend to be interested in growth and therefore to focus on profit and loss accounts and profitability indicators such as returns on equity and price-earnings ratios. In contrast, corporate bond investors tend to be interested in risk and therefore to focus on balance sheets and risk indicators such as shareholders' equity, interest-bearing debt and debt-equity ratios. Similarly, equity investors tend to be less interested in redemption schedules, credit-rating outlooks and covenants than investors in corporate bonds. This is not to deny, however, that both groups of investors often use the same criteria to make their investment decisions. For example, they—like credit-rating analysts—

are both interested in general sector developments as well as the earnings, cash flow, strategy, segment data and quality of management of individual companies.

These differences in investor interest explain why companies provide different information for the two groups. How different is the information provided to the equity investors and bond investors? We may illustrate the differences from viewing an example: Citigroup, which organizes two analyst meetings each year for credit analysts (referred to by Citigroup as its "Fixed Income Investor Review.") Figure 8 compares the two presentation materials of Citigroup's results for the second quarter of 2003—one for equity investors, the other for bond investors..

Figure 8 Citigroup Presentation Materials for Equity and Corporate bond investors

		Equity investor relations	Bond investor relations
Same	Second-quarter highlights (earnings, EPS, ROE, etc.)	○	○
Same	Breakdown of earnings (quarterly and semi-annual) with year-on-year data or highlights for each departments	○	○
Same	Credit quality	○	○
Different	Dividend	○	×
Different	Growth (earnings, revenue and expenditure by geographical area)	○	×
Different	Group organization	×	○
Different	Credit rating and relations with rating agencies	×	○
Different	Maintaining liquidity	×	○
Different	Amount and average maturity of bonds and commercial paper outstanding	×	○
Different	Details of bonds outstanding in the second quarter (breakdown by maturity and currency)	○	○
Different	Bond issuance plan for fiscal 2003	×	○

Source: NRI, from Citigroup, "Second Quarter 2003 Earnings Review" (July 14, 2003), "Fixed Income Investor Review" (July 17, 2003).[9]

Both sets of presentation materials have the following sections (totaling 11 pages): quarterly highlights (including earnings per share and return on equity); a breakdown of earnings by departments; credit quality; and capital adequacy ratios.

Where they differ is that, whereas the materials for equity investors include sections on dividend policy and the bank's growth potential, those for bond investors include sections on group organization, the bank's credit rating (and its relations with credit-rating agencies), and liquidity. Similarly, when it comes to describing how the bank raises capital by issuing bonds, the materials for equity investors consist of one

[9] Available from Citigroup's website at http://www.citigroup.com/citigroup/fin/index.htm.

page with two graphs (one giving the amount, average maturity and a breakdown by currency of bonds issued in the second quarter of 2003; the other showing the expected impact of a 100bp rise in US long-term interest rates on the group's profits), while those for bond investors consist of three pages (including detailed information on existing and future bond issues).

3) Bond investor relations in the United States

Let us now take a closer look at bond investor relations in the United States. The following is based on interviews conducted by the authors. The companies listed in Figure 9 all adopt either a reactive or a proactive approach and could serve as models for Japanese companies wishing to improve their bond investor relations.

Figure 9 Examples of How Particular Companies Conduct Their Bond Investor Relations

Company	Approach	Special features
GMAC	Special bond investor relations section (staff of 3)	・ Began investor relations for commercial paper investors 30 years ago. ・ Began investor relations for corporate bond investors 13 years ago. ・ Follows a pro-active approach. ・ Believes in one-to-one meetings with investors. ・ Participates in AFSA conferences. ・ Rarely uses investment banks for US investor relations (only when identity of contact person unknown). ・ Lets investment banks arrange road shows overseas. ・ Maintains an investor database.
Citigroup	Special bond investor relations section (staff of 1)	・ Management interest in bond investor relations has increased along with issuance of convertible bonds. ・ Has held semi-annual meetings briefings for corporate bond investors since 2002 (attended by chairman, chief financial officer and treasurer). ・ Treasurer visits major investors.
Bank of America	Bond investor relations specialist in finance department	・ Began bond investor relations 5-6 years ago. ・ Does not hold meetings briefings especially for corporate bond investors. ・ Main activities are answering telephone enquiries and holding one-on -one meetings with investors. ・ Maintains a list of main investors and analysts.
Sears Roebuck	Bond investor relations representative in finance department	・ Credit analysts also invited to annual meetings briefing. ・ Has separate investor relations specialist for securitized products. ・ Holds semi-annual meetings for investors in securitized products. ・ Answers enquiries from credit-rating agencies, credit analysts and investors. ・ Participates in AFSA conferences.

