



CHAPTER 1

Introduction

1.1 Statement of the Problem

For the past five years, the Thai government particularly the Ministry of Finance and the Bank of Thailand has taken an important role in developing the bond market which is instrumental to the development of financial instruments as a whole. The implementation of government measures include amendments of law, rules and regulations, financial deregulation and other measures to support such a development such as the establishment of the first credit rating agency " Thai Rating and Information Services Co.,Ltd. (TRIS) ", and the Bond Dealers' club.

The development of the Thai bond market has stimulated the growth of the corporate bond market since 1994 up to present.. There is substantial potential for further growth because there is a need for significant capital to fund numerous infrastructure projects and other corporate investments in Thailand. This is why the Thai bond market is growing rapidly. At the end of 1996, the total size of the bond market was Baht 508 billion or 10% of GDP. Furthermore, the Bond Dealers Club (BDC) was established as the country's first secondary bond market, poised to widen and strengthen its mandate in the rapidly growing bond market.

However, there are still a lot of obstacles preventing rapid development of the bond market which include insufficiency of supply of bond, burden of income tax on bond interest, shortage of institutional investors, shortage of personnel

with profound knowledge, and absence of benchmark interest rates. To advance at a further level, therefore, there is a need to identify the trend of the bond market as well as the problems related to the market in the long-run.

The usual perception of bond risk is that holding bond exposes investors to three major sources of risk ;

- 1) risk associated with default of coupon interest or principal.
- 2) risk related to unanticipated changes in interest rates.
- 3) risk resulting from unanticipated price level changes.

Concerning default risk, a credit rating by a credit rating agency is an example of the measurement of the default risk. Credit rating agency acts as a credit analyst for individual and institutional investor providing investors with fair and objective measure of the quality of a debt instrument. Eventhough the determinants of credit rating are the internal corporate variables which include debt ratio, earnings levels, earnings variability, interest coverage, and pension obligation. These variables should be related to the business conditions such as economics, politics, and sociological changes. Thus, we expect that as business conditions decline (low return on the market portfolio), bond prices should drop because the probability of default increases. This implies that default risk is one of the factors that determines systematic risk. Therefore, this research will concentrate on the association between the systematic risk and the default risk measures for corporate bonds.

1.2 Objective of the Study

The objective of this research is to study the association between the systematic risk measures for bonds and the default risk in the Thai bond market.

1.3 Scope of the Study

The study of the association between the systematic risk measures for the corporate bonds and the default risk in the Thai bond market is to cover the period of 1995 to 1996.

1.4 Sources of Data

1. The Stock Exchange of Thailand
2. The Bank of Thailand
3. The Ministry of Finance
4. The Bond Dealers Club
5. The Capital Market Research Institute
6. Thai Rating Information Services
7. The S-ONE Research Institute

1.5 Organization of the Study

This study will be organized into 5 chapters. Chapter 1 is the introduction, which details the readers with the background and rationale, objective, scope, source of data, and the benefit of the study. Chapter 2 will detail about the development of the Thai bond market. Chapter 3 is the conceptual framework and research methodology, which consist of review literature and methodology used in the study. Chapter 4 will present the empirical results. Conclusion and recommendation will be drawn in the last chapter.

1.6 Benefit of the Study

This research presents the finding that the systematic risk of corporate bonds is related to the default risk to which the bond holder is exposed. It does benefit the investor who wants to invest in the Thai bond market because a bond portfolio manager wants an efficient portfolio of bonds, or wants to introduce bonds into his total portfolio of risky assets. Therefore, the systematic risk measures for bond and the measure of default risk should be considered by portfolio managers concerned with investing in bonds. Furthermore, it will provide the readers to realize the efficiency of the credit rating agency (TRIS) and the Thai bond market .