

RISK AND RETURN ANALYSIS OF COMMERCIAL PAPERS TRADED IN WHOLESALE DEBT MARKET

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ABSTRACT

The corporations issuing commercial papers are doing so typically in order to financing of payroll, accounts payable, inventories, and meeting other short-term liabilities. Usually the maturity periods of the Commercial paper varies from one to six months. The commercial paper is one of the preferred choices of many individual investors as it offers higher return in a short period of time with considerable risk. This paper analyzed the commercial paper traded in India in regard to its traded price, volume and number of trade, Yield to maturity and real return by using standard deviation, co-efficient of variation. To know the relationship between variables relating to commercial paper namely yield to maturity, number and volume of trade, price traded with monetary policy rates correlations applied. The commercial paper has lower risk since its standard deviation is less and coefficient of variation is lower than the accepted norms of risk level.

Keywords: Co-efficient of Variation, Real Return, Return Analysis, Debt Market

INTRODUCTION

Commercial paper is one of the securities issued by corporate, financial institution and even by banks to maintain liquidity and short term solvency position. Corporate utilize the commercial paper to give money to the suppliers, office and administrative expenses. Bankers and financial institutions issue commercial paper to maintain working capital position. Commercial paper is unsecured liability on the part of the issuer and issued at discount and redeemable at par. Commercial papers are a form of fixed-income securities with maturities ranging from a few days to months but less than 270 days. This essentially falls into the money market. These forms of unsecured issues are preferred by retail fixed income investors who are looking for a better rate of return on their money. This is a proven method of convenient financing as it allows the issuer to fulfill their short term financial needs thereby enabling the issuer to avoid the hassles of applying for a series business loans and registering with the Securities and Exchange Commission as the money market issues does not require registering.

STATEMENT OF PROBLEM

In India, the institutions permitted to issue commercial papers are the corporate borrowers who are highly rated corporate borrowers, primary dealers and institutions which have been permitted to raise resources through money market instruments which were given an umbrella limit fixed by the Reserve bank of India. The minimum denomination issued as a Commercial paper by any institution has to be 5 lakhs and it's multiple thereafter. The researcher after considering the 20-year data on the commercial paper traded in the money market has considered it to be the right choice to be analyzed as the Commercial paper has been only traded for five years in the whole sale debt market, National Stock Exchange.

OBJECTIVES

1. To assess the risk involved in trading of commercial paper in the wholesale debt market
2. To evaluate the real return on commercial paper traded during the study period.

METHODOLOGY

The study is based on secondary data. Data relating to secondary trading details of commercial paper collected from wholesale debt market on daily basis. Data is converted into yearly data by using average. Literatures relating to commercial paper are collected from various journals and websites. Real return is obtained by subtracting the inflation from the Yield to maturity of commercial paper. Standard deviation and co-efficient of variation is used to assess the risk level of commercial paper. To know the trend in trading in regard to number, volume, price and yield to maturity, line graph is used to better understand the data. The data collected from the wholesale debt market from 2001-02 to 2020-21 and the researcher found that the commercial paper is traded only for the 5 years namely 2001-02, 2002-3, 2003-04, 2019-20 and 2020-21.

ANALYSIS AND INTERPRETATION

The investors expect return on their investment. The return on investment must cover the inflation in order for the investor to get neither loss nor profit on their investment. The real return is the difference between actual return and inflation. Positive real return will satisfy the investors and thereby motivate the investors to invest further investment on that commercial paper. Figure 1 gives a clear picture on the relationship between Yield to maturity and inflation during the traded period.

Table 1: Number of commercial paper traded, its volume of trade, traded price and yield to maturity

Year	No., of Trade	Trade Value in Crores	Traded Price	Yield to Maturity
2001-02	687	7499	98.282	7.4553
2002-03	610	6695	98.2954	7.5826
2003-	207	2961	98.3166	5.1738

04				
2019-20	36	1905	98.2054	5.6624
2020-21	97	5560	98.5046	4.6448
Mean	327.4	4924	98.3208	6.10378
S.D.	300.69	2405.17	0.11	1.34
C.V.	91.84322	48.84577	0.112877	21.98326

Source: Wholesale debt market, NSE

It can be inferred from Table 1 that the average of number of commercial paper traded is 327.4 its standard deviation is 300.69. The co-efficient of variation is 91.84 with regard to number of commercial paper traded. The average for volume of commercial paper traded is 4924 crore with a standard deviation of 2405.17. The co-efficient of variation is 48.85 in volume of commercial paper traded is 48.85. Price at which commercial paper traded during the traded price has 98.3208 as its average, standard deviation is 0.11 and 0.112877 per cent co-efficient of variation. The commercial paper has lower risk since its standard deviation is less and coefficient of variation is lower than the accepted norms of risk level. The mean value of yield to maturity is 6.10378, standard deviation is 1.34 and co-efficient of variation is 21.98 which is less than the normal acceptable level of risk.