John Hancock	Bond investor relations representative in finance department	• Began bond investor relations in 1998. • Keen to have meetings with sell-side analysts. • Lets investment banks arrange road shows and meetings.
Anadarko Petroleum	Bond investor relations representative in finance department	• Often has one-on -one meetings with investors in private placements. • Lets credit-rating agencies and investment banks arrange road shows and meetings for public offerings. • Provides information to investors with enquiries. • Does not maintain a list of investors.
Hewlett-Packard	Investor relations department is responsible for bond investor relations	• Has a long-term commitment to bond investor relations but does not take part in non-deal road shows. • Finance department deals with credit-rating agencies. • Does not maintain a list of corporate bond investors.

Source: NRI, from interviews.

(1) Organization of bond investor relations

Although some of the companies that are committed to bond investor relations have a special bond investor relations department or a bond investor relations specialist in their finance department, most simply have someone in the finance or investor relations department. Those companies that adopt a reactive or proactive approach make a point of trying to reassure investors and sell-side analysts by ensuring that they know who is in charge of bond investor relations and how that person can be contacted. This is also considered a good way of demonstrating to corporate bond investors that they have the same status as equity investors.

Although most companies have one such specialist, those, such as GMAC, that attach particular importance to bond investor relations may have as many as three.[10] If a company's investor relations department is also in charge of bond investor relations, it will need to work closely with the finance department in order to gain access to financial expertise.

In companies where a member of the finance department is also in charge of bond investor relations, that person will normally spend about 15% to 25% of his time on such matters. Companies that raise only a relatively small proportion of their capital by means of bond issues tend to welcome questions from credit analysts when they come to market but otherwise only on special occasions. Some companies also have specialist teams to deal with commercial paper and asset-backed securities separately from their bond investor relation teams.

[10] One of these will be in overall charge of bond investor relations while the other two will be responsible for the eastern and western halves of the country, respectively.

(2) Relations with investment banks

Until issuers establish a name for themselves in the corporate bond market it is common for them to rely on investment banks to arrange road shows and meetings with investors. Indeed, even companies that frequently come to market use investment banks when they do not know the best person to contact at an investment institution. This is apparently particularly the case when an issue is due to take place overseas.

While using an investment bank has the advantage of putting issuers in touch with a wide range of potential investors, the presence of a representative of such a bank at a meeting with an investor apparently inhibits issuers from asking investors for their honest opinion.

(3) Providing information to investors

Issuers that adopt a reactive or proactive approach to bond investor relations hope that providing information regularly to corporate bond investors will enable them to form a clearer view of their businesses and make better investment decisions.

One approachis to organize a so-called "non-deal road show" (i.e., a small group meeting for or individual visit to corporate bond investors). If it proves difficult to attract enough investors to such a meeting , a company can team up with other companies in the same industry to organize a joint non-deal road show. This often takes the form of a general briefing on the industry as a whole by a credit-rating agency followed by individual company presentations.

Another possibility is the approach adopted by the American Financial Services Association (AFSA), which organizes conferences for corporate bond investors on behalf of a particular industry where issuers can provide investors with information.

A second approach—for a proactive issuer—is to organize a meeting for corporate bond investors separately from any traditional meeting for equity investors. Citigroup, for example, organizes such meetings (with presentations by the chairman, chief financial officer and treasurer) twice a year.

A third approach—adopted by some companies—is to maintain an in-house database of investors and credit analysts, and to keep in daily touch with them. Companies that attach particular importance to bond investor relations arrange for the person in charge of bond investor relations to visit their main investors. Those

companies attache particular importance to individual visits , where both sides can exchange views freely and the company can reply in detail to questions of particular concern to the investor, rather than the traditional type of conference or meeting, where the communication is all one-way.

4) The benefits of bond investor relations

Let us consider the benefits to an issuer of adopting a positive approach to bond investor relations.

First (and this is also true of equity investor relations), bond investor relations can help a company to broaden and consolidate its investor base. In June 2003 General Motors and its financial subsidiary GMAC announced a deal worth $17.6 billion—the biggest corporate bond issue in US history. A deal of this size requires a big investor base. While good relations with the investment banks that are going to underwrite the deal are also, clearly, important, the benefits of maintaining close relations with potential bond investors should not be underestimated. It would also seem reasonable to suppose that bond investor relations help to reassure and satisfy existing investors, thereby making it more likely that they will hold their investments until maturity and be willing to take up a proportion of each issue the company brings to market.

Second, bond investor relations can serve as a useful crisis management tool. A company that suddenly finds its access to credit threatened because, for example, its bonds have been downgraded to "non-investment grade" as a result of some unpredictable event is more likely to be able to avoid a situation where investors dump all their holdings of its bonds or it is unable to raise more capital if it keeps in daily touch with its corporate bond investors.

Third, bond investor relations can help a company to reduce its cost of capital. While a company's credit rating is paramount, it is also the case that there are bonds trading on the secondary market with the same residual maturity and rating but with spreads of 20bp or more representing the market's premium on the perceived risk of the issuer. Bond investor relations can help to reduce this perceived risk and, thereby, the premium represented by the spread. Similarly, issuers can minimize the volatility of this spread by disclosing information as frequently and in as much detail as possible, thereby reducing the risk of a surprise. At the same time, this should increase the liquidity of a company's bonds on the secondary market. Companies that do all this can expect to achieve better terms when they come to the market.

4. An Investor's View of Bond Investor Relations

So far, we have looked at the current state of bond investor relations in the United States. In this section we shall look at bond investor relations from the perspective of investors. Our interviews with investors revealed the following.

First, investors see bond investor relations as a means of gaining access to an issuer's top management. As was mentioned above, investors regard the quality of a company's management as one of the most important criteria when deciding whether to invest in its bonds. Also, a credit analyst with considerable experience of a sector or company can do without superficial explanations. What he wants is to be able to talk to the people at the top making the decisions. In the past, companies tended to treat equity investors more favorably than corporate bond investors, but corporate bond investors want to be treated on equal terms. Whereas, until recently, it was rare for a company's chief executive officer or chief financial officer to meet corporate bond investors, it now appears to be more common. Some investors with large holdings of corporate bonds want to be able to exercise influence over the companies they invest in by talking openly to their management.

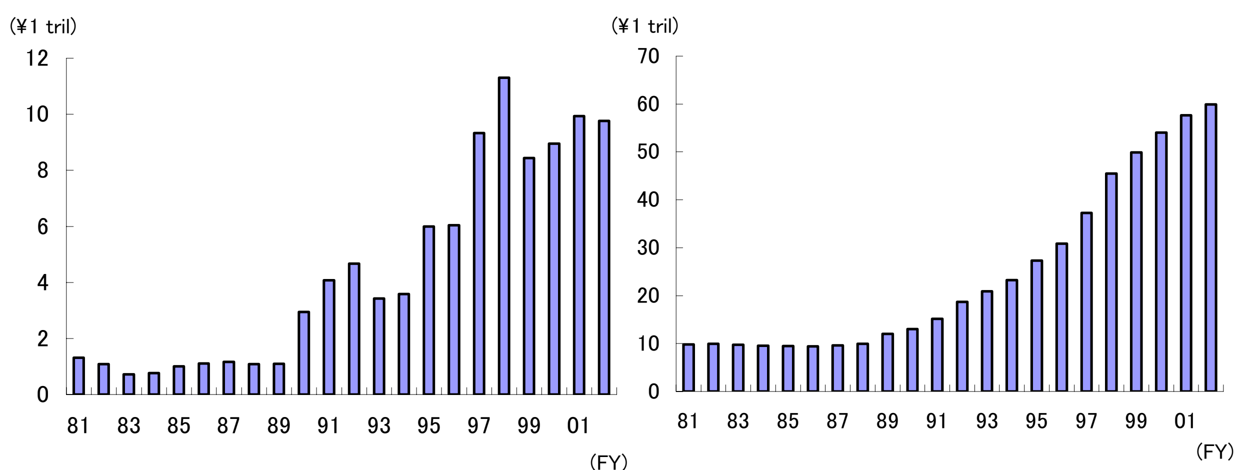
Second, investors see bond investor relations as a means of keeping open the channels of communication with the companies they invest in. The road shows that companies organize when they come to market are not enough: investors want to have frequent contact with the companies they invest in (and, particularly, those they have large holdings in)—whether it be in the form of regular meetings with company representatives or talking to them on the telephone. One bond investor said that he and his colleagues wanted close contact with the companies they invested in in order to put their minds at ease. Likewise, investors want companies to be pro-active in the way they disclose information: the more detailed and comprehensive, the better.