To know the relationship between volume and number of trade, price traded and yield to maturity on correlation is applied and the results are given in Table 2

Table 2: Correlation Result between number and volume of trade

Variables	Correlation
Number and Volume of Trade	0.828 [*]
Price and Yield to Maturity	-0.509
*. Correlation is significant at the 0.05 level	

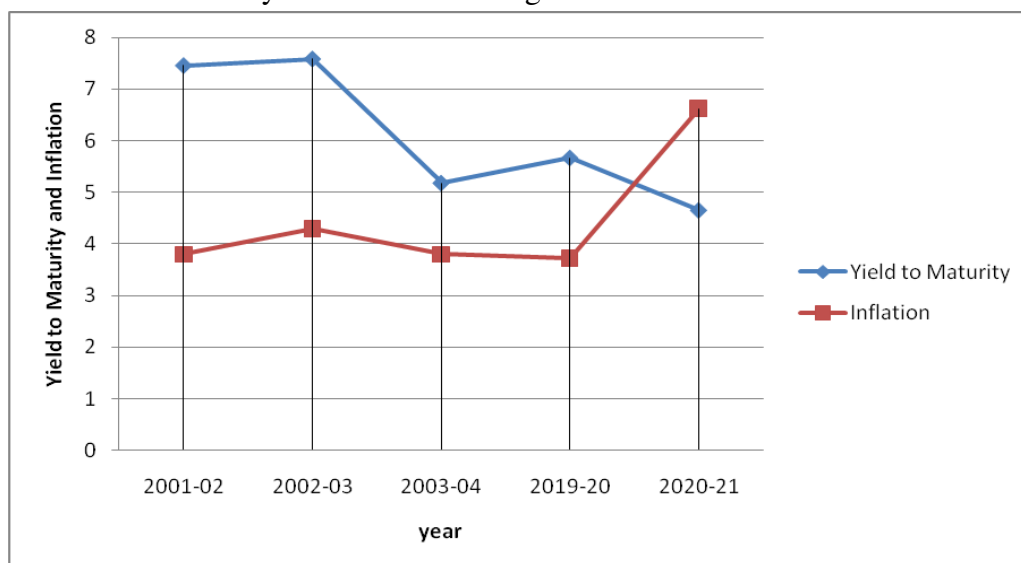
Source: Computed

It can be interpreted from Table 2 that there is high degree positive correlation (0.828) lies between number and volume of commercial bills traded during the traded period.

Table 3: Monetary Policy Rates and Number of commercial Paper Trading

Variables	Correlation
Number of Trade Repo Rate	0.889[*]
Number of Trade and Cash Reserve Ratio	0.923[*]
Number of Trade and Reverse Repo Rate	.903[*]
*. Correlation is significant at the 0.05 level	

It is found from Table 3 that out only Repo rate, Reverse Repo rate, and Cash reserve ratio have a high degree of positive correlation towards a number of commercial paper traded during the traded period.

Figure 1: Yield to Maturity and Inflation during the Traded Period

It can be understood from Figure 1 that the yield to maturity is more than the inflation in all the years except in the year 2020-21.

SUGGESTION

- The commercial paper can only be issued by the institutions registered with the Securities and Exchange Commission and highly rated institutions as this type of borrowing is only for short term financial needs average performing institutions might be permitted to issue them as it would easily fund their short term needs and improve smooth functioning.
- The allocation of the issued commercial paper must be transparent and the whole data that is the previous performances must be available for the investor in order to boost confidence in the individual investors.
- The RBI could enable the issuing companies to have smoother and swift issuing mechanisms in place to ensure faster processing and thereby providing the issuer with the finances they require on time and the investor a hassle free transaction.

CONCLUSION

The corporate mostly large banks in order to suffice their short term financial shortages and obligations issues unsecured form of promissory notes called Commercial Paper. The issuance was done with the hope that the issuing institution would be able to pay the interest rate with the principle at maturity. Commercial paper is one of the unsecured debt through that the corporate raise money to meet short term requirements. The regulators by considering the medium, small and micro enterprises frame policies to facilitate them to access money market through commercial papers. Eventually, the cash flows into the money market and trading of commercial papers will also be increased considerably that leads to economic development by removing imbalances among industrial development.

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