Third, investors want companies to be honest and consistent. For example, a company is unlikely to be willing to disclose information that might affect its credit rating. In fact, however, investors are more likely to trust a company if it is willing to do this. If a company is downgraded, it should analyze the reason for the downgrade rather than protest and make it clear to investors what it intends to do about it. Likewise, it should give a consistent account of itself to both equity and corporate bond investors.

5. Lessons for Japan

Since the series of reforms it underwent in the 1990s, Japan's corporate bond market has grown considerably (see Figure 10). Corporate bond investors are much more aware of credit risk following the sharp increase in corporate failures during the past few years. Likewise, the fact that a number of Japanese credit-rating agencies had "investment grade" ratings on the bonds of Mycal only 12 months before the company collapsed in September 2001 has made investors realize that they cannot afford to be overdependent on ratings.

Figure 10 Issuance of Corporate Bonds in Japan (left)
Amount of Corporate Bonds Outstanding (right)



Note: Includes private placements.
Source: NRI, from Japan Securities Dealers Association, "Shoken Gyoho" .

Meanwhile, more Japanese companies are aware of the need to keep open the channels of communication with corporate bond investors if they want to be able to count on their support when they come to market, and a number have begun to adopt a pro-active approach to bond investor relations during the past few years. For example, companies such as Nippon Telegraph and Telephone Corporation (NTT), NTT DoCoMo, East Japan Railway, Nissan, Aiful and Acom now organize annual and semi-annual meetings for corporate bond investors in addition to those for equity investors. Likewise, a number of companies that used to consider only the needs of equity investors when they announced their results now include information on their credit ratings and redemption schedules for the benefit of corporate bond investors.

Finally, we should like to make a few suggestions about how Japanese companies might improve their bond investor relations.

First, they should find out who their corporate bond investors are. While there is nothing wrong with making information for corporate bond investors as widely available as possible (e.g., via the company Web site) in the same way as for equity investors, the universe of corporate bond investors is smaller than that of equity investors. Companies should therefore make sure they know which investor should receive their information and the persons responsible for investment within those investors. Furthermore, in a long term, it is also important for companies to analyze and target their corporate bond investors

Second, companies should adopt a long-term approach. Rather than put a lot of effort into bond investor relations just when they face a credit crisis (e.g., after a downgrade), they should make a point of disclosing information regularly.

Third, senior management needs to take the initiative. Although the best solution (e.g., which section of the company should be responsible and whether the company should set up a section especially for this) will vary depending on circumstances, in all cases the chief executive officer, the chief financial officer or some other senior member of management should develop an interest in this aspect of the business and ensure that the necessary information is disseminated. It also means that this senior member of management must be well informed about fixed-income securities.

As we said in the section on bond investor relations in the United States, it is both unrealistic and unnecessary for every company that issues a bond to adopt a pro-active approach to bond investor relations. Any company thinking of making a commitment to bond investor relations should, first of all, weigh up the costs and benefits. For once a company makes this commitment, to abandon it will mean losing confidence among the investors. Continuity is therefore of the essence, and companies need to decide what role they want bond investor relations to play within their overall strategy for investor relations. Let us hope that, as Japan's corporate bond market expands, the right companies will make appropriate commitment